

## **SBIC TechNotes**

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### **Fast Track Process for Small Business Investment Companies Seeking a Subsequent License**

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#### **Introduction**

The Office of Investment has instituted a Fast Track process for reviewing applications for Small Business Investment Company (“SBIC”) licenses for successor funds to be operated by managers of current SBICs that meet certain criteria. The Fast Track applies only to (i) applicants whose previous SBICs have been licensed to issue Debenture leverage only (“Debenture SBIC Applicants”) or (ii) applicants who are not seeking leverage for their subsequent SBIC (“Non-leveraged SBIC Applicants”).

This TechNote describes the criteria for Fast Track. Please note that management teams may be licensed for a subsequent SBIC even if they do not qualify for the Fast Track process. Similarly, qualifying for Fast Track does not guarantee that the applicant will be licensed.

#### **Process**

SBA uses a three step process to license an SBIC: Phase I – Initial Review; Phase II – Capital Raising; and Phase III - Licensing. The Fast Track is anticipated to shorten the Phase I process to 2 weeks from receipt of SBIC notification and the Phase III process to 60 days from the date SBA accepts the licensing application. (Note: Due to the shortened timeframe, Fast Track applicants will not be allowed to make pre-licensing investments.)

#### **PHASE I: INITIAL REVIEW (2 WEEKS)**

Debenture SBIC Applicants and Non-leveraged SBIC Applicants should notify their Operations Analyst in writing (email is acceptable) with a copy to the Area Chief, providing the following information:

- Name of new fund;
- Amount of leverage being sought;
- Anticipated private capital size (include hard-circled and soft circled commitments, if any);
- Minimum targeted capital required to execute strategy;
- Anticipated closing date to raise minimum targeted capital required to execute strategy;
- Estimated date applicant expects to file application, if known (specifically identifying if you expect to file immediately);
- Any anticipated changes in the management team from the current SBIC(s); and

- A brief description of the proposed fund’s strategy with regards to industry, geography, size of investments, investment structure, portfolio company initial stage/ revenue range/EBITDA range; and a discussion regarding how this strategy differs from its current strategy.

The Operations Analyst will review the information submitted and the current SBIC(s) using criteria A through C in Attachment 1. The Operations Analyst will prepare a written memo concerning his/her review for the Investment Committee. The Investment Committee will consider the memo and other issues that might impact the Fast Track process and licensing decision. If the Investment Committee concludes by majority vote that the applicant satisfies the Fast Track criteria at this stage and the Investment Committee has identified no other concerns about other issues that impact the Fast Track Process, the applicant can expect to receive a “Fast Track Green Light” letter within 2 weeks from the date the Office of SBIC Operations receives the notification. If the Investment Committee does not conclude that the applicant satisfies the Fast Track criteria or the Investment Committee requires further information, SBA will notify the applicant within 2 weeks.

If an applicant is denied “Fast Track” status at this stage, SBA will continue to evaluate the application to determine whether the applicant should be provided a “Standard Green Light” letter. If the Investment Committee decides by majority vote to approve a “Standard Green Light” letter to the applicant, when the applicant submits its application in Phase III, the Licensing Analyst will re-evaluate the applicant against the Fast Track Criteria A through C in Attachment 1 to determine if the applicant qualifies for Fast Track at that point.

## **PHASE II – CAPITAL RAISING PROCESS**

An applicant who receives either “Green Light” letter has up to 1 year from the date of the letter to raise capital and submit its licensing application. The SBIC application remains the same regardless of whether an applicant qualifies for Fast Track processing. Applicants seeking to qualify for the Fast Track need to raise the minimum targeted capital required to execute the strategy prior to submitting its licensing application to the SBA. Applicant managers should keep their Operations Analyst updated on their capital raising progress and advise them at least 30 days prior to filing the application as to when they expect to file. (This will allow Operations to provide current information on the applicant to the Licensing staff prior to filing.)

## **PHASE III - FAST TRACK LICENSING PROCESS**

Upon receipt of the application, the Licensing Analyst will determine whether any material adverse information or changes have occurred or become known since Phase I and verify that all requirements identified in Attachment 1 have been satisfied. The Licensing Analyst and the Office of General Counsel (“OGC”) will preliminarily assess the organizational structure, legal documents, and capitalization to ensure they meet conformance requirements identified in Attachment 2. (Note: SBICs will not be allowed to modify their organizational documents for 6 months after being licensed.) If the applicant meets all Fast Track requirements, the applicant can

expect to be notified of the final Fast Track qualification within 10 days after the SBA accepts the application.

