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SMALL BUSINESS INVESTMENT COMPANY AMENDMENTS ACT OF 2001

AUGUST 28, 2001.—Ordered to be printed

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Mr. KERRY, from the Committee on Small Business and
Entrepreneurship, submitted the following

REPORT

[To accompany S. 1196]

On July 19, 2001, the Senate Committee on Small Business and Entrepreneurship considered S. 1196, “the Small Business Investment Company Amendments Act of 2001.” The bill would permit a moderate increase in the annual fee paid by the Small Business Investment Companies to the Small Business Administration (SBA) and would make other technical changes in the Small Business Investment Company (SBIC) program. Having considered S. 1196, the Committee reports favorably thereon without further amendment and recommends that the bill do pass.

I. INTRODUCTION

In 1958, Congress created the SBIC program to assist small business owners obtain investment capital. Forty-three years later, small businesses continue to experience difficulty in obtaining investment capital from banks and traditional investment sources. Although investment capital is readily available to large businesses from traditional investment firms, small businesses seeking investments in the range of \$250,000 to \$5 million have to look elsewhere. SBICs frequently are the only sources of investment capital for growing small businesses.

The SBIC program has helped some of our Nation’s best-known companies. It has provided a financial boost at critical points in the early growth period for many companies that are familiar to all of us. For example, the FedEx Corporation received a needed infusion of capital from two SBA-licensed SBICs at a critical juncture in its

development stage. The SBIC program also helped other well-known companies, when they were not so well-known, such as Intel, Outback Steakhouse, America Online, and Callaway Golf.

In 1992 and 1996, the Committee on Small Business worked closely with the Small Business Administration to correct earlier deficiencies in the Small Business Investment Act of 1958 in order to ensure the future of the program. In 1992, and again in 1996, Congress enacted major changes to strengthen and reform the SBIC program. Today, the SBIC program is expanding rapidly in an effort to meet the growing demands of small business owners for debt and equity investment capital. More qualified investment teams are seeking license approval from SBA than ever before. Since October 1998, the number of new SBIC licensees has increased by more than 35 percent, as SBA approved 53 new licenses in FY 1999 and 60 new licenses in FY 2000, bringing the total number of active SBIC licenses to 415.

At the same time the SBIC program is experiencing significant growth, the investment groups that are receiving guaranteed funds for investing in small businesses are performing at an exceptionally high level. Each year the SBA and the Office of Management and Budget (OMB) develop a credit subsidy rate estimate, which is the cost of running the program based largely on its projected future losses. Under the Debenture and Participating Securities programs, the credit subsidy rates have dropped dramatically. For example, the credit subsidy rate for the Debenture program dropped from 3.19 percent in FY 1997 to zero (0.0%) in FY 2000, a milestone achieved for the first time in the program's history. The credit subsidy rate for the Debenture program dropped again in FY 2001 and is projected to drop still further in FY 2002.

For FY 2002, the Bush Administration has recommended a program level of \$2.5 billion for the Participating Securities program and increasing the annual interest fee paid by the Participating Securities SBICs by thirty-seven basis points (0.37%, taking the fee from 1 percent to 1.37 percent) in order to cause the credit subsidy rate to drop to 0.0% and eliminate all appropriations for the program. The Committee does not agree that the program participants alone should pay for the entire cost of running the program and believes the program level should be \$3.5 billion in order to meet the needs of the market as projected by the National Association of Small Business Investment Companies (NASBIC). Consequently, when the Committee considered S. 1196, it agreed to increase the fee from 1 percent up to no more than 1.28 percent, effectively splitting the cost of running the program between the Participating Securities SBICs and the Agency. By allowing the annual interest fee to increase to no more than 1.28 percent, the Committee assumed a level appropriation of \$26.2 million, which in FY 2001 provided for a program level of \$2 billion, and that the Participating Securities SBICs would pay the difference with higher fees in order to increase the program level for FY 2002 to \$3.5 billion.

II. DESCRIPTION OF BILL

SBIC fees

The "Small Business Investment Company Amendments Act of 2001" would permit the annual interest fee paid by Participating

Securities SBICs to increase from 1.0 percent to no more than 1.28 percent. In addition, the bill would make three technical changes to the Small Business Investment Act of 1958 ('58 Act) that are intended to make improvements in the day-to-day operation of the SBIC program.

As stated in the introduction, the projected demand for the Participating Securities SBIC program for FY 2002 is \$3.5 billion, a significant increase over the FY 2001 program level of \$2.0 billion. It is imperative that Congress approve this relatively small increase in the annual interest charge paid by the Participating Securities SBICs before the end of the fiscal year because without the increase, the program level would be significantly below projected demands. This fee increase, when combined with an appropriation of \$26.2 million for FY 2002, the same amount Congress approved for FY 2001, would support a program level of \$3.5 million.

