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## SBIC Subsidiaries

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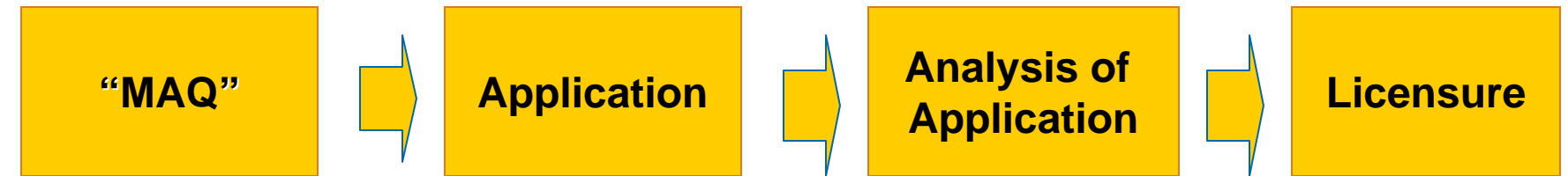
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# SBIC Program Overview

- A Small Business Investment Company (“**SBIC**”) is a privately owned and operated company that makes long-term investments in U.S.-based small businesses and is licensed by the U.S. Small Business Administration (“**SBA**”).
- Maximum SBA funding levels for fully funded SBICs (at \$75 million) is up to two times the private capital raised by the SBIC, or \$150 million and \$225 million for multiple licensees under common control.
- Pending legislation would allow SBIC subsidiaries of BDCs to increase leverage up to \$350 million.

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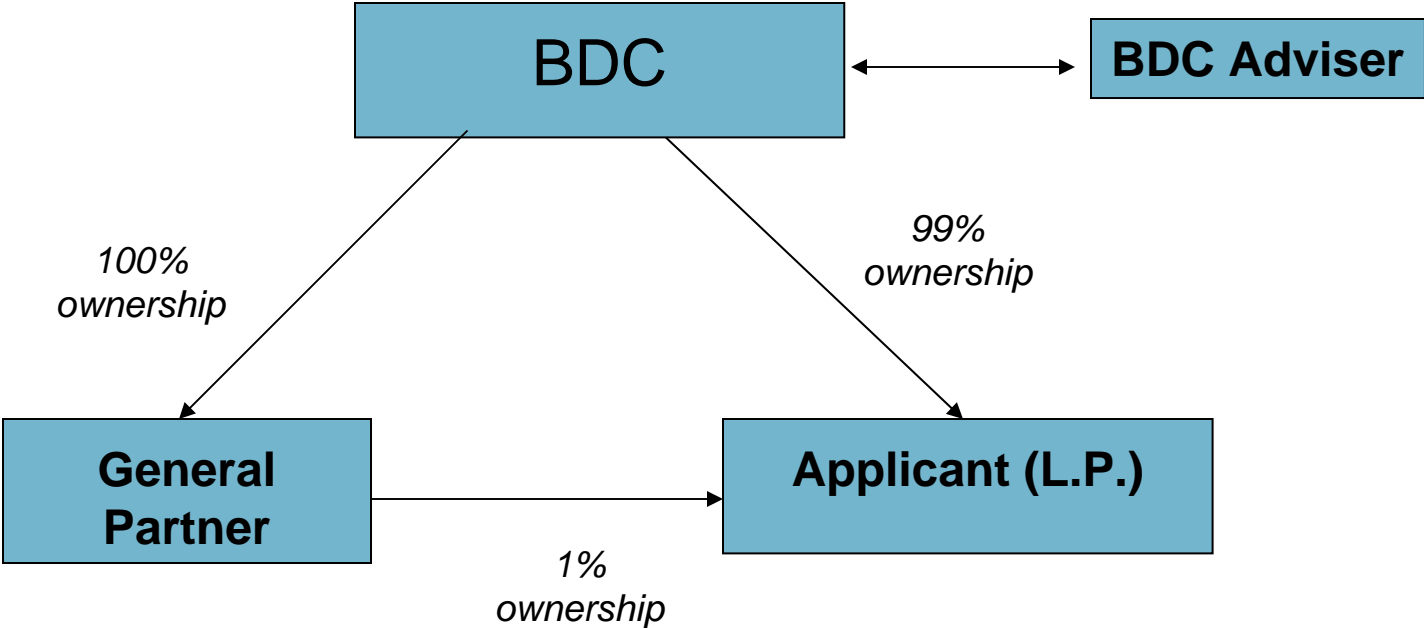
- Initial Review
- Meeting with Investment Committee
- “Green Light”

- Minimum Regulatory Capital Committed
- “Pre-Licensing Investments”
- SBIC Class

- Due Diligence
- Analysis (Financial & Legal)
- Comment Letters
- Meeting with Investment Division

- 3 Levels of Decision Makers
- Timing: 6 to 8 months
- Fees (SBA, Legal)

