



March 4, 2016

Mark Walsh
Associate Administrator
Office of Investment & Innovation
U.S. Small Business Administration
409 3rd Street SW
Washington, D.C. 20416

**Re: Request for Comment on Proposed Rulemaking Creating Formal
“Impact SBIC” License**

Dear Mr. Walsh:

On February 3, 2016, the Small Business Administration (“SBA”) issued proposed rules to formalize the current “Impact Investment Fund” pilot initiative and create a permanent subclass of small business investment companies (“SBICs”) called “Impact SBICs” which seek to achieve focused “positive and measurable social impact in addition to financial return[s]” (“Proposed Rules”).¹ The Proposed Rules create new regulations to formalize and implement the new Impact SBIC license, in connection with licensing, leverage eligibility, fees, reporting and regulatory compliance.

The Small Business Investor Alliance (“SBIA”) appreciates the opportunity to comment on the Proposed Rules on behalf of the SBIC industry. SBIA is the premier organization of lower middle market funds and investors, as well as the principal representative of SBICs and their limited partner (“LP”) investors. SBIA’s membership includes all seven Impact Investment SBICs that have been licensed by the SBA.²

**I. SBIA Supports Impact Investing & Believes That Impact Investment SBICs
Are an Important Part of the Market**

SBIA supports the goal of attracting more investors that focus on “impact investing” into the SBIC program. SBIA also supports reforming SBA licensing and operations to

¹ Small Business Investment Company Program – Impact SBICs, 81 Fed. Reg. 5666-5676 (February 3, 2016).

² These funds include Bluehenge Secured Debt SBIC; Morgan Stanley Impact Fund; Bridges Ventures U.S. Sustainable Growth Fund; Renovus Capital Partners; Small Business Community Capital II; SJF Ventures III; and Michigan Growth Capital Partners SBIC.

ensure that all qualified managers, particularly women and minority fund managers, are welcomed into the program and can be licensed and thrive within the program. As the Small Business Investment Act of 1958 (“SBIC Act”) makes clear, SBA should consider “the need for and availability of financing for small business concerns in the geographic area in which the applicant is to commence business.”³ Therefore, facilitating investment dollars in Low and Moderate Income (“LMI”) areas is consistent with the core statute and the Congressional mandate of the SBIC program.

Impact investing is a growing market segment, with the SBIC program being at the forefront of investing in underserved areas. In fact, while the new Impact SBICs are branded as impact investors, as described in the Statement of Policy of the SBIC Act,⁴ the *entire* SBIC program is engaged in impact investing, with Impact SBICs being a more focused and specialized subset of the small business ecosystem.

Increasing the number of Impact SBICs will encourage more LPs and more GPs that are interested in impact investing to look at the SBIC program. Unfortunately, the Proposed Rules create significant disincentives by adding additional compliance burdens and default events for Impact SBICs. In the spirit of enhancing the program’s effectiveness and adoption, some of the impact investors we surveyed shared the following as effective incentive tools for Impact SBICs:

1. Creating effective fund raising support, through educational events and the dissemination of impact information for the program, led by SBA. Dissemination of this additional information will encourage potential new Impact funds and new impact investors to participate.
2. Improving the clarity and simplicity of policies and processes during licensing and examinations, which will allow funds to free more time and resources and dedicate them to the success of their investment strategies. This issue applies to all SBICs, not only Impact SBICs.

Throughout the letter we elaborate further on some of the above points.

II. The Remedy for Impact Investment Non-Compliance is Significant & Detrimental to Attracting Program Participants

SBIA encourages SBA to reconsider new sections 107.1810(f)(13) and 107.1810(f)(14) and the application of SBA remedies under section 107.1810(g) to Impact SBICs that fail to invest at least 50 percent of their financing dollars in Impact Investments, or fails to obtain an acceptable third party assessment on the impact of their investments.⁵ The

³ Small Business Investment Act of 1958, 15 U.S.C § 681(c)(3)(B)(i).

⁴ Small Business Investment Act of 1958, 14 U.S.C. 661

⁵ Small Business Investment Company Program – Impact SBICs, 81 Fed. Reg. at 5671.

application of section 107.1810(g) remedies, if an Impact SBIC is unable to cure in a certain period of time, can result in SBA having the “right to declare outstanding debenture leverage immediately due and payable.”⁶ Application of this remedy would result in effectively putting an Impact SBIC out of business for not meeting the impact investment or 3rd party assessment requirements. This would have devastating effects on the fund manager, investors in the fund, and ultimately taxpayer dollars that were provided in the form of SBIC leverage, because investments would potentially have to be liquidated at a loss. Furthermore, section 107.1810(f)(13) could result in managers making poor investments that qualify as impact to prevent an “event of default” and remain above the 50 percent requirement.

