Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

June 18, 1998

Intepretive Letter #832
August 1998
12 U.S.C. 24(7)

Dear [ ]:

This is in response to your request that the OCC reconsider the statement in Interpretive Letter No. 617, *reprinted in* [1992-1993 Transfer Binder], Fed. Banking L. Rep. (CCH) ¶ 83,457 (March 4, 1993) ("Letter 617") that a national bank may not invest in a small business investment company ("SBIC") that is in the process of organizing and has not yet obtained its license from the Small Business Administration ("SBA").

You seek confirmation of your opinion that, particularly in light of the 1997 amendments to 15 U.S.C. 682(b), it is more reasonable to take the position that a national bank may invest in an SBIC that is in the process of organization as well as one that has already been organized, approved and licensed by the SBA. For the reasons given below, I agree with your conclusion.

In 1993, when Letter 617 was issued, 15 U.S.C. 682(b) provided that "shares of stock in small business investment companies shall be eligible for purchase by national banks." The only limitation was that the bank's investment in one or more SBICs could not in aggregate exceed five percent of the bank's capital and surplus.

Because the investment authorization in section 682(b) referred specifically to the purchase of shares of stock in an SBIC, the question arose whether a national bank could invest in an SBIC organized as a limited partnership, as well as in an SBIC organized as a corporation. Letter 617 concluded that such a limited partnership investment would be permissible because the statute did not prohibit it, and because other OCC precedents had generally taken the position that a national bank can become a partner in an enterprise where its liability is limited and the enterprise engages solely in activities permitted for investment by a national bank. Since an SBIC is an eligible investment for national banks, the investment could take the form of a limited partnership interest.

The letter went on to observe that the bank could make its investment in the limited partnership SBIC only after the company obtained its license from the SBA:

> Section 682(b) enables national banks to invest in SBICs, which are defined to mean "a company *approved* by the Administration [SBA] to operate under the provisions of this chapter *and issued a license* as provided in section 681 of this title." 15 U.S.C. § 662(3) (Emphasis added). The statutory scheme implies that national banks are limited to investments in existing SBICs. Therefore, any potential national bank investor will have to await approval and licensing of the Partnership as a SBIC by the SBA before it disburses any funds.

Letter 617 at 2.

While this additional conclusion was not unreasonable per se, it was not compelled by the statutory language either. Upon reconsideration, both of the statutory scheme as it has existed since 1958, and particularly as Congress has revised 15 U.S.C. 682(b) in 1997, we believe that the better view is that national banks have flexibility in the timing of their investments in SBICs. There is no good reason based upon the language of the statute as amended, or its underlying policy, that national banks should be limited to investing in SBICs that have already been organized, approved, and granted a license by the SBA.

Fifteen U.S.C. 662, Definitions, subparagraph (3), states in pertinent part that "the terms 'small business investment company,' 'company,' and 'licensee' mean a company approved by the Administration to operate under the provisions of this Act and issued a license as provided in" 15 U.S.C. 681. Section 662(3) is merely identifying what is being talked about in the entire Small Business Investment Act of 1958, as amended, 15 U.S.C. 661 et seq. In order to operate, an SBIC must be approved and licensed by the SBA. But this language about SBA approval and licensure was not carried over into the more specific authorization for national banks to purchase shares of stock in SBICs. Thus, as of 1993, when Letter 617 was issued, section 682(b) did not state or imply that the bank could not purchase shares until the SBIC had become licensed by the SBA. The law was silent on this timing-of-investment issue.

We note that the Federal Reserve Board has taken a different position than Letter 617 on the investment timing issue. The Board's regulation at 12 C.F.R. 225.107, which addresses the investment by member banks in SBICs organized as subsidiaries, authorizes a bank to "organize and subscribe for stock in" a proposed SBIC. This interpretation thus appears to contemplate and approve investment by a member bank prior to the applicant subsidiary's receipt of its license as an SBIC from the SBA.

It will be difficult if not impossible for a national bank to establish an SBIC, either alone or in conjunction with one or more other bank investors, if it cannot fund the enterprise prior to SBA licensure. An SBIC cannot obtain a license unless it is adequately capitalized, 15 U.S.C. 682(a). Current SBA regulations require that an applicant for an SBIC license must have at

least $2,500,000 in contributed capital in order to be licensed as an SBIC, 13 C.F.R. 107.210(a). This minimum capital requirement specifically excludes unfunded capital commitments.

