VIA Electronic Submission

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Legislative & Regulatory Activities Division
Office of the Comptroller of the Currency (OCC)
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Washington, D.C. 20219

Robert E. Feldman, Executive Secretary
Attn: Comments
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Robert De V. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
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Re: Community Reinvestment Act; Interagency Questions and Answers Regarding Community Investment; Docket ID OCC-2014-0021 (OCC) Docket No. OP-1497 (Fed)

The Small Business Investor Alliance ("SBIA") welcomes the opportunity to comment on the proposed revisions to the Community Reinvestment Act Interagency Questions and Answers[1] ("Q&A Revisions") issued by the three banking regulatory agencies, the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Board"), and the Federal Deposit Insurance Corporation ("FDIC") (collectively "the Agencies").

SBIA is a national association that develops, supports, and advocates on behalf of policies that benefit investment funds that finance small businesses, as well as the investors that provide capital to these funds. Our membership includes the vast majority of all the active Small Business Investment Company (SBIC) funds and institutional investors that invest in these

[1] Notice, Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment, 79 F.R. 53838 (September 10, 2014).

funds, including a number of banks.[2] Banks have been investing in or owning their own SBIC funds for decades due to both the financial and public policy benefits they provide. The ability to earn Community Reinvestment Act ("CRA") credit is a critical consideration in the decision of banks to invest in small businesses. .[3]

I. Background on SBICs

SBICs are small, highly regulated investment funds that are licensed and regulated by the U.S. Small Business Administration ("SBA") and have been since 1958.[4] These funds invest exclusively in domestic small businesses. Eligible small businesses are limited to those that will continue operation long after the investment has been completed so extraction industries and project finance are not permitted. To become licensed as an SBIC, private capital is raised from a variety of sources including individuals, banks, pension funds, and other investors. After passing through the private sector filter of an adequate fundraising, the SBA vets potential applicants for performance, regulatory compliance, and a variety of other measures, after which the applicant may be licensed. Only about 25% of potential SBICs exit the process earning a license. After licensing, depending on the SBIC's strategy, an SBIC fund may draw leverage from the SBA on a 2:1 ratio against private capital, up to a maximum $150,000 in leverage for one license, and $225,000 for a family of licenses. The leverage is not taken at the level of the small businesses, but at the SBIC fund level. SBIC funds that choose not to draw SBA leverage are non-leveraged SBICs. These non-leveraged SBICs include SBICs owned by banks or with bank LPs who do not need the increased returns the leverage provides. Currently, as of end of the Fiscal Year 2014, there are 45 bank-owned or non-leveraged SBICs out of a total of 294 SBICs.[5] However, there are significantly more SBICs that have bank investors, but are not bank-owned. In Fiscal Year 2014, SBICs provided over $5.46 billion in financing to small businesses, defined generally as those businesses below $19.5 million in tangible net worth and $6.5 million in tangible net income.

SBICs are providing capital to areas that are not traditionally reached by banks, particularly as banks have been shifting activity away from the small business credit market since the late 1990s.[6]The number of bankable credit-worthy small businesses has declined as regulatory requirements have increased and business demand was impacted as a result of the 2008 financial crisis. Many excellent small businesses are growing and are cash flow positive, but do not have the assets to loan against to finance their growth. SBICs are critical to these growing companies. Without SBIC capital, the growth of these businesses would be choked off.

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[2] SBIA currently enjoys over 400 individual fund members, including 26 BDCs (currently there are 65 BDCs operating in the marketplace. SBIA also has a number of bank members that engage in SBIC investments.
[3] *See* 12 U.S.C. 24 (Eleventh); 12 CFR 25.23; 12 CFR 160.36; 15 U.S.C. § 682(b).
[4] Small Business Investment Act of 1958, 15 U.S.C. § 681.
[5] SMALL BUSINESS ADMINISTRATION OFFICE OF INVESTMENT & INNOVATION, SBIC PROGRAM OVERVIEW*,* (September 30, 2014).
[6]Ann Marie Wiersch & Scott Shane, *Why Small Business Lending Isn't What it Used to Be,* Federal Reserve Bank of Cleveland, August 14, 2013, *available at:* http://www.clevelandfed.org/research/commentary/2013/2013 -10.cfm

