



U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416

August 20, 2024

Submitted by Email: [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

Federal Reserve Board of Governors  
Attn: Ann E. Misback  
Secretary of the Board  
M-4775, 2001 C St. NW  
Washington DC, 20551

Re: The Board of Governors of the Federal Reserve System (Board) invites comment on a proposal to extend for three years, with revision, the Capital Assessments and Stress Testing Reports (FR Y-14A/Q/M; OMB No. 7100-0341).

Dear Ms. Misback:

The U.S. Small Business Administration (SBA), Office of Investment and Innovation (OII) would like to provide comments on the revisions to FR Y-14Q, Schedule F, Section F.24-Private Equity in response to the Board of Governors of the Federal Reserve System's invitation for comment on a proposal to extend for three years, with revision, the Capital Assessments and Stress Testing Reports (Comment Letter).

SBA supports the Board's amended language in FR Y-14Q, Section F.24 to include a new row labeled SBIC Interests under "Unspecified Sector / Industry" for the use of regulated financial institutions to report funded limited partner equity interests and unfunded commitments in SBA-licensed Small Business Investment Companies (SBICs). SBICs are private funds licensed and regulated by the U.S. Small Business Administration to provide equity or debt financing exclusively to U.S. small businesses. SBICs are required to hold a broadly diversified portfolio of small business investments. SBICs are managed by experienced investors who are responsible for sourcing, selecting, investing and monitoring a portfolio of investments in U.S. small businesses on behalf of private investors and the U.S. government. SBA does not invest directly in U.S. small businesses. Instead, SBA provides government-guaranteed loans, debentures, to private funds licensed as SBICs, which are then invested alongside private capital in U.S. small businesses.

While SBA supports the recommendation to include the new label to distinguish SBICs from private equity funds, which SBICs distinctly vary from in terms of a lower volatility, lower loss rates and their requirement to focus on public welfare invest in small businesses, SBA

recommends that the Board modify the instructions guidance which currently states that the label “SBIC Interests” be used only for equity interests in “Standard Debenture” SBICs, to instead state that the label “SBIC Interests” be applied for “SBIC interests excluding Participating Security SBICs.” It is the legacy Participating Security SBICs that have a volatility and loss profile more akin to traditional venture capital funds. Participating Security SBICs are SBICs in which SBA participated in the equity profits of SBIC licensed funds, and loss rates could be high due to lack of requirements related to capitalization rates and coverage of SBA funding.

SBA has permanently closed the Participating Securities SBIC program, however, some limited partners, including banks, still have legacy holdings in Participating Securities SBICs. Today, all non-Participating Security SBIC licensed funds are subject to the same rigorous licensing, due diligence, and underwriting processes in conjunction with ongoing SBA monitoring and regulatory examinations to ensure compliance with statutory and regulatory requirements and to mitigate risk of loss of investors and SBA government-guaranteed funding. Accordingly, SBA recommends that all SBIC interests, aside from Participating Security SBIC interests, should be reported in the Industry Group – SBIC Interests rows. Please see Appendix 1 to this Comment Letter for our proposed language to Section F.24.

SBA is in agreement with the Board’s identification of SBICs that are licensed and regulated by SBA as a unique type of private fund, however, not all SBICs are private equity funds. SBICs may invest equity, debt, or a combination of thereof in U.S. small businesses. In fact, 75% of the current 318 SBICs as of 2023 fiscal year-end were private credit and mezzanine debt funds, not private equity funds. SBA offers for the Board’s consideration additional information that in our view would support further reductions to the loss rate. As of fiscal year-end 2023, SBA loss rates over the last 20 years were 5%. And, as of December 31, 2023, only 3% of all non-Participating Securities SBICs more than four years into the life of the fund had a Multiple on Invested Capital (MOIC) of less than 1.0x. The average for the 3% was an MOIC of 0.67x. The average MOIC for the total population of non-Participating Security SBICs was 1.44x.

