



February 14, 2017

Michelle Schimpp
Deputy Associate Administrator
Office of Investment & Innovation
U.S. Small Business Administration
409 3rd Street SW, 6th Floor
Washington, D.C. 20416

Re: Request for Comment on Small Business Investment Companies – Administrative Fees (RIN-3245-AG65)

Dear Ms. Schimpp:

On December 16, 2016, the Small Business Administration (“SBA”) issued a notice requesting comment on a proposed increase on Small Business Investment Company (“SBIC”) licensing and examination fees, fees which are permitted to be assessed under the Small Business Investment Act of 1958 (“Proposed Increase”).¹ The Proposed Increase would significantly increase these administrative fees over a five-year period, while also putting in place open-ended, ongoing fee increases using a permanent inflationary adjuster. The maximum licensing fee is proposed to nearly double from \$25,000 in 2017 to \$45,000 in 2021, with inflationary increases thereafter. Moreover, there are accompanying significant increases in examination fees, including the removal of fee discounts for SBICs, increasing the impact of these increases.

The Small Business Investor Alliance (“SBIA”) appreciates the opportunity to comment on the Proposed Increase 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. After substantive review and analysis of the Proposed Increase, *we reject and strongly oppose* the increases in the proposal. The Proposed Increase violates President Trump’s recently signed executive order titled “Reducing Regulation and Controlling Regulatory Costs” (the “Executive Order”).² The increases in licensing and examination fees are excessive and unreasonable and the amount sought in total funds raised does not correlate to the resources needed by SBA to conduct its responsibilities. Beyond the desire for “more”, there is minimal explanation or justification as to why the SBA thinks the higher fees are appropriately calculated or explained. Nowhere in the proposed fee increase is there any clear plan to fix, reform,

¹ Small Business Investment Companies – Administrative Fees, 81 Fed. Reg. 91049-91058 (December 16, 2016) (the “Release”).

² Exec. Order No. 13771, 82 Fed. Reg. 9339 (January 30, 2017).

or otherwise make any improvements or increase efficiencies. Further, the new exam fee discounts confuse promoting political goals with the SBA's statutory responsibilities. The SBIC industry is not supportive of these higher fees with no clear plan for improvements in service.

This rule is the result of arbitrary decision-making, and the Proposed Increase will create significant deterrence to existing and prospective SBIC fund managers from continuing in the program. Finally, the SBA appears to misrepresent where the money from the fee increase will be directed. While the increased fees may be dedicated to be used for the core SBIC program, the Office of Investment & Innovation ("OII") has been redirecting its human capital and funding to SBIR and social/political efforts for several years at the expense of the SBIC program. There is nothing offered in the Proposed Increase that would indicate that the fungibility of resources will not continue to fund non-SBIC activities. In summary, this fee increase is indefensible without a serious reform plan that is set forward for public comment and input.

SBIA has testified in the past that the SBIC program does need more resources, better technology, and more attention from the SBA.³ However, our proposals regarding adding further resources for the industry were based on specific improvements and reforms, not an open-ended fee increase as is set forward in the Release. We welcome the chance to discuss improvements to the SBIC program for which the industry would be willing to provide additional resources. As the rule is written now, it appears to lack significant planning and details.

I. The Proposed Increase Does Not Comport with President Trump's Executive Order on Regulatory Relief and Controlling Regulatory Costs

On January 30, 2017, President Trump signed the Executive Order.⁴ The Executive Order required that federal agencies, including the SBA, implement a policy that "for every one new regulation issued, at least two prior regulations be identified for elimination, and that the cost of planned regulations be prudently managed and controlled through a budgeting process."⁵ The Proposed Increase does not comport with this new policy as it creates a new regulation, without identifying two prior regulations that will be eliminated. While this policy was put into place subsequently to the rule being proposed, for this rule to be issued as a final rule, it must conform with the policy. On this point, the Executive Order further states in section 2(b) that in FY 2017, the current fiscal year, the "heads of all agencies are directed that the total incremental cost of all new regulations, including repealed regulations, to be finalized this year shall be no greater than zero, unless otherwise required by law or consistent with advice provided in writing by the Director of the Office of Management and Budget..."⁶ The Proposed Increase fits within the definition of "regulation" or "rule" set forth in the Executive Order. Given the significant increase in cost to regulated entities under the Proposed Increase, as well as the lack of stated regulations that will be

³ *Testimony by Steven Brown, Trinity Capital Fund II, LP, Phoenix, Arizona, on behalf of the Small Business Investor Alliance*, Hearing "Examining the Small Business Investment Company Program, House Small Business Committee, July 25, 2013.

