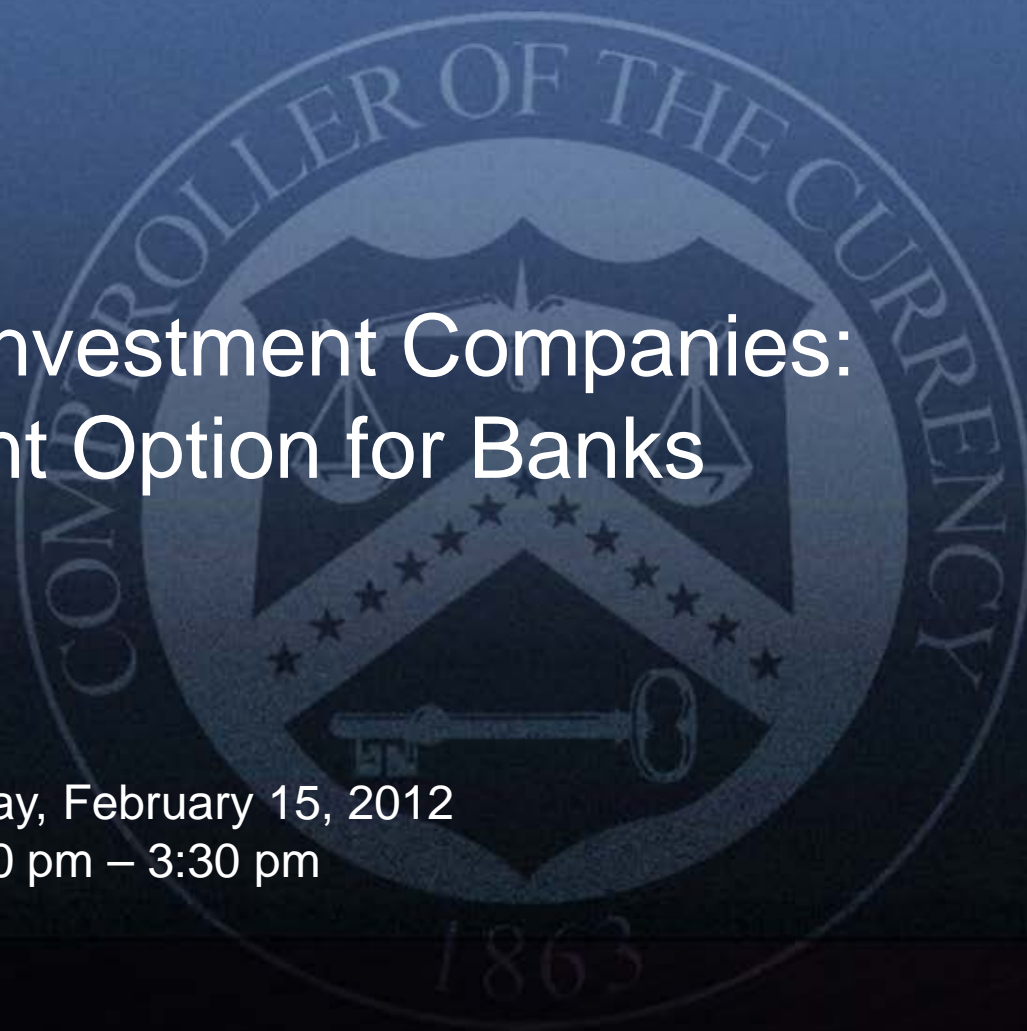




Comptroller of the Currency
Administrator of National Banks

Small Business Investment Companies: An Investment Option for Banks

Wednesday, February 15, 2012
2:00 pm – 3:30 pm



Small Business Investment Companies: An Investment Option for Banks



Presented by:

- Barry Wides, Moderator and Presenter
Office of the Comptroller of the Currency
- Sean Greene
U.S. Small Business Administration
- Robert McE. Stewart
Spring Capital Partners II, LP
- Carl Kopfinger
TD Bank



Agenda



Welcome by John Walsh

Opening Remarks by Barry Wides

PowerPoint Presentation

Questions and Answers



John Walsh



John Walsh

Acting Comptroller of the Currency

John Walsh became acting Comptroller of the Currency on August 15, 2010. The Comptroller of the Currency is the chief executive of the Office of the Comptroller of the Currency (OCC), which supervises approximately 2,000 national banks and federal savings associations as well as 50 federal branches and agencies of foreign banks in the United States. These institutions comprise nearly two-thirds of the assets of the commercial banking system. The Comptroller also is a director of the Federal Deposit Insurance Corporation and NeighborWorks® America.

Mr. Walsh joined the OCC in October 2005 and previously served as Chief of Staff and Public Affairs.

Prior to joining the OCC, Mr. Walsh was the Executive Director of the Group of Thirty, a consultative group that focuses on international economic and monetary affairs. He joined the Group in 1992, and became Executive Director in 1995. Mr. Walsh served on the Senate Banking Committee from 1986 to 1992 and as an International Economist for the U.S. Department of the Treasury from 1984 to 1986. Mr. Walsh also served with the Office of Management and Budget as an International Program Analyst, with the Mutual Broadcasting System, and in the U.S. Peace Corps in Ghana.

Mr. Walsh holds a masters in public policy from the Kennedy School of Government, Harvard University (1978), and graduated magna cum laude from the University of Notre Dame in 1973. He lives in Catonsville, Maryland. He is married with four children.



Barry Wides



Barry Wides

Deputy Comptroller for Community Affairs

Barry Wides is the OCC's Deputy Comptroller for Community Affairs, in which capacity he leads a department of community development professionals located in Washington, D.C., and the four OCC districts. The Community Affairs staff is responsible for outreach to banks and their community partners, the administration of the Public Welfare Investment authority, the development of policy, and the creation and distribution of educational materials on community development issues.

Prior to joining the OCC in 1999, Mr. Wides was Director of Affordable Housing Sales at Freddie Mac. He led a nationwide sales team responsible for developing products and strategies to achieve the company's congressionally mandated affordable housing goals. He previously served as Deputy Director of the Resolution Trust Corporation's Affordable Housing Program. Mr. Wides began his career in Washington as a presidential management intern and budget examiner at the Office of Management and Budget.

Mr. Wides is a Certified Public Accountant and holds a B.S. in accounting and an M.B.A. from Indiana University.



Sean Greene



Sean Greene

*Associate Administrator for Investment and Special
Advisor for Innovation*

Sean Greene is the Associate Administrator for Investment and Special Advisor for Innovation at the U.S. Small Business Administration (SBA). He is responsible for the Small Business Investment Company program, a growth capital program with approximately \$16 billion of assets under management, and the Small Business Investment Research program, one of the government's largest innovation programs, which provides more than \$2 billion of research and development funding to small businesses each year. He also leads SBA's efforts to stimulate high-growth entrepreneurship and has been one of the leaders in the administration's Startup America initiative.

Mr. Greene brings 20 years of experience as an entrepreneur, investor, and business strategist to the SBA. He was the founder and CEO of Away.com, an online travel company that he sold to Orbitz. He was a co-founder of Rock Creek Ventures and LaunchBox Digital, a seed-stage investment firm in Washington, D.C. Previously Mr. Greene was a management consultant with McKinsey and Co.

Mr. Greene holds a bachelor of arts degree from Princeton University and a master of business administration degree from Yale University's School of Management. He was a Fulbright Scholar at the National University of Singapore.



Robert McE. Stewart



Robert McE. Stewart
General Partner
Spring Capital Partners, LP

Robert McE. Stewart is a General Partner and co-founder of Spring Capital Partners which was started in 1999. The firm provides expansion and acquisition capital to growing and medium-size businesses. Mr. Stewart has over 20 years of experience as a commercial lender, investment banker, and merchant banker. He is responsible for generating new investment opportunities, negotiating and structuring investments, monitoring current investments, and overall fund management. The firm operates two funds – Spring Capital Partners LP and Spring Capital Partners II, L.P. - both Small Business Investment Company funds (“SBIC”).

Mr. Stewart has initiated, invested, and closed numerous transactions involving various financing techniques, including subordinated debt with warrants, bridge loans with warrants, convertible and preferred stock, and common stock. He has closed merger and acquisition transactions ranging from \$5 million to \$350 million; completed initial public offerings and follow-on equity offerings ranging from \$25 million to \$150 million; and conducted overall analysis, due diligence, valuation, investment negotiation, and ongoing oversight of these investments.

He has served as board observer to the firm’s portfolio companies and has been a director of numerous companies. He is the Chairman of the Small Business Investor Alliance (formerly the National Association of Small Business Investment Companies), and his professional affiliations include the Association for Corporate Growth, the Mid-Atlantic Venture Association, and the Florida Venture Forum.

Mr. Stewart holds a bachelor of arts (cum laude) from Hampden-Sydney College and a master of business administration from Wake Forest University.



Carl Kopfinger



Carl Kopfinger

*Senior Vice President
TD Bank*

Carl Kopfinger is a Senior Vice President of TD Bank, based in Philadelphia, Pa. He is responsible for managing the bank's venture capital and mezzanine investment portfolio, which comprises more than 70 funds from Maine to Florida. He joined TD Bank and its predecessor bank in 2004.

He also represents the bank as a limited partner, advisory, and/or valuation committee member in many of its venture and mezzanine fund investments, including Argosy Capital, BIA Digital, Boathouse Capital, CapitalSouth Partners, CEI Ventures, Commerce Health Ventures, Edison Ventures, First New England, Greycroft Partners, Ironwood Equity, Ironwood Mezzanine, High Peaks, Liberty Ventures, Long River Ventures, NewSpring Health Ventures, NewSpring Mezzanine, North Atlantic Capital, Pine Street Capital, Plexus Capital, Point Judith Ventures, Praesidian Opportunity Fund, Seacoast Capital, and Village Ventures.

Mr. Kopfinger has more than 30 years of progressive financial experience. He has coached and judged venture-backed companies for the Mid-Atlantic Venture Conference, the Three Rivers Venture Fair, Early Stage East, and the NJ Venture Conference. Before joining TD Bank, Mr. Kopfinger worked for FleetBoston Financial, now Bank of America, and with Comerica Bank's Technology & Life Sciences Division. While with previous employers—Bank Hapoalim, PNC Bank, and Mellon Bank—he worked with Fortune 1000 companies, providing them with structured finance and other credit and non-credit products.

Mr. Kopfinger is on the board of the Small Business Investor Alliance (formerly the National Association of Small Business Investment Companies), the Delaware Tamanend Foundation, the University City Science Center, and the NJ Technology Council. His professional affiliations include the Association for Corporate Growth and the Greater Philadelphia Alliance for Capital & Technologies.



