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State Small Business Credit Initiative: Implementation and Funding Issues

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Summary

Congressional interest in small business access to capital has increased in recent years because of concerns that small businesses might be prevented from accessing sufficient capital to enable them to assist in the economic recovery. Some, including President Obama, have argued that the federal government should provide additional resources to assist small businesses in acquiring capital necessary to start, continue, or expand operations and create jobs. Others worry about the long-term adverse economic effects of spending programs that increase the federal deficit. They advocate business tax reduction, reform of financial credit market regulation, and federal fiscal restraint as the best means to assist small businesses and create jobs.

During the 111th Congress, P.L. 111-240, the Small Business Jobs Act of 2010, provided the Small Business Administration (SBA) additional funding and enhanced several SBA lending programs in an effort to assist small businesses access capital. The act also authorized the Secretary of the Treasury to establish a \$30 billion Small Business Lending Fund (SBLF; \$4.0 billion was issued) to encourage community banks with less than \$10 billion in assets to increase their lending to small businesses and a \$1.5 billion State Small Business Credit Initiative (SSBCI).

The SSBCI provides funding, allocated through a statutorily created formula and distributed in one-third increments, to states, territories, and eligible municipalities to expand existing or to create new state small business investment programs, including state capital access programs, collateral support programs, loan participation programs, loan guarantee programs, and venture capital programs. In most instances, the initial round of funding (called a tranche) took place in FY2011. Most SSBCI participants received their second tranche in FY2013, and Treasury anticipates that most SSBCI participants will receive their final tranche in FY2014.

SSBCI participants are expected to leverage their SSBCI funds to generate private financing and investment that is at least 10 times the amount of their SSBCI funds. Forty-seven states, American Samoa, the District of Columbia, Guam, the Northern Mariana Islands, Puerto Rico, the U.S. Virgin Islands, Anchorage, Alaska, two consortiums of municipalities in North Dakota, and a consortium of municipalities in Wyoming currently participate in the program.

During congressional consideration, advocates argued that the SSBCI would promote economic growth and job creation by enhancing small business access to capital. Opponents argued that the SSBCI did not address the need to stimulate demand for credit by small businesses, which, in their view, is the core issue affecting small business job creation during the economic recovery. They argued that “the solutions to America’s economic problems do not lie in more taxpayer-funded bailouts,” and advocated small business tax reductions as a more effective means to stimulate small business job creation and economic growth.

This report examines the SSBCI and its implementation, including Treasury’s response to initial program audits conducted by the U.S. Government Accountability Office and Treasury’s Office of Inspector General. These initial audits suggest that SSBCI participants are generally complying with the statute’s requirements, but that some compliance problems exist; Treasury’s oversight of the program could be improved; and performance measures are needed to assess the program’s efficacy.

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Overview

Congressional interest in small business access to capital has increased in recent years because of concerns that small businesses might be prevented from accessing sufficient capital to enable them to assist in the economic recovery. Some, including President Obama, have argued that the federal government should provide additional resources to assist small businesses in acquiring capital necessary to start, continue, or expand operations and create jobs. They argue that in recent years many financial institutions have tightened their small business lending standards in reaction to higher loan default rates and higher percentages of loans in arrears resulting largely from relatively weak economic conditions throughout the nation. They also assert that the federal government should intervene because it is relatively difficult for many small businesses, including some with excellent credit histories, to access the capital they need to grow.¹

Others worry about the long-term adverse economic effects of spending programs that increase the federal deficit. They advocate business tax reduction, reform of financial credit market regulation, and federal fiscal restraint as the best means to assist small businesses and create jobs.²

During the 111th Congress, P.L. 111-240, the Small Business Jobs Act of 2010, provided the Small Business Administration (SBA) additional funding, authorized several SBA pilot programs, and enhanced several of the SBA's lending programs in an effort to assist small businesses access capital.³ The act also authorized the Secretary of the Treasury to establish a \$30 billion Small Business Lending Fund (SBLF) (\$4.0 billion was issued) to encourage community banks with less than \$10 billion in assets to increase their lending to small businesses and a \$1.5 billion State Small Business Credit Initiative (SSBCI).⁴

