U.S. Department of the Treasury

State Small Business Credit Initiative (SSBCI)

Frequently Asked Questions

December 15, 2021

GENERAL

1. What are the upcoming SSBCI Capital Program deadlines?

- February 11, 2022 – Full applications are due for states of the United States, the District of Columbia, territories, and Tribal governments.
- March 11, 2022 – Applications are due for eligible municipalities located in states of the United States that did not submit a complete application for SSBCI Capital Program funding.

2. What is the process for application approval, and when will applications be reviewed?

An application for SSBCI Capital Program funding is not a competitive award process. Treasury will approve applications that satisfy the requirements under the SSBCI statute, Capital Program Policy Guidelines, and all other SSBCI regulations and guidance, including frequently asked questions. To expedite processing, applicants should make every effort to ensure that their applications include all applicable supporting documentation. Treasury will review complete applications in the order in which they are received.

3. Can eligible jurisdictions amend their SSBCI Capital Program applications by February 11, 2022?

The deadline to submit a complete application is February 11, 2022. Eligible jurisdictions (i.e., states, the District of Columbia, territories, and Tribal governments) that submit applications on or before February 10, 2022, may amend their applications by February 11, 2022. For example, they may add or remove programs from their list of proposed programs or update their documentation related to the designation of the implementing entity. Treasury may request additional information or documentation from an applicant.

4. How may a jurisdiction amend its programs after Treasury's approval of its application?

After a jurisdiction's application is approved, the jurisdiction is permitted to submit a request to modify its programming due to a change in the condition (financial or otherwise) or operations of the jurisdiction or a desire to create new programming (modification request). Approval from Treasury in the form of a written amendment to the Allocation Agreement will be required before any such modification may be implemented. A modification request is not considered to be approved until both the jurisdiction's authorized representative and Treasury have executed an amendment to the Allocation Agreement (which will be prepared by Treasury).

5. **When will SSBCI Technical Assistance Program guidance be published?**

SSBCI Technical Assistance Program guidance for the portion of technical assistance funding that will be available directly to eligible jurisdictions is expected to be published in early 2022.

CAPITAL PROGRAM

Below, the following is additional information regarding certain aspects of the SSBCI Capital Program Policy Guidelines published on November 10, 2021. The questions are categorized by the relevant section of the Guidelines.

Section VIII.c, Approving State OCSPs – 1:1 Financing

1. **As a part of the application, eligible jurisdictions must describe how their Other Credit Support Programs (OCSPs) will in fact "cause and result in" private financing. How can an eligible jurisdiction meet this requirement when it plans to work with venture capital funds?**

As required by 12 U.S.C. § 5705(c)(1), each OCSP must "demonstrate that, at a minimum, $1 of public investment by the [jurisdiction's] program will cause and result in $1 of new private credit." Each eligible jurisdiction must describe how their OCSPs will "cause and result in" private financing in the SSBCI Capital Program application. For an eligible jurisdiction that plans to work with a venture capital fund, the jurisdiction might, for example, specify that the OCSP meets the requirement because the jurisdiction's participation in the fund serves as an anchor investment and thus sends a strong signal regarding the merits and risk profile of the fund that encourages other investors to invest in the fund. The jurisdiction might also specify, for instance, that the OCSP has a policy that any contract with a venture capital fund will ensure that the SSBCI investment is catalytic to private financing, based on the fund's age, size, or experience. An example of a situation where the SSBCI investment might not be catalytic is if it occurs after the venture capital fund's initial close; if this is the case, then the jurisdiction's explanation for "cause and result" in the application may address this circumstance.

2. **For OCSPs in which the jurisdiction invests in venture capital funds, how is the 1:1 financing requirement measured?**

The OCSP 1:1 financing requirement must be met at the venture capital fund level. Specifically, private investment in the specific fund must be equal to or greater than the SSBCI investment in that fund. The private investment should constitute "private financing," as defined in the Capital Program Policy Guidelines in Section VIII.c on 1:1 financing.

<u>Section VIII.d, Approving State OCSPs – Lender or Investor Capital at Risk</u>

1. **What is the difference between a "lender" and a "debt investor" in SSBCI?**

An entity can be a lender or debt investor depending on whether the risk of the loan transactions is borne on a transaction-by-transaction basis or in a pooled manner.

Lenders are entities that bear the risk of loan transactions on a transaction-by-transaction basis. Under SSBCI capital-at-risk guidelines, lenders must bear 20 percent or more of the risk of loss in any loan transaction and must retain at least 5 percent of the risk of loss of the transaction if they transfer the ownership or risk of the lending transactions.