⁴ Exec. Order No. 13771, 82 Fed. Reg. 9339 (January 30, 2017).

⁵ *Id.*

⁶ *Id.*

repealed while the Proposed Increase is finalized, this rule will not comport with the standards set forth in the Executive Order. SBIA encourages SBA to reconsider moving forward with this rule, given the terms set forth in the Executive Order.

II. SBA Proposed Large Fee Increases, Without Justification or Reform Plan

SBIA opposes increasing licensing fees for SBICs because the process should be further reformed and streamlined, particularly for repeat licensees. The Proposed Increase includes a rolling increase from 2017 through 2021, increasing from \$25,000 in 2017 to \$45,000 in 2021, with an increase of \$5,000 each year. After 2021, these fees continue to rise due to a proposed permanent inflation adjustment. SBA claims in the Release that the impact of this increase on SBICs is quote “not significant”.⁷ It appears very easy to demand someone else pay on the grounds it is “not significant.” However, the increases are very large on their face and are in excess of what an increase for inflation would be – raising an additional \$3-4 million per year, from SBICs, by October 2020.⁸ SBA claims that their expenses related to licensing and examination activities have doubled due to inflation, and the cost of obtaining necessary resources to manage SBA’s increased risk⁹ - however then point out that this risk has declined significantly as SBA has improved its licensing and vetting process. While the financing of SBICs have continued to operate at zero subsidy to the taxpayer, and the risk and associated annual charge is at an all-time low, the cost of OII’s administration and staffing of the program incorporates the expenses of unrelated programs administered by OII. The OII should use all its resources to support the SBIC program.

Again, SBICs have no certainty that if these higher fees are imposed that the additional resources generated would not be used to offset increased spending for non-SBIC matters as the funds raised are placed in the overall SBA account “for salaries and expenses of the Administration.”¹⁰ While these fees are supposed to be allocated to cover the costs of licensing and examinations¹¹, there is no limitation on monies that are currently spent on licensing and examinations from being diverted to other uses by the SBA. In fact, while the SBA has indicated it is short-staffed and needs additional funding, rather than fill positions in core competencies, it recently created and hired a staff position to duplicate what is already the role of the head of the Office of Program Development, after the Release was issued. This suggests that the OII’s priorities are not the core competencies of the program and there is not a reform/efficiency agenda, but rather a political one.

a. SBA Must Further Substantiate Why a Fee Increase is Needed

SBA has failed to adequately make the case as to why \$3-4 million additional fees are needed to offset the administrative costs to the program. SBIA believes that SBA should first conduct an in-depth accounting of the needs and requirements of OII to provide first-class service to SBICs and conduct expeditious and thorough examinations and an efficient SBIC licensing process. After

⁷ Small Business Investment Companies – Administrative Fees, 81 Fed. Reg. at 91056.

⁸ *Id.* at 91055.

⁹ *Id.* at 91050.

¹⁰ 15 U.S.C. § 681(e)(2).

¹¹ *Id.*; 15 U.S.C. § 687b(b).

determining what minimum resources are required to fulfill its mission, OII should determine the specific cost of each of the items needed and provide this calculation in a transparent manner to the SBIC community and congressional appropriators. This calculation should also include areas where OII can cut costs and better allocate existing resources without shifting the burden onto SBICs. Some examples of where this can be accomplished is by providing a streamlined licensing process for repeat SBIC funds, and utilizing private-sector solutions such as off-the-shelf virtual data rooms to encourage efficiency and transparency in the process. After this final accounting has been done, SBA should present the total amounts required to the public. We believe this scientific accounting approach will result in a total amount that is substantially less than the \$3-4 million estimate of what amount will be raised by the Proposed Increase, and highlight that the SBA's original estimate of need was not correlated to the express needs of the SBIC program.

