

104TH CONGRESS  
2D SESSION

# H. R. 3720

To amend the Small Business Investment Act of 1958, and for other purposes.

---

IN THE HOUSE OF REPRESENTATIVES

JUNE 26, 1996

Mrs. MEYERS of Kansas introduced the following bill; which was referred to the Committee on Small Business

---

## A BILL

To amend the Small Business Investment Act of 1958, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Small Business Invest-  
5 ment Company Reform Act of 1996”.

6 **SEC. 2. DEFINITIONS.**

7 (a) SMALL BUSINESS CONCERN.—Section 103(5) of  
8 the Small Business Investment Act of 1958 (15 U.S.C.  
9 662(5)) is amended by inserting before the semicolon the  
10 following: “, except that, for purposes of this Act, an in-

1 vestment by a venture capital firm, investment company  
2 (including a small business investment company) employee  
3 welfare benefit plan or pension plan, or trust, foundation,  
4 or endowment that is exempt from Federal income tax-  
5 ation—

6           “(A) shall not cause a business concern to be  
7 deemed not independently owned and operated;

8           “(B) shall be disregarded in determining wheth-  
9 er a business concern satisfies size standards estab-  
10 lished pursuant to section 3(a)(2) of the Small Busi-  
11 ness Act; and

12           “(C) shall be disregarded in determining wheth-  
13 er a small business concern is a smaller enterprise”.

14       (b) PRIVATE CAPITAL.—Section 103(9) of the Small  
15 Business Investment Act of 1958 (15 U.S.C. 662(9)) is  
16 amended to read as follows:

17           “(9) the term ‘private capital’—

18           “(A) means the sum of—

19           “(i) the paid-in capital and paid-in  
20 surplus of a corporate licensee, the contrib-  
21 uted capital of the partners of a partner-  
22 ship licensee, or the equity investment of  
23 the members of a limited liability company  
24 licensee; and

1           “(ii) unfunded binding commitments,  
2           from investors that meet criteria estab-  
3           lished by the Administrator, to contribute  
4           capital to the licensee; provided that such  
5           unfunded commitments may be counted as  
6           private capital for purposes of approval by  
7           the Administrator of any request for lever-  
8           age, but leverage shall not be funded based  
9           on such commitments; and

10          “(B) does not include any—

11                 “(i) funds borrowed by a licensee from  
12                 any source;

13                 “(ii) funds obtained through the issu-  
14                 ance of leverage; or

15                 “(iii) funds obtained directly or indi-  
16                 rectly from any Federal, State, or local  
17                 government, or any government agency or  
18                 instrumentality, except for—

19                         “(I) funds invested by an em-  
20                         ployee welfare benefit plan or pension  
21                         plan; and

22                         “(II) any qualified nonprivate  
23                         funds (if the investors of the qualified  
24                         nonprivate funds do not control, di-  
25                         rectly or indirectly, the management,

1 board of directors, general partners,  
2 or members of the licensee);”.

3 (c) NEW DEFINITIONS.—Section 103 of the Small  
4 Business Investment Act of 1958 (15 U.S.C. 662) is  
5 amended by striking paragraph (10) and inserting the fol-  
6 lowing:

7 “(10) the term ‘leverage’ includes—

8 “(A) debentures purchased or guaranteed  
9 by the Administration;

10 “(B) participating securities purchased or  
11 guaranteed by the Administration; and

12 “(C) preferred securities outstanding as of  
13 October 1, 1996;

14 “(11) the term ‘third party debt’ means any in-  
15 debtedness for borrowed money, other than indebt-  
16 edness owed to the Administration;

17 “(12) the term ‘smaller enterprise’ means any  
18 small business concern that, together with its affili-  
19 ates—

20 “(A) has—

21 “(i) a net financial worth of not more  
22 than \$6,000,000, as of the date on which  
23 assistance is provided under this Act to  
24 that business concern; and

1           “(ii) an average net income for the 2-  
2           year period preceding the date on which  
3           assistance is provided under this Act to  
4           that business concern, of not more than  
5           \$2,000,000, after Federal income taxes  
6           (excluding any carryover losses); or

