

# SBIC TechNotes

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## Guidance Regarding 13 CFR §107.585 Voluntary Decrease in Licensee's Regulatory Capital for Early Stage SBICs

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### 1. **Background.**

In April 2012, SBA published the final Early Stage SBIC rule [FR Doc No: 2012-10120] (<http://www.gpo.gov/fdsys/pkg/FR-2012-04-27/pdf/2012-10120.pdf>). The final rule included the following addition to 13 CFR §107.585, Voluntary Decrease in Licensee's Regulatory Capital: “. . . if you are an Early Stage SBIC, you must obtain SBA's prior written approval for any reduction of your Regulatory Capital, including any reduction pursuant to a Distribution under §107.1180 of this part.” A reduction in Regulatory Capital typically occurs when an SBIC returns capital to its investors. SBA established special rules for Early Stage SBICs to mitigate the additional risk associated with early stage investing. This TechNote provides guidance for Early Stage SBICs that want to make a Distribution that will result in a reduction of Regulatory Capital.

### 2. **Existing Guidance.**

SBA currently provides guidance for approval of Regulatory Capital reductions in the following documents:

- a. Standard Operating Procedure (“SOP”) 10 06 - Oversight and Regulations of SBICs Investment Division ([http://www.sba.gov/sites/default/files/serv\\_tools\\_sops\\_1006.pdf](http://www.sba.gov/sites/default/files/serv_tools_sops_1006.pdf)) Chapter 3 paragraph d.
- b. TechNote 5 – Credit Management Procedures (<http://www.sba.gov/content/sbic-technotes-number-5-november-2000>), under “WIND-UP ARRANGEMENTS FOR LIMITED LIFE SBICs ISSUING DEBENTURES”.

TechNote 5 states that SBA will only consider reductions in Regulatory Capital by a debenture SBIC as part of a wind-up plan approved by SBA. SBA recognizes that Early Stage SBICs may seek to make distributions that reduce Regulatory Capital prior to wind up. This policy letter provides supplemental guidance for Early Stage SBICs that seek to reduce Regulatory Capital as part of a Distribution pursuant to §107.1180.

### 3. **Process for Approval.**

An Early Stage SBIC must obtain SBA's prior written approval of any Distribution that would reduce its Regulatory Capital. An Early Stage SBIC seeking to make a Distribution that will reduce its Regulatory Capital must submit a written request to its assigned analyst in the Office of SBIC Operations at least 30 days in advance of the proposed Distribution. In addition to providing the information identified in SOP 10 06, the Early Stage SBIC must include a spreadsheet with the following information:

- a. Contemplated Distribution: Amount of Total Distribution; Amount of SBA Leverage Redemption; Amount of Total Distribution to Private Investors; Amount of Reduction of Regulatory Capital
- b. Post Distribution Balances: Amount of SBA Leverage Outstanding; Amount of SBA Leverage Commitment Remaining; Amount of Leverageable Capital; Amount of Regulatory Capital; Portfolio Cost and Value; Retained Earnings Available for Distribution; Net Asset Value = Total Assets – Other Assets – Non-SBA Leverage Liabilities
- c. Identification of any potential positive or negative changes to the valuations of any investments in the Early Stage SBIC’s portfolio contemplated in the next 6 months, including any reasons for the expected change. If no potential changes are anticipated, the Early Stage SBIC’s general partner must certify that the valuations are correct to the best of the SBIC’s knowledge and that the SBIC does not know of any events or circumstances that would cause it to write down or write off any assets in the next 6 months.

#### **4. SBA Considerations.**

In making its determination, SBA will also consider:

- a. Regulatory Compliance. SBA will consider whether the Early Stage SBIC has any unresolved regulatory violations.
- b. Valuation. Valuations reported by the Early Stage SBIC must be in accordance with the SBIC’s approved valuation policy. If SBA believes that valuations are not correctly reported, SBA may request a third party valuation before considering a reduction in Regulatory Capital.
- c. Coverage Ratio on Post Distribution Amount of Leverage Outstanding. The Leverage Coverage includes the Net Asset Value (as computed above) plus unfunded limited partner commitments (computed as Regulatory Capital minus Leverageable Capital). SBA does not expect to favorably consider a request that will result in a post-Distribution coverage of less than \$1.50 in coverage for every \$1 in outstanding leverage.
- d. Fund Maturity. If an Early Stage SBIC has submitted a wind-up plan, the SBA will review the distribution pursuant to TechNote 5 to evaluate whether the distribution is in accordance with the approved SBA wind-up plan. If an Early Stage SBIC has not submitted a wind-up plan as required by §107.590 and has been licensed for 7 years or more, the SBA will likely require submission of a wind-up plan before it will consider a reduction in Regulatory Capital to ensure that the SBIC has appropriately planned for repayment of SBA leverage at or prior to maturity.

#### **5. Policy Considerations.**

SBA will review this policy to provide further guidance as needed.