Guidelines for State Small Business Credit Initiative

I. Overview

On September 27, 2010, President Obama signed into law the Small Business Jobs Act of 2010 (the "Act") to help increase credit availability for small businesses. The Act created the State Small Business Credit Initiative (SSBCI) and appropriated $1.5 billion to be used by the U.S. Department of the Treasury ("Treasury") to provide direct support to states for use in programs designed to increase access to credit for small businesses. Pursuant to the Act, Treasury allocated funds to all fifty states along with the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of Northern Mariana Islands, Guam, American Samoa, and the United States Virgin Islands according to a statutory formula that takes into account a state's job losses in proportion to the aggregate job losses of all states. Under the Act, each state or territory was guaranteed a minimum allocation of 0.9 percent of the $1.5 billion.

II. Eligible Programs

The SSBCI provides funding for two state program categories: capital access programs ("CAPs") and other credit support programs ("OCSPs").

CAPs provide portfolio insurance for business loans based on a separate loan loss reserve fund for each participating financial institution. The reserve fund will be used to provide portfolio insurance for all loans enrolled in the CAP by participating financial institutions. To enroll a loan in the CAP, both the lender and the borrower of the loan make insurance premium payments to the reserve fund. The state also must make a payment to the reserve fund for each loan to match the insurance premium. Under the Act, states may use the federal funds allocated to them under the Act to make their matching contributions to the reserve fund. Under the Act, for a loan to be eligible for enrollment in the CAP, the borrower must have 500 employees (as defined in 13 CFR 121.106) or less and the loan cannot exceed $5 million.

OCSPs include collateral support programs, loan participation programs, state-sponsored venture capital programs, loan guarantee programs or similar programs.[1] Under the

[1] Collateral support programs help viable businesses that are struggling to get credit because the value of the collateral they hold has fallen, possibly due to the decline in commercial real estate values. These programs – which set aside funds to augment collateral the borrower already holds – provide banks greater confidence in extending credit to these borrowers, particularly in some of the communities hardest hit by the economic downturn. Loan participation programs entail risk sharing and loan contributions by the government and private lenders. State-sponsored venture capital programs

Act, OCSPs must target an average borrower-size of 500 employees (as defined in 13 CFR 121.106) or less and cannot extend credit support to borrowers with more than 750 employees. The OCSP must target loans with an average principal amount of $5 million or less and cannot extend credit for loans with principal amounts in excess of $20 million.

OCSPs also include qualifying loan or swap funding facilities, which are contractual arrangements between a participating state and a private financial entity. Under such facilities, the state delivers funds to the private financial entity as collateral; that entity, in turn, provides funding to the state. The full amount resulting from the arrangement, less any fees or other costs of the arrangement, is contributed to, or for the account of, an approved state program.

III. Allocations

In General

Each state that is approved for participation in the SSBCI will receive its allocation of funds in three disbursements as follows: 33 percent, 33 percent and 34 percent. As a precondition to receipt of the second and third disbursements, the state must, among other things, certify to Treasury that it has expended, transferred or obligated 80 percent or more of the last-disbursed one-third disbursement of allocated funds to or for the account of one or more approved state programs. The certification must be signed by an official of the state with oversight responsibility for the approved state program(s).

The requirement that the federal funds be disbursed in three increments, and the related certification requirement, will not apply with respect to federal funds used for a qualifying loan or swap funding facility.

IV. Approving States for Participation

In General

Before a state's program is approved for participation in the SSBCI, the applicant must demonstrate that all actions required under state law have been taken to delegate administrative responsibility for the program to a specific department, agency or political subdivision of the state. The term "agency" includes state government corporations and other instrumentalities of the state. The applicant will be required to submit a short narrative statement describing such actions and attach any relevant documentation in support of that

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typically entail joint public-private investment programs focused on "seeding" high-growth-potential small businesses.

statement. The narrative statement will need to be signed by an official of the state with oversight responsibility for the state program(s) for which federal funds are being requested.