7           “(B) satisfies the standard industrial clas-  
8           sification size standards established by the Ad-  
9           ministration for the industry in which the small  
10          business concern is primarily engaged;

11          “(13) the term ‘qualified nonprivate funds’  
12          means any—

13               “(A) funds directly or indirectly invested in  
14               any applicant or licensee on or before August  
15               16, 1982, by any Federal agency, other than  
16               the Administration, under a provision of law ex-  
17               plicitly mandating the inclusion of those funds  
18               in the definition of the term ‘private capital’;

19               “(B) funds directly or indirectly invested  
20               in any applicant or licensee by any Federal  
21               agency under a provision of law enacted after  
22               September 4, 1992, explicitly mandating the in-  
23               clusion of those funds in the definition of the  
24               term ‘private capital’; and

1           “(C) funds invested in any applicant or li-  
2           censee by one or more State or local govern-  
3           ment entities (including any guarantee extended  
4           by those entities) in an aggregate amount that  
5           does not exceed—

6                   “(i) 33 percent of the private capital  
7                   of the applicant or licensee, if such funds  
8                   were committed for investment before the  
9                   date of enactment of the Small Business  
10                  Investment Company Improvement Act of  
11                  1996; or

12                   “(ii) 20 percent of the private capital  
13                   of the applicant or licensee, if such funds  
14                   were committed for investment on or after  
15                   the date of enactment of the Small Busi-  
16                  ness Investment Company Improvement  
17                  Act of 1996;

18           “(14) the terms ‘employee welfare benefit plan’  
19           and ‘pension plan’ have the same meanings as in  
20           section 3 of the Employee Retirement Income Secu-  
21           rity Act of 1974, and are intended to include—

22                   “(A) public and private pension or retire-  
23                   ment plans subject to such Act; and

24                   “(B) similar plans not covered by such Act  
25                   that have been established and that are main-

1           tained by the Federal Government or any State  
2           or political subdivision, or any agency or instru-  
3           mentality thereof, for the benefit of employees;

4           “(15) the term ‘member’ means, with respect to  
5           a licensee that is a limited liability company, a hold-  
6           er of an ownership interest or a person otherwise ad-  
7           mitted to membership in the limited liability com-  
8           pany; and

9           “(16) the term ‘limited liability company’  
10          means a business entity that is organized and oper-  
11          ating in accordance with a State limited liability  
12          company statute approved by the Administration.”.

13 **SEC. 3. ORGANIZATION OF SMALL BUSINESS INVESTMENT**  
14 **COMPANIES.**

15          (a) LIMITED LIABILITY COMPANIES.—Section  
16 301(a) of the Small Business Investment Act of 1958 (15  
17 U.S.C. 681(a)) is amended in the first sentence, by strik-  
18 ing “body or” and inserting “body, a limited liability com-  
19 pany, or”.

20          (b) ISSUANCE OF LICENSE.—Section 301(c) of the  
21 Small Business Investment Act of 1958 (15 U.S.C.  
22 681(c)) is amended to read as follows:

23           “(c) ISSUANCE OF LICENSE.—

24           “(1) SUBMISSION OF APPLICATION.—Each new  
25          applicant for a license to operate as a small business

1 investment company under this Act shall submit to  
2 the Administrator an application, in a form and in-  
3 cluding such documentation as may be prescribed by  
4 the Administrator.

5 “(2) PROCEDURES.—

6 “(A) STATUS.—Not later than 90 days  
7 after the initial receipt by the Administrator of  
8 an application under this subsection, the Ad-  
9 ministrator shall provide the applicant with a  
10 written report detailing the status of the appli-  
11 cation and any requirements remaining for  
12 completion of the application.

13 “(B) APPROVAL OR DISAPPROVAL.—With-  
14 in a reasonable time after receiving a completed  
15 application submitted in accordance with this  
16 subsection and in accordance with such require-  
17 ments as the Administrator may prescribe by  
18 regulation, the Administrator shall—

19 “(i) approve the application and issue  
20 a license for such operation to the appli-  
21 cant if the requirements of this section are  
22 satisfied; or

23 “(ii) disapprove the application and  
24 notify the applicant in writing of the dis-  
25 approval.

