

## Small Business Investment Companies: Investment Option for Banks

### **Abstract**

This *Community Developments Insights* report describes the U.S. Small Business Administration's (SBA) Small Business Investment Company (SBIC) program, its role in capital markets, and how financial institutions—including national banks and federal savings associations (collectively, banks)—can use the program to expand their small-business finance activities. This report also describes how the SBA licenses these companies, how they operate and are supervised, and the guidelines they should follow. Finally, this report outlines risks and regulatory considerations of bank investments in SBICs and explains how these investments may receive consideration under the Community Reinvestment Act (CRA).

The information in this report was obtained from a variety of sources, including bankers, non-supervised financial intermediaries, SBICs' general partners (GP), trade groups, the SBA's Office of Investment and Innovation (OII), and other parties involved with small business investment companies. Appendix E provides a resource directory for additional program information.

### **I. What Are SBICs?**

SBICs are privately owned and managed investment funds that the SBA licenses and regulates. The SBIC license allows SBICs to employ private capital and SBA leverage (funds borrowed at low cost using SBA-guaranteed securities, called debentures), to make investments in qualifying small businesses and smaller enterprises as defined by SBA regulations.<sup>1</sup> Congress created the SBIC program in 1958 to stimulate growth in America's small business sector by supplementing the long-term debt and private equity capital available to small businesses. In fiscal year (FY) 2014, Congress increased the SBIC program's annual authorization amount from \$3 billion to \$4 billion, which is the authorized level in FY 2015.

SBICs generally are formed as limited partnerships, with the SBIC managers acting as the GPs. The limited partners (LP), who supply the majority of the private funding, are typically institutional investors, including banks, and individual investors with high net worths.

By regulation, SBICs may invest only in small businesses and must allocate a minimum of 25 percent of their capital to smaller enterprises. A small business is a business, including its affiliates, that has a tangible net worth not in excess of \$19.5 million,

<sup>1</sup> 13 CFR 121.

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.<sup>2</sup> A business may also be deemed “small” using the SBA’s North American Industry Classification System (NAICS) codes.<sup>3</sup> A smaller enterprise is a small business that (1) together with its affiliates, and by itself, meets the NAICS size standard at the time of financing; or (2) together with its affiliates has a net worth of not more than \$6 million and average net income after federal income taxes (excluding any carry-over losses) for the preceding two years no greater than \$2 million.<sup>4</sup>

Typically, SBICs invest in small businesses with \$10 million to \$50 million in annual revenues, but still fulfill the regulatory small business size requirements. On average, SBICs invest between \$1 million and \$10 million in each small business in its portfolio, although some SBICs go outside this range.

There are other regulatory limitations on SBICs besides small business size. For example, an SBIC may not invest an amount greater than 10 percent of its total capital (private and SBA leverage), and 30 percent of its private capital, in any single portfolio company. The SBIC may not invest in businesses with more than 49 percent of their employees located outside the United States, or in industry sectors deemed contrary to the public interest. SBICs are also prohibited from investing in project finance, real estate, or financial intermediaries. Finally, SBICs may not control small businesses for longer than seven years without first obtaining approval from the SBA.<sup>5</sup>

The SBA’s SBIC license covers three types of SBICs: standard, Early Stage, and Impact. The application process and leverage guidelines vary depending on the type of SBIC. Generally, and regardless of the type of SBIC, SBICs can be either leveraged (their private capital is supplemented with SBA-guaranteed debentures), or non-leveraged (use private capital alone), including bank-owned SBICs. Leveraged SBICs make up the majority of SBICs and are the focus of this report.<sup>6</sup> Although a few banks own non-leveraged SBICs (usually as wholly owned subsidiaries), most bank investments in SBICs are in leveraged SBICs where the bank is one of several LPs. Non-leveraged SBICs make up approximately 15 percent of active SBICs. Section III.F of this report provides more discussion of non-leveraged SBICs.

As of March 31, 2015, there were 296 licensed SBICs using combined private capital and SBA leverage of approximately \$24 billion. In FY 2014, 30 new SBICs were licensed that represented more than \$1.3 billion in private capital. Further, in the same FY, SBICs provided nearly \$5.5 billion in financing to 1,085 small businesses, which either created or sustained an estimated 113,022 jobs.<sup>7</sup>

Financial institutions that invest in SBICs vary by size and charter and are dispersed geographically. They include large banks and community banks. As figure 1 shows, from FY 2010–2014, 44 percent of SBIC financings were made in the New England, Middle Atlantic, and South Atlantic regions, as defined by the SBA.

<sup>2</sup> 13 CFR 121.301(c). The size standards have been adjusted for inflation in 2014, according to the interim final rule in 79 Fed. Reg. 113 (June 12, 2014).

<sup>3</sup> 13 CFR 121.201.

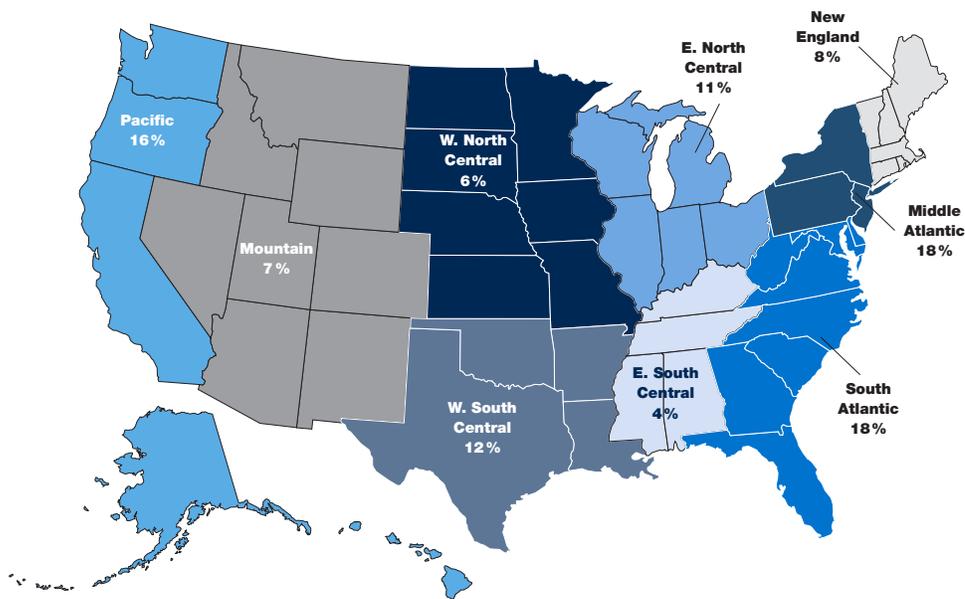
<sup>4</sup> 13 CFR 107.710.

<sup>5</sup> See 13 CFR 107.50 for the definition of control. For a summary of what SBICs may or may not do under SBA regulations, see the SBA’s “SBIC Investment Requirements” in the [SBIC program overview](#).

<sup>6</sup> Throughout this report, the terms “leveraged SBIC” and “debenture SBIC” are used interchangeably.

<sup>7</sup> The SBA’s “[Small Business Investment Company \(SBIC\) Program Overview](#),” Quarterly Reports, March 31, 2015.

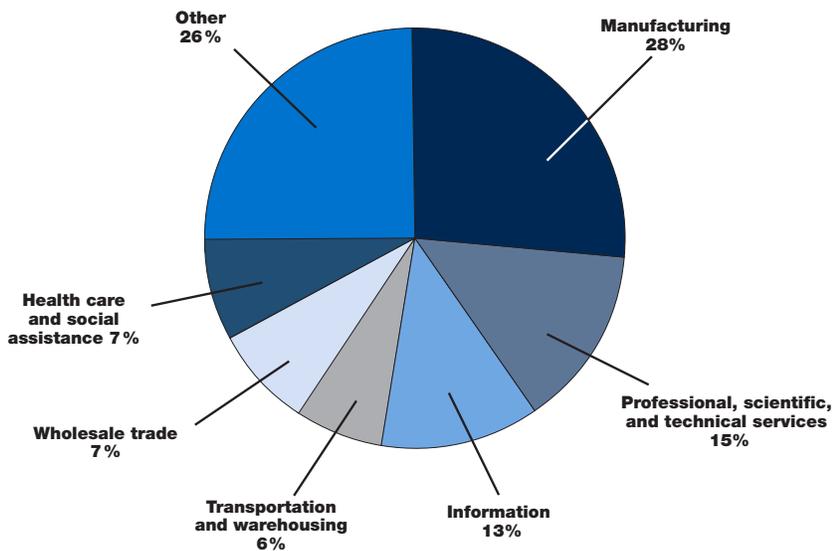
**Figure 1: Distribution of SBIC Financing Dollars by Region, FY 2010–2014**



Source: OII, SBA.

