

Small Business Administration

§ 108.720

EXAMINATIONS OF NMVC COMPANIES BY SBA FOR REGULATORY COMPLIANCE

§ 108.690 Examinations.

All NMVC companies must submit to annual examinations by or at the direction of SBA for the purpose of evaluating regulatory compliance.

§ 108.691 Responsibilities of NMVC Company during examination.

You must make all books, records and other pertinent documents and materials available for the examination, including any information required by the examiner under § 108.620(c). In addition, the agreement between you and the independent public accountant performing your audit must provide that any information in the accountant's working papers be made available to SBA upon request.

§ 108.692 Examination fees.

(a) *General.* SBA will assess fees for examinations in accordance with this section. Unless SBA determines otherwise on a case by case basis, SBA will not assess fees for special examinations to obtain specific information.

(b) *Base fee.* A base fee of \$3,500 will be assessed, subject to adjustment in accordance with paragraph (c) of this section.

(c) *Adjustments to base fee.* The base fee will be decreased based on the following criteria:

(1) If you have no outstanding regulatory violations at the time of the commencement of the examination and SBA did not identify any violations as a result of the most recent prior examination, you will receive a 15% discount on your base fee; and

(2) If you were fully responsive to the letter of notification of examination (that is, you provided all requested documents and information within the time period stipulated in the notification letter in a complete and accurate manner, and you prepared and had available all information requested by the examiner for on-site review), you will receive a 10% discount on your base fee.

(d) *Delay fee.* If, in the judgment of SBA, the time required to complete your examination is delayed due to your lack of cooperation or the condi-

tion of your records, SBA may assess an additional fee of up to \$500 per day.

Subpart I—Financing of Small Businesses by NMVC Companies

DETERMINING THE ELIGIBILITY OF A SMALL BUSINESS FOR NMVC FINANCING

§ 108.700 Compliance with size standards in part 121 of this chapter as a condition of Assistance.

You are permitted to provide financial assistance and management services only to a Small Business. To determine whether an applicant meets the size standards for a Small Business, you may use either the financial size standards in § 121.301(c)(1) of this chapter or the industry standard covering the industry in which the applicant is primarily engaged, as set forth in § 121.301(c)(2) of this chapter.

§ 108.710 Requirement to finance Low-Income Enterprises.

(a) *Low-Income Enterprise Financings.* At the close of each of your fiscal years—

(1) At least 80 percent of your Portfolio Concerns must be Low-Income Enterprises in which you have an Equity Capital Investment; and

(2) For all Financings you have extended, you must have invested at least 80 percent (in total dollars) in Equity Capital Investments in Low-Income Enterprises.

(b) *Non-compliance with this section.* If you have not reached the percentages required in paragraph (a) of this section at the end of any fiscal year, then you must be in compliance by the end of the following fiscal year. However, you will not be eligible for additional Leverage until such time as you reach the required percentages (see § 108.1120).

§ 108.720 Small Businesses that may be ineligible for financing.

(a) *Relenders or reinvestors.* You are not permitted to finance any business that is a relender or reinvestor. Relenders or reinvestors are businesses whose primary business activity involves, directly or indirectly, providing funds to others, purchasing debt obligations, factoring, or long-term leasing

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of equipment with no provision for maintenance or repair.

(b) *Passive Businesses.* You are not permitted to finance a passive business.

(1) *Definition.* A business is passive if:

(i) It is not engaged in a regular and continuous business operation (for purposes of this paragraph (b), the mere receipt of payments such as dividends, rents, lease payments, or royalties is not considered a regular and continuous business operation); or

(ii) Its employees are not carrying on the majority of day to day operations, and the company does not provide effective control and supervision, on a day to day basis, over persons employed under contract; or

(iii) It passes through substantially all of the proceeds of the Financing to another entity.

(2) *Exception for pass-through of proceeds to subsidiary.* With the prior written approval of SBA, you may finance a passive business if it is a Small Business and it passes substantially all the proceeds through to one or more subsidiary companies, each of which is an eligible Small Business that is not passive. For the purpose of this paragraph (b) (2), “subsidiary company” means a company in which at least 50 percent of the outstanding voting securities are owned by the Financed passive business.

(3) *Exception for certain Partnership NMVC companies.* With the prior written approval of SBA, if you are a Partnership NMVC Company, you may form one or more wholly owned corporations in accordance with this paragraph (b) (3). The sole purpose of such corporation(s) must be to provide Financing to one or more eligible, unincorporated Small Businesses. You may form such corporation(s) only if a direct Financing to such Small Businesses would cause any of your investors to incur unrelated business taxable income under section 511 of the Internal Revenue Code of 1986, as amended (26 U.S.C. 511). Your investment of funds in such corporation(s) will not constitute a violation of §108.730(a).