In general, unlike traditional private equity and venture funds exempt from SEC registration, lower loss rates to private investors are supported by the highly regulated nature of the non-Participating Security SBIC program. SBA maintains stringent SBIC licensing requirements, a rigorous due diligence framework, recurring regulatory examinations, detailed financial reporting requirements subject to SBA’s conservative accounting and valuation requirements<sup>1</sup>, and ongoing Federal oversight. SBA underwrites SBICs to address and manage risk including limiting all SBICs licensed to use any type of SBIC Debentures not to exceed 2x private capital, while SBICs licensed to use SBIC Debentures with predominately equity investment strategies are limited to a maximum of 1.25x leverage.

SBA’s risk management efforts have resulted in investments in small business concerns that are diversified across industry sectors and geographic regions, including rural and underserved areas,

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<sup>1</sup> Regulations [13 CFR 107.503](#) and [13 CFR 107.650](#) and provided in Appendix 15: Valuation Guidelines for Small Business Investment Companies: [Valuation Guidelines for SBICs \(sba.gov\)](#)

and are subject to SBA's conservative valuation requirements, which have contributed to keeping the SBIC program loss rate at 5%<sup>2</sup> over the last 20 years.

The SBA is proud with the successful performance of the SBIC Program which based on all the aforementioned factors combined have resulted in SBIC average IRR returns from 2000 to 2023 of 16.9%<sup>3</sup> as compared to MSCI-Burgiss benchmarks of 12.8% for the same period.<sup>4</sup>

Furthermore, for vintage years 2010 through 2019, SBICs have already made distributions to limited partners in excess of paid-in capital (DPI), after management fees (net), in 7 out of the 10 vintage years, and SBICs have exceeded capital distributions as compared to Cambridge Private Equity Benchmarks in 7 of the 10 vintage years.<sup>5</sup> Less mature SBIC funds, from vintage 2020 through 2023, generally lag DPI net benchmarks as the funds face a steep j-curve in early years because of the management fees charged on the debentures, which is subsequently compensated for as the funds mature. It should be remembered, that SBICs are highly illiquid investments with a typical 10-year fund life with two 1-year extension options and DPI is not expected to reach 0.5-0.7x of invested capital until year 6 or 7 of the fund life. Furthermore, SBA works with SBICs that have high residual value and low distributions reaching the end of the 10-year fund life order to support a positive outcome for the small business portfolio companies who are receiving financing.

For the reasons listed above, SBA is requesting that the Board consider another adjustment to the loss rate that is more closely aligned with comparable investments in public welfare investment (PWIs) categories, such as Low-Income Housing Tax Credit (LIHTC) and renewable energy and does not disincentivize regulated financial institutions to invest in SBICs relative to other PWIs. Such disincentives could have the unintended result of over concentration of bank investments in LIHTC and renewable energy relative to SBICs, two categories of investments which generally have experienced higher historical loss rates and volatility over the last 20 years than non-Participating Security SBICs. It is also important to note that the Small Business Investment Act of 1958, as amended, limits the exposure of regulated financial institutions in SBIC investments not to exceed 5% of the institutions' capital and surplus.<sup>6</sup>

To further support modifications to the loss rate on private equity investments in SBICs and to better reflect the inherent risks of investment in SBICs, SBA would like to suggest that the Board add to the Proposed Agency Information Collection Activities the percentage of underlying

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<sup>2</sup> Source: SBA, reflects the number of Debenture SBICs licensed in a given vintage year and the number of those funds to ultimately default. Cumulative defaults for the period of 2000 – 2021 (16/322 licensed SBICs)

<sup>3</sup> As calculated by the Institute for Private Capital from SBIC survey data. Data are from fund vintages 2000 through 2020 and as published in The Performance of Small Business Investment Companies, dated June 19, 2024: [The Performance of Small Business Investment Companies – Institute for Private Capital \(uncipc.org\)](#).

<sup>4</sup> The benchmark includes U.S. buyout, expansion capital, venture capital, and generalist equity funds in the MSCI-Burgiss database.

<sup>5</sup> Source: SBA Executive Summary performance data from SBA Form 468 as reported by SBICs for the period ending 12/31/2023.