A review of the case made for the increase in fees indicates that the additional fees will be used to (1) offset inflationary increases by “recoup[ing] a significant portion of its projected expenses associated with licensing and examination-related activities; (2) pay for necessary technology upgrades related to licensing and examinations; (3) pay for additional licensing and examiner training; (4) pay for necessary information resources commonly available to private equity fund of funds to support due diligence, analysis, and decision-making in the licensing area; and, (5) pay for contractors with specialized expertise to help support staff associated with licensing and examination-related activities.¹² While many of these things may in fact be necessary resources at the SBA, there is no or little explanation of what each of these elements would cost, and whether these costs will add up to the \$3-4 million in revenue that the SBA has stated will be raised by the Proposed Increase. Calculating the numbers provided¹³ to justify the Proposed Increase results in \$1.7 million in additional costs, which are not fully substantiated in any way. If OII needs additional resources from additional fees, they should fully substantiate them as explained above, in a clear manner, and seek funding from SBICs as a last resort.

b. SBIA Believes Staged In Licensing Fees Could be Paid for Filing a MAQ and a Licensing Application

In the Proposed Increase, the SBA highlights that under current regulation 13 CFR 107.300, SBIC applicants are required to pay the licensing fee when they submit their complete license application.¹⁴ This is after an applicant files a Management Assessment Questionnaire (“MAQ”) and receives a green light letter, which represents a cost to OII in the process. As indicated in the release on the Proposed Increase, less than 50% of applicants end up paying the licensing fee as others do not ultimately submit a license application after receiving a green light letter.¹⁵ As SBA has stated, this indicates that currently, licensed SBICs are covering the cost for those that do not make it through the process, a condition that will dramatically increase under the Proposed

¹² Small Business Investment Companies – Administrative Fees, 81 Fed. Reg. at 91051.

¹³ \$100,000 in information subscription services, \$500,000 in increased licensing and examination costs for technology improvements, \$100,000 to incur additional training costs, and \$1 million in contracting resources.

¹⁴ Small Business Investment Companies – Administrative Fees, 81 Fed. Reg. at 91051.

¹⁵ *Id.* at 91052.

Increase. The OII should fix their MAQ process so that it is clear what qualification are needed to be licensed. A 50% failure rate is not an indicator of high standards, but is a clear indicator of ambiguous standards that waste the time and money of both the OII and many applicants. SBIA does not believe that it is appropriate for licensed funds to pay the full brunt of the cost for those going through the process, and while balancing the potential discouraging impact of charging a fee on prospective applicants, contends that a portion of the licensing fee could be paid by those submitting MAQs. This would offset the cost on successful SBICs that make it to the license application process, while not going so far as to deter applicants. Further, requiring MAQ filers to pay some fee may provide an appropriate level of deterrence if so many fund managers deemed worthy of a green light letter ultimately prove willing to walk away from the process. We believe a fee of \$5,000-10,000 would be appropriate with a requisite decrease in the licensing fee on the back end. This would help offset some of the cost for successful applicants, while not discouraging prospective groups submitting MAQs. However, even with a staged fee, OII needs to better communicate clear standards to applicants.

c. SBIA Opposes a Permanent Adjustment for Inflation on Licensing and Examination Fees

The Release includes a permanent inflationary adjuster on the licensing and examination fees going forward after the significant increases in 2021. SBIA does not support a blanket increase in these fees on an annual basis, and believes SBA must continue to make the case for licensing and examination fee increases when they wish to implement them. Adding a permanent adjuster removes the SBA's accountability to reducing costs and streamlining their processes to permit more capital to be provided to small businesses, rather than to the government agency.

III. SBIA Opposes Increases in Examination Fees

SBIA opposes the increase of examination fees on SBICs. While we realize more staffing resources may be needed in SBIC examinations, we believe additional resources should be dedicated from other budgets in OII, or sought from congressional appropriations. The Proposed Increase seeks to raise the maximum base fee for leveraged SBICs from \$20,000 in 2017 to \$44,000 in 2021 – more than doubling the maximum amount of the base fee.¹⁶ While the base fee is raised, SBA proposes to eliminate the “fully responsive discount” which almost all SBICs currently received.¹⁷ This discount of 15% is significant and its elimination results in an even more dramatic increase than the raise in the base fee. While there has been an increase in the number of SBICs to be examined and a resulting increase of the overall examination expense, there is no evidence provided that the cost of examining an individual SBIC has doubled.

SBIA does applaud the removal of additions to the base fee that are currently in place under 13 CFR 107.692 for early-stage SBICs, participating securities licensees and partnership and LLC SBICs. This corresponds with SBIA's belief that the examination fees should be uniform across the board for all SBIC licensees. While we applaud these changes, they will not have a significant

¹⁶ *Id.* at 91053.

