



August 20, 2024

**BY ELECTRONIC TRANSMISSION**

Ann E. Misback, Secretary  
Board of Governors of the Federal Reserve System,  
2001 C St., N.W., Mailstop M-4774  
Washington, DC 20551

RE: Proposal to Revise and Extend: Capital Assessments and Stress Testing Reports (FR Y-14/A/Q/M; OMB No. 7100-0341

On behalf of its membership, the Small Business Investor Alliance (“SBIA”) urges the Board of Governors of the Federal Reserve (“Board”) to revise its Capital Assessments and Stress Testing Reports proposal because the draft amendments to the instructions for Reporting Form FR Y-14Q, Schedule F (“Trading, PE and Other Fair Value Assets Schedule”) (“Form Y-14Q”), would, as applied, harm small business access to capital while at the same time risk removing an important investment diversification option for banks.

The SBIA is the national organization that represents small business funds and their investors, including federally licensed Small Business Investment Companies (SBIC) and federally licensed Rural Business Investment Companies (RBIC), and the many banks and capital providers that invest in them. These SBIC and RBIC funds are chartered to make important economic development contributions to domestic job creation, retention, and improvement, commonly in under-served areas and among under-represented groups.

Specifically, the SBIA is concerned with proposed amendments to the instructions for Form Y-14Q that would govern the treatment of SBIC investments by the Board’s regulated financial institutions.<sup>1</sup> In the Board’s supporting statement explaining recommended amendments to Form Y-14Q, the Board explains that it is proposing to add a separate reporting category for “SBIC Interests” as an industry group to capture funded and unfunded equity interests in SBICs held by its regulated financial institutions.<sup>2</sup> Currently, the Board collects data on the SBIC investments of its regulated financial institutions on Form Y-14Q in a row labeled “Unspecified Sector/Industry,” which serves as a catch-all category to capture the carry value of instruments not easily categorized on the worksheet. The Board, however, explains that “the unique characteristics of SBICs that distinguish them from general private equity exposures” supports its proposed amendment.<sup>3</sup>

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<sup>1</sup> Board-regulated financial institutions may both invest in SBICs generally, and, in some cases, hold a license issued by the U.S. Small Business Administration (SBA) to operate non-leveraged SBIC funds.

<sup>2</sup> Supporting Statement for the Capital Assessments and Stress Testing Reports (FR Y-14A/Q/M; OMB No. 7100-0341) at 18.

[www.federalreserve.gov/apps/reportingforms/Download/DownloadAttachment?guid=54866089-D365-47EE-9CE9-252036433970](http://www.federalreserve.gov/apps/reportingforms/Download/DownloadAttachment?guid=54866089-D365-47EE-9CE9-252036433970) (last visited on August 6, 2024).

<sup>3</sup> Id.



SBIA supports the Board’s recommendation to amend its worksheet with a separate row for regulated financial institutions to report their SBIC funded investments and unfunded commitments separately.

For the following reasons, however, SBIA does not support the Board’s proposed instructions that narrow the definition of “SBIC Interests” to a regulated financial institution’s equity investment in leveraged SBICs (“Standard Debentures”) only.

- 1. The SBIC program, which is a market-driven public policy vehicle, was created by federal statute to serve a public purpose just like Low-Income Housing Tax Credits or New Market Tax Credits, which federal regulators assign a significantly lower risk-weight to bank investments.**

The Form Y-14Q instructions for reporting private equity investments acknowledge the low risk assigned by the Board to public welfare investments (“PWI”) like Low-Income Housing Tax Credits or New Markets Tax Credits because bank investments in either are expressly excluded from reporting as “private equity”. Rather, the Board requires financial institutions to report their investments in these instruments separately either as non-tax oriented (“Affordable Housing PWI”) or tax-oriented PWI, which “should not be included anywhere on F.24 Private Equity” row and are presumptively assigned a lower risk weight because of the public purpose for each vehicle.<sup>4</sup>

Like Low-Income Housing Tax Credits or New Market Tax Credits, the congressionally-authorized SBIC program promotes important public purpose goals that offer capital access to domestic small businesses that may otherwise have limited options from traditional sources.<sup>5</sup> The Federal Reserve, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation recently affirmed that investments into SBICs qualify for Community Reinvestment Act credit as community development under the term’s “economic development” prong because those are “activities undertaken consistent with federal, state, local or tribal government plans, programs, or initiatives that support small businesses.”<sup>6</sup>

SBICs are not only market-driven public policy vehicles but also capital engines for job creation and small business growth throughout the United States.

- 2. The Basel III endgame proposal treats all SBICs the same for stress test purposes and assigns the same risk-weight percentage to both leveraged and non-leveraged SBICs.**

Financial services regulators in the proposed Basel III endgame proposal do not distinguish between but rather assign the same risk weight average for bank investments made in both

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<sup>4</sup> (Draft) Instructions for the Capital Assessments and Stress Testing information collection (Reporting Form FR Y-14Q) at 126.

