SMALL BUSINESS INVESTOR ALLIANCE

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Testimony of SBIA President Brett Palmer Before the U.S. House Small Business Committee

"SBA Management Review: Small Business Investment Company (SBIC) Program"

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Dear Chairwoman Velázquez, Ranking Member Chabot, and Members of the Committee:

The Small Business Investor Alliance ("SBIA") is pleased to submit the following testimony about the U.S. Small Business Administration's Small Business Investment Company ("SBIC") Program." SBIA is the national association that has represented SBICs since their inception over 60 years ago.

SBICs are an American success story and are an example of a successful public policy that aligns the power of private market with the public interest of job creation and economic growth. SBICs invest exclusively in domestic small businesses to create job, empower American small businesses to grow and compete in a global economy, and support communities.

The SBIC program, like all government programs, should be regularly examined for effectiveness and for opportunities to make reforms to better serve the American people. We welcome Congressional oversight and review.

This testimony explains the SBIC program and the role it fills in aiding high growth small businesses and thereby job creation. We are disappointed that we must dedicate a large section of our testimony to the mismanagement plaguing the SBIC program – issues that are harming small businesses and creating unnecessary risks to the taxpayer. The following testimony documents many of these fully avoidable, man-made problems.

After well over two years, the Office of Investment and Innovation (OII) Associate Administrator's management style being applied to this otherwise successful small business program could be summarized with the phrase "linger, languish, and fester."

We are at the point that small business investors are unable to distinguish between what is mismanagement by the Associate Administrator and what is passive aggressive hostility to the successful operation of this otherwise successful small business program. Small business investors see a pattern of mismanagement by OII leadership using or warping the regulations not for good faith execution of the law and the benefit of small business, but instead to set up a near never-ending series of delays, roadblocks, and unnecessary costs at every step of the program. Every process with which the Associate Administrator is involved has become slowed, erratic, and unpredictable. When there is any regulatory or procedural question small business investors now are forced to assume that the most adverse interpretation is the likely outcome.

Small Business Investment Companies need and want regulation that is reasonable, clear, predictable, and maintains the alignment of interests between the private and public sectors.

In some cases, the SBIC processes work adequately and as they should, but in too many other cases random delays and unpredictable outcomes have been the growing norm. There are numerous, interdependent steps in the many SBIC processes. The regulatory steps that do not involve the Associate Administrator generally seem to be working adequately. Nearly all processes involving the Associate Administrator are delayed, commonly for exceedingly long periods of time. Since many processes have multiple steps, the delays build upon other delays and to the point of near programmatic dysfunction. Management of a $30 billion-dollar federal program should not be so unpredictable and unsteady.

Small business investors have wasted significant time over the past two years trying to get OII leadership to simply execute the law in good faith. This wasted time and effort should otherwise have been spent finding more small businesses with growth potential and then helping them grow to their full potential. SBIA's members would prefer to be spending time and resources to identify ways to work with this Committee and Administration to better serve the public. For example, what policies can be improved to better fill the remaining gaps in capital access? How can we facilitate a more robust equity market for small businesses? Are there better ways to capitalize small businesses in underserved communities, both rural and urban? How can we make investments into veteran, women, or minority-owned businesses more commonplace? What changes should be made to ensure the taxpayer is fully protected under all economic conditions? These are issues where the private sector, Congress, and the SBA could have been working together. Instead, we are again before Congress asking that the leadership of the OII stop breaking what is otherwise a successful small business program and to simply allow the program work. There is no public benefit from the rampant delays, unpredictability, and lack of communication exhibited by the leadership of the OII.

Our testimony exposes, in many cases using SBA's own official data, the current management's dismal record. For example,

According to SBA's most recent data through three quarters of FY 2019:

- Licensing for SBIC Debenture funds is down 46%
- The number of Green Light Letters issued is down 42%
- The number of first time SBIC licensing applicants is down 83%
- The amount of leverage commitments issues (a leading indicator of future investment) is down 39%

It is worth noting that licensing numbers get the most attention because they are the most easily counted metric and are a clear indicator of future small business investment. However, there are many other areas where there are significant management problems that are mission critical but are not as widely reported or as easily quantifiable. For example, the OII has numerous critical management positions which are sitting vacant and preventing the SBIC program from operating properly, despite having the FTE's and the money appropriated to hire these key staff. The OII has also spent significant financial resources on outside contractors, particularly for computer systems – systems that previously worked, but which and now are collapsing. This testimony includes many other examples.

The SBIC program is a long-term investing platform and the successes for the past several years and the current year are lagging indicators. For example, the majority of licenses issued and the small businesses receiving capital are largely the results of previous OII management. The leading indicators are the result of the current leadership of the SBIC program and are trending very negatively. With the current program management of this otherwise successful small business program, the amount of small business investment is on a downward path where the future will have fewer small business funds with fewer small businesses able to access capital. The current mismanagement is also creating unnecessary risk to the taxpayer.

The President has spoken many times about his commitment to support American small businesses. He has placed an emphasis on manufacturing, on economic growth for underserved areas and people, and on not promoting offshoring of American jobs. These goals are widely shared by this Committee, this Congress, and your constituents. These goals are exactly what the SBIC program does, which is why the program has always had strong bipartisan support. This is a good program doing good work for the American people. It should be allowed to work.

SBIA appreciates the opportunity to present this testimony and looks forward to collaborating with the Committee in its work to ensure the SBIC program continues to benefit America's small businesses with access to the growth capital they need.

On behalf of the small business investors, I look forward to answering any questions you may have.

SBA Management Review:
Small Business Investment Company Program

Prepared by the Small Business Investor Alliance (SBIA)
September 24, 2019

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8. SBIA Letter to Associate Administrator Joe Shepard on licensing delays, February 7, 2019.
9. SBIA Letter to SBA on Reducing Regulatory Burden, August 10, 2018.
10. SBIA Letter to SBA Administrator Linda McMahon on the state of the SBIC program, December 1, 2017.

Studies and Reports on the SBIC Program

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Section One Serious Mismanagement Issues and Hostility Undercutting the Success of the SBIC Program

- **<u>SBIC Program Only Allowed to Work When There is Impending Oversight</u>**. Without public review and Congressional oversight, the current leadership of the SBIC program will not let the SBIC program operate effectively or efficiently, but when there could be public scrutiny the program is allowed to work (albeit only until the threat of oversight wanes).
    - The first licenses for fiscal year 2019 were issued less than 24 hours before the SBA Administrator was scheduled to testify before the Senate Small Business Committee in February 2019.
    - For over two years, the Associate Administrator of OII blocked the release of a Library of Congress report on SBIC Financing of Small Businesses that was favorable to the program. Only after a Freedom of Information Act (FOIA) request by SBIA forced the Associate Administrator to release the report was Congress able to read it. Access to this report was repeatedly sought by this Committee and was repeatedly denied.
        - In the closing months of FY 2018 the rate of Debenture licenses issued dramatically accelerated in advance of the SBA Administrator speaking to a large gathering of small business investors. Shortly thereafter, the pace of licensing again returned to a crawl.
        - A SBIC license was only delivered to the applicant, who had been waiting months for the license documents, when OII was informed that the Administrator was going to be appearing with the home state Senator of the applicant.
        - After waiting for an extended period of time for an approved license to be sent, it was emailed an hour after a Senate office completed SBA's required paperwork before the SBA would talk to the Senate office about the reason for the delays.
        - Several Representatives had to intervene with SBA to get the OII to release the approved licenses of their constituents after months of delays.
        - The Associate Administrator refused to process the surrender of many licenses, some of which had been pending for ten months, until SBIA appealed to SBA leadership in advance of a Congressional hearing.
        - A number of SBIC applicants were approved for a "Greenlight Interview" in July 2019. However, the Associate Administrator would not make himself available to interview the applicants for over five months (i.e., late November 2019). Only after a letter was sent to Congress about these unreasonable delays were the interviews quickly rescheduled for a few weeks later.
        - The small business investing community expects that a number of the metrics for the SBIC program will noticeably improve just prior to this Congressional hearing – and only because of Congressional oversight. However, the small business investing community also expects that shortly after any Congressional oversight of the SBIC program, the current leadership of the Office of Investment and Innovation will quickly return the program to near dysfunction.
        - Senators and Representatives should not have to personally involve themselves in the SBA operations to get the leadership of the Office of Investment and Innovation to do his job.

- **<u>Undercutting the Implementation of Chairman Rubio's "Spurring Business in Communities Act"</u>**. A new law sponsored by Chairman Rubio and Rep. McMorris-Rogers requires SBA to prioritize licensing small business investment funds in underserved states and regions. The Associate Administrator's response to this law has been to gut the staff charged with fulfilling this statutory mandate.
    - The Program Development team had four (4) FTE's prior to the law being signed. This team was responsible for outreach to underserved areas and to educate the small business investing community about how to amplify small business investment by accessing this program.
    - Since the law's enactment, the Associate Administrator has reassigned the people on the team and reduced it to one person: The Director of Program Development. The program's data tells the story. Instead of increasing licensing in underserved states, the number of applicants entering the licensing pipeline has dropped precipitously. Rather than growing the program, it appears that the Associate Administrator's model for achieving small business investor parity between the states is apparently to stunt SBIC growth for all the states.
    - OII finally released guidance on the implementation of this Act on September 10, 2019, with no public notice.

Figure 1:

Program Development and Licensing Activity Applicant Initial Review/Program Development SBA Data through June 30, 2019

SBA'S REPORTED DATA AS OF 6/30/2019	FY 2015	FY 2016	FY 2017	FY 2018 (FIRST FULL FY WITH AA SHEPARD)	FY 2019 (HALF FY THRU 3/31/2019)	FY 2019 (THRU 6/30/19)	YEAR OVER YEAR CHANGE 6/30/2018 VS 6/30/2019
Total Received During FY	48	57	55	39	11	23	**(18%)**
1st Time SBIC Applicants	24	30	27	17	5	8	**(33%)**
Subsequent Fund Applicant	24	27	28	22	6	15	**(6%)**
Processed in FY	44	50	52	41	9	17	**(39%)**
Green Light Letters Issued	25	32	31	28	7	11	**(42%)**

- **Faux-Outreach to the Small Business Investor Community**. Under the Associate Administrator's management, taxpayer money has been spent on outreach that has been poorly handled and, at best, is ineffective and has built a paper trail of faux outreach:
  - The Associate Administrator was so disorganized and late in organizing an "outreach" event in New York that there were only eight attendees – four from SBA and three were asked by SBA to be there on the SBA's panel – one independent attendee.
  - On October 17, 2018, the Associate Administrator held an SBIC rural investing outreach seminar the morning after the SBIC community's annual event which took place over 700 hundred miles away, ensuring minimal participation from SBICs who want to invest in rural areas.
  - On May 21, 2019, the Associate Administrator held an SBIC event in Maine. The only SBIC in Maine was disinvited by SBA from attending.
  - There is no meaningful follow up from OII for their "outreach" events.

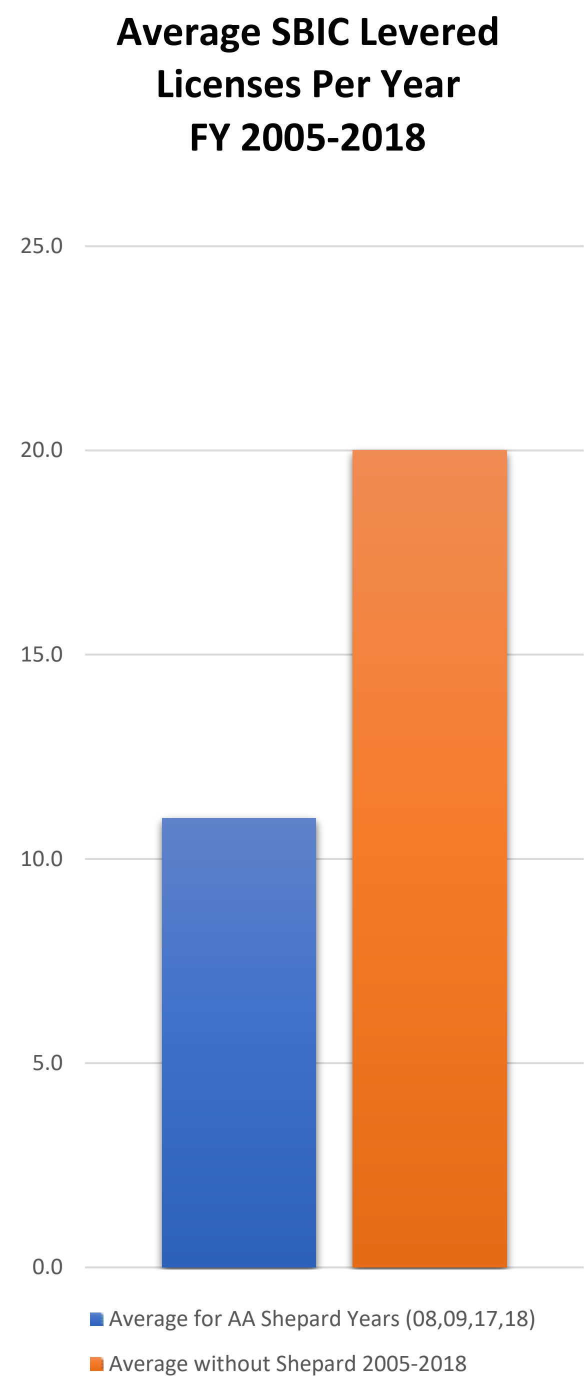
- The OII held three SBIC "Listening Sessions" in 2018. Taxpayers funded mediators to facilitate discussions that have been held for decades directly between SBA and the private sector without intermediaries. There has been no follow up or improvements stemming from these sessions. The private sector put a good deal of effort in preparing constructive input to SBA, but it appears that these events created a paper record of engagement without any outcome or improvement.
    - The Associate Administrator will not participate in any forum where he has not pre-screened all the questions and removed any substantive questions. This approach has been received poorly by small business investors, the institutional investors that provide the provide capital into SBICs, and those considering forming a new SBIC fund. Further, because of the hollowing out of the Program Development Team, there is effectively no follow up to the outreach that has occurred, ensuring minimal positive impact.

- **Refusal to Share with Congress Taxpayer Funded Reports on the SBIC Program**. The taxpayers paid for three (3) in-depth studies of the SBIC program by the Library of Congress in conjunction with academics from Duke and Pepperdine University's business schools. Two of these studies were released during the prior Administration.
    - The final Library of Congress study on the impact of the SBIC program on the health of the private small business capital market was blocked for over two years from release by the Associate Administrator, despite being completed in July 2017.
    - The House and Senate Small Business Committees asked for this completed report, but the Associate Administrator blocked the sharing of the report with the Congress. As the Committee is reauthorizing the SBIC program it is owed full access to all studies on the SBIC program so it can make informed decisions. Further, it is unclear how a single office in an executive branch agency is able to block Congress' own Library of Congress from sharing its research with the authorizing committees of the House and Senate.
    - It is also worth noting that the Senate Small Business Committee submitted numerous questions for the record to the SBA about the SBIC program following a February 2019 hearing with then-SBA Administrator McMahon. Seven months later, it appears the SBA has still not responded with answers to all the Senate Committee's questions about the SBIC program.
    - The Associate Administrator has also blocked the release of the SBA's annual reports for the SBIC program for FY 2015 and FY 2016, which are both completed. There are no annual reports expected for FY 2017 or FY 2018.
    - The SBA has hired dozens of contractors to do studies and work on projects related to the SBIC program. While some of them may be value-producing work, none of these studies have been shared with the public or the committees. The authorizing and appropriating committees are owed the knowledge of what these contractors are being hired to do, what are their results, and how much money is being spent.

