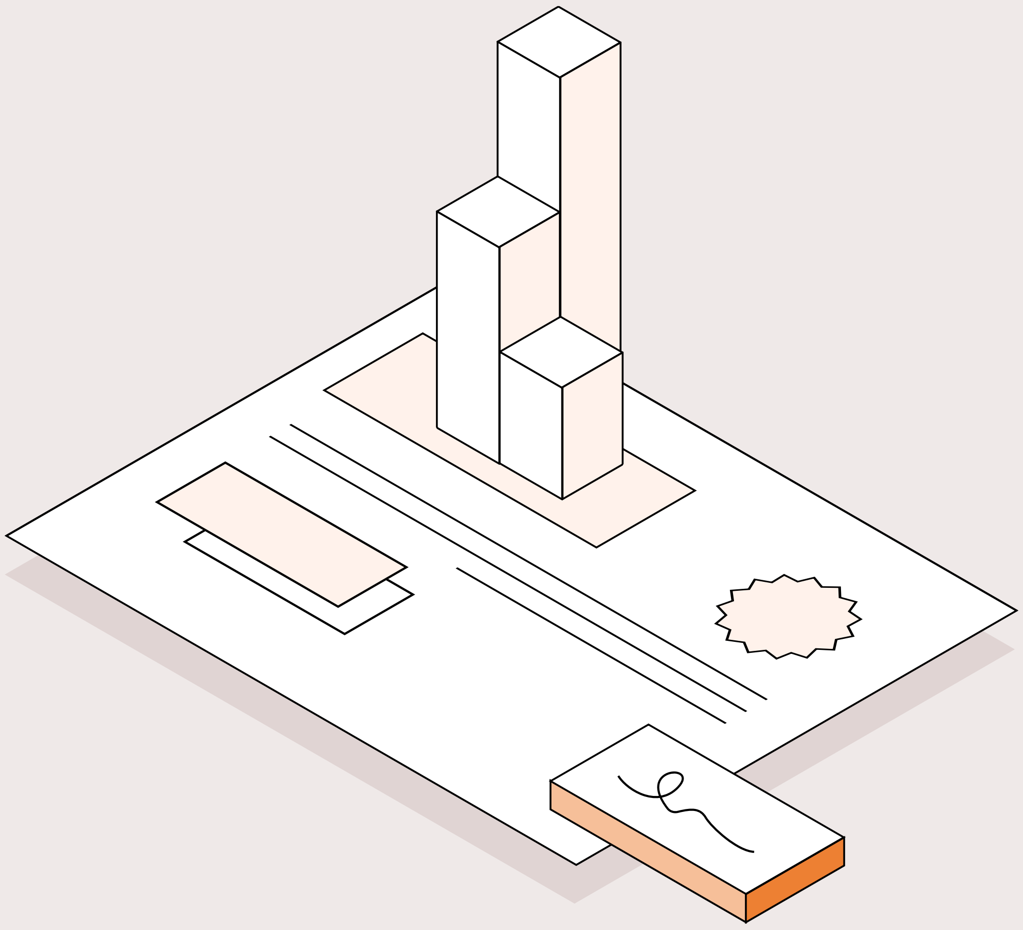
So you're pursuing an SBIC license: What comes next?



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Executive summary

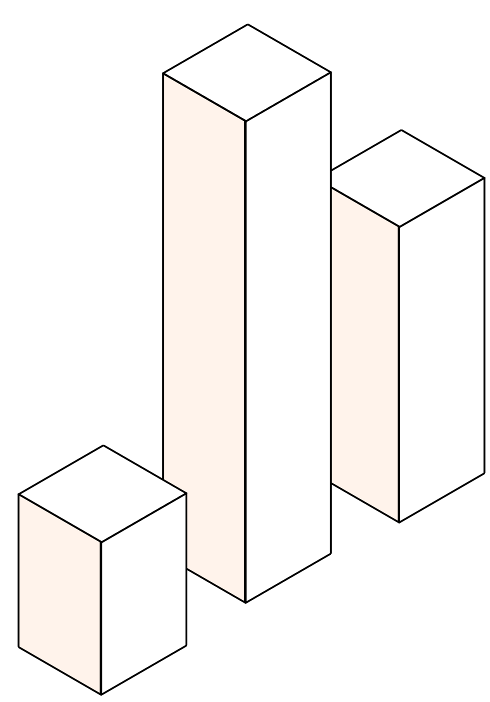
In each year from 2019 through 2023, the Small Business Investment Company (SBIC) program received somewhere between 25 and 40 applications from new funds seeking SBIC licenses.