The SBIC investment portfolio covers all sectors of the economy. Accounting for 56 percent are manufacturing; professional, scientific, and technical services; and information industries. Figure 2 illustrates the distribution of SBIC financing by industry.

**Figure 2: Distribution of SBIC Financing Dollars by Industry, FY 2010–2014**



Source: OII, SBA.

Note: Distribution percentages do not add to 100 percent because of rounding.

In 2011, the SBIC program launched two new initiatives to encourage further investments in the nation's small businesses. The first, the Early Stage SBIC Initiative, committed \$1 billion over FY 2011–2016 to help finance early-stage small businesses facing difficult challenges accessing capital, particularly those without the necessary assets or cash flow needed to secure traditional bank funding. Early Stage SBICs must invest at least 50 percent of their investment dollars in early-stage small businesses. For the purposes of this initiative, an early-stage business is one that has never achieved positive cash flow from operations in any fiscal year.<sup>8</sup>

The second initiative, called the Impact Investment Fund, initially made the same five-year, \$1 billion commitment, but the SBA announced in 2014 that it would continue allocating approximately \$200 million a year to Impact SBICs beyond 2016. Impact SBICs commit to invest at least 50 percent of their investment dollars into SBA-Identified or Fund-Identified “impact investments.” SBA-Identified impact investments can be place-based, such as investments in rural businesses, or sector-based, such as energy-saving qualified investments. Impact SBICs may identify their own impact investments, but to do so they must obtain SBA approval, declare their intention to pursue this strategy, and measure results. The SBA encourages, but does not require, these SBICs to make Fund-Identified impact investments in sectors of national priority, such as clean energy, education, or advanced manufacturing.<sup>9</sup>

Both the Early Stage SBICs and the Impact SBICs provide additional investment opportunities for banks.

## II. Why Are SBICs of Interest to Banks?

Investments in SBICs allow banks to earn competitive returns and potentially receive CRA consideration while helping the banks attract, serve, and retain small business customers. Banks can collaborate with SBICs to provide long-term financing to small businesses that might not otherwise obtain the financing they need from traditional sources. In general, banks may be interested in investing in SBICs for a number of reasons.

**Investment performance.** When investing in SBICs, banks' primary consideration is to earn a competitive return on invested capital. As with other investment choices, an SBIC has to make the case to its potential investors that its business model is sound. Because debenture SBICs can supplement their own private capital with SBA leverage in amounts of up to three times their private capital, their cost of capital is often lower than might be the case had they depended entirely on private equity capital.<sup>10</sup> Section V of this report provides information about the historic returns of debenture SBICs compared with similar investment funds.

**CRA consideration.** Bank investments in SBICs meet the definition of qualified investments under the CRA.<sup>11</sup> Large banks and intermediate small banks receive CRA consideration under the “investment test” or “community development test,” respectively,

<sup>8</sup> For more information, see the [Early Stage Initiative page](#) on the SBA's Web site.

<sup>9</sup> For more information, see the [Impact Investment Fund page](#) on the SBA's Web site.

<sup>10</sup> Typically, SBA leverage is provided at twice the amount of private capital. It can go up to three times the amount of capital, however, if the SBIC fund meets certain requirements. These requirements can be found in [13 CFR 107.1150](#).

<sup>11</sup> 75 Fed. Reg. 47 (March 11, 2010),\_12(t)-4, p.11652.

for investments in SBICs when they benefit the bank’s assessment area or a broader statewide or regional area that includes the bank’s assessment area or areas.<sup>12</sup>

To enhance a satisfactory rating, banks evaluated as small institutions under the CRA can request that examiners review their performance in making qualified investments, such as investments in SBICs.<sup>13</sup>

Federal banking regulators revised the “Community Reinvestment Act; Questions and Answers Regarding Community Reinvestment; Notice” in November 2013 and clarified language related to (1) activities in the broader statewide or regional area that include, but do not benefit, the institution’s assessment area or areas; (2) the meaning of a “regional area”; and (3) qualified investments in nationwide funds.<sup>14</sup>

**Small business development opportunities.** When investing in SBICs as LPs, many banks build financial relationships with the companies that comprise the SBIC’s investment portfolio. For example, SBICs often refer their portfolio firms that need commercial banking services to the banks that have invested in the SBICs as LPs. Similarly, banks may refer their small-business customers that do not meet the banks’ underwriting guidelines to the SBICs in which the banks have invested. By doing so, banks can maintain their commercial banking relationships with small-business customers.

**Volcker Rule exemption.** The Dodd–Frank Wall Street Reform and Consumer Protection Act contains a provision, the Volcker Rule,<sup>15</sup> which prohibits banks from ownership of hedge or private equity funds. The rule states that, subject to certain exceptions, “a banking entity may not, as principal, directly or indirectly, acquire or retain any ownership interest in or sponsor a covered fund.”<sup>16</sup> The final rule, however, excludes SBICs from the definition of a covered fund and does not restrict banks from investing in or sponsoring SBICs.<sup>17</sup>

### III. How Do SBICs Work?

Like other private investment funds, SBICs make investments with the goal of achieving favorable rates of return for their investors. The difference lies in the nature of the investments the SBICs make and the role the government plays in providing leverage. The SBIC program currently employs a so-called “debenture” model, where SBICs use their own capital plus funds borrowed through the issuance of debentures with an SBA guarantee to make equity and debt investments in qualifying small businesses.<sup>18</sup> An SBIC that successfully invests its funds in portfolio companies can achieve enhanced rates of return using SBA-guaranteed debentures.

<sup>12</sup> 12 CFR 25.23 and 12 CFR 25.26(c).

<sup>13</sup> 75 Fed. Reg. 47 (March 11, 2010), \_26(d)-1, p.11663.

<sup>14</sup> 78 Fed. Reg. 224 (November 20, 2013), \_12(h)-6 and \_12(h)-7, p.69678 and \_23(a)-2, pp.69679-80.

<sup>15</sup> The Dodd–Frank Wall Street Reform and Consumer Protection Act (Public Law 111–203, H.R. 4173; commonly referred to as Dodd–Frank) was signed into federal law on July 21, 2010. Title VI of Dodd–Frank, or the Bank and Savings Association Holding Company and Depository Institution Regulatory Improvements Act of 2010, introduced the so-called “Volcker Rule” amending the Bank Holding Company Act of 1956. The final regulations were published in the Federal Register on January 31, 2014, and became effective on April 1, 2014.

<sup>16</sup> 12 CFR 44.10(a)(1).

<sup>17</sup> 12 CFR 44.10(c)(11).

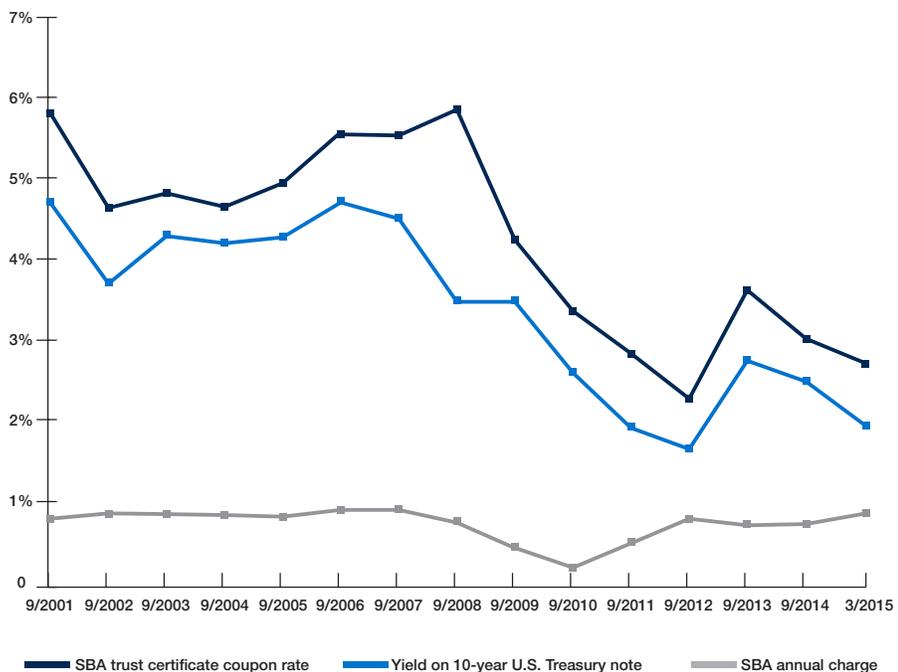
<sup>18</sup> Before 2004, SBICs could obtain SBA leverage in one of two ways: preferred limited partnership interests, called participating securities, or interest-only loans, called debentures. The SBA participating securities program was terminated in 2004.