- **<u>License Surrenders.</u>** SBICs have a finite life of about 10-12 years. As the SBIC fund winds down it pays off all money owed to the SBA, including fees and leverage. Once the SBA is fully paid off, then the SBIC surrenders its license and ceases to be an SBIC. Prior to the current management, a surrender was a pro forma exercise which was uniformly accepted and processed in a matter of days.
  - Under the current OII management, SBICs have been forced to wait as long as 10 months for the Associate Administrator to approve license surrenders.
  - During these periods of unreasonable administrative delays, forms must be filed, examinations may be required, and as a result SBICs are bearing unnecessary costs; their other active SBICs also can face unnecessary delays or barriers to reserving leverage for prospective investments or advancing an application for a new SBIC licenses.
  - There is no statutory or regulatory reason for these excessive periods of inaction by the Associate Administrator. (*See* SBIA letters dated April 18, 2019, and May 8, 2019, to the SBA regarding this issue in the appendix to this testimony.)
- **<u>Receiving License After Approval</u>**. By statute and regulations, until SBICs have a license in their possession either digital or paper from the SBA, they are not legally licensed and very restricted in their ability to invest in small businesses. Applicants for an SBIC license go through a rigorous, multi-step vetting process. The last vetting is performed by the SBA's "Agency Committee". Prior to current management, the period from approval by the Agency Committee to receiving a license number commonly ranged from 0 to 10 business days. The period to receive a license number now can takes months. There is no reasonable justification for these delays. These delays appear to be caused by several actions/inactions by the Associate Administrator.
  - The Associate Administrator sometimes will not send a license until he has found time on his calendar to personally call the applicant to tell them that they have been licensed. This can take over a month to receive this unnecessary call. In some cases, funds have received a call that they were licensed and then were unsure if they were able to legally operate because they did not receive anything in writing for a very long time. A phone call is not a license to operate a multimillion-dollar fund.
  - An additional source of delays is the inability of the Associate Administrator to submit the paperwork with all the approvals for processing in a timely manner. SBICs and SBA staff have expressed concerns about backdating of documents, and these concerns may be worthy of further investigation.
  - Finally, on numerous occasions it has taken the direct intervention by Members of Congress for the Associate Administrator to release the approved licenses, after extensive delays. (*See* SBIA letters in the appendix to this testimony dated August 10, 2018, February 7, 2019, and February 27, 2019, to SBA and to the Committee regarding these delays.)

Figure 2:

Comparison of SBIC Licensing of Current Management and Historical Norms



- **Green Light Letters**. The first major step in the licensing process is receiving a "Green Light" letter inviting the applicant to apply for a SBIC license subject to meeting or exceeding several SBA-determined criteria.
    - For existing SBIC funds forming a new small business fund, the Green Light process used to take several weeks because the SBA already has detailed performance and regulatory information about the applicant. This process can now take over a year.
    - The Associate Administrator has inserted a series of new unnecessary delays that have severely slowed the formation of more SBIC funds. For example, repeat funds seeking subsequent licenses face unnecessary hurdles and delays despite the SBIC having been in the program for years and the SBA having extensive knowledge of their operations. Repeat SBIC funds are subject to examination delays that can exceed those experienced by first time applicants. Repeat funds must travel to Washington to be re-interviewed at the sole scheduling discretion of the Associate Administrator, which can add months of delay. Prior to the current Associate Administrator, decisions on "Green Lights" would occur shortly after any interview. It now can take several months after the interview to receive the "Green Light" decision.
    - A number of SBIC applicants were approved for a "Greenlight Interview" in July 2019. However, the Associate Administrator would not make himself available for over five months (Late November 2019). Only after a letter was sent to Congress about these unreasonable delays were the interviews rescheduled for July and August 2019.
    - The current Associate Administrator is not only wasting taxpayer money and small business investors' time with these Green Light delays for repeat small business investors, but these new practices are absorbing finite resources that should be deployed to expand the program such as fulfilling the *Spurring Business in Communities Act*, which was signed by President Trump. By statute SBA should be directing its energies to adding more small business investment companies in more parts of the country to gain more small business investment parity.

Figure 3:

SBA'S REPORTED DATA AS OF 6/30/2019 *(In millions)*	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019 THRU 6/30/2019**	**YEAR OVER YEAR CHANGE 6/30/2018 VS 6/30/2019**
Green Light Letters Issued	25	31	32	28	11	**(42%)**

- **<u>Examinations as a Delaying Tool, not as Compliance Tool.</u>** By statute, SBA must examine SBIC funds for regulatory compliance. These examinations are in addition to the normal independent audits performed annually on SBIC funds.
    - Beginning with the current Associate Administrator the examinations process has been used as a tool to insert delays into nearly every core SBIC operation (e.g., licensing, accessing leverage, normal regulatory approvals, surrendering licenses).
    - It is critical to note that the delays that have been created are not because examinations found a violation, but because: 1) the Associate Administrator created new arbitrary timelines completely outside the control of the SBICs; 2) SBA could not schedule an examination in a timely fashion (SBICs have no control over when these exams occur); 3) SBA could not finalize the examination in a timely fashion; 4) The SBA was unable or unwilling to transmit the results to the fund; or 5) the Associate Administrator has inserted himself into the examinations process and the release of the examination to the SBICs adding further delays. Examinations should be used to monitor regulatory compliance.
    - The Associate Administrator has repeatedly misrepresented the issue by accusing SBICs of not being in compliance for examinations. The timing issues and the processing of examinations are solely under the Associate Administrator's control.
    - Even after completing examinations, it now can take up to nine months or longer for SBA to share the examination report with the SBICs, during which time the SBIC is frozen regulatorily and unable to reserve investment leverage or submit a license application.
    - The precipitous drop off in leverage reserved (a measure of future small business investing) and in funds forming is in part due to the misuse of the examination regime. According to SBA's most recent year-to-date data, there has been a 39% drop in the amount of leverage issued/reserved - $958 million. If OII continues to stifle SBICs from reserving leverage for the rest of the fiscal year, the results will be a reduction in leverage issued of just over $1.3 billion, indicating a reduction in future small business investment by about $1.8 billion (assuming 2:1 leverage ratio).

Figure 4:

Debenture Leverage Issued – SBA Data as of June 30, 2019

SBA'S REPORTED DATA AS OF 6/30/2019 *(In millions)*	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019 PARTIAL THRU 6/30/2019**	**YEAR OVER YEAR CHANGE 6/30/2018 VS 6/30/2019**
Leverage Commitments Issued	$2,553	$2,514	$1,960	$2522	$958	**(39%)**

- **Licensing Interviews**. Applicants for an SBIC license, even repeat SBICs, are being required to come to Washington for a personal interview with the Associate Administrator. Applicants are very willing to come in for interviews; however, the Associate Administrator commonly will not schedule the required interview for months – adding unnecessary delay on top of the other delays.
  - The SBIC licensing process is a complicated legal process that is alien to most small business investors. They are experts in growing small businesses, not navigating the federal regulatory gauntlet. As is their right, small business investors use legal/regulatory counsel to help them prepare their applications and to serve as a translator to better understand the government's questions and statements.
    - In some cases, the Associate Administrator has asked to meet privately with applicants without counsel or other SBA staff present, which is not only inappropriate but effectively an offer that applicants cannot refuse without risking additional delays and an adverse decision by the Associate Administrator.
    - The Associate Administrator asks for post-interview materials after almost all interviews, much of which were already in the application, but in a different form. This causes an additional delay.
- **Timing of Regulatory Responses**. Many regulatory decisions are time sensitive with serious ramifications for small businesses, their employees, and the SBICs. SBA must make an informed decision so that SBICs can know how they are allowed to help small businesses. But, instead of making timely informed decisions, matters involving the Associated Administrator are often delayed creating impossible situations for the SBIC and their portfolio companies.
  - For example, SBICs have been faced with the choice of adhering to regulatory timelines or saving a small business and the jobs it provides because the leadership of OII has been unable to decide when to approve a regulatory request in a reasonable time.
- **Refusal to Allow the Office of Investment to Fulfill its Mission by Refusing to Hire**. The Office of Investment and Innovation oversees nearly $30 billion dollars of domestic investment with approximately 88 staff positions. For more than two years, this office has been operating without nearly 20% of its workforce with approximately 17 vacant positions because the Associate Administrator will not approve filling the vacant positions. Many of these positions are mission critical, senior management positions.
  - Vacancies in these positions are causing significant increases in risk to the taxpayer.
  - Some of the vacant leadership positions include: Deputy Associate Administrator (the most senior career management position in the office, Director of Licensing, and two Operations Chiefs (there are only 3 total Operations Chiefs and these staff oversee the regulation and operations of $30 billion dollars).
  - OII may have given these vacant FTE's to other parts of SBA, hindering the ability to fill needed positions once competent management is installed.
- **Inability to Execute Basic Program Operations.** According to the SBA's published Standard Operating Procedures, an applicant for an SBIC license will not be issued a license until after the management team has attended an SBIC Regulations class taught by the SBA. For decades, these classes have been

held at least once a quarter and sometimes more often. However, the SBA has not held or scheduled any SBIC Regulations classes in 2019. The last SBIC Regulations Class was held on November 29, 2018.

- The OII, at the direction of the Associate Administrator, has provided conflicting and inconsistent guidance as to why SBA is not able to hold these classes and what the plan is going forward.
- To the private sector this appears to be one more step in the SBIC process that has collapsed due to mismanagement.
- The SBIA has built an online training platform to replace the class being withheld by the SBA.

- **Inability or Unwillingness to Communicate Effectively with the SBIC Licensees**. Communication is critical in a complicated, highly regulated program like the SBIC program. The communications from OII are minimal and often not informative.
  - For example, the OII informed SBICs that because of the January 2019 shutdown it would delay by one month the due date for certain required filings. However, shortly before the original deadline some funds were informed that the delay was revoked, and they must file their forms by the original deadline. But, shortly after this revocation and without explanation, OII disabled for an extended period the computer systems that allowed SBICs to file their required forms. This made it nearly impossible to comply with these moving deadlines. There was no communication about OII taking the computer system down or when it would reopen. Once the computer system was finally opened up, SBA directed SBICs to wake up and log in at 3:00 am in the morning to access SBA's computer system. The extension date was for a Sunday, initially leaving SBICs unclear as to whether the real deadline was the previous Friday or the following Monday.

- **Data Problems – Collapse of SBIC-Web**
  - As the Associate Administrator testified in June, making changes in information technology systems has been one of his top priorities for the past 2.5 years. This summer, the SBIC Web system, which is the portal by which all financial/regulatory filings are submitted, crashed at the end of the third quarter filing period, causing serious delays, costs, and a loss of regulatory data. SBA eventually extended the filing deadline for 30 days, but by then, the system had been completely inoperable for nearly two weeks, and many funds had incurred significant costs. The SBIC-Web was scheduled to be moved to a faster, more stable cloud-based platform instead of staying on older, internal SBA servers, but that upgrade was blocked by the leadership of the OII. Shortly thereafter, the platform collapsed and regulatory data and filings were lost.

SBIC Program Overview

- The 61-year-old SBIC program is a market-driven platform that serves an important public purpose of facilitating and amplifying private investment into domestic small businesses. President Eisenhower, as the former Allied Commander in World War II, recognized that America had won World War II and would be competing to win the Cold War with the dynamism of American industry and our system of free enterprise as strategic allies. Eisenhower signed the Small Business Investment Act of 1958 and created the SBIC program in part to help ensure that the United States would continue to be a dynamic economy and industrial leader.

- Congress declared in its original authorizing legislation that the SBIC program should "stimulate and supplement the flow of private equity capital and long-term loan funds which small business concerns need for the sound financing of their business operations" while also stimulating the national economy and job growth.[1]

- As of June 30, 2019— three quarters through the fiscal year—the SBIC program included more than 300 licensed funds, representing approximately $30 billion in small business investment capital. Over the last five fiscal years, SBICs have invested $5-6 billion annually in over 1,100 small businesses.[2] Companies that in their early stages received SBIC investments and have subsequently grown into icons of American industry include Federal Express, Apple, Intel, and Callaway Golf. Many more small businesses backed by SBICs have grown from smaller businesses into robust, sustainable mid-sized businesses that bring prosperity and employment to communities across the country.

- SBICs are federally regulated, privately-owned and managed investment funds that invest exclusively in domestic small business. SBICs, primarily formed as limited partnerships, provide long-term loans, equity, or debt-equity investments along with management assistance to small businesses across a range of sectors, geographic locations, and stages of growth. Some SBICs specialize in an industry sector while others invest more broadly. There are various forms of SBICs:

  - *Leveraged (Debenture) SBICs* increase the amount of capital available for domestic small business investing by accessing the SBIC credit facility. SBIC leverage is borrowed at the fund level, not at the small business level.

  - *Non-leveraged SBICs* do not seek or receive SBA leverage. Non-levered funds can provide debt or equity or both. They are able to provide more equity to small businesses than levered (debenture) SBIC funds because they do not need to make interest payments on SBIC leverage. Banks commonly invest some of the Institutional Capital into these funds. These funds have no taxpayer risk.

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[1] Small Business Investment Act of 1958, Pub. L. 85-699 (Aug. 21, 1958). 15 U.S.C. 661.

[2] SBIC Program Overview, U.S. Small Business Administration (March 31, 2019). The number of licenses are inflated because SBA is not reporting a significant number of licenses that have been submitted for surrender or are inactive.

- Bank-Owned SBICs are fully owned or funded by a single bank. Like other non-levered SBIC funds, they do not access leverage and have no taxpayer risk. Like other non-levered SBICs, these bank-owned SBICs can provide debt or equity. Since these SBICs are unlevered, they are able to provide more equity because they do not have interest payments to make on SBIC leverage.

- Most SBICs are Levered (Debenture). These levered SBICs invest private capital that is amplified by access to an SBA-backed credit facility using the Federal Home Loan Bank system. This permits individual SBICs to multiply paid-in private capital up to three-times or up to $175 million, whichever is less. The maximum leverage for an SBIC family of funds (a group that hold multiple SBIC licenses) is currently $350 million. Three times leverage is the statutory limit, which is rarely used and which the SBA will only permit under unusual circumstances. Most levered SBIC funds lever private capital one to two times their private capital.

  - For example, an SBIC may raise $87.5 million in private capital and then, after licensure, may access up to an additional $175 million line of credit (SBA leverage), which combines for a total of $262.5 million – a very large boost in the small business economy. The leverage is provided at a zero-subsidy rate (no appropriation necessary to fund up to $4 Billion a year in SBC leverage) and is eventually paid back in full to the SBA (plus interest andfees).

  - Unlike many government programs, the SBIC private capital is in first-loss position, meaning private investors lose their money before the taxpayer is exposed to risk of loss. In practice there is generally a 33-50% private asset coverage of the leverage. This is an important taxpayer safeguard and a key reason why the SBIC program has been able to maintain its zero-subsidy rate. SBICs are also very different from the SBA's other capital programs because of the Portfolio Effect of the SBICs. A loss in a single small business investment does not have to expose the taxpayer to a loss – no individual small business investments are guaranteed by the taxpayer. Losses in a single investment can be backfilled by the profits of other small businesses in the portfolio. In the other SBA programs (504 and 7a), the government guarantees the performance of each loan to each individual small business and shares first loss position with the private sector (offset by fees).

    - The SBIC program is effective and distinct because the private sector leads with its capital and investment expertise, and then SBIC leverage follows to augment the impact of the private investment. The government does not pick winners and losers, private investors guide capital to the companies with the best potential.

    - It is a mark of SBIC industry pride that the program maintained its zero-subsidy throughout the Great Recession. It is important to SBICs that this zero-subsidy rate be protected by prudent regulatory policies and good program management.

    - This successful alignment of private markets with public goals where private capital leads and the SBA-leverage follows provides SBICs a deeper capital pool from which to make equity and debt investments in qualifying small businesses.

- A recent independent study prepared for the Library of Congress found that SBIC-backed small businesses created almost 3 million new jobs and supported an additional 6.5 million jobs over the 20-year period of their study.[3]

- Another independent Library of Congress study found that "the SBIC program is not only widely diversified by industry sector and geographic subregion but varies from non-SBIC private equity on key dimensions concerning the companies, industries, and regions receiving investments." [4]

- Every one of the jobs created by each of those small businesses was a gain to the communities where they are located and to the broader regions from where they drew employees and to whom they provided goods and services. These businesses and jobs continue on, succeeding independently of SBICs after the investment is completed. These small businesses are not "propped up" or subsidized.

