



October 17, 2018

Christopher Kirkpatrick  
Secretary  
Commodity Futures Trading Commission  
1155 21<sup>st</sup> Street NW  
Washington, DC 20581

**Re: Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Volcker Rule); Request for Public Input (RIN 3038–AE72)**

Dear Mr. Kirkpatrick:

The Small Business Investor Alliance (“SBIA”) is the trade association that represents small business private equity funds and their investors, including Small Business Investment Companies (“SBICs”) and banks that invest in them. SBICs are highly-regulated private funds that invest exclusively in domestic small businesses.<sup>1</sup>

SBIA filed comments last year in support of the exclusion for SBICs from the definition of “covered funds” under the Volcker Rule.<sup>2</sup> Today’s submission reiterates those comments and, for the reasons outlined below, also recommends that the agencies expand the exemption to include SBICs that retire their licenses after their investment period.

**SBICs are Highly-Regulated Investment Vehicles**

The Investment Company Act of 1940 provides the definition of an investment company, and Section 13 relies on this definition to cover hedge funds and private equity funds. For sound public policy reasons, SBICs are rightfully excluded from the definition of a covered fund under the Volcker Rule, and investments by banking entities in SBICs are explicitly permitted activities

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<sup>1</sup> The SBIC program, administered by the Small Business Administration (“SBA”), is a market-driven platform that serves an important public purpose of facilitating private investment into domestic small businesses. The program was created in 1958 during the Glass-Steagall era. SBIC investments by banks are specifically and clearly permitted in statute in Dodd-Frank, as they were under Glass-Steagall. SBICs were permitted because they are highly regulated, have a clear public policy purpose, and because of their unique role in job creation and economic impact. A 2017 Library of Congress study found that SBIC-backed businesses created 3 million net new jobs and supported an additional 6.5 million jobs from 1995-2014 (a period that included the Great Recession and the tech bubble recession).

<sup>2</sup> On December 10, 2013, the Federal Reserve (“Fed”), Federal Deposit Insurance Company (“FDIC”), the Commodity Futures Trading Corporation (“CFTC”), the Securities and Exchange Commission (“SEC”), and the OCC issued final rules implementing the Volcker Rule. Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), which created the new Section 13 of the Bank Holding Company Act, and the final regulations issued by multiple agencies (together, the “Volcker Rule”) were made effective on April 1, 2014, and all “banking entities” were required to conform to the rule by July 21, 2015. The Volcker Rule prohibits these banking entities from proprietary trading and from ownership or sponsorship relationships with private equity funds and hedge funds (“covered funds”). In August 2017, the agencies issued another request for comments, and SBIA submitted a comment letter in September 2017.

under Section 619(d)(1)(E) of Dodd-Frank. SBIA strongly supports this exclusion for SBICs, as they are a highly-regulated, strong vehicle for job creation and do not contain the same type of risks for bank investors as other investment vehicles.

Banks are a critical source of investment into SBICs, commonly providing capital that is required for SBICs to become licensed by the SBA. Most importantly, the funding provided by banks is used by SBICs to carry out their mission to provide needed capital to domestic small businesses. Even though SBICs are permissible investments for banks, banks still encounter challenges in how the Volcker Rule exemption regarding SBIC investments is applied and are burdened from reporting requirements.

Banking entities have suggested that the Volcker Rule is overbroad and restricts a number of essential financial functions, potentially limiting activities that could spur economic growth. Even with the explicit statutory exclusion for SBICs, SBIA feels that additional regulatory clarifications are necessary. Specifically, 1) the reporting requirements for SBICs should be made simpler and less burdensome; and 2) banks should continue to be allowed to hold and realize their investments after an SBIC surrenders its license in its wind-down phase and is only harvesting investments and returning invested capital.

Banking regulators should allow banks to invest through “fund of funds” structures that invest exclusively in SBICs or other permitted investments. Banks are struggling with a range of cumbersome regulatory burdens that do not seem to scale with the risk they pose. SBIA would encourage the agencies to provide appropriate expanded regulatory relief to these banks in this and all regulatory matters.

### **Banks Should Be Permitted to Retain Their Investments in SBICs That Surrender Their Licenses During Wind-Down Phase (Question 181)**

SBIA recommends that the agencies should modify the current exclusion and provide that it remains applicable to any SBIC that relinquishes or voluntarily surrenders its license.