V. Municipalities

The Act grants municipalities of a state special permission to apply directly for funding under the SSBCI if: (1) that state did not file a notice of intent by November 26, 2010; or (2) that state filed a notice of intent by November 26, 2010 but does not submit a complete application for approval of a state program by close of business on June 27, 2011. For municipalities in states that did not submit a timely notice of intent to participate, Treasury will begin accepting applications at the same time as states. Municipalities in states that do not submit a timely application must submit their applications no later than close of business on September 27, 2011 pursuant to the Act. The same approval criteria and program requirements that are applicable to a state will [generally] apply to each municipality that is granted special permission.

VI. Approving State CAPs

a. *Federal Contribution*

Under the Act, approved CAPs are eligible for federal contributions to their reserve fund in an amount equal to the amount of the insurance premiums paid by the borrower and the financial institution lender to the reserve fund as calculated on a loan-by-loan basis. A participating state may use the federal contribution to make its contribution to the reserve fund. Accordingly, the federal contribution may be used to match the borrower/lender contribution at a level of 1:1. The state may supplement the federal contribution with state funds if it chooses.

b. *CAP Program Requirements*

i. <u>Experience and Capacity</u> – Each state should exercise due care to determine that banks and non-bank financial institutions participating in the SSBCI possess sufficient commercial lending experience, financial and managerial capacity and operational skills to meet the objectives as set forth in the Act. Each state shall apply the same standards for participation in the SSBCI program to all classes of lenders. As required by the Act, states shall consult with the appropriate federal banking agency or, as appropriate, the Community Development Financial Institution Fund. The following documents and certifications may be used by states to determine adequacy of financial and managerial capacity for all classes of private lenders:

TYPE OF INSTITUTION	RATINGS AND REGULATORY REPORTS	PERFORMANCE REPORTS	SELF-CERTIFICATION
Banks (including CDFI banks)		• *Uniform Banking Performance Report (UBPR) showing that. commercial loans and leases comprise a significant part of the institution's assets.* • *A UBPR peer group analysis showing that the institution's percentage of non-current loans and leases does not exceed its peer group average \ (UBPR reports may be obtained for any bank online on the public website www.ffiec.gov/UBPR.htm for no charge.)*	*Self-certification that the financial institution is not operating under any supervisory enforcement action.*
Credit Unions (including CDFI Credit Unions)		• *Financial Performance Reports (FPRs) from the NCUA*	*Self-certification that the institution is not operating under any supervisory enforcement action.*
Community Development Financial Institutions (excluding banks and credit unions))	• *A review of the CDFI's CARS ratings.*	• *Annual Report with audited financial statements.*	

ii. Lender Capital at Risk – For any loan enrolled in a CAP, the state shall require the financial institution lender to have a meaningful amount of its own capital at risk in the loan. Consistent with OMB Circular A-129, CAP programs in which private lenders bear 20 percent or more of the loss from a default will satisfy this requirement. States with CAP programs for which the state government bears more than 80 percent of any loss must articulate in the application exceptional circumstances as to why the private sector is unable to bear a greater share of the risk.

iii. Loan Purpose – As required by Section 3005(e)(7) of the Act, for each loan enrolled in a state CAP, the state shall require the financial institution lender to obtain an assurance from each borrower. One assurance required by Section 3005(e)(7) is that the loan will be used for a "business purpose." A "business purpose" includes, but is not limited to, start up costs, working capital, business acquisitions, franchise financing, equipment loans, inventory financing, commercial real estate acquisitions, construction and expansion.

Another assurance that the state shall require the financial institution lender to obtain from each borrower is that the loan will not be used for purposes prohibited by Treasury, as described below.

