



February 16, 2021

BY ELECTRONIC TRANSMISSION

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th St., and Constitution Ave., N.W.
Washington, D.C. 20551

RE: Federal Reserve Docket No. R-1723 and RIN 7100-AF94, Community Reinvestment Act

Dear Ms. Misback:

On behalf of its membership, the Small Business Investor Alliance (“SBIA”) is pleased to submit the following comments in response to the above-referenced advanced notice of proposed rulemaking by the Board of Governors of the Federal Reserve System (“Board”) regarding modernizing the Board’s Community Reinvestment Act of 1977 (“CRA” or “Act”) regulatory and supervisory framework codified at Regulation BB.¹

The SBIA is the national organization that represents small business funds and their investors, including Small Business Investment Companies (“SBICs”), some non-SBIC funds, and the many banks that invest in them. These funds make important contributions to job creation, retention, and improvement, and can provide a valuable vehicle for first-time fund managers, including founders of color and other emerging managers that may focus on early-stage small businesses.

SBICs are an outstanding example of the type of investments that are worthy of complete CRA consideration and scoring. SBICs, administered by the U.S. Small Business Administration (“SBA”), are highly regulated private funds that invest exclusively in domestic small businesses, which by statutory mission provide capital that is otherwise unavailable or in short supply to small businesses². An investment group that seeks an SBIC license must establish a record of not only solid investment performance, but also a record of being a good actor to the small businesses they have backed. SBICs may only provide long-term capital, not short-term lending, and must do so with a number of meaningful protections to the small business that otherwise would not be provided.

¹ 12 U.S.C. 2901 et seq. The Board implements the CRA through Regulation BB. 12 CFR part 228.

² Small Business Investment Act of 1958, Pub. L. 85-699 (Aug. 21, 1958). 15 U.S.C. 661.

Related, the U.S. Department of Agriculture (“USDA”) operates the Rural Business Development Company (RBIC) program, a developmental venture capital program for the purpose of promoting economic development and the creation of wealth and job opportunities in non-metropolitan areas and among residents living in those areas. Like the SBA, the USDA licenses investment fund applicants to address the unmet capital needs of small enterprises primarily located in rural areas. The RBIC program does not offer its licensees federally guaranteed capital access like the SBIC program.

Together, however, SBICs and RBICs are capital engines for job creation and small business growth throughout the United States.

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 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 but transformed into stronger businesses because of SBIC investments.

The Board’s current CRA regulatory framework emphasizes the importance of SBICs and RBICs by expressly including them on the list of types of entities into which a bank loan or investment will be “presumed” to promote economic development and thus satisfy the “purpose” test without have to submit any further documentation.⁴

SBIA presents the following comments to help inform the Board in its work to draft proposed amendments to its current CRA regulatory framework that governs its regulated financial institutions. In general, SBIA offers the following recommendations:

- Retain all of the current categories and types of activities and entities that currently qualify for CRA credit under the current regulatory framework for the “promotion of economic development,” including the express inclusion of SBICs and RBICs on the list of entities “presumed” to promote economic development.
- Do not revise the current small business size standards. Rather, SBIA suggests that, as outlined below, the current CRA regulatory framework can be enhanced to promote increased loans to or investments in the “smallest businesses” and also minority-owned small businesses.

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 Interagency Questions & Answers Regarding Community Reinvestment (“CRA Interagency Q&A”) at Sec. _____.12(g)(3)–1.

The Story of Small Business Investment Companies (SBICs)

SBICs are an American success story and example of a successful federal public policy that aligns the power of private markets with the public interest of job creation and economic growth.

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.⁵

As of the first quarter of 2021, the SBIC program has grown to a combined SBA guaranteed and private capital program exceeding \$33 billion, an increase of 19 percent since 2016 and the highest level ever in program history.⁶ SBICs completed \$630 million in financings to small businesses in December 2020, which was a 25 percent jump from \$500 million in December 2019.⁷

At the end of fiscal year 2020, the SBIC program included more than 300 licensed funds.⁸ Over the last five fiscal years, on average, SBICs have invested nearly \$6 billion annually in over 1,100 small businesses, creating or sustaining nearly 109,000 jobs annually.⁹ Fifty-five (55%) percent of SBIC investments were made in small businesses that were either women-, minority- or veteran-owned, located in LMIs areas, or were special competitive opportunity gap businesses.¹⁰

SBICs invest exclusively in domestic small businesses, creating jobs and empowering U.S. small businesses to compete in a global economy. SBICs may not invest in certain sectors (e.g., real estate; project financing; farmland) and may not make investments in companies that offshore jobs; SBICs may not finance any business “contrary to the public interest, including but not limited to activities which are in violation of law, or inconsistent with free competitive enterprise”.¹¹

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. While these are recognized companies globally, many more small businesses backed by SBICs have grown from smaller businesses into robust, sustainable mid-sized businesses.

