



# NASBIC

America's Small Business Partners

November 22, 2002

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Via E-Mail to [regcomments@fincen.treas.gov](mailto:regcomments@fincen.treas.gov)

Fin CEN  
U.S. Department of Treasury  
P.O. Box 39  
Vienna, VA 22183-1618

Attn: NPRM-Section 352 Unregistered Investment Company Regulations

Dear Ladies and Gentlemen:

This letter responds to the request for comments on a proposed new rule covering the obligations of unregistered investment companies with respect to the establishment of anti-money laundering programs under the USA PATRIOT Act. The rule was published in the Federal Register on September 26.

I am President of the National Association of Small Business Investment Companies ("NASBIC"). NASBIC is the national trade association for Small Business Investment Companies ("SBICs") with 281 SBICs as members. Our membership represents approximately 75% of all active SBICs by number and about 80% by amount of capital resources. SBICs are entities that make long-term investments in U.S. small businesses and that are licensed by the U.S. Small Business Administration ("SBA") pursuant to the authority set forth in the Small Business Investment Act of 1958, as amended, and the regulations promulgated thereunder. SBICs can use their private capital to qualify for government funding in the form of equity securities or debentures. SBICs are usually in limited partnership form, although bank-owned SBICs often use a corporate form.

NASBIC strongly supports the proposed rule and its exclusion from the requirement to establish an anti-money laundering program for an unregistered investment company that does not give an investor a right to redeem any portion of the investor's ownership interest within two years after the purchase of the interest. We ask, however, that in the four instances explained below that the wording of the exclusion be clarified in connection with publication of the final rule. Specific requests for clarification appear in **bold type** at the end of the section to which they apply.

1. An SBIC may be either a private equity fund or a venture capital fund, as defined in the proposed rule, or a combination of these types. Occasionally, an SBIC requires all its investors to fund their entire commitments at the time of the closing at which they become equity owners. The norm for SBICs (as we believe it is for almost all other types of private

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equity funds and venture capital funds), however, is to draw the commitments of their investors over a period of time. To the extent that an investor does not fully fund in full its commitment at the time of the closing of the acceptance of its commitment, the investor makes an irrevocable commitment to fund that commitment over the life of the SBIC. In some instances, this funding is subject to various timing and amount restrictions. Such a restriction by way of example might be that no more than one-third of an investor's commitment can be drawn in any consecutive twelve-month period. **Consequently, we request that the final rule change the word "purchase" to "binding commitment" or similar phrase. In addition, there should be a clarifying explanation that the two-year period will be measured from the date on which the investor's commitment to invest in the fund is accepted, not on the dates on which that commitment is actually funded by the investor.**

2. SBA suggests that a fund formed as a limited partnership and applying for a license as an SBIC use the model forms of limited partnership agreement prepared by SBA. One model is to be used by applicants that may seek government funding in the form of equity securities. The other model is to be used by applicants that may seek government funding in the form of debentures. These model forms contain provisions that the SBA strongly recommends be used without modification; other provisions can be changed and adapted to the needs of the fund. Among the provisions that the SBA suggests be used without modification are provisions that permit the withdrawal from the fund of a limited partner that is either (i) an employee benefit plan within the meaning of and subject to the provisions of ERISA, (ii) government plans within the meaning of ERISA subject to state laws and regulations, (iii) government plans within the meaning of ERISA subject to ERISA, (iv) entities exempt from taxation under Section 501(a) or 501(c)(3) of the Internal Revenue Code, and (v) investment companies registered under the Investment Company Act of 1940 if the limited partner obtains an opinion of counsel to the effect that such withdrawal is required by the applicable regulatory authority. The form and content of the opinion and the counsel rendering it must be acceptable to both the SBIC's general partner and the SBA. If the SBIC has not eliminated within ninety days the reason that the limited partner must withdraw, then the limited partner is permitted to withdraw. SBA may consent to a period shorter than ninety days. **We request that the final rule make clear that, if a limited partner has a right to withdraw or elects to withdraw because of regulatory requirements, such right and any actual withdrawal based thereon, will not be considered as permitting the limited partner to redeem its ownership interest within two years of its purchase.**
3. A number of SBICs have banks or bank affiliates as limited partners. In fact, SBICs are a favored investment vehicle for banks and their affiliates because of the Community Reinvestment Act credits that are available by reason of the investment in an SBIC. Some banks are concerned that a change in banking regulations may require their withdrawal from an SBIC. Accordingly, SBA has permitted a bank or bank affiliate to withdraw from an SBIC if the bank or bank affiliate submits an opinion that such withdrawal is required by a change in applicable banking regulations and SBA approves the withdrawal. **We request that the final rule make clear that, if a bank or bank affiliate has such a withdrawal right or decides to withdraw because of a change in applicable regulations, such right and actual withdrawal will not be considered as permitting the limited partner to redeem its ownership interest within two years of its purchase.**

4. Some SBIC general partners and limited partners have negotiated special provisions which permit the limited partners by some supermajority vote (often eighty percent) to cause the fund to cease making investments, to limit draws of additional capital, to liquidate investments and to wind up the fund. Sometimes these provisions are tied to unacceptable conduct of the general partner or its principals or the fact that one or more principals has withdrawn. These provisions are generally designed to protect limited partners if there is a material change in personnel of the general partner or a violation of the obligations of the general partner or its principals. Our experience is that such provisions are rarely invoked. In an SBIC, if such a provision were invoked and if upon liquidation of the fund the SBA was owed money, SBA has a right to call the unfunded capital commitments of the private owners of the SBIC (in the case of an SBIC in the form of a limited partnership, the general partner and the limited partners) to pay this shortfall. **Based on the special nature of these provisions, we ask that the final rule make clear that, if such special withdrawal rights exist or are activated, such right and actual withdrawal will not be considered as permitting limited partners to redeem their ownership interests within two years of their purchases.**

In conclusion, NASBIC strongly believes that it is highly unlikely that an SBIC would be used to launder money because of the long-term nature of the investment commitment required as well as the degree of active oversight by the SBA. In the capital certificate that a fund submits to SBA prior to being licensed as an SBIC and at least semi-annually after being licensed, all equity owners are identified by name, address, amount of commitment, amount of capital contributed and amount of commitment unpaid. These capital certificates are certified as correct by the general partner of the SBIC or the equivalent manager. For investors owning more than ten percent of an SBIC, the SBA requires that additional identifying information be submitted. NASBIC believes that requiring SBICs to set up anti-money laundering programs would be extremely burdensome. SBICs are required to invest in U.S. small businesses. Diverting time and resources from that objective would be unfortunate, and, we believe, unnecessary because of the nature of these investment funds. We ask that you consider the requests for clarification in this letter in the broader context of the purpose and nature of the SBIC program and the USA PATRIOT Act.

Thank you for your consideration of our views. If you wish additional information or wish further clarification, please do not hesitate to telephone me at 202-628-5055.

Sincerely yours,

A handwritten signature in black ink that reads "Lee W. Mercer". The signature is written in a cursive, flowing style.

Lee W. Mercer, President