The above remedies that may now be applied under the event of default under section 107.1810(g) appear to contradict the newly proposed regulation, section 107.1940, which is a more rational approach to dealing with Impact SBICs that fail to meet their independent assessment and 50 percent impact investing requirement. Proposed section 107.1940 would grant SBA the authority to (1) convert the licensee’s Impact SBIC license to a standard SBIC license (including, in SBA’s discretion, requiring the licensee to notify its private investors of the conversion; (2) require the licensee to return to SBA up to the full dollar amount of any licensing of examinations fee discounts it has received prior to the date of the written notice.⁷ This approach is the one that will ensure taxpayer dollars and investors are protected, and will ensure that a fund that is unable to meet its impact investment commitments will be forced to repay any fee discounts it received as an Impact SBIC, and continue on as a traditional SBIC.⁸ Moreover, creating new sections 107.1810(f)(13) and (f)(14) appear to go against the policy SBA advances in the Proposed Rules, notably that:

Impact SBICs subject to [section 107.665] will face penalties if they fail to obtain impact assessments, but SBA will neither penalize nor reward an Impact SBIC based solely on the results of those impact assessments. One purpose of permitting Impact SBICs to make Fund-Identified Impact Investments is to encourage innovative approaches to social, environment and economic challenges. Penalizing licensees that fail to meet their impact goals, *despite their best efforts, would be counterproductive*. Instead the Agency trusts that successful fund managers will earn their rewards in the marketplace, using the strength of their financial and social returns to attract private capital. SBA will also look favorably on subsequent Impact SBIC applicants with a record of strong social and financial performance. By contrast, Impact SBICs with poor impact

⁶ *Id.*

⁷ *Id.*

⁸ SBIA believes that funds that are not performing generally, beyond not meeting the specialized reporting and investment criteria for Impact SBICs, should still be subject to the requirements of section 107.1810(g).

assessments are more likely to face difficulty raising private capital and obtaining a subsequent Impact SBIC license.⁹ [*emphasis added*]

As indicated above in the Proposed Rules, SBA argues that penalizing licensees that fail to meet their impact goals, despite their best efforts, is counterproductive. Unfortunately, the draconian requirements under section 107.1810(f)(13) and (f)(14) engage in just that. SBIA encourages SBA to, at a minimum, remove section 107.1810(f)(13). Proposed section 107.1940 gives sufficient remedies to the SBA for failure to meet the Impact SBIC standards. SBIA believes that section 107.1810(f)(14) should also be removed, but since this requirement should be able to be easily met (whereas sourcing certain deals may not), it is less objectionable than section 107.1810(f)(13), a violation of which could have resulted from no wrongdoing by the fund managers, but merely the drying up of suitable deal flow.

III. All SBICs Should Be Treated Similarly In SBA Fee Structures

SBIA believes that SBA has taken the wrong approach in adopting fee discounts for any single subset of SBICs at the expense of the rest of the SBICs in the program. The entire SBIC program is geared towards “impact” investment in small businesses, and the SBA consistently expresses concerns about being resource deprived, both factors which contradict the approach taken here by the agency. Moreover, the SBIC Act does not appear to authorize this differentiation. SBIA encourages the SBA to treat all SBICs equally regardless of race, gender, country of origin, etc., just as SBICs must treat the small businesses they serve.

The Proposed Rules propose new section 107.301, which provides a licensing fee discount of 60%¹⁰ for Impact SBIC applicants. New section 107.301 states that it is “intended to incentivize the formation of Impact SBICs.”¹¹ The current full licensing fee for partnership SBIC license applicants is \$15,000.¹² As a result, Impact SBIC licensees will only pay \$6,000 for the licensing fee under the Proposed Rules, as opposed to partnership SBICs paying \$15,000, and early-stage SBICs (another initiative, similar to Impact SBICs, that does not exist in statute), \$25,000.¹³

Similarly, new section 107.693 in the Proposed Rules¹⁴ will provide a discount for Impact SBIC licensee of 10% in examination “base fee.” The discounted examination fee is based on an SBIC’s total assets at the time of examination, capped at \$14,000 for

⁹ Small Business Investment Company Program – Impact SBICs, 81 Fed. Reg. at 5670.