The Committee elected to approve legislation that maintained the requirement for an annual appropriation in part because of the volatility the credit subsidy rate has experienced over the past two years. Whereas, the credit subsidy rate has declined dramatically in the recent fiscal years leading up to FY 2002, the Administration's credit subsidy rate estimate for FY 2002 for the Participating Securities program would increase nearly 50% over FY 2001.

Administration officials explained to the Committee that the estimated credit subsidy rate increase was not the result of increased defaults in the program, but the result of a decrease in the cost of money to the Federal government, which, when included in the credit subsidy rate calculations, causes the credit subsidy rate to increase. While this change on its face may seem to be counter-intuitive, the Administration officials explained that the lower cost of money would generate less income in the financing account over the life of the FY 2002 cohort of loans made under the Participating Securities program. The projected drop in interest income in the financing account would necessitate an increase in principle paid into the financing account for the FY 2002 cohort in order to support the cost of the program.

Conflicts of interest

The "Small Business Investment Company Amendments Act of 2001" would also make some technical changes to the '58 Act that are drafted to improve the operations of the SBIC program. Section 3 would remove the requirement that the SBA take out local advertisements when it seeks to determine if a conflict of interest exists involving an SBIC. This section has been recommended to the Committee by NASBIC, and the SBA, in light of the fact that the Agency has never received a response to a local advertisement and believes the requirement is unnecessary.

Criminal penalties

The bill would amend Title 12 and Title 18 of the United States Code to insure that false statements made to the SBA under the SBIC program would have the same penalty as making false statements to an SBIC. This section would make it clear that a false statement to the SBA or to an SBIC for the purpose of influencing their respective actions taken under the '58 Act would be a crimi-

nal violation. The courts could then assess civil and criminal penalties for such violations.

The purpose of this section is to correct a problem in 18 U.S.C. 1014 which makes it a crime to make a false statement or representation for the purpose of trying to influence the actions of an SBIC; however, it has not been interpreted to also make it a crime for an SBIC or any person to make false statements or representations intended to influence in any way the actions of the SBA. As a result, the Department of Justice lost a case seeking civil penalties against an individual in control of an SBIC that was charged with making false statements to the SBA for the purpose of obtaining millions of dollars in funds guaranteed by the SBA and steering the SBA away from prompt collection actions.

The charge of violation of 18 U.S.C. 1014 was dismissed in the case because the statute does not mention the SBA by name, and the court found the SBA was not among the generic types of agencies listed in the statute. As a result, civil penalties could not be imposed under 12 U.S.C. 1833a (FIRREA). The judge also refused to award civil penalties under the general criminal false statements provision, 18 U.S.C. 287, based on his determination that the SBIC was not a “federally insured financial institution.” The change would ensure that persons who make false statements to an SBIC or the SBA would be subject to the civil penalties set forth under FIRREA.

Section 4 would also add 15 U.S.C. 645(a) to the civil penalty provision of FIRREA. The provision would provide fines for violations of, or conspiracies to violate, certain criminal statutes, including 18 U.S.C. 1001. For purposes of FIRREA, 18 U.S.C. 1001 must involve a false statement made to a federally insured financial institution. Section 4 would add false statements made to a federally-licensed financial institution (such as an SBIC), a federal lending agency or a federal guarantor, including the SBA. Because 15 U.S.C. 645(a) does not require the showing of materiality necessary to establish a violation of 18 U.S.C. 1001, it is often used in lieu of 18 U.S.C. 1001 by criminal prosecutors. Evidently, when the civil penalty provision of FIRREA was enacted, it did not amend 15 U.S.C. 645(a). Accordingly, unless this provision is changed, those who make false statements or conspire to make false statements to the SBA and are charged under a more specific statute, 15 U.S.C. 645(a), are subject to a lesser penalty than others who commit similar crimes but are charged under 18 U.S.C. 1001.

Removal of management officials

Section 5 of the bill would amend Section 313 of the '58 Act to permit the SBA to remove or suspend key management officials of an SBIC when they have willfully and knowingly committed a substantial violation of the '58 Act, any regulation issued by the SBA under the Act, a cease-and-desist order that has become final, or committed or engaged in any act, omission or practice that constitutes a substantial breach of a fiduciary duty of that person as a management official.

