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Insights

SBICS AND THE CARES ACT

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WHAT IS AN SBIC?

A small business investment company ("SBIC") is an investment company that is licensed and regulated by the Small Business Administration ("SBA"). The SBA lends low-cost, government-backed capital to SBICs, which SBICs may use in combination with private capital to invest in small businesses. SBICs are privately owned and managed.

WHAT ADVANTAGES DOES THE CARES ACT OFFER TO SBICS?

Under the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), any business concern whose employee count does not exceed 500 or the maximum number of employees permitted under the size standards for the industry in which the business concern operates is eligible to receive a Section 7(a) loan under the Paycheck Protection Program (a "PPP Loan"), subject to certain exceptions. In determining its number of employees, a business must include the employees of each of its affiliates, a requirement that could limit access to loans for businesses that control, are controlled by, or are under common control with other entities. "[A]ny business concern that receives financial assistance from" an SBIC, however, is exempt from the affiliation rules under the CARES Act, easing the burden on meeting the size requirements to qualify for covered loans. This exemption is primarily to the advantage of the business concern, rather than the SBIC, but the SBIC may indirectly benefit from the assurance of increased financial assistance to the business concern via the availability of the PPP loans.

HOW CAN RECEIVING FUNDS FROM AN SBIC QUALIFY A BUSINESS FOR EXEMPTION FROM THE AFFILIATION RULE?

The exemption of recipients of SBIC funding from affiliation rules is not a concept unique to the CARES Act. Under 13 C.F.R. § 121.103 ("Section 103"), which sets forth the principles of affiliation for the purpose of determining the size of a business concern, a business concern owned "in whole or substantial part" by an SBIC is not considered an affiliate of the SBIC. The exemption provided for in the CARES Act differs from the exception under Section 103 in three significant ways. *First*, it does not provide that the business concern need be owned by an SBIC (meaning the exemption does not preclude non-SBIC investors), which may broaden the scope of eligibility for the exemption

to include businesses that receive loans or other types of financial assistance from SBICs—the type of financial assistance is not specified so any form of investment should qualify. *Second*, the CARES Act does not indicate that any ownership by an SBIC need meet any particular threshold, potentially reducing the level of business involvement or amount of financial commitment required of an SBIC. *Third*, where the Section 103 exception appears to break only the affiliation between a business concern and its SBIC owner, but perhaps not the affiliation between the business concern and another entity under the SBIC's control, the CARES Act exemption suggests that a business concern will not be considered an affiliate of any entity that would otherwise be an affiliate under Section 103. Further administrative guidance may be necessary to determine whether the exemption can be read so broadly.

WHAT REQUIREMENTS AND RESTRICTIONS APPLY TO SBICS?

An SBIC cannot provide financial assistance or management services to any business other than a small business, either as determined by the traditional size standards (see SBA guidance here) designated for the primary industry in which the business operates, or defined as a business that, together with its affiliates, has a net worth not in excess of $19,500,000 and an average net income after Federal income taxes for the preceding two fiscal years not in excess of $6,500,000. An SBIC must invest at least 25 percent of its total outstanding financial assistance in smaller enterprises, as determined either by industry size standards or a net worth not in excess of $6,000,000 and an average net income after Federal income taxes for the preceding two years not in excess of $2,000,000, in each case together with affiliates. An SBIC cannot invest in certain types of businesses, including relenders and reinvestors, real estate businesses, project financing businesses, and small businesses with more than 49 percent of their employees overseas. Additionally, certain restrictions apply to providing financing to an associate of an SBIC.

HOW CAN AN ENTITY QUALIFY AS AN SBIC?

Management and Capitalization Requirements

An entity must apply for a license to become an SBIC. An entity applying to become an SBIC must demonstrate to the SBA that its management team is qualified and has the knowledge, experience, and capability to invest in the types of businesses contemplated by the Small Business Investment Act, applicable regulations, and the applicant's business plan. The applicant must have sufficient capital to provide reasonable assurance that it will operate profitably over the long term and that it will be able to operate actively in accordance with its charter and within the context of its business plan, as approved by the SBA. Subject to some exceptions, an applicant must have capital of at least $5,000,000, and must meet certain other capitalization requirements. In addition, certain ownership and control requirements apply to applicants seeking to obtain SBA financial assistance evidenced by a security of the applicant, and to applicants formed as limited partnerships.

Application

An applicant must submit a Management Assessment Questionnaire and a non-refundable Initial Licensing Fee of $10,000. Upon receipt of written permission by the SBA, the applicant may proceed to final licensing, by submitting a complete license application and a non-refundable Final Licensing Fee of $30,000 (to be increased to $35,000 on October 1, 2020). The SBA evaluates applicants based on their submitted materials, interviews with their management team, results of background investigations, public record searches, and other due diligence conducted by the SBA.

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MEET THE TEAM

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