The SSBCI provides funding, allocated through a statutorily created formula and distributed in one-third increments (called tranches), to states, the District of Columbia, eligible territories, and eligible municipalities (hereinafter referred to as states unless otherwise noted) to expand existing or to create new state small business investment programs, including capital access programs, collateral support programs, loan participation programs, loan guarantee programs, and venture capital programs. In most instances, states received their initial tranche in FY2011, with over \$366 million in SSBCI funds transferred to states.⁵ At that time, Treasury anticipated providing

¹ The White House, "American Jobs Act," at <http://www.whitehouse.gov/economy/jobsact>; The White House, "Startup America Initiative," at <http://www.whitehouse.gov/economy/business/startup-america>; and Federal Reserve Board, "Senior Loan Officer Opinion Survey on Bank Lending Practices," at <http://www.federalreserve.gov/boarddocs/SnLoanSurvey/>.

² U.S. Congress, House Committee on Financial Services, To Create the Small Business Lending Fund Program to Direct the Secretary of the Treasury to make Capital Investments in Eligible Institutions in order to Increase the Availability of Credit for Small Businesses, and for other Purposes, report to accompany H.R. 5297, 111th Cong., 2nd sess., May 27, 2010, H.Rept. 111-499 (Washington: GPO, 2010), pp. 37, 38; and National Federation of Independent Businesses, "Issues: The Economy," Washington, DC, at <http://www.nfib.com/advocacy/economy>.

³ For further information and analysis concerning the Small Business Jobs Act of 2010, see CRS Report R41385, *Small Business Legislation During the 111th Congress*, by Robert Jay Dilger and Gary Guenther and CRS Report R40985, *Small Business: Access to Capital and Job Creation*, by Robert Jay Dilger.

⁴ For further information and analysis concerning the Small Business Lending Fund see CRS Report R42045, *The Small Business Lending Fund*, by Robert Jay Dilger.

⁵ U.S. Office of Management and Budget, "Budget of the U.S. Government, FY2013: Department of the Treasury, Appendix," p. 1061, at <http://www.gpo.gov/fdsys/pkg/BUDGET-2013-APP/pdf/BUDGET-2013-APP.pdf>.

another \$859 million in SSBCI funds to states in FY2012.⁶ However, it took states somewhat longer than anticipated to expend, transfer, or obligate their first tranche of SSBCI funds. As a result, Treasury transferred \$172 million (for a total of \$538 million) in SSBCI funds to states in FY2012.⁷

Most states received their second tranche of SSBCI funds in FY2013, and Treasury anticipates that most states will receive their third, and final, tranche in FY2014, depending on how quickly they expend, transfer, or obligate their SSBCI funds. Treasury anticipated transferring about \$551 million in SSBCI funding to states in FY2013, and the remaining \$380 million in FY2014.⁸

States are expected to leverage their SSBCI funds to generate private financing and investment that is at least 10 times the amount of their SSBCI funds (a leverage ratio of 10:1). Forty-seven states, American Samoa, the District of Columbia, Guam, the Northern Mariana Islands, Puerto Rico, the U.S. Virgin Islands, Anchorage, Alaska, two consortiums of municipalities in North Dakota, and a consortium of municipalities in Wyoming currently participate in the program.

During congressional consideration, advocates argued that the SBLF and SSBCI will promote economic growth and job creation by enhancing small business access to capital. Opponents argued that the SBLF and SSBCI did not address the need to stimulate demand for credit by small businesses, which, in their view, is the core issue affecting the role of small business in job creation during the economic recovery. They argued that “the solutions to America’s economic problems do not lie in more taxpayer-funded bailouts,” and advocated small business tax reductions as a more effective means to stimulate job creation and economic growth.⁹ For additional discussion of these different approaches to stimulate job creation and economic growth see CRS Report R40985, *Small Business: Access to Capital and Job Creation*, by Robert Jay Dilger and CRS Report R42045, *The Small Business Lending Fund*, by Robert Jay Dilger.

It is still too early to determine the full extent of the SSBCI’s effect on small business lending. Only about half of the program’s funds have been disbursed, and less than that amount has been obligated or spent by the states. Also, determining the program’s influence on small business lending is likely to be more suggestive than definitive because differentiating the SSBCI’s effect on small business lending from other factors, such as changes in the lender’s local economy, is methodologically challenging, especially given the relatively small amount of financing involved relative to the national market for small business loans. The SSBCI’s \$1.5 billion in financing represents less than 0.3% of outstanding non-agricultural small business loans.¹⁰

⁶ Ibid.