Welcome



John Walsh
Acting Comptroller of the Currency



Opening Remarks



Barry Wides

Deputy Comptroller for Community Affairs





Investing With the SBA

The Small Business Investment Company (SBIC) Program

Sean Greene

*Associate Administrator for Investment and
Special Advisor for Innovation*

sean.greene@sba.gov

harry.haskins@sba.gov



Why Invest in SBICs



- Compelling market need and opportunity
- Attractive returns and strong economics
- Unique considerations for bank investors – Volcker rule and CRA
- Long-established program with long history and recent momentum



The SBIC Program in Brief

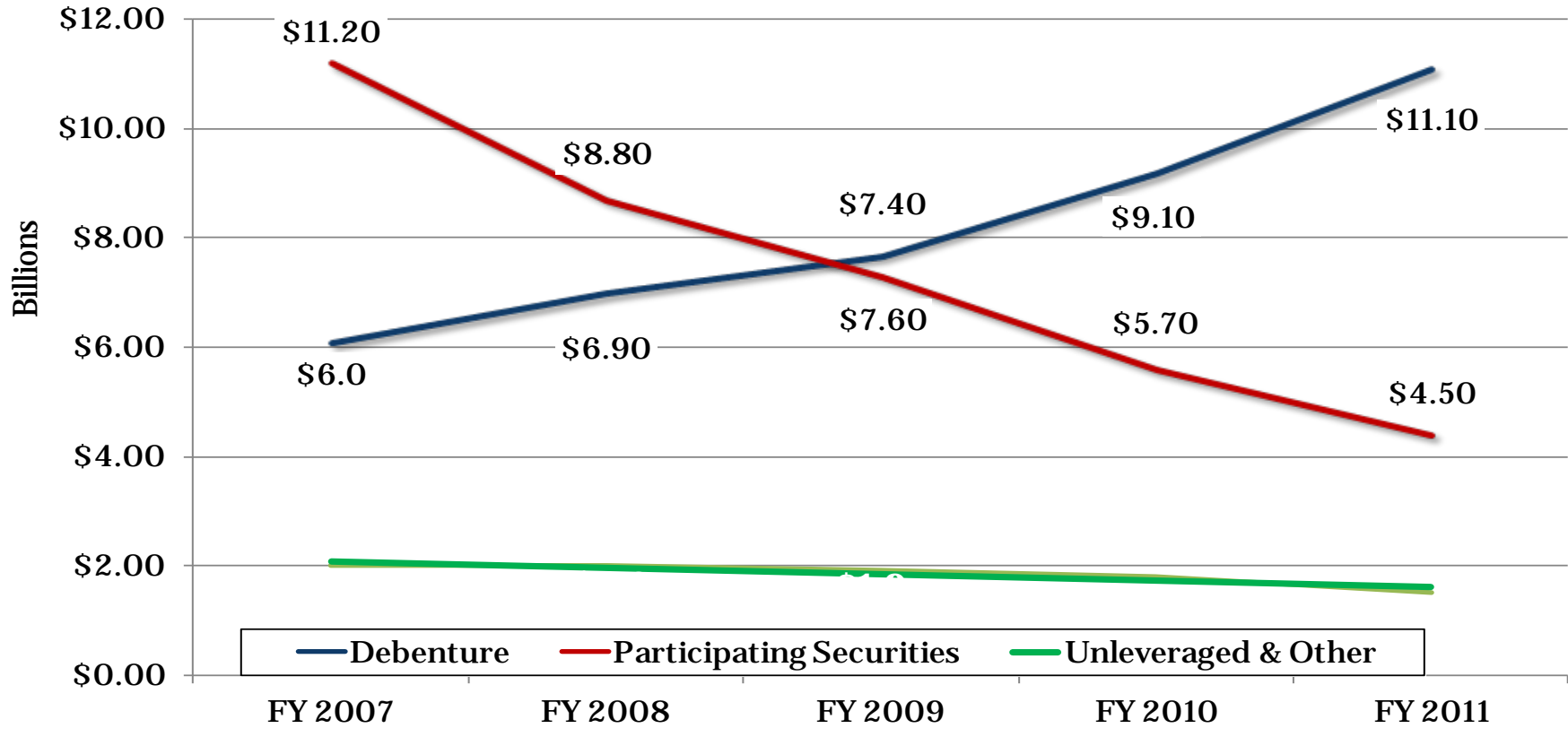
- Created in 1958 to bridge the gap between entrepreneurs' need for capital and traditional sources of financing:
- SBA invests long-term capital in privately owned and managed investment firms licensed as Small Business Investment Companies (SBICs)
- Once capitalized, SBICs make debt and equity investments in some of America's most promising small businesses, helping them grow



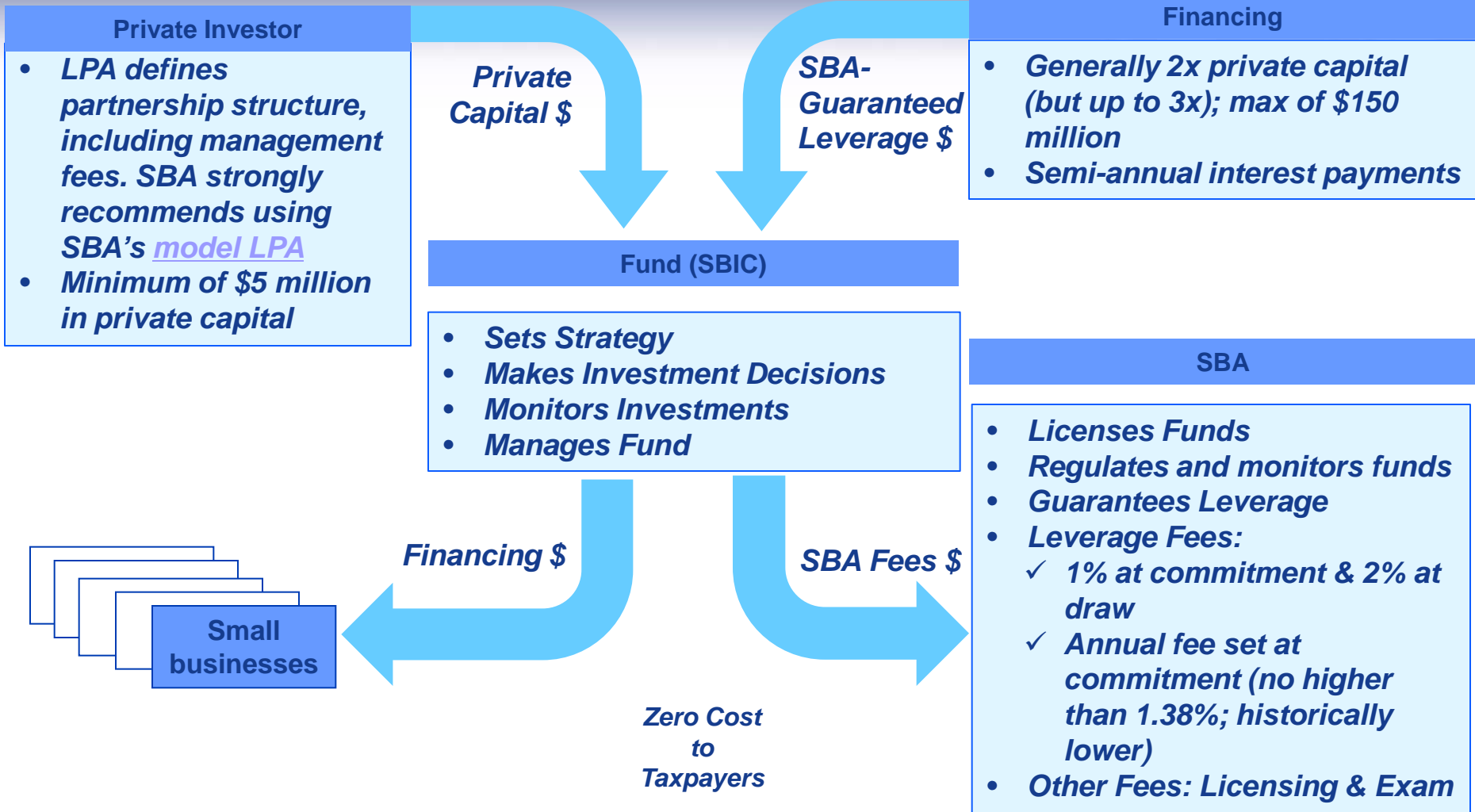
SBIC Program: Snapshot



Committed capital: Private and SBA



How SBIC Leverage Works



SBIC Structure



After issuing them a license, the SBA allows funds to access low-cost, government-guaranteed capital in the form of debentures.

Standard License

Investment Strategy:
Applicants have broad mandate to invest in U.S. small businesses, with few restrictions on their strategy or capital allocation.

Application Process:
- *Rolling*

Leverage Available:
- *Two Tiers*
- *Cap of \$150 million*

Standard Terms of SBA Debentures

Amount:	Typically 2x (but up to a maximum of 3x) the capital raised from private investors
Term:	10 years with principal payment due at maturity; NO prepayment penalty
Interest:	Semi-annual payment based on a spread above the 10-year Treasury note
Fees:	1% commitment fee; 2% drawdown fee Annual fee due semi-annually
Uses:	Investments in “small businesses” as defined by the SBA Office of Size Standards and federal regulations, generally in later stage and “buyout” transactions. Real estate and project finance generally prohibited.



Step 1: Licensing



Licensing Decision

Management Assessment Questionnaire ("MAQ")

Green Light Letter

Licensing Application & Minimum Capital

Initial Review

- Submit MAQ
 - Fund Strategy
 - Track Record
- Review track record
- Due Diligence
- Investment Committee Decision

- Target Time Frame: 8 weeks

Raise Capital

- Must raise \$5 million minimum prior to submitting Licensing application. (Applicants must raise sufficient capital to execute business plan prior to licensing decision.)

- Time: Up to 18 months

Licensing

- Submit Licensing Application
- Due Diligence
- Legal Review
- FBI Background Check
- Committees:
 - Divisional
 - Agency
- Administrator approves.