Specifically, the proceeds of loans enrolled in, or financed by, a CAP shall not be used for the following prohibited purposes (in addition to those set forth in the Act):

a. Refinancing existing debt where the lender is in a position to sustain a loss and the government (state and/or federal) would take over that loss through refinancing;

b. Effecting a partial change of business ownership or a change that will not benefit the business;

c. Permitting the reimbursement of funds owed to any owner, including any equity injection or injection of capital for the business's continuance;

d. Repaying delinquent state or federal withholding taxes or other funds that should be held in trust or escrow; and

e. Financing a non-business purpose.

The state shall also prohibit the proceeds of loans enrolled in or financed by a CAP from being used to finance the following ineligible businesses:

a. Real estate investment firms, when the real property will be held for investment purposes as opposed to loans to otherwise eligible small business concerns for the purpose of occupying the real estate being acquired.

b. Firms involved in speculative activities that develop profits from fluctuations in price rather than through the normal course of trade, such as wildcatting for oil and dealing in commodities futures, unless those activities are incidental to the regular activities of the business and part of legitimate risk management strategies to guard against price fluctuations related to the regular activities of the business.

c. Firms involved in lending activities, such as banks, finance companies, factors, leasing companies, insurance companies (but excluding agents of insurance companies), and any other firm whose stock in trade is money.

d. Pyramid sales plans, where a participant's primary incentive is based on the sales made by an ever-increasing number of participants.

e. Firms engaged in activities that are prohibited by federal law or applicable law in the jurisdiction where the business is located or conducted. Included in these activities are the production, servicing, or distribution of otherwise legal products that are to be used in connection with an illegal activity, such as selling drug paraphernalia or operating a motel that knowingly permits illegal prostitution.

f. Gambling activities, including any business whose principal activity is gambling. While this precludes loans to racetracks, casinos, and similar enterprises, the rule does not restrict loans to otherwise eligible businesses, which obtain less than one-third of their annual gross income from either the sale of official state lottery tickets under a state license, or legal gambling activities licensed and supervised by a state authority.

g. Charitable, religious, or other non-profit or eleemosynary institutions, government-owned corporations, consumer and marketing cooperatives, and churches and organizations promoting religious objectives are not eligible.

iv. Capital Access in Underserved Communities

The Act requires that each application contain a report detailing how the state plans to use the federal contributions to the reserve fund to help provide access to capital for small businesses in low- and moderate-income, minority, and other underserved communities, including women- and minority-owned small businesses. That report shall include historical data concerning capital access in underserved communities within the state along with a discussion of how the applicant’s participation in the SSBCI will lead to increased small business lending in those communities compared with past baselines.

VII. Approving OCSPs

a. *1:10 Leveraging*

Under the Act, for OCSPs to be eligible for federal funding, a state must demonstrate a "reasonable expectation" that, when considered with all other CAPs and/or OCSPs of the state, such programs together have the ability to use federal contributions to such programs to generate small business lending at least 10 times the new federal contribution amount.

Although the 1:10 requirement does not apply to CAPs, the public to private dollar leveraging that applicants must demonstrate may include the leverage achieved by any CAPs of the state. Accordingly, states will be permitted to present an average that aggregates both CAP and non-CAP programs to satisfy the 1:10 requirement.

I. <u>CAPs</u>

For purposes of calculating that average, states may measure CAP leverage on a loan-by-loan basis, comparing the state contribution to the size of the loan – and then aggregate the totals over the seven-year lifespan of the SSBCI. (For example, if the borrower/lender contribution is 4 percent, the federal contribution also must be 4 percent, since, under the Act, CAPs are eligible for federal contributions to their reserve fund "in an amount equal to" the amount of the insurance premium paid by the borrower and the financial institution lender. Accordingly, for a $100,000 loan, the leverage achieved will be 1:25.)

States that have active CAPs may rely on historical data. States that do not have active CAPs may present estimates based on historical data from other states' programs that are being used as models for new CAPs. States establishing new programs also will be required to provide detailed assumptions for their estimates of total enrolled loans, total loan amounts and the estimated total federal contributions over the lifespan of the SSBCI.