### III.A. SBIC Leverage and Cost of Capital

Applicants to the SBIC program raise capital for a specific investment fund, which then sets its own strategy by making debt or equity investments in small businesses.<sup>19</sup> SBIC managers are required by statute to raise a minimum of \$5 million of private capital to establish an SBIC.<sup>20</sup> In practice, however, most SBICs raise significantly more. Debenture SBICs in FY 2014, for example, raised an average of \$47.7 million in private capital.<sup>21</sup>

The primary difference between a leveraged SBIC and non-leveraged SBIC is the former's access to low-cost funding through the SBA's guarantees of debentures.<sup>22</sup> Issued by the SBICs, debentures are non-amortizing 10-year debt securities with interest payments made on a semiannual basis. The interest rate of the debenture is fixed within six months of issuance at a premium over the 10-year U.S. Treasury note. Debentures mature and are payable in full by the end of the 10-year term. The SBIC debentures are pooled by the SBA twice a year (in March and September), securitized, and sold to the public in the form of trust certificates. These certificates are fractional undivided interests in the pool of debentures and are backed by SBA guarantees.<sup>23</sup> Figure 3 illustrates the debenture trust certificate's coupon rate over the last 14 years as compared with the yield on the 10-year Treasury note. As of March 31, 2015, the trust certificate's rate was 2.52 percent.

**Figure 3: SBA Debenture Coupon and Annual Charge Rate**



Source: OII, SBA.

<sup>19</sup> Out of \$5,464.6 million in SBIC financing to small businesses reported on the SBA's [December 31, 2014, quarterly report](#) titled "Small Business Investment Company (SBIC) Program Overview," debt-only funds represented 64 percent, debt-with-equity funds represented 19 percent, and equity-only funds represented 17 percent.

<sup>20</sup> [13 CFR 107.210](#).

<sup>21</sup> The SBA's "[Small Business Investment Company \(SBIC\) Program Overview](#)," Quarterly Reports, December 31, 2014.

<sup>22</sup> Once a debenture SBIC is licensed and operating, it makes investments using a combination of its private capital and SBA leverage. The SBA leverage is typically drawn in installments over a five-year period. For each installment, the SBIC issues a debenture.

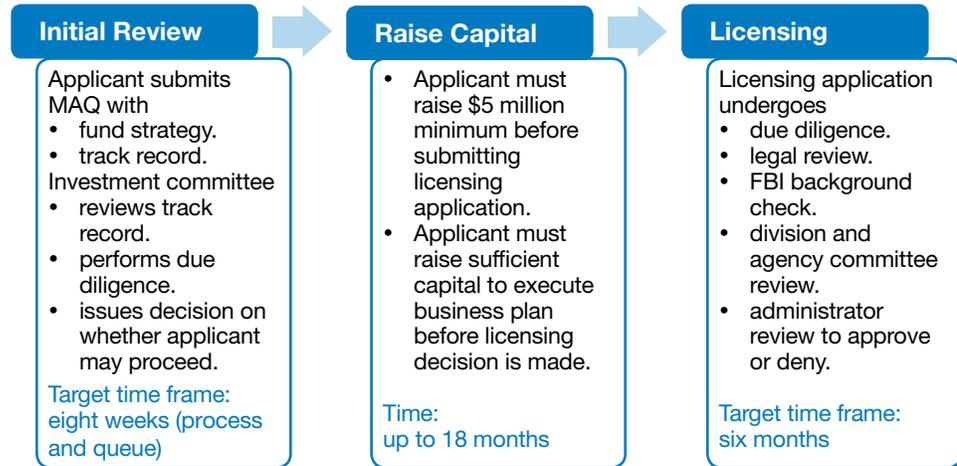
<sup>23</sup> The certificates typically are issued in multiples of \$5,000 with minimum original principal amounts of \$100,000. The denomination signifies a holder's pro rata share of the aggregate principal amount of the debentures on the pooling date.

### III.B. SBIC Licenses and Licensing Process

The process of obtaining an SBIC license from the SBA is rigorous. An applicant must (1) undergo an initial review, (2) raise capital, and (3) go through a final licensing review that includes due diligence, legal review, and background checks. As part of the initial review, and to determine whether the management team has the necessary qualifications to manage an SBIC, the SBA requires the applicant to complete an extensive management assessment questionnaire (MAQ). The applicant's answers to the MAQ provide important information about the proposed fund, its investing strategy, its operations, its decision-making process and oversight, and its legal provisions.<sup>24</sup>

Once the SBA has preliminarily approved the SBIC applicant, it provides a "green light" letter that authorizes the applicant to file a final application for an SBIC license that includes evidence of its private capital commitments and copies of its executed legal documents. The applicant must secure private capital commitments of at least \$5 million before its license is approved. The average number of months to process a license by the SBA in FY 2014 was 7.4 months.<sup>25</sup> The process is illustrated in figure 4.

**Figure 4: SBIC Licensing Process**



Source: OII, SBA.

### III.C. SBIC Operations and Oversight

Once an SBIC is licensed, it must meet the SBA's reporting requirements, which include quarterly and annual financial reports.<sup>26</sup> SBICs receiving SBA leverage must have an annual independent audit conducted by a certified public accountant. The SBA's Office of Examinations regularly examines SBICs' financial health and regulatory compliance; leveraged SBICs are examined annually, while non-leveraged SBICs are examined every two years. The SBA monitors the performance of SBICs through key metrics, including portfolio company performance, portfolio values relative to leverage, and capital impairment percentage (CIP). A more detailed discussion of how LPs can monitor SBIC performance is provided in section IV of this report.

<sup>24</sup> The MAQ and license application forms can be downloaded from the [SBA's Web site](#).

<sup>25</sup> The SBA's "Small Business Investment Company (SBIC) Program Overview," Quarterly Reports, December 31, 2014, page 3.

<sup>26</sup> See SBA's [Standard Operating Procedures 1006](#). For example, these reports include Form 468 (Annual Financial Report), Form 1031 (Portfolio Financing Report), and the Capital Impairment Percentage Worksheet. See appendixes A and B for more information.

### **III.D. SBIC Fund Cycles**

Once the SBA has approved an SBIC's license application, the SBIC typically proceeds with additional fundraising for a specific fund, a process that usually lasts from 12 to 18 months. When the funding commitments have been obtained, the SBIC evaluates its investment opportunities, makes investments, manages the investments, and, finally, receives returns and exits the investments.<sup>27</sup>

A leveraged SBIC's limited partnership agreement (LPA) typically is set up as a 10-year partnership with renewal options. The SBIC, however, may not terminate its partnership without first repaying its SBA leverage in full. Because it may take up to five years to make all investments, most SBIC funds exist for 10 to 15 years before exiting the program. Many successful SBICs start a second fund before they exit fully all the portfolio firms from the first fund. If a second fund is created, a new license application must be submitted to the SBA.

### **III.E. Investment Pay-In and Return of Investor Capital**

Typically, an LP makes a one-time capital commitment to an SBIC fund but disburses the funds over a number of years, depending on the GP's investment timing needs. For example, an LP could make a one-time \$1 million commitment to a fund, payable in 25 percent increments over the subsequent four years. The LP would have to be prepared, however, to disburse the entire commitment at one time if the GP needs funds quickly for immediate investment opportunities. In addition, the LP cannot be released from its capital commitment without written permission from the SBA.