Last year, that number spiked. The program received 127 applications for SBIC licenses in 2024, a year-over-year increase of 285%.

The SBIC program has always been a popular option for investors seeking to invest in startups and other small businesses: Since its founding in 1958, it has licensed nearly 2,400 SBIC funds and led to the investment of more than $130 billion in total capital.

As of Sept. 30, 2024, there were 318 active SBICs.

And interest in the SBIC program is soaring to new heights, aided by a few key tailwinds.



Factors driving the growth of SBICs

Because of the ability to raise debt financing from the government, the cost of capital for SBICs is lower than what investors can find in other types of private funds. Across both venture capital and private equity, the recent market for raising new funds has tightened, and broader interest rates remain high relative to recent history. These current macroeconomic factors combine to make SBICs look more appealing to some managers.

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Another tailwind for SBICs was the introduction in 2024 of accrual debentures, a new type of debt instrument that allows SBICs to accrue PIK (payment-in-kind) interest on the loans they receive from the government. This allows funds to defer interest payments on their loans until later years of the fund lifecycle, easing cash-flow burdens in the early years when capital is still being deployed. In 2024, 28% of total SBIC applications received were for accrual licenses.

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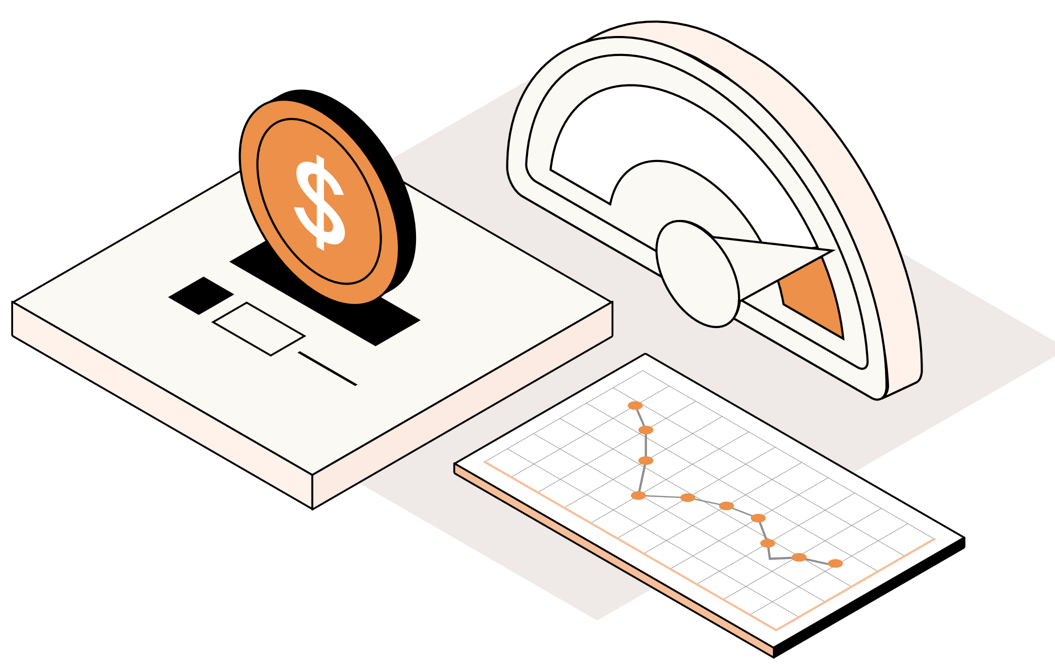
The advantages of SBICs

Forming an SBIC can also be a way for fund managers to increase their operational flexibility and open up new fundraising opportunities. An example: U.S. law requires most investors with more than $150 million in assets under management held in private funds to register with the U.S. Securities and Exchange Commission (SEC) as investment advisers, which can create new regulatory obligations. Any assets managed by an SBIC, however, are not counted toward that $150 million threshold.

