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U.S. Small Business Administration (SBA) Proposes Rules Relating to New “Early Stage Small Business Investment Companies”

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▶ **U.S. Small Business Administration (SBA) Proposes Rules Relating to New “Early Stage Small Business Investment Companies”**

On December 9, 2011, the SBA published a proposed rule defining a new category of small business investment companies (SBICs) which will focus on equity investments in early stage companies. Noting in the background section of the proposed rule that in 2010 less than one third of venture financing dollars went to early stage or start up businesses, and less than 10 percent to businesses outside of California, Massachusetts, and New York, the SBA will allocate from its current debenture authorization up to \$200 million per year for five years for use by early state SBICs to make equity available to those businesses. [The proposed rule is at Federal register, Vol. 76, No., 237, p. 76907-76917 (December 9, 2011)]

Among the details of the proposed rule are:

Annual Licensing: The SBA will publish an annual call for applications with a fixed deadline for response. The SBA will utilize the same management assessment questionnaire as used for regular SBICs.

Review and application: The SBA will review the applicant’s management team, track record, strategy, and fund structure and economics. Applicants determined to be preliminarily qualified will be invited to the licensing application step.

Licensing application and SBA due diligence: Selected applicants will submit the standard SBIC license application and a \$25,000 non-refundable fee. SBA will perform due diligence and license qualified applicants.

Private capital requirement: Not less than \$20 million.

Investments: 50 percent of investment dollars into early stage businesses (defined as those not yet achieving positive cash flow from operations for any prior fiscal year).

Maximum leverage: Up to tier 1 leverage; no greater than \$50 million.

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Term: Ten year maturity. Repayment without penalty at any time.

SBA fees: 1 percent commitment fee; 2 percent draw fee; annual fee (expected to be under 1 percent); licensing fee of \$25,000; examination fee (factor test defined in the proposed rule).

The proposed rule also contains other details of leverage, distribution rules, and SBA rights to valuations, priority of distribution, and liquidation.

The SBA has invited comments on the rule to be provided on or before February 7, 2012.

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