- These investments are in real companies with real staying power and real growth potential.

[3] Paglia and Robinson, Measuring the Role of the SBIC Program in Small Business Job Creation, Report for the Library of Congress, at 4 (January 2017) <https://www.sba.gov/sites/default/files/articles/SBA_SBIC_Jobs_Report.pdf>.

[4] Paglia, J. and D.T. Robinson. (2017). Measuring the Role of the SBIC Program in Financing Small Businesses: A Report Prepared by the Federal Research Division, Library of Congress under an Interagency Agreement with the Office of Investment and Innovation, U.S. Small Business Administration.

SBIC Frequently Asked Questions

How does the SBIC Program Help the Taxpayer and the American Public?

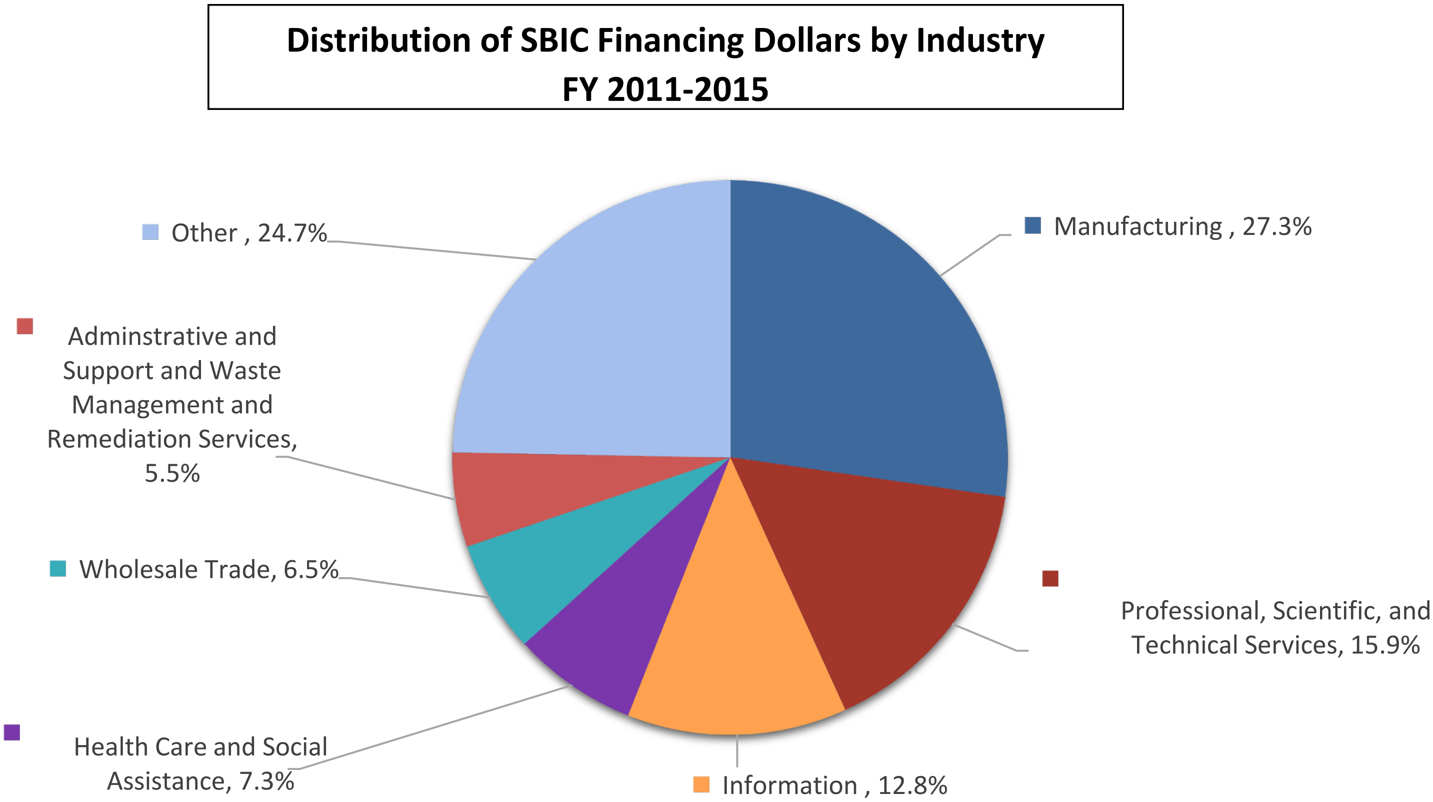
- The SBIC Program helps the taxpayer by providing capital to growing small businesses that in turn hire more employees, invest in capital improvements, and generally grow the economy. A 2017 study by the Library of Congress found that 1 new job was created for every 35 dollars of taxpayers' money spent administering the program. (The leverage operates at zero subsidy, but there are still some administrative costs.) Correlation is not causation, but there is no doubt that the ability of successful small businesses to access growth capital empowers them to grow and hire more employees.

- SBIC investments are made in areas of the country and in industry sectors that are commonly overlooked by conventional venture capital and private equity. The overwhelming percentage of venture capital is invested in Northern California and the New York to Boston corridor.

  While SBICs do invest in those areas, SBICs invest most of their capital in places other than this investment footprint. For example, from 2014-2018, 22% of SBIC investments were in areas certified as Low- Moderate Income. Even SBICs that are primarily located in population centers regularly invest well outside of their local area, so the SBIC program helps move capital to underserved areas – both urban and rural.

- SBIC investments are commonly made in industry sectors largely passed over by many conventional venture capital and private equity funds, including manufacturing and asset-light services businesses.

Figure 3:



** Numbers will not add to 100% due to rounding.*

(Chart *Source*: U.S. Small Business Administration (SBA), *The Small Business Investment Company Program (SBIC): Annual Report; Fiscal Year 2015* (unpublished manuscript, July 13, 2017).)

Is the SBIC Program Effective?

- Yes. Multiple studies, including a 2017 Library of Congress study (attached) have found the SBIC program is very effective at supporting growing small businesses and creatingjobs.
- With modest reforms, it could be even more effective, with broader benefits to more communities.
- There are additional studies completed by the Library of Congress that were supposed to be released in 2017 but have yet to be released by the SBA.

Is the SBIC Program an Efficient Use of Capital?

- Yes. It is one of the most efficient, job-creating programs within the government. According to a 2017 Library of Congress study, only $35 in average administrative government costs were associated with creating each new job. There were only $11 in average administrative costs for each job created or sustained.[5] Further, the fact that the SBIC program's leverage has successfully maintained its zero subsidy for so long is a testament to its operational effectiveness and efficient use of capital.

[5] Paglia and Robinson, supra note 4, at 2.

Is SBIC Investing the Same as Bank Lending?

- No. SBIC investing and bank lending are very different.
- SBICs provide education, training, and professional guidance to their portfolio companies that banks generally do not provide.
- Banks are often only able to provide conventional lending to a small business *after* an SBIC has invested in a small business.
- SBICs provide long-term capital that empowers small businesses to survive and recover from the inevitable surprises that can happen in business.
- SBIC capital can be in the form of debt, equity, or both.
- Banks and SBICs collaborate but offer different types of capital, so they do not compete.

Does SBIC Investment Displace Conventional Bank Lending?

- No. Banks are partners, not competitors to SBICs.
- Banks are often only able to provide capital after a business has received SBIC capital because the SBIC capital changes the capital structure of the business and thereby makes it more"bankable."
- Over 500 banks, ranging from small community banks to large banks, are investors in SBIC funds.
- Some banks own non-levered SBIC funds and other banks are forming their own internal SBIC units to provide equity capital that the banks cannot otherwise provide.
- If small businesses could access this capital from banks, they would get bank loans because there are thousands of banks and conventional bank lending is less expensive.
- The Library of Congress completed a SBIC study in 2017 (that SBA is still blocking the release of) is expected to report that:

  1. SBICs spread capital in a more dispersed manner across the country than conventional venture capital and private equity.
     a. The SBIC program provides funds for deals that are more widely geographically distributed than by the broader fund community.
     b. There is a lower concentration of SBIC capital on the west coast.
     c. More of SBIC funds go to underserved regions in the north and south.
     d. SBICs deploy funds towards different sectors differently than other private sector funding.
     e. SBICs are generally deploy their largest concentration of dollars towards the business-to-business sector. SBICs are also less likely to invest in sectors targeted by other types of financing.
     f. Sectors with high capital requirements, like energy and healthcare are likelyto have lower coverage by SBICs.
  2. SBICs investment supports companies less likely to be considered by traditional private equity investors.
     a. SBICs invest in companies that are less profitable than those invested bytraditional growth capital and debt funds of similar fund size.
     b. SBICs are investing in companies that might look unattractive from the point of view of a traditional private equity investor, either because a company operates in a less profitable sector or because the small business faces risks not attractive to other investors.

Figure 4:

Comparison of Conventional Bank Lending and SBICs

	Bank	SBIC
Provide Debt	Yes	**Yes**
Provide Equity	No	**Yes**
Provide Convertible Debt	No	**Yes**
Provide Unitranche Capital	No	**Yes**
Can revoke capital on 30 to 60-day notice in the event small business hits a snag or if there is a macroeconomic disruption?	Generally, Yes	**No**
Are loans required to be fully collateralized?	Generally, Yes	**No**
Cash flow lending	Limited	**Yes**
Able to provide Capital to businesses that are not otherwise bankable	No	**Yes**
Commonly has a formal role on the Board of the Small Business	No	**Yes**
Provides management assistance to help the small business grow and have good governance	No	**Yes**

Does the Government Own Any Part of these Small Businesses?

- No. The government does not invest in or own any portion of any small businesses.
- There was a time (1994-2004) when the government effectively participated in the ownership of some types of SBIC funds, and therefore the small businesses, but that program ceased licensing these funds 15 years ago (2004).

Is the Government a "Limited Partner" in SBIC Funds or Does It Own a Part of the SBIC Fund?

- No. The government manages access to and guarantees a private sector credit facility but is not a "Limited Partner." The government is in a far more advantaged position than the private sector limited partners because the SBA leverage must be repaid before private investors are repaid.
- The SBA does not own an interest in SBICs or their portfolio companies.
- The SBA stopped being a "fund of funds" and stopped being a "Limited Partner" with the end of licensing funds where the government participated in the profits and losses (last licensed in 2004).
- The SBA is a regulator and a guarantor of the SBIC leverage credit facility.

Figure 5: *Can the 7a and 504 programs do what the SBIC program is doing?*

	SBA 7a	SBA 504	SBA SBIC
Government (Taxpayer) guarantee on each individual investment	Yes	Yes	**No**
Must the small business have collateral or a personal guarantee to loan against?	Yes	Yes	**No**

Does the Government Choose Which Small Businesses Receive Capital?

- All SBIC investments are made entirely by the private sector via investing professionals without the government's direct involvement.
- Investments are made by the private sector for real economic reasons. SBICs invest in growing small businesses and then notify the SBA which small businesses received capital after the investment has been made. There are size standards and other basic requirements and taxpayer protections that must be adhered to, but government involvement stops there.
- The program is successful at creating jobs and growing small businesses because it allows the private sector to find the businesses with the greatest growth potential and direct capital to them.

What Happens if an Investment Underperforms?

- A single SBIC will invest in many different small businesses.
- Unlike the 7a and 504 loan programs, when a single investment underperforms or loses money, only private capital is lost, not taxpayer guaranteed capital (leverage). The profits from the other portfolio investments cover the losses from the isolated underperforming investment(s). If the profits from the other portfolio investments are inadequate to cover all the losses, then the private investors' capital is lost before taxpayer money is at risk. There normally a large private capital cushion that would need to be exhausted before the taxpayer guarantees would be realized.
- Even if the guarantees would be used, SBIC funds pay an annual fee on their leverage that is designed to offset losses and maintain the statutorily required zero subsidy rate. SBA can cut off SBICs from accessing additional leverage or trigger an orderly liquidation process run. Even if a fund is ordered into orderly liquidation, it does not necessarily lose private capital or realize losses for the taxpayer.
- The "annual charge" is a fee on leverage used to prevent taxpayer losses and to maintain the zero subsidy on the program. The current Annual Charge is the lowest rate in the 60+ years of the program because SBICs have done such a good job at investing and protecting the taxpayer. However, SBIA has for some time flagged this record low Annual Charge as worthy of cautious review because at some point investment losses will revert to something closer to the historical norm and SBICs want to make sure the taxpayer is protected for the long term.

What Built-in Accountability Exists in the SBIC Program?

- There is extensive accountability built into the program.
- Private capital being in first-loss position is a very effective accountability tool because there is no "gambling with other people's money." Private capital being in first-loss position is an important, built-in taxpayer safeguard.
- The SBA has reporting obligations that ensure the SBA is fully apprised of the health of the fund, and the funds receive independent audits plus SBA on-site examinations. The SBA can cut off underperforming SBICs from further leverage and can even require disgorgement if an investment does not meet the SBA's statutory and regulatory requirements. SBA can require an orderly wind down of the SBIC and limit SBIC fund managers' compensation. In extreme cases, SBA can remove the fund managers.

Are Repeat Licensees a Good Thing?

- Repeat licensees are exceptionally good for the small businesses and the taxpayer.
- Repeat SBICs specialize in small business investing, which is good for small businesses, the SBA, and ultimately the taxpayer.
- SBICs are only able to receive an additional license if their previous SBIC fund was a success and the private sector was willing to commit its own money first. The private sector leads, and only then can a license be issued: the market speaks before the SBA licenses. Keeping successful fund managers in the program and culling poor performers is one of the reasons the program has been so good at growing businesses and has been able to sustain its zero-subsidy rate.
- Congress recognized the importance of repeat licensees by raising the "family of funds limit" to allow more successful managers to continue to invest more money into more growing small businesses. The GAO studied this issue in 2016 and found repeat licensees were far less likely to be placed by SBA into an orderly wind-down than first time funds.

Is the SBIC Program Stress Tested and Sound?

- The Great Recession and Financial Crisis were a real-life stress test. Unlike other SBA programs, the SBIC Debenture program was able to maintain its zero-subsidy rate.
- Further, many small businesses were able to survive the Great Recession because they were backed by SBICs. Banks were forced by their regulators to pull lines of credit from thousands of small businesses, which then failed. SBIC-backed small businesses benefitted from the longer-term capital provided by SBICs and had a much better chance of surviving.

What can under-licensed states do to get more SBIC small business Investment?

- In general, smaller states that are difficult to reach tend to attract less investment, but investments are still made in those states and more can be done to improve their attractiveness.
- First, since investing in small business is very much dependent on personal relationships, we need to build more of those relationships in under-licensed states. These relationships commonly start with relationships with banks. Getting banks to invest in SBICs would not only provide solid returns to the banks, but it would also create a connection between SBICs and the small businesses served by the local banks.

- Banks in under-licensed states can form their own SBIC fund. These bank-owned, non-levered SBICs can use their extensive networks to provide equity to small businesses and create relationships with both the bank for senior lending and other SBICs for subordinated debt access.

- SBA needs to make the licensing process more consistent because newer, smaller small business investment funds are easily scared off by regulatory uncertainty.

- SBA needs to make it less painful and less expensive to start and run smaller small business investment funds outside of the major money center cities.

- Finally, investment bankers, business brokers, and small business owners themselves can reach out to SBICs and start the business relationship.