SBICs are also able to raise capital from unique sources, including banks, which are permitted to invest in SBICs but are disallowed from investing in most other private funds. Some banks are therefore eager to serve as LPs for SBICs, as it provides exposure to an asset class that can otherwise be difficult to access.

Find out what criteria a small business must meet to qualify for SBIC funding.

Learn more →



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Key considerations when setting up your SBIC

For fund managers navigating the SBIC process for the first time, here are three key considerations to keep in mind while ramping toward a first close and preparing for SBA compliance. Then, our SBIC first-year milestone checklist can help you stay on track.

1 The path to your first leverage draw may be longer than you think

After receiving the green light to move forward and obtain an SBIC license, it's common for funds to face a window of 6–12 months before they can first receive leverage drawn from the SBA. During this period, fund managers will likely start establishing an investment pipeline and begin setting the table for their first investments.

This planning process should include strategic thinking about the timing of capital calls to LPs and drawdown requests from the SBA. Just because an SBIC fund has been initially approved to draw a certain amount of leverage from the SBA does not mean it has access to that capital all at once. Instead, draw requests must be coordinated to align with LP capital calls. And the groundwork for those drawdowns begins long before the capital shows up in a fund's bank account.

Here's an example

Consider an SBIC fund that was approved to receive 2× leverage up to $175 million. Say this fund successfully raised $87.5 million in capital from outside LPs, giving it access to that full 2× leverage.

That full $175 million total is not available all at once. Instead, the amount of leverage that the fund is able to access at any given time is dependent on the amount of leverageable capital the fund has called from its LPs. At all times, the SBIC wants to stay within its prescribed limit of 2× leverage. If a fund has called $20 million from its LPs, then it is only eligible to receive $40 million in concurrent debt funding.

To access that $40 million, the fund would need to submit a formal commitment request. This is in addition to the initial approval for leverage that the fund would have received during its SBIC application process. Once a commitment request is approved, the SBIC must pay a 1% fee within 30 days of receiving the commitment—a potentially significant expense that funds must prepare for in advance.

Once an SBIC fund has an approved commitment from SBA, it is authorized to begin making draw requests to fund expenses and investments. When an SBIC makes a draw request, it asks for the SBA to issue discrete debentures of specific sizes, with no more than five debentures in any one request. These debentures cannot be paid off partially, only in full. SBIC managers may therefore want to think strategically about how they divide those debentures. In a draw request for $40 million, for instance, an SBIC might request five debentures each worth somewhere around $8 million, in order to split the sum into chunks that are easier to pay off in the future.

In order to submit accurate and timely draw requests at the outset of the fund lifecycle, SBIC managers must have detailed projections for how much capital they plan to spend over the fund's first year. Aligning draw requests, capital calls, and spending plans is a key strategic need during the initial months after an SBIC is licensed.

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2 Fund management and workflows must be SBIC-ready

An SBIC fund faces more stringent compliance and reporting requirements than most other types of private funds. Before a fund starts to draw leverage from SBA, it might benefit from addressing certain gaps that may exist related to fund documentation, internal reporting, audit readiness, or operational structure.