Funds licensed as SBICs serve a statutorily mandated public policy purpose to improve and stimulate the national economy by investing in the small business segment of the national economy. The SBIC program supports and stimulates the flow of capital and long-term loan funds to small business concerns by investing in their business operations and their growth, expansion and modernization. This program has been extraordinarily successful in funding small businesses and job creation, with well-known companies such as Apple, Intel, Costco and Federal Express all receiving SBIC funding when they were small businesses. Thanks to SBIC capital, they aren't small businesses any longer.

Congress has long recognized the value to public welfare of SBICs. Even under Glass-Steagall the only permitted exemption was for SBIC investments. Congress again recognized the critical, mutually beneficial relationship of banks, SBICs, and small businesses by exempting SBICs and SBIC funds in formation from the definition of "covered funds" in the statute implementing the Volcker Rule[7].Bank regulators have long allowed banks to receive CRA credit for making these investments.[8]

SBIA encourages the Agencies to continue to encourage SBIC investment and other targeted public welfare investments in their CRA evaluations of banking institutions. SBICs are exceptionally good investments, not only because they provide the banks exceptional returns, but because the small businesses receiving capital continue to flourish long after the investment is completed. The Agencies should make a stronger effort to clarify and harmonize the benefits of SBIC investments and the way the Q&As are applied between the agencies' examiners. Many banks still don't invest in SBICs because these investments are unfamiliar to their examiners and the banks have concerns they will not be given full credit for their investments.

II. SBIA applauds the Agencies for preserving language presumptively qualifying investments to SBICs as "promoting economic development" in the existing Q&As

SBIA applauds the Agencies for retaining language in Existing Q&A_.12(g)(3) that states "[t]he Agencies will presume that any loan to or investment in an SBDC, SBIC, Rural Business Investment Company, New Markets Venture Capital Company, or New Markets Tax-Credit eligible Community Development Entity promotes economic development."[9] This language is critical to ensure that investing in SBICs, which promotes significant job growth and economic development, continues to be clearly defined as "promoting economic development". The economic benefits of SBIC investment continue long after the investment has been realized. This language should ensure that both agency examiners and CRA officers at banking institutions will have certainty that these investments will qualify as community development activities and receive full CRA credit under the investment test.

[7] 12 U.S.C. § 1851(d)(1)(E).
[8] *See* 12 U.S.C. 24 (Eleventh); 12 CFR 25.23; 12 CFR 160.36; 15 U.S.C. § 682(b).
[9] 12 CFR_.12(g)(3)—1, *see* Notice, Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment, 75 F.R. 11642, 11646 (March 11, 2010).

III. The Agencies should consider bank investments in SBICs engaged in lending activities as "Community Development Loans" for the purpose of CRA ratings

The Q&A Revisions make changes to §_.12(h), which defines the term: "community development loans." The Agencies should consider adding SBICs engaged in lending activities to the "financial intermediaries" section of §_.12(h)-1, as many are engaged in lending activities to small businesses such as providing mezzanine loans to small businesses in various communities. Including SBICs in this group of "financial intermediaries" is consistent with the definition of "community development loan" because SBICs are primarily involved in lending or the facilitation of lending to promote community development. Moreover, many banks are providing revolving lines of credit and other lending facilities directly to SBICs, or participating as a senior lender in joint deals, thereby lending directly to the SBIC to facilitate economic development in local communities. In effect, SBICS are acting as similar conduits as community loan funds or pools, Community Development Financial Institutions, and others for lending activities in the community.