⁷ U.S. Office of Management and Budget, “Budget of the U.S. Government, FY2014: Department of the Treasury, Appendix,” p. 991, at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/tre.pdf>.

⁸ Ibid.

⁹ U.S. Congress, House Committee on Financial Services, To Create the Small Business Lending Fund Program to Direct the Secretary of the Treasury to make Capital Investments in Eligible Institutions in order to Increase the Availability of Credit for Small Businesses, and for other Purposes, report to accompany H.R. 5297, 111th Cong., 2nd sess., May 27, 2010, H.Rept. 111-499 (Washington: GPO, 2010), pp. 37, 38.

¹⁰ Federal Deposit Insurance Corporation, “Statistics on Depository Institutions,” at <http://www2.fdic.gov/SDI/main.asp>. As of September 30, 2013, there was \$579,847,320 in outstanding non-agricultural small business loans (defined as the sum of “total loans secured by nonfarm nonresidential properties of \$1,000,000 or less” and “total commercial and industrial loans to U.S. addressees of \$1,000,000 or less”).

This report examines the SSBCI and its implementation, including Treasury's response to initial program audits conducted by the U.S. Government Accountability Office (GAO) and Treasury's Office of Inspector General (OIG). These audits suggested that SSBCI participants were generally complying with the statute's requirements, but that some compliance problems existed; Treasury's oversight of the program could be improved; and performance measures were needed to assess the program's efficacy.

Legislative Origins

On January 27, 2010, President Obama announced in his State of the Union Address that because "financing remains difficult for small business owners across the country, even those that are making a profit," he would send Congress several legislative proposals designed to enhance small business access to capital, including a proposal to establish a \$30 billion SBLF.¹¹ On May 7, 2010, the Obama Administration sent Congress draft legislation to establish the SBLF and the SSBCI.¹²

On May 13, 2010, Representative Gary Peters introduced H.R. 5302, the State Small Business Credit Initiative Act of 2010. The bill would have authorized a \$2 billion SSBCI modeled on the President's SSBCI proposal. That same day, Representative Barney Frank, chair of the House Committee on Financial Services, introduced H.R. 5297, initially titled the Small Business Lending Fund Act of 2010. Based on the President's SBLF proposal, the bill was designed to encourage lending to small businesses by creating a \$30 billion SBLF to make capital investments in eligible community banks with total assets of less than \$10 billion.¹³ On May 18, 2010, the Committee on Financial Services held a hearing on H.R. 5297 and, the following day, approved the bill, 42-23, as amended.¹⁴ Perhaps the most significant amendment approved was an amended version of the \$2 billion State Small Business Credit Initiative Act of 2010. It was approved by a vote of 39-23.¹⁵

SBLF and SSBCI advocates argued that the programs were necessary because "many companies, particularly small businesses, claim that it is becoming harder to get new loans to keep their business operating and that banks are tightening requirements or cutting off existing lines of credit even when the businesses are up to date on their loan repayments."¹⁶ In their view, the

¹¹ The White House, "Remarks by the President in State of the Union Address," at <http://www.whitehouse.gov/the-press-office/remarks-president-state-union-address>.

¹² U.S. Congress, House Committee on Financial Services, To Create the Small Business Lending Fund Program to Direct the Secretary of the Treasury to make Capital Investments in Eligible Institutions in order to Increase the Availability of Credit for Small Businesses, and for other Purposes, report to accompany H.R. 5297, 111th Cong., 2nd sess., May 27, 2010, H.Rept. 111-499 (Washington: GPO, 2010), p. 17.

¹³ U.S. Congress, House Committee on Financial Services, To Create the Small Business Lending Fund Program to Direct the Secretary of the Treasury to make Capital Investments in Eligible Institutions in order to Increase the Availability of Credit for Small Businesses, and for other Purposes, report to accompany H.R. 5297, 111th Cong., 2nd sess., May 27, 2010, H.Rept. 111-499 (Washington: GPO, 2010), p. 18.

¹⁴ U.S. Congress, House Committee on Financial Services, *Incentives to Promote Small Business Lending, Jobs, and Economic Growth*, 111th Cong., 2nd sess., May 18, 2010, Serial No. 111-137 (Washington: GPO, 2010).