II. <u>OCSPs</u>

To measure the leverage achieved for OCSPs, states may use a simple metric that compares the state contribution or guarantee to the overall loan or support amount.

- *State Sponsored Venture Capital Programs*

To demonstrate the leverage ratio for state venture capital (VC) programs, applicants may compare the federal commitment to a state-sponsored VC program with estimated total private dollars invested, including any transaction-level debt used to fund investments, net of fees. For purposes of calculating the leverage ratio, state-sponsored VC programs will be permitted to include any amount of the private investors' committed capital drawn down during the investment period in respect of both follow-on investments and new investments. If an applicant has already secured private investor commitments to a state-sponsored VC fund, the applicant should compare the federal commitment to the VC program with such private investor commitments. The leverage ratio may be measured during the lifespan of the SSBCI. Example:

	Year 1	Year 2	Year 3	Year 4
Federal Commitment (1)	$10 (m)	$10 (m)	$10 (m)	$10 (m)
State VC Program	$100 (m)	$100 (m)	$100 (m)	$100 (m)
Private Investor (PI) Dollars Invested (2)	$10 (m)	$20 (m)	$30 (m)	$40 (m)
Private Investor Committed Capital	$40 (m)	$40 (m)	$40 (m)	$40 (m)
Amount Drawn Down from PI				
Committed Capital	$10 (m)	$10 (m)	$10 (m)	$10 (m)
Leverage Calculation				
Federal Commitment (1)	$10 (m)	$10 (m)	$10 (m)	$10 (m)
Private Investor Dollar Invested (2)	$10 (m)	$20 (m)	$30 (m)	$40 (m)
Amount Drawn Down from PI				
Committed Capital (3)	$10 (m)	$10 (m)	$10 (m)	$10 (m)
Total State Sponsored VC -- (2)+(3)	$20 (m)	$30 (m)	$40 (m)	$50 (m)
Leverage Ratio (Fed:SSVC)	1:2	1:3	1:4	1:5

- *Loan Participation Programs*

To demonstrate the leverage ratio for loan participation programs, the federal portion of a loan may be compared with the private lenders' stake. Aggregated over the lifespan of the SSBCI, this measure will take into consideration overall federal contributions compared with the overall loan amounts made as part of the participation program. Example:

	Year 1	Year 2	Year 3	Year 4
Aggregate Federal/State Contribution	$10 (m)	$20 (m)	$30 (m)	$40 (m)
Private Aggregate Investor Contributions	$10 (m)	$30 (m)	$60 (m)	$100 (m)
Leverage Ratio	1:1	1:1.5	1:2	1:2.5

- *Loan Guarantees*

To demonstrate the leverage ratio for loan guarantee programs, total estimated federal contributions to support guarantees may be compared to total estimated loan amounts over the lifespan of the SSBCI. States that have credit guarantee programs in place may rely on historical data. States that plan to enact new programs may rely on data from other states' programs that are being used as models for their new programs or to provide a reasonable estimation of future leverage. For the latter category, states must provide detailed assumptions concerning estimated number of loans and estimated loan amounts during the course of the SSBCI. Example:

	Year 1	Year 2	Year 3	Year 4
Federal Contributions (1)	$4 (m)	$4 (m)	$4 (m)	$4 (m)
Private Contributions (2)	$50 (m)	$50 (m)	$50 (m)	$50 (m)
Other State Guaranteed Programs (3)	$4 (m)	$4 (m)	$4 (m)	$4 (m)
Private Contributions -- State (4)	$20 (m)	$25 (m)	$30 (m)	$35 (m)
Federal Contributions	$4 (m)	$4 (m)	$4 (m)	$4 (m)
Total State Guarantee Programs -- (2)+(3)+(4)	$74 (m)	$79 (m)	$84 (m)	$89 (m)
Leverage Ratio	1:18.5	1:19.75	1:21	1:22.25