If an applicant is removed from Fast Track, the applicant will be notified within the 10 day period with the reason(s) for removal. The Associate Administrator for Investment (“AA/I”) must approve any removals from Fast Track. Applicants that are removed from Fast Track for non-conformance due to issues concerning qualifications A.1, A.2, and/or D in Attachment 1 will be sent a Notice of Non-conformance and be given 30 days to respond from the date of the notice. If the applicant cures within the 30 days, they will be placed back on Fast Track. (Applicant time to respond for non-conformance will not be counted towards the 60 day licensing time goal.)

The SBA transmits security documents to the Federal Bureau of Investigation (“FBI”) for two criminal history checks: fingerprint and name checks. The fingerprint clearance must be completed before the applicant can receive leverage, a process which typically takes 2 to 3 weeks (although it should be noted that the SBA has no control over the length of the process). This will not impact the Fast Track process.

During the Phase III process, the SBA will perform due diligence including telephone reference calls, electronic public records searches, strategic/business plan validation, regulatory diligence, and financial analysis. If any material adverse information arises during this timeframe, the SBA may remove the applicant from Fast Track. If this should occur, the applicant will be notified within 10 days of identifying the issue.

Within 3 to 4 weeks after submitting its application, the SBA will send a “comment letter” to the applicant containing any comments, questions, and concerns. Applicants will be given 1 week from the date of the letter to respond. During the response timeframe, the applicant must also provide SBA with an executed capital certificate and bank letter showing the minimum \$2.5 million of leverageable capital, as well as fully executed legal documents. If the legal documents have been signed under a power of attorney, executed copies of each power of attorney must also be submitted. If the applicant requires more time than 1 week to provide the capital certificate and bank letter and respond to the comment letter or the applicant provides an insufficient response, additional time to resolve these issues will not be counted towards the 60 day licensing goal.

Once all issues are resolved and documents are submitted, the application will be presented to the Divisional SBIC Licensing Committee and then to the Agency Licensing Committee.

## Attachment 1 – Fast Track Licensing Qualification Checklist

Qualification	Y or N
<b>A. Same Business Plan*</b>	
1. Key management personnel are substantially the same with similar expected time commitment, financial incentives, and roles. Management team does not contain any foreign principals, requiring further investigation.	
2. Existing SBIC is using the same type of leverage as proposed or the proposed SBIC is non-leveraged.	
3. Investment strategy is substantially the same as existing SBIC.	
<b>B. Performance</b>	
1. All current SBICs have had at least 2 exams and at least half of the exams must be with no findings including the last one, no unresolved findings, and no pattern of repeat violations.	
2. All current SBICs have a capital impairment of no more than 20%.*	
3. All current SBICs must have had at least 3 audited Form 468s (audited by their independent public accountant).*	
4. SBICs must have either repaid the SBA in full with no further commitments or demonstrated in at least 3 out of the last 5 years, including the current operating year (can be current year to date if there are at least 2 quarters) positive cash flow from operations. *	
5. Last SBIC licensed must not have been transferred to the Office of Liquidation and any previously licensed SBIC that was transferred to the Office of Liquidation must have repaid SBA in full.*	
<b>C. Recently Licensed*</b>	
1. The last SBIC licensed for the management team must have been licensed within the last 8 years.	
<b>D. Legal, Structure and Capitalization (See Attachment 2.)</b>	

\* Only applies to SBICs seeking leverage.

## Attachment 2 – Fast Track Guidance

*General Note: SBA encourages a coordinated effort by industry legal practitioners and representatives to assist with the further development of this guidance by proposing standardized legal provisions addressing the topics in this attachment and by raising additional issues not discussed below.*

### I. ORGANIZATION

#### A. SBIC Applicant

1. Capital commitments from LPs must be made directly to the SBIC (or its parent fund, in the case of a drop-down) with no intermediaries involved.
2. Applicant cannot be a BDC or other public or regulated entity.
3. Drop-down SBICs
  - a. The drop-down structure should be used only when it has a clear business purpose:
    - i. Example 1 – Parent fund is already operating
    - ii. Example 2 – Substantial capital will be retained for investment at the parent level (SBA suggests that managers consider the alternative of structuring a non-SBIC fund side by side with the SBIC)
  - b. Drop-down funds must have one domestic US parent fund only
  - c. Parent must qualify as a traditional investment company based on established SBA precedent.
  - d. Parent must disclose the identity of all its investors.
  - e. All of the investors in the parent fund (the SBIC’s “Class A” limited partner) must agree to be “Class B” limited partners of the SBIC, unless the SBIC’s Regulatory Capital will not include any unfunded commitments.
  - f. The Class B limited partners’ commitments to the SBIC applicant must be expressed as a specific dollar amount (not just as the “proportionate share” of parent fund’s commitment).
  - g. The total dollar amount of Class B commitments must be equal to the Class A partner’s unfunded commitment to the SBIC.
4. All provisions governing the operation of the SBIC must be included in the limited partnership agreement (no side letters).
5. Applicant must adopt SBA Model Valuation Guidelines.