¹⁵ U.S. Congress, House Committee on Financial Services, To Create the Small Business Lending Fund Program to Direct the Secretary of the Treasury to make Capital Investments in Eligible Institutions in order to Increase the Availability of Credit for Small Businesses, and for other Purposes, report to accompany H.R. 5297, 111th Cong., 2nd sess., May 27, 2010, H.Rept. 111-499 (Washington: GPO, 2010), pp. 21, 22.

¹⁶ *Ibid.*, p. 16.

SBLF and SSBCI would promote economic growth and job creation by enhancing small business access to capital.

The House Committee on Financial Services' Republicans indicated in the report accompanying H.R. 5297 that they "were unanimous in our opposition to this misguided legislation."¹⁷ They argued that the SBLF and SSBCI did not address what they considered to be the core issue affecting small business job creation during the economic recovery—the need to stimulate demand for credit by small businesses.¹⁸ They argued that the bill would fail to help small businesses or create jobs, would succeed only in adding billions of dollars to the nation debt, and concluded that "the solutions to America's economic problems do not lie in more taxpayer-funded bailouts."¹⁹ Instead of supporting federal spending programs to enhance small business access to capital, they advocated an extension of a series of small business tax credits as a more effective means to stimulate small business job creation and economic growth.²⁰

On June 14, 2010, the House Committee on Rules issued a rule for H.R. 5297 (H.Res. 1436), which provided that "in the engrossment of H.R. 5297, the Clerk shall add the text of H.R. 5486, as passed by the House, at the end of H.R. 5297 and that H.R. 5486 shall be laid on the table."²¹ H.R. 5486, To Amend the Internal Revenue Code of 1986 to Provide Tax Incentives for Small Business Job Creation, and for Other Purposes, included several tax incentives for small businesses and several revenue raising provisions designed to offset the costs of the tax incentives. Also, at that time, the House Committee on Rules posted on its website legislative language for a proposed amendment in the nature of a substitute to H.R. 5297, as reported, which included a proposed \$1 billion Small Business Early-Stage Investment Program.

On June 17, 2010, the House passed H.R. 5297, by a vote of 241-182. The engrossed bill, retitled the Small Business Jobs and Credit Act of 2010, also included the language in H.R. 5486 and the Small Business Early-Stage Investment Program, as well as the \$30 billion SBLF and \$2 billion SSBCI.

The arguments presented in the House report accompanying the bill, both for and against the bill's passage, were also presented during House floor debate. For example, advocates argued that the SSBCI would "increase small business lending which will retain and create jobs."²² Opponents argued that the bill "is repeating the same failed initiatives that have helped our national debt grow to \$13 billion in the past two years" and did not address what they viewed as the top problem facing small businesses—"the lack of sales and demand."²³

The House-passed version of H.R. 5297 was placed on the Senate Legislative Calendar on June 18, 2010. Following a series of votes on motions to invoke cloture on several amendments in the

¹⁷ Ibid., p. 18.

¹⁸ Ibid., p. 37.

¹⁹ Ibid., p. 38.

²⁰ Ibid.

²¹ H.Res. 1436. A second rule (H.Res. 1448) was issued on June 16, 2010, to allow consideration of two amendments that were revised to comply with House "pay-go" rules.

²² Representative Melissa Bean, "The Small Business Jobs and Credit Act of 2010," House debate, *Congressional Record*, vol. 156, no. 90 (June 16, 2010), p. H4514.

²³ Representative Randy Neugebauer, "The Small Business Jobs and Credit Act of 2010," House debate, *Congressional Record*, vol. 156, no. 90 (June 16, 2010), p. H4514, H4515.

nature of a substitute to H.R. 5297, and the August recess, the Senate passed an amended version of the bill (S.Amdt. 4594, an amendment in the nature of a substitute for H.R. 5297) on September 16, 2010, by a vote of 61-38.²⁴ The Senate-passed version of the bill, which included the SSBCI but funded at \$1.5 billion instead of \$2 billion, was passed by the House on September 23, 2010, by a vote of 237-187. The enrolled bill, retitled the Small Business Jobs Act of 2010, was signed into law (P.L. 111-240) by President Obama on September 27, 2010.²⁵