Section Three

Appendices

Letters Submitted; Studies and Reports; and SBIC Data

Small Business Investment Company (SBIC) Program Overview

as of June 30, 2019

PROGRAM COMPOSITION

Program Composition of Operating SBICs

	FY End 2015	FY End 2016	FY End 2017	FY End 2018	As of 06/30/19
Total Number of Licensees	**303**	**313**	**315**	**305**	**302**
Debenture	205	216	227	227	225
Participating Security	46	41	33	25	22
Bank-Owned/Non-Leveraged	43	47	47	47	49
Specialized SBICs	9	9	8	6	6
Private Capital of Operating SBICs by Fund Type ($ in millions)					
a. Regulatory Private Capital	**$12,995.0**	**$14,115.3**	**$ 15,014.7**	**$15,808.2**	**$16,332.4**
Debenture	10,414.2	11,357.7	12,259.3	13,252.8	13,366.8
Participating Security	887.8	716.8	504.6	352.3	327.5
Other	1,693.0	2,040.8	2,250.8	2,203.1	2,638.1
b. Leverageable Private Capital	**$ 7,930.5**	**$ 8,897.0**	**$9,565.2**	**$10,015.0**	**$10,221.7**
Debenture	6,413.4	7,309.8	7,974.6	8,533.4	8,633.1
Participating Security	684.7	571.7	383.5	262.5	237.8
Other	832.4	1,015.5	1,207.1	1,219.1	1,350.8
c. Unfunded Private Commitments	**$5,064.5**	**$ 5,218.2**	**$5,449.7**	**$ 5,793.1**	**$6,110.6**
Debenture	4,000.8	4,047.9	4,284.8	4,719.4	4,733.7
Participating Security	203.1	145.0	121.2	89.8	89.7
Other	860.6	1,025.3	1,043.7	983.9	1,287.2
Leverage from SBA of Operating SBICs by Fund Type ($ in millions)					
d. SBA Capital at Risk (e+f)	**$12,351.2**	**$13,696.7**	**$13,996.4**	**$14,280.7**	**$14,242.8**
Debenture	11,883.6	13,356.3	13,810.2	14,203.4	14,193.8
Participating Security	392.6	249.5	96.8	18.0	5.8
Other	75.0	90.9	89.4	59.3	43.2
e. Outstanding SBA Leverage	**$ 9,157.2**	**$10,330.4**	**$10,708.9**	**$10,860.5**	**$11,308.9**
Debenture	8,712.0	10,010.8	10,525.3	10,785.8	11,262.5
Participating Security	384.6	244.6	96.8	18.0	5.8
Other	60.6	75.0	86.8	56.7	40.6
f. Outstanding SBA Commitments	**$ 3,194.0**	**$3,366.3**	**$3,287.6**	**$3,420.2**	**$2,933.9**
Debenture	3,171.6	3,345.5	3,285.0	3,417.6	2,931.3
Participating Security	8.0	4.9	0.0	0.0	0.0
Other	14.4	15.9	2.6	2.6	2.6
g. Unreimbursed Prioritized Payments	**$142.2**	**$113.1**	**$55.5**	**$0.1**	**$0.0**
Combined Private Capital and SBA Capital at Risk of Operating SBICs ($ in millions)					
h. Total Capital at Risk (a+d)	**$25,346.2**	**$27,812.0**	**$29,011.1**	**$30,088.9**	**$30,575.2**
Debenture	22,297.8	24,714.0	26,069.5	27,456.2	27,560.6
Participating Security	1,280.4	966.3	601.4	370.3	333.3
Other	1,768.0	2,131.7	2,340.2	2,262.4	2,681.3

Small Business Investment Company (SBIC) Program Overview

as of June 30, 2019

Program Composition in Liquidation ($ in Millions)	FY End 2015	FY End 2016	FY End 2017	FY End 2018	as of 06/30/19
Total Number of Licensees	115	104	97	87	87
Participating Security	81	76	72	66	65
Other	34	28	25	21	22
Leverage Balance	**$959.2**	**$810.5**	**$671.7**	**$413.1**	**$411.6**
Participating Security	697.5	571.1	451.8	257.1	249.3
Other	261.7	239.4	219.9	156.0	162.3

Program Funding ($ in millions)					
Debenture Authorization ($ in Millions)	**$4,000.0**	**$4,000.0**	**$4,000.0**	**$4,000.0**	**$4,000.0**
Annual Charge	*0.742%*	*0.672%*	*0.347%*	*0.222%*	*0.094%*
Average Debenture Pooled Interest Rate	*2.68%*	*2.29%*	*2.70%*	*3.35%*	*N/A*

ECONOMIC IMPACT: SBIC FINANCINGS TO SMALL BUSINESS REPORTED *

Total SBIC Program

	FY End 2015	FY End 2016	FY End 2017	FY End 2018	As of 06/30/19	Chg. from 06/30/19
Financing Amount Reported ($ in millions)	**$6,285.5**	**$5,991.7**	**$5,727.3**	**$5,502.6**	**$4,321.3**	**7%**
Type of Financing ($ in millions)						
Straight Debt	3,810.5	3,791.7	3,720.2	3,543.0	2,578.1	(0%)
Debt with Equity Features	1,351.2	1,157.1	859.8	807.3	607.6	1%
Equity Only	1,123.8	1,042.9	1,147.4	1,152.2	1,135.6	35%
Number of Companies Financed	**1,210**	**1,201**	**1,077**	**1,151**	**950**	**5%**
Special Competitive Opportunity Gap	288	332	308	315	233	(3%)
Businesses Located in LMI Areas*	229	284	262	265	197	(6%)
Women, Minority, Veteran Owned*	73	61	68	66	46	10%
Number of Jobs Created or Sustained**	**129,749**	**122,382**	**112,865**	**106,021**	**82,064**	**5%**

Debenture SBICs

Financing Amount Reported ($ in millions)	**$5,939.6**	**$5,653.8**	**$5,353.8**	**$5,159.0**	**$4,011.0**	**6%**
Type of Financing ($ in millions)						
Straight Debt	3,701.8	3,665.5	3,617.6	3,422.1	2,495.3	(0%)
Debt with Equity Features	1,265.9	1,110.6	835.4	791.8	587.6	(1%)
Equity Only	971.9	877.7	900.9	945.0	928.1	33%
Number of Companies Financed	**1,010**	**986**	**904**	**940**	**801**	**9%**
Special Competitive Opportunity Gap	226	260	245	238	190	7%
Businesses Located in LMI Areas*	182	232	212	206	162	3%
Women, Minority, Veteran Owned Businesses*	51	35	47	39	36	33%

Number of Jobs Created or Sustained**	122,608	115,481	105,505	99,400	76,171	4%

Non-Leveraged, Bank-Owned, and Specialized SBICs

	FY End 2015	FY End 2016	FY End 2017	FY End 2018	As of 06/30/19	Chg. from 06/30/18
Financing Amount Reported ($ in millions)	$300.1	$307.0	$357.7	$328.0	$300.8	35%
Type of Financing ($ in millions)						
Straight Debt	98.8	116.5	94.1	111.9	76.3	5%
Debt with Equity Features	72.6	38.2	23.4	13.4	18.5	91%
Equity Only	128.8	152.3	240.1	202.6	206	47%
Number of Companies Financed	147	203	189	236	171	(6%)
Special Competitive Opportunity Gap	48	70	67	84	48	(26%)
Businesses Located in LMI Areas*	34	50	54	66	40	(27%)
Women, Minority, Veteran Owned*	21	26	22	27	10	(33%)
Number of Jobs Created or Sustained**	6,196	6,271	7,048	6,319	5,712	33%

Participating Security SBICs

Financing Amount Reported ($ in millions)	$46.8	$30.9	$15.8	$15.7	$9.5	(13%)
Type of Financing ($ in millions)						
Straight Debt	9.9	9.7	8.6	9.0	6.5	12%
Debt with Equity Features	12.8	8.3	0.9	2.0	1.5	200%
Equity Only	24.1	12.9	6.3	4.6	1.5	(67%)
Number of Companies Financed	53	40	23	15	10	(23%)
Special Competitive Opportunity Gap	14	9	6	3	1	(67%)
Businesses Located in LMI Areas*	13	9	6	3	1	(67%)
Women, Minority, Veteran Owned*	1	0	0	0	0	0%
Number of Jobs Created or Sustained**	945	630	312	302	182	(14%)

* The Office of Investment and Innovation reports financing information based on data collected on the SBA Form 1031. Information is aggregated, by fiscal year, based on the date of the submission of the form and not on the date of the financing to the small business.

** SBA estimates jobs created or sustained using "The 1999 Arizona Venture Capital Impact Study" (confirmed by the DRI-WEFA study of 2001) indicating that 1 job is created for every $36,000 of SBIC Program investment (adjusted for inflation).

PROGRAM OFFICE ACTIVITIES

New Licensees

New Licensees by Fund Type	25	21	15	25	10	(38%)
Debenture	22	17	11	21	7	(46%)
Bank-Owned/Non-Leveraged	3	4	4	4	3	0%
Initial Private Capital ($ in millions)	$1,236.4	$1,188.0	$831.7	$1,224.1	$761.3	(9%)
Debenture	1,204.1	893.0	656.5	1,137.9	513.8	(32%)
Bank-Owned/Non-Leveraged	32.3	295.0	175.2	86.2	247.5	205%

Small Business Investment Company (SBIC) Program Overview

as of June 30, 2019

Licensing Pipeline *	FY End 2015	FY End 2016	FY End 2017	FY End 2018	as of 06/30/19	Chg. from 06/30/18
Total in Pipeline	37	49	62	53	55	(7%)
In Applicant Review/Program Development	13	20	22	20	26	18%
In Capital Raising	14	22	26	23	21	(5%)
In Licensing	10	7	14	10	8	(47%)

Program Development and Licensing Activity **						
Applicant Initial Review/Program Development						
Received during FY	**48**	**57**	**55**	**39**	**23**	**(18%)**
1st Time SBIC Applicants	24	30	27	17	8	(33%)
Subsequent Fund Applicants	24	27	28	22	15	(6%)
Processed in FY	**44**	**50**	**52**	**41**	**17**	**(39%)**
Green Light Letters Issued	**25**	**32**	**31**	**28**	**11**	**(42%)**
% of Processed Receiving Green Light	*57%*	*64%*	*60%*	*68%*	*65%*	*(4%)*
1st Time SBIC Applicants	11	10	18	10	5	(38%)
Subsequent Fund Applicants	14	22	13	18	6	(45%)
Number Denied -- 1st Time and Subsequent	17	15	15	7	3	(40%)
Number Withdrawn -- 1st Time and Subsequent	2	3	6	6	3	(25%)
Capital Raising Completed/Terminated						
Green Light Letters Expired/Other	**10**	**0**	**5**	**7**	**4**	**0%**
Licensing Applications Submitted						
Total, Capital Raising Completed/Terminated	**25**	**24**	**22**	**24**	**8**	**(58%)**
% in Capital Raising	35	24	27	31	12	(48%)
Completed/Terminated Submitting Applications	*71%*	*100%*	*81%*	*77%*	*67%*	*(19%)*

Small Business Investment Company (SBIC) Program Overview

as of June 30, 2019

Licensing * * *

	FY End 2015	FY End 2016	FY End 2017	FY End 2018	As of 06/30/19	Chg. from 06/30/18
Received during FY	**25**	**24**	**22**	**24**	**8**	**(58%)**
1st Time SBIC Applicants	15	2	9	8	1	(83%)
Subsequent Fund Applicants	10	22	13	16	7	(46%)
Otherwise Resolved During FY	7	6	0	3	1	(50%)
FY Number of New Licensees	**25**	**21**	**15**	**25**	**10**	**(38%)**
1st Time SBIC Applicants	12	8	1	11	4	(33%)
Subsequent Fund Applicants	13	13	14	14	6	(40%)
Average Months to Process	8.4	5.8	5.1	8.2	7.8	3%

* OII re-evaluated the data collection in the Office of Program Development. Consequently, the content of Licensing Pipeline, for previous years, was updated and therefore may not be consistent with previously issued Program Overview reports.

** OII identified several historical data discrepancies. Consequently, the content of Program Development and Licensing Activity, for previous years, was updated and therefore may not be consistent with previously issued Program Overview reports.

* * * FY2019 Licensing data has been adjusted for the lapse in appropriations.

Leverage Activities in Operations

Debenture Leverage						
Commitments Issued	$2,553.0	$2,514.3	$1,959.8	$2,521.9	$958.2	(39%)
Draws	$2,337.4	$2,157.6	$1,901.8	$2,118.7	$1,394.5	(14%)
Redemptions (Pre-Paid and at Maturity)	$806.1	$807.8	$1,372.0	$1,893.5	$920.2	25%
Transfers to Liquidation	$ 26.5	$38.6	$42.4	$0.0	$13.7	100%
% of Beginning Leverage Transferred	*<1%*	*<1%*	*<1%*	*0%*	*0.10%*	*100%*
Participating Securities Leverage						
Prioritized Payments (PP) Advanced	$28.4	$15.5	$8.9	$3.3	$0.3	(90%)
SBA Distributions	**$201.6**	**$137.4**	**$73.1**	**$56.6**	**$12.1**	**(69%)**
Prioritized Payments	$24.8	$13.1	$1.8	$4.0	$0.0	(100%)
Adjustments and Annual Fees	$3.7	$4.0	$0.4	$17.0	$0.0	(100%)
Profit Participation	$13.3	$5.1	$11.3	$13.6	$1.1	(91%)
PS Redemptions--Operating SBICs	$159.8	$115.2	$59.6	$21.9	$11.0	(40%)
Transfers to Liquidation	$109.2	$22.8	$49.3	$51.7	$1.2	(98%)
% of Beginning Leverage *Transferred*	*18%*	*7%*	*25%*	*60%*	*10%*	*(83%)*
Prioritized Payments at Transfer	$42.8	$11.1	$49.6	$59.2	$0.3	(99%)

Small Business Investment Company (SBIC) Program Overview

as of June 30, 2019

SBIC Examination Activities

	FY End 2015	FY End 2016	FY End 2017	FY End 2018	as of 06/30/19	Chg. from 06/30/18
Exam Reports Issued	**222**	**186**	**167**	**177**	**97**	**15%**
Exam Cycle (months)	12.7	13.0	16.3	17.3	16.7	(7%)
% of Reports with Major Findings	*19%*	*19%*	*17%*	*24%*	*15%*	*(44%)*
Licensees with Leverage	**173**	**137**	**126**	**139**	**74**	**19%**
Exam Cycle (months)	11.2	11.5	15.4	16.9	15.6	42%
% of Reports with Major Findings	*21%*	*19%*	*19%*	*26%*	*18%*	*(38%)*
Licensees without Leverage	**49**	**49**	**41**	**38**	**23**	**5%**
Exam Cycle (months)	18.1	17.1	19.2	18.8	20.1	1%
% of Reports with Major Findings	*8%*	*18%*	*12%*	*16%*	*5%*	*(78%)*

Surrenders and Transfers to Liquidation

	FY End 2015	FY End 2016	FY End 2017	FY End 2018	as of 06/30/19	Chg. from 06/30/18
SBIC License Surrenders	**13**	**7**	**7**	**31**	**11**	**(58%)**
Debenture	4	3	0	21	10	(38%)
Participating Security	4	4	3	5	1	(80%)
Bank-Owned/Non-Leveraged	5	0	4	4	0	(100%)
Specialized SBICs	0	0	0	1	0	(100%)
SBIC Licensee Transfers to Liquidation	**3**	**2**	**6**	**4**	**2**	**(50%)**
Debenture and Specialized SBICs	0	1	1	1	1	0%
Participating Security	3	1	5	3	1	(67%)

Activities in the Office of Liquidation

	FY End 2015	FY End 2016	FY End 2017	FY End 2018	as of 06/30/19	Chg. from 06/30/18
Participating Security Leverage						
Total Leverage Collections	**$170.7**	**$98.6**	**$118.4**	**$200.0**	**$10.2**	**(91%)**
Collections *as % of Beginning Leverage*	*22%*	*14%*	*21%*	*44%*	*4%*	*(85%)*
Leverage Write-offs	$34.4	$52.5	$51.4	$89.9	($0.7)	(104%)
Prioritized Payments Collections	$14.1	$2.7	$0.4	$50.7	$0.8	(88%)
Prioritized Payments Write-offs	$55.9	$15.7	$14.0	$14.6	$0	0%
Debenture Leverage						
Total Leverage Collections	**$83.6**	**$54.0**	**$37.8**	**$9.2**	**$7.4**	**(77%)**
Collections as % of Beginning Leverage	*24%*	*21%*	*16%*	*4%*	*5%*	*(67%)*
Leverage Write-offs	$36.0	$7.1	$24.7	$12.7	$0.0	(100%)