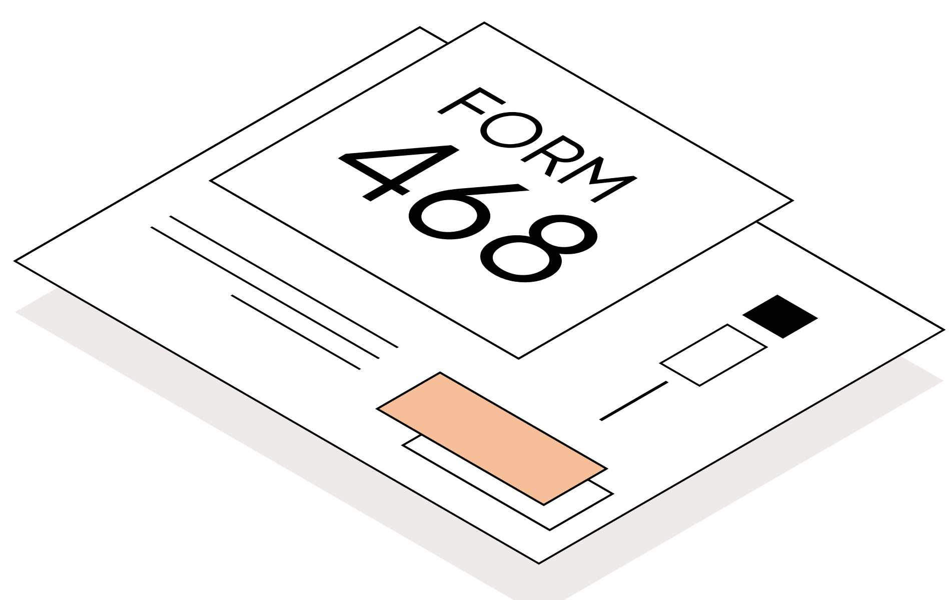
By staying on top of these sorts of compliance-related tasks, GPs can help streamline the drawdown process and reduce the risk of unwanted and unnecessary delays, particularly for documents that require inputs from across the organization.

Form 468

Each year, every licensed SBIC must file Form 468 within 90 days of the end of its fiscal year. The purpose of Form 468 is to provide the SBA with a comprehensive picture of each SBIC's finances. It includes information regarding nearly every aspect of an SBIC's operations, including its balance sheet, income statement, investment portfolio, and the economic impact of each new portfolio investment. For SBIC funds, Form 468 is the focal point of the periodic examination performed by the SBA's Office of Investment and Innovation Examinations Division.

Completing this form will likely require less time for new funds, who don't have existing portfolios to report. But accuracy is key. Fund administrators or other preparers might be copying and pasting data from many different spreadsheets, and any errors could cause issues in the examination. Form 468 also must be audited, which can require time and advance planning.

Within the SBA, one of the most closely watched metrics included in Form 468 is Retained Earnings Available for Distribution, or READ. This statistic measures the amount of profit a fund has on hand that has yet to be distributed to investors, which makes it a useful tool for assessing risk.



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Capital certificates

Each SBIC is required to maintain a current capital certificate on file with SBA. This document details the private capital committed to an SBIC fund and initially demonstrates the fund's ability to obtain sufficient private capital. The document outlines, by investor, the amount of the commitment, along with its name and address. During fundraising, this document needs to be updated for each closing. Subsequent to the final close, whenever the fund then calls capital from its LPs, it must file a new capital certificate within 30 days of receipt of the funds to provide updated information to the SBA on what portion of the initial commitment has been called so far, and what remains unfunded.

Capital certificates are typically filed through an Excel template that will be managed by an SBIC's fund admin team. The template is broken down both by individual investor and by investor type. The SBA is usually less concerned about the capitalization status of LPs who are major institutional investors, such as pension funds or endowments, while LPs who are high-net-worth individuals may receive more scrutiny.

If the initial capital certificates aren't issued in a timely and accurate fashion, it can lead to delays in licensing and receiving leverage. In most cases, SBICs rely on legal counsel to help file the fund's initial capital certificates with the SBA. Moving forward, SBIC admins are more likely to assume responsibility for capital certificates themselves or to work with some other sort of outside service provider.

Structural and entity alignment

The SBIC program includes strict guidelines around how SBICs and any potential related entities—such as parallel funds, SPVs, or other funds that a GP may manage—may be legally structured. Essentially, the SBIC program wants to make sure that the licensed SBIC entity is at the center of all relevant fund operations in order to make it easier for the SBA to monitor fund compliance.

Some structures and terms that are common in other types of private funds may need to be adjusted to fulfill the SBA's more stringent regulatory requirements. This could include the structure of management service agreements, details around how management fees are calculated and paid, restrictions around affiliated-party transactions, or certain LP terms and agreements.

For instance, SBA regulations prohibit SBIC funds from being subject to any prepayment penalties from other lenders, a common term in other types of private loans. SBIC managers should consult with counsel to ensure that their deal terms and structures are in accordance with SBIC guidelines.

A GP's fund administration team should be prepared to take on new responsibilities related to the operations and management of an SBIC. All workflows and documentation must be prepared to withstand the scrutiny of both auditors and the SBA's Examination Division.