The arguments presented during Senate floor debate, both for and against the bill's passage, were similar to those presented during House floor debate. One difference was a greater emphasis by the bill's advocates in the Senate on the SSBCI's support of state loan collateral programs. Several Senators argued that the SSBCI's support of state loan collateral programs was needed because, as one Senator pointed out "just as the recession has battered the value of our homes, it has also battered the value of business property such as real estate, factories, and equipment. That has damaged the ability of small businesses to get bank financing because it has lowered the value of property they can offer as collateral."²⁶

SSBCI Programs

The SSBCI provides funding to expand existing or to create new state small business investment programs, including capital access programs, loan participation programs, loan guarantee

²⁴ On June 29, 2010, cloture on a motion to proceed to H.R. 5297 was invoked in the Senate, by a vote of 66-33. That same day, Senator Harry Reid proposed a motion to commit H.R. 5297 to the Senate Committee on Finance with instructions to report back forthwith S.Amdt. 4407, an amendment in the nature of a substitute, which included the Small Business Lending Fund (SBLF) and most of the provisions later included in S.Amdt. 4594. In response to perceived opposition to the SBLF, S.Amdt. 4407 was withdrawn on July 21, 2010. In its place, Senator Harry Reid proposed for Senator George LeMieux S.Amdt. 4500, to establish the Small Business Lending Fund Program. He also proposed for Senator Max Baucus S.Amdt. 4499, an amendment in the nature of a substitute, which contained S.Amdt. 4407, with modifications, minus the SBLF. On July 22, 2010, cloture on S.Amdt. 4500 was invoked in the Senate, by a vote of 60-37. On July 27, 2010, Senator Harry Reid withdrew S.Amdt. 4500 and introduced for Senator Max Baucus S.Amdt. 4519, which included the SBLF, the provisions in S.Amdt. 4499, with modifications, \$1.5 billion in emergency disaster agricultural assistance, and additional revenue off-sets. On July 29, 2010, a motion to invoke cloture on S.Amdt. 4519 failed, by a vote of 58-42. Debate on the motion focused on differences concerning the SBLF and the number of amendments to be offered. On August 5, 2010, Senator Harry Reid introduced for Senators Max Baucus and Mary Landrieu S.Amdt. 4594, an amendment in the nature of a substitute. It contained the provisions in S.Amdt. 4519 except that it removed a provision to eliminate the advance payment option for the earned-income tax credit that would have raised \$1.1 billion, removed a provision that would have reallocated \$500 million in future spending from P.L. 111-5, the American Recovery and Reinvestment Act of 2009, and removed a provision to provide \$1.5 billion in emergency agricultural assistance funding. On September 14, 2010, the Senate invoked cloture on S.Amdt. 4594, by a vote of 61-37, and passed it on September 16, 2010, by a vote of 61-38. See Senator Harry Reid, "Text of Amendments: SA 4519," *Congressional Record*, vol. 156, no. 111 (July 27, 2010), pp. S6309-S6337; Senator Kay Hagan, "Motion to Invoke Cloture on amendment No. 4519," Roll Call Vote No. 221 Leg., *Congressional Record*, vol. 156, no. 113 (July 29, 2010), p. S6473; Senator Harry Reid, "Small Business Lending Fund Act of 2010," Remarks in the Senate, *Congressional Record*, vol. 156, no. 113 (July 29, 2010), pp. S6472, S6473; Senator Mitch McConnell, "Small Business Lending Fund Act of 2010," Remarks in the Senate, *Congressional Record*, vol. 156, no. 113 (July 29, 2010), pp. S6472, S6473; Senator Kay Hagan, "Motion to Invoke Cloture on H.R. 5297, the Small Business Lending Fund Act of 2010," Rollcall Vote No. 236 Leg., *Congressional Record*, daily edition, vol. 156, part 125 (September 16, 2010), p. S7158; and Senator Al Franken, "Small Business Lending Fund Act of 2010," Rollcall Vote No. 237 Leg., *Congressional Record*, daily edition, vol. 156, part 125 (September 16, 2010), p. S7158.

²⁵ Senator Al Franken, "Small Business Lending Fund Act of 2010," Rollcall Vote No. 237 Leg., *Congressional Record*, daily edition, vol. 156, part 125 (September 16, 2010), p. S7158.