Examples of lenders include, but are not limited to:

- An entity, such as a financial institution, that originates a loan that is:
  - supported by an SSBCI guarantee fund,
  - supported by SSBCI participation in the loan, or
  - supported by SSBCI collateral support or other credit enhancement,

  for which the entity bears 20 percent or more of the risk of loss of that transaction. For instance, consider a financial institution that makes a $100 loan, of which the SSBCI program purchases a $20 participation with no seniority rights. After several years, the loan defaults, and total losses on the loan are $30, after accounting for amounts already repaid and any recoveries. In this scenario, the SSBCI funds would absorb $6 in losses, and the financial institution would absorb $24. This financial institution would be a lender under SSBCI capital-at-risk guidelines because the financial institution bore at least 20 percent of the risk of loss. As another example, consider a financial institution that makes a $100 loan, of which the SSBCI program purchases a $20 participation that is subordinate to the financial institution's interest. After several years, the loan defaults, and total losses on the loan are $30. In this case, the SSBCI funds would absorb the first $20 in losses, because it is subordinate, and the lender would absorb the remaining $10. This financial institution would also be a lender under SSBCI capital-at-risk guidelines because the financial institution bore at least 20 percent of the risk of loss; if the loan was a total loss (i.e., a loss of $100), then the financial institution would have absorbed more than 20 percent ($20) in losses.

- An entity that pools capital from the SSBCI investor and capital from private investors (e.g., loan funds) to make loans, but only if the pooling of capital does not result in the pooling of the risk of the loan transactions. Rather, the contract governing payments to the SSBCI investor and private investors must specify that loss is borne on a transaction-by-transaction basis. For instance, consider a venture debt fund that makes 12 loans of $100 each. Rather than specifying terms for payment to the fund's private investors based on the pool of losses, the contract specifies that each private investor bears the private investor's pro rata share of the 20 percent of the loss for each of the 12 loans and prohibits compensation for losses from future repayments. Assume that there are losses on 3 of the 12 loans, with losses of $100, $50, and $80, respectively. In this case, each private investor would bear its pro rata share of 20 percent of the first loss (i.e., $20), 20 percent of the second loss (i.e., $10), and 20 percent of the third loss (i.e., $16).

In contrast, debt investors are entities that bear the risk of loan transactions in a pooled manner. Under the SSBCI capital-at-risk guidelines, for debt investors that originate loans, the capital from private investors must be *pari passu* with, or junior to, the SSBCI capital in cash flow rights up to the repayment of the SSBCI investment. For debt investors that do not originate loans, the capital from private investors in the same risk layer as the SSBCI capital must be *pari passu* with, or junior to, the SSBCI investment in cash flow rights.

One example of a debt investor that originates loans is a loan fund originating loans, where the SSBCI investor and private investors participate in the fund and bear the risk of loan transactions on a pooled basis rather than on a transaction-by-transaction basis. In this case, the loan fund may distribute cash flow to its investors in a manner that is not based on losses related to each individual loan.

One example of a debt investor that does not originate loans is a special purpose vehicle (SPV) that securitizes loans obtained from an originating lender, where the SPV packages the loans into asset-backed securities in which an SSBCI investor and private investors invest. In this scenario, the investors bear the risk of loan transactions on a pooled basis, not based on losses related to individual loans held by the SPV.

2. **Do lenders need to comply with the capital-at-risk requirement if they subsequently transfer the ownership or risk of the loan to another entity?**

Lenders may transfer the ownership or risk of a loan to another entity, such as a debt investor. However, lenders must bear 20 percent or more of the risk of loss in each loan at origination and retain at least 5 percent of the risk of loss of each loan after any transfer. If a lender transfers the ownership or risk of a loan, the subsequent entity must comply with the capital-at-risk requirement.

For example, consider a community development financial institution (CDFI) that makes 120 loans and sells the loans to a special purpose vehicle (SPV) while maintaining 5 percent of the risk of loss of each of the 120 loans. The SPV issues two tranches of interests: a junior tranche held by both an SSBCI investor and private-capital investors in equal amounts and on a *pari passu* basis within this tranche, and a senior tranche held only by private-capital investors. In this example, both the CDFI and the SPV are complying with the capital-at-risk requirement.

3. **If a lender hires one or more entities to provide services related to SSBCI-supported small business loans on the lender's behalf, do these entities need to comply with the capital-at-risk requirement?**

A lender may hire or contract with one or more entities, such as a community development financial institution (CDFI), to provide services, such as assisting a small business in applying for SSBCI-supported loans or servicing such loans, on behalf of the lender. In this scenario, if the hired entity acts on the lender's behalf and the lender approves the loan and abides by the capital-at-risk requirement, then the hired entity is not considered a lender for purposes of this capital-at-risk requirement. However, if an entity (e.g., a CDFI) is acting separately and making and approving loans, then it must abide by the capital-at-risk requirements.