<sup>6</sup> Source: Small Business Investment Act of 1958 (15 U.S.C. 682(b)), as amended by title II of the Small Business Act Amendments of 1967 (Pub. L. 90-104, 81 Stat. 268, 270)

SBIC portfolio investments that are equity and the percentage of that are debt/loans as a means to continually monitor debt and equity exposure via SBIC licensed funds.

Since 1958, the mission of the U.S. Small Business Administration's SBIC program has been to stimulate and supplement the flow of private equity capital and long-term debt financing to provide sustainable access to capital, networks, and assistance for small businesses and start-ups to start, scale and sustain over time. SBA does this by licensing professionally managed debt and equity investment funds as SBICs and providing capital to SBICs in the form of a government-guaranteed loan to the fund to match privately raised capital. As of December 31, 2023, there were a total of 318 licensed investment funds in operation with a combined \$42.7 billion in public and private assets under management. From program inception through December 31, 2023, SBICs have invested over \$130 billion in more than 194,000 financings to small businesses. SBA notes that all SBICs are categorized as PWIs and considered non-significant equity exposures. In addition, all SBICs are considered Community Development investments under the Community Reinvestment Act of 1977.

As always, SBA appreciates the opportunity to discuss these issues and looks forward to working together to update applicable regulations so that the SBA and SBIC program can continue to provide America's small business sustainable access to private equity capital and long-term debt financings, networks, and assistance for small businesses and start-ups to start, scale, and sustain.

Sincerely,

**BAILEY DEVRIES**  
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Date: 2024.08.20 17:27:00 -04'00'

Bailey G. DeVries  
Associate Administrator, Office of Investment and Innovation  
U.S. Small Business Administration

## Appendix 1 – Proposed Language

### F.24 – Private Equity

#### **General:**

This worksheet is meant to capture the carry value of Private Equity investments across regions and aggregated by GICS code. Report the carry value of Private Equity investments reported at fair value and NAV in section (A). Report the carry value of Private Equity investments and [SBIC interests](#) measured using accounting methods other than fair value, i.e. cost or equity methods, in section (B).

Real estate, minority interest in hedge funds, fund seed capital, infrastructure funds and investments where the GICS code is not clearly defined should be entered in the separate sections below the Data by GICS code section.

The row labelled "Unspecified Sector/Industry" is meant to capture the carry value of investments not easily categorized into one of the specified industries and sectors, investments in several sectors, and investments for which there is insufficient detail to break out the carry value of the holdings into component sectors. An example would be a fund that invests in several sectors and for which there is insufficient detail to break out the carry value of the holdings into component sectors. Funded equity interests in Small Business Investment Companies<sup>11</sup>, [excluding Participating Securities SBICs](#), should also be reported under "Unspecified Sector/Industry" in the "SBIC Interests" row provided. Unfunded commitments to SBICs meanwhile should similarly be reported under "Unfunded Commitments" in the dedicated "SBIC Interests" row there. ~~Note, only equity interests in "Standard Debenture" SBICs may be reported as SBIC interests. Other forms of Participating Securities~~ SBIC interests should be reported as normal Private Equity rather than in SBIC line item.

Report non-tax oriented private equity investments in affordable housing that qualify as public welfare investments (PWI)<sup>12</sup> only in the "Affordable Housing PWI" line items provided (for both funded exposures and unfunded commitments). Do not include such positions in any non-PWI line items, to avoid double counting.

Tax oriented PWI should not be included anywhere on F.24-Private Equity (though note that if held at fair value, such investments are reportable in the Tax Credits section of F.25-Other Fair Value Assets).

#### **Unfunded Commitments**

All unfunded commitment balances are expected to be included, regardless of accounting and regulatory approaches used by the firms. This applies whether the institution holds a limited or general partner position.

#### **Regional Definitions**

**Western Europe:** Austria, Belgium, France, Germany, Greece, Ireland, Italy, Luxembourg, Monaco, Netherlands, Portugal, Spain, Sweden, Switzerland, UK.

**Other Developed Markets:** All "Advanced Economies" defined on the Regional Groupings worksheet, excluding those in Western Europe defined above.

**Emerging Markets:** All other countries.

**Unspecified Geography:** Use in cases where current systems do not allow for the geographical source to be easily identified.