²⁶ Senator Carl Levin, "Small Business Lending Fund Act of 2010," remarks in the Senate, *Congressional Record*, vol. 156, part 124 (September 15, 2010), p. S7123.

programs, collateral support programs, venture capital programs, and any other small business credit or equity support program that meets the SSBCI's program requirements.

State Capital Access Programs

State capital access (CAP) programs are loan portfolio insurance programs that enable “small businesses to obtain credit to help them grow and expand their business.”²⁷ Under a CAP, when a participating lender originates a loan, the lender and borrower combine to contribute a percentage of the loan or line of credit into a reserve fund which is held by the lender. Under the SSBCI, the contribution must be from 2% to 7% of the amount borrowed. Typically, the contributions range from 3% to 4%. The state then matches the combined contribution, and sends that amount to the lender who deposits the funds into the lender-held reserve fund. State CAPs encourage lending to small businesses because the reserve fund reduces the lender's risk of losses by being available to cover any losses on any of the loans in the lender's CAP portfolio. Interest rates, maturity, collateral, and other loan terms are negotiated between the lender and the borrower.²⁸

Under the SSBCI, approved state CAPs are eligible for federal funding equal to the amount of the insurance premiums paid by the borrower and the lender into the lender-held reserve fund, as calculated on a loan-by-loan basis. The state may use SSBCI funding to make its contribution to the lender-held reserve fund. States may also supplement the federal contribution with state and/or private funds if it chooses to do so.²⁹

Subject to some restrictions, SSBCI state CAP loans may be used for most business purposes, “including, but not limited to: start-up costs, working capital, business procurement, franchise fees, equipment, inventory, and the purchase, construction, renovation, or tenant improvements of an eligible place of business that is not for passive real estate investment purposes.”³⁰ In addition, the borrower must have 500 employees or less at the time that the loan is enrolled in the program and the loan amount may not exceed \$5 million.³¹

State Loan Participation Programs

State loan participation programs enable “small businesses to obtain medium to long-term financing, usually in the form of term loans.”³² States may structure loan participation programs in two ways: (1) by purchasing a portion of a loan originated by a lender (also known as a purchase transaction or purchase participation), or (2) by participating in the loan as a co-lender (also known as a companion loan) where a lender originates a senior loan and the state originates

²⁷ U.S. Department of the Treasury, “SSBCI Program Profile: Capital Access Program,” at http://www.treasury.gov/resource-center/sb-programs/Documents/SSBCI_Program_Profile_Capital_Access_Program_FINAL_May_17.pdf.

²⁸ Ibid.

²⁹ Ibid.

³⁰ Ibid. State CAPs under the SSBCI program may not enroll the unguaranteed portions of SBA guaranteed or other federally guaranteed loans without the express, prior written consent of Treasury. Also, restrictions apply to refinancing and other uses.

³¹ Ibid.

³² U.S. Department of the Treasury, “SSBCI Program Profile: Loan Participation Program,” at http://www.treasury.gov/resource-center/sb-programs/Documents/SSBCI_Program_Profile_Loan_Participation_FINAL_May_17.pdf.

a second loan, which is usually subordinate to the lender's senior loan should a default occur, to the same borrower. State loan participation programs encourage lending to small businesses because the lender is able to diversify its risk of loss by sharing its exposure to loan losses with the state. Interest rates, maturity, collateral, and other loan terms for purchase transactions and purchase participations are negotiated between the lender and the borrower, although the state may seek to approve the loan terms prior to closing. For companion loans, the state and lender negotiate interest rates, maturity, collateral and other loan terms.³³

Subject to some restrictions, loans in SSBCI state loan participation programs may be used for most business purposes (start-up costs, working capital, business procurement, franchise fees, etc.). In addition, SSBCI state loan participation programs must target an average borrower size of 500 employees or less, and may not extend credit to borrowers with more than 750 employees. They must also target an average loan amount of \$5 million or less, and may not extend credit for any single loan exceeding \$20 million.³⁴

