

Small Business Administration

§ 108.730

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

written approval, you may not Finance any business in which your Associate has either a voting equity interest or total equity interests (including potential interests) of at least five percent, except as otherwise permitted under paragraph (a)(1) of this section.

(2) *Other Financings with Associates.* If you and an Associate provide Financing to the same Small Business, either at the same time or at different times, you must be able to demonstrate to SBA's satisfaction that the terms and conditions are (or were) fair and equitable to you, taking into account any differences in the timing of each party's financing transactions.

(3) *Exceptions to paragraphs (d)(1) and (d)(2) of this section.* A Financing that falls into one of the following categories is exempt from the prior approval requirement in paragraph (d)(1) of this section or is presumed to be fair and equitable to you for the purposes of paragraph (d)(2) of this section, as appropriate:

(i) Your Associate is a Lending Institution that is providing financing under a credit facility in order to meet the operational needs of the Small Business, and the terms of such financing are usual and customary.

(ii) Your Associate invests in the Small Business on the same terms and conditions and at the same time as you.

(iii) Both you and your Associate are NMVC companies.

(e) *Use of Associates to manage Portfolio Concerns.* To protect your investment, you may designate an Associate to serve as an officer, director, or other participant in the management of a Small Business. You must identify any such Associate in your records available for SBA's review under §108.600. Without SBA's prior written approval, the Associate must not:

(1) Have any other direct or indirect financial interest in the Portfolio Concern that exceeds, or has the potential to exceed, the percentages of the Portfolio Concern's equity set forth in paragraph (a)(1) of this section.

(2) Receive any income or anything of value from the Portfolio Concern unless it is for your benefit, with the exception of director's fees, expenses, and distributions based upon the Associ-

ate's ownership interest in the Concern.

(f) *1940 and 1980 Act Companies: SEC exemptions.* If you are a 1940 or 1980 Act Company and you receive an exemption from the Securities and Exchange Commission for a transaction described in this section, you need not obtain SBA's approval of the transaction. However, you must promptly notify SBA of the transaction.

(g) *Restriction on options obtained by NMVC Company's management and employees.* Your employees, officers, directors, managing members or general partners, or the general partners of the management company that is providing services to you or to your general partner, may obtain options in a Financed Small Business only if:

(1) They participate in the Financing on a *pari passu* basis with you; or

(2) SBA gives its prior written approval; or

(3) The options received are compensation for service as a member of the board of directors of the Small Business, and such compensation does not exceed that paid to other outside directors. In the absence of such directors, fees must be reasonable when compared with amounts paid to outside directors of similar companies.

§ 108.740 Portfolio diversification ("overline" limitation).

(a) Without SBA's prior written approval, you may provide Financing or a Commitment to a Small Business only if the resulting amount of your aggregate outstanding Financings and Commitments to such Small Business and its Affiliates does not exceed 10 percent of the sum of:

(1) Your Regulatory Capital as of the date of the Financing or Commitment; plus

(2) The total amount of leverage projected in your participation agreement with SBA; plus

(3) Any permitted Distribution(s) you made during the five years preceding the date of the Financing or Commitment which reduced your Regulatory Capital.

(b) For the purposes of paragraph (a) of this section, you must measure each outstanding Financing at its current