- *Collateral Support Programs*

To demonstrate the leverage ratio for collateral enhancement programs**,** the estimated federal guarantee used to support the collateral provided for loans may be compared with the estimated amount of loans made pursuant to a state's program. Once again, states that have such programs in place may present historical data. States that are establishing new programs should present detailed assumptions concerning estimated loan volume and overall federal collateral support used for such loans. Example:

	Year 1	Year 2	Year 3	Year 4
Estimated Federal/State Guarantee (1)	$10 (m)	$15 (m)	$20 (m)	$25 (m)
Estimated Amount of Loans (2)	$20 (m)	$30 (m)	$40 (m)	$50 (m)
Leverage Ratio	1:2	1:2	1:2	1:2

b. *Operative Date for Tracking of Leverage*

The trigger date for tracking or calculating the 10:1 leverage requirement will be the date on which the state obligates funds to the OCSP as opposed to the date the funds are transferred – in other words, the date on which the State has entered into an agreement to provide funds to the OCSPs.

c. *Lender Capital at Risk* – The state shall require financial institution lenders that provide any form of credit support pursuant to an OCSP that is supported by the SSBCI to have a meaningful amount of their own capital at risk in the loan or other credit assistance.

- *Loan Guarantee Programs* in which private lenders bear 10 percent or more of the loss from a default satisfy this requirement. Although OMB Circular A-129 sets as the standard that lenders bear 20 percent of the risk under federal credit support programs, the Act raised the percentage of the government's guarantee for the U.S. Small Business Administration (SBA) Section 7(a) Loan Guarantee Program from 75 percent to 90 percent, thereby lowering the standard set by the OMB circular.

- *Remaining OCSPs (Other than Loan Guarantees)* – Consistent with OMB Circular A-129, OCSPs in which private lenders bear 20 percent or more of the loss from a default will satisfy this requirement. OCSPs for which the government (state and/or federal) bears more than 80 percent of any loss must demonstrate exceptional circumstances as to why the private sector is unable to bear a greater share of the risk.

d. *Loan Purpose*

The proceeds of loans financed through an OCSP shall not be used for the following prohibited purposes (in addition to the prohibited purposes in Section 3005(e)(7) of the Act):

I. Refinancing existing debt where the lender is in a position to sustain a loss and the government (state and/or federal) would take over that loss through refinancing;

II. Effecting a partial change of business ownership or a change that will not benefit the business;

III. Permitting the reimbursement of funds owed to any owner, including any equity injection or injection of capital for the business's continuance;

IV. Repaying delinquent state or federal withholding taxes or other funds that should be held in trust or escrow; and

V. Financing a non-business purpose.

The state shall prohibit the proceeds of loans financed through an OCSP from being used to finance the following ineligible businesses:

I. Real estate investment firms, when the real property will be held for investment purposes as opposed to loans to otherwise eligible small business concerns for the purpose of occupying the real estate being acquired.

II. Firms involved in speculative activities that develop profits from fluctuations in price rather than through the normal course of trade, such as wildcatting for oil and dealing in commodities futures, when not part of the regular activities of the business.

III. Firms involved in lending activities, such as banks, finance companies, factors, leasing companies, insurance companies (but excluding agents of insurance companies), and any other firm whose stock in trade is money.

IV. Pyramid sales plans, where a participant's primary incentive is based on the sales made by an ever-increasing number of participants.

V. Firms engaged in activities that are prohibited by federal law or applicable law in the jurisdiction where the business is located or conducted. Included in these activities are the production, servicing, or distribution of otherwise legal products that are to be used in connection with an illegal activity, such as selling drug paraphernalia or operating a motel that knowingly permits illegal prostitution.

VI. Gambling activities, including any business whose principal activity is gambling. While this precludes loans to racetracks, casinos, and similar enterprises, the rule does not restrict loans to otherwise eligible businesses, which obtain less than one-third of their annual gross income from either the sale of official state lottery tickets under a state license, or legal gambling activities licensed and supervised by a state authority.