¹⁰ *Id.* at 5668.

¹¹ *Id.*

¹² 13 CFR §107.300

¹³ *Id.*

¹⁴ Small Business Investment Company Program – Impact SBICs, 81 Fed. Reg. at 5670.

those having total assets over \$60 million.¹⁵ Traditional debenture SBICs and Early-Stage SBICs do not receive either discount and pay full price, with Early-Stage SBICs paying a significantly higher licensing fee than the others.

These proposed fee differentiation rules are unlikely to achieve their purpose, as: (1) the discounts are too small to encourage non-impact investors to start an Impact SBIC; (2) Given the additional reporting SBA is requiring on the impact of the fund's investments, Impact SBICs actually require *significantly* more review and oversight resources at the time of licensing and examination than traditional SBICs; and, (3), the SBA has indicated that it already does not charge enough fees to support the program, yet is reducing revenue by providing certain SBICs a discount on the fees.

a. Fee Discounts Are Unlikely to Attract New Participants to the Impact SBIC Program, while Disadvantaging Traditional SBICs

The proposed licensing and examination fee discounts in the Proposed Rules are too small to garner the attention of fund managers outside of the program. Instead, the reductions come at the expense of fund managers and funds that are longstanding participants in the traditional SBIC program and consume less of the SBA's resources in terms of oversight and examination. SBA should remove these fee discounts.

b. The Proposed Rules Will Make Impact Funds Require More SBA Resources than Traditional SBICs

Due to the additional regulations and reporting burdens placed on Impact SBICs, fully covered in the Proposed Rules, Impact SBICs will require more oversight and review by the SBA. Therefore, more SBA resources will be dedicated to ensure Impact SBICs are in compliance with the requirements in the Proposed Rule. The specific requirements in the Proposed Rules for Impact SBICs go far beyond those requirements for traditional SBICs. In the licensing stage, under proposed section 107.331, SBA will evaluate an Impact SBIC's proposed definitions of a Fund Identified Impact Investment, and its plan to comply with measurement and reporting requirements for impact assessment under section 107.665, conducting additional due diligence beyond that required for a traditional SBIC.¹⁶ In the operational stage, the examination team will go beyond the review of a traditional SBIC to ensure that Impact SBICs are meeting their impact assessment requirements under proposed section 107.665, reviewing the certification of an Impact SBIC that they have met the 50% impact requirement under proposed section 107.1120 and 107.1810(f)(13), and reviewing the certifications for loans and investments from the small business concern under proposed section 107.610.¹⁷ All of these new specific regulations and compliance requirements for Impact SBICs will result in a

¹⁵ 13 CFR § 107.692

¹⁶ Small Business Investment Company Program – Impact SBICs, 81 Fed. Reg. at 5675.

¹⁷ *Id.*

significant diversion of SBA's resources to examining and licensing Impact SBICs. As a result, oversight and licensing times for traditional SBICs will suffer, despite them paying for a higher level of service.

As a further point, SBA indicates in the Proposed Rules that “[d]espite the fee reduction, SBA will devote neither less time nor fewer resources to the assessment of Impact SBIC [licensing] applications than it devotes to the assessment of standard SBIC applications.”¹⁸ Nor will the SBA “devote less time nor fewer resources to the examination of Impact SBIC licensees as a result of th[e] [examination] discount.”¹⁹ The approach to charging lower fees for Impact SBIC licensees in examinations and licensing is significantly unequitable due to attestations that SBA will provide not only the same level of service, but provide additional levels of service than that given to traditional SBICs.

c. SBA Has Indicated it Needs to Raise Licensing and Examination Fees in Proposed Rule RIN 3245-AG65, While at the Same Time Is Reducing Their Revenues By Providing Fee Discounts

The SBA has indicated that they plan to raise SBIC licensing and examination fees for all SBICs.²⁰ While this was proposed to occur in Fall 2015, and has not yet been posted in the Federal Register, the proposed rule indicated that:

SBA last adjusted SBIC licensing fees in 1996 and examination fees in 1998. These fees currently cover *only a fraction* of necessary SBA administrative expenses related to these activities. The rule proposes to simplify the current exam fee structure and increase both administrative fees to recoup a greater proportion of SBA expenses related to SBA licensing and examination activities. These fees would be annually adjusted based on the urban consumer price index as determined by the Bureau of Labor Statistics. To encourage investment in underserved areas, the rule will propose examination fee discounts for regular SBICs that make significant low and moderate income (LMI) investments. [emphasis added]²¹

Proposed rule RIN 3245-AG65 indicates that the SBA believes it needs more resources given that it claims current licensing and examination fees do not cover the agency's administrative expenses. However, the SBA believes it should provide fee discounts

¹⁸ *Id.* at 5668.