1           “(3) MATTERS CONSIDERED.—In reviewing and  
2           processing any application under this subsection, the  
3           Administrator—

4                   “(A) shall determine whether—

5                           “(i) the applicant meets the require-  
6                           ments of subsections (a) and (c) of section  
7                           302; and

8                           “(ii) the management of the applicant  
9                           is qualified and has the knowledge, experi-  
10                          ence, and capability necessary to comply  
11                          with this Act;

12                   “(B) shall take into consideration—

13                           “(i) the need for and availability of fi-  
14                           nancing for small business concerns in the  
15                           geographic area in which the applicant is  
16                           to commence business;

17                           “(ii) the general business reputation  
18                           of the owners and management of the ap-  
19                           plicant; and

20                           “(iii) the probability of successful op-  
21                           erations of the applicant, including ade-  
22                           quate profitability and financial soundness;  
23                           and

24                   “(C) shall not take into consideration any  
25                   projected shortage or unavailability of leverage.

1           “(4) EXCEPTION.—

2                   “(A) IN GENERAL.—Notwithstanding any  
3 other provision of this Act, the Administrator  
4 may, in the discretion of the Administrator and  
5 based on a showing of special circumstances  
6 and good cause, approve an application and  
7 issue a license under this subsection with re-  
8 spect to any applicant that—

9                           “(i) has private capital of not less  
10 than \$3,000,000;

11                           “(ii) would otherwise be issued a li-  
12 cense under this subsection, except that  
13 the applicant does not satisfy the require-  
14 ments of section 302(a); and

15                           “(iii) has a viable business plan rea-  
16 sonably projecting profitable operations  
17 and a reasonable timetable for achieving a  
18 level of private capital that satisfies the re-  
19 quirements of section 302(a).

20                   “(B) LEVERAGE.—An applicant licensed  
21 pursuant to the exception provided in this para-  
22 graph shall not be eligible to receive leverage as  
23 a licensee until the applicant satisfies the re-  
24 quirements of section 302(a).”.

1 (c) SPECIALIZED SMALL BUSINESS INVESTMENT  
2 COMPANIES.—Section 301(d) of the Small Business In-  
3 vestment Act of 1958 (15 U.S.C. 681(d)) is repealed.

4 **SEC. 4. CAPITAL REQUIREMENTS.**

5 (a) INCREASED MINIMUM CAPITAL REQUIRE-  
6 MENTS.—Section 302(a) of the Small Business Invest-  
7 ment Act of 1958 (15 U.S.C. 682(a)) is amended by strik-  
8 ing “(a)” and all that follows through “The Administra-  
9 tion shall also determine the ability of the company,” and  
10 inserting the following:

11 “(a) AMOUNT.—

12 “(1) IN GENERAL.—Except as provided in para-  
13 graph (2), the private capital of each licensee shall  
14 be not less than—

15 “(A) \$5,000,000; or

16 “(B) \$10,000,000, with respect to each li-  
17 censee authorized or seeking authority to issue  
18 participating securities to be purchased or guar-  
19 anteed by the Administration under this Act.

20 “(2) EXCEPTION.—The Administrator may, in  
21 the discretion of the Administrator and based on a  
22 showing of special circumstances and good cause,  
23 permit the private capital of a licensee authorized or  
24 seeking authorization to issue participating securi-  
25 ties to be purchased or guaranteed by the Adminis-

1       tration to be less than \$10,000,000, but not less  
2       than \$7,500,000, if the Administrator determines  
3       that such action would not create or otherwise con-  
4       tribute to an unreasonable risk of default or loss to  
5       the Federal Government.

6               “(3) ADEQUACY.—In addition to the require-  
7       ments of paragraph (1), the Administrator shall—

8                       “(A) determine whether the private capital  
9                       of each licensee is adequate to assure a reason-  
10                      able prospect that the licensee will be operated  
11                      soundly and profitably, and managed actively  
12                      and prudently in accordance with its articles;  
13                      and

14                     “(B) determine that the licensee will be  
15                     able”.

16       (b) EXEMPTION FOR CERTAIN LICENSEES.—Section  
17       302(a) of the Small Business Investment Act of 1958 (15  
18       U.S.C. 682(a)) is amended by adding at the end the fol-  
19       lowing new paragraph:

20               “(4) EXEMPTION FROM CAPITAL REQUIRE-  
21       MENTS.—The Administrator may, in the discretion  
22       of the Administrator, exempt from the capital re-  
23       quirements in paragraph (1) any licensee licensed  
24       under subsection (c) or (d) of section 301 before the

1 date of enactment of the Small Business Investment  
2 Company Improvement Act of 1996, if—

3 “(A) the licensee certifies in writing that  
4 not less than 50 percent of the aggregate dollar  
5 amount of its financings after the date of enact-  
6 ment of the Small Business Investment Com-  
7 pany Improvement Act of 1996 will be provided  
8 to smaller enterprises; and

9 “(B) the Administrator determines that—

10 “(i) the licensee has a record of prof-  
11 itable operations;

12 “(ii) the licensee has not committed  
13 any serious or continuing violation of any  
14 applicable provision of Federal or State  
15 law or regulation; and

16 “(iii) such action would not create or  
17 otherwise contribute to an unreasonable  
18 risk of default or loss to the United States  
19 Government.

20 *Provided further,* That no licensee with less than  
21 \$2,500,000 in private capital shall receive additional  
22 leverage from the Administration.”.

23 (c) DIVERSIFICATION OF OWNERSHIP.—Section  
24 302(c) of the Small Business Investment Act of 1958 (15  
25 U.S.C. 682(c)) is amended to read as follows:

1       “(c) DIVERSIFICATION OF OWNERSHIP.—The Ad-  
2 ministrator shall ensure that the management of each li-  
3 censee applying for a license after the date of enactment  
4 of the Small Business Investment Company Improvement  
5 Act of 1996 is sufficiently diversified from and unaffiliated  
6 with the ownership of the licensee in a manner that en-  
7 sures independence and objectivity in the financial man-  
8 agement and oversight of the investments and operations  
9 of the licensee.”.

10 **SEC. 5. BORROWING.**

11       (a) DEBENTURES.—Section 303(b) of the Small  
12 Business Investment Act of 1958 (15 U.S.C. 683(b)) is  
13 amended in the first sentence, by striking “(but only” and  
14 all that follows through “terms)”.

15       (b) THIRD PARTY DEBT.—Section 303(c) of the  
16 Small Business Investment Act of 1958 (15 U.S.C.  
17 683(c)) is amended to read as follows:

18       “(c) THIRD PARTY DEBT.—The Administrator—

19               “(1) shall not permit a licensee having out-  
20 standing leverage to incur third party debt that  
21 would create or contribute to an unreasonable risk  
22 of default or loss to the Federal Government; and

23               “(2) shall permit such licensees to incur third  
24 party debt only on such terms and subject to such

1 conditions as may be established by the Adminis-  
2 trator, by regulation or otherwise.”.

3 (c) REQUIREMENT TO FINANCE SMALLER ENTER-  
4 PRISES.—Section 303(d) of the Small Business Invest-  
5 ment Act of 1958 (15 U.S.C. 683(d)) is amended to read  
6 as follows:

7 “(d) REQUIREMENT TO FINANCE SMALLER ENTER-  
8 PRISES.—The Administrator shall require each licensee,  
9 as a condition of approval of an application for leverage,  
10 to certify in writing that not less than 20 percent of the  
11 aggregate dollar amount of the financings of the licensee  
12 will be provided to smaller enterprises.”.

13 (d) CAPITAL IMPAIRMENT REQUIREMENTS.—Section  
14 303(e) of the Small Business Investment Act of 1958 (15  
15 U.S.C. 683(e)) is amended to read as follows:

16 “(e) CAPITAL IMPAIRMENT.—Before approving any  
17 application for leverage submitted by a licensee under this  
18 Act, the Administrator—

19 “(1) shall determine that the private capital of  
20 the licensee meets the requirements of section  
21 302(a); and

22 “(2) shall determine, taking into account the  
23 nature of the assets of the licensee, the amount and  
24 terms of any third party debt owed by such licensee,  
25 and any other factors determined to be relevant by

1 the Administrator, that the private capital of the li-  
2 censee has not been impaired to such an extent that  
3 the issuance of additional leverage would create or  
4 otherwise contribute to an unreasonable risk of de-  
5 fault or loss to the Federal Government.”.