#### B. General Partner

1. All principals must:

- a. Hold direct ownership interest in and be the direct individual managers of the general partner, with no intervening entities.
  - b. Receive carried interest directly from the general partner; for drop-down SBICs, carried interest may be received from the parent fund's general partner.
2. A maximum of 25% of the carried interest may be allocated to non-principals.
  3. Any provision to remove or terminate a principal must be spelled out within the general partner's organizational document and must not be tied to events occurring under other agreements (e.g., a principal's employment agreement with the management company).
- C. Investment Advisor ("Management Company")
1. Ownership of the management company that is highly disproportionate to the ownership of the general partner (e.g., one principal is the 100% owner) is undesirable, but may be acceptable if there are adequate checks and balances on the powers of the dominant owner. Areas that cannot be subject to unilateral decision-making include the following:
    - a. Power to remove or terminate other principals.
    - b. Power to change the composition of the SBIC's investment committee.

## II. CAPITALIZATION

1. Regulatory Capital must be within the targeted range for fundraising and be sufficient to execute the SBIC's business plan when the application is submitted.
2. The SBIC must have the unconditional ability to legally enforce collection of each capital commitment.
3. Capital Certificate
  - a. A signed Capital Certificate must be submitted with the application
  - b. The only permitted conditions on private capital commitments are:
    - i. Receipt of SBIC license
    - ii. Approval of organizational document.
  - c. Individual investors must list residence address, not a business address.
  - d. Street addresses are required (no P.O. Box addresses).
4. A dual commitment may be obtained to back up the commitment of any direct investor in the SBIC who is not an Institutional Investor. Dual commitments are not permitted for investors in the parent fund of a drop-down SBIC or other indirect investors.
5. Capital commitments by the principals, general partner, or their affiliates must be payable in cash when called (cannot be satisfied with notes or management fee waivers).

### III. DOCUMENTATION

#### A. Limited Partnership Agreement

1. Limited partnership agreement must be marked against SBA's Model LP Agreement ("Model") in accordance with the instructions provided at the beginning of the Model, including instructions concerning use of fonts. For required provisions, the paragraph structure used in the Model must be retained.
2. Bolded sections of the Model must be adopted with no omissions or changes.
3. Discretionary provisions must be sufficiently transparent so that SBA can readily understand what each provision is for and how it works.
4. There must be no conditions or restrictions on the ability of the GP to call private capital commitments except under a permitted "Key Person" provision
5. A "Key Person" provision is permitted if limited to the suspension of capital calls for new investments until a replacement is found; cannot release any investors from their unfunded commitments or allow withdrawal from the fund
6. Withdrawal rights are limited to those permitted by the Model.
7. Management fees must be in accordance with SBIC TechNote 7A.
8. Designation of Partnership expenses and expenses to be paid out of the management fee must be consistent with SBIC program regulations (see 13 CFR 107.520).
  - a. Organizational costs are a partnership expense. SBA encourages applicants to include in the LP agreement a reasonable cap on the total organizational costs to be paid by the SBIC. If there is no cap, SBA will review the organizational costs incurred prior to licensing and determine whether they are reasonable. Costs deemed excessive can be paid by the GP or management company or be deducted from the applicant's Regulatory Capital.
  - b. Unreimbursed expenses on deals that do not close may be designated as a partnership expense but should be capped at a reasonable level.
9. Right of limited partners to remove general partner – Provisions allowing removal of the general partner without cause ("no-fault divorce" provisions) are not permitted. Otherwise, SBA has no established position on removal rights and is not mandating or prohibiting any specific provision for purposes of fast track qualification. SBA's general concern in this area is ensuring the continued orderly operation of the fund and the avoidance of a prolonged period of disruption or inactivity during the removal and replacement process. SBA welcomes input regarding provisions that would address these concerns.

B. Fingerprint Cards, Personal History Statements, and Entity Name Check Forms

1. Must be submitted with license application for all required parties.

C. Transferor's Liability Contract

1. Executed contract from all required parties must be submitted with license application.

D. Post-Licensing Amendments

1. For SBICs licensed under the fast track procedure, SBA will not consider amendments to the organizational documents for a minimum of six months after licensing.