¹⁹ *Id.* at 5670.

²⁰ Small Business Investment Companies (SBIC); Administrative Fees, RIN 3245-AG65, available at: <http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201510&RIN=3245-AG65>

²¹ *Id.*

(when they claim to be unable to meet expenses currently) which will likely have no measurable impact on attracting new Impact SBIC applicants. Furthermore, RIN 3245-AG65 indicates that SBA will propose discounts for *all SBICs* that make LMI investments, rather than just Impact SBICs. If discounts must be provided, it should be provided equitably across the program, as this rule indicates.

One real incentive that should be contemplated is the one described above, in terms of clarity and simplicity of policies and processes to allow new fund managers to successfully navigate through licensing and examination processes.

In sum, instead of providing a *de minimus* fee discount to only Impact SBICs, SBA should consider ways in which *all SBICs* can be sufficiently incentivized to engage in more impact investing on a program-wide basis. This would be in line with the proposal in RIN 3245-AG65 indicated above. SBIA would like to be a resource to the SBA in promoting this goal and finding helpful solutions that treat all SBICs equally, while encouraging greater investment in these important areas.

IV. The Proposed Rules Should Only Apply to New Impact SBICs, Not Existing Impact Investment SBICs

SBIA is concerned that many of the current Impact SBICs were told certain things by the SBA during their licensing process that will ultimately be changed in the Proposed Rules. Of particular concern is the SBA's proposed testing for impact investment progress of these funds. During licensing, our funds were told that testing for impact investment progress would be conducted at the "half-way mark" of the fund. Now, in the Proposed Rules, under section 107.1940, SBA states that an Impact SBIC must meet the 50 percent impact requirements when "cumulative total Financings (in dollars) are at least equal to your Regulatory Capital..." or be found in violation of the SBIC regulations.²² For a 2X levered fund, the point this would occur would be at the 1/3 mark for the Impact SBIC fund. Unfortunately, this is harmful for existing Impact SBICs that draw SBA leverage, because it accelerates the testing requirement that was promised to them. In contrast, unlevered Impact SBICs would not have to report this until the end of the Impact SBIC's investment period. SBA should adjust this and other rules to account for what was originally promised to fund managers entering into the Impact SBIC program. These provisions would create additional burdens and disincentives, which we believe is the opposite of what SBA is looking to achieve.

V. The Impact Certification Requirements Should Be Adjusted to Remove the Requirement that Portfolio Companies Certify as Impact

SBIA is concerned about the new proposed section 107.610, which creates new certification requirements for Impact SBICs for loans and investments. Under proposed

²² Small Business Investment Company Program – Impact SBICs, 81 Fed. Reg. at 5676.

sections 107.610(g)(i) and (ii), both the Impact SBIC and the small business being financed must certify as the basis for qualifying the small business concern as an impact investment.²³ SBIA understands that small business concerns being financed by an Impact SBIC may be reluctant to make such a certification to the federal government, not being familiar with the standards being applied under the certification, despite them being in the federal regulations. Small businesses may have many options for financing, and adding an additional certification requirement from them is a significant burden for the Impact SBIC and the small business. Instead, the SBA should rely on information about the business collected from the small business concern by the Impact SBIC management, and have them certify that information is correct to the best of their knowledge.

In addition, SBIA believes that follow-on investments made by Impact SBICs in Impact Investments should count towards the 50 percent impact investing threshold.²⁴ Follow-on financings in impact businesses continue to create value and growth in those small businesses and their local communities. It should not matter whether the investment is a follow-on investment or a newly discovered business, as the capital flowing to the impact investment may make just as great an impact in driving job creation in both investments.