⁵ *Supra* Note 2.

⁶ *An Update from SBA's Office of Investment and Innovation*, presentation to SBIA Outlook 2021 Virtual Conference at 2, <https://www.sbia.org/wp-content/uploads/2021/02/SBIA-Outlook-SBA-Update-Presentation-HANDOUT-1.pdf> (last visited Feb. 7, 2021).

⁷ *Id.*

⁸ SBA – *SBIC Program Overview* at 2 (Sept. 30, 2020). Accessed Feb. 1, 2021 (unpublished).

⁹ *Id.* SBA estimates jobs created or sustained using “The 1999 Arizona Venture Capital Impact Study” (confirmed by the DRI-WEFA study of 2001) whereby one (1) job is created for every \$36,000 of SBIC investment (adjusted for inflation).

¹⁰ *Id.*

¹¹ 13 CFR 107.720.

SBICs were essential not only to the success but, in certain cases, survival of these smaller businesses that bring prosperity, employment, and hope to communities across the country, many in LMI and underserved markets, because there were no other sources of capital available to them.

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

i. SBIC Program Structure and Function:

The SBIC program is a market-driven platform that serves an important public purpose of facilitating private investment into and filling capital access gaps for domestic small businesses. The program was created in 1958 during the Glass-Steagall era. SBIC investments by banks are specifically and clearly permitted in statute in the Dodd-Frank Act, as they were under Glass-Steagall.

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 investments, or both 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-levered SBICs* do not seek or receive SBA leverage. Non-levered funds can provide debt, 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 a portion of their own capital into these funds. These funds present no taxpayer risk because there are no public funds or federal guarantees involved.
- *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.

ii. *The Power of SBIC Leverage*

Most SBICs are levered (debenture) funds. 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 capital or \$175 million, whichever is less. In exchange for accessing federal leverage, SBICs limit themselves in a number of ways including to investing only in domestic small businesses. The performance of the SBIC debentures is guaranteed by the federal government, but not the performance of any single SBIC investment or the SBIC fund itself.

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, with no annual appropriations necessary to fund up to \$4 billion a year in SBIC leverage, which is eventually paid back in full to the SBA with interest and fees.

Real economic development continues positive economic impacts well beyond the time of initial deployment of capital. Successful small business investing continues to support the community with jobs and local taxes for many years.

CRA Community Development Subcomponents – “Economic Development”

The Board’s current CRA regulatory framework expressly recognizes the critical role that small businesses play in the United States in its definition of “community development,” which captures:

...activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration’s Development Company or Small Business Investment company program (13 CFR 121.301) or have gross annual revenues of \$1 million or less.¹²

In addition to this “size” test, the current CRA framework also outlines a “purpose” test, focused primarily on activities that support: (1) jobs for low- or moderate- income (LMI) people, in LMI communities, in areas targeted for redevelopment, by financing intermediaries that lend to or invest in start-ups or recently formed small businesses, and through various types of technical assistance or supportive services for small businesses or farms; or, (2) federal, state, local, or tribal economic development initiatives focused on creating or improving access by low- or moderate-income persons to jobs or job training or workforce development programs.¹³

¹² 12 CFR 12(g)(3).

¹³ CRA Interagency Q&As at Sec. ____12(g)(3)-1.

As mentioned above, the CRA framework emphasizes the importance of SBICs by expressly including them on the list of types of entities into which a bank loan or investment will be “presumed” to promote economic development and thus satisfy the “purpose” test without have to submit any further documentation.¹⁴

In 2016, the three federal regulators of financial institutions, the Board, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC), revised their CRA Interagency Q&A to *expand* the “promotion of economic development” prong of the definition of community development. The 2016 guidance contained compelling policy discussions about small businesses and economic development and provided strong support for expanding the categories of the “purpose” test.

SBIA agrees with the policy underpinnings of the CRA Interagency Q&A and strongly urges the Board not to second-guess its 2016 guidance on the interpretation and application regarding the “promoting economic development” prong.

We counsel the Board, especially during this period of economic dislocation, to retain *all* of the current variety of qualified methods for a financial institution to demonstrate that its community development activities promote economic development, and to re-emphasize its language from the 2016 guidance that “[CRA] examiners will employ appropriate *flexibility* in reviewing any information provided by a financial institution that reasonably demonstrates that the purpose, mandate, or function of an [CRA qualifying] activity meets the purpose test.”¹⁵ (*emphasis added*).

Specifically, the Board seeks responses to the following questions:

- **Question 57.** *What other options should the Board consider for revising the economic development definition to provide incentives for engaging in activity with smaller businesses and farms and/or minority-owned businesses?*

i. *“Responsiveness” Option:*

The Board is considering specifying that “economic development activity with the smallest businesses...as well as minority-owned small businesses would be considered responsive and impactful” in developing a CD conclusion of rating per bank.¹⁶

¹⁴ *Id.*

¹⁵ 81 FedReg 48508 (July 25, 2016). The CRA Interagency Q&A then gave additional guidance about qualitative aspects of demonstrating the “purpose” test: “Examiners will also consider the qualitative aspects of performance. For example, activities will be considered more responsive to community needs if a majority of jobs created, retained, and/or improved, benefit low- or moderate-income individuals.”

¹⁶ 85 FedReg 66446 (Oct. 19, 2020).

The Board proffers no proposed definition for “smaller businesses” or metrics for “responsiveness”. The “responsiveness” option would make no changes to the business size standards that apply to existing qualifying activities like SBIC or RBIC investments, but the Board notes its concern that this option “might provide insufficient incentives” for banks to engage in activities with smaller businesses and minority-owned smaller businesses.¹⁷

SBIA acknowledges the Board’s concerns about access to credit for the “smallest segment of small business.” but counsels the Board to examine existing regulations that govern the SBIC and RBICs programs because they are directly on point.¹⁸

In addition to owning and financing small businesses, an SBIC licensed since 2009 must have 25 percent (in dollars) of its financings in “smaller enterprises”.¹⁹ SBICs that are out of compliance have until the end of the following fiscal year to do so, or the SBIC will not be eligible for additional federal leverage.²⁰ USDA regulations require that more than 50 percent of RBIC financings (in total dollars) must go to “smaller enterprises” that meet either a net worth/net income or size standard test.²¹ Like SBICs, RBICs that are non-compliant have until the end of the following fiscal year to do so.²²

“Smaller enterprises” are defined for both SBICs and RBICs as companies with a net worth not in excess of \$6 million, and a net income after taxes not in excess of \$2 million for the preceding two fiscal years.²³

SBIA reminds the Board that SBICs and RBICs are already responsive to smaller businesses and recommends that the Board evaluate for CRA purposes existing SBA and USDA regulations, definitions, and specific metrics.

ii. Narrowing the Size Standard:

The Board is considering narrowing the scope of CRA credit eligibility to bank investments in only the “smallest” small businesses and farms by using just the revised gross annual revenue threshold and eliminating the SBIC and SBDC size standards.

SBIA strongly opposes this option because this would exclude and essentially redefine down “small business” to just “smaller businesses” which would chill job creation, risk damaging more small businesses, and run counter to the 60-plus years of federal policy supporting the SBIC program.

¹⁷ Id. at 66447.

¹⁸ 85 FedReg 66446 (fn 135) (2020)

¹⁹ 13 CFR 107.710. The percentage requirement is adjusted slightly for levered and non-levered SBICs licensed prior to 2009.

²⁰ See 13 CFR §107.1120(c) and (g).

²¹ 7 CFR 4290.700 (a)(2).

²² Id. (USDA warns non-compliant RBICs that “[f]or as long as you remain out of compliance, you are not eligible for additional [Leverage](#) (see § 4290.1120).”)

²³ 13 CFR 107.710 and 7 CFR 4209.50.