State Loan Guarantee Programs

State loan guarantee programs enable “small businesses to obtain term loans or lines of credit” by providing the lender “with the necessary security, in the form of a partial guarantee, for the lender to approve a loan or line of credit.”³⁵ The guarantee percentage is determined by the states and lenders, but, under the SSBCI, may not exceed 80% of loan losses. Also, origination and annual utilization fees are determined by each state to defray the program's cost. Under the SSBCI, fees may range from 0% to 3% of the loan amount. States typically establish limits on the amount of loans any one lender can originate in the program, and have a cash reserve to cover anticipated losses on the guarantees. Interest rates, maturity, collateral, and other loan terms are typically negotiated between the lender and the borrower, although in some cases, loan terms are subject to state approval and, in many cases, the state and lender will discuss and negotiate loan terms and guarantee options prior to reaching agreement to approve the loan and issue a guarantee.³⁶

Subject to some restrictions, loans in SSBCI state loan guarantee programs may be used for most business purposes. In addition, SSBCI state loan guarantee programs must target an average borrower size of 500 employees or less, and may not guarantee credit to borrowers with more than 750 employees. They must also target an average loan amount of \$5 million or less, and may not guarantee credit for any single loan exceeding \$20 million.³⁷

State Collateral Support Programs

State collateral support programs are “designed to enable financing that might otherwise be unavailable due to a collateral shortfall.”³⁸ They provide pledged collateral accounts to lenders to

³³ Ibid.

³⁴ Ibid.

³⁵ U.S. Department of the Treasury, “SSBCI Program Profile: Loan Guarantee Program,” at http://www.treasury.gov/resource-center/sb-programs/Documents/SSBCI_Program_Profile_Loan_Guarantee_FINAL_May_17.pdf.

³⁶ Ibid.

³⁷ Ibid.

³⁸ U.S. Department of the Treasury, “SSBCI Program Profile: Collateral Support Program,” at http://www.treasury.gov/resource-center/sb-programs/Documents/SSBCI_Program_Profile_Collateral_Support_FINAL_May_17.pdf.

enhance the collateral coverage of individual loans. Lenders are required to have at least 20% of their own capital at risk in each loan. Interest rates, maturity, collateral, and other loan terms are negotiated between the lender and the borrower. The state and lender negotiate the amount of cash collateral to be pledged by the state. In practice, state collateral support is rarely provided for more than 50% of the loan value.³⁹

Subject to some restrictions, SSBCI state collateral support program loans may be used for most business purposes. In addition, SSBCI state collateral support programs must target an average borrower size of 500 employees or less, and may not support credit to borrowers with more than 750 employees. They must also target an average loan amount of \$5 million or less, and may not support credit for any single loan exceeding \$20 million.⁴⁰

State Venture Capital Programs

State venture capital programs provide “investment capital to create and grow start-up and early-stage businesses.”⁴¹ They come in two forms: a state-run fund, which may include private investors, that invests directly in businesses; and a fund of funds that invests in other venture capital funds that, in turn, invest in individual businesses.⁴² In both cases, the day-to-day management of the fund is typically outsourced to a professional firm. Investments are typically equity (stock) and hybrid investments, such as preferred equity and subordinated debt. Terms are negotiated between the business owner and the venture capital fund. The standard life of most state venture capital funds is 12 years, and individual fund investments are typically for 3 to 7 years.⁴³

Subject to some restrictions, SSBCI state venture capital program investments may be used for most business purposes. In addition, SSBCI state venture capital programs must target its investments to businesses that have 500 employees or less, and may not invest in businesses with more than 750 employees. They must also target an average investment of \$5 million or less, and may not make a single investment exceeding \$20 million.⁴⁴

SSBCI Funding

P.L. 111-240 appropriated \$1.5 billion to the Department of the Treasury (hereinafter Treasury) for the SSBCI program, including the “reasonable costs of administering the program.”⁴⁵ The 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, the Northern Mariana

³⁹ Ibid.

⁴⁰ Ibid.

⁴¹ U.S. Department of the Treasury, “SSBCI Program Profile: Venture Capital Program,” at http://www.treasury.gov/resource-center/sb-programs/Documents/SSBCI_Program_Profile_Venture_Capital_FINAL_May_17.pdf.

⁴² Ibid.

⁴³ Ibid.

⁴⁴ Ibid.

⁴⁵ 12 U.S.C. §5708(b). Treasury reports that SSBCI administrative expenses, which include the cost of government employee salaries, