

For purposes of this review, the Agencies have grouped our regulations into 12 categories: Applications and Reporting; Banking Operations; Capital; Community Reinvestment Act; Consumer Protection; Directors, Officers and Employees; International Operations; Money Laundering; Powers and Activities; Rules of Procedure; Safety and Soundness; and Securities. On June 4, 2014, we published a **Federal Register** notice announcing the start of the EGRPRA review process and also asking for public comment on three of these categories—Applications and Reporting; Powers and Activities; and International Operations regulations.<sup>2</sup> In that notice we published a chart, listing the Agencies' regulations in the 12 categories included in the EGRPRA review. On February 13, 2015, we published a **Federal Register** notice asking for public comment on three additional categories—Banking Operations; Capital; and the Community Reinvestment Act.<sup>3</sup> The comment period for the second **Federal Register** notice closed on May 14, 2015. On June 5, 2015, the Agencies published a third **Federal Register** notice asking for public comment on three additional categories—Consumer Protection; Directors, Officers and Employees; and Money Laundering.<sup>4</sup> The comment period for the third notice closed on September 3, 2015. As noted in the third **Federal Register** notice, the Agencies' will take comment on all of our regulations issued in final form up to the date that we publish the last EGRPRA notice for public comment. In the third notice, we published an additional chart, listing the rules included in the review that had not been reflected in prior charts. Before the end of the year, the Agencies intend to issue the final **Federal Register** notice, requesting comment on regulations in the last three categories—Rules of Procedure; Safety and Soundness; and Securities, as well as on any other final rules not covered by one of the prior **Federal Register** notices.

Dated: September 25, 2015.

**Thomas J. Curry,**

*Comptroller of the Currency.*

By order of the Board of Governors of the Federal Reserve System, September 28, 2015.

**Robert deV. Frierson,**

*Secretary of the Board.*

Dated: September 29, 2015.

Federal Deposit Insurance Corporation by  
**Robert E. Feldman,**  
*Executive Secretary.*

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## SMALL BUSINESS ADMINISTRATION

### 13 CFR Part 107

**RIN 3245-AG67**

#### **Small Business Investment Companies; Passive Business Expansion & Technical Clarifications**

**AGENCY:** U.S. Small Business Administration.

**ACTION:** Proposed rule.

**SUMMARY:** The U.S. Small Business Administration (SBA) proposes to revise the regulations for the Small Business Investment Company (SBIC) program to expand the use of Passive Businesses and provide further clarification with regard to investments in such businesses. SBICs are generally prohibited from investing in passive businesses under the Small Business Investment Act of 1958, as amended (Act). SBIC program regulations provide for two exceptions that allow an SBIC to structure an investment utilizing a passive small business as a pass-through. The first exception provides conditions under which an SBIC may structure an investment through up to two levels of passive entities to make an investment in a non-passive business that is a subsidiary of the passive business directly financed by the SBIC. The second exception enables a partnership SBIC, with SBA's prior approval, to provide financing to a small business through a passive, wholly-owned C corporation, but only if a direct financing would cause the SBIC's investors to incur Unrelated Business Taxable Income (UBTI). A passive C corporation formed under the second exception is commonly known as a blocker corporation. This proposed rule would clarify the first exception, and would expand the permitted use of blocker corporations and eliminate the prior approval requirement in the second exception. The rule also proposes to add new reporting and other requirements for passive investments to help protect SBA's financial interests and ensure adequate oversight and make minor technical amendments.

**DATES:** Comments on the proposed rule must be received on or before December 4, 2015.

**ADDRESSES:** You may submit comments, identified by RIN 3245-AG67, by any of the following methods:

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.

- *Mail, Hand Delivery/Courier:* Javier Saade, Associate Administrator for Investment and Innovation, U.S. Small Business Administration, 409 Third Street SW., Washington, DC 20416.

SBA will post comments on <http://www.regulations.gov>. If you wish to submit confidential business information (CBI) as defined in the User Notice at <http://www.regulations.gov>, please submit the information to Theresa Jamerson, Office of Investment and Innovation, 409 Third Street SW., Washington, DC 20416. Highlight the information that you consider to be CBI and explain why you believe this information should be held confidential. SBA will review the information and make the final determination of whether it will publish the information or not.