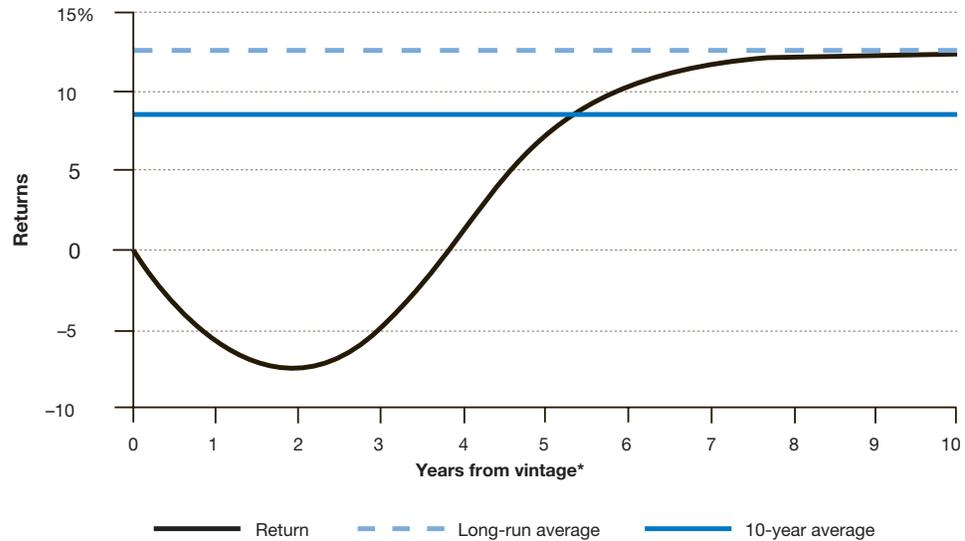
Since investments in portfolio firms take time to produce returns, a typical SBIC may report little or no return in its first few years of operation, as the interest or dividends collected are typically insufficient to cover the interest on debentures and the fund's management fees. Depending on how the LP accounts for the SBIC investments, a loss may be reported on the LP's income statement in the initial phase. This pattern of cash flows is referred to as a "J-curve" because the net cash flows from the fund look like the letter "J." Figure 5 illustrates the hypothetical returns an LP might see over the life of a mezzanine SBIC.<sup>28</sup>

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<sup>27</sup> Conversations with fund managers indicate that on average a typical manager reviews 100 investment opportunities for every one or two firms selected as a portfolio investment.

<sup>28</sup> A mezzanine SBIC typically is an investment fund that engages in debt financing such that it has the right to convert unpaid debt to an ownership or equity interest in the company. It is generally subordinated to debt provided by senior lenders such as banks and venture capital companies.

**Figure 5: J-Curve for a Hypothetical Mezzanine SBIC**



Source: OCC, “[Small Business Investment Companies: An Investment Option for Banks](#),” slide 62, February 15, 2012.

\* Vintage is the year the SBIC obtains the SBIC license.

Of course, different investment strategies produce different payback schedules and, in turn, different-looking J-curves. For example, SBICs that invest in the so-called mezzanine financing segment (repayment priority after senior debt instruments, but before equity financing) usually engage in all-debt financing, which means they collect interest almost immediately after the investments are made. That, in turn, reduces losses in the early phase and produces a shallower J-curve than that of an SBIC fund that engages mostly in equity financing. Non-leveraged SBICs typically pay back investor capital faster, as they do not have to pay back the SBA debentures. Furthermore, the shape and steepness of the J-curve varies with the debenture coupon rate, the timing and amount of payments, and whether capital gains are reinvested or not.

During the initial phase (commonly referred to as the investment period), portfolio firms are expected to pay interest or dividends, depending on the structure of the SBIC and the type of security provided. In the second phase (commonly referred to as the harvest period), the investments are repaid, which allows the GP to make capital distributions to LPs. The SBIC must pay interest on the SBA-guaranteed debentures before dividends are paid to investors. The exact distribution schedule is outlined in the SBIC’s Private Placement Memorandum (PPM) or its LPA.<sup>29</sup>

Often termed the “distribution waterfall,” the distribution provisions establish the order in which profits are paid to each member of the limited partnership. In one type of waterfall, the SBIC first distributes 100 percent of its profits to LPs until the LPs have received the entirety of their initial capital contributions, plus a predetermined annual rate of return, often 8 percent. Profits earned in excess of this amount are then distributed 100 percent to the GP, until the GP has received 20 percent of the cumulative distributions. Finally, the

<sup>29</sup> The SBA has drafted a model LPA for an SBIC issuing debentures that spells out the structure of the formal relationship between the LPs and the SBIC. See the SBA’s “[Model Debenture SBIC, L.P. \(Model Partnership Agreement\)](#).”

LPs take 80 percent and the GP 20 percent of any remaining profits.<sup>30</sup>

Many SBICs issuing debentures recycle investment proceeds during the investment period, and thus invest the dollars more than once. Most bank LPs reportedly avoid such arrangements, however, because the LPs prefer receiving distributions as soon as they are available.

### **III.F. Other Vehicles for Participating in the SBIC Program**

**Non-leveraged SBICs.** These SBICs forgo the use of SBA-guaranteed debentures and rely solely on private capital. From the GP and LP point of view, there are several advantages to being a non-leveraged SBIC, including the following:

- Non-leveraged SBICs are more suitable for funds interested in early-stage equity investments. These types of funds are less likely to be licensed as debenture SBICs by the SBA, but they can be licensed as non-leveraged SBICs.
- The SBA typically examines non-leveraged SBICs every other year, versus every year for leveraged SBICs.
- Non-leveraged SBICs are not required to comply with the SBA's rules on capital impairment and only have to report their required Annual Financial Report (Form 468) on an annual basis versus every quarter for leveraged SBICs.
- All income received by the non-leveraged SBIC may be passed directly to the GP and LPs without regard to paying debenture interest or repaying SBA leverage.

The principal disadvantage with a non-leveraged SBIC is that it does not get the benefit of returns associated with SBA leverage (see section V of this report).

Bank-owned SBICs are typically non-leveraged. Banks sometimes prefer owning the SBIC themselves because doing so allows them to have more control over where the SBIC fund investments are made while avoiding risks associated with leveraged financing.

**Fund of funds.** A bank also may participate in the SBIC program by investing in a “fund of funds,” which invests in a portfolio of SBICs. A fund of funds is overseen by a fund manager and holds limited partnership interests in many SBICs that typically operate throughout the United States. Because this fund holds interest in many SBICs, a bank that invests in this type of fund can limit the risk associated with investing in SBICs.

## **IV. Key Risks and Regulatory Considerations**

### **IV.A. Risks**

Investments made in SBICs have risks similar to those made in other types of private investment funds. Banks should manage these risks by performing proper due diligence on the SBICs being considered for investment. Potential bank investors need to have appropriate resources and experienced staff to manage SBIC investments in a safe and sound manner. The following are key issues banks should consider in any risk management strategy associated with investing in SBICs.

**Liquidity risk.** SBIC investments are illiquid. Bank LPs in SBICs should recognize that making investments in SBICs is similar to purchasing un-ratable and non-marketable

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<sup>30</sup> The 20 percent portion that the GP receives from capital gain distribution is commonly referred to as “carried interest.” Carried interest and the distribution arrangement is designed to motivate GPs to look for and invest in portfolio firms with good profit potential in order to produce returns above the 8 percent threshold (commonly referred to as “preferred return”).

securities. There is no formal secondary market to provide SBIC investors with the option of selling their investments should the bank have an immediate need for cash.

**Loss of principal.** Loss of principal is a risk of investing in small businesses. Investments in SBICs, therefore, are long-term in nature with no guarantee of repayment. Moreover, the fact that SBICs are licensed by the SBA does not, in itself, protect bank investments in SBICs. In fact, in the case of leveraged SBICs, this risk is somewhat heightened because the SBA is first in line for repayment. If a leveraged SBIC defaults on either the interest or the principal payments, the SBA makes those payments to the bondholders and has the right to liquidate the SBIC to recover its losses.

**Operational risk.** SBICs are governed by a detailed set of rules established by the SBA and are audited by the SBA either annually (leveraged SBICs) or every other year (non-leveraged SBICs). Banks investing in SBICs should familiarize themselves with SBA regulatory considerations on SBIC investment size and eligibility standards; affiliates and conflict of interest; qualifying investments; management ownership diversity; and reporting requirements.<sup>31</sup>

**General partner.** During the underwriting process, a bank considering an investment as an LP must carefully evaluate the management team serving as the SBIC's GP. The individuals comprising the GP team and their related experience have a significant impact on how the proposed SBIC performs. They are responsible for identifying portfolio companies in which the SBIC invests as well as maintaining an ongoing advisory role with these companies, with the goal of securing repayment of the SBIC's original investment plus a healthy return. When evaluating a GP, a bank should review the following.