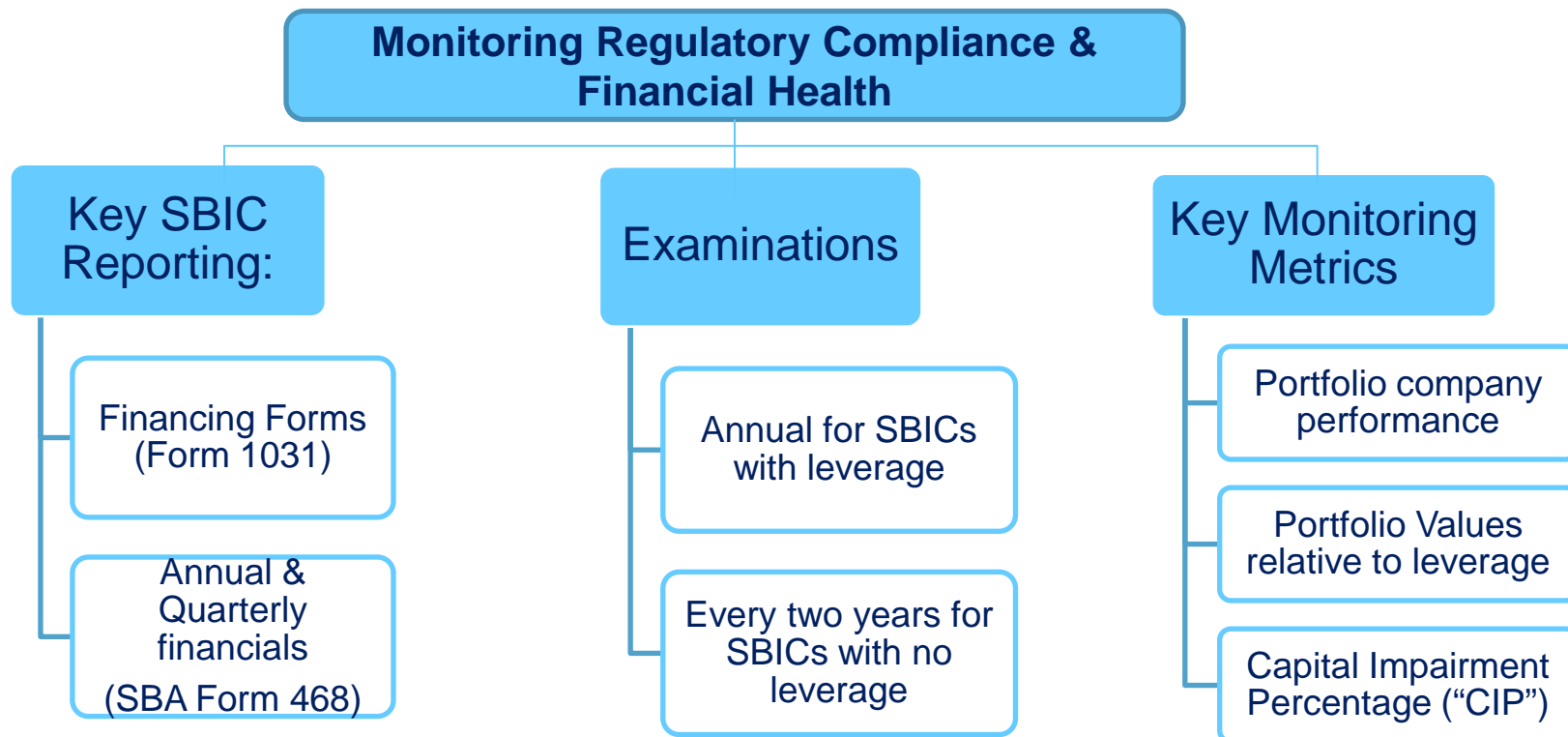
- Target Time Frame: 6 months



Step 2: Operating as SBIC



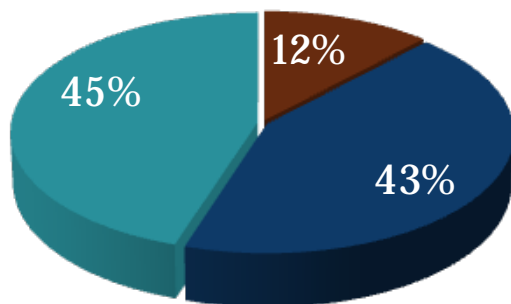
- The Office of Operations acts as the primary point of contact for licensed SBICs.
 - Process leverage commitments & draws
 - Process requests (conflicts of interests, transfer of LP interests, etc...)
 - Monitor regulatory compliance and financial health.



Program Data



SBIC Program Debenture Portfolio: FY '07-'11



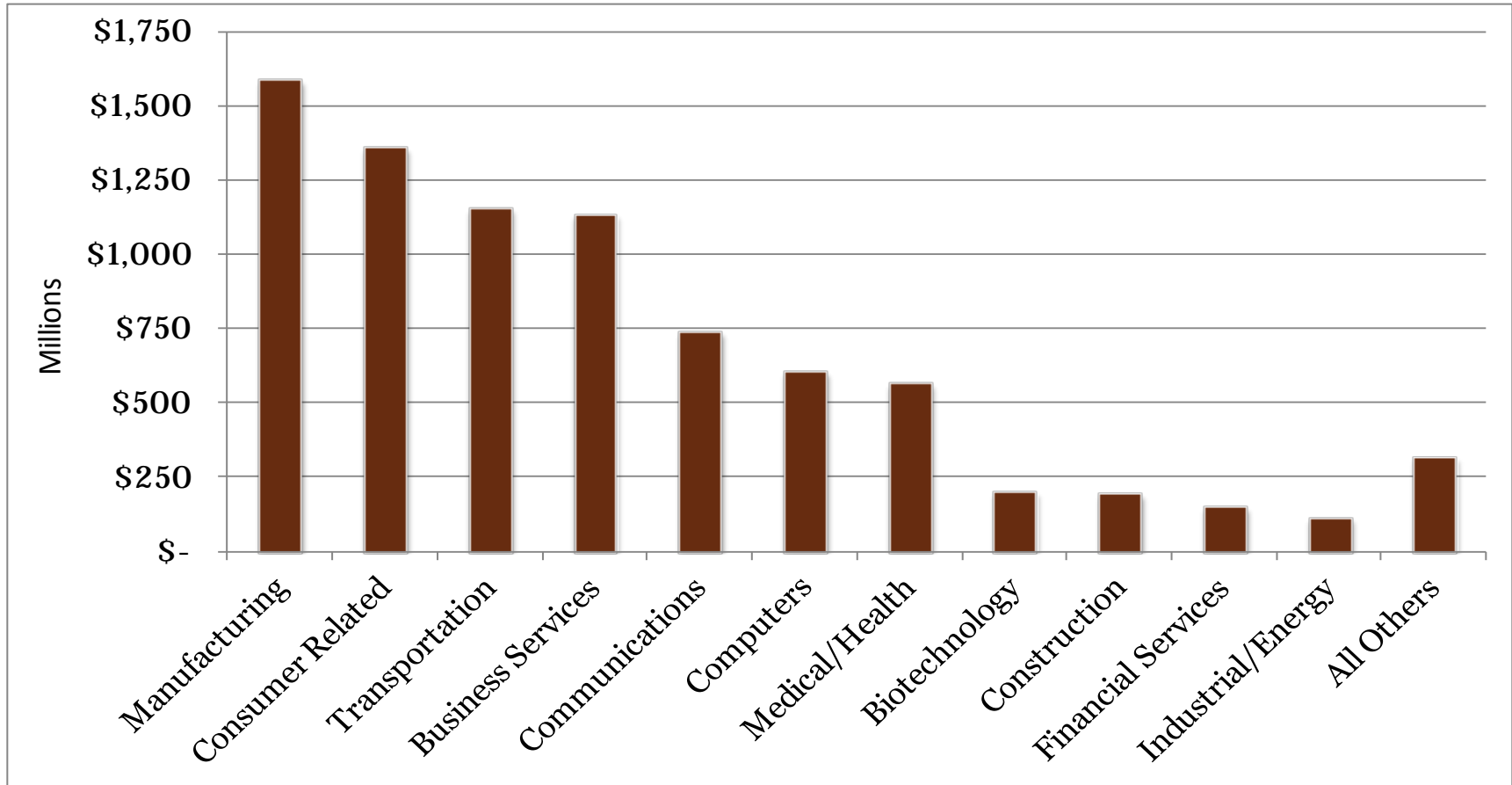
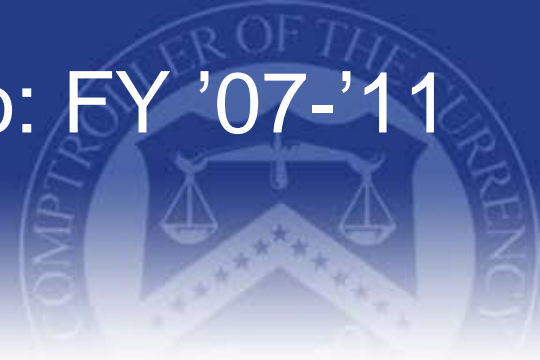
■ Equity ■ Debt with equity ■ Debt

Typical Fund Strategies

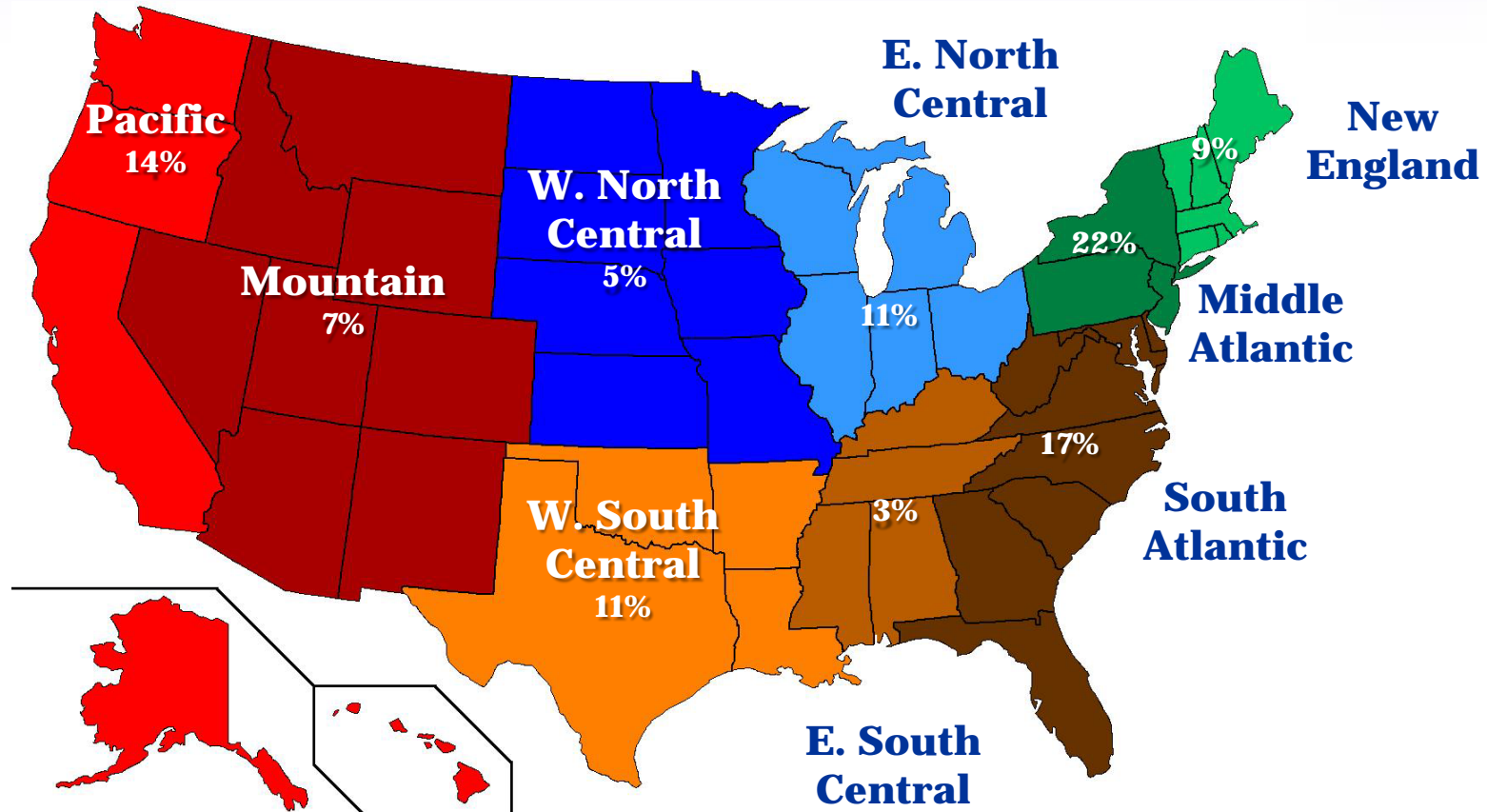
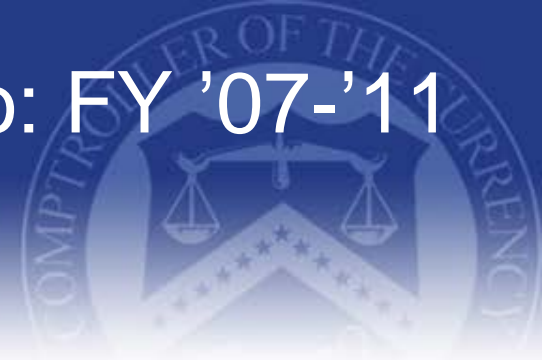
- Mezzanine
- Senior Debt
- “One Stop”
- Venture Debt
- Leasing