**FOR FURTHER INFORMATION CONTACT:** Theresa Jamerson, Office of Investment and Innovation, (202) 205-7563 or [sbic@sba.gov](mailto:sbic@sba.gov).

#### **SUPPLEMENTARY INFORMATION:**

##### **A. Passive Businesses**

###### *Section 107.720 Small Businesses That May Be Ineligible for Financing*

The Small Business Investment Act of 1958, as amended, and the SBIC program regulations prohibit an SBIC from making passive investments. The implementing regulation at 13 CFR 107.720(b) defines a business as passive if: (1) It is not engaged in a regular and continuous business operation; (2) its employees do not carry on the majority of day-to-day operations, and the company does not exercise day-to-day control and supervision over contract workers; or (3) the business passes through substantially all financing proceeds to another entity.

The current regulation provides for two exceptions that allow an SBIC to structure an investment utilizing a passive small business as a pass-through. The first exception, identified in § 107.720(b)(2), permits an investment utilizing up to two passive entities, as long as substantially all of the financing proceeds are passed through to one or more active "subsidiary companies," each of which is an eligible small business. The regulation defines a subsidiary company as one in which the financed passive business directly or indirectly owns at least 50% of the outstanding voting securities. As an example, this exception allows an SBIC to finance

<sup>2</sup> 79 FR 32172.

<sup>3</sup> 80 FR 7980.

<sup>4</sup> 80 FR 32046.

ABC Holdings 1, a passive small business, with the proceeds flowing through ABC Holdings 2, another passive small business, and then to ABC Manufacturing, a non-passive small business in which ABC Holdings 1 owns directly or indirectly at least 50% of the outstanding voting securities. SBA also interprets § 107.720(b)(2) to permit a financing to ABC Holdings 1 that is used to acquire an ownership interest in ABC Manufacturing (either directly or indirectly through ABC Holdings 2). In this case, ABC Manufacturing would have to qualify as a subsidiary of ABC Holdings 1 post-acquisition.

The second exception, identified in § 107.720(b)(3), allows a partnership SBIC, with SBA's prior approval, to form and finance a passive, wholly-owned C corporation (commonly known as a blocker corporation) that in turn provides financing to an active, unincorporated small business. This structure is permitted only if a direct financing of the unincorporated small business would cause at least one of the SBIC's investors to incur Unrelated Business Taxable Income (UBTI) under section 511 of the Internal Revenue Code, which may arise from an activity engaged in by a tax-exempt organization that is not related to the tax-exempt purpose of that organization.

SBA published a final rule (79 FR 62819) on October 21, 2014 that expanded the exception contained in § 107.720(b)(2) to allow two levels of pass-through entities, as described above. Prior to the rule change, the regulation permitted only one pass-through entity. As part of that rulemaking, SBA received one set of comments suggesting further expansion of the rule. In the preamble to the final rule, SBA stated that it would consider the following suggestions in future rulemaking:

(1) Revise § 107.720(b)(2) to explicitly state that an SBIC may "form and finance" (rather than merely "finance") a passive business;

(2) Eliminate the requirement for SBA's prior approval to form a blocker corporation under § 107.720(b)(3); and

(3) Revise § 107.720(b)(3) to permit an SBIC to form a blocker corporation to enable its foreign investors to avoid "effectively connected income" under the Internal Revenue Code.

This proposed rule addresses each of these suggestions. With respect to the suggestion to allow SBICs to not only finance, but form and finance, a passive business, SBA interprets the existing regulation to implicitly permit formation of a passive business. SBA recognizes that many SBICs have relied

on § 107.720(b)(2) to finance newly-formed passive holding companies that in turn have used the proceeds to acquire active small businesses. Particularly since the regulatory restrictions on control of a small business were largely removed in 2002 in response to an amendment to the Act, a number of SBICs have taken controlling equity interests in many of their portfolio companies, typically through a holding company. In these cases the SBIC first formed, and then financed, the holding company. To formalize SBA's interpretation of the regulation, the proposed rule would revise § 107.720(b)(2) to explicitly allow SBICs to form and then finance a passive business as part of an otherwise permitted transaction. As a further clarification, and consistent with SBA's interpretation of current § 107.720(b)(2), the proposed rule would explicitly permit a financing of a passive business that uses the proceeds to acquire all or part of a non-passive business.

In considering the suggestion to eliminate the requirement for SBA prior approval to form a blocker corporation under § 107.720(b)(3), SBA acknowledges that these requests are routinely approved as long as an SBIC identifies one or more tax-exempt investors that would incur UBTI absent the blocker corporation. SBA believes the prior approval requirement could be replaced by a certification that would provide the same assurance. The proposed rule would remove the approval requirement from § 107.720(b)(3) and revise § 107.610, a regulation that requires SBICs to make certain certifications upon financing a small business, to require the SBIC to certify as to the basis of the qualification of a financing under § 107.720(b)(3), as discussed below.

In considering the suggestion to permit an SBIC to form a blocker corporation to enable its foreign investors to avoid "effectively connected income" (ECI), SBA believes that it is consistent with the goals of the SBIC program to encourage foreign investment that will benefit U.S. small businesses. This proposed rule would expand § 107.720(b)(3) to permit an SBIC to form a blocker corporation if a direct financing would cause its investors to incur ECI.

SBA is proposing two additional changes to § 107.720(b)(3). First, the rule proposes to remove part of the last sentence that provides that an SBIC's ownership of a blocker corporation formed under § 107.720(b)(3) will not constitute a violation of § 107.865(a). This provision was necessary when § 107.865(a) generally prohibited an

SBIC from assuming control over a small business (in this case, the wholly-owned blocker corporation). On October 22, 2002, SBA published a final rule (67 FR 64789) that revised § 107.865(a) to permit an SBIC to exercise control over a small business for up to seven years without SBA approval. This rule made the carve-out in § 107.720(b)(3) unnecessary. An SBIC that needs to hold an investment in a blocker corporation longer than seven years can seek SBA approval of an extension of control in accordance with § 107.865(d).

Second, the proposed rule addresses structuring an investment with a second passive level when the first passive level is a blocker corporation formed under § 107.720(b)(3). The proposed change would allow the blocker corporation to either (1) directly finance a non-passive small business, or (2) provide financing to a second passive small business that passes the proceeds through to a non-passive small business in which it owns at least 50 percent of the outstanding voting securities. SBA's intention in proposing this change is to provide SBICs with flexibility similar to that provided in § 107.720(b)(2), while still limiting investments to a maximum of two passive levels to ensure effective oversight of SBICs.

The proposed revisions of § 107.720(b)(2) and (3), particularly when added to the changes promulgated in the October 21, 2014 final rule, would provide SBICs with considerably more flexibility to invest through passive holding companies and can be expected to increase the prevalence of permissible passive investments in the SBIC program. As a result, SBA has also reviewed certain credit concerns it has related to passive investments. As noted in the October 21, 2014 final rule, these concerns relate specifically to SBA's ability to collect from SBICs that default on their debt to SBA. Even under § 107.720(b) as it existed prior to the final rule, SBA had encountered issues that adversely affected its recoveries from defaulting SBICs with assets that were held indirectly through a passive company: These concerns included the effect of fees and expenses charged at each level, potentially diverting money from the actual investment and returns, as well as SBA's potential lack of access to the books and records of the passive business(es). To address these concerns, proposed § 107.720(b)(4) would add or clarify the following requirements with respect to any passive investment made under § 107.720(b)(2) or (b)(3):

(1) Clarifying the meaning of "substantially all." Current § 107.720(b)(2) requires "substantially all" financing proceeds to be passed

through to an eligible non-passive small business, but does not define what constitutes “substantially all.” SBA believes that a specific definition would help ensure that eligible small businesses benefit from the financing dollars, as intended, and would provide SBICs and SBA with more certainty that a transaction complies with the regulations. SBA proposes to define “substantially all” for purposes of this regulation to mean 99 percent of the financing proceeds *after* deduction of actual application fees, closing fees, and expense reimbursements, which may not exceed those permitted under § 107.860. SBA recognizes that SBICs engage in many different types of financing transactions, and does not seek to impose a definition that interferes with an SBIC’s ability to structure a transaction appropriately; however, SBA believes the amount of the proceeds received by the non-passive business should not be reduced merely because of the SBIC’s use of one or more passive vehicles.

(2) Requiring fees charged by an SBIC or its Associate to not exceed those permitted if the SBIC had directly financed the eligible Small Business. Among SBICs that have defaulted on SBA leverage, SBA has observed that passive investments are often associated with higher overall fees than direct investments in active small businesses. As noted in the preamble to the October 2014 final rule, SBA is concerned that excessive fees may reduce the funding provided to the active small business investment and adversely affect returns to the SBIC. To limit the potential for excessive fees in financings permitted under § 107.720(b)(2) and (b)(3), SBA is proposing to add a provision to clarify that fees collected by SBICs and their Associates under §§ 107.860 and 107.900 may not exceed the fees that would be permitted under the same two sections if the SBIC directly financed a non-passive small business. The proposed rule also provides that such fees be remitted to the SBIC within 30 days of receipt. This requirement will help SBA regulate whether the fees meet regulatory requirements, ensure that the SBIC benefits from those fees in a timely manner, and help in the identification and recovery of fees in the case of an SBIC default.

(3) Clarifying that both passive and non-passive businesses included in a financing are “Portfolio Concerns.” The SBIC program regulations provide SBA with certain information rights with respect to any “Portfolio Concern,” defined in § 107.50 as “a Small Business Assisted by a Licensee.” SBA believes that in a permitted passive investment,

both the passive business(es) and the non-passive business are Portfolio Concerns. Nevertheless, particularly in attempting to make recoveries from SBICs that have defaulted on SBA leverage, SBA has sometimes been hindered by a lack of access to the books and records of the passive business. Therefore, the proposed rule would add a provision under § 107.720(b)(4) to clarify that both passive and non-passive businesses included in a financing are Portfolio Concerns subject to all informational rights under 13 CFR part 107, including without limitation § 107.600, “General requirements for Licensee to maintain and preserve records,” and § 107.620, “Requirements to obtain information from Portfolio Concerns.”

In the October 2014 final rule, SBA also noted that it has credit concerns regarding the increased opportunity for disproportionate distributions to entities other than the SBIC as a result of an SBIC structuring investments through a passive entity. In evaluating this concern, SBA recognized that disproportionate distributions can occur due to different securities and preferences even if the SBIC directly financed the non-passive business. SBA believes as long as an SBIC has no conflicts of interest with respect to a particular financing (other than a conflict for which SBA has provided a regulatory exemption under § 107.730), the SBIC will make a permitted passive investment with the same considerations as a direct investment. Therefore, SBA believes that a specific regulatory provision to address this issue is not needed.

#### *Section 107.610 Required Certifications for Loans and Investments*

The proposed rule would add a certification requirement to § 107.610 to require an SBIC that finances a business under § 107.720(b)(3) to certify as to the basis of the qualification of the financing. The permissible basis would be the participation of one or more investors who would be subject to either UBTI or ECI in the event of a direct financing. As part of this certification, SBICs must identify those investor(s) subject to either UBTI or ECI as part of a direct financing. As discussed previously, the certification would replace the requirement for SBA prior approval of the formation and financing of a blocker corporation.

### **B. Technical Changes to Regulations**

#### *Section 107.50 Definition of Terms*

The proposed rule would correct the typographical error of “Associates’s” to

“Associate’s” in the last sentence under the “Lending Institution” definition.

#### *Section 107.210 Minimum Capital Requirements for Licensees*

SBICs typically have an investment period in which they draw capital and provide financings to small businesses, followed by a harvest and wind-up period in which they realize investments and repay capital to their private investors. SBA approves SBIC wind-up plans in accordance with § 107.590(c) and capital distributions above 2% in accordance with § 107.585. To conform with SBA’s current oversight practices, the proposed rule would modify paragraph (a) of § 107.210 to allow both Leverageable Capital and Regulatory Capital to fall below the stated minimums if the reductions are performed in accordance with an SBA-approved wind-up plan per § 107.590(c).

#### *Section 107.503 Licensee’s Adoption of an Approved Valuation Policy*

The proposed rule would change the last sentence of § 107.503(a) to indicate that valuation guidelines for SBICs may be obtained from the SBIC program’s public Web site, [www.sba.gov/inv](http://www.sba.gov/inv). SBA maintains SBIC-related guidelines and policies on this Web site as a convenience to the public.

#### *Section 107.630 Requirement for Licensees To File Financial Statements With SBA (Form 468)*

Current § 107.630(d) provides a mailing address for submission of SBA Form 468. These instructions are no longer necessary because SBICs submit this information electronically using the SBA’s web-based application. The proposed rule would remove this paragraph and redesignate paragraph (e) as paragraph (d).

#### *Section 107.1100 Types of Leverage and Application Procedures*

The proposed rule would correct the misspelling of “Yu” to “You” in the second to the last sentence in paragraph (b). The proposed rule would also remove paragraph (c) which identifies where to send Leverage applications. This paragraph is unnecessary because the application forms provide these instructions.

#### *Compliance With Executive Orders 12866, 12988, 13132, and 13563, the Paperwork Reduction Act (44 U.S.C. Ch. 35) and the Regulatory Flexibility Act (5 U.S.C. 601–612)*

#### *Executive Order 12866*

The Office of Management and Budget has determined that this rule is not a

“significant” regulatory action under Executive Order 12866. This is also not a “major” rule under the Congressional Review Act, 5 U.S.C. 801, *et seq.*

#### *Executive Order 12988*

This action meets applicable standards set forth in section 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. The action does not have retroactive or presumptive effect.

#### *Executive Order 13132*

The proposed rule would not have substantial direct effects on the States, or the distribution of power and responsibilities among the various levels of government. Therefore, for the purposes of Executive Order 13132, Federalism, SBA determines that this proposed rule has no federalism implications warranting the preparation of a federalism assessment.

#### *Executive Order 13563*

This proposed rule was developed in response to the comments received on previous amendments to the regulations concerning investments in passive businesses. As part of that rulemaking, published on October 21, 2014 at 79 FR 62819, SBA received one set of comments suggesting further expansion of the rule. The commenter suggested that SBA consider: (1) Revising § 107.720(b)(2) to explicitly state that an SBIC may “form and finance” (rather than merely “finance”) a passive business; (2) eliminating the requirement for SBA’s prior approval to form a blocker corporation under § 107.720(b)(3) and requiring a certification instead; and (3) revising § 107.720(b)(3) to permit an SBIC to form a blocker corporation to enable its foreign investors to avoid “effectively connected income” under the Internal Revenue Code. SBA discussed these concerns and informational requirements with industry representatives as part of its evaluation of these comments and development of this proposed rule.

#### *Paperwork Reduction Act, 44 U.S.C. Ch. 35*

SBA has determined that this rule would impose additional reporting and recordkeeping requirements under the Paperwork Reduction Act. In particular this rule proposes changes to the Portfolio Financing Report, SBA Form 1031 (OMB Control Number 3245–0078), to clarify information to be reported in Parts A, B, and C of the form. The proposed changes, described in detail below, also include designating

current Part D as Part F and adding new Parts D and E.

The title, description of respondents, description of the information collection and the proposed changes to it are discussed below with an estimate of the revised annual burden. Included in the estimate is the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing each collection of information.

SBA invites comments on: (1) Whether the proposed changes to Form 1031 are necessary for the proper performance of SBA’s functions, including whether the information will have a practical utility; (2) the accuracy of SBA’s estimate of the burden of the proposed collections of information, including the validity of the methodology and assumptions used; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques, when appropriate, and other forms of information technology.

Please send comments by the closing date for comment for this proposed rule to the address set forth above in the **ADDRESSES** section and to SBA Desk Officer, Office of Management and Budget, Office of Information and Regulatory Affairs, 725 17th Street NW., Washington, DC 20503.

*Title:* Portfolio Financing Report, SBA Form 1031 (OMB Control Number 3245–0078).

*Summary:* SBA Form 1031 is a currently approved information collection. SBA regulations, specifically, § 107.640, require all SBICs to submit a Portfolio Financing Report using SBA Form 1031 for each financing that an SBIC provides to a Small Business Concern within 30 days after closing an investment. SBA uses the information provided on Form 1031 to evaluate SBIC compliance with regulatory requirements. The form is also SBA’s primary source of information for compiling statistics on the SBIC program as a provider of capital to small businesses.

SBA proposes to revise the form as follows:

(1) *Clarifying the SBIC should report the non-passive Small Business Concern information in the Form 1031.* SBA has noted that SBICs sometimes report data on the passive Small Business Concern rather than the non-passive Small Business Concern when reporting financing information. SBA intends to clarify that the SBIC should report data

on the non-passive Small Business Concern when reporting information on financings using passive businesses in the Form 1031 Part A—the Small Business Concern; Part B—the pre-financing data; and Part C—the financing information, with the exception of the financing dollars in Question 29. The amount of financing dollars provided by the SBIC should be the total amount of such financing, regardless of whether the dollars were provided directly or indirectly to the non-passive business concern. Example: The SBIC provides \$5 million in equity to ABC Holding Corporation, which passes \$4.98 million to the non-passive business, Acme Manufacturing LLC. In addition, the SBIC provides \$5 million in debt directly to Acme Manufacturing LLC. The SBIC would report information on Acme Manufacturing LLC in Parts A, B, and C. However, the total financing dollars would be reported as \$5 million in equity and \$5 million in debt for a total of \$10 million in total financing dollars.

(2) *Identifying financings using one or more passive businesses.* SBA is proposing to add a question as to whether the financing utilizes one or more passive businesses as part of the financing, to help SBA identify these financings.

(3) *Adding information on passive business financings to aid in regulatory compliance monitoring.* SBA is proposing to have SBICs upload a file in Portable Document Format (PDF) that contains information needed to help SBA assess whether the financing meets regulatory compliance. The proposed file would contain the following information on the passive business financing:

(a) *Qualifying exception:* The SBIC would identify under which passive business exception the financing is made (§ 107.720(b)(2) Exception for pass-through of proceeds to subsidiary, or § 107.720(b)(3) Exception for certain Partnership Licensees). If the SBIC indicates that the financing is made under § 107.720(b)(3), it would also indicate the qualifying basis for the financing (*i.e.*, financing would cause an investor in the fund to incur either unrelated business taxable income or effectively connected income).

(b) *Passive Business Entities:* The SBIC would be required to clearly identify the name and employer ID for each passive business entity used within the financing. This is needed so that SBA can identify all Portfolio Concerns involved in the financing.

(c) *Financing Structure Description:* SBA is also proposing that the SBIC describe the financing structure,

including the flow of the money between the SBIC and the non-passive Small Business Concern that receives the proceeds (including amounts and types of securities between each entity), and the ownership from the SBIC through each entity to the non-passive Small Business Concern. This information will help SBA assess that the Small Business Concern receives “substantially all” the financing dollars and the ownership percentages are in compliance with the regulations. This will also help SBA if an SBIC is transferred to the Office of Liquidation to identify the structure of the financing and aid in recovery of SBA leverage.

**4. Impact Fund Policy Initiative**  
Although not resulting from this rule, the new proposed Part D would provide a vehicle for SBICs licensed to participate in SBA’s Impact Investment Fund (Impact Fund) to identify whether they are reporting on an SBA-identified impact investment or a Fund-identified impact investment. The Impact Fund was launched in April 2011 as part of President Obama’s Start-Up America Initiative. See, [<https://www.sba.gov/about-sba/sba-initiatives/startup-america/about-startup-america>.] The initiative was amended in September 2014 to allow Impact SBICs to invest in self-identified impact investments. [[https://www.sba.gov/sites/default/files/articles/SBA%20Impact%20Investment%20Fund%20Policy%20-%20September%202014\\_1.pdf](https://www.sba.gov/sites/default/files/articles/SBA%20Impact%20Investment%20Fund%20Policy%20-%20September%202014_1.pdf) or <https://www.sba.gov/content/new-2014-expanding-sbas-impact-fund>] While Impact SBICs, like all SBICs have been using Form 1031 to report on their financings, SBA has determined that it would be beneficial to Impact SBICs, if SBA Form 1031 were to include questions specifically targeted towards impact investments. As a result the agency is proposing to add two questions regarding whether the investment is a fund-identified impact investment or SBA-identified impact investment.

**Description of Respondents and Burden:** There are currently 299 licensed SBICs. All of these SBICs are required to submit SBA Form 1031 for each financing. The current estimated number of responses (*i.e.*, number of financings) is 2,021 based on the past three years (FY 2012 through 2014). The current estimate indicates that it takes approximately 12 minutes to complete the form, for a total annual burden of 404 hours. Neither the number of respondents nor the number of responses per year is expected to be affected by this proposed rule. However, SBA estimates a slight increase in the burden hour as a result of the additional

reporting in new Parts D (Impact Investments) and Part E (Passive Business).

**Impact Fund Reporting.** This reporting is expected to have minimal impact. The estimated eight SBICs making impact investments would complete new proposed Part D an estimated total 56 times annually. At an estimated 2 minutes per response, this additional reporting would add 2 hours to the annual burden for Form 1031.

**Passive Business Reporting.** SBA believes that the SBIC should be able to provide the proposed passive business information since it should be readily available as part of the financing. SBA estimates that providing the proposed information will take on average an additional 30 minutes for those financings utilizing passive businesses, with no incremental burden for those financings that do not use a passive business. SBA estimates that about 12% of the annual responses relate to passive businesses financings (based on financing data in 2014). Based on the number of SBICs reporting such financings the total estimated annual hour burden resulting from new Part E reporting would be 122.

Therefore the total estimated annual hour burden for all SBICs submitting SBA Form 1031s in a year would be 528 hours.

The current cost estimate for completing SBA Form 1031 uses a rate of \$35 per hour for an accounting manager to fill out the form. Using that same rate, the cost per form would change from \$7 per form to \$9.14 per form. However, SBA has increased its estimate of an hourly rate for an accounting manager to \$43 per hour (estimated using [www1.salary.com/Accounting-Manager-hourly-wages.html](http://www1.salary.com/Accounting-Manager-hourly-wages.html) in July 2015), which rate results in a new cost per form of \$11.23 for an aggregate cost of \$22,704 for the 2,021 estimated responses.

The recordkeeping requirements under the proposed rule also identify information that an SBIC must maintain in its files to support the required changes. SBA believes that the SBICs should already be maintaining this information since a passive business by definition is a Portfolio Concern and the SBIC should be maintaining all documents needed to support each financing. The proposed rule makes this expectation explicit. Furthermore, currently, an SBIC must maintain this information for it to effectively monitor and evaluate an investment that uses a passive business to finance a non-passive business. Therefore, SBA does not believe this recordkeeping requirement should increase the burden.

The proposed rule also requires a certification under § 107.610 when the SBIC makes a financing using the proposed exemption § 107.720(b)(3). This includes maintaining records supporting the certification. Since this regulation effectively replaces the current requirement for SBICs to seek prior SBA approval and maintain these records, SBA does not believe this change will increase the burden.

*Regulatory Flexibility Act, 5 U.S.C. 601–612*

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601, requires administrative agencies to consider the effect of their actions on small entities, small non-profit businesses, and small local governments. Pursuant to the RFA, when an agency issues a rule, the agency must prepare an Initial Regulatory Flexibility Act (IRFA) analysis which describes whether the impact of the rule will have a significant economic impact on a substantial number of small entities. However, Section 605 of the RFA allows an agency to certify a rule, in lieu of preparing an IRFA, if the rulemaking is not expected to have a significant economic impact on a substantial number of small entities. This proposed rule would affect all SBICs, of which there are currently close to 300. SBA estimates that approximately 75 percent of these SBICs are small entities. Therefore, SBA has determined that this proposed rule would have an impact on a substantial number of small entities. However, SBA has determined that the impact on entities affected by the rule would not be significant. The proposed changes in the passive business regulation would provide SBICs with additional flexibility to employ transaction structures commonly used by private equity or venture capital funds that are not SBICs.

SBA asserts that the economic impact of the rule, if any, would be minimal and beneficial to small SBICs. Accordingly, the Administrator of the SBA certifies that this rule would not have a significant impact on a substantial number of small entities.

#### **List of Subjects in 13 CFR Part 107**

Investment companies, Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

For the reasons stated in the preamble, the Small Business Administration proposes to amend 13 CFR part 107 as follows:

**PART 107—SMALL BUSINESS INVESTMENT COMPANIES**

■ 1. The authority citation for part 107 is revised to read as follows:

**Authority:** 15 U.S.C. 681, 683, 687(c), 687b, 687d, 687g, 687m.

**§ 107.50 [Amended]**

■ 2. Amend § 107.50 by removing from the definition of “Lending Institution” the term “Associates’s” and adding in its place the term “Associate’s”.

■ 3. Amend § 107.210 by revising the paragraph (a) introductory text to read as follows:

**§ 107.210 Minimum capital requirements for Licensees.**

(a) *Companies licensed on or after October 1, 1996.* A company licensed on or after October 1, 1996, must have Leverageable Capital of at least \$2,500,000 and must meet the applicable minimum Regulatory Capital requirement in this paragraph (a), unless lower Leverageable Capital and Regulatory Capital amounts are approved by SBA as part of a Wind-Up Plan in accordance with § 107.590(c):

\* \* \* \* \*

■ 4. Amend § 107.503 by revising the last sentence of paragraph (a) to read as follows:

**§ 107.503 Licensee’s adoption of an approved valuation policy.**

(a) \* \* \* These guidelines may be obtained from SBA’s SBIC Web site at [www.sba.gov/inv](http://www.sba.gov/inv).

\* \* \* \* \*

■ 5. Amend § 107.610 by adding paragraph (g) to read as follows:

**§ 107.610 Required certifications for Loans and Investments.**

\* \* \* \* \*

(g) For each passive business financed under § 107.720(b)(3), a certification by you, dated as of the closing date of the Financing, as to the basis for the qualification of the Financing under § 107.720(b)(3) and identifying one or more limited partners in which a direct Financing would cause those investors to incur “unrelated business taxable income” under section 511 of the Internal Revenue Code (26 U.S.C. 511) or “effectively connected income” to foreign investors under sections 871 and 882 of the Internal Revenue Code (26 U.S.C. 871 and 882).

**§ 107.630 [Amended]**

■ 6. Amend § 107.630 by removing paragraph (d) and redesignating paragraph (e) as paragraph (d).

■ 7. Amend § 107.720 by revising paragraphs (b)(2) and (b)(3) and adding paragraph (b)(4) to read as follows:

**§ 107.720 Small Businesses that may be ineligible for financing.**

\* \* \* \* \*

(b) \* \* \*  
(2) *Exception for pass-through of proceeds to subsidiary.* You may provide Financing directly to a passive business, including a passive business that you have formed, if it is a Small Business and it passes substantially all the proceeds through to (or uses substantially all the proceeds to acquire) 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 the financed passive business either:

(i) Directly owns, or will own as a result of the Financing, at least 50 percent of the outstanding voting securities; or

(ii) Indirectly owns, or will own as a result of the Financing, at least 50 percent of the outstanding voting securities (by directly owning the outstanding voting securities of another passive Small Business that is the direct owner of the outstanding voting securities of the subsidiary company).

(3) *Exception for certain Partnership Licensees.* If you are a Partnership Licensee, 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 (26 U.S.C. 511) or “effectively connected income” to foreign investors under sections 871 and 882 of the Internal Revenue Code (26 U.S.C. 871 and 882). Your ownership and investment of funds in such corporation(s) will not constitute a violation of § 107.730(a). For each passive business financed under this section 107.720(b)(3), you must provide a certification to SBA as required under § 107.610(g). The wholly-owned corporation(s) formed under this paragraph may provide Financing:

(i) Directly to one or more eligible non-passive Small Businesses; or

(ii) Directly to a passive Small Business that passes substantially all the proceeds directly to (or uses substantially all the proceeds to acquire) one or more eligible non-passive Small Businesses which the passive Small Business directly owns, or will own as a result of the Financing, at least 50% of the outstanding voting securities.

(4) *Additional conditions for permitted passive business financings.* Financings permitted under paragraphs (b)(2) or (b)(3) of this section must meet all of the following conditions:

(i) For the purposes of this paragraph (b), “substantially all” means at least ninety-nine percent of the Financing proceeds after deduction of actual application fees, closing fees, and expense reimbursements which may not exceed those permitted by § 107.860.

(ii) If you and/or your Associate charge fees permitted by §§ 107.860 and/or 107.900, the total amount of such fees charged to all passive and non-passive businesses that are part of the same Financing may not exceed the fees that would have been permitted if the Financing had been provided directly to a non-passive Small Business. Any such fees received by your Associate must be paid to you in cash within 30 days of the receipt of such fees.

(iii) For the purposes of this part 107, each passive and non-passive business included in the Financing is a Portfolio Concern. The terms of the financing must provide SBA with access to Portfolio Concern information in compliance with this part 107, including without limitation §§ 107.600 and 107.620.

\* \* \* \* \*

**§ 107.1100 [Amended]**

■ 8. Amend § 107.1100 by removing the term “You” in the second to the last sentence of paragraph (b) and adding in its place “You”, and by removing paragraph (c).

Dated: September 21, 2015.

**Maria Contreras-Sweet,**  
*Administrator.*

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**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 201**

[Release No. 34–75977; File No. S7–19–15]

**RIN 3235–AL87**

**Amendments to the Commission’s Rules of Practice**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** The Securities and Exchange Commission (“Commission”) is proposing for public comment amendments to its Rules of Practice that would require persons involved in