SBICs are the bridge linking conventional bank loans to eligible small businesses. SBICs facilitate improvements to the financial condition and operations of a small business without which banks could not lend to them. Banks investing through an SBIC or providing a lending facility to an SBIC have an outsized impact, extending their lending beyond their regional footprint. Even though not directly lending to small businesses, bank lending to SBICs indirectly facilitates lending to small businesses by the SBIC, providing a mechanism for additional lending that the bank itself may not be able to do. In the FY 2013 report for SBICs stated that out of all SBICs in existence, as of September 30, 2013, 59.1% of those funds were engaged in mezzanine lending, with 19.6% being engaged in senior lending or "other creditor" activities, for a total of 78.7% of SBICs being engaged in lending activities to small businesses in the United States.[10] The record is clear that SBICs are acting akin to other financial intermediaries in terms of engaging in community lending activities and therefore should be considered under the CRA lending test.

Allowing SBICs engaged in lending activities to be considered a financial intermediary of a "community development loan" would provide clarification for small banks on the treatment of SBIC investments, as they would realize consideration for these economic development activities under the lending test. While currently small banks receive some positive treatment for SBIC investments as a "qualified investment," such investments are not considered under the lending test for small banks, and thus, fail to have the desired impact on a small banks' CRA rating (raising it from Needs to Improve or Substantial NonCompliance up to a Satisfactory rating).[11] Allowing these investments to be considered under the lending test would be substantially

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[10] SMALL BUSINESS ADMINISTRATION OFFICE OF INVESTMENT & INNOVATION, SMALL BUSINESS INVESTMENT COMPANY (SBIC) PROGRAM ANNUAL REPORT FOR FISCAL YEAR ENDING SEPTEMBER 30, 2013, 9 (June 9, 2014).
[11] OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMMUNITY DEVELOPMENTS INSIGHTS, SMALL BUSINESS INVESTMENT COMPANIES: AN INVESTMENT OPTION FOR BANKS, f.n.11, (September2012).

beneficial to the small banks, as SBIC investments typically have a strong investment rate of return (IRR) and as opposed to many CRA investments, would contribute to strengthen the bank's balance sheet and thus, have positive impacts on the safety and soundness of small banks. This change would also provide significant benefits for large banks as SBIC investments could be considered not only under the investment test, but also the lending test. As the Agencies are aware, the lending test carries substantial weight in attaining a favorable CRA rating, as is illustrated in the following table:

Points assigned for CRA performance under the Individual Lending, Investment & Service Tests[12]

Rating	Lending	Investment	Service
Outstanding	12	6	6
High Satisfactory	9	4	4
Low Satisfactory	6	3	3
Needs to Improve	3	1	1
Substantial Noncompliance	0	0	0

Banks investing in or lending to small businesses through an SBIC should be benefit for doing so, given that these funds act directly as a conduit for encouraging economic growth and job creation, particularly in areas that are underserved in terms of small business investment. As the OCC highlighted in their September 2012 report, in fiscal year (FY) 2014, 294 SBICs made 2,309 financings of 1,085 small businesses with a total financing amount of $5.46 billion.[13] Of this amount, $3.48 billion was in the form of debt financing to small businesses. The Agencies should consider adding SBICs to the list of financial intermediaries under the "Community Development Loans" definition and allow banks that are lending to these funds to receive credit for them under the lending test.

[12] Darryl E. Getter, *The Effectiveness of the Community Reinvestment Act,* CONGRESSIONAL RESEARCH SERVICE, 4-5, (July 25, 2014); *see also* Federal Financial Institutions Examinations Council, *Community Reinvestment Act: Interagency Questions and Answers Regarding Community Reinvestment,* 66 F.R. 36639, (July 12, 2001).

[13] SMALL BUSINESS ADMINISTRATION OFFICE OF INVESTMENT & INNOVATION, SBIC PROGRAM OVERVIEW*,* (September 30, 2014).

SBIA appreciates this opportunity to share our thoughts on the Q&A Revisions and stands willing to discuss our comments and any other ways in which the Agencies can better help banks understand how CRA credit is applied, particularly in regard to SBICs.

Sincerely,

Brett Palmer
President
Small Business Investor Alliance