Currently, in statute and regulation, the Volcker Rule exempts from the definition of “covered funds” SBICs and funds that have received a “green light letter” from the SBA to apply for an SBIC license. Therefore, a bank may invest in a fund while it is in the process of applying for an SBIC license, as well as during the time when the fund is actually licensed. SBIA strongly supports continuing this exemption for SBICs and recommends making a modest change to permit holding onto investments already made in SBICs after the SBIC surrenders its license, after the active investing phase is complete, and when the fund is in its final wind-down phase.

SBIC funds have a finite life with four basic stages: Fundraising, investing, harvesting, and wind-down. While there is some overlap in these stages, all funds get to a point where they are no longer investing and only harvesting and realizing returns for their investors. During this wind-down phase, SBICs often surrender their licenses, which can cause unintended problems for bank investors who could lose their SBIC exemption at exactly the time when profits are being realized and selling their stake in the secondary market would be least liquid because of the short time left in the fund. Based on the current Rule, a fund that surrenders its SBIC license prior to its final termination creates a compliance risk for its bank investors. If the SBIC surrenders the license prior to termination of the fund, it may be viewed as no longer exempt from the definition of a

“covered fund” under the Volcker Rule. Bank LPs typically cannot control whether or when an SBIC surrenders its license. Therefore, banks are put in a position where they may need to engage in a regulatory-forced fire sale or withdrawal of their interest from the fund (oftentimes at values below current valuations) in order to avoid being out of compliance with the Volcker Rule. Allowing banks to realize their investments from funds in wind-down that held an SBIC license is consistent with the intent of the law and would protect banks from forced sales of what should be valuable investments. It should be noted that this issue is coming up now because SBICs who received bank capital in the Dodd-Frank era are in the wind-down phase and many are facing this issue.

### **Suggested Modification**

Our suggested modification would be to extend the exemption to an SBIC that surrenders its SBIC license after the SBIC’s investment period has ended. After an SBIC’s investment period has ended, the SBIC may no longer make new investments other than “follow-on” investments in existing portfolio companies. Therefore, any such additional investments would be made in companies which were eligible SBIC investments. Follow-on investing after an investment period has ended is relatively limited and is sometimes needed to support the continued growth of the portfolio company and/or protect an SBIC’s existing investment through capital support.

SBIA offers the following draft amendment to provide certainty and clarity at 12 CFR §248.10(c)(11): “An issuer (i) That is a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), or that has received from the Small Business Administration notice to proceed to qualify for a license as a small business investment company, which notice or license has not been revoked *or (ii) that was a small business investment company that has voluntarily surrendered its license to operate as a small business investment company in accordance with 13 CFR 107.1900 following the end of the period during which such issuer may call capital from its investors for new investments*”

### **Banks and SBIC Funds of Funds**

The current prohibition against banks using funds-of-funds as an intermediary vehicle to invest in SBIC funds should be lifted because it would comport with the clear intent of the statute of allowing bank investment into SBICs but would allow banks to do so with less risk concentration, without hiring more internal staff, and with potentially better returns. A fund of funds vehicle that limits its investments to SBICs and other permitted activities would allow banks to use professionals who specialize in identifying and investing in the highest performing SBIC funds rather than requiring the banks to have this investing expertise in-house. Further, this would allow a greater risk diversification via the portfolio effect. Finally, it would be particularly beneficial to smaller banks who are investing smaller dollars and have fewer internal resources to select funds.

### **Conclusion**

SBIA supports sensible regulation that promotes soundness in our financial system. We believe that excluding SBICs from the definition of covered funds for purposes of the Volcker Rule fits squarely within those purposes. We ask that, per the statute, SBICs continue to be excluded and that the exemption be expanded to include SBICs that retire their licenses after their investment period. This small change will eliminate the costly burden associated with banks needing to exit

SBIC investments prior to final dissolution of the partnership without sacrificing the safety and soundness of the institutions impacted.

As always, SBIA appreciates the opportunity to discuss these issues and looks forward to working together to update applicable regulations to ensure America's small businesses have access to the capital they need.

Sincerely,

A handwritten signature in blue ink that reads "Brett Palmer". The signature is fluid and cursive, with the first name "Brett" and last name "Palmer" clearly distinguishable.

Brett Palmer  
President  
Small Business Investor Alliance