6 (e) EQUITY INVESTMENT REQUIREMENT.—Section  
7 303(g)(4) of the Small Business Investment Act of 1958  
8 (15 U.S.C. 683(g)(4)) is amended by striking “and main-  
9 tain”.

10 (f) FEES.—Section 303 of the Small Business Invest-  
11 ment Act of 1958 (15 U.S.C. 683) is amended—

12 (1) in subsection (b), in the fifth sentence, by  
13 striking “1 per centum,” and all that follows before  
14 the period at the end of the sentence and inserting  
15 the following: “1 percent, plus an additional charge  
16 of 1 percent per annum which shall be paid to and  
17 retained by the Administration”;

18 (2) in subsection (g)(2), by striking “1 per cen-  
19 tum,” and all that follows before the period at the  
20 end of the paragraph and inserting the following: “1  
21 percent, plus an additional charge of 1 percent per  
22 annum which shall be paid to and retained by the  
23 Administration”; and

24 (3) by adding at the end the following new sub-  
25 sections:

1       “(i) **LEVERAGE FEE.**—With respect to leverage  
2 granted by the Administration to a licensee, the Adminis-  
3 tration shall collect from the licensee a nonrefundable fee  
4 in an amount equal to 3 percent of the face amount of  
5 leverage granted to the licensee, payable upon the earlier  
6 of the date of entry into any commitment for such leverage  
7 or the date on which the leverage is drawn by the licensee.

8       “(j) **CALCULATION OF SUBSIDY RATE.**—All fees, in-  
9 terest, and profits received and retained by the Adminis-  
10 tration under this section shall be included in the calcula-  
11 tions made by the Director of the Office of Management  
12 and Budget to offset the cost (as that term is defined in  
13 section 502 of the Federal Credit Reform Act of 1990)  
14 to the Administration of purchasing and guaranteeing de-  
15 bentures and participating securities under this Act.”.

16 **SEC. 6. LIABILITY OF THE UNITED STATES.**

17       Section 308(e) of the Small Business Investment Act  
18 of 1958 (15 U.S.C. 687(e)) is amended by striking “Noth-  
19 ing” and inserting “Except as expressly provided other-  
20 wise in this Act, nothing”.

21 **SEC. 7. EXAMINATIONS; VALUATIONS.**

22       (a) **EXAMINATIONS.**—Section 310(b) of the Small  
23 Business Investment Act of 1958 (15 U.S.C. 687b(b)) is  
24 amended in the first sentence by inserting “which may be  
25 conducted with the assistance of a private sector entity

1 that has both the qualifications to conduct and expertise  
2 in conducting such examinations,” after “Investment Divi-  
3 sion of the Administration,”.

4 (b) VALUATIONS.—Section 310(d) of the Small Busi-  
5 ness Investment Act of 1958 (15 U.S.C. 687b(d)) is  
6 amended to read as follows:

7 “(d) VALUATIONS.—

8 “(1) FREQUENCY OF VALUATIONS.—

9 “(A) IN GENERAL.—Each licensee shall  
10 submit to the Administrator a written valuation  
11 of the loans and investments of the licensee not  
12 less often than semiannually or otherwise upon  
13 the request of the Administrator, except that  
14 any licensee with no leverage outstanding shall  
15 submit such valuations annually, unless the Ad-  
16 ministrator determines otherwise.

17 “(B) MATERIAL ADVERSE CHANGES.—Not  
18 later than 30 days after the end of a fiscal  
19 quarter of a licensee during which a material  
20 adverse change in the aggregate valuation of  
21 the loans and investments or operations of the  
22 licensee occurs, the licensee shall notify the Ad-  
23 ministrator in writing of the nature and extent  
24 of that change.