¹⁷ *Id.*

impact, given the massive increase in the regular base fee. The removal of the participating securities licensee fee provides little impact given that such funds are not currently being licensed and have not been licensed for many years, and the LLC and Partnership fee increase is 5%, which is smaller than the 15% discount under the “fully responsive” discount that is being eliminated. The removal of the early-stage addition to the fee is significant since it is a 10% increase on the base fee.

a. SBA’s Examination Fees Should Not Be Based on Arbitrary Decisions by Examiners

The Release adds several additional fees in the examination process which provide the opportunity for SBA examiners to arbitrarily determine when additional fees should be charged without an appeals process. Giving such broad discretion creates financial incentives for OII to find reasons not to give discounts and artificially lowers the advertised cost of an examination. SBIA supports a uniform base examination fee, with no discounts and no additional fees tacked on based on examiner discretion, except in egregious cases. Instead of this approach, which could result in disparate treatment by examiners, the Proposed Increase highlights several additional fees that can be added through an SBA examiner’s discretion. These include an “unresolved finding addition”, the discount for not having violations, the addition charged for SBICs maintaining records located in multiple locations, an additional “delay fee” with inflation adjuster of \$700 a day, and the most concerning of all, the additional fee for “non-responsiveness”.¹⁸ These additions and discounts create the opportunity for disparate impact, due to the lack of context and vague description of “non-responsiveness” and the potential that having an unresolved finding might occur out of necessity by the SBIC.

In the first case, SBA proposes that a 15% addition be added to an examination fee if an SBIC is “not responsive.”¹⁹ Proposed 13 CFR 107.692(c)(3) states that an SBIC that is not “fully responsive” to the letter of notification of examination (that is, the “SBIC did not provide all requested documents and information within the time period stipulated in the notification letter in a complete and accurate manner, or you did not prepare or did not have available all information requested by the examiner for on-site review), an additional 15% charge will be added to the examination fee.” This approach can result in an examiner treating SBICs differently because of the discretion available to the examiner to add this significant fee and the lack of clear language as to what constitutes “non-responsive.” For instance, some information may not be available for the examiner that is requested, or the examiner’s views on “complete and accurate manner” might be different than the CFO of an SBIC. In addition, there is no penalty here for SBA’s lack of responsiveness, which is common in examination issues. For these reasons, SBIA opposes implementing additional penalties on top of the base examination fees, without at minimum, a warning about non-responsiveness before a fee is charged.

¹⁸ *Id.* at 91053-91054.

¹⁹ *Id.* at 91057.

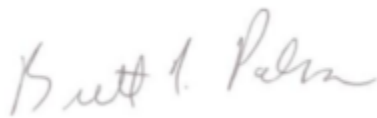
In the second case, an SBIC that has an “unresolved finding” would be charged a 5% addition to the examination base fee for each finding every 30 days, beyond a 90-day grace period.²⁰ While on its face this may appear reasonable, given the 90-day response period, it may be difficult for an SBIC to resolve a finding in that period, particularly if an SBIC is being required by the SBIC to sell a portfolio company. If that portfolio company is sold too quickly it may result in a “fire sale” loss, which harms the SBIC and the small business. In that case, a 90-day window may be too short, and cause harm to the fund and the businesses relying upon it. If this fee must be included, it should be worded more carefully to ensure that only when it is explicitly clear that the SBIC is taking no steps to resolve an “unresolved finding” should they be penalized.

b. SBIA Opposes an Examination Fee Discount to Achieve Political & Social Goals Outside of the Statutory Mandate

As we have indicated above, SBIA does not believe that examination fees should be supplemented with discounts or add-ons. This includes discounts for achieving political and social goals of the agency. The goals of the program are already clearly defined in statute. All SBICs, through their efforts to invest in domestic small businesses, are fulfilling the mandate of the agency to bring economic growth to American communities. The program is designed to drive capital where it is needed and not where the political winds blow. SBICs invest heavily in LMI areas and to the benefit of many communities, but the government should not be pressuring SBICs to invest where the money might not be best used. The Proposed Increase seeks to treat various SBICs differently, by providing a 1% discount for every \$10 million in LMI investments that are made by an SBIC, from their examination fee.²¹ We believe this is a slippery slope towards the SBA arbitrarily picking investments as opposed to market drivers, and is the wrong approach for the sustainability of the program.

SBIA, as always, is interested in working together with the SBA to make improvements to the SBIC program, and ensure that it continues to make such a positive impact on domestic communities. We look forward to a discussion on what additional resources the SBA needs, and how, through greater efficiency and congressional involvement, we can work together.

Sincerely,



Brett Palmer
President
Small Business Investor Alliance

²⁰ *Id.*

²¹ *Id.*