[www.federalreserve.gov/apps/reportingforms/Download/DownloadAttachment?guid=F7F486CE-FD85-4BF0-9875-1B99D25F390C](https://www.federalreserve.gov/apps/reportingforms/Download/DownloadAttachment?guid=F7F486CE-FD85-4BF0-9875-1B99D25F390C) (last visited on August 6, 2024.)

<sup>5</sup> Small Business Investment Act of 1958, Pub. L. 85-699 (Aug. 21, 1958). 15 U.S.C. 661.

<sup>6</sup> Title 12 CFR § \_\_.13 (c)(1). CRA regulations are provided in the following format: current 12 CFR \_\_.xx (*e.g.*, references to 12 CFR 25.12 (OCC), 12 CFR 228.12 (Board), and 12 CFR 345.12 (FDIC)).

leveraged and non-leveraged SBICs described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682).<sup>7</sup>

SBICs, administered by the U.S. Small Business Administration (“SBA”), are highly regulated private funds that invest exclusively in domestic small businesses, which by statutory mission provide capital that is otherwise unavailable or in short supply to small businesses<sup>8</sup>. All investment groups that seek an SBIC license, including bank-owned non-leveraged SBICs, must establish a record of not only solid investment performance, but also a record of being a good actor to the small businesses they have backed. SBICs may only provide long-term capital, not short-term lending, and must do so with numerous meaningful protections to the small business that otherwise would not be provided.

**3. Bank investments in non-leveraged SBICs should also be reported on Form Y-14Q as “SBIC Interests” because the “Non-leveraged” and Standard Debenture (or “Leveraged”) licensing categories are simply different sides of the same SBIC “coin”.**<sup>9</sup>

A financial institution may participate in the SBIC program either as a general partner (*i.e.*, bank owned non-leveraged SBIC), a limited partner investor in an SBIC, or both. The bank’s capital commitment, however, whatever side of the SBIC coin, remains exposed to risk. Recent data curated for a separate report on SBIC performance supports this position because it shows that non-leveraged and Standard Debenture SBICs (vintage years 2000-2020) maintain similar risk profiles.<sup>10</sup>

SBIA’s position is that for reporting purposes associated with the Board’s annual stress test evaluations, the Board should permit its regulated financial institutions to report their investments in non-leveraged and Standard Debenture SBICs collectively under the “SBIC Interests” row in Form Y-14Q.

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<sup>7</sup> 88 Fed Reg 64213-64214 (Sept. 18, 2023) (§\_\_\_.141 Expanded simple risk-weight approach (ESRWA)). *See also* 12 CFR 3.152(b)(3)(iii)(B) (OCC); 12 CFR 217.152(b)(3)(iii)(B) (Board); 12 CFR 324.152(b)(3)(iii)(B) (FDIC).

<sup>8</sup> *Supra* Note 5.

<sup>9</sup> SBIA does not opine on the proposed reporting treatment for any of the new subcategories of SBIC licenses established by the SBA under its revised SBIC program regulations that became effective in August 2023 (*i.e.*, Accrual; Reinvestor SBIC; Critical Technology SBIC), because there is no time series data available currently to measure credit risk.

<sup>10</sup> *See* Attachment One. *The Performance of Small Business Investment Companies*, Institute for Private Capital, Kenan-Flagler Business School, University of North Carolina, Dr. Greg Brown, et al., June 19, 2024. The underlying data is from a recent original statistical survey of SBIC performance along with data from MSCI-Burgiss. The survey findings include that: (i) SBICs have an average internal rate of return (IRR) of 16.9%, which is about four (4%) percent higher than for a comparable set of non-SBIC peer funds, and (ii) SBICs have an average multiple on invested capital (MOIC) of 2.3x, which is about 0.7 of a multiple higher than for the peer funds. Report at 3.

Table One. IPC - Curated Data Set, SBIC Vintage Years 2000-2020, July 2024

		IRR (%) by Leverage Ratio									
		Average	StdDev	Min	P10	P25	P50	P75	P90	Max	P10-90 Spread
<b>A</b>	<b>Non-leveraged SBICs</b>	13.54	8.42	-4.12	6.04	8.74	11.40	18.77	26.80	27.74	20.76
<b>B</b>	<b>All Debentures</b>	17.31	10.79	-13.35	7.40	11.00	14.65	21.30	30.20	73.27	22.80
<b>Memo: by Leverage Amount</b>											
<b>B.i</b>	<b>0-0.49x Debentures</b>	16.84	3.86	12.87	12.87	12.87	17.06	20.58	20.58	20.58	7.71
<b>B.ii</b>	<b>0.5-1x Debentures</b>	18.22	11.17	-13.35	7.20	13.35	19.30	24.84	33.70	36.08	26.50
<b>B.iii</b>	<b>1.01-1.75x Debentures</b>	20.83	13.90	3.81	7.84	11.80	17.20	25.32	41.00	73.27	33.16
<b>B.iv</b>	<b>1.76-2.0x Debentures</b>	15.51	8.74	-4.01	7.51	10.34	13.89	18.97	24.93	65.05	17.42