SBIC Program

Financing to Businesses by State

Fiscal Year 2014 through Fiscal Year 2018

	----------- FISCAL YEAR 2018 ---------			----------- FISCAL YEAR 2017 ---------			----------- FISCAL YEAR 2016 ---------			----------- FISCAL YEAR 2015 ---------			----------- FISCAL YEAR 2014 ---------		
State Name	# of Financings	# of Businesses	Amount of Financing ($M)	# of Financings	# of Businesses	Amount of Financing ($M)	# of Financings	# of Businesses	Amount of Financing ($M)	# of Financings	# of Businesses	Amount of Financing ($M)	# of Financings	# of Businesses	Amount of Financing ($M)
Alabama	1	1	9.6	5	4	17.3	8	7	71.4	9	3	21.6	7	6	42.1
Alaska	4	1	1.7	4	1	14.4	0	0	0.0	1	1	20.0	0	0	0
Arizona	56	26	96.6	62	18	168.5	79	26	95.5	57	24	82.8	33	21	64.7
Arkansas	13	5	53.4	11	6	24.6	5	2	6.5	28	5	57.6	11	1	2.8
California	392	175	1,049.1	447	189	993.5	483	192	1,041.3	438	196	1,015.3	297	151	765.7
Colorado	74	30	121.8	71	28	155.7	84	30	160.3	71	23	164.5	47	21	133.1
Connecticut	26	15	55.4	22	8	28.9	32	17	102.5	32	15	64.5	42	18	130.9
Delaware	3	2	2.4	4	3	16.6	9	3	20.3	5	2	27.0	5	5	9.4
District of Col.	7	5	14.7	3	2	2.0	5	3	6.0	0	0	0	1	1	0.3
Florida	154	63	256.5	202	70	417.8	176	62	418.5	217	74	476.6	136	52	335.1
Georgia	61	28	147.2	87	28	163.2	124	49	250.6	101	37	183.6	74	32	223.5
Guam	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Hawaii	0	0	0	0	0	0	0	0	0	1	1	0.5	3	1	1.8
Idaho	8	4	35.3	7	5	9.3	7	3	22.1	4	3	5.0	6	3	15.6
Illinois	164	66	341.5	184	46	288.7	222	70	386.0	172	52	244.5	118	49	252.2
Indiana	45	16	96.7	50	16	104.3	34	16	32.8	27	15	142.9	24	8	53.2
Iowa	4	2	4.1	5	2	16.0	4	3	18.6	1	1	1.8	6	3	23.4
Kansas	30	16	58.0	25	9	20.5	36	13	75.4	29	10	53.9	20	12	21.7
Kentucky	6	5	28.7	8	5	49.3	12	6	15.4	23	9	25.7	11	5	14.7
Louisiana	16	8	104.1	20	8	55.3	29	10	55.2	32	14	74.1	36	10	53.8
Maine	12	7	34.1	6	3	18.8	5	3	26.1	5	3	8.6	3	2	4.2
Maryland	42	11	57.0	38	16	76.0	36	12	61.3	32	17	126.5	18	12	33.4
Massachusetts	105	53	258.5	96	51	229.1	126	60	264.3	144	71	286.4	138	73	231.5
Michigan	72	28	116.6	59	20	133.7	44	21	107.7	83	36	254.4	18	12	82.1
Minnesota	69	28	92.7	124	30	185.2	83	29	145.3	55	26	165.7	54	26	166.3
Mississippi	7	4	26.4	17	3	17.6	22	3	21.5	7	2	6.4	2	2	23.4
Missouri	91	23	108.9	63	24	85.7	46	17	68.2	51	22	107.7	37	16	99.0
Montana	14	3	23.4	11	2	12.4	4	1	23.0	1	1	1.0	4	1	4.9
Nebraska	11	6	52.7	11	5	37.7	2	2	11.8	2	1	10.5	5	3	20.4
Nevada	7	4	23.3	6	3	1.3	12	2	16.7	16	4	53.5	6	3	29.6
New Hampshire	9	6	25.5	13	5	26.3	9	6	34.5	2	2	7.9	15	9	43.3
New Jersey	111	46	241.9	87	37	208.7	81	30	166.8	86	52	152.0	110	59	167.0
New Mexico	4	2	2.2	5	3	15.3	10	6	17.2	11	5	20.9	5	3	3.6
New York	233	124	482.6	178	94	389.9	247	123	373.1	183	108	329.0	236	139	506.1
North Carolina	72	28	138.5	84	36	167.3	114	40	164.5	140	41	198.8	137	49	271.5
North Dakota	21	2	10.3	18	4	12.9	16	4	15.0	0	0	0	0	0	0
Ohio	97	48	135.9	61	29	111.5	95	41	297.0	57	28	132.7	45	22	111.9
Oklahoma	27	8	29.8	22	10	27.8	32	12	52.1	40	15	65.2	31	9	36.7
Oregon	40	16	118.7	19	11	44.5	14	9	34.7	27	10	142.3	24	10	57.7
Pennsylvania	77	31	130.0	134	40	317.3	99	37	254.4	110	50	331.1	68	33	228.0
Puerto Rico	3	2	2.8	1	1	1.5	3	2	9.0	0	0	0	3	2	5.6
Rhode Island	9	2	10.0	3	2	1.1	4	2	15.7	6	2	6.1	6	3	10.6
South Carolina	18	10	53.6	49	10	46.0	36	16	98.4	14	7	38.5	33	13	73.2
South Dakota	3	2	20.0	0	0	0	2	1	0.4	2	1	8.5	9	3	30.4
Tennessee	48	23	123.2	50	25	124.7	44	19	100.2	43	20	73.6	41	21	137.5
Texas	276	89	427.6	253	94	486.1	273	107	527.4	269	108	701.9	237	85	538.2
Utah	49	31	75.6	43	23	61.3	57	34	90.6	71	40	125.4	39	21	129.5
Vermont	2	1	3.0	1	1	3.1	2	1	16.5	4	1	8.9	6	5	30.8
Virgin Islands	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Virginia	47	19	72.1	37	21	153.8	36	21	75.6	33	16	73.4	52	23	90.7
Washington	33	10	37.4	41	12	79.7	28	10	41.9	43	21	107.8	25	15	90.3
West Virginia	0	0	0	0	0	0	0	0	0.0	1	1	0.3	0	0	0
Wisconsin	37	15	91.3	32	14	105.3	29	17	78.0	29	14	79.0	25	12	63.0
Wyoming	1	1	0	0	0	0	2	1	4	0	0	0	0	0	0
	2,711	1,151	$5,502.6	2,779	1,077	$5,727.3	2,962	1,201	$5,991.7	2,815	1,210	$6,285.5	2,309	1,085	$5,464.6

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September 13, 2019

The Honorable Marco Rubio
Chairman
U.S. Senate Committee on Small Business
& Entrepreneurship
428A Russell Senate Office Building
Washington, DC 20515

The Honorable Ben Cardin
Ranking Member
U.S. Senate Committee on Small Business
& Entrepreneurship
428A Russell Senate Office Building
Washington, DC 20515

RE: SBIC Program 3rd Quarter FY2019 Data

Dear Chairman Rubio, Ranking Member Cardin, and Members of the Committee:

We thank you for holding the June 26th hearing entitled "Reauthorization of SBA's Small Business Investment Company Program." The Committee took a serious look at the Office of Investment and Innovation's (OII) management of the SBIC program. With several months having passed, we would like to share with Congress some updates on the program since the hearing.

In mid-August, SBA finally released the SBIC program data for the first three quarters of the fiscal year:

- Total new SBIC license issuance (for Levered and Non-levered funds) is down 38% compared to the comparable three quarters of the previous fiscal year.
- Licensure of Levered SBIC funds are down 46% year over year.
- Green Light letters issued, the first step in advancing in the licensing process, were down 42%, meaning that significantly fewer funds are being given the go-ahead to pursue an SBIC license.
- Debenture commitments are a leading indicator of future small business investments. SBA reports new commitments issued are down 39%. As of June 30, 2019, SBA had issued $958.2 million in debenture leverage commitments and, if this rate continues, then SBA is on pace to issue $1.286 billion in debenture commitments for FY 2019. This would be a decline of nearly 50% from FY 2018.
- SBA reports that zero dollars of SBIC debentures have been written off in the Office of Liquidation. This is a strong testament to the health of the economics of the program and further evidence that it should be strengthened instead of choked off.

The Associate Administrator for OII has not filled the management or general staff vacancies that Senators questioned him about during the June hearing. The Deputy Associate Administrator position remains vacant as does the Director of Licensing. The Office of Program Development, charged with helping SBICs form in underserved parts of the country, has been reduced to one employee. In addition, two of the three Operations Managers (aka "Area Chief" positions) remain vacant, and several new analyst vacancies have arisen with the departure of other career staff since the hearing. Rather than fill positions, it appears that FTE's have been removed from this division and ceded to other parts of the SBA. The OII has not filled a staff vacancy since February 2018.

As the Associate Administrator testified in June, making changes in information technology systems has been one of his top priorities for the past 2.5 years. This summer, the SBIC Web system, which is the portal by which all financial/regulatory filings are submitted, crashed at the end of the third quarter filing period, causing serious delays, costs, and a loss of regulatory data. SBA eventually extended the filing deadline for 30 days, but by then, the system had been completely inoperable for nearly two weeks, and many funds had incurred significant costs. It should be noted that the SBIC Web was recommended to be moved to a more stable cloud-based platform instead of staying on older, internal SBA servers, but that upgrade was blocked by the leadership of the OII.

For several years, the Associate Administrator has blocked multiple requests by Members of Congress and the private sector to release a completed Library of Congress study entitled, "Measuring the Role of the SBIC Program in Financing Small Businesses." In August, using the Freedom of Information Act, SBIA was able to force the release of the study that had been denied to Congress and the public. The researchers, professors from top business schools, had access to SBA's confidential internal data on SBICs and their investments. It says a great deal about the leadership of the Office of Investment that he would try to hide from Congress and the public independent information like the following:

- *"the authors found that the SBIC program is not only widely diversified by industry sector and geographic subregion, but varies from non-SBIC private equity funding on key dimensions concerning the companies, industries, and regions receiving investments." (p. 1)*

- *"SBICs invest in companies that are smaller than those funded by traditional private equity sources of similar size and investment focus." (p. 2)*

- *"SBIC investments fund different sectors than the rest of the private equity universe." (p. 2)*

- *"SBIC investments spread capital in a more dispersed manner across the country than traditional investors.*
    - *"the majority of SBIC funds invest in traditionally underserved regions of the United States, particularly Kansas, Minnesota, Nebraska, North Dakota, and South Dakota in the northern Midwest, and Alabama, Kentucky, Mississippi, and Tennessee in the South." (p. 2)*
    - *"...SBICs have higher capital distribution ratios among small businesses and distribute capital more evenly among nine geographic subregions." (p. 2)*

- *"Based on this data, SBICs reflect a broader and more consistent geographic presence than private capital funds on all three counts measured: total number of deals, relative concentration across subregions, and business population per deal ratio." (p. 40)*

- *"SBIC funds contributed capital in all seven major industrial sectors during the sample period." (page 41)*

- *"SBIC investment capital is spread much more evenly across the United States; much less is concentrated in the traditional hubs of private equity investment activity like the Pacific subregion, which is home to Silicon Valley. The authors' analysis of the geographic dispersion of investments revealed that SBIC funds contributed capital in all four geographic regions and nine subregions of the United States." (pp. 41-2)*

We thank you for your support in increasing access to capital for American small businesses. We look forward to working with you to strengthen this job-creating program to expand prosperity across a broader swath of the country and to more Americans.

Sincerely,

Brett Palmer
President
Small Business Investor Alliance

CC: Senate Small Business Committee
House Small Business Committee
Senate Appropriations Committee
House Appropriations Committee

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August 15, 2019

Office of the Ombudsman
U.S. Small Business Administration
409 3rd Street SW
Washington, DC 20416

Re: **<u>SBIA Testimony and Report for SBA's National Regulatory Fairness Hearing</u>**

The Small Business Investor Alliance ("SBIA") offers the following report about the Small Business Investment Company ("SBIC") program as our testimony for SBA's National Regulatory Fairness Hearing. This report was also recently submitted to Congress to inform them of what is happening to the SBIC program. SBIA is the national association that has represented the Small Business Investing Companies since their inception over 60 years ago.

Most Small Business Investment Companies are themselves small businesses. It is not uncommon for SBICs to have 3-5 employees. For decades SBICs have been an American success story and are an example of a successful public policy that aligns the power of private market with the public interest of job creation and economic growth. SBICs invest exclusively in domestic small businesses, creating jobs and empowering American small businesses to compete in a global economy.

Given the mission of SBA, the fact that most SBICs are small businesses, and that SBICs help thousands of small businesses grow, it is out of a deep sense of exasperation that we must seek the aid of the SBA's Ombudsman to get the SBA's Office of Investment to cease the hostile regulatory treatment by the leadership of the Office of Investment and Innovation toward small business investors. Our testimony includes a lengthy section (Section 3) documenting a sampling of the mismanagement that is currently plaguing the SBIC program and thereby harming small businesses and creating unnecessary risks to the taxpayer. SBICs now have come to expect that every regulatory question that arises will likely have an adverse outcome or inexplicable extended delays. For example:

- Delays in receiving completed examination results have created hardships for many SBIC funds, in advancing in the licensing process or accessing capital. There are SBICs who whose regulatory examinations were completed and paid for (by the SBIC) in October 2019, but who still do not have the results of their exams. These SBA exams are so delayed that the new exams have already begun without knowing the outcome of the prior years.
- SBIC must do regulatory reporting through the "SBIC-Web" system. A system failure that occurred at the end of the 2nd quarter resulted in SBA losing data for many funds who had already spent hundreds of work hours completing their filings. SBICs must now waste their time and money completing this work. SBICs were already spending over $100,000 dollars a year on complying with SBA regulations and these data losses will increase those costs.
- SBIC funds going through the "green light" licensing approval process have faced lengthy administrative delays simply because the Associate Administrator refused to schedule meetings or interviews in a timely manner.

SBIA appreciates the opportunity to present these comments and looks forward to collaborating with the Ombudsman to strengthen the SBIC program and to ensure America's small businesses and the communities they serve have access to the capital they need. On behalf of the small business investors, I look forward to answering any questions you may have.

Sincerely,

Brett Palmer
President
Small Business Investor Alliance

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May 8, 2019

Joseph Shepard
Associate Administrator
Small Business Administration
403 3rd Street SW
Washington, DC 20024

Dear Associate Administrator Shepard,

As the person responsible for managing the Small Business Investment Company (SBIC) program, the small business investors feel the need to raise another important issue with you.

As you know, SBIC funds are licensed and regulated by your office, the Office of Investment and Innovation (OII). SBICs have a finite life and are entitled to surrender their license once all SBIC leverage has been paid back. SBIC funds that were never leveraged are able to surrender their licenses at any time. There are more than a dozen SBIC licenses that have paid back all leverage and submitted their licenses for surrender. Some of these surrenders were submitted well over nine months ago, yet they await your acceptance of the surrender. These are unreasonable administrative delays that serve no purpose in helping small businesses, creating jobs, protecting the taxpayer, or benefitting the investors into the SBIC. To the contrary, these arbitrary, capricious, and inexplicable delays add costs to both the taxpayer and the SBIC fund manager, reduce returns to limited partners, and display another general breakdown in the basic operating abilities of the OII. These would-be-surrendered licenses are still accruing not only direct administrative and examination costs, but SBA may also demand exams on these winding down SBICs to delay the processing of new applications or accessing leverage for their other younger active SBIC funds.

The success of this small business program is dependent on basic functions of the program operating in a reasonable and dependable manner, which they are not doing. The inability of SBIC funds to exit the program adds to the current chilling effect on small business investors considering forming a new SBIC fund. It is important to note there are more small business investors trying to surrender their licenses than have been new SBICs licenses issued this fiscal year.