- **Strength of management team.** A bank considering investing in an SBIC as an LP should review what experience the GPs have in small-business investment and the overall GP team cohesion (i.e., how long the current management team has worked together and in what capacity). The strength of the management team also is a critical factor for the SBA during the SBIC licensing process. By reviewing the SBIC's MAQ and PPM, a bank can gain insight into the credentials, experience, and track record of each member of the SBIC management team. These documents provide information about the principals' other business interests, backgrounds, pending or past litigation, and criminal history. They also contain references for the GPs and their previous business associates.
- **Track record.** Before taking an LP interest in an SBIC, a bank should review the investment performance of the GP principals in previous SBICs or investment funds that the GP sponsored (or in which they were principals) and how their performance compares with that of managers of funds with similar investment structures and strategies.<sup>32</sup> The bank should assess how the GP's actual investment returns compare with projections made when the fund was first formed. The bank may also want to examine the objectives and strategies of the current fund and determine if the GP team is leveraging the skills it demonstrated in previous funds. The track record of the principals is confirmed and thoroughly reviewed by the SBA during the licensing process. Performance of SBICs can be validated by using metrics reported on SBA Form 468.

<sup>31</sup> For a summary of these considerations, see the SBA's "[The Pre-Screening Process](#)."

<sup>32</sup> Data on private-equity fund performance can be purchased from private vendors such as [Preqin](#), [Cambridge Associates](#), and [Thomson Reuters](#).

- **Investment strategy.** Before investing as an LP, the bank should review the investment strategy of the GP, the GP’s competitive advantage, and whether the SBIC will be pursuing investments in geographic areas and in industries with which the bank is familiar. The bank should determine if these strategies are consistent with its risk profiles, business objectives, and financial conditions. The industry sectors in which the SBIC intends to invest, the intended level of asset diversification, and whether the GP will distribute the capital gains or recycle them in the SBIC also are important considerations. How actively the GP will be involved in the portfolio companies is another consideration.<sup>33</sup> Some SBICs set up an advisory board comprising independent LPs, which provide guidance on the fund investment strategy.
- **Financial incentives.** A bank should ensure that the GP’s financial interests are aligned with its own. Typically, GPs earn their income in three ways: management fees, carried interest, and ownership in the fund. SBA policies establish the maximum management fee an SBIC may earn; the LPA, however, may set the management fee at any lower amount.<sup>34</sup> Because management fees can deplete a fund’s investment capital, most bank LPs prefer GPs to earn their return based on the success of the fund through carried interest and fund participation. There is no requirement that the GP contribute part of the SBIC’s capital. Interviews with both GPs and LPs indicate, however, that a minimum 1 percent contribution, inclusive of the SBA leverage, by the GP is typically expected, and, in practice, the percentage contributed is often higher. Higher levels of ownership by the GP indicate principals have a greater personal stake in the success or failure of the fund. In today’s SBIC market, many GPs invest between 1 percent and 5 percent of the SBIC’s capital.

**Timing of capital calls and investment period.** After receiving a “green light” letter from the SBA, SBIC applicants must raise a minimum of \$5 million in private capital before submitting their license application. The applicants must raise sufficient funds to execute their business plan before the SBA considers granting them an SBIC license. Once the fund is licensed, the SBIC begins making investments in its portfolio companies and, if leveraged, begins drawing down its leverage from the SBA. It is at this point that investors begin receiving capital calls. A bank should review the guidelines of these capital calls. The guidelines are outlined in the subscription agreement and the LPA. Agreements typically assess penalties if the capital calls are not honored when requested.

**Documentation checklist and review.** There are several documents that a bank should request and thoroughly review before deciding whether to become an LP investor in an SBIC. They include the following:

- LPA
- Subscription agreement
- PPM
- MAQ
- SBIC’s investor presentation
- Audited financial statements (for previous funds sponsored by the GP)

**SBA leverage.** Before becoming an LP in an SBIC, a bank should understand whether the

<sup>33</sup> Discussions with industry practitioners indicate GPs of mezzanine SBICs often seek to negotiate a nonvoting seat on a portfolio firm’s board of directors, while GPs of equity SBICs often seek to obtain a seat on the board, depending on their ownership level. For more information on control of a small business by an SBIC, see [13 CFR 107.865](#).

<sup>34</sup> The maximum SBIC management expense allowed by the SBA is determined according to a formula that considers a combination of factors, including the age of the fund, the size of the fund, and the assets under management. For definitions and calculations of management fee rates, see the SBA’s “[SBIC TechNotes Number 7a](#).”

SBIC would leverage debt from the SBA and in what amount. This information should be available in the PPM or other investor marketing materials. There is credit risk associated with SBA leverage in that repayments from portfolio companies must go toward interest payments on the debentures before LPs can receive returns. Likewise, when debentures mature, they must be repaid before LPs receive their return of capital. If the SBIC experiences losses in its underlying investments, the use of leverage can reduce returns or even increase losses experienced by the LPs. Losses in underlying investments may result in a condition of capital impairment. Capital impairment and defaults on leverage may result in the SBA transferring the SBIC to the SBA's Office of SBIC Liquidation, in which case the SBA will take priority in repayment until it is fully repaid.

**Profit and loss distribution.** Before investing, a bank should determine how the SBIC will allocate profits and losses, the terms and timing of distribution of returns, and whether preferred returns are being provided to LPs and on what terms. The PPM should outline whether distributions from the portfolio companies will be reinvested or returned to investors.<sup>35</sup>

**Asset management or portfolio monitoring.** Before investing in an SBIC, a bank's senior management responsible for overseeing investments in SBICs should establish a sound process for evaluating the financial performance of the SBIC. Typically, SBICs conduct an annual in-person meeting with the GP and LPs. After acquiring an LP interest in an SBIC, a bank should stay apprised of all new SBIC investments by obtaining copies of the Portfolio Financing Reports (SBA Form 1031) the GP provides to the SBA identifying each new portfolio company in which the SBIC invests.

**Financial reports.** Before investing, a bank should identify the type and number of reports the LPs will receive from the GP. The bank also may want to review reports submitted by the SBIC to the SBA. These include the financial report (SBA Form 468), which is a comprehensive review of the SBIC's financials; the Retained Earnings Available for Distribution (READ) Worksheet, which delineates the status of retained earnings and distributions; and the CIP Worksheet, which constitutes an early-warning report about the SBIC's capital position.<sup>36</sup> More information on how to use the READ and the CIP Worksheet is provided in appendixes A and B.

## IV.B. Regulatory Considerations

**Investment authority:** Banks may make investments in SBICs using one or more of the authorities discussed in the following subsections of this report.

**Small Business Investment Act.** National banks and federal savings associations (FSA) have authority under the Small Business Investment Act of 1958 (as amended) to invest in SBICs. Specifically, under [15 USC 682](#), national banks and FSAs may invest in one or more SBICs, or any entity established to invest solely in SBICs.<sup>37</sup> Total investments in SBICs by any

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<sup>35</sup> The SBA places no limitations on the SBIC's distributions of profits to investors. When it comes to distributions of invested capital, however, an SBIC may not distribute more than 2 percent of its private capital, unless it receives the SBA's prior approval. For regulatory guidelines on this issue, see [13 CFR 107.585](#).

<sup>36</sup> See [13 CFR 107.630](#) for requirements for SBIC licensees to file financial statements with the SBA. [13 CFR 107.630 \(a\) \(1\)](#) requires that the annual Form 468 must be audited by an independent public accountant acceptable to the SBA.

<sup>37</sup> See [15 USC 682\(b\)\(1\) and \(2\)](#). Also, see [OCC Interpretive Letter #832](#) (August 1998), which clarifies that a national bank may invest in an SBIC that is in the process of organization as well as in one that has already been organized, approved, and licensed by the SBA.

national bank or FSA under this authority may not exceed 5 percent of the institution's capital and surplus.