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3 Ongoing compliance is not a set-and-forget exercise

Receiving an SBIC license and meeting the requirements to first begin drawing leverage are both key milestones for an SBIC fund manager. But from a compliance perspective, they are only the beginning. Remaining compliant with SBA regulations and guidelines requires continued vigilance through the lifespan of an SBIC.

One major part of this ongoing compliance is staying on top of required filings. SBICs must file Form 1031 each quarter and an audited Form 468 each year. Leveraged SBICs must also file unaudited quarterly Form 468s, adding to the reporting requirements. Preparing these forms can require regular and close coordination with a GP's fund administrator and external audit firm.

Some firms are taking advantage of the SBA Accrual Debenture Program instituted in October 2023 that is designed for funds that are focused on longer-term equity investments. This relatively recent regulatory change allows SBICs to accrue interest and reduce cash pressure during an equity fund's early years, unlike standard SBIC debenture funds that are required to make semi-annual interest payments to SBA. Principal and interest payments by Accrual SBICs are generally due when the SBIC makes distributions to its private investors. These interest deferrals must be accurately documented and disclosed over time. Like preparing reporting forms, this can require a significant time commitment each quarter from an SBIC's fund admin.

This Carta whitepaper was written in collaboration with Jackie Byers of Liftbridge, a provider of SBIC Fund CFO services and other accounting and finance solutions.

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SBIC first-year milestone checklist: From approval to first leverage draw

1

Strategize capital call & drawdown timeline

	Yes	No
• Create detailed projections of fund capital needs over the first 12 months	☐	☐
• Align LP capital call timeline with anticipated SBA leverage draw schedule	☐	☐
• Confirm expected investment pipeline to time cash needs	☐	☐
• Build internal model to stay within 2:1 leverage ratio at all times	☐	☐

2

Submit leverage commitment request to SBA

	Yes	No
• Complete and submit formal commitment request to SBA based on leverageable capital	☐	☐
• Coordinate with fund counsel/admin to ensure submission accuracy	☐	☐
• Plan for 1% commitment fee due within 30 days of SBA's commitment approval	☐	☐
• Ensure liquidity is available to pay commitment fee promptly	☐	☐

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3

Design drawdown strategy

	Yes	No
• Determine initial draw amount based on near-term investment plans	☐	☐
• Plan how draw request will be split into up to five SBA debentures	☐	☐
• Strategically size debentures for future repayment flexibility (cannot be partially repaid)	☐	☐
• Confirm that draw size stays within authorized leverage limits per called capital	☐	☐

4

Build infrastructure for draw & compliance readiness

	Yes	No
• Set up administrative workflows for draw requests and supporting documentation	☐	☐
• Engage fund administrator to manage capital certificates and Excel templates	☐	☐
• Draft standard timeline/checklist for draw request preparation and SBA communication	☐	☐
• Ensure banking relationships are ready to support SBA draw verification steps	☐	☐

5

Monitor communications with SBA

	Yes	No
• Maintain close coordination with SBA on draw request timing (requests only accepted every 2 weeks)	☐	☐
• Identify and resolve any follow-up items requested by SBA before leverage release	☐	☐
• Confirm SBA acknowledgment of draw request and debenture schedule	☐	☐

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6

Prepare LPs for capital call coordination

	Yes	No
Notify LPs of upcoming capital call and align timing with SBA draw requirement	☐	☐
Ensure legal documentation covers SBA leverage structure to avoid delays	☐	☐
Regularly update LPs on the fund's leverage status and next steps	☐	☐

7

Ensure investment readiness

	Yes	No
Review deal pipeline for near-term opportunities to align with first draw	☐	☐
Target closing first investments shortly after draw receives SBA approval and funds are received	☐	☐
Maintain compliance cornerstones in early deployment (investment types, limits, reporting)	☐	☐

SBIC support from Carta

Carta's SBIC solution can help reduce administrative lift by automating capital certificate workflows, managing draw documentation, and integrating SBA reporting into a GP's existing operations—without increasing headcount or overheads.

Speak to a Carta expert about managing your SBIC. Book your custom demo →