  

		MOIC by Leverage Ratio									
		Mean	StdDev	Min	P10	P25	P50	P75	P90	Max	P10-90 Spread
<b>A</b>	<b>Non-leveraged SBICs</b>	1.98	1.82	0.94	1.13	1.31	1.65	2.01	2.20	10.29	1.07
<b>B</b>	<b>All Debentures</b>	2.37	1.42	0.00	1.20	1.51	2.03	2.70	3.89	9.52	2.69
<b>Memo: by Leverage Amount</b>											
<b>B.i</b>	<b>0-0.49x Debentures</b>	2.04	0.55	1.44	1.44	1.44	2.16	2.52	2.52	2.52	1.08
<b>B.ii</b>	<b>0.5-1x Debentures</b>	2.57	1.41	0.80	1.03	1.56	2.21	3.07	4.64	5.75	3.61
<b>B.iii</b>	<b>1.01-1.75x Debentures</b>	2.63	1.75	1.10	1.31	1.52	1.96	2.90	4.52	9.52	3.21
<b>B.iv</b>	<b>1.76-2.0x Debentures</b>	2.22	1.27	0.00	1.18	1.49	2.00	2.48	3.36	9.05	2.18

The original data was evaluated for the proposition that, in terms of risk exposure and potential capital loss to investors, there is limited to no material differential between non-leveraged and Standard Debenture SBICs. Almost no non-levered SBICs in the data set have lost money and the ones that did lost only a de minimis amount. For example, the worst performing non-leveraged SBIC lost just six (6%) percent (MOIC of 0.94) and the lowest IRR was negative four (-4%) percent.

As a proxy for risk, the standard deviation (SD) of IRRs and MOICs are a measure of return dispersion of funds and, therefore, historical risk. The SD of IRRs and MOICs is about the same for non-levered and levered SBICs. The slightly higher SD of MOICs is driven by greater earnings, not losses; therefore, when evaluating the data set for downside performance only, a snapshot to SBICs performing at the “minimum” level or lower percentage levels (*i.e.*, “P10”, “P25”) reveals that non-levered SBICs appear to have less risk, or similar risk, to Standard Debenture (levered) SBICs. Examining the spread in IRRs for SBICs from 10<sup>th</sup> percentile performance to 90<sup>th</sup> percentile performance indicates that non-levered SBICs have similar risk to Standard Debentures (*i.e.*, similar/lower return dispersion). There is no consistent trend between risk and the degree of leverage held by an SBIC.<sup>11</sup>

SBIA also notes that if the Board approves the proposed instructions without change then the practical effect may trigger the concentration of investment risk among the Board’s regulated banks. The instructions would create a disincentive for banks to continue making investments in public-purpose investment vehicles like SBICs because those investments would likely face the burden of a higher capital risk weight value. Investment risk concentration is a negative unintended consequence that the Board can mitigate by expanding, not narrowing, the definition of “SBIC Interests” in Form Y-14Q.

<sup>11</sup> Looking at the level of risk among Standard Debenture SBICs, funds with low leverage (0-0.49x) have the lowest risk as measured by SD and P10-90. The higher leveraged SBICs (1.76-2.0x) have the next lowest risk. Middle-leveraged SBIC funds (0.5-1.0x and 1.01-1.75x) have somewhat higher risk.



Finally, all SBICs, leveraged and non-leveraged, must adhere to the same comprehensive SBIC program rules including those governing qualifying small business investments.<sup>12</sup>

For the reasons stated, the SBIA respectfully urges that the Board permit its regulated financial institutions to report their investments in non-leveraged and Standard Debenture SBICs collectively under the “SBIC Interests” row in Form Y-14Q.

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As always, SBIA appreciates the invitation to discuss these issues and looks forward to the opportunity to work together to ensure America’s small businesses have access to the capital they need.

Sincerely,

A handwritten signature in blue ink that reads "Brett Palmer".

Brett Palmer  
SBIA President

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<sup>12</sup> Small Business Investment Act of 1958, Pub. L. 85-699 (Aug. 21, 1958) (15 U.S.C. 661 *et seq.*) SBICs may invest in a domestic “small business,” as defined under federal law, which does not engage in foreign activities (*i.e.*, more than half of employees and assets must be located within the United States) and is not engaged in a “prohibited business” (*e.g.*, passive businesses, real estate businesses, farmland purchases, project financings, foreign investments, associated suppliers, financing licensees or businesses contrary to the public interest. *See* 13 C.F.R. 107.720. All licensed SBICs must comply with ongoing regular reporting requirements to the SBA regarding fund operations and investments.



*ATTACHMENT ONE*

*The Performance of Small Business Investment Companies*

Institute for Private Capital, Kenan-Flagler Business School,  
University of North Carolina  
Dr. Greg Brown, et al.

June 19, 2024