This narrow approach stands in opposition to the purpose of the CRA “to encourage regulated financial institutions to help meet the credit needs of their *entire* communities” (*emphasis added*).²⁴ It would have the unintended consequence of shutting off essential access to capital for small businesses with annual gross revenues over \$1 million generally because it would remove an important incentive for bank investments in those recipients.²⁵ Related, it would create a perverse incentive for smaller businesses not to grow in terms of new jobs and revenues if graduation from the “smaller business” designation blocks access to capital because banks would have no incentive under the CRA to make investments in them.

Eliminating activities that currently qualify for CRA consideration is a risk that the Board admits is in play should it proceed to qualify economic development activities using only a revised gross annual revenue threshold.²⁶ But for the CRA consideration, bank investments in SBICs would become less advantageous for them to make.

Without investments from SBICs that qualify for CRA consideration, which would be lost under this option, all small businesses risk a reduction in their access to capital.

SBIA suggests that, instead of narrowing the “size” standard, a more appropriate way to encourage more lending to and investments in the smallest businesses and minority-owned small businesses would be to enhance the current CRA framework by adding them to the list of entities that are “presumed” to promote economic development. This would also relieve those small businesses from the data collection burden sometimes associated with proving that they meet the “purpose” test.

Given the damage to the small business economy and resulting jobs losses from the pandemic, reducing access to capital with overly restrictive investment practices would lead to stunted job creation and extended economic dislocation.

- **Question 58.** *How could the Board establish clearer standards for economic development activities to “demonstrate LMI job creation, retention, or improvement”?*

The Board seeks ways to “provide more clarity” on the standard that financing activities for *small businesses* (and not just the undefined category of “smaller businesses”) show LMI job creation, retention, or improvement. The Board seeks recommendations about how to quantify and document jobs creation progress.

²⁴ 81 FedReg 48506 (July 25, 2016).

²⁵ *Supra* Note 3 at 13-14 and 20 (“Comparing SBICs to the overall private equity universe, SBICs invest in portfolio companies that are smaller and potentially less profitable on average. This can be seen by comparing the average portfolio company revenues across all private capital funds (US\$404.3 million) to the average for all active SBICs (US\$31.6 million). Even compared to funds less than or equal to US\$225 million, for which average portfolio company revenues are US\$180.5 million, SBIC funds invest in smaller companies.”)

²⁶ 85 FedReg 66447 (“The Board recognizes that a possible drawback to using only a revised gross annual revenue threshold is that certain currently eligible activities that qualify under the economic development definition might no longer qualify for (CRA credit) consideration.”) (Oct. 19, 2020).

SBIA encourages the Board to survey current federal data collection sources and practices because the issue is not identifying new standards but finding reliable metrics to measure those standards. SBA collects data from SBICs on a regular basis about job creation-retention by their portfolio companies (i.e., SBA Form 1031, *SBA Portfolio Financing Report*; SBA Form 468, *SBA Annual Financial Report*). For instance, Schedule 8 of the SBA Form 468 contains employment and other general data on the portfolio companies.²⁷

Similarly, non-SBIC fund members of SBIA report that for many years they have assembled and provided to their bank investors clear documentation of the “purpose” test, which the banks then in turn provided to their federal bank CRA examiners, with all bank investors receiving CRA for their investments.²⁸

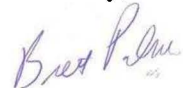
Identifying and inventorying existing federal data sources and, exploring private sources of data, would be a better use of limited federal dollars and personnel than setting new standards.

* * *

During the current economic dislocation caused by the Covid pandemic, expanding or, at minimum maintaining, not narrowing, the application and interpretation of the “promoting economic development” prong signals to financial institutions that they should be creative and nimble in extending capital to all qualifying small businesses, including the smallest ones, and especially those in LMIs.

As always, SBIA appreciates the opportunity to discuss these issues and looks forward to the opportunity to work together to update applicable regulations to ensure America’s small businesses have access to the capital they need.

Sincerely,



Brett Palmer
SBIA President

²⁷ See SBA SBIC forms at: <https://www.sba.gov/sbic/sbic-resource-library/forms>.

²⁸ The documentation included a list of all small businesses their fund invested in, the location of each small business, applicable jobs and income data for each small business annually, and any other information relevant to the “purpose” test.