

# T. FITZGERALD & ASSOCIATES

FINANCIAL CONSULTANTS

June 28, 2001

Acting Director  
Community Development  
Financial Institutions Fund  
U.S. Department of Treasury  
601 13<sup>th</sup> Street, NW, Suite 200 South  
Washington, DC 20005

Re: Comments to New Markets Tax Credit Guidance; National Association of Investment Companies

Dear Sirs:

Triad Capital Corporation, (Triad), in conjunction with the National Association of Investment Companies ("NAIC"), a trade association of minority-focused investment firms is submitting these comments concerning the Department of Treasury's "Guidance, New Markets Tax Credit Program. Triad is one of the oldest Specialized Small Business Investment Companies (SSBIC), being incorporated in the early 1980's. Acquired from New National Bank in 1994 by the Business Consortium Fund (BCF), Triad has played an active role in providing capital to socially or economically disadvantaged firms. The BCF is the financing program of the National Minority Supplier Development Council (NMSDC). The NMSDC provides a nationwide link between 3,500 corporations and 15,000 certified minority owned businesses, many of which are located in "low income" areas.

NAIC member firms include private equity investment partnerships and specialty finance companies that are licensed by the Small Business Administration ("SBA") as SSBICs. These comments are divided into two parts. The first part presents some general background on SSBICs and the recently enacted New Markets Tax Credit ("NMTC"). Part two provides specific comments concerning the issues raised in Section VII of the Guidance ("Pending Issues").

## **I. SSBICs and the New Markets Tax Credit**

1. **SSBICs.** SSBICs were authorized by the Small Business Investment Act, as amended ("the SBIC Act"). As such, they are a part of the Small Business Investment Company ("SBIC") program established by the SBIC Act and administered and regulated by the SBA.

SSBICs are privately owned and professionally managed investment firms. Prior to licensing, the background and experience of a company's management is fully and carefully reviewed. A comprehensive investment plan must be submitted and approved by SBA and, once licensed an SSBIC operate within the framework of SBA regulations. (See 13 CFR 107). In addition, SSBICs are audited annually and are subject to rigorous safety and soundness requirements. SSBICs are eligible to apply for SBA financing (referred to as "leverage"). If approved, however, the amount is based upon the level of an individual licensee's private investor capital.

- B. **SSBICs and New Markets.** SSBICs are return (ROI) oriented, just as other venture capital firms or specialty finance companies. As such the economics of each potential investment must be considered. That said, SSBICs have an admirable record of risk taking with overlooked entrepreneurs and in under served markets. Some licensees have significant investment activity in "low income " geographic areas (as that term is referred to in the Department's Guidance); others less so. In Triad's case, a high percentage of its historical investments over the years have been in what are today is classified as "low income" areas. All SSBIC licensees, however, share a common characteristic-a commitment to financing firms owned by those who are socially or economically disadvantaged.

In this regard SSBICs are unique. By law SSBICs provide equity capital and/or long-term debt only to small businesses owned and controlled by persons who are "socially or economically disadvantaged" (as defined by federal regulations). Thus, the intent of Congress in authorizing SSBICs was to stimulate targeted capital pools for talented small business owners and would be entrepreneurs who are being ignored by traditional capital providers. Consequently, SSBICs are at the core of "new markets" policy -- wealth creation, economic development and financing for entrepreneurs whose participation in the free enterprise system has been/is hampered because of social or economic disadvantage and prejudice.

SSBIC have been constrained by the amount of private investor capital committed to this market segment. As you may be aware, as a precondition for licensing an SSBIC must have raised a certain minimum amount of private investor capital. Also, as mentioned above, SBA leverage is based upon a licensee's private capital. For this reason, Triad and NAIC members are keenly interested in the potential incentive effects of the NMTC. However, as further discussed below, the incentive effects and the constructive role that Triad and other SSBICs can play as intermediaries may be undercut by the proposed regulatory scheme. Accordingly, all of us at Triad, the BCF and the NAIC strongly urge the Department to adopt rules and policies that will facilitate the possibility of SSBIC participation in the NMTC program.

## **II. Comments on Pending Issues**

1. **Priority in Allocating NMTCs.** Internal Revenue Code ("IRC") Section 45D(f)(2) sets forth certain criteria regarding priority in allocating NMTCs. Triad and NAIC believe that the objectives of the NMTC program will be best served and obtained if priority is accorded

to those entities with demonstrable prior experience in providing financing and/or technical assistance to small disadvantaged businesses. As noted previously, SSBICs are entities established for this purpose and as such we urge that SSBIC applicants be given priority consideration. Triad and NAIC believe that such priority consideration is consistent with congressional intent given that SSBICs and Community Development Financial Institutions (“CDFIs”) are statutorily made eligible for designation as community development entities (“CDEs”).

The NMTC statute also directs the Department to give priority to those entities that intend to invest the proceeds raised in businesses in which persons unrelated to the CDE holds the majority interest. Triad and NAIC supports this provision as a factor in establishing NMTC allocation priority. The provision is consistent with the general rules of the SBIC program that prohibits a licensee from controlling a portfolio company (except in certain limited circumstances) and which address potential conflicts of interest.

2. **The “Substantially All Test”.** IRC Section 45D(b)(1)(B) requires a CDE to use “substantially all” of the cash raised as a result of its NMTC allocation to make qualified investments. As proposed by the Department, this requirement would be satisfied if at least 85% of a CDE’s gross assets (as opposed to 85% of the proceeds raised) are invested in qualified low-income community investments.

The Department’s proposed interpretation of this provision would be problematic for SSBICs and thus, we believe, is incompatible with the intent of Congress. As a practical matter the Department’s proposed interpretation would severely limit the number of SSBICs that could apply for an allocation. In most cases, a SSBIC designated as a CDE will have an existing portfolio of investments. Under SBA regulations, the location of SSBIC investments are not limited by geography to low-income geographic areas as defined in the NMTC statute. Also, the SSBIC may have retained earnings or unused SBA leverage that is outstanding.

Moreover, the statutory language does not refer to a CDE’s gross assets. Rather, in defining the term “qualified equity investment” in a qualified CDE, it specifically makes reference to “substantially all of such cash” is used by the CDE to make qualified investments. (Emphasis added) Accordingly, with reference to a CDE that is an SSBIC (or any other designee which has an existing investment portfolio) the “substantially all requirement should focus on the use of the proceed raised rather than the entity gross assets. For ease of administration and tracking compliance, the proceeds could be placed in a restricted account on the books of the CDE.

3. **Accountability to Low-Income Community Residents.** The NMTC statute among other requirements, defines a CDE as an entity that “maintains accountability to residents of low-income communities through their representation on any governing board or the entity or on any advisory board of the entity”.

As previously, NAIC believes that the NMTC is a unique opportunity to increase the amount

of private capital targeted to overlooked disadvantaged small business owners and under served markets. We also believe that, as entities that have a track-record of investing in firms owned by those who are socially or economically disadvantaged, SSBIC are well positioned to advance the policy objectives of the NMTC.

- D. **Targeting of SSBIC Investments.** In general, we recommend simplifying the participation of all SSBIC in the NMTC Program. SSBICs should qualify for the various incentives and benefits by virtue of being SSBICs and targeting their investments (by regulation) to an under served market (i.e., socially or economically disadvantaged individuals). In all matters, the SSBICs should function only as per the current SBIC regulations, and the sections relating to SSBICs. As such, SSBICs should not be limited by geography in their investment activity in order to qualify for the NMTC Program.

Sincerely,

  
Thomas C. Fitzgerald  
Chairman  
Triad Capital Corporation