**Other bank investment authorities.** In addition to the Small Business Investment Act authority, national banks may make investments designed primarily to promote the public welfare under [12 USC 24\(Eleventh\)](#).<sup>38</sup> Under this public welfare investment authority, national banks may make investments in community and economic development entities and projects that are designed primarily to promote the public welfare, as specified in [12 USC 24\(Eleventh\)](#) and its promulgating regulation, [12 CFR 24](#). The OCC's regulations for national banks define eligible public welfare investments to include investments that would receive consideration as a "qualified investment" under the CRA ([12 CFR 25.23](#)). Qualified investments under the CRA include "Small Business Investment Companies (SBICs), specialized SBICs, and Rural Business Investment Companies (RBICs) that promote economic development by financing small businesses."<sup>39</sup>

FSAs make public welfare investments pursuant to different statutory and regulatory authorities than those utilized by national banks.<sup>40</sup> An FSA's public welfare investments are also subject to different investment limits. In addition to their general lending and investment authorities, FSAs may use the following authorities to make public welfare investments:

- **De minimis investments ([12 CFR 160.36](#)):** Under the de minimis authority, an FSA may invest, in the aggregate, less than or equal to the greater of 1 percent of capital or \$250,000 in community development investments of the type permitted for a national bank under [12 CFR 24](#).
- **Investments in service corporations and service corporation subsidiaries for community development investments ([12 CFR 5.59](#)):** Under this authority, and pursuant to [12 CFR 5.59\(f\)\(8\)](#), the FSA, through one or more service corporation, may make community development investments that are permissible under [12 CFR 24](#). Pursuant to [12 CFR 5.59\(g\)](#), an FSA may invest up to 3 percent of its assets in service corporations, but any amount exceeding 2 percent must serve "primarily community, inner-city, or community development purposes."

**Transactions with affiliates:** Additional risk management and compliance issues may arise when a bank has a business relationship with a portfolio company of an SBIC. In some instances, the portfolio company may constitute an affiliate of the bank under sections 23A and 23B of the Federal Reserve Act. Lending and other business transactions between a bank and a portfolio company that meets the definition of an affiliate under [12 CFR 223.2](#) must conform with section 23A and be negotiated on an arm's-length basis pursuant to section 23B.

**Capital treatment:** Depending on their size, national banks and FSAs are subject to minimum risk-based capital requirements as calculated under either the standardized

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<sup>38</sup> National bank investments made under the requirements of [12 USC 24\(Eleventh\)](#) and [12 CFR 24](#) are limited to 5 percent of capital and surplus without prior, written approval of the OCC. National banks, however, may exceed the 5 percent limit up to a maximum of 15 percent if they obtain prior OCC approval. All investments are subject to certain notice and filing requirements set forth in [12 CFR 24](#).

<sup>39</sup> See "[Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Notice](#)," 75 Fed. Reg. 47, p.11652, \_12(t)-4 (March 11, 2010).

<sup>40</sup> See the [Federal Savings Association Investment Authorities](#) in the [Public Welfare Investments Web Resource Directory](#) on the OCC's Web site.

risk-based capital rules or the advanced approaches. Under the standardized risk-based capital rules,<sup>41</sup> SBIC investments in the form of equity are assigned a capital charge using the simple risk-weight approach (SRWA) for equity exposures. When SBIC equity exposures, in the aggregate, are under 10 percent of total risk-based capital, a 100 percent risk weight is assigned (which is considered a non-significant equity exposure). When SBIC equity exposures, combined with any other equity exposures of the bank, are equal to or greater than 10 percent of total capital, the equity exposure amount up to 10 percent of total capital receives a 100 percent risk weight, and the remaining amount of equity exposure receives a 300 percent or 400 percent risk weight, depending on whether or not the equity exposure is a publicly traded equity.<sup>42</sup>

Advanced approaches banks and FSAs may also use the SRWA for equity exposures. In addition, subject to prior written approval by the OCC, an advanced approaches institution may calculate the risk-weighted asset amount for SBIC equity exposures using the internal models approach.<sup>43</sup>

Additionally, a zero percent risk weight may be assigned to the carrying value of the guaranteed portion of held-for-sale SBA Guaranteed Interest Certificates purchased in the secondary market. Generally, a 20 percent risk weight is assigned to the carrying value of the guaranteed portion of an SBA loan originated and held by the reporting bank.<sup>44</sup>

**Accounting treatment:** Investments in SBICs are accounted for by one of three primary methods of accounting: (1) cost, (2) equity, or (3) consolidation. Banks making investments in SBICs should refer to the call report instructions (e.g., glossary entries on “Equity Method of Accounting” and “Variable Interest Entities”) and generally accepted accounting principles (GAAP) for guidance on accounting for these investments.<sup>45</sup>

## V. What Are Typical Returns on SBIC Investments?

The main advantage of leveraged SBICs is their potential for producing competitive returns, compared with similar classes of investment funds, as a direct result of employing low-cost SBA-guaranteed debentures to supplement the SBICs’ private capital.

Performance data on individual SBICs are not publicly available. The SBA’s OII has compared, however, the fund performance of debenture SBICs with fund indexes published by private aggregators. Overall, according to the SBA, the average return on debenture SBIC funds compares well with selected industry average returns.<sup>46</sup> Figure 6 illustrates pooled SBIC internal rate of return (IRR) by vintage compared with private-equity pooled funds.<sup>47</sup>

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<sup>41</sup> 12 CFR 3(D).

<sup>42</sup> 12 CFR 3.152.

<sup>43</sup> 12 CFR 3.153.

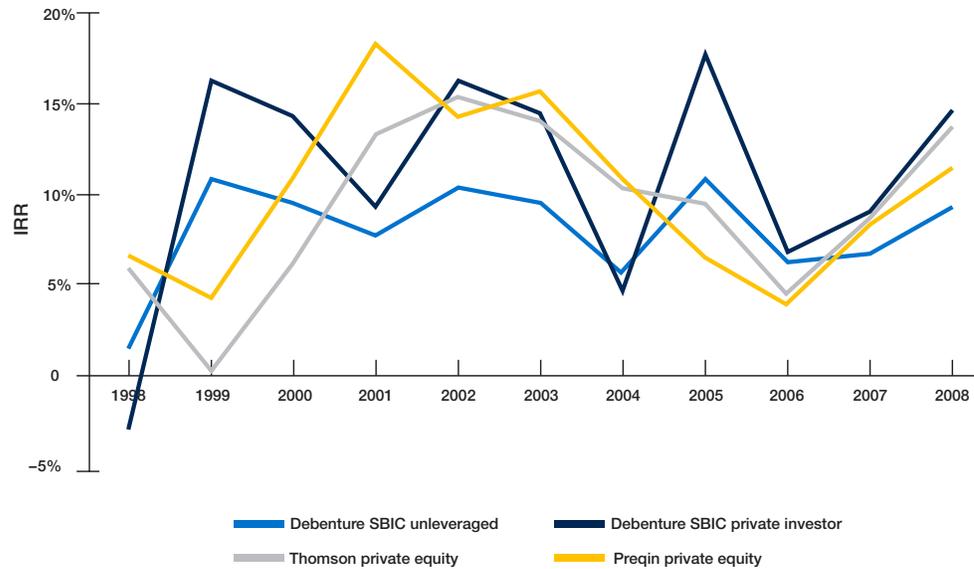
<sup>44</sup> 12 CFR 3.152.

<sup>45</sup> Financial Accounting Standards Board, Accounting Standards Codification (ASC) 323-30, *Investments—Equity Method and Joint Ventures—Partnerships, Joint Ventures, and Limited Liability Entities*, ASC 325-20, *Cost Method Investments*, and ASC 810, *Consolidation*.

<sup>46</sup> See the “Debenture SBIC Performance” section in “[The Small Business Investment Company \(SBIC\) Program Annual Report for Fiscal Year Ending September 30, 2013](#),” OII, SBA, pp. 29–35.

<sup>47</sup> The IRR of an investment is the discount rate that makes the net present value of costs (negative cash flows) of the investment equal to the net present value of the benefits (positive cash flows) of the investment. The higher a project’s IRR, the more desirable it is to undertake the investment.

**Figure 6: Debenture SBIC Pooled IRR by Vintage Year**



Source: OII, SBA.

Notes: As of December 31, 2012; sample size=100.

Because it takes a few years before an SBIC produces returns, including vintages that are more recent would be misleading. That is why the SBA reports returns on mature vintages only (and the horizontal axis denoting the year in figure 7 stops at 2008).

Pooled statistics were calculated by pooling the cash flows from all funds in each vintage year and computing industry metrics. The cash flows include both cash flows associated with private investors and SBA leverage.

The SBA calculates both returns to the private investor and unleveraged returns. Unleveraged returns (shown as “Debenture SBIC unleveraged” line in figure 6) treat SBA leverage as part of private investor capital, in which draws are treated as paid in capital, and interest, charges, and redemptions are treated as private investor distributions. This helps the SBA understand the value of leverage to the private investor and the underlying fund performance.