VII. Charitable, religious, or other non-profit or eleemosynary institutions, government-owned corporations, consumer and marketing cooperatives, and churches and organizations promoting religious objectives are not eligible.

VIII. Additional Considerations for Approving an OCSP

The following metrics are intended to guide applicants in demonstrating that an OCSP meets reasonable standards of public benefit, sound program design, operational and managerial capacity and financial integrity.

(1) In describing the anticipated benefits to the state, its businesses, and its residents to be derived from the federal contributions, applicants should focus on, but not necessarily limit their discussion to, the following measures. Estimates may cover a five-year time horizon.

- Jobs created – The projected permanent, full-time workers hired by firms as a result of receiving OCSP supported small business loans and investments should be reported.

- The projected number and amount of new OCSP small business loans, including all forms of financing funded, guaranteed or insured by OCSPs including leases, credit lines and investments.

- The projected increases in state or local sales, income or other tax revenues resulting from new OCSP small business loans. These estimates may include taxes paid by both permanent and temporary workers hired as a result of new OCSP small business loans.

(2) The operational capacity, skills, and experience of the management team of the state or OCSP can be demonstrated by any or all of the following metrics, among others.

- Qualifications and experience of senior management. An OCSP's senior management may include people who have significant credit underwriting or risk management experience with private credit institutions such as banks, commercial finance companies, rating agencies or insurance companies.

- Experience of senior management in operating public credit support or capital access programs. Personnel with underwriting or credit risk management experience with federal, state or local small business credit programs (e.g., SBA or state development finance authorities) will be viewed favorably in assessing an OCSP's managerial capacity.

- Adoption of industry best practices. Employment of industry best practices, such as those listed in Section XII below can be used to demonstrate management's industry knowledge and sophistication.

(3) The capacity of the OCSP to manage increases in the volume of its small business lending can be demonstrated through:

- Financial strength. As a general rule, an applicant must demonstrate that it possesses adequate financial resources to support the staffing increases and "infrastructure" improvements needed to undertake a significantly increased number of financing transactions.

- Operational capacity. An applicant must demonstrate that the state OCSP has systems, policies and procedures in place to accommodate a significant increased transaction volume.

(4) Reasonable assurance that OCSPs have internal accounting and administrative controls systems to guard against waste, fraud and abuse of public funds can be demonstrated by:

- Evidence that management conducts, or in the case of a new OCSP, intends to conduct periodic internal audits.

- A requirement for annual independent audits (including management letters).

(5) The soundness of an OCSP's program design and implementation plan can be evidenced by:

- For both new and existing OCSPs, the adoption of established business models and strategies. Most high-performance OCSPs will employ similar, well-proven approaches to managing the various risks associated with making, insuring or guaranteeing small business loans. Adoption and use of such strategies and models can be construed as evidence of sound program design.

- For an existing OCSP, the absence of material weakness or deficiency findings by external auditors. Soundness of program design can also be shown through operating results. For example, a management letter citing no significant operational or financial weaknesses can be employed as evidence of appropriate program design.

IX. SBA-Guaranteed Loans

OCSP loan guarantee programs may not guarantee the unguaranteed portions of SBA-guaranteed loans.

Pursuant to 13 CFR § 120.411, states that participate in the SSBCI will not be permitted to enroll in CAP loan loss reserve funds the unguaranteed portions of SBA-guaranteed loans. However, states may seek a waiver from this rule from the SBA pursuant to 13 CFR § 120.3 for permission to enroll the unguaranteed portions of SBA-guaranteed loans in CAP reserve funds.

X. Reports

Quarterly Report Certifications – Along with the report on the use of federal funding, an official of the state with oversight responsibility for the approved state program(s) will be required to sign a Treasury-prescribed certification for each quarterly report that must be submitted to Treasury pursuant to Section 3007(a) of the Act.