# BDC/SBIC Structure



# BDC/SBIC Structure

- BDCs that have SBIC subsidiaries:
  - Hercules Technology Growth Capital, Inc.
  - Fifth Street Finance Corp.
  - Medallion Financial Corp.
  - MCG Capital Corporation
  - Main Street Capital Corporation
  - PennantPark Investment Corporation
  - Rand Capital Corporation
  - Triangle Capital Corporation

# SBIC Exemptive Relief

- Exemptive Relief under Section 18 to get SBIC leverage treatment at BDC level.
- Question of whether BDC with an SBIC subsidiary must comply with the asset coverage requirements of Section 18(a) (as modified by Section 61(a) for BDCs) on a consolidated basis.
- The senior securities issued by the SBIC Subsidiary would be excluded from the SBIC Subsidiary's individual asset coverage ratio by Section 18(k) if the SBIC Subsidiary were a BDC.

- Guidance – TechNote 13
  - With respect to SBIC subsidiaries of BDCs, the SBA will count a parent BDC's unfunded capital commitment as Regulatory Capital if the parent's funded net worth is at least ten times its total capital commitment to the SBIC and sufficient liquidity exists to fund the commitment.
  - With respect to the calculation of the leverage commitment available to the SBIC of a BDC, the SBA will consider the SBIC eligible to obtain a leverage commitment up to two times its Regulatory Capital if the parent BDC has funded net worth at least six times its total capital commitment to the SBIC and sufficient liquidity exists to fund the commitment.
    - The SBIC's leverage draw downs will initially be limited to a single tier and a 1:1 leverage ratio until Regulatory Capital is fully paid-in.
  - If a parent BDC has funded net worth less than six times its total capital commitment to the SBIC and/or if the Investment Division determines that liquidity is insufficient, its commitment will only be counted as Regulatory Capital to the extent that it is paid-in.

- The SBA also issued the following guidance to BDC applicants:
  - SBICs may apply for leverage commitments a maximum of two times per calendar year;
  - BDC applicants are encouraged to carefully consider the appropriate Regulatory Capital amount in light of their investment strategy and typical investment size when determining whether or not a SBIC license is a good fit for their business;
  - SBICs that have a planned 10-15 year lifespan, rather than an evergreen or indefinite life structure, are preferred; and
  - As a general rule, SBA will only license funds that satisfactorily link, either directly or indirectly, incentive compensation of the principals responsible for the SBIC portfolio to the performance of the SBIC.

- **Capital Commitment**

- The SBA has implemented an accelerated commitment process for up to one tier of leverage.
- Applicant may apply for up to one tier of leverage prior to obtaining a license or up to 30 days after licensure.

- **Just in Time Financing**

- SBIC is eligible to draw down off of its capital commitment.
- These “draw requests” are processed by the SBA twice a month and the SBIC must provide the SBA with a statement of need for such funds in its draw request application.

- Investment Size:

- At least 25% of investments will be in Smaller Enterprises with a net worth of \$6 million (max) and a net income after taxes of \$2 million (max).
- No more than 75% of investments will be in Small businesses with a net worth of \$18 million (max) and a net income after taxes of \$6 million (max).
- Maximum investment in any 1 company or group of affiliated companies (the “overline limit”) is 10% of total capital.
  - “Total capital” is the sum of private capital and “the total amount of leverage projected by the SBIC in its business plan that was approved by SBA at the time of the grant of the company’s license.”
  - Since most SBICs project the use of two tiers of leverage (*i.e.*, leverage equal to two times their private capital), this calculation is generally equivalent to raising the overline limit to 30% of private capital.

- **Affiliate/Associate Issues**
  - SBICs are precluded from making investments in a small business if the investment would give rise to a conflict of interest.
  - Generally, a conflict of interest may arise if an associate of the SBIC has or makes an investment in the small business or serves as one of its officers or directors or would otherwise benefit from the financing.
  - Joint investing with an associate of the SBIC, such as another fund controlled by affiliates of the SBIC's general partner, may be made on identical terms or on terms which are fair to the SBIC.
  - SEC exemptive relief for certain joint transactions.

- Other Regulatory Requirements

- Financial reporting on SBA Form 468.
- Annual (semi-annual, if leverage is used) valuation of assets pursuant to SBA valuation guidelines.
- An SBIC using leverage must invest its “idle funds” in liquid, safe, short-term investments specified in the regulations (principally, U.S. government obligations, repurchase obligations, federally-insured deposits, and deposits in “well-capitalized” federally-insured financial institutions).
- If an SBIC issues leverage, it will be required to avoid “Capital Impairment” which will be considered to exist if the SBIC’s “Capital Impairment Ratio” (calculated by adding the SBIC’s realized losses and net unrealized depreciation and dividing the result by the SBIC’s private capital) exceeds permitted levels detailed in the regulations and which vary depending on the proportion of equity investments made by the SBIC.
- An SBIC’s ability to borrow funds from third parties is subject to SBA regulation. SBICs only may incur unsecured debt.