May 17, 2013

Robert Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. OP-1456

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
Mail Stop 9W-11
400 7th Street, SW
Washington, DC 20219
Docket ID OCC-2013-0003

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Community Reinvestment Act (CRA): Proposed Changes to the Interagency Questions and Answers Regarding Community Reinvestment

Dear Sir or Madam:

Thank you for seeking input from the public on improvements to the Interagency Questions and Answers regarding Community Reinvestment. The explanations and the proposed changes make clear that the FFIEC made a very strong effort to incorporate the views and concerns expressed by many parties in previous communications and hearings with regulators.

The Small Business Investor Alliance (SBIA) is a trade association comprised of private equity funds investing in domestic small businesses and investors into these funds. Most of our member funds are SBA licensed Small Business Investment Companies (SBIC).

SBICs are highly regulated private equity funds that invest exclusively in domestic small businesses. SBICs are designed to be a catalyst for market-driven development providing sustained benefits to small businesses. Growing small businesses and creating jobs provides lasting and expansive benefits.

SBICs pool capital from many sources: individuals, pension funds, funds of funds, banks, and insurance companies. SBICs provide capital that creates jobs and enables innovation. SBICs provide capital to small business that many financial institutions have great difficulty serving. It can be a challenge for a large financial institution to provide capital to small businesses because small businesses need capital in amounts too small to provide efficiently. It requires more work to provide one million dollars to a small business than it would to provide one-hundred million dollars to a larger business. Small businesses are often seen as too risky to provide long term capital because they are light on assets, despite having positive cash flows. Further, small businesses are often in niches that are very different from better known larger businesses and therefore their business model is often less easily understood. Despite these obstacles, small businesses are fantastic job creators and are the economic engine to many communities. It was for all of these reasons, which were as true in 1958 as they are today, that Congress created SBICs.

Banks - national, regional, and community- are vital sources of capital for many of these SBIC funds. Banks commonly provide at least a portion of the total private capital invested in SBICs. In some cases SBICs derive 100% of their investments from banks. For bank investors, the SBIC mechanism is a multi-purpose tool because SBIC enable capital to flow to worthy small businesses in a safe and sound manner that is clearly beneficial to sustainable development of that business and its community. It is worth noting that in addition to promoting sound fund management practices, SBIC regulations protect not just the bank investors, but also ensure that the small businesses accessing the funds have protections too. The SBIC mechanism enables banks to achieve their fiduciary, regulatory, and public policy mandates.

Banks, and the SBICs to whom they provide capital, need a significant level of certainty that they will receive full CRA investment credit for their investments. Confusion and uncertainty on the amount of credit have reduced SBIC investment below what it would otherwise be. We note that the OCC has been particularly helpful in educating banks, SBICs, and the public as to the interaction of SBICs and CRA credit. The OCC's actions have helped remove some of the ambiguities surrounding CRA credit. SBIA believes the proposed changes by the FFIEC can, with a few adjustments, make meaningful progress toward greater clarity and promote more investment. Some honing of the language would be beneficial to make sure the guidance is as clear as possible. In addition to increased clarity in formal guidance, consistent training of examiners to implement the new language will also be a vital part of an improved CRA process.

Assessment Areas

With regard to §___.12(h)-6 and §___.12(h)-7, the SBIA believes the language retained is appropriate and the new language is an improvements, but some modification to the new language would be beneficial.

SBIA believes that retaining the language for the first paragraph of §___.12(h)-6 is appropriate and we support its reaffirmation by the FFIEC. The revisions to the second paragraph also appear to be an improvement, but modification may be necessary to avoid adverse interpretations.

SBICs are already highly regulated and created with a Congressional mandated public policy purpose that is consistent and synergistic with the investment goals of the CRA. As such, investments in licensed SBICs should be evidence that the bank is pursuing investments in a safe and sound manner. SBIC fund managers have cleared a background check that reviews both criminal history and investment track record. SBICs have numerous regulations that prohibit conflicts of interest, overconcentration of investments, and other risky and inappropriate activities. SBIC funds are also regularly examined by federal examiners for financial condition and for regulatory compliance. Investment in SBICs are investments in funds that have been vetted by more than just the bank investor.

The area that needs further honing is the "in lieu of" language. SBICs generally market to an assessment area. But ultimately SBICs should choose to make the most promising investment from all the investment options available to them. The better investment may be inside the state or inside the region, but may be outside of the strict confines of the assessment area. As written, an examiner might interpret the current language to mean that credit will not be given for the investment because the SBIC chose the regional (and in this case more promising) investment "in lieu of" the less promising investment located within the assessment area. If an examiner were to interpret the new language this way it would create a disincentive to invest outside the investment area and therefore in SBIC funds that invest in the region. Further, this might even create an incentive to invest in a manner that does not promote safety and soundness of the fund because consistently seeking less promising investment is not a recipe for success. If the intent is to promote real investment and the growth that comes with it, then the language should be clarified to make sure we are not continuing financial capture of investments to financial centers. Removing the words "in lieu of" would fix it and maintain the intent. It will be important to address, either in this language or in examiner training, that "detriment" means demonstrable harm and not just being passed over for investment.

§___.12(h)-7 Appears to provide better clarity and positive flexibility that will promote greater small business investment.

SBICs generally market to the assessment areas and invest in the state or region of the assessment area. The confusion over whether their investment would get full credit was a source of frustration and a disincentive to investment. SBIA believes promoting positive flexibility for SBIC funds to invest across a single state or region that includes the assessment area will benefit more communities by attracting more investment capital. CRA credit should not be diminished or otherwise diffused for regional or state investments outside the strict confines of the assessment area.