The section expands the definition of persons covered by Section 313 from officers and directors to “management officials,” which includes not only officers and directors but also general partners, managers, employees agents or other participants in the manage-

ment or conduct of the SBIC. At the time Section 313 of the '58 Act was enacted in November 1966, an SBIC was organized as a corporation, with directors or officers built into the management structure. Since that time, it has become more common for SBICs to organize as partnerships and Limited Liability Companies (LLCs), with general partners and other individuals taking an active role in the management of the entity, and this amendment would take into account those different organizations.

III. COMMITTEE VOTE

In compliance with rule XXVI(7)(b) of the Standing Rules of the Senate, the following vote was recorded on July 19, 2001. A motion by Senator Bond to adopt S. 1196, the Small Business Investment Company Amendments Act of 2001, was approved by a recorded vote, 19–0, with the following Senators voting in the affirmative: Kerry, Bond, Levin, Harkin, Lieberman, Wellstone, Cleland, Landrieu, Edwards, Cantwell, Carnahan, Burns, Bennett, Snowe, Enzi, Fitzgerald, Crapo, Allen, and Ensign.

IV. EVALUATION OF REGULATORY IMPACT

In compliance with rule XXVI(11)(b) of the Standing Rules of the Senate, it is the opinion of the Committee that no significant additional regulatory impact will be incurred in carrying out the provisions of this legislation. There will be no additional impact on the personal privacy of companies or individuals who utilize the services provided.

V. CHANGES IN EXISTING LAW

In the opinion of the Committee, it is necessary to dispense with the requirement of section 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

VI. COST ESTIMATE

In compliance with rule XXVI(11)(a)(1) of the Standing Rules of the Senate, the Committee estimates the cost of the legislation will be equal to the amounts discussed in the following letter from the Congressional Budget Office.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, August 16, 2001.

Hon. JOHN F. KERRY,
*Chairman, Committee on Small Business and Entrepreneurship,
U.S. Senate, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for S. 1196, the Small Business Investment Company Amendments Act of 2001.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Ken Johnson.

Sincerely,

DAN L. CRIPPEN,
Director.

Enclosure.

S. 1196—Small Business Investment Company Act of 2001

Summary: S. 1196 would increase the maximum annual fee charged by the Small Business Administration (SBA) for guaranteeing loans under Small Business Investment Company (SBIC) programs from 1 percent to 1.28 percent. The bill also would create new civil and criminal penalties for knowingly making false statements to the SBA regarding loan guarantees offered under the SBIC and other loan programs.

CBO estimates that implementing S. 1196 would reduce the cost of guaranteeing loans under the SBIC participating securities program by about \$125 million over the 2002–2006 period, assuming appropriation of the necessary amounts. By creating new civil and criminal penalties, S. 1196 also would increase receipts and direct spending by negligible amounts each year. Therefore, pay-as-you-go procedures would apply.

S. 1196 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

Estimated cost to the Federal Government: The estimated budgetary impact of S. 1196 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By fiscal year, in millions of dollars—					
	2001	2002	2003	2004	2005	2006
SPENDING SUBJECT TO APPROPRIATION						
Spending Under Current Law for the SBIC Participating Securities Program: ¹						
Estimated Authorization Level ²	26	65	75	0	0	0
Estimated Outlays	23	35	54	53	26	0
Proposed Changes:						
Estimated Authorization Level	0	–58	–67	0	0	0
Estimated Outlays	0	–15	–40	–47	–23	0
Spending Under S. 1196 for the SBIC Participating Securities Program: ¹						
Estimated Authorization Level	26	7	8	0	0	0
Estimated Outlays	23	20	14	6	3	0

¹ Excludes administrative costs.

² The 2001 level is the amount appropriated for that year. The 2002 and 2003 levels are estimates of the appropriation that would be necessary to support the existing authorization levels for new loan guarantees in those years.

Basis of estimate: CBO estimates that implementing S. 1196 would reduce the cost of guaranteeing loans under the two SBIC programs about \$125 million over the 2002–2006 period, assuming appropriations are adjusted to reflect these savings. The bill would create new civil and criminal penalties, but CBO estimates that the effect on revenues and direct spending would be insignificant.

Spending subject to appropriation

The Federal Credit Reform Act of 1990 requires appropriation of the subsidy costs for operating credit programs. The subsidy cost is the estimated long-term cost to the government of a direct loan or loan guarantee, calculated on a net present value basis, excluding administrative costs.

Through two SBIC programs, participating securities and debentures, SBA guarantees 10-year loans made to venture capital firms. To offset the subsidy cost of those guarantees, SBA charges venture

capital firms that participate in the programs a fee of up to 1 percent of the loan amount each year. Under current law, the annual fee cannot exceed the percentage necessary to reduce the subsidy cost to zero.