As the trade association representing SBIC funds and their limited partners, we formally ask:

- That you immediately process all license surrenders that have been submitted;
- OII have the surrender documents include an accurate date as to when the surrender was signed and approved by SBA (no backdating);
- OII provide email or other written confirmation to the SBIC of the surrender and the date of approval for the surrender; and
- On a going forward basis, OII process all license surrenders within a two week period.

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The small business investors have numerous other concerns about the mismanagement of the SBIC program, but this issue is an issue that can be fully addressed in minutes. Please do so.

Sincerely,

Brett Palmer
President

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April 18, 2019

The Honorable Christopher Pilkerton
Acting Administrator and General Counsel
Small Business Administration
403 3rd Street SW
Washington, DC 20024

Dear Acting Administrator Pilkerton:

The Small Business Investor Alliance (SBIA) is the trade association representing small business investors, the Small Business Investment Companies (SBIC), and limited partners investing via SBICs. As the new Acting Administrator of the Small Business Administration, we would like to draw your attention to the management of the Small Business Investment Company program which is now under your oversight.

The SBIC program is a proven job-creating program driven by the private sector and enhanced by the SBA via leverage. When allowed to function properly the SBIC program increases the capital available to growing small businesses. The SBIC program has not been allowed to function properly since the appointment of Joseph Shepard to run the Office of Investment and Innovation (OII). Through the first two quarters of FY 2019, some of the effects of mismanagement of the SBIC program have been clear and quantifiable. Below is a sampling of the performance through the first half of FY 2019:

- OII has one of the worst SBIC licensing rates in decades (only 4 licenses issued and received).
    - Only 2 SBIC Debenture funds received a license through the first half of the fiscal year.
        - Both licenses delivered immediately prior to Congressional Oversight hearing
    - Only 2 non-levered SBIC funds received a license through the first half of the fiscal year.
        - 1 license delivered immediately prior to Congressional Oversight hearing
    - Only 1 new SBIC platform was licensed (1 of the 2 non-levered funds) through the first half of the fiscal year.
        - License delivered immediately after Congressional inquiry into status of license.
        - No new levered SBIC platforms licensed
- More than 3 times as many SBICs surrendered their licenses than received a license.
    - 14 licenses have been submitted for surrender through the first half of FY 2019.
    - These license surrenders are in legal limbo because they have been pending on Associate Administrator Shepard's desk for up to 6 months, despite having fully paid off all of their leverage to the SBA. There is no justification for these unreasonable administrative delays.

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- OII only issued $690 million in leverage commitments to SBICs.
    - OII is currently on pace to have a 45% decrease (over $1 Billion less) in SBIC leverage commitments for FY 2019 – down from $2.5 Billion in FY 2018.
    - This represents billions of dollars in reduced future small business investments.
- No SBIC program data was released until March 30, 2019 - six months after beginning the fiscal year.
    - OII was once able to release this data monthly.
    - The 7a and 504 programs release data weekly or biweekly.
- There have been no SBIC regulations classes held so far this calendar year and there are currently none scheduled for the rest of the year.
    - The last SBIC Regulations class was held in November 2018.
    - SBA requires applicants for SBIC licenses to receive regulations training before being licensed.
    - SBIA has been asking for dates for SBIC regulations classes since the summer of 2018.
    - Outside of force majeure disruptions, it is extremely unusual to go at least a quarter without a regulations class – and it is unheard of that SBA has gone so long without a class. There is no precedent for having zero classes scheduled for the entire calendar year.
    - SBIA is in the final stages of building an online SBIC regulations training (at no expense to the taxpayer).
- OII's budget requests additional funding to study the SBIC program, but still has not released reports that were completed in 2017 and for which the taxpayer has already funded the research.
    - Releasing completed reports and studies before performing duplicative studies would prevent wasting additional taxpayer funds.
- OII's budget request seeks additional funding for 11 new FTE's for risk management.
    - OII has created new additional risks to the program because its leadership has not posted or filled existing, prolonged vacancies in mission critical positions despite having authorities and funding to do so.

I would like to meet with you to discuss how small business investors and SBA can work together to get the SBIC program working again so we can return the focus toward helping small businesses access growth capital.

Sincerely,

Brett Palmer

Brett Palmer
President

SBIA
SMALL BUSINESS INVESTOR ALLIANCE

February 27, 2019

The Honorable Marco Rubio
Chairman
U.S. Senate Committee on Small Business
& Entrepreneurship
428A Russell Senate Office Building
Washington, DC 20515

The Honorable Ben Cardin
Ranking Member
U.S. Senate Committee on Small Business
& Entrepreneurship
428A Russell Senate Office Building
Washington, DC 20515

Dear Chairman Rubio, Ranking Member Cardin, and Members of the Committee:

Thank you for asking questions about the Small Business Investment Company (SBIC) program during the recent oversight hearing of the SBA. When allowed to function, the SBIC program is a powerful catalyst for small business growth and job creation. As a 2017 Library of Congress study revealed, SBIC-backed small businesses created over 3 million new jobs and supported over 6 million more jobs. As the voice of small business investors, we feel it is important to clarify the record of what has been happening with the SBIC program.

Despite strong, pro-small business policies of the broader Trump Administration and the professionalism and dedication of the SBA career staff, for two years there have been serious problems with the management of the SBIC program. Until the day before this hearing, over four months into FY 2019 and through more than one third of the fiscal year, SBA had issued zero SBIC licenses. Less than 24 hours before this oversight hearing, the Office of Investment and Innovation (OII) finally released the first SBIC licenses of the fiscal year. All three licenses were approved by SBA's Agency Committee on November 16, 2018, but the leadership of OII was unable or unwilling to release the SBIC licenses until hours before the Committee's oversight hearing. Until 2017 releasing licenses would have taken 1 to 2 weeks. SBICs are not allowed to operate until they possess the license.

For the past two years, the SBIC program has suffered from ongoing problems that are clearly seen in the licensing process but are also manifest in nearly all facets of the SBIC Program. Where the OII leadership has inserted itself into any SBIC processes, each step of those processes has slowed to near paralysis and the outcomes are at best uncertain. As the association representing small business investors, we have been informing the OII and leadership of the SBA of these emerging problems from very early on, but the problems and the primary cause of these problems persist.

The Chairman asked a good question about SBIC licensing. The SBA Administrator answered honestly with what normally would be the textbook answer of what is supposed to happen. However, it is clear that the information being given to the Administrator, which was then passed on to the Committee in good faith, does not reflect the complete picture. SBIA hopes that this chart will inform the Committee and the leadership of SBA as to what is really happening from the private sector perspective. While it is true that SBIC licensing in FY 2018 increased relative to FY 2017, it is also true FY17 was one of the worst licensing periods in nearly a decade. Licensing was working well in FY 2017 until the Associate Administrator was appointed to oversee the OII.

Licensing returned to near average in 2018, but this too is misleading because given the underperformance and backlog of FY 2017 applicants, the number of licenses should have been much higher in FY 2018. To be clear, time to fundraise is not the reason for the slowdown in licensure, particularly for the funds licensed in FY 2019. SBIA agrees with SBA that technology improvements are needed and will improve some of these issues, but technology alone will not fix the primary cause of the problems at the Office of Investment and Innovation.

	FY 2010-2016	**Feb. 1, 2017-Feb. 10, 2019**	**FY 2019 (SBICs licensed from Oct 1, 2018 through date of Hearing Feb. 13, 2019)**
Time for Greenlight Approval for Repeat Funds	Commonly 0.5 Months	Commonly up to 6 Months	Average of 7.25 Months (100% repeat SBICs)
Time to Receive License After Approval by Agency Committee	Commonly 1-2 Weeks	Commonly 1 - 2 Months (sometime more)	3 months
Annual Pace of funds licensed per year	26.4 Licenses Per Year Average (Fewest 21 and highest 34 per year)	Averaging 16 Licenses Per Year for the last 24 months • 7 in FY17 (excludes licenses issued by previous Administration in FY 2017) • 25 in FY 2018 (repeat and new SBICs)	On pace for 9 to 12 licenses (No new platforms licensed as of date of hearing)
Average Time for Licensure	6.6 Months (185 first-time and repeat funds)	SBA reported numbers for FY 2017 are 5.1 months – this number is misleading because more than 50% of licenses issued were issued in a timely manner by the previous Administration (further, this data excludes SBA-caused delays) (includes new and repeat funds) 8.7 Months for FY 2018 (includes new and repeat funds and *excludes SBA-caused delays that are omitted from SBA's reported data*) Zero SBICs Licensed from Oct. 1, 2018 through Feb 10, 2019	9.7 months (100% repeat SBICs, which should be much faster to analyze than first time funds)

Source of data 2009-2018 SBA, Source of FY 2019 SBIA (OII appears to have ceased releasing SBIC data for FY 2019)

Licensing is only one area where OII's leadership has broken the efficient and successful operation of this small business investing program. The leadership of the OII has created new uncertainty and delays at every step of the entire SBIC process from pre-licensure to operations to examinations and even to surrendering of licenses. Each of the new delays builds upon the preceding delays. Adding to the delays is the fact that the OII has numerous critical career director, manager, and chief positions that have been vacant for extremely long periods of time, but there has been no attempt by the leadership of the OII to post these open positions for replacement. Attached to this letter is a sample of the private sector's concerns that were submitted to the SBA in the summer of 2018. SBIA has also highlighted these problems in Congressional testimony to the House Small Business Committee with the hope that SBA would address the problem with OII's leadership. This small business program needs your oversight to return it to a fully functional resource for small businesses.

We encourage the Committee and the leadership of the SBA to review these concerns and address them as warranted. This is a program regulating over $30 Billion in small business investment capital, and it needs competent leadership. As an industry, small business investors want to be working collaboratively with Congress and the SBA to get more SBICs in underserved areas, more equity-oriented SBICs, more investments in rural areas, more women fund managers, more veteran fund managers, and more small businesses growing. Instead our energy must be spent begging SBA to get the most basic functions of the OII to work. The SBIA looks forward to working with Congress and the SBA to better serve and empower growing small businesses with an efficient and functional SBIC program.

Sincerely,

Brett Palmer
President
Small Business Investor Alliance

cc U.S. Senate Committee on Small Business & Entrepreneurship
U.S. Senate Committee on Appropriations
U.S. House Committee on Small Business
U.S. House Committee on Appropriations
SBA Administrator Linda McMahon

February 7, 2019

Mr. Joseph Shepard
Associate Administrator
Office of Investment and Innovation
U.S. Small Business Administration
409 3rd Street SW
Washington, DC 20416

Dear Associate Administrator Shepard:

As the appointee leading the Office of Investment and Innovation (OII), your responsibilities include overseeing and executing the Small Business Investment Company (SBIC) program. SBIA again requests you take corrective action to address what appears to the small business investing community to be another breakdown of the SBIC program, particularly the delays with the delivery of licenses.

Today, over four months into the new fiscal year, only one SBIC license has been issued and received by an applicant. This license was issued last week despite being approved by the Agency Committee on November 16, 2018. This single new license is a non-levered SBIC. With more than a third of the fiscal year completed, not a single levered SBIC license has been issued and delivered. This inability to license any levered SBIC funds is confounding because there are several SBIC applicants that also completed SBA's entire licensing process and were approved by the Agency Committee on November 16, 2018. These would-be-SBICs are in limbo and are currently not able to operate and invest in small businesses until SBA issues the licenses.

It is important to also put on the record that the single license issued and the several would-be-licenses-in-limbo are all repeat SBICs with well-established, successful track records in the program. These applicants are extremely well-known to the SBA. Not a single license has been issued to a new SBIC platform in FY 2019. Our industry wants to see more small business investment with more women, more minorities, and more veterans running SBICs. Our industry wants to see more SBIC funds licensed in more geographies – under licensed states and underinvested areas. Our industry wants to see more SBIC funds investing in a broader array of investments in a broader mix of small businesses. How can SBA expect any investing professional, but particularly new entrants to the program who are women, minorities, veterans, or investors from new areas, to take the entrepreneurial risk of forming an SBIC fund when even established and successful SBIC funds are facing unpredictable delays and are struggling to be licensed? Even longtime institutional investors in SBICs, who know the program well, are worried about deploying capital into SBICs that are entering the licensing process because many aspects of the program are now unpredictable and slower than ever.

The government shutdown is not a meaningful cause of these licensing delays. The licenses-in-limbo were approved by the Agency Committee on November 16, 2018. The government did not shut down until December 23, 2018. These licenses should have been issued well before the shutdown. The government reopened on January 25th, almost two weeks ago and still there are approved applicants without an SBIC license.

The private sector is having difficulty making sense of the delays. Applicants and their investors can only sit and wait. The civil servants in the Office of Investment and Innovation are not the cause of these licensing delays. By all accounts the civil servants appear to be doing their work professionally and with a sense of purpose. The Agency Committee, composed of both political appointees and civil servants, appears to have done their job and approved applicants for SBIC licenses months ago.

Other parts of the Trump Administration have done an excellent job in promoting small businesses, reducing taxes on small businesses, reducing regulations on small business, and prioritizing capital access to small businesses. The SBIC program is completely in line with the President's goals of supporting small business, promoting investment in domestic companies, and promoting hiring American workers and limiting offshoring of jobs. The SBIA wants to partner with and support this Administration to aid growing small businesses, but the SBIC program must be allowed to function.

On behalf of the small business investing community, the SBIA asks that OII ends these delays and release to the applicants all approved licenses. OII should also prevent these delays from happening in the future. Further, we ask that the SBIC program's other operational issues, not just licensing, be righted so the program can become reliable again. Small businesses, their employees, the private sector investors into SBICs, and SBA's SBIC partners expect a functional Office of Investment and Innovation. SBIA stands ready to assist you in this undertaking in any way that we can.

Sincerely,

Brett Palmer

Brett Palmer
President
Small Business Investor Alliance

CC: Pradeep Belur
Chris Pilkerton
Bill Manger
Nina Levine
Tim Gribben

SBIA
SMALL BUSINESS INVESTOR ALLIANCE

August 10, 2018

Joseph Shepard
Associate Administrator
Office of Investment and Innovation
Small Business Administration
409 3rd Street SW, Suite 6300
Washington, D.C. 20416

Re: Industry Comments on Reducing Regulatory Burden

Dear Associate Administrator Shepard:

For 60 years, the Small Business Investor Alliance (SBIA) has been the trade association that serves as the collective voice of the Small Business Investment Company (SBIC) industry. SBIA's membership includes both GPs and LPs in the SBIC program. This membership ensures that our SBIC policy proposals are solid, balanced, and aligned with promoting a healthy capital market for small businesses.

Debenture and non-levered SBICs are highly-regulated private funds that serve the important public purpose of facilitating private investment into domestic small businesses. Core to the success of the program is that investments are market-driven and not government-chosen. A 2017 Library of Congress study found that SBIC-backed businesses created 3 million net new jobs and supported an additional 6.5 million jobs from 1995-2014 (a period of 20 fiscal years that included the Great Recession and the tech bubble recession). The underlying economics of the SBIC program are sound: for years it has maintained its zero subsidy, and for several years it has been operating at or near the lowest loss rates in the 60-year history of the program.

On August 15, 2017, SBA published in the Federal Register a request for public comment entitled "Reducing Unnecessary Regulatory Burden." The request was issued in accordance with three executive orders aimed at reducing regulatory burdens. Executive Order 13771 was issued by President Trump on January 30, 2017 and has the goal of reducing regulatory costs by eliminating two regulations for every new regulation that is issued. Executive Order 13777, issued by President Trump on February 24, 2017, aims to—among other things—repeal, replace, or modify regulations that "eliminate jobs, or inhibit job creation; are outdated, unnecessary, or ineffective; impose costs that exceed benefits;" and "create a serious inconsistency or otherwise interfere with regulatory reform initiatives and policies." Executive Order 13563, issued by President Obama on January 11, 2011, requires agencies to propose regulations whose benefits are justified by their costs and to issue the least burdensome regulations possible. In November 2017, SBIA submitted a comment letter in response to the August 2017 request from SBA. SBIA stands by that letter and would like to see those recommendations implemented. We submit the comments below as additional items that would make the SBIC program operate more efficiently.