In assessing an SBIC’s performance, banks may wish to compare performance to appropriate benchmarks maintained by vendors such as Thomson Reuters, Preqin, and Cambridge Associates.

## **VI. What Are the Barriers to Bank Participation?**

There is general agreement that SBIC program participants—and investors in particular—would benefit from additional publicly available performance data. Because of privacy rules, however, performance data on individual SBICs cannot be made public. And, while there are private firms that publish private-equity market data for a fee, smaller community banks may find the subscription cost to be too expensive. As a result, many SBIC program participants operate as an informal network, with information collected and exchanged by experienced GPs and LPs.

Additionally, the negative legacy of the participating securities program, which was discontinued in 2004, has left some potential bank investors apprehensive about participating as LPs in the SBIC program. By contrast, the debenture program has had a solid performance to date.

## **VII. Conclusion**

The goal of the SBIC program is to encourage the flow of private investment capital into dynamic small businesses that innovate, grow, and create jobs. Many times these small businesses' financing needs are not suitable for traditional bank credit products, but the growth of these companies is vital to the health of the U.S. economy.

The government helps facilitate the flow of private capital into these businesses by guaranteeing a large portion of the total capital employed using SBA-guaranteed leverage. SBICs, with proper oversight and risk management, can present banks with an opportunity to invest in private equity while developing business relationships with companies in the SBICs' investment portfolios. Further, SBICs are competitive alternative investment options that have the potential to generate financial returns for bank LPs while potentially providing CRA consideration for the banks.

## Appendix A

### How Banks Can Use the READ Form

SBICs typically submit a READ<sup>48</sup> form to the SBA annually as part of the Annual Financial Report (Form 468), which is designed to give an overall picture of the fund's financial health.<sup>49</sup> The form, which also can be submitted quarterly, generally is examined in conjunction with the statement of partners' capital and the schedule of delinquent loans and investments.

The READ gives the bank an indication of the fund's earnings available for distribution and, in turn, expected income from an LP investment.

Table 1 shows a hypothetical example; a simplified statement of financial position with assets and liabilities. In this case, the SBIC fund collected \$5 million in private capital and \$10 million in SBA leverage. In the investment period (typically, years one through three), the fund produced negative net earnings and did not draw all of its debenture leverage. Consequently, the READ was negative, meaning not enough interest or returns would be available to distribute to investors. Later, in the harvest stage (typically, years five through seven), earnings increased and the full SBA leverage was drawn, resulting in distributed gains, as shown in the positive calculated READ figure.

**Table 1: Hypothetical Example of an SBIC's READ During Investment and Harvest Periods**

Statement of financial position	Investment period (typically years 1–3)	Harvest period (typically years 5–7)
<b>Assets</b>		
Loans and investments	\$3,500,000	\$11,500,000
Current and other assets	\$4,500,000	\$2,500,000
Unrealized depreciation	(\$50,000)	(\$500,000)
Total assets	\$7,950,000	\$13,500,000
<b>Liabilities</b>		
Long-term liabilities (debentures)	\$3,975,000	\$8,000,000
LP capital	\$4,000,000	\$4,000,000
Undistributed net realized earnings	(\$25,000)	\$1,500,000
Total liabilities	\$7,950,000	\$13,500,000
<b>READ calculations</b>		
Undistributed net realized earnings	(\$25,000)	\$1,500,000
Less: unrealized depreciation	\$50,000	\$500,000
<b>READ</b>	<b>(\$75,000)</b>	<b>\$1,000,000</b>

Source: OCC

<sup>48</sup> The Code of Federal Regulations defines READ as “the Undistributed Net Realized Earnings less any Unrealized Depreciation on Loans and Investments (as reported on SBA Form 468), and represents the amount that a Licensee may distribute to investors (including SBA) as a profit distribution, or transfer to Private Capital.” See [13 CFR 107.50](#).

<sup>49</sup> SBIC funds typically employ GAAP when producing financial reports to LPs. The SBA, on the other hand, requires reports using regulatory guidelines, which in some cases differ from GAAP standards. This explains why READ uses terms that are not common GAAP terminology.

## Appendix B

### How Banks Can Use the CIP Worksheet

Leveraged SBICs are required to submit a CIP Worksheet to the SBA each quarter, to report potential exposure from capital losses. The worksheet gauges the capital condition of a leveraged SBIC and serves as an early-warning indicator to alert the SBA before the fund's capital losses become too large to recoup the leverage extended.<sup>50</sup>

SBA regulations outline the maximum CIP allowable for a leveraged SBIC depending on its ratio of equity investment to outstanding leverage. Low equity investment and high leverage represent higher capital impairment risk, so the lower the ratio of equity investment to outstanding leverage, the lower the maximum CIP allowed by the SBA.<sup>51</sup>

The maximum permissible CIP ranges between 35 percent (for funds with low equity capital and high leverage ratio) and 70 percent (for funds with high equity capital and low leverage ratio).

If the SBIC fund is not experiencing any losses, the CIP is zero and its calculation is not required. If, on the other hand, the fund is experiencing losses, it is required to calculate and report its CIP to the SBA.

Table 2 shows a hypothetical simplified example illustrating two scenarios in which a leveraged SBIC fund incurs losses. In the first scenario, the CIP falls within an acceptable range, while in the second it does not. In both scenarios, the regulatory capital is \$10 million.

**Table 2: Hypothetical CIP Example for Two Scenarios**

		Scenario 1	Scenario 2
		Acceptable CIP	Unacceptable CIP
Line 1	Undistributed net realized earnings	-\$25,000	-\$2,500,000
Line 2	Includable non-cash gains	\$0	\$0
Line 3	Unrealized gains on securities held	-\$100,000	-\$2,000,000
Line 4	Total (lines 1+2+3)	-\$125,000	-\$4,500,000
Line 5	Regulatory capital	\$10,000,000	\$10,000,000
Line 6	CIP (line 4÷line 5)	1.25%	45%
Line 7	SBA maximum permissible CIP	35%	35%

Source: OCC

<sup>50</sup> The CIP can be shown as the ratio of (undistributed net realized earnings + includable non-cash gains + adjusted unrealized gains on securities held) ÷ regulatory capital.

<sup>51</sup> Because of the importance of the equity position to the impairment calculations, the CIP Worksheet is typically more relevant to funds using participating securities, not the debenture program.

## Appendix C

### IRR

The IRR of an investment is the discount rate that makes the net present value of costs (negative cash flows) of the investment equal to the net present value of the benefits (positive cash flows) of the investment. The higher a project's IRR, the more desirable it is to undertake the investment.

In the SBIC context, capital calls on the LPs are treated as negative cash flow, while distributions to the LPs and the residual value at the end of the investment period are treated as positive cash flows. Most commonly used spreadsheet programs can calculate the IRR from the cash inflows and outflows. Some banks that hold LP interests in an SBIC request these spreadsheet calculations from the GPs in order to validate the reported IRRs on previous funds, and to determine, in the case of future funds, if IRR projections are realistic.

The major variable with IRR calculations in the context of SBIC investments lies in the estimation of the net asset value (residual) at the time of exit from the investment. Depending on the valuation method and the actual performance, the final IRR can vary.

Table 3 shows how, keeping the paid-in capital and distribution flow the same, the IRR changes as the net asset value changes. In the first hypothetical scenario, the estimate of the net asset value is \$55 million and the resulting IRR is 10.1 percent. In the second, the estimate of the net asset value is reduced to \$45 million and the resulting IRR is 7.5 percent. In both examples, all cash flows are net of expenses, fees, SBA leverage, carried interest, and other liabilities.

**Table 3: Hypothetical Example Illustrating IRR Calculations in Two Scenarios**

				Scenario 1 Net IRR: 10.1%		Scenario 2 Net IRR: 7.5%	
Year	LP capital calls (in millions)	LP distributions (in millions)	Net asset value (in millions)	Net cash flows (in millions)	Net asset value (in millions)	Net cash flows (in millions)	
2002	-\$7.0			-\$7.0		-\$7.0	
2003	-\$8.0	\$0.3		-\$7.7		-\$7.7	
2004	-\$8.0	\$0.5		-\$7.5		-\$7.5	
2005	-\$9.0	\$1.0		-\$8.0		-\$8.0	
2006	-\$3.0	\$2.0		-\$1.0		-\$1.0	
2007	-\$5.0	\$2.0		-\$3.0		-\$3.0	
2008		\$3.0		\$3.0		\$3.0	
2009		\$3.0		\$3.0		\$3.0	
2010		\$5.0		\$5.0		\$5.0	
2011			\$55	\$55.0	\$45	\$45.0	
Total	-\$40.0	\$16.8		\$31.8		\$21.8	

Source: OCC

Note: The first year (vintage) is 2002. The terminal year is 2011.