XI. Administrative Costs

Cost standards for state and local governments are included in OMB Circular A-87 (see also 2 CFR Part 225). The OMB circular contains criteria that must be used to establish chargeable costs (allowable, allocable, and reasonable), and specific information on allowable costs in various cost categories. SSBCI participants will be required to report on their administrative costs on a quarterly basis pursuant to the allocation agreement.

XII. Implementation and Administration

Among its program management and implementation responsibilities, Treasury is required to establish standards for, provide technical assistance to and disseminate best practices to state programs. Knowledge of techniques and strategies applicants currently use in managing their insurance and guarantee programs will be helpful to Treasury in establishing national standards for CAPs and OCSPs, in organizing suitable technical assistance programs, and in recommending best practices designed to improve performance. Thus, Treasury encourages applicants to describe in the application whether and how the following "best practices" for managing credit risk have been explored, tested or adopted.

i. Risk-based pricing of loans or insurance premiums - Setting loan interest rates and insurance premiums to reflect a potential borrower's probability of default is well-established practice for most lenders and insurers. State CAPs and OCSPs often use cash and high quality securities to collateralize guarantees and insurance contracts. Risk-based pricing can help ensure that insurance payments and reserve funds accurately reflect the credit risk of enrolled loan portfolios. Among other benefits, the rationalization of pricing can allay lender fears that changes in underwriting practices will not be adequately reflected in the amount of cash backing a program.

ii. Credit scoring - Many lenders, both public and private, have employed credit scores—a statistically sound and empirically derived measure of creditworthiness—to standardize processes, control risk and reduce the cost of underwriting. In addition, credit scoring can serve as the common language providing a basis for performance monitoring across programs. For CAPs, using scores to determine the size of borrower/lender CAP premium payments will ensure that loan-loss reserve accounts are adequately funded. For OCSPs, credit scoring can be employed to determine how much capital—in trust accounts or reserve funds—needs to be set aside to cover each guaranteed loan.

iii. Financial modeling - Shifting economic conditions or changes in lenders, borrowers and credit products can dramatically affect how enrolled loans perform. Financial modeling can help CAP and OCSPs evaluate their performance under various scenarios, including catastrophic increases in loan defaults. Knowledge gained through such "stress testing" can reveal the need for changes in the underwriting, pricing or management of credit risk.

iv. Risk-based capital adequacy standards **-** Bank regulators require banks to hold capital based on the risk of their assets. For example, small business loans require more capital than Treasury securities. Similarly, under federal law, Congress must appropriate the present value of expected losses for SBA and other federal credit programs. For CAPs and OCSPs, establishing such standards can accurately align the amount of capital that an organization holds with the actual credit risk of enrolled loans. Once again, this can help make sure that programs are neither undercapitalized (and thus unable to meet their obligations) nor overcapitalized (thus unnecessarily limiting credit support capacity).

v. Reinsurance or other credit risk transfers - Commercial lenders and insurers can also manage credit risk by transferring it to third parties through reinsurance contracts and other credit risk transfer agreements. Reinsuring or transferring risk offers a major benefit because it allows a CAP or OCSP to increase its capacity without an increase in capitalization.

vi. Standardized reporting - The collection of detailed transaction-level data allows credit grantors and guarantors to generate reports and analyses by which performance may be evaluated across segments of interest (i.e., geography, type of business, etc.). For CAPs and OCSPs, standardized reporting of transaction-level data will improve lender oversight (e.g., weaker lenders can be identified and assisted) and provide the basis for needed changes in underwriting, pricing, and managing risk.

XIII. Limitation to New Extensions of Credit

Funds made available to states under the SSBCI will be permitted only for new extensions of credit. That is, funds made available to states pursuant to the SSBCI shall not be used to support existing extensions of credit – including but not limited to prior loans, lines of credit or other borrowing – that were previously made available as part of a state small business credit enhancement program.