S. 1196 would raise the maximum annual fee that SBA can charge under the two SBIC programs for loan guarantees that are obligated after October 1, 2001. Based on information from SBA, CBO assumes that the agency will obligate all the amounts previously appropriated for these guarantees by September 30. Therefore, we estimate that this provision only would affect the loan guarantees that are authorized under current law for 2002 and 2003.

Participating Securities. For fiscal year 2002, the Administration estimates that it will charge venture capital firms in the participating securities program the full 1 percent annual fee, yielding an estimated subsidy rate of 1.87 percent. (By comparison, the estimated subsidy rate for 2001 is 1.31 percent.) Because current law authorizes SBA to guarantee \$3.5 billion in new loans under the program in 2002 and \$4 billion in 2003, CBO estimates that the subsidy cost of guaranteeing these new loans under current law would be \$140 million over the 2002–2005 period.

S. 1196 would increase the maximum annual fee for the participating securities program from 1 percent to 1.28 percent. Although CBO estimates that it is likely that the fee increase would reduce the subsidy to zero, there is some possibility that the subsidy rate would remain above zero. Our estimate reflects that uncertainty. CBO estimates that implementing this provision would reduce the subsidy cost of these loan guarantees by a total of \$125 million over the 2002–2005 period, assuming appropriations are adjusted downward to reflect such savings.

Debentures. S. 1196 would raise the maximum annual fee that the SBA can charge venture capital firms under the debentures program to 1.28 percent. However, the subsidy cost of the program is very likely to reach zero without assessing the full 1 percent annual fee allowed under current law. As a result, CBO expects that the probability of charging the higher fees authorized by the bill would be very small. Therefore, CBO estimates that implementing the bill would not have any significant impact on the debentures program.

Revenues and direct spending

CBO estimates that S. 1196 would increase governmental receipts (revenues) by an insignificant amount each year because the bill would create new civil and criminal penalties. Collections of criminal fines are deposited in the Crime Victims Fund and are available to be spent without further appropriation in the following year. Therefore, CBO estimates that direct spending also would rise by a negligible amount each year beginning in 2003.

Pay-as-you-go considerations: The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. Because S. 1196 would create new civil and criminal penalties, the bill would increase both receipts and direct spending. However, CBO estimates that these effects would not be significant.

Intergovernmental and private-sector impact: S. 1196 contains no intergovernmental or private-sector mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

Estimate prepared by: Federal Costs: Ken Johnson. Impact on State, Local, and Tribal Governments: Susan Sieg Tompkins. Impact on the Private Sector: Cecil McPherson.

Estimate approved by: Peter H. Fontaine, Deputy Assistant Director for Budget Analysis.

VII. SECTION-BY-SECTION ANALYSIS

Section 1. Short title

This Act will be called the “Small Business Investment Company Amendments Act of 2001.”

Section 2. Subsidy fees

This section amends the Small Business Investment Act of 1958 to permit the SBA to collect an annual interest fee from SBICs in an amount not to exceed 1.28 percent of the outstanding Participating Security and Debenture balance. In no case will SBA be permitted to charge an interest fee that would reduce the credit subsidy rate to less than 0 percent, when combined with other fees and congressional appropriations. This section would take effect on October 1, 2001.

Section 3. Conflicts of interest

Section 3 would remove the requirement that SBA run local advertisements when it seeks to determine if a conflict of interest is present. SBA has informed the Committee that it has never received a response to a local advertisement and believes the requirement is unnecessary. SBA would continue to publish these notices in the Federal Register. This section would not prohibit the SBA from requiring a local advertisement should it believe it is necessary; it is supported by the SBA.

Section 4. Penalties for false statements

This section would amend Title 12 and Title 18 of the United States Code to insure that false statements made to SBA under the SBIC program would have the same penalty as making false statements to an SBIC. The section would make it clear that a false statement to SBA or to an SBIC for the purpose of influencing their respective actions taken under the Small Business Investment Act of 1958 would be a criminal violation. The courts could then assess civil and criminal penalties for such violations.

Section 5. Removal or suspension of management officials

This section would amend Section 313 the Small Business Investment Act of 1958 to expand the list of persons who could be removed or suspended by the SBA from the management of an SBIC to include officers, directors, employees, agents, or other participants of an SBIC. The persons subject to this section are called “Management Officials,” a new term added by this amendment. The amendment does not change the legal or practical effect of the

provisions of Section 313; however, it has been drafted to make its provisions easier to follow.

Sections 3, 4 and 5 would take effect on enactment of this bill.

