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SBIC Distinctions Relative to BDCs and Other Private Credit Vehicles[1]

While there are important differences in the underlying terms of typical SBIC loans vs. the loan portfolios in larger private credit funds and Business Development Companies (BDCs), there are also important differences in how these vehicles are funded, what they are permitted to own, and how their valuations are maintained and disclosed. Recent headlines across the private credit and BDC complex have put the structural advantages of SBICs in sharper relief.[2]

The comparison below isolates areas where the structural gap has been recently most apparent: (1) the leverage structures supporting each vehicle and the terms of liquidity for investors and (2) the investment exposures in each vehicle. These structural distinctions are central to LMMA's investment thesis and some of the reasons LMMA invests exclusively in SBIC funds.

1. Inherent Risks of Market-Sensitive Leverage Structures

Large BDCs and private-credit vehicles often rely on bank facilities and off-balance-sheet financing arrangements, which in turn depend on lender calculations of borrowing bases, NAV/asset-coverage tests, and other variable portfolio value metrics. The vehicles often at times rely on unsecured debt markets. These arrangements are not necessarily "callable" overnight, but they can become highly constraining when marks fall, defaults rise, or investors seek liquidity.

Recent examples include:

- **Bank-facility dependence.** For bank-funded BDCs and private-credit vehicles, borrowing capacity can contract precisely when credit risks rise (lower valuations or defaults reduce the borrowing base). Credit stress can weaken borrowing capacity, force renegotiation of bank facilities, or, in more severe cases, pressure funds to sell assets to repay lenders. **SBIC distinction:** An SBIC funded with SBA debentures is not dependent on discretionary bank borrowing. Once SBA leverage is committed it can be drawn on demand by the SBIC, and the SBA debentures are long-term fixed-rate obligations of the SBIC and not subject to borrowing-base re-valuation.

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[1] *This material is for informational purposes only and does not constitute investment advice or an offer to sell or a solicitation to buy securities. This discussion is illustrative and not intended to be a comprehensive comparison of all private credit strategies.*
[2] *Does not guarantee superior performance or reduced risk which may be higher / lower depending on market conditions.*

Opaque look-through leverage. Some non-SBIC structures use non-consolidated affiliates, joint ventures, or financing vehicles that can add leverage that is less visible in parent-level financial statements and therefore can be harder for investors to assess. While private credit and BDC structures are subject to securities laws and reporting requirements, their leverage arrangements generally do not require the same kind of SBA licensing, leverage approval, and quarterly regulatory reporting applicable to SBICs.

- **SBIC distinction:** To us, SBIC leverage is simpler and limited to SBA debentures, which are transparent to SBIC investors. Because an SBIC is licensed and regulated by SBA, the structure leaves no room for complex off-balance-sheet leverage arrangements that obscure look-through leverage.
- **Redemption-driven liquidity risk.** Open-end and semi-liquid private-credit vehicles offer periodic redemption rights against fundamentally illiquid assets. When sentiment turns, outflows can force asset sales, drawdowns on credit lines, or gating of investors.
- **SBIC distinction:** SBIC funds are closed-end vehicles and do not offer periodic redemption rights or retail liquidity features. SBIC investment periods are limited, and SBIC loans are structured with maturities that can support a more predictable return of capital. This can eliminate the risk that investor redemptions could force asset sales, constrain liquidity, or increase reliance on credit lines during stress.[3]

2. Investment Exposures Outside the Permissible or Practical SBIC Universe

Large BDCs and non-SBIC private-credit funds can finance larger, highly leveraged sponsor-backed borrowers, and companies in sectors that are either outside SBIC eligibility rules or much less common in SBIC portfolios.

Recent examples include:

- **Software / technology LBO exposure.** Some larger BDCs and private-credit funds have meaningful exposure to sponsor-backed software companies, where AI-related disruption and elevated leverage have pressured valuations and marks.
  SBIC distinction: Software is not automatically SBIC-ineligible. However, in our experience, the large PE-backed software deals are usually outside SBIC investment

[3] *Closed-end structures introduce other risks, including illiquidity and limited investor exit options.*

parameters because of borrower size, financing size, or leverage profile. SBIC portfolios generally focus on smaller, lower-leverage businesses across diverse end markets.

- **Upper-middle-market borrower size.** Large credit funds are built to deploy hundreds of millions into individual borrowers, which structurally pushes them up-market into companies that often exceed SBIC size standards.
- **SBIC distinction:** SBA rules limit SBIC financings to qualifying U.S. small businesses. Borrowers of the size and enterprise value that drove recent BDC losses would typically fall outside SBIC eligibility entirely — a regulatory boundary, not a stylistic preference.[4]
- **Finance companies, structured credit, and relender exposure.** BDCs and large private-credit funds can lend to specialty finance companies or other capital-providing platforms, adding a layer of indirect, intermediated credit risk.

  SBIC distinction: SBA regulations prohibit SBICs from financing relenders or reinvestors, including businesses primarily engaged in lending, purchasing debt obligations, factoring, or certain leasing activities.
- **Valuation and transparency.** When portfolio marks influence borrowing-base capacity, asset-coverage tests, or distribution policy, valuation practices can affect reported performance, leverage metrics, and investor confidence. Recent BDC stress has highlighted that reported NAVs may not fully resolve investor or lender concerns about private-credit marks, particularly where those marks affect borrowing capacity or leverage tests.

  SBIC distinction: SBICs operate under SBA-approved valuation policies and regular SBA reporting within a more standardized regulator-facing valuation framework.[5] Marks remain important, but they do not directly flex a bank borrowing base or trigger covenant resets in the same way they can in bank-financed private-credit or BDC structures.

Taken together, these distinctions do not make SBIC portfolios immune to credit losses. However, in periods when private-credit structures are stressed by marks, redemptions, and complex leverage, those constraints can be a source of structural resilience.

[4] *SBIC eligibility rules are subject to change.*

[5] *Valuation remains inherently subjective and may vary across managers.*