This clarification is important, particularly for smaller banks. If CRA credit were only given for investments made in the strict confines of the assessment area it would be very limiting for community and smaller banks to provide capital to SBICs and get CRA credit. A regional or state-specific SBIC with 30 community banks as investors might only make 15-20 investments. While the SBIC will likely market to all of the assessment areas, it is unlikely that it would be able to invest in every assessment area because there may be more investors than investments to put in each of their assessment areas. However, it is very possible, if not likely, that the SBIC could and would invest in their bank investors' region. Unleashing the collective investment power of smaller and community banks via the SBIC mechanism should be encouraged via CRA, not inadvertently limited.

State specific funds exist and more are being formed. It would be beneficial for language to be added to make clear that state-specific SBIC funds that make at least two thirds of their investments in a single state will earn their bank investors CRA credit for investments made in that state. This is important for small banks who lack the size to support their own SBIC vehicle, but who choose to band together with other small banks across a state.

Nationwide Funds

SBIC funds can be regional or national funds. SBIA believes that SBIC investments, whether national or regional should be encouraged. The new language of §___.23(a)-2 appears to make investment in SBICs with a national focus less risky from a CRA perspective. We welcome this improved clarity and expect increased investment via SBICs with increased certainty. Greater clarity in a few areas would be beneficial and avoid unintended consequences.

The FFIEC asked several important and interrelated questions about nationwide funds. The SBA's 2012 Annual Report documented the broad geographic and sector diversity supported by SBIC investments, a diversity that is not common across platforms of private investment. The definition or interpretation of nationwide funds should include funds that invest across multiple regions, if not in every region of the country.

Providing a clear path to CRA credit for investments made in the region that includes the assessment area addresses many of the problems that nationwide and multiple region funds have faced. If CRA credit is earned without dilution for investments in the state or region then banks can truly know what they need and SBIC funds can stop guessing about those needs. Clarity for regional investment allows banks and SBICs to pair off according to the alignment of the CRA need and the investment strategy. This addresses the issues for nationwide, super-regional, or even regional SBIC funds. An additional benefit to regional credit clarity is that it is easier to document and track. The amount of bank investment in an SBIC can be easily documented as can where the SBIC investments were made and how much capital was made in the small business. Given that SBICs generally market to their bank investors' assessment area and region, it is a safe bet that small businesses receiving investment benefitted from the bank investment in the SBIC. Credit for SBIC investments makes reporting easier and decreases the risk of double counting and investment.

Side letters and earmarks have been useful to a degree, but they can add considerable expense and complexity for both banks and fund managers. For example, side letters may delay the SBIC licensing process for months because SBA must review, comment and eventually approve each one. Side letters and earmarks should not be required and the new language provides better options for documentation.

The term "earmarking" means different things to different people. If earmarking means documenting investments made in a bank's assessment area or region then those "earmarks" should be allowed. SBICs are interested in seeking investments in their bank investor's region and assessment areas. While investment decisions are ultimately made on business criteria, exposure to the opportunity likely would not have happened without the bank's interest in servicing their assessment area and region. Therefore banks should get full credit if there is an investment made in their region, state or assessment area. If there are multiple banks in the fund that share the assessment area then they should be able to split the credit up to the size of their investment in the fund. This would ensure that there is no double counting of the same credit while recognizing the reality of the beneficial impact bank investors have on their region and assessment areas. A straight pro-rata share of the fund may shortchange the value of having the bank investor in the fund by automatically diluting their credit and undervaluing the SBIC's desire to market to their region, state, and assessment area. If earmarking means giving credit solely to one bank investor at the expense of another bank investor with the SBIC fund manager as the arbiter, then earmarking puts the fund manager in a distinctly difficult, unpleasant, and unwanted position.

FFIEC agencies should work with SBIA to educate SBICs and banks as to how to appropriately document investments for CRA credit. The new language provides for positive flexibility in documentation and seems to strike a collaborative tone in setting standards on documentation. This approach is welcomed.

One area that the Q&A does not clearly address and has never adequately addressed is the issue of "funds of funds." The fund of fund is a pass-through structure that pools capital from institutions for deployment by experts in certain investment sectors. Funds of Funds investing in SBICs should qualify under the nationwide funds descriptor. This has not been a major issue because most banks do not invest in funds of funds because there would be even less certainty about the amount of CRA credit that a bank would receive. However, if clarity were provided it would increase the likelihood that this vehicle would attract bank capital. In particular, banks investing in funds of funds that are investing in SBICs should be able to have the CRA credit pass through to the bank. The fund of fund model is particularly attractive for banks making their first investments into SBICs because they are able access experts who can help them find the SBIC funds that correlate with their assessment areas and region as well as for other specialized criteria.

<u>Training and Education</u>

Upon completion of the updated Q&A language, SBIA encourages the FFIEC agencies to train examiners on the new language, specifically on understanding the guidelines for SBIC investments. SBIC investments are very different from many of the other CRA mechanisms and a greater understanding and consistency would be very beneficial.

The OCC worked with the SBA, banks and SBICs to prepare a comprehensive informational report on SBIC investing. The updated Q&A will help fill in some of the guidance gaps in that report. Banks, SBICs, and small businesses would benefit from the other agencies updating the OCC report in light of the new language and sharing it broadly with their examiners and banks.

Again, thank you for your efforts and your willingness to consider to our views.

Sincerely,

Brett Palmer

Brett Palmer
President
Small Business Investor Alliance