## Appendix D

### Debenture SBIC Performance

Table 4 shows the capitalization, distributions, and residual values for debenture SBICs licensed since 1998 by vintage year that issued Debenture SBIC leverage before December 31, 2012.

**Table 4: Capitalization and Fund Value for Leveraged Debenture SBICs Licensed Since 1998 (in Millions)**

Vintage year	Number of SBICs by status*				Capitalization					SBA	LP distributions and residual value		
	Total	Liquidations	Surrender	Active	Private committed capital	Private paid-in capital	Leverage issued	Total capital paid-in or issued	\$ Weighted interest & annual charge	Leverage redemptions, interest & leverage fees	Private net distributions	Private residual value	Private total value
1998	10	6	3	2	\$200.0	\$184.1	\$257.4	\$441.5	7.43%	\$301.2	\$118.1	\$40.1	\$158.2
1999	10	1	7	3	\$301.5	\$191.7	\$393.9	\$585.6	5.95%	\$518.9	\$321.7	\$123.2	\$444.8
2000	14	4	10	3	\$350.6	\$208.5	\$298.1	\$506.6	6.25%	\$365.0	\$307.3	\$93.9	\$401.2
2001	9	3	3	4	\$216.4	\$127.4	\$226.8	\$354.2	5.73%	\$278.5	\$136.6	\$70.2	\$206.8
2002	8	0	2	6	\$174.9	\$133.2	\$285.5	\$418.6	5.08%	\$212.7	\$177.0	\$115.9	\$292.9
2003	9	0	0	9	\$422.9	\$368.8	\$673.5	\$1,042.3	5.46%	\$543.7	\$423.1	\$275.9	\$699.1
2004	4	0	0	4	\$128.4	\$103.4	\$195.1	\$298.5	5.96%	\$154.6	\$52.1	\$76.5	\$128.6
2005	9	0	1	8	\$365.6	\$278.9	\$486.1	\$765.0	5.84%	\$391.4	\$260.5	\$330.1	\$590.6
2006	12	0	0	12	\$585.7	\$482.1	\$927.8	\$1,409.9	5.37%	\$488.0	\$159.7	\$458.0	\$617.7
2007	8	1	0	8	\$518.6	\$405.6	\$692.4	\$1,098.0	4.52%	\$138.9	\$134.3	\$368.1	\$502.4
2008	7	0	0	7	\$256.5	\$206.1	\$371.4	\$577.5	4.14%	\$48.6	\$61.8	\$224.8	\$286.6
2009	9	0	0	9	\$534.3	\$333.1	\$587.3	\$920.4	3.65%	\$52.2	\$44.6	\$305.7	\$350.3
2010	20	0	0	20	\$1,153.0	\$697.6	\$1,207.6	\$1,905.2	3.51%	\$84.7	\$135.5	\$685.0	\$820.6
2011	18	0	0	18	\$1,202.7	\$551.4	\$782.9	\$1,334.3	3.31%	\$35.4	\$58.3	\$498.7	\$557.0
2012	18	0	0	18	\$813.1	\$291.2	\$259.5	\$550.7	3.45%	\$13.3	\$9.1	\$258.1	\$267.2
1998–2008	100	15	26	66	\$3,521.1	\$2,689.7	\$4,808.1	\$7,497.7	5.45%	\$3,441.6	\$2,152.2	\$2,176.6	\$4,328.8
2009–2012	65	0	0	65	\$3,703.1	\$1,873.3	\$2,837.3	\$4,710.6	3.47%	\$185.6	\$247.5	\$1,747.6	\$1,995.1
1998–2012	165	15	26	131	\$7,224.2	\$4,563.0	\$7,645.3	\$12,208.3	5.45%	\$3,627.2	\$2,399.7	\$3,924.2	\$6,323.9

Source: OII, SBA, and appendix B, SBIC Annual Report FY 2013.

\* Status as of September 30, 2013.

### Definitions and Methodology

- Vintage is the year the SBIC obtains the SBIC license.
- SBA estimated SBIC performance metrics using data reported by SBICs on Form 468 (SBIC Annual Financial Report) and the Office of SBIC Liquidations Ultimate Loss Reports. These metrics exclude SBICs that did not issue debenture leverage before December 31, 2011, or issued preferred stock or participating securities at some time. SBICs licensed before 1998 are not included because of data limitations.
- SBIC surrenders: Once a fund repays SBA its guaranteed leverage and surrenders its license, SBA is no longer able to report performance. SBA reports the last observed metrics for Surrendered SBICs. In some cases, the Form 468 data may not contain a

cash flow showing the SBIC repaid its leverage. In these cases, SBA assumes that all surrendered SBICs repay leverage in the year it surrendered. In addition, since SBICs may have made distributions to private investors post surrender, distributions to paid-in capital metrics may be understated and other performance metrics may differ from actual performance.

- Distributions to paid-in capital: Total private distributions minus estimated 20 percent carried interest on any profits divided by private paid-in capital.

## **Appendix E**

### **Resource Directory**

#### **Federal Government Resources**

13 CFR 107 Small Business Investment Companies

[www.gpo.gov/fdsys/pkg/CFR-2009-title13-vol1/pdf/CFR-2009-title13-vol1-part107.pdf](http://www.gpo.gov/fdsys/pkg/CFR-2009-title13-vol1/pdf/CFR-2009-title13-vol1-part107.pdf)

Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Notice, 75 Fed. Reg. 47 (March 11, 2010).

[www.ffiec.gov/cra/pdf/2010-4903.pdf](http://www.ffiec.gov/cra/pdf/2010-4903.pdf)

Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Notice, 78 Fed. Reg. 224 (November 20, 2013).

[www.gpo.gov/fdsys/pkg/FR-2013-11-20/pdf/2013-27738.pdf](http://www.gpo.gov/fdsys/pkg/FR-2013-11-20/pdf/2013-27738.pdf)

Dilger, Robert Jay, “SBA Small Business Investment Company Program,” Congressional Research Service, 7-5700, R41456 (July 18, 2013).

[www.fas.org/sgp/crs/misc/R41456.pdf](http://www.fas.org/sgp/crs/misc/R41456.pdf)

“Interagency Questions and Answers Regarding Community Reinvestment,” Outlook Live Webinar Presentation Material.

<https://consumercomplianceoutlook.org/outlook-live/2014/interagency-questions-answers-regarding-community-reinvestment/>

#### **Office of the Comptroller of the Currency**

Public Welfare Investments Web Resource Directory

[www.occ.gov/topics/community-affairs/resource-directories/public-welfare-investments/index-public-welfare-investments.html](http://www.occ.gov/topics/community-affairs/resource-directories/public-welfare-investments/index-public-welfare-investments.html)

Small Business Resource Directory

[www.occ.gov/topics/community-affairs/resource-directories/small-business/index-small-business.html](http://www.occ.gov/topics/community-affairs/resource-directories/small-business/index-small-business.html)

Third-Party Relationships Risk Management Guidance (October 30, 2013)

<http://el.occ/news-issuances/bulletins/2013/bulletin-2013-29.html>

Volcker Rule Final Regulation (March 25, 2014)

<http://el.occ/news-issuances/bulletins/2014/bulletin-2014-9.html>

Small Business Administration SBIC Program

[www.sba.gov/category/lender-navigation/sba-loan-programs/sbic-program-0](http://www.sba.gov/category/lender-navigation/sba-loan-programs/sbic-program-0)

## **Industry and Private Firms Resources**

Institutional Limited Partners Association Private Equity Glossary

<http://ilpa.org/topics/glossary/>

“A Summary Guide to Small Business Investment Companies,” Semmes, Bowen & Semmes, Attorneys at Law.

[www.sbiclicense.com/pdf/SBIC\\_SummaryGuide.PDF](http://www.sbiclicense.com/pdf/SBIC_SummaryGuide.PDF)

Small Business Investor Alliance

[www.sbia.org/](http://www.sbia.org/)

Staebler, Michael B., “Description of the Small Business Investment Company Debenture Program,” Pepper Hamilton LLP (January 20, 2015).

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