President Trump deserves credit for his pro-small business efforts to reduce regulations and taxes. Further, SBIA is supportive of the goals laid out in the President's executive orders and appreciates the opportunity to comment on ways to reduce unnecessary regulatory burdens. SBICs embody SBA's goal "to preserve free competitive enterprise and to maintain and strengthen the overall economy of our nation," while instituting strong taxpayer protections. SBICs are proof that these goals can coexist, and we welcome the opportunity to offer suggestions to extend and enhance that record.

The recommendations contained below are all in line with the goals of the executive orders issued by Presidents Trump and Obama and applying them would ease burdens on small business investors and help unleash more capital to domestic small businesses in a more efficient manner.

In preparation for the SBA's regulatory review, SBICs and Limited Partners (LPs) were surveyed about the regulations and, equally important, the SBA's real-world application of the regulations. Many of our LPs participated in a conference call to help us further flesh out our comments to reflect their views. SBIA staff also spoke to many more SBICs, LPs, lawyers, and accountants to ensure we were capturing and communicating critical issues. The survey produced results based on a very large sample size of all actively investing SBIC license holders. Fund managers who hold over 100 active SBIC licenses completed the survey as did LPs who have investments in a similarly large number of SBIC funds. The survey encompassed the four main regulatory aspects of the SBIC program: licensing, operations, examinations, and forms.

This comment letter includes some of the findings of the survey. For the sake of brevity, we are including only comments which received overwhelming consensus from the SBIC industry and which are appropriate for this specific comment letter. It is important to note that a number of SBICs had serious concerns about responding to the survey out of an explicitly stated fear that SBA would trace back their responses and retaliate against them if SBA was able to identify fund managers who had raised concerns about the regulations or how they were being applied. As such, SBIA will only be describing the results of the survey and not be releasing the survey or any other information that could be tied back to any specific person, group, or SBIC fund.

Overall Regulatory Challenges

The Debenture and non-levered SBICs have been successfully operating for decades under regulations that have barely changed. Most of the regulations are time-tested and reasonable. While the regulations have been adequate to the task, with the passage of time, personnel, and management philosophies, a review and update of the regulations and their applications are appropriate. Our survey documented a significant number of regulations, policies, and practices that are unnecessary, outdated, burdensome, conflicting with other law, and hindering job creation. By an overwhelming margin in our survey, respondents noted that the biggest challenge facing the SBIC program is uncertainty about the management of the program and confusion about the current leadership's vision for the operation of the program, not the regulations. Not only was this the answer to the specific question about the biggest challenge facing the SBIC program, it also showed up in the "word cloud" of responses to the survey. Words like "confusion," "delays," and "uncertainty" were some of the most common concerns. Words like "clarity," "timelines," "consistency," "standards," and "communication" were some of the most common in the questions where suggestions for improvement were sought. SBIA applauds SBA's efforts to clean up and modernize the regulations, but we also strongly encourage SBA to focus on fixing the delays, uncertainties, and other execution problems that may continue long after any written word of regulation is changed. LPs described it this way:

> [It is now] about 20 months into the Administration and the leadership of the SBIC program has not articulated what they want to accomplish with the Small Business Investment Company program.
>
> Improved regulations are welcome, but how the leadership of the SBIC program implements the regulations has a far bigger effect on how effective SBICs are allowed to be.
>
> LPs choose between competing investments every day. If the leadership of the SBIC program makes it difficult to invest in SBICs and for SBICs to operate, then we can redirect our investments away from SBICs and small business and into other investments.

SBIC Licensing

SBIC licensing is core to the program because without a license, no investments can be made into small businesses. SBA has an extraordinary group of public servants doing the best they can to fulfill the demands of their jobs. They are at the front lines of both taxpayer protections and small business access to capital. The SBICs and LPs are concerned that licensing is understaffed and that the staff does not have the adequate technological resources needed to perform at their full potential. LPs in particular see the SBIC licensing team as disciplined professionals who complement the private sector's efforts to vet and approve fund managers. Further, there are a number of regulatory and policy improvements that can make licensing clearer, faster, and better for both applicants and the SBA.

<u>Green Light letters</u>

SBIA's members believe that the SBA's Green Light letter process should lay out the specific targets that the applicant must reach to be licensed. SBA should honor their letter and license applicants who meet the standards set therein, provided that no new material adverse information develops during the review of the license application. If SBA's expectations are clear, quantifiable, and written, then there is greater transparency and less regulatory frustration for both sides. Clear standards must be communicated from the Agency Committee to make this happen. Also, LPs commit to GPs and their business model. SBA forcing changes to the business model that was approved for the Green Light, by significantly reducing leverage late in the process, is not fair to LPs or GPs.

Agency Committee

The survey shows there is overwhelming confusion or doubt about the value that the Agency Committee brings to the licensing process. The Agency Committee was created under the Administration of President Bill Clinton to get more political appointees involved in SBIC licensing. The Agency Committee makes decisions without many of its members having ever met an SBIC fund manager, without any members ever meeting the applicant whose fate they are deciding, without clearly documenting and communicating their expectations and standards to the Office of Investment, and without ever communicating their expectations and standards to the small business investing community. By the time applicants reach the Agency Committee for their consideration, hundreds of thousands of dollars and up to two years may have been spent forming the SBIC, but these expenses and applicants' work going through the process is not necessarily valued or respected.

It should be noted that, according to SBA's Standard Operating Procedure (SOP), all issues must have been dealt with satisfactorily before being presented to the Agency Committee. So, if all the legal, financial, and other approvals have already been satisfied, then it is not clear what value this body adds to the process. SBA should either have the Agency Committee communicate their standards and expectations to the SBIC community, or it should reconsider what value this additional step adds to the process beyond more time and expense. Every member of the Agency Committee was invited to meet the SBIC industry at SBIA's 2018 Washington Fly-In, and none accepted the invitation. SBIA would welcome the chance to have members of the Agency Committee engage the SBICs and understand more about our market.

Licensing Decisions Based on Facts in the Record (13 CFR 107.305)

Licensing decisions by SBA should be based on the facts in the record that are discovered during the process of approving a fund. The licensing team in OII does excellent diligence, a very small amount of which must be kept confidential, but there is no documentation of how decisions are made or what facts were used to make determinations. Applicants should have the right to address or correct any issues, but they cannot do so if they do not have a chance to address and correct the record.

Specific Reason for Non-Approval with Opportunity for SBIC Applicants to Cure

SBIA's survey respondents believe that SBA should give applicants clear and specific reasons for non-approval with an opportunity to cure any issues that SBA raises. Not every applicant for a license is worthy of licensure, but some issues deemed worthy of non-approval by SBA can often be cured by the applicant. If applicants cure the issues, SBA should promptly reconsider the application and grant approval if all conditions are met. An applicant should not be turned down or prohibited from filing a formal application without a clear, meaningful, written explanation from the SBA and a good faith opportunity to fix any issues. The SBA should also recognize that some of the reasons SBICs are being delayed or prohibited from filing an application are 100% due to SBA's actions or inactions and are on matters over which the applicant has zero control (timing of exams, for example).

Clear Appellate Mechanism for Adverse Decisions

SBIA members also believe that a clear appellate process should exist for funds who receive an adverse regulatory decision, particularly, but not limited to, licensing.

Meaningful Fast-Track Licensing for Known, Repeat SBIC Applicants

SBIA members surveyed unanimously support a meaningful fast track licensing process for repeat SBICs. The GAO has studied the risks of first-time and repeat licensees and found that repeat SBICs are lower risk[1]. Repeat licensees (some of whom have been successfully operating SBICs for decades) are fundamentally less risky and more well-known to SBA than first time applicants. SBA is intimately aware of their investments and is very familiar with their management teams and investment strategies. Beyond a new FBI background check and review of new capital certificates, nothing is not already known to the SBA. If there are no material changes, the process should be significantly expedited.

Existing SBICs have the added burden of not being able to apply for a license until SBA's (recently broken) examinations process has run its course. Existing SBICs may already have had dozens of clean exams previously, but that is not considered. First-time licensees have never been examined and therefore do not face these unnecessary delays. Existing SBICs should not face delays or have limitations put on the amount of leverage they can access because of an examination process that is completely outside of their control. (Greater explanation of the issues surrounding the problems with examinations are covered later in this letter.)

Recognizing the inefficiencies created by the treatment of existing SBICs and how that removes resources from attracting and vetting new SBICs from across the country, the House and Senate Appropriations Committees' Financial Services and General Government appropriations bills for FY 2019 recommended a 60- to 90-day window for repeat licenses.

Transparency During the Licensing Process

SBIA members surveyed unanimously agreed that the licensing process should be more transparent, more predictable, and that applicants should know where they stand at all stages during the process. As one LP described it, "The inability to forecast licensing causes cash flow and allocation planning problems for many LPs." Further, an LP described the following:

> SBA wants banks to finalize their commitments to SBICs before licensure, but banks investing in SBICs are being forced to withhold their commitments until after licensure because we don't have insight into the timing of the licensing process. Banking laws do not allow us to be put in the position of being held hostage to the SBA's uncertainties.

[1] U.S. Government Accountability Office, *Small Business Investment Companies: Characteristics and Investment Performance of Single and Multiple Licensees*, GAO-16-107 (Washington, DC, 2016), 14-18.

Other SBIA members described the situation this way:

> Institutional Investors need to plan allocations yearly. SBA's delays have caused us problems with planning our allocations. Further, we have been forced to go back to our investment committee to get renewed approvals or to rebalance our allocations because of SBA's actions and timing.
>
> For those of us (LPs) that are publicly traded companies, this is a problem because we want to be transparent with our shareholders who hold us accountable for meeting the investing goals that we set.

<u>Acknowledging Receipt of Materials and Accepting All Forms (Including Licensing Materials) Electronically without a "Wet Signature"</u>

The requirement for a wet signature of licensing or regulatory materials is unnecessary, and the survey showed that removal of this requirement is overwhelmingly supported by SBIA members. With current technology, all required signatures can be collected safely and securely electronically. SBIA's membership recognizes that this is not a requirement that is peculiar to SBA. Accepting materials electronically will also address the issues/questions about when materials were received. The date SBA received regulatory or licensing requests should not be a question. This could easily be addressed with the use of virtual data rooms and other off-the-shelf technology, like email.

<u>SBICs Should Receive Their Actual License within Two Weeks of Approval</u>

SBICs need their license to operate and for their bank LPs to comply with banking law. Upon approval, SBICs should receive their actual license as soon as possible and definitely within two weeks. SBIC survey respondents overwhelmingly agreed on this point.

Recently, it has taken months to get a written confirmation of licensure. This time frame is arbitrary, expensive and challenging for the licensee, and does not benefit small businesses seeking capital. These delays are an added headache for bank LPs who need the letter to document compliance with banking laws. SBA should have a regulation providing SBICs with a timely confirmation of licensure. SBA should also publicly announce when funds are licensed and when licenses are surrendered.

<u>SBICs Should Be Able to Maintain Their Licenses in Wind Down after Paying Down Their Leverage Below the $5 Million-Dollar Threshold</u>

When SBICs complete their life cycle, their fund size will eventually reduce to zero, but before they get to zero, they generally drop below the $5 million minimal threshold that SBA requires. Surrendering the license can harm bank LPs because of the banks' allowance to invest in SBICs under the banking laws. Survey respondents feel that SBA should allow SBICs to hold onto their licenses as they wind down and should make regulatory changes to significantly reduce the cost of operating SBIC funds that are in wind down. At the final stages of a fund's life there is minimal fund income, so it is important that SBA reduce regulatory costs so as not to create an artificial incentive to surrender the license.

SBA's Model Limited Partnership Agreement (LPA) Should Be More Customizable

SBA has a fairly rigid model LPA. SBIA recognizes that the lawyers reviewing the SBIC LPA are severely under-resourced, which requires some level of standardization. It is very hard for an applicant to make changes to the LPA, even the "non-bold" language that is theoretically flexible. SBIA members surveyed believe that there should be more flexibility for General Partners (GP) and institutional Limited Partners (LP) to negotiate market terms for their LPAs. SBA should require LPA language that is necessary to fulfill its statutory mandate and provide the necessary protections to serve its role as a guarantor of a credit facility and as a regulator. Since SBA is a guarantor of a credit facility and not an LP, it should leave the non-statutory and non-credit related terms to the GPs and LPs to negotiate.

Affiliation

The SBA's affiliate rules need to be updated to ensure that investments with private equity funds are not inadvertently limited, survey respondents agreed. Some SBA regulations were written before related SEC regulations were written and now the SBA regulations need to be updated to reflect these changes. The lack of an exception from affiliation for portfolio companies that are owned by private equity funds that are exempt from registration under the Investment Company Act of 1940 because of Section 3(c)(7) only restricts or harms SBICs' investment activities. The exemptions from the Affiliates definition should be changed to expressly include 3(c)(7) funds. Many SBIC funds are affected by this regulation, and a simple fix would be to remove the current exception under 13 CFR 121.103(b)(5)(vi) and replace it with a reference to any "private fund" as defined by SEC Rule 203(m)-1, which includes any 3(c)(1) or 3(c)(7) fund.

Capitalizing an SBIC: Private and Regulatory, Institutional Capital

LP Capital from Bona Fide "Funds of Funds" Should Be Recognized as Institutional Capital

There are a number of well-established, proven "Funds of Funds" whose investments in SBICs are not treated as institutional regulatory capital. This harms capital inflows into domestic small businesses and does not treat all significant LPs similarly. SBIA's survey revealed that well-known and established Funds of Funds who meet or exceed the qualifications to be an "institutional investor" should be treated as providers of institutional, regulatory capital. We recognize that a new Fund of Funds that might warrant scrutiny and a review, but there are top-tier, long establish, SEC-regulated Funds of Funds that are not treated as institutional capital. Further, fair treatment of the Funds of Funds model will allow new entities to form to provide professional investment opportunities to unique sources of capital that may need to be pooled to gain the benefits of scale, to access unique market expertise, or to find particularly SBIC characteristics (looking for SBICs that focus on rural areas, for example).

Pensions and Endowments from State-Chartered Universities Should Be Recognized as Private, Regulatory Capital Instead of as "Instrumentalities of the State." (Instrumentalities of the State May Not Qualify as Regulatory Capital.)

Recently, SBA has started treating endowments and pension funds from some universities as "instrumentalities of the states." This is not an accurate description of what they are. Further, this treatment effectively blocks other endowment and pension funds from investing in an SBIC that has these investors. As one large LP described it, “SBIC investments are only a fraction of our multibillion dollar endowment’s overall capital. If SBA continues to make it difficult to invest in SBICs, then we can and will redirect our investments away from domestic small businesses to other investment opportunities.” This new interpretation of the regulations runs directly counter to the President’s goals for fostering domestic investment and small business job growth.

<u>SBA Should Recognize LP Investments from Canada and Other Treaty Countries as Regulatory Capital</u>

Under US law, investments from certain countries may not be discriminated against. Canada, Australia, and Mexico are three examples where this US law applies. Contrary to US law, SBA is not treating investments from these countries as regulatory, institutional capital. Survey respondents agreed that SBA’s regulations should be modified to reflect existing law. Creating barriers for our trading partners to empower domestic small businesses via SBICs appears to run counter to the President’s goals for job creation and more equitable treatment of American small businesses.

<u>Transfer of LP Interests That Represent 10% or Less of an SBIC Fund Should Be Streamlined or Permitted without Prior SBA Approval</u>

SBICs have Limited Partner Advisory Committees (LPACs). Survey respondents feel that if an SBIC has the approval of its LPAC, then it should be allowed to transfer smaller LP interests (10% or less of the committed capital). Existing restrictions are cumbersome and unnecessary.