VI. The Requirement to Brand an SBIC as an Impact SBIC Should be Optional To Ensure Maximum Utilization of the Program

SBIA's members believe that the requirements in proposed sections 107.502(b) and 107.502(c) should be eliminated, and "impact" branding should remain optional for the manager of a particular Impact SBIC. The new requirements would require Impact SBIC applicants and Impact SBICs to identify themselves as impact investment funds in marketing material. Many SBIC managers wish to engage in impact investment and may want to utilize the new Impact SBIC license, but may not wish to market themselves with the "impact" brand. Many funds wish to engage in impact investing, but some LPs are scared off by the impact brand as they assume a focus on social issues as the primary focus of the funds, rather than achieving strong returns. In other cases, LPs may be attracted by the "impact" branding. The marketing approach of the fund should be left up to the SBIC manager to determine what is best for their fund operations and fundraising strategy.

VII. SBA Should Honor Existing Commitments to Impact SBICs

SBA has previously made certain promises to assist current Impact SBIC licensees and those applicants going through the process of applying for an Impact SBIC license. These promises included expedited licensing for Impact SBICs, as well as SBA

²³ *Id.* at 5670.

²⁴ *Id.*

assistance with fundraising for these Impact SBICs.²⁵ Our members have indicated that the commitment of the SBA to expedited licensing has been uneven in application, with some of the Impact SBICs that are currently licensed receiving expedited licensing, and others not. Furthermore, SBA had promised assistance with fundraising, including connecting Impact SBICs in the process with limited partners that are interested in investing in Impact SBIC investing. SBA should work harder to ensure that Impact SBIC applicants receive the expedited licensing they were promised, and build a stable of limited partners who are interested in impact funds. SBIA encourages the SBA to further market the program to limited partners interested in impact investing and establish the SBA as a bridge between prospective Impact SBIC managers and investors.

VIII. SBA Should Explicitly State that the GIIRS Standard is Permitted for Use

In the Proposed Rules, SBA has indicated that it intends to approve the use of three sets of standards to measure impact, for Impact SBICs utilizing the Fund-Identified Impact Investment definition. These include the Impact Reporting and Investment Standards (“IRIS”), which are incorporated into the Global Impact Investment Ratings System (“GIIRS”), the G4 Sustainability Reporting Standards produced by the Global Reporting Initiative (“GRI”), and the standards produced and maintained by the Sustainability Accounting Standards Board (“SASB”).²⁶ In the opinion of our members, the GIIRS standard is currently the most user-friendly at the moment, providing a supported tool for assessing impact investment. However, SBIA supports SBA’s effort to ensure that various standards may be utilized by Impact SBICs. SBIA encourages the SBA to explicitly state that GIIRS is an approved standard, rather than highlighting the overall IRIS standard which it incorporates.

IX. Certain Regulatory Requirements Are Unnecessary for Non-Levered SBICs & Should be Removed

Currently, SBICs must file a capital certificate with the SBA after each deal that is completed. While this is an important part of the oversight over SBIC funds drawing leverage from the SBA, it is unnecessarily burdensome on non-levered SBICs, which do not draw leverage from the SBA. The SBA could make the filing requirement on a quarterly basis for these types of funds, including non-levered impact funds, to eliminate the burden of completing the capital certificate on a deal-by-deal basis.

X. SBA Should Continue to Improve Licensing and Examination Clarity

²⁵ *Expedited Licensing for Impact SBICs: Applying for an Impact SBIC License*, U.S. Small Business Administration, available at: <https://www.sba.gov/content/expedited-licensing-impact-sbics>

²⁶ Small Business Investment Company Program – Impact SBICs, 81 Fed. Reg. at 5669.

The lack of clarity around the SBIC licensing process, particularly for funds with strategies that are not “straight down the fairway” results in difficulty managers with diverse background and experiences to be successfully licensed through the program. SBA should maintain the highest standards and should give full consideration to a diverse array of managers and strategies, as they move through the licensing process.

Additionally, the SBA should review their examination procedures to ensure that all SBICs, not just Impact SBICs, have adequate information and guidance about what examiners are seeking, honor and respect the time periods for which they are conducting the examinations, as well as the process and timelines of examinations, to ensure adequate preparation on behalf of fund compliance personnel. Examiners should follow clear guidelines regarding time periods of review, length and depth of examinations, time provided to the funds to prepare for examination, information that may be requested at the Fund, GP and Management Company level, information to be provided in advance of examination, etc. Disparity of process generates a significant negative impact especially for new and small SBIC’s as well as new program investors who may become concerned with the disparity of process.

We look forward to hearing your thoughts on our proposed solution and to moving forward on this important issue.

Sincerely,

A handwritten signature in cursive script that reads "Brett Palmer".

Brett Palmer
President
Small Business Investor Alliance (SBIA)