25 “(C) INDEPENDENT CERTIFICATION.—

1           “(i) IN GENERAL.—Not less than once  
2           during each fiscal year, each licensee shall  
3           submit to the Administrator the financial  
4           statements of the licensee, audited by an  
5           independent certified public accountant ap-  
6           proved by the Administrator.

7           “(ii) AUDIT REQUIREMENTS.—Each  
8           audit conducted under clause (i) shall in-  
9           clude—

10                   “(I) a review of the procedures  
11                   and documentation used by the li-  
12                   censee in preparing the valuations re-  
13                   quired by this section; and

14                   “(II) a statement by the inde-  
15                   pendent certified public accountant  
16                   that such valuations were prepared in  
17                   conformity with the valuation criteria  
18                   applicable to the licensee established  
19                   in accordance with paragraph (2).

20           “(2) VALUATION CRITERIA.—Each valuation  
21           submitted under this subsection shall be prepared by  
22           the licensee in accordance with valuation criteria,  
23           which shall—

24                   “(A) be established or approved by the Ad-  
25                   ministrator; and

1           “(B) include appropriate safeguards to en-  
2           sure that the noncash assets of a licensee are  
3           not overvalued.”.

4 **SEC. 8. TRUSTEE OR RECEIVERSHIP OVER LICENSEES.**

5           (a) FINDING.—It is the finding of the Congress that  
6 increased recoveries on assets in liquidation under the  
7 Small Business Investment Act of 1958 are in the best  
8 interests of the Federal Government.

9           (b) DEFINITIONS.—For purposes of this section—

10           (1) the term “Administrator” means the Ad-  
11           ministrator of the Small Business Administration;

12           (2) the term “Administration” means the Small  
13           Business Administration; and

14           (3) the term “licensee” has the same meaning  
15           as in section 103 of the Small Business Investment  
16           Act of 1958.

17           (c) LIQUIDATION PLAN.—

18           (1) IN GENERAL.—Not later than October 15,  
19           1996, the Administrator shall submit to the Com-  
20           mittees on Small Business of the Senate and the  
21           House of Representatives a detailed plan to expedite  
22           the orderly liquidation of all licensee assets in liq-  
23           uidation, including assets of licensees in receivership  
24           or in trust held by or under the control of the Ad-  
25           ministration or its agents.

1           (2) CONTENTS.—The plan submitted under  
2 paragraph (1) shall include a timetable for liquidat-  
3 ing the liquidation portfolio of small business invest-  
4 ment company assets owned by the Administration,  
5 and shall contain the Administrator’s findings and  
6 recommendations on various options providing for  
7 the fair and expeditious liquidation of such assets  
8 within a reasonable period of time, giving due con-  
9 sideration to the option of entering into one or more  
10 contracts with private sector entities having the ca-  
11 pability to carry out the orderly liquidation of simi-  
12 lar assets.

13           (3) REPORT.—Not later than 90 days after the  
14 date of enactment of this Act, the Comptroller Gen-  
15 eral of the United States shall submit to the Com-  
16 mittees on Small Business of the Senate and the  
17 House of Representatives a report on the activities  
18 and expenditures of the receiver’s agents employed  
19 by or under contract with the Investment Division of  
20 the Small Business Administration. The report shall  
21 detail the qualifications and experience of the receiv-  
22 er’s agents, their billing practices and procedures,  
23 expenses, costs, overhead, and use of outside con-  
24 tractors or attorneys.

1 **SEC. 9. REPEAL OF PREFERRED STOCK REDEMPTION.**

2 Section 303(f) of the Small Business Investment Act  
3 of 1958 (15 U.S.C. 683(f)) is hereby repealed.

4 **SEC. 10. TECHNICAL AND CONFORMING AMENDMENTS.**

5 The Small Business Investment Act of 1958 (15  
6 U.S.C. 661 et seq.) is amended in subsection (a) of section  
7 303 by striking “debenture bonds” and inserting “securi-  
8 ties,” and by striking subsection (f) and redesignating  
9 subsequent subsections accordingly.

10 **SEC. 11. EFFECTIVE DATE.**

11 This Act and the amendments made by this Act shall  
12 become effective on the date of enactment of this Act.

○