<u>Side Letters</u>

Side letters are necessary documents for many LPs, particularly banks. Many banks have their own standard side letter to reflect their bank’s (banking) regulatory requirements. Side letters are extremely time consuming to the under-resourced legal staff because they are commonly treated as if each were *de novo*. SBIA’s survey found that side letters that have already been approved and used numerous times by LPs (commonly from bank LPs) should be presumed by SBA to be acceptable for future commitments. Alternatively, LPs should be able to get a standard side letter pre-approved once for use across multiple and future funds that they plan to invest in for a set period of time. SBIA’s LP Council could work with SBA to provide guidance and standards for these side letters.

SBIC Operations

<u>Common Contact File/Resource to Prevent Multiple Requests for Information</u>

Survey respondents said that SBA should have a common contact file/resource/customer relationship management system in place that will prevent SBA from asking for the same information that has previously been submitted – often many times or in many similar ways. Redundant requests of information are common, burdensome, and could be easily remedied. A system of this type could expedite processes at SBA significantly and reduce burdens for both SBICs and the SBA.

Addressing Regulatory Questions through a "No Action Letter" System

SBIA survey respondents overwhelmingly support the establishment of a no action letter system, modeled off that of the SEC, to help SBIC industry participants address good faith regulatory questions that may arise. SBIA believes this would help facilitate productive communication between industry participants and regulators and would provide an outlet to address questions and potential issues early. As appropriate, no action letters should also be shared with the SBIC community so there is clarity in the regulatory environment.

Conflicts of Interest (13 CFR 107.730)

The conflict of interest rules are being interpreted so narrowly that in some cases they are now harming LPs and GPs by preventing or terminally delaying legitimate small business investments. Similar to transfer of LP interests below a certain threshold, if the LPACs from two affiliated SBICs (often two successive SBIC funds, e.g., SBIC Fund 1 and SBIC Fund 2) both agree that an investment is appropriate, then it should be allowed. With LPAC approval, and when two SBIC entities are financing a small business under the same terms, this should be automatically approved and should not be viewed as a conflict of interest. SBIA survey respondents recommend that the regulations follow 13 CFR 107.730(d)(2) for conflicts of interest. The regulations should also provide automatic approval if all SBIC LPACs have been approved and the SBA has not made a determination within 30 days.

Overline Requests (13 CFR 107.740)

SBIA's members recommended in the survey the establishment of clear, binding timelines within which SBA must make a determination on overline requests, or else the request should be deemed approved if the LPAC has already been approved of the investment. Such timelines will be helpful in reducing uncertainty and providing structure for industry participants. If SBA does not decide on an overline request within the time allotted (30 days), requests should be granted automatic approval. It should be noted that during the economic stresses of 2008, small businesses failed, and Americans lost their jobs because SBICs were not able to get timely approvals for follow-on SBIC investments from the SBA. The economy is solid now, but the regulations will need to be applied in tougher times, too. No American should lose their job because paperwork was pending for month after month at SBA.

Similarly, SBIA and its members overwhelmingly feel that the SBA should develop clear and binding timelines for processing all regulatory requests, not just overlines, to promote efficiency and certainty in the industry. SBA should create a list of regulations that will be deemed approved if SBA does not make a decision within a pre-determined amount of time.

Personnel Changes and Absences

By regulation, the SBA should provide SBICs with a formal notification when their analyst, examiner, etc. is reassigned or on extended leave. It is not uncommon that an analyst leaves the government, leaves SBA, goes on extended vacation, is out ill, or otherwise becomes unavailable. Often, no notice is given to the SBIC, and no information is given as to whom critical and time sensitive requests should be submitted. In this scenario, SBICs could unknowingly submit time-sensitive regulatory requests to a person who is unable to receive the filing.

SBIA members surveyed believe that SBICs should be aware of whom they are supposed to communicate with at all times. SBIA hopes that informing SBICs of analyst changes will facilitate improved communication between SBA and the industry and contribute to the smooth functioning of regulatory processes. Further, the use of virtual data rooms and other off-the-shelf technologies commonly used in the private sector will make it easier for SBA staff to find information and records when assigned to a new SBIC.

Fund Expenses vs. Management Company Expenses

According to the survey, SBIA members feel that the allocation of an expense as either a fund expense or a management company expense should be negotiated between the private LPs and the GPs in the LPA. The expense allocation should not be decided solely via SBA regulation; rather, a negotiated decision made jointly by LPs and GPs in the LPA will allow for a mutually beneficial solution. It is appropriate that expense allocations should be included in the LPA which is shared with SBA.

Technological Modernization

Similarly, SBIA's members support the removal of regulations related to outdated technological requirements. Specifically, SBICs should no longer be required to maintain a fax machine at the primary office (13 CFR 107.504), as email and mobile communication systems provide faster, more reliable, and more ubiquitous forms of communication.

Additionally, to prevent fraud and protect market information, the SBIC industry participants responding to SBIA's regulatory survey agreed unanimously that the SBA should have a secure, encrypted mechanism for communicating sensitive materials and information such as leverage commitments and wiring instructions. Cybercrime is a growing problem across all industries, and SBICs, their LPs, and the SBA all should have more secure communications for the movement of large financial transactions than conventional email provides. It should be noted that the survey received comments about making sure any new communications system or portal not be too cumbersome, expensive, or limiting.

Recordkeeping

SBIA survey respondents recommend that SBICs be allowed to use a single safe to maintain the records for all affiliated SBICs. SBICs should also be allowed to keep records electronically in secure virtual data rooms or other secure cloud services.

Prepayment of Financing (13 CFR 107.830)

SBIA survey respondents also recommend that SBICs be allowed to put modest pre-payment limitations on the capital they invest in small businesses. Small businesses should be allowed to make prepayments, but reasonable limitations should be permitted. Every prepayment requires time and some expense by the SBIC. Being paid a penny (or a single dollar) is not reasonable. Perhaps prepayments of at least a certain percentage—5%, for example—would be reasonable.

SBIC Industry Data

SBA should return to publishing SBIC industry data on a regular, timely basis, according to the majority of survey respondents. The 7a and 504 programs release their data weekly. The SBIC program used to release the data monthly, and it would be released within a week of the month ending. Now SBA releases the data quarterly and waits an additional 6 weeks to release the data. LPs and GPs would benefit from having fresh, not stale, data. SBIC industry participants rely on up-to-date data to identify industry trends and remain informed as they make key decisions pertaining to their businesses. This data should be released monthly and within 5-10 business days of the end of the month.

Cost of Money

SBIA members believe that cost of money regulations should be made more flexible. Further, the definition of "default interest" should be revised to allow for increased charges without violating the Cost of Money. The definition of default should be expanded to be more consistent with the market and to not leave SBICs and the SBA in a disadvantaged position. SBICs should be allowed to be more proactive in taking necessary steps to address risks to investments.

Liquidations

SBIA members who were surveyed also overwhelmingly believe that an SBIC should be able to get out of "liquidations" and back into regular operations if the issues that caused them to be moved to liquidation are cured, and they otherwise would be able to operate as an SBIC. This is an unusual circumstance, but it should be addressed.

Debenture Pooling

SBIA survey respondents feel that the SBA should pool SBIC debentures four times a year (instead of the current two) and allow repayment four times a year (instead of the current two). Until about 10 years ago, SBA pooled four times a year (twice for Debenture SBICs and twice for the defunct Participating Securities program). SBICs may draw leverage and have to wait up to six months to know the interest rate on that leverage. SBICs also may be paid back from a small business and have millions of dollars sit idle for up to six months. If SBA were to keep the exact terms on the SBIC debentures, but pool/price four times a year instead of two, then SBICs would often have less timing/interest rate risk and would be able to pay back debentures sooner and reduce risk to SBA. This could be achieved without any change to the offerings other than adding summer and winter pooling/pricing dates.

OII Interaction with SBIC Fund Managers and Limited Partners

SBIA members would also like to see more engagement by OII leadership with the SBIC industry via SBIA. If there are regulations that are somehow preventing the OII leadership from attending industry gatherings, then those regulations should be changed. The leadership of OII has attended only one of the many SBIA industry events held since January 2017. These events are an opportunity to learn about what is happening in the market the SBA is regulating. Industry dialogue has been exclusively in closed, invite-only settings where the government chooses the participants;

in private, one-on-one meetings with LPs and GPs; or in settings where all questions are screened/chosen by SBA and all the answers are pre-scripted. This lack of engagement by SBA is not only an inefficient and ineffective way of having two-way communication, but it also raises doubts that market participants are being told the same information. As one LP put it, "The leadership of the SBIC program should be engaging the SBIA to work with SBICs and with LPs. Engagement should be regular and two-way."

Examinations

Examination Reports

SBIA survey participants recommend that examination reports be provided to the SBIC within four weeks of a completed examination. Despite recent massive increases in examination fees, the examination process has recently become a choke point for the effective operation of the program. Currently, exams are being completed with the examiner verbally informing the SBIC that there were no findings, but the actual letter informing the SBIC of the results of their exam may not be given for up to six months later – awaiting approvals from higher ups at SBA. There is no justification for these delays in issuing the examination letters. This means that the SBIC may be blocked by SBA from reserving leverage or from submitting a licensing application for another entire year and exam cycle because their exam results are considered out of date and stale. It is also inappropriate for SBA to exclude from the licensing times report the amount of time SBA blocked SBICs from filing for a license due to SBA's inability to produce an examinations letter.

It should be noted that licensed SBICs have been unable to invest because they have been waiting many months for the results of their examinations and therefore cannot purchase leverage. There is no reason SBICs are not given their results promptly after the examination. Further, the SBIC has begun misusing the existing regulations by applying a "must" standard to regulations that clearly state "should" regarding a fresh examination. Further, SBA's delays in issuing exam reports prevent SBICs from responding to potential findings and resolving any outstanding concerns – meaning that they may get findings two consecutive years because SBA withheld that there was a finding, adding to SBICs' expenses under the new higher fee regime. Timely exam results empower the SBICs to make needed changes prior to their next review.

Finally, it is critical to note that SBICs have absolutely zero control over when they receive an exam, but SBA is holding SBICs accountable for the timing of the exams by blocking their ability to file for a license or access leverage. Ultimately, both of these withholding actions hinder the ability of small businesses to access capital.

Examinations for Multiple SBIC Licenses

The overwhelming number of survey respondents thought it best to have all licenses of an SBIC platform examined at the same time. It is not uncommon to have multiple licenses under common control examined at different times by different examiners. This is inefficient for both the SBIC and the SBA. Further, during examinations, many smaller SBICs are unable to continue their normal operations until the exam is complete, so spreading out the exams is particularly disruptive. Finally, having all licenses reviewed simultaneously by the same examiner will prevent getting different results for the same practice inside the same SBIC group. However, simultaneous or sequential examinations should not be a reason for SBA delaying examinations in a way that could delay licensure, leverage, or other actions.

Examination Issues Shared with the Industry

There was overwhelming support in SBIA's member survey for the SBA to share an annual notice of the most common examination findings. Once a year, the SBA should share with the entire SBIC industry the most common negative findings from examinations. SBIA would be happy distribute this information and help the SBIC industry develop "best practices" to make regulatory violations far more rare. If GPs and LPs are informed of the most common errors, then GPs will have the opportunity to proactively review their practices to make sure they are in full compliance, and LPs will be able to consider these matters when interviewing funds for future investments. All parties will benefit from SBA sharing this information.

Examination of the Management Company

SBIA members also responded in the survey that examinations should be limited to the examination of the SBIC. SBA commonly examines things well outside of the scope of their legal and regulatory authority, specifically the management company contracted with SBICs. SBA should not conduct such examinations unless there is a specific, clear, and compelling reason to review the management company. Management companies regularly manage SBICs and non-SBIC vehicles, and the examiners confuse the two, causing SBIC regulations questions to be raised on entities that are not SBICs. SBA should clarify the regulations and SOP to make sure they are not wasting the time of SBA examiners and the money of SBICs by examining issues outside their legal mandate.

Choice of Accounting Method

SBICs should be given the option of using Generally Accepted Accounting Principles (GAAP) instead of statutory accounting at the time of licensure. Given the unique nature of leveraged SBICs, statutory accounting is needed while leverage is outstanding. Once leverage is paid off, SBICs should be allowed to reduce their operating expenses by going to GAAP.

Updating Forms

The survey received many comments that most SBA forms relating to the SBIC program are outdated, confusing, redundant, or overly cumbersome and require updating. SBIA's survey participants specifically identified Form 468 as confusing and difficult to read, with no opportunity to amend or correct investments that were entered erroneously. SBIC participants also identified Form 1031 as particularly dated, complicated, and in need of reform. SBA and SBIA should conduct a joint review of its SBIC forms to streamline and remove duplicative content.

The SBIC-Web system was always clunky, but recently it has become at times almost unworkable – with delays for each data entry being measured in seconds. With hundreds of entries required, it takes days and nights to enter the data. With the recent changes, SBIC-Web is also regularly unavailable to even access. Recently, SBA's use of technology has been getting worse, not better. SBA should allow SBICs to submit an Excel spreadsheet if SBIC-Web is not working.

SBIA thanks the Small Business Administration for its attention to SBIC regulatory issues and appreciates the opportunity to share feedback from the SBIC community. We look forward to a thoughtful and continued dialogue throughout the regulatory review process.

Sincerely,

Brett Palmer
President
Small Business Investor Alliance

SBIA
SMALL BUSINESS INVESTOR ALLIANCE

December 1, 2017

The Honorable Linda McMahon
Administrator
Small Business Administration
Washington, DC 20416

Dear Administrator McMahon,

With the transition completed, fiscal year 2017 closed, and the calendar year coming to an end, I write you today to provide an update on the Small Business Investment Company (SBIC) program from the perspective of the small business investor community.

While no program is perfect, the SBIC program inherited by this Administration was operating well and had been for a very long time. SBICs were investing near record amounts in domestic small businesses, losses were at record lows, licenses were being processed in a timely manner, quality fund managers were being attracted to the program, jobs were being created, and there was record interest from institutional investors to provide capital to small businesses via SBICs. The program was working to benefit America's small businesses. With the increased small business optimism spurred by the election of President Trump and with your appointment to lead the Small Business Administration, SBICs were optimistic that they could be a constructive partner in translating that optimism into positive outcomes.

By the close of FY 2017, the optimism around the operation of the SBIC program has changed. Licensing for first time SBIC funds was down 92% year over year. Licensing for all Debenture SBICs funds (first time and repeat SBICs) was down 35%. This reduction in licensing appears less precipitous than it really was because the licensing numbers in FY 2017 included strong licensing results from the previous Administration. For example, through March 31 of this year total licensing was up 40% year over year, but then there was a change and licensing finished the fiscal year down 35%. The number and amount of investments by SBICs were down in FY 2017 as were the jobs created, but the actual amounts are not known because the SBA's Investment Division ceased releasing most SBIC data to the public. Some private institutional investors (e.g., endowments, banks, pension funds) that provide the bulk of the private capital into SBICs have become unnerved by the slow pace of the operations of the program, the unpredictability of licensing and operations, and the lack of constructive engagement by the political leadership of the Investment Division. Some of these institutional investors are now building in an additional four to six month waiting period for each stage of the licensing process, while others are completely stepping back from the SBIC program until there is new management of the program. The new management culture and practices are discouraging the best fund managers from being in the program and this will create an adverse selection problem and create unnecessary downside risk that previously did not exist. In sum, there is now a serious leadership problem at the Investment Division that has not existed since the nadir of the program during the period of mismanagement from 2007 through January of 2009.

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The pro-small business regulatory reforms and performance of the 7a program are clear examples of what the Trump Administration, as good stewards of a small business program, is accomplishing. However, and in contrast to the successes of the 7a program, there is very deep and broad-based concern across the small business investor community about the management of the SBIC program. Given that this program was fully operational less than a year ago, there is still time to address the problem before the current situation is institutionalized. Given your unwavering commitment to American small businesses and your entrepreneurial and executive experience, I ask that you address the problem in the SBIC program before a stable, productive small business resource becomes neither stable nor productive.

The SBIC industry is committed to improving the nation by empowering small businesses and the SBIA would welcome the opportunity to work constructively with the SBA to make effective use of the Small Business Investment Company program.

Sincerely,

Brett Palmer
President
Small Business Investor Alliance

cc: The Honorable Althea Coetzee Leslie

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