SBIC Program Debenture Portfolio: FY '07-'11



SBIC Program Debenture Portfolio: FY '07-'11



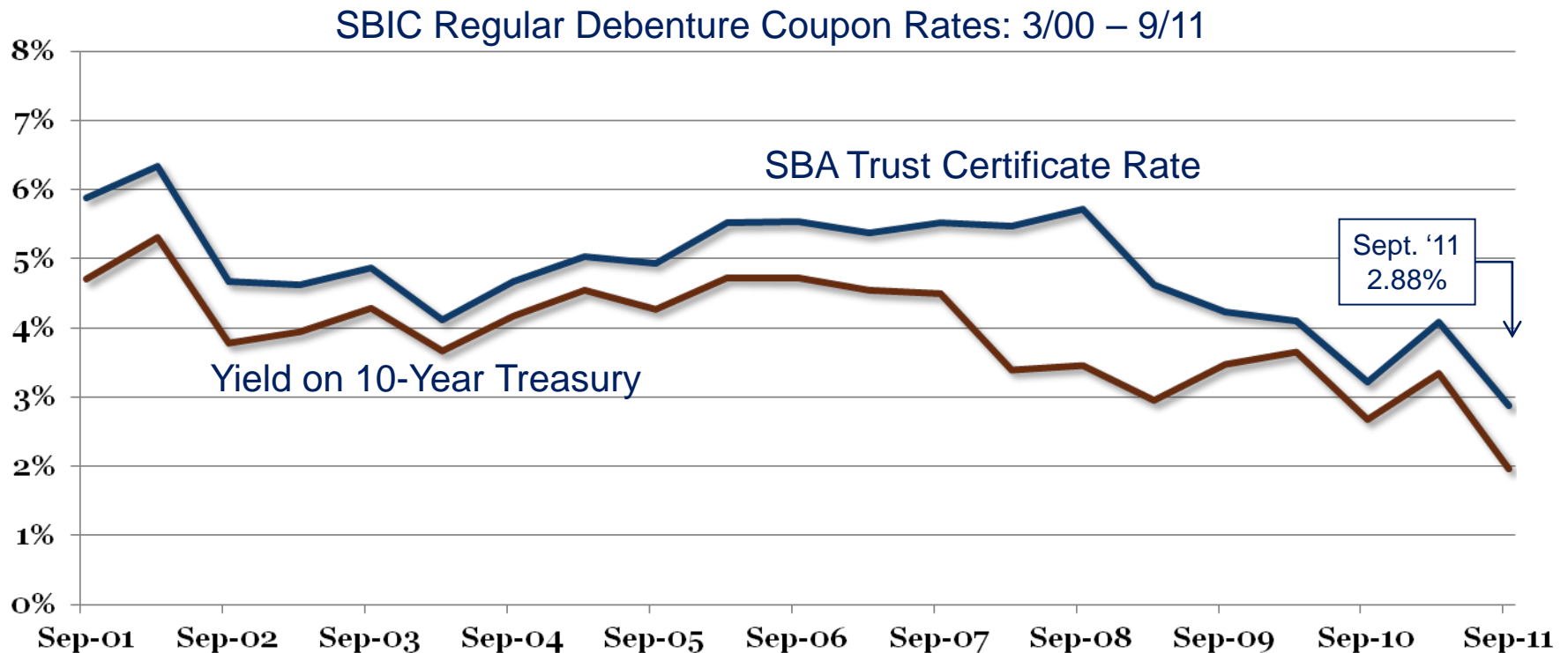
Note: Percentage total does not sum to 100% due to rounding



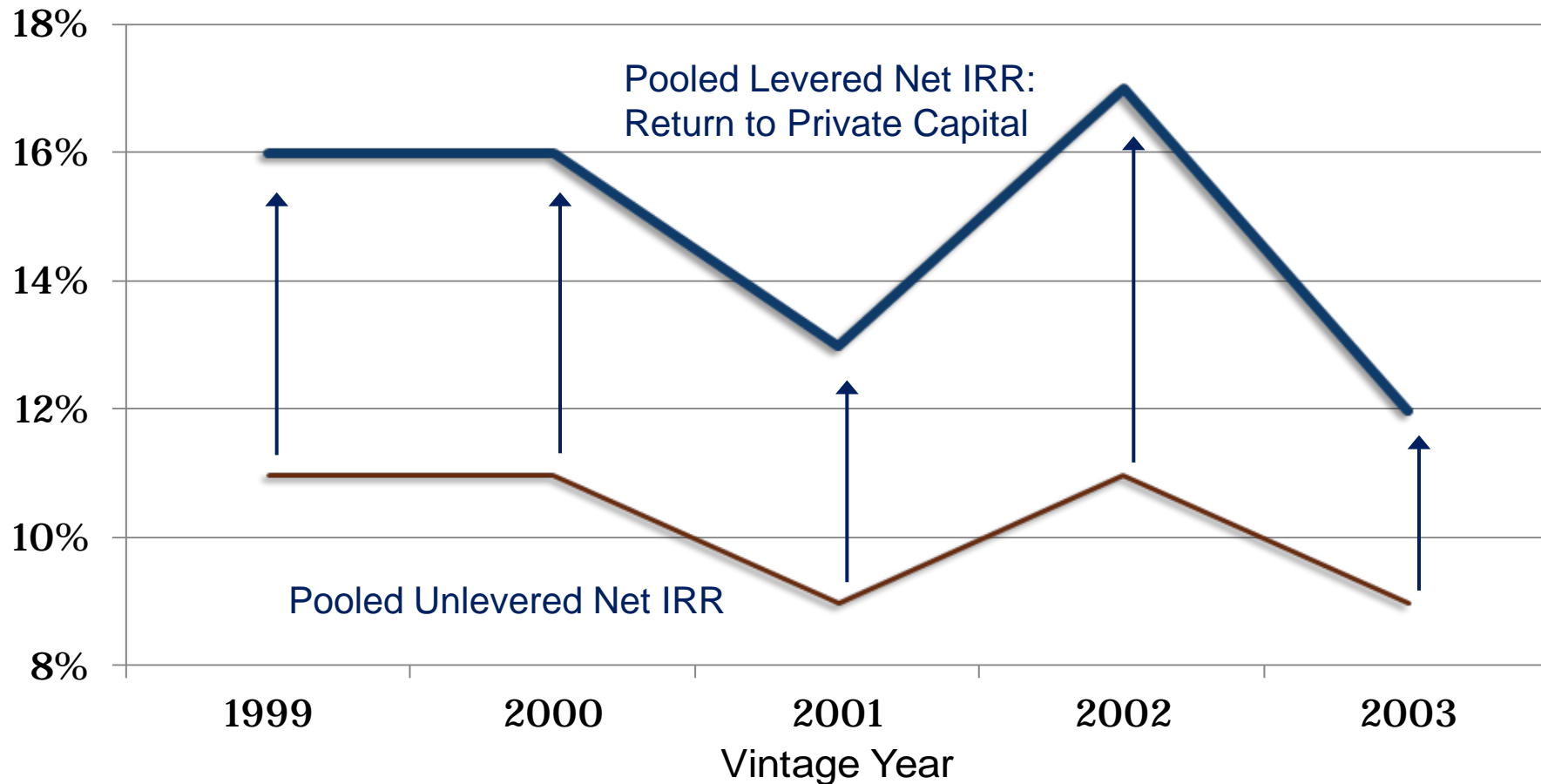
Low Cost Capital



The SBA's leverage commitments to licensed SBICs are funded through the sale of government-backed securities called "trust certificates." Every March and September, these commitments are pooled and sold on the open market at a premium over 10-year Treasury Notes.



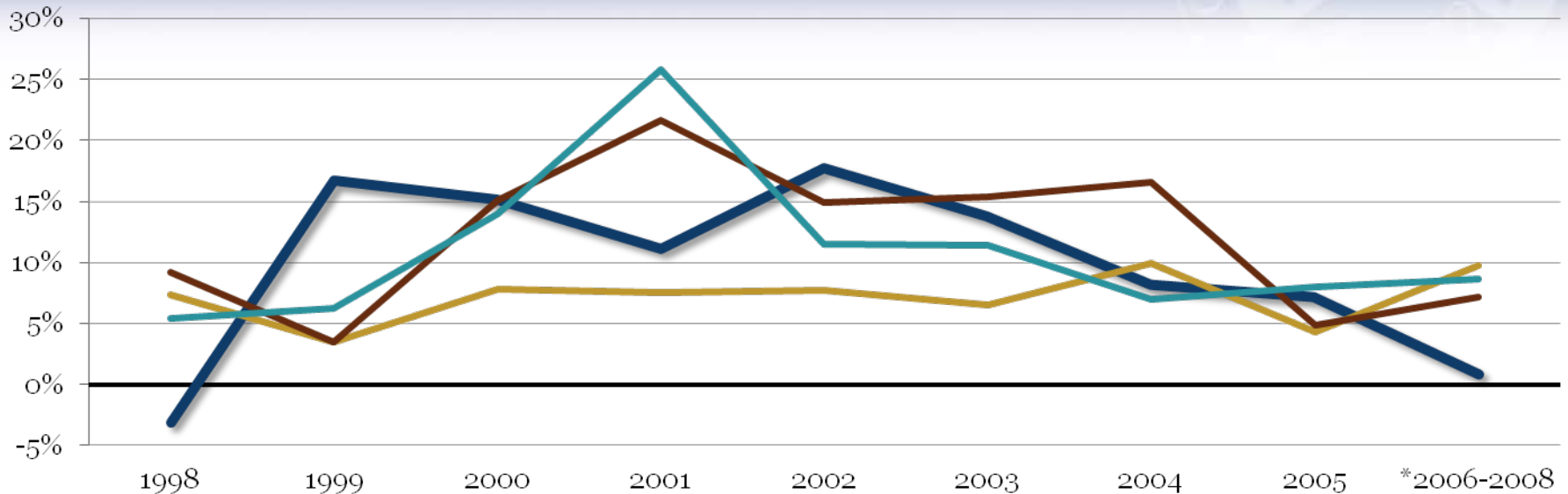
Historical Impact of SBA Leverage



Strong Historical Returns



Returns by Vintage Year 1998 – 2008



- SBIC Debenture Funds Pooled IRR (1)
- Preqin US Mezzanine Pooled IRR (2)
- Thomson Sm. & Med. Buyout & Mezzanine Pooled (3)
- Preqin US Sm. Buyout Pooled IRR (2)

* 2006 – 2008 data is presented as an arithmetic mean of the pooled IRRs for those years

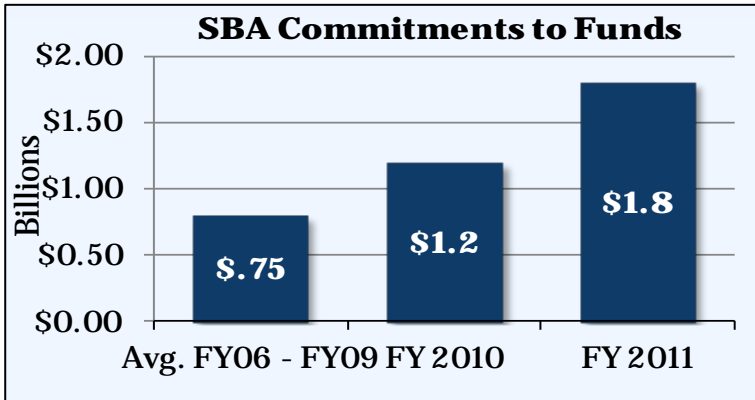
(1) SBIC Vintage Year determined by date of license. Data as of 12/31/10 ; Returns calculated based on information collected as part of annual financial statement submissions to SBA; Returns include an assumed 20% carried interest payment to the GP after LPs have received distributions equal to paid-in capital.
 (2) Source: Preqin Ltd. www.preqin.com. Data includes "Most up-to-date" figures and was accessed 12/12/11; Benchmark may include some funds licensed as SBICs
 (3) Source: Thomson Reuters. www.thomsonone.com. Data as of 12/31/10. Data includes US funds from \$5M to \$500M categorized as Small Buyout, Medium Buyout, or Mezzanine.



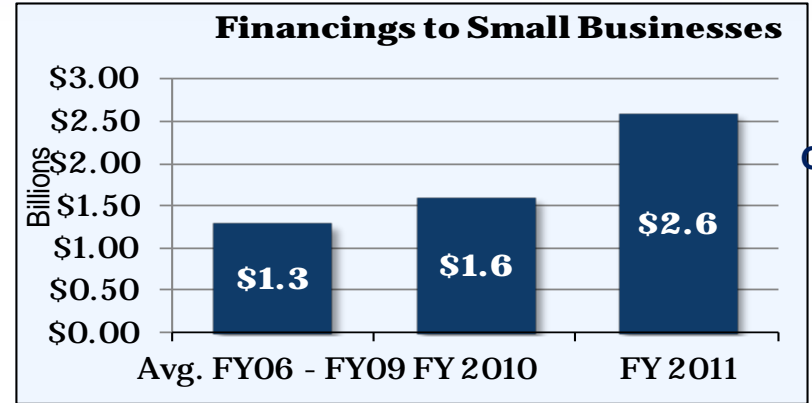
2011 SBIC Debenture Program – Another Record Year



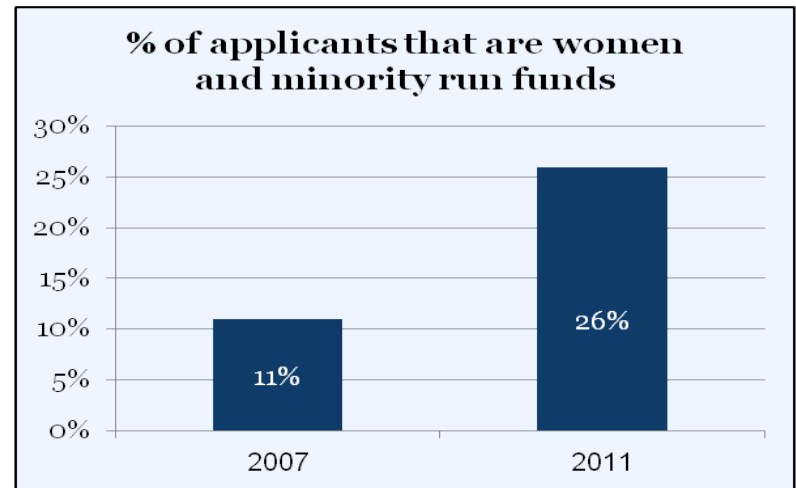
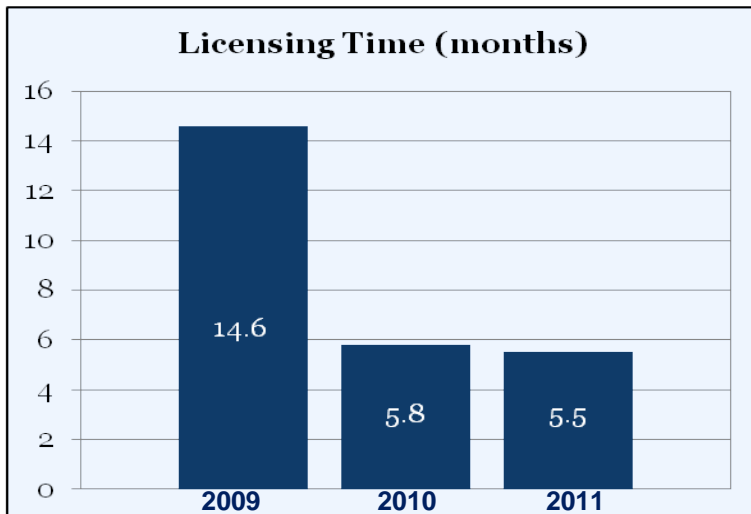
Fiscal years 2010 and 2011 have been record years for the SBIC Program. More capital has been committed to SBICs and more dollars have been channeled to small businesses than at any other point in the program's 53 year history.



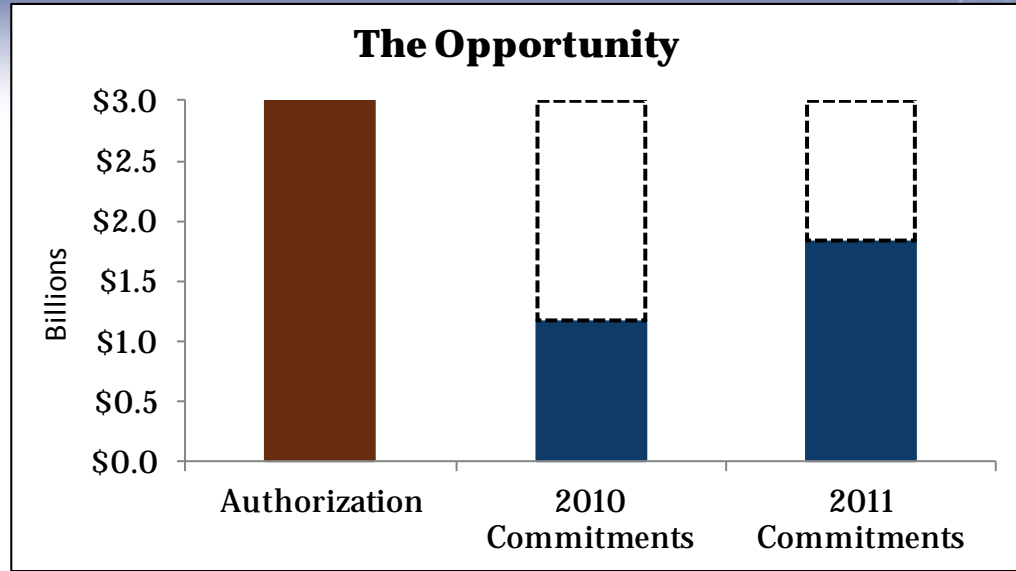
2.4x Growth



2.0x Growth



Where We Are Going



Internal Improvements:

- Continued focus on speed
- Technology upgrade
- Data-driven decision-making
- Communication

Better Outreach:

- Changes to the SBA's Model Limited Partnership Agreement (LPA)
- Creation of a single point of contact for Limited Partners (LP)
- Increase in the use and availability of SBIC Program data
- Taking a more proactive approach to outreach

New Initiatives:

- Impact Investing
- Early Stage
- Energy-Savings



Additional initiatives



- Unleveraged licensees
 - CRA and Volcker rule benefits
 - Could be bank owned, or bank funded
- Impact Investing program
 - \$1 Billion commitment over 5 years
 - Focus on 1) underserved communities (LMI or economically distressed or 2) Sectors of national priority (e.g. education, energy)
- Early Stage Program
 - \$1 Billion commitment over 5 years
 - Focus on early stage venture funds
 - 1:1 leverage, max leverage of \$50 mil



Advantages of an SBIC



- **Compelling Economics**

- ✓ **Low cost of capital:** SBA Debenture leverage interest rates based on 10-year Treasury plus a market-based spread for liquidity and prepayment risk. See [website](#) for historic rates.
- ✓ **Enhanced Returns to Private Investors:** The low cost of capital increases returns to private investors in good performing funds. See appendix for historic SBIC Debenture performance.
- ✓ **Rapid Deployment of Funds:** Ability to raise typically two-thirds of a fund's capital from SBA, thereby minimizing the time they spend fundraising and focusing their efforts on investing.
- ✓ **Flexible terms:** Ten year debenture term with semi-annual interest payments avoids problem of duration mismatch.
- ✓ **Increased Financial Scale:** SBA leverage provides increased capital from which SBICs may fund more investments or increase funding to portfolio companies.

- **Friendly to Bank Investors**

- ✓ **Volcker Rule Exemption Benefits:** Bank investments into SBICs are exempt, from the 3% cap set forth by the Volcker Rule enacted by the Dodd-Frank Wall Street Reform and Consumer Protection Act (PL-111-203)
- ✓ **Community Reinvestment Act:** Investments in Small Business Investment Companies are presumed qualified for Community Reinvestment Act credits.

- **The Opportunity of "Small Business"**

- ✓ **Despite being the bedrock of the American economy, the small business community is underserved and represents a value opportunity for investors.**





How SBICs Operate

Robert McE. Stewart
General Manager
Spring Capital Partners II, LP
rms@springcap.com



Mission



- To contribute materially to the success of small businesses by providing critical components of investment capital
- To generate superior risk-adjusted returns for the Fund's limited partners



SCP Overview



- Founded in 1999: Fund I -- \$75.0 million; Fund II -- \$113.0 million
- Investments in 39 portfolio companies
- Investments of \$148.4 million
 - SBA leverage used of \$77.8 million
 - Limited partner capital used \$49.7 million
- 21 active portfolio companies

Industry sectors for the 39 Portfolio Companies:

Manufacturing (11)

Retailers (3)

Aviation Services (7)

Software (3)

IT Outsourcing (6)

Healthcare Services (1)

Telecom (6)

Logistics (2)



Different Types of Funds



Investment Strategy

- Senior debt—stretch, cash flow, or “air ball”
- Purchase money financing—primarily for capital expenditures
- Enterprise value—mezzanine or second lien with equity upside through warrants
- Equity-oriented—unsecured, higher risk, higher return



Use of Proceeds



- Growth and expansion capital
- Acquisition/buyout financing
- Debt refinancing
- Recapitalizations



SBA Relationship



- \$102.0 million of leverage commitments
- \$45.0 million of leverage outstanding
- \$32.8 million of leverage repaid
- Just-in-time funding with permanent 10-year fixed-rate takedowns market-based off of 10-year Treasuries
- Weighted average cost of funds: SCP I–5.36%
- Weighted average cost of funds: SCP II–4.77%



Investment Philosophy



- Strong products and market positions (execution risk, not product or market risk)
- Quality management with a significant equity stake
- Sound credit position ► equity sponsor, ample liquidity, or other identified source of additional junior capital if needed
- Minimum revenue of \$10 million (most recent fiscal year or projected for the next fiscal year based on contracts or current run rate)
- Profitable and predictable financial performance
- Exit strategy, realization of equity value



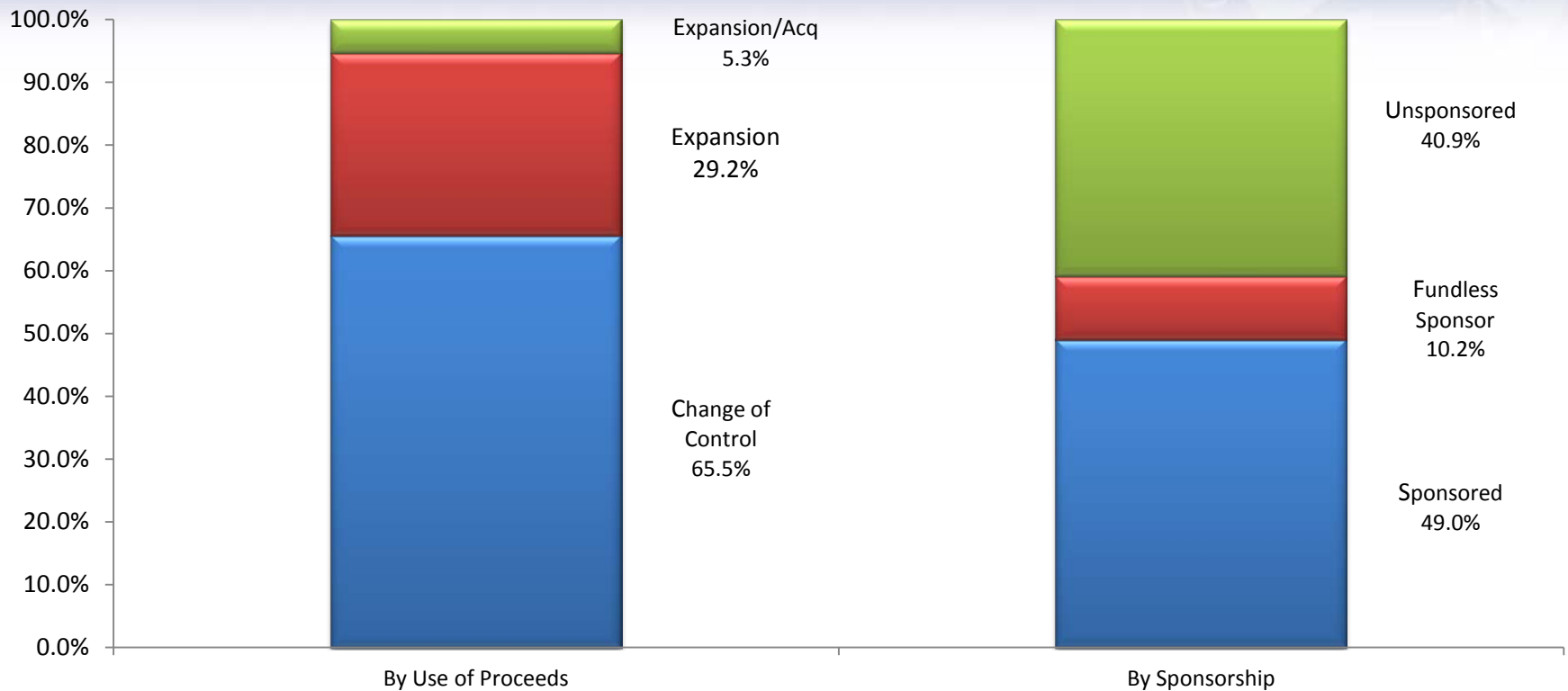
Excluded Investments



- Start-ups or seeds
- Turnarounds or bankruptcies
- Real estate companies
- Finance or investment companies
- Foreign companies



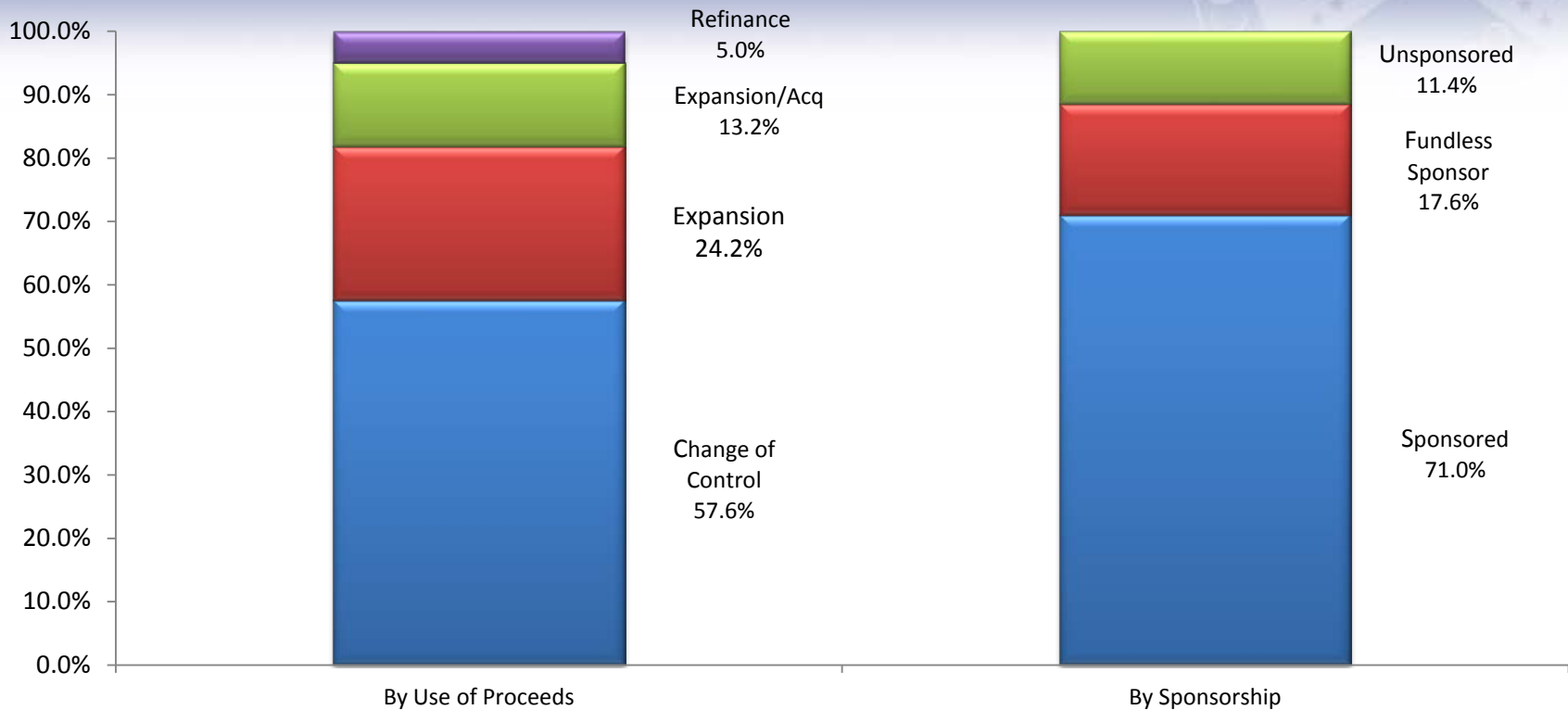
SCP I Investment Statistics



- Average Revenue at Close: ~\$26 million
- Average EBITDA at Close: ~\$1.9 million
- Average Investment per Company: ~\$3.0 million



SCP II Investment Statistics



- Average Revenue at Close: ~\$41.5 million
- Average EBITDA at Close: ~\$4.5 million
- Average Investment per Company: ~\$4.2 million



Fund Operations



- Origination
- Deal structuring
- Due diligence
- Investment approval
- Investment monitoring
- LP communications/reporting

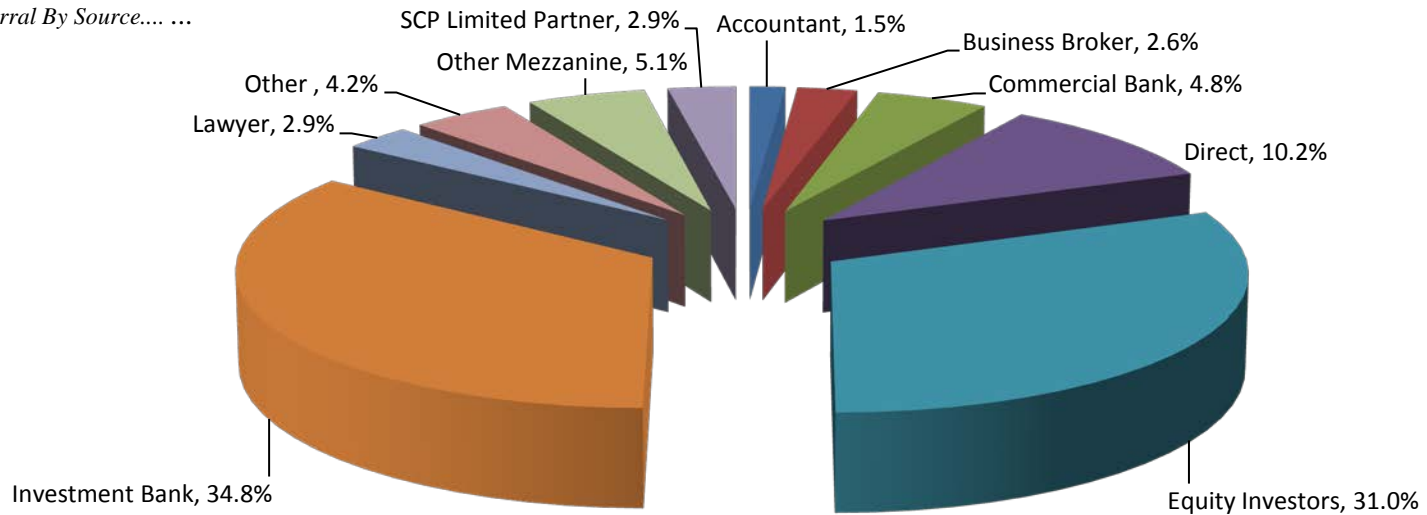


Origination



- Approximately 2,500 referrals

Referral By Source.....