Section VIII.f, Approving State OCSPs – Loan/Investment Purpose Requirements and Prohibitions

1. **Can Tribal governments use SSBCI Capital Program funds to provide investments, loans, or other credit or equity support to Tribal enterprises?**

For purposes of the SSBCI, a "Tribal enterprise" is an entity: (1) that is wholly owned by one or more Tribal governments, or by a corporation that is wholly owned by one or more Tribal governments; or (2) that is owned in part by one or more Tribal governments, or by a corporation that is wholly owned by one or more Tribal governments, if all other owners are either United States citizens or small business concerns.

Tribal enterprises may use SSBCI Capital Program funds to provide investments, loans, or other credit or equity support to other Tribal enterprises if these transactions comply with the SSBCI statute, the Capital Program Policy Guidelines, all other SSBCI regulations and guidance, and the Tribe's own conflict of interest policy.

Section VIII.i, Approving State OCSPs – Additional Guidance Regarding Venture Capital Programs

1. **How can jurisdictions that contract with venture capital funds use the federal contribution to cover services to portfolio companies?**

Venture capital funds offer a variety of services to their portfolio companies (i.e., the potential SSBCI investees). These services can include, for example, financial management, operational guidance, IT consulting, transaction consulting, and connecting portfolio companies to potential customers, investors, board members, and officers. These are services that the portfolio companies need to grow their businesses and vary depending on the portfolio company's stage in the venture capital ecosystem. As these services to portfolio companies are a type of equity support, SSBCI funds, out of the federal contribution, may be used to pay for such support up to an annual average of 1.71 percent of the federal contribution to a venture capital fund over the life of the jurisdiction's venture capital program.

In the agreement between a jurisdiction and a venture capital fund, the fund must be required to identify the services to be provided to portfolio companies and annually certify that these services were provided. The agreement between the fund and the portfolio companies should include disclosure of these services offered by the fund manager. Consistent with industry standards on payments of fees to cover these services to portfolio companies, the fund should reimburse the jurisdiction for payments of such services covered by SSBCI funds before returns on investment are paid to the general or limited partners.

2. **What is the definition of a venture capital fund?**

For purposes of the SSBCI program, a venture capital fund is an entity that meets the venture capital fund definition in 17 C.F.R. § 275.203(l)-1.

<u>Section IX.c, Other SSBCI Program Requirements – In-State and Out-of-State Loans and Investments</u>

1. **Treasury requires each jurisdiction to use at least 90 percent of its SSBCI Capital Program funding for loans, investments, and other credit or equity support for small businesses headquartered in the jurisdiction. What types of transactions would qualify in this 90-percent funding category for Tribal governments?**

For Tribal governments, the following types of transactions qualify for purposes of this 90 percent requirement (i.e., qualify as "in-jurisdiction transactions"):

- Transactions with businesses on Tribal lands, which include lands defined in 18 U.S.C. § 1151; Alaska Native regions established pursuant to the Alaska Native Claims Settlement Act (43 U.S.C. § 1601 *et seq.*); and any land owned by a Tribal government in trust, fee, or restricted fee status.
- Transactions with businesses in states of the United States where the Tribe is physically located or within which the Tribe exercises jurisdiction.
- Transactions with Tribal enterprise-operated businesses, businesses owned by Tribal members, and businesses in states of the United States in which Tribal members reside. For example, a Tribe that is headquartered in Arizona may have most of its members in a town on the border of Nevada and Arizona. Because the Tribe exercises jurisdiction over its members in both states, it may invest in both states.

Tribal SSBCI program transactions that do not fall into the above categories do not qualify as in-jurisdiction transactions and thus are "out-of-jurisdiction transactions." Up to 10 percent of a Tribal government's SSBCI funding can be used for out-of-jurisdiction transactions, and for each out-of-jurisdiction transaction, a Tribal government must reasonably explain how the transaction benefits the Tribe's economy. For example, the Tribal government may explain that the out-of-jurisdiction transaction may create or increase demand for products and services of businesses within the Tribe's jurisdiction.

Additionally, regardless whether the Tribal government's OCSP will involve transactions in or out of the 90-percent funding category, the Tribal government should describe, as part of its SSBCI application, the expected benefits to the Tribe, Tribal businesses, and Tribal members from the OCSP. In the description, the Tribal government should focus on, but not limit their discussion to, the projected number and amount of SSBCI loans or investments closed through the OCSP; the number, types, and quality of jobs created; projected increases in tax revenues resulting through the OCSP; long-term economic benefits of the OCSP's investments; and other expected benefits from the economic development objectives of the Tribal government. In accordance with 12 U.S.C. § 5705(d)(1), in determining whether an OCSP is eligible for SSBCI, Treasury must consider this information. In recognition of the differential tax status of Tribal enterprises and member businesses, a Tribe may describe how the tax revenue category is applicable or inapplicable for their respective jurisdiction. See Section VIII.g, Approving State OCSPs – Considerations for Approving OCSPs.