COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

APR 27 1978

B-149685

The Honorable Gaylord Nelson
Chairman, Select Committee on
Small Business
United States Senate

Dear Mr. Chairman:

This is in response to your request for an opinion from our Office on the eligibility of small business investment companies (SBICs) to participate as non-guaranteed lenders in loan programs administered by the Farmers Home Administration (FmHA).

As you know, our decision of February 3, 1977, 56 Comp. Gen. 323 held that "SBICs are not eligible to participate as guaranteed lenders in either SBA's 7(a) loan program or FmHA's Business and Industrial loan program." However, as indicated in your submission, that decision did not specifically address the question of whether SBICs could participate in FmHA's loan programs as non-guaranteed lenders.

The specific question you have asked us to resolve is "whether an SBIC can finance the non-guaranteed portion of an FmHA loan in participation with another qualified lender that supplies the proceeds for the guaranteed portion of a loan." In such a situation, you state, "FmHA in no way would reimburse the SBIC on its exposure in the event of a default."

For the following reasons, it is our view that SBICs do not have authority to participate in FmHA's loan programs as non-guaranteed lenders.

As stated in our decision of February 3, 1977, FmHA is authorized to guarantee loans made to eligible borrowers pursuant to section 310B of the Consolidated Farm and Rural Development Act, as amended, 7 U.S.C. § 1932 (1976). In its Business and Industrial Loan program authorized by this provision, FmHA guarantees up to 90 percent of loans made and serviced by eligible lenders. Our February 3, 1977, decision reaffirmed the position we had taken earlier in 49 Comp. Gen. 32 (1969), in which we concluded that SBICs could not participate with SBA in making loans to small business concerns under section 7(a) of the Small Business Act, 15 U.S.C. § 636(a)(1976). In both of those decisions, we relied heavily

ceg

on the legislative history of the Small Business Investment Act, 15 U.S.C. § 661 et seq. (1976) which indicated that the SBIC program was to "be launched with a minimum of Federal activity and with only a modest increase in personnel and administrative expenditures by the Small Business Administration" and was "to operate and be accounted for in complete separation from other Federal small business programs." See S. Rep. No. 1652, 85th Cong., 2nd Sess. 2, 3 (1958). Thus our 1977 decision reached the conclusion that:

> "This exclusion from participation in other Federal small business programs would apply equally to FmHA's programs as to SBA's section 7(a) program under the reasoning of our 1969 decision."

Applying this rationale to the instant question, we see no basis, in light of the specific statement of congressional intent that SBICs "operate and be accounted for in complete separation from other Federal small business programs," for distinguishing between SBIC participation in an FmHA program as a guaranteed or non-guaranteed lender. This was implicitly recognized in our 1977 decision in our discussion of the legal effect, if any, on our position if the participating SBIC retained only the unguaranteed portion of the FmHA loan and sold at the closing of the loan or immediately thereafter, the guaranteed portion, to a non-SBIC investor. We said:

> "For the reasons discussed previously with respect to proposed SBIC participation in SBA loans, it makes no difference that the SBICs would retain only the unguaranteed portion of the FmHA Business and Industrial loan and sell at the closing of the loan, or immediately thereafter, the guaranteed portion, to non-SBIC investors. Even under this type of arrangement the SBIC would be a participant in the loan program of another Government agency, thereby engaged in activities not contemplated by the Small Business Investment Act, and would be making and servicing loans which were intended to achieve purposes other than, or at least in addition to, those contemplated by that Act, thereby violating the statutory language and intent."

Although we recognize that the proposed arrangement would not necessarily involve the SBIC in either making or servicing the loan, we believe that the instant proposal and that which we held to be unauthorized in our prior decision are very similar and require consistent treatment. In both situations, at the time of loan closing, the SBIC would end up holding the non-guaranteed portion of the loan.

Moreover, there is another and perhaps even more compelling reason to disapprove the instant proposal. In accordance with our general policy, we requested the agencies involved in this matter--FmHA and SBA--to furnish us with a statement of their position on the question presented. By letter of April 5, 1978, the Administrator of FmHA advised us that in FmHA's opinion, "SBICs could possibly participate with an eligible lender in the unguaranteed portion of a B&I loan." This was based on a provision in 7 C.F.R. § 1980.13(d)(and 1980.419(d)) which provides that "Lenders who are not eligible lenders are not barred from participating in loans by eligible lenders."

However, notwithstanding FmHA's position that under its regulations SBICs would not necessarily be precluded from participating as non-guaranteed lenders, even though they could not participate as guaranteed lenders, we were advised by SBA that its regulations prohibit such a financing arrangement. SBICs are, of course, established by the provisions of the Small Business Investment Act and are subject to SBA's licensing and regulatory oversight. See 15 U.S.C. § 687(c)(1976).

As explained by SBA, an SBIC can become the holder of the non-guaranteed portion of an FmHA loan in one of three ways:

1. The SBIC could make the entire loan and immediately upon closing or shortly thereafter sell the guaranteed portion to another qualified lender.

2. The loan could be jointly financed, with the SBIC financing all of the non-guaranteed portion and the other qualified lender furnishing the guaranteed portion.

3. The entire loan could be made by a qualified lender eligible to make guaranteed loans who would upon loan closing or shortly thereafter sell the non-guaranteed portion thereof to the SBIC.

We agree with the position taken by SBA that, for the following reasons, none of the foregoing "possibilities" would be legally permissible.

The first arrangement is precisely the type of situation that we specifically held in our decision of February 3, 1977, to be unauthorized, involving the sale by the SBIC making the loan of the guaranteed portion, while it retained the non-guaranteed portion and the concomitant responsibility for servicing the loan.

The second alternative would also be unauthorized since it is really just a variation of the first in so far as it would require SBIC participation in the making of the loan from its inception. Moreover, we were informally advised by FmHA that its procedures do not allow a loan to be made jointly with one lender financing the guaranteed portion and the other lender the non-guaranteed portion.

With respect to the third possibility, we were advised by SBA that its regulations specifically prohibit participation by SBICs in this type of financing arrangement. The relevant regulation only allows an SBIC to make this type of investment in a small business concern with respect to:

> "Securities of a Small Concern purchased from a seller other than the issuer or his underwriter * * * when such acquisition constitutes a reasonably necessary part of the overall sound financing of such concern pursuant to the Act, or when the securities are acquired to finance a change of ownership * * *." 13 C.F.R. § 107.504(b)(3) (1977).

Moreover, the Act referred to in this regulatory section is the Small Business Investment Act of 1958 (see 13 C.F.R. § 107.3) and not the Consolidated Farm and Rural Development Act under which FmHA's Business and Industrial Loan program operates, so even this limited exception does not apply. Accordingly, we agree with SBA's position that an SBIC may not purchase the non-guaranteed portion of an FmHA loan from a lending institution since this would constitute a purchase of a security from a non-issuer in violation of the limitations contained in 13 C.F.R. § 107.504(b)(3).

In accordance with the foregoing, it is our position that SBICs cannot finance the non-guaranteed portion of an FmHA loan in participation with another qualified lender financing the guaranteed portion of the loan, no matter how the arrangement is structured.

We trust that the foregoing has been responsive to your request.

Sincerely yours,

R.F. KELLER

Deputy

Comptroller General
of the United States