- Active participation in industry organizations
 - Small Business Investor Alliance (SBIA)
 - Association for Corporate Growth (ACG)
 - Mid-Atlantic Venture Association (MAVA)
 - Alliance of Merger & Acquisition Advisors (AMAA)
- Strategic partnering



Deal Structuring



Standard terms: Subordinated Debt With Warrants

- 12%-14% interest rate
- Warrants to achieve an expected return of 20+% with 5 year put right
- 5-year maturity
- 2% closing fee

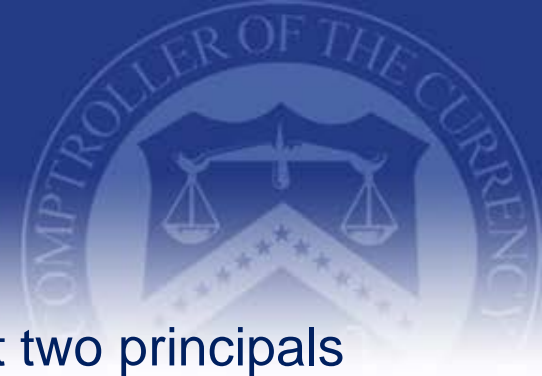
Alternative Structure

- Coupon-only subordinated debt
- Minority equity position

Significant current return and redeemable equity upside on all investments



Due Diligence



- Site visits and management interviews by at least two principals
- Extensive business and legal due diligence checklists customized for each transaction
- Frequent utilization of knowledgeable network resources
- Background checks of key managers and investors
- Audited financials or independent accounting review
- Customer calls
- Investment memorandums and follow-up on Investment Committee questions



Investment Approval



- Investment committee of the General Partner: the principals and two outside members
- Unanimous approval required for all investments
- Advisory Board: 5-7 outsiders
- Quarterly meetings
- Review current portfolio companies, valuations, fund operations, and prospective investments



Investment Monitoring



- Monthly financial packages
- Board observation rights—quarterly attendance
- Quarterly covenant compliance certification
- Consent rights on key events
- Advisory role as needed



LP Communications/Reporting



- Daily communication among principals
- Biweekly partners' meetings
- Investment Committee meetings as needed
 - Transaction approval
 - Approval of material changes in investment terms
- Quarterly Advisory Board meetings
- Quarterly reports to limited partners
 - Financial reports
 - Portfolio company reports
 - Letter from the General Partner
- Annual limited partners' meetings



Case Study



- Well-known government contractor providing high-end technical application software with underutilized IP
- Revenues at time of investment slightly over \$17.0 million
 - EBITDA approximately \$1.0 million
 - Investment of \$3.75 million sub-debt and \$750k of equity
 - New management /employees invested alongside venture fund
- After transaction company grew dramatically
 - Strong organic growth—domestic/international
 - Developed strong commercial products
 - Provided additional \$2.0 million for growth capital
 - Increased employee base over 100% - largest small business contract
- Revenues/EBITDA at exit approximately \$60 million/\$3 million
 - Conducted extensive sale process
 - Global Fortune 100 acquired all stock
 - Management /employees retained by acquirer
- IRR in excess of 33% and cash-on-cash of 1.5x





Investing in SBICs: A Bank LP's Perspective

Carl Kopfinger
Senior Vice President
Community Capital Group
TD Bank
carl.kopfinger@td.com



History With SBIC Program



- TD Bank has been investing in the SBIC asset class for more than a decade.
- TD Bank has a blended investment in both the mezzanine and participating securities programs within the bank's footprint from Maine to Florida.
- The participating securities program was terminated in October 2004 and expired on September 30, 2008, following the technology bubble burst.



Bank Investment Considerations



- Permissible bank investment under Dodd-Frank/ Volcker Rule—carve out for SBICs.
- Equally important is the expected economic returns generated for each bank's shareholders.
- Evaluate strong investment managers with a dependable track record of delivering solid results.



Other Investment Considerations



- Banking relationships that develop with the fund, the fund manager, the General Partners and the fund's portfolio companies.
- Investment asset diversification.
- An attraction for a bank is the CRA-qualified opportunity.



Due Diligence – Checklist



- Prior Track Record
- Management
- Investment Process
- Partnership Terms
- References
- Document Checklist
- Portfolio Monitoring



Due Diligence – Track Record



- Evaluate prior investment track record of Fund managers
 - Assess prior IRR returns
 - Contrast the team’s deal underwriting to its stated strategy
 - Is it consistent or does the team deviate from its stated underwriting approach, e.g., investing in equity securities when its skill set is mezzanine lending?



Due Diligence - Management



- Team cohesiveness
 - How long has the team worked together and in what capacity?
- Team departures
 - Understand why there are changes
- Conduct face-to-face meeting with team
- Perform Lexis-Nexis background checks on senior professionals
- Understand how management communicates with its Limited Partners—e.g., does it provide quarterly LP updates?



Due Diligence - Fund Investment Process



- What are the fund's key competitive differentiators?
- Decision-making process
- For new investments
 - What is the exit strategy thought process on the front end?
- Formal procedures managing portfolio risk
- Valuation process & policies
- Lessons learned & measures taken to avoid future risks



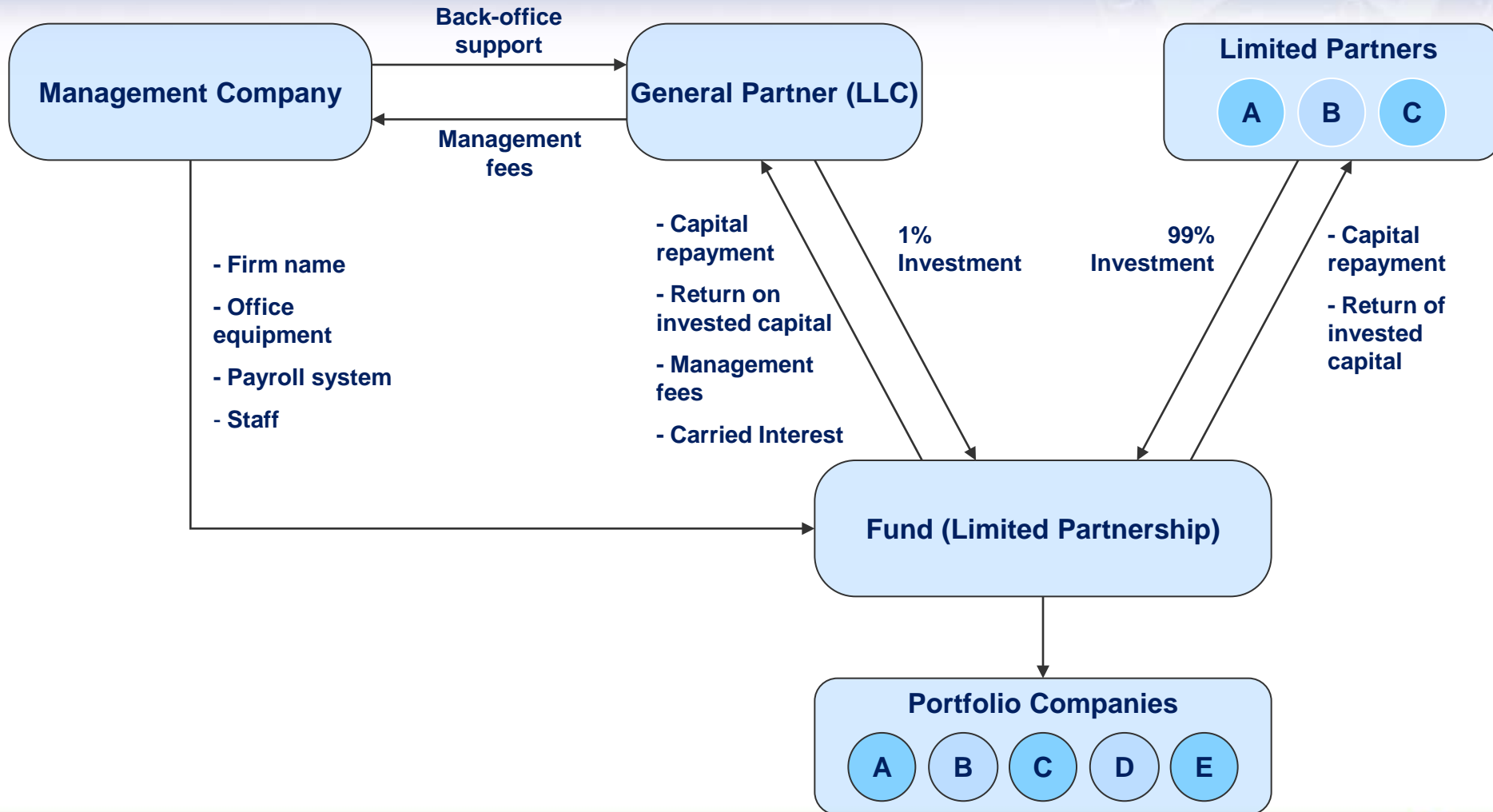
Due Diligence-Partnership Terms



- Limited partnership terms
 - Investment period
 - Recycling of returned capital
 - Diversification
- Fund capitalization—private LP capital vs. SBA match
- How much are the general partners contributing to the fund?
- Any preferred return to the limited partners
- How are losses/ gains distributed
- Investment Committee/ Advisory Board roles



Limited Partnership Structure



Due Diligence–Background References



- Co-investors
- Other limited partners (talk with LPs who are not returning LPs)
- Former partners
- Former employers
- Portfolio company CEOs
- Senior lenders



Due Diligence–Document Checklist



- Limited Partnership Agreement
- Subscription Agreement
- Private Placement Memo
- Management Assessment Questionnaire (MAQ)
- Most Recent PowerPoint Presentation
- Audited Financial Statements, if available



Portfolio Monitoring – Best Practices



- Conduct annual in-person meeting and more frequent telephonic meetings with the investment team
- Review fund communications—quarterly and audited annual financial statements, K-1s, etc.
- Obtain annual capital account statement



Risks



- Loss of capital—by far the greatest risk
- Fund impairment
 - Fund is required to provide SBA with quarterly Capital Impairment Worksheet.
- Timing of the “return of capital”
 - Understanding of when the SBA allows distributions of retained earnings available for distribution, or “READ,” as it is referred to commonly



Risk Mitigants



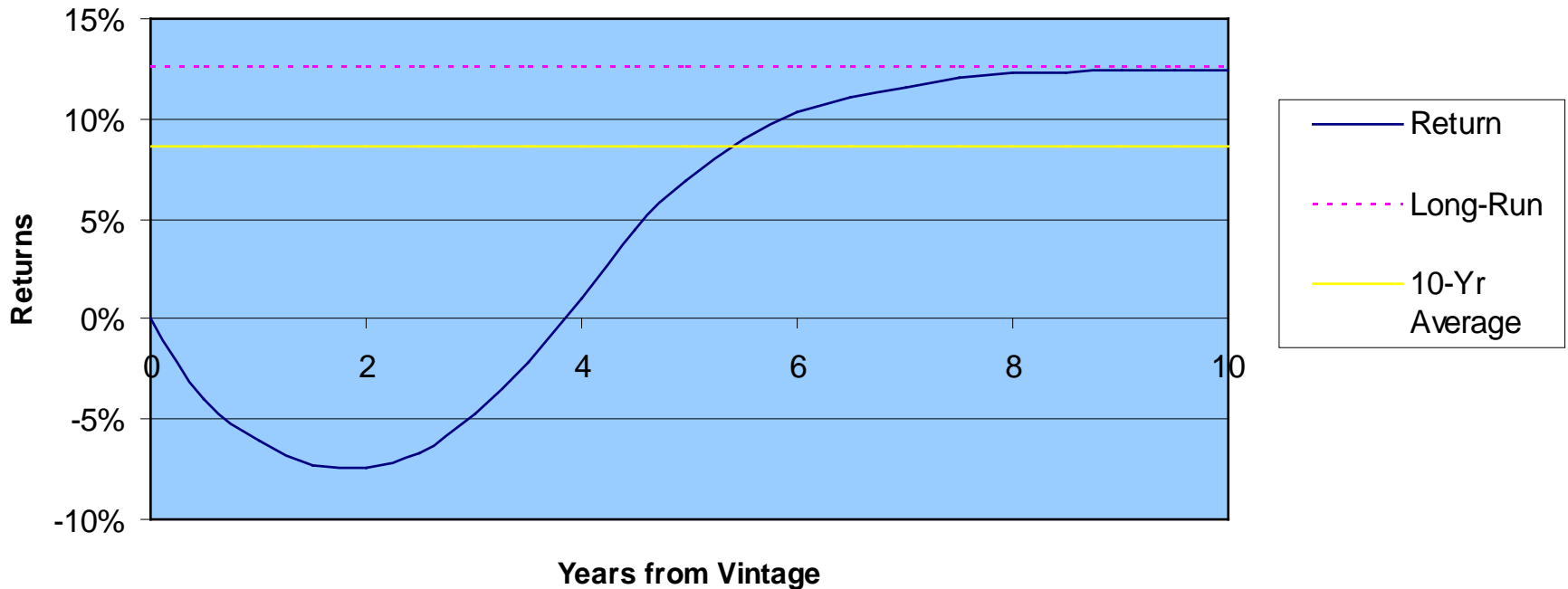
- Mitigants
 - Meticulous due diligence process
 - Underwriting-experienced managers who have previously executed upon consistent strategy
 - Shallower J Curve for mezzanine funds



Return on Investor Capital



Mezzanine Fund J-Curve



Summary



- SBA and OCC have a tremendous opportunity to educate the banking sector with this investment class
- Understand the SBIC program—talk with SBA
- CRA credit for Fund investment—talk with your OCC examiner
- Perform your own due diligence—do not rely on others
- Comfort with Fund Management team and its past performance
- Patient capital





Investing in SBICs: Regulatory Considerations

Barry Wides
Deputy Comptroller for Community Affairs
Office of the Comptroller of the Currency
barry.wides@occ.treas.gov



Identifying Suitable SBIC Investments



- Contact SBA to identify SBICs currently raising funds:
 - Send email to harry.haskins@sba.gov or sean.greene@sba.gov
 - The complete SBIC list is at <http://www.sba.gov/content/all-sbic-licensees-state>
- Choose a promising SBIC, and then review investment strategies with senior management
 - Investment should be consistent with bank's financial condition, risk profile, and risk tolerance
 - Industry sectors and geographies should align with bank's investment and business objectives
 - Evaluate risk/return thoroughly
 - Recognize invested capital is at risk
 - SBA leverage can increase return but also increases risk and delays return of capital
 - Equity funds pose greater risk than debt funds
 - Recognize the illiquid nature of the investment



Bank Due Diligence



- Steps for evaluating SBIC investment include reviewing:
 - Limited Partnership Agreement
 - Subscription Agreement
 - Private Placement Memo
 - Fund Marketing Package
 - Management Assessment Questionnaire
 - Performance/background of general partners
 - Audited financial statements for previous funds by the sponsor



SBIC Due Diligence



- Higher level of due diligence for initial SBIC fund offering
 - 'Full' Management Assessment Questionnaire (MAQ)
 - Gathers comprehensive information on proposed SBIC
 - 'Abbreviated' MAQ for investment in repeat fund from existing SBIC
 - Also request 'Full' MAQ for the first SBIC issued by the sponsor



Process to Manage Investment



- Establish a sound process for ongoing management of SBIC investment—
 - Investment valuation
 - Performance Reviews
 - Mechanisms for reporting



SBIC Investment Authority



- National banks and federal savings associations (FSA) may invest up to 5% of capital and surplus in SBICs (15 USC § 682[b]).
- SBICs are eligible public welfare investments
 - Public welfare authority for national banks (12 CFR 24)
 - *De minimus* public welfare investment authority for FSAs (12 CFR 160.36)
- FSAs also authorized to invest in service corporations engaged in a broad range of preapproved activities, including SBICs (12 CFR 159)



Capital Considerations for SBICs



- **Capital rules applying to SBIC investments**
 - **General risk-based capital rules for national banks**
 - SBICs fall into the category of nonfinancial equity investments.
 - 100% risk weight if, in aggregate, SBIC investments are less than 15% of a bank's Tier 1 capital.
 - Subject to deduction from capital if greater than 15% of a bank's Tier 1 capital.
 - **General risk-based capital rules for federal savings associations**
 - SBIC investments are risk-weighted at 100%.
 - **Advanced Approach capital rules for large national banks and FSAs**
 - 100% risk weight for SBIC equity exposures representing less than 10% of Tier 1 and Tier 2 capital (non-significant equity exposures).
 - 400% risk weight for equity exposures greater than 10% of Tier 1 and Tier 2 capital.



SBIC Investments Under CRA



- SBIC investments are qualified community development investments under CRA
 - Section 12(t)(4) of the Interagency Questions and Answers
- Assessment Area Issues—
 - CRA consideration is available if the SBIC plans to invest in a broader statewide or regional area that includes the institution's assessment area.
 - Assessment area(s) need not receive an immediate or direct benefit from the SBIC's investments, provided that the purpose, mandate, or function of the SBIC includes serving geographies or individuals located within the institution's assessment area.
- Dollar amount, innovativeness, complexity, and responsiveness are taken into consideration when evaluating an institution's investment in SBICs.
- Consideration Methods:
 - Firm information in fund's prospectus
 - Best efforts by fund manager
 - Specific earmarks in assessment areas



SBIC Investment Under CRA (cont.)



Investment Timing Treatment

- Current period CRA consideration for the entire funded and unfunded commitment amount, if the bank's commitment to invest in an SBIC is—
 - Unconditional and legally binding, and
 - Is included on the bank's balance sheet in accordance with Generally Accepted Accounting Principles (GAAP)
 - Section 23(e)-2 of the Interagency CRA Qs&As
- Investment commitments in SBICs that received full credit in the prior period and remain unfunded will be considered as prior-period qualified investments.

Small Bank Treatment

- A small bank can request that examiners review its performance in making qualified investments, such as SBICs, to enhance a satisfactory rating.
 - Performance in making qualified investments may not be used to lower a rating.
 - Cannot raise a “needs to improve” or “substantial noncompliance” rating.



Volcker Rule



- Section 619 of the Dodd-Frank Act—also known as the Volcker Rule—amended the Bank Holding Company Act to prohibit any banking entity from engaging in proprietary trading or from acquiring or retaining an ownership interest in or sponsoring a hedge fund or private equity fund (“covered fund”)
- Generally prohibits a “banking entity” from sponsoring, acquiring, or retaining an ownership interest in a “covered fund.”
- A “covered fund” is an issuer that would be an investment company but for sections 3(c)(1) or 3(c)(7) of the Investment Company Act.
- Statutory exemption for investments in any SBIC that would otherwise qualify as a “covered fund” under Volcker Rule.
- However, a banking entity may not enter into any “covered transaction” with a permitted covered fund that it manages, advises, or sponsors, including an SBIC.
 - “Covered transaction” includes loan or extension of credit, a guarantee, or purchase of certain assets.
- Express prohibition against any permitted activities that involve or result in:
 - Material conflict of interest;
 - Material exposures to a high-risk asset or trading strategy;
 - Threat to the safety and soundness of the bank; or
 - Threat to the financial stability of the United States



Resources



- Frequently Asked Questions About Small Business Finance, Office of Advocacy, Small Business Administration, September 2011 <http://www.sba.gov/sites/default/files/Finance%20FAQ%208-25-11%20FINAL%20for%20web.pdf>.
- Office of the Comptroller of the Currency, Community Affairs, Small Business Resource Directory <http://www.occ.gov/topics/community-affairs/resource-directories/small-business/index-small-business.html>
- Part 107 Small Business Investment Companies, Code of Federal Regulations, Title 13, Volume 1, Revised as of January 1, 2009, can be accessed from http://www.access.gpo.gov/nara/cfr/waisidx_09/13cfr107_09.html
- Guidance on Equity Investment and Merchant Banking Activities of Financial Holding Companies and Other Banking Organizations Supervised by the Federal Reserve, June 22, 2000 <http://www.federalreserve.gov/boarddocs/SRLetters/2000/sr0009a1.pdf>
- Private Equity Glossary of Terms <http://mba.tuck.dartmouth.edu/pecenter/resources/glossary.html>
- Small Business Administration Office of Investment <http://www.sba.gov/about-offices-content/1/2890>
- Small Business Investor Alliance <http://www.nasbic.org/>
- Staebler, Michael B., “Overview of the Small Business Investment Company Program”, Pepper Hamilton, LLP, January 6, 2012 http://www.pepperlaw.com/publications_article.aspx?ArticleKey=13



Questions



Questions and Answers



Push *1 on your telephone key pad to comment or ask your question

OR

Submit your comment/question in writing by clicking on the **General Chat** tab below. Enter your comment/question in the box below the chat area and press **Enter** or click **Send**.

Submitted questions will be answered as time allows.



Thank you for joining us!



Interactive Seminars
Speaker Phones
Group Exercises
Internet Banking Security

Interested in learning about OCC educational programs?

Third-Party Relationships
Credit Risk
Privacy Regulation Compliance
Workshops
Web and Telephone Seminars
Strategic Approaches to Community Development Banking
Effective Anti-Money Laundering Program
Audit and Internal Controls
Condition of the Banking Industry
Audit Roundtable

**Sign-up for email notifications at
www.occ.treas.gov/listserv3.htm**



Evaluation Form



- Please complete the evaluation form online,
- OR**
- Return it via fax