(c) *Real Estate Businesses.* (1) You are not permitted to finance:

(i) Any business classified under subsector 5311 (Lessors of Real Estate) of the NAICS Manual; or

(ii) Any business listed under subsector 5312 (Offices of Real Estate Agents and Brokers) unless at least 80 percent of the revenue is derived from non-Affiliate sources.

(2) You are not permitted to finance a business, regardless of NAICS classification, if the Financing is to be used to acquire or refinance real property, unless the Small Business:

(i) Is acquiring an existing property and will use at least 51 percent of the usable square footage for an eligible business purpose; or

(ii) Is building or renovating a building and will use at least 67 percent of the usable square footage for an eligible business purpose; or

(iii) Occupies the subject property and uses at least 67 percent of the usable square footage for an eligible business purpose.

(d) *Project Financing.* You are not permitted to finance a business if:

(1) The assets of the business are to be reduced or consumed, generally without replacement, as the life of the business progresses, and the nature of the business requires that a stream of cash payments be made to the business’s financing sources, on a basis associated with the continuing sale of assets. Examples include real estate development projects and oil and gas wells; or

(2) The primary purpose of the Financing is to fund production of a single item or defined limited number of items, generally over a defined production period, and such production will constitute the majority of the activities of the Small Business. Examples include motion pictures and electric generating plants.

(e) *Farm land purchases.* You are not permitted to finance the acquisition of farmland. Farmland means land, which is or is intended to be used for agricultural or forestry purposes, such as the production of food, fiber, or wood, or is so taxed or zoned.

(f) *Public interest.* You are not permitted to finance any business if the proceeds are to be used for purposes contrary to the public interest, including but not limited to activities which

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are in violation of law, or inconsistent with free competitive enterprise.

(g) *Foreign investment*—(1) *General rule.* You are not permitted to finance a business if:

(i) The funds will be used substantially for a foreign operation; or

(ii) At the time of the Financing or within one year thereafter, more than 49 percent of the employees or tangible assets of the Small Business are located outside the United States (unless you can show, to SBA's satisfaction, that the Financing was used for a specific domestic purpose).

(2) *Exception.* This paragraph (g) does not prohibit a Financing used to acquire foreign materials and equipment or foreign property rights for use or sale in the United States.

(h) *Financing NMVC companies or SBICs.* You are not permitted to provide funds, directly or indirectly, that the Small Business will use:

(1) To purchase stock in or provide capital to a NMVC Company or SBIC; or

(2) To repay an indebtedness incurred for the purpose of investing in a NMVC Company or SBIC.

§ 108.730 **Financings which constitute conflicts of interest.**

(a) *General rule.* You must not self-deal to the prejudice of a Small Business, the NMVC Company, its shareholders or partners, or SBA. Unless you obtain a prior written exemption from SBA for special instances in which a Financing may further the purposes of the Act despite presenting a conflict of interest, you must not directly or indirectly:

(1) Provide Financing to any of your Associates, except for a Small Business that satisfies all of the following conditions:

(i) Your Associate relationship with the Small Business is described by paragraph (8) or (9) of the definition of Associate in §108.50;

(ii) No Person triggering the Associate relationship identified in paragraph (a)(1)(i) of this section is a Close Relative or Secondary Relative of any Person described in paragraph (1), (2), (4), or (5) of the definition of Associate in §108.50; and

(iii) No single Associate of yours has either a voting interest or an economic interest in the Small Business exceeding 20 percent, and no two or more of your Associates have either a voting interest or an economic interest exceeding 33 percent. Economic interests shall be computed on a fully diluted basis, and both voting and economic interests shall exclude any interest owned through the NMVC Company.

(2) Provide Financing to an Associate of another NMVC Company if one of your Associates has received or will receive any direct or indirect Financing or a Commitment from that NMVC Company or a third NMVC Company (including Financing or Commitments received under any understanding, agreement, or cross dealing, reciprocal or circular arrangement).

(3) Borrow money from:

(i) A Small Business Financed by you;

(ii) An officer, director, or owner of at least a 10 percent equity interest in such business; or

(iii) A Close Relative of any such officer, director, or equity owner.

(4) Provide Financing to a Small Business to discharge an obligation to your Associate or free other funds to pay such obligation. This paragraph (a)(4) does not apply if the obligation is to an Associate Lending Institution and is a line of credit or other obligation incurred in the normal course of business.

(b) *Rules applicable to Associates.* Without SBA's prior written approval, your Associates must not, directly or indirectly:

(1) Borrow money from any Person described in paragraph (a)(3) of this section.

(2) Receive from a Small Business any compensation in connection with Assistance you provide (except as permitted under §108.825(c)), or anything of value for procuring, attempting to procure, or influencing your action with respect to such Assistance.

(c) *Applicability of other laws.* You are also bound by any restrictions in Federal or State laws governing conflicts of interest and fiduciary obligations.

(d) *Financings with Associates*—(1) *Financings with Associates requiring prior approval.* Without SBA's prior