It is our understanding that as a practical matter many SBICs are closed-end ventures. The owners tend to be few, and to fund the enterprise in the initial stages of organization. Frequently, after the SBIC obtains its license, no additional investors are sought or brought in. The ability of a bank to make an investment in an applicant, so that the applicant can meet the minimum capital requirements necessary to obtain its SBIC license, is critical to the formation of a new SBIC. As mentioned, even in the case where a bank organizes a wholly owned subsidiary that applies for an SBIC license, SBA regulations require that the bank must capitalize its applicant subsidiary before it can receive an SBIC license.

These regulatory and marketplace realities mean that limiting national bank investments to only those SBICs that have already been organized, approved and licensed by the SBA will diminish the possibilities for national banks to participate in a meaningful way in the program. This in turn leads us to note that Congress has consistently evidenced its intention that banks be encouraged to provide loan and equity funding to small businesses through the use of SBICs.

Most recently, in 1997 Congress revised 15 U.S.C. 682(b) to authorize national banks to "invest in any 1 or more small business investment companies, or in any entity established to invest solely" in SBICs. These amendments changed section 682(b) in two ways. First, the statute now expressly authorizes national banks to "invest in" SBICs, however they may be organized. This is an expansion of the prior permission to purchase shares of stock in SBICs.

Second, the statute now authorizes national banks to invest in an entity that in turn will invest in SBICs. Clearly, the investment in such an entity will precede the entity's investment in SBICs. It is an additional option being made available to national banks that desire to invest in SBICs. And there is no requirement that the entity be registered as an investment company or be licensed by the SBA.

The Senate Report that accompanied the Small Business Reauthorization Act of 1997 indicates that the amendments were intended to make the SBIC Program "more responsive to the small business and investor communities." In order to bring the law up to date with "current investment practices," the 1997 amendments included the changes in 15 U.S.C. 682(b) that have been quoted above. The Senate Report explains :

> Currently, the Small Business Investment Act only provides that banks may purchase stock from SBICs. Many SBICs now are organized as limited liability companies and partnerships, which do not have stock, and some banks may want to structure their SBIC investments though a separately managed "fund of funds" to diversify among several different SBICs. These language changes [to section 682(b)] are being made to allow banks to continue to invest in SBICs,

> whether organized as corporations, partnerships, or limited liability companies, and expressly permits banks to invest in entities established to invest solely in SBICs, with no requirement that such entities be registered investment companies.

Senate Report No. 105-62, Aug. 9, 1997 [To accompany S. 1139], 105th Cong., 1st Sess. at 2, 8, *reprinted in* 4 U.S.C.C.A.N. at 3077, 3082 (1997).

Nothing in the literal language of the statutory permission limits a national bank's investment to a point in time after the SBIC has obtained its license from the SBA. The authority granted is to invest in SBICs, not "licensed SBICs" or some comparable limiting provision. In other words, 15 U.S.C. 682(b) as amended allows national banks to invest in SBICs, and neither this section nor any other provision in the SBIC law imposes a time period limitation, either before or after the company obtains its license.

As a result of the 1997 changes banks are now specifically authorized to invest in SBICs, rather than merely purchase their shares. Whereas the "purchase of shares" permission could reasonably be construed as limiting the investment to an existing SBIC, the broader investment authority in the 1997 amendments makes it clearer that investments are contemplated to come at any time in the process of organizing an SBIC as well as after it obtains a license. So too does the other change, permitting a national bank to invest in an entity that will in turn invest in SBICs. This confirms that there is sufficient flexibility for the bank to expend funds prior to the receipt of a license by a planned SBIC. The investment in the entity will be made prior to any particular investment in an SBIC, which obviously will follow.

Finally, concluding that banks have flexibility to time their funding of SBICs based upon individual circumstances is both consistent with and helps to promote the overall purposes of the statutory scheme. *See, e.g., ANA Small Business Invest., Inc. v. SBA*, 391 F.2d 739 (9th Cir. 1968) (statutory provisions relating to SBICs were enacted to increase the availability of loans to those engaged in comparatively small enterprises who could not obtain adequate borrowed funds through customary financial institution channels); *SBA v. Barron*, 240 F.Supp. 434 (D.S.C. 1965) (Congress enacted statute relating to SBICs for the purpose of providing additional source of long-term equity capital and long-term loans for small business concerns).

For all of these reasons, it is my opinion that a national bank may invest in an SBIC that is in the process of being organized, as well as in one that has already obtained a license from the SBA. Letter 617 is overturned on this narrow point.

I trust this reply is responsive to your inquiry.

Very truly yours,

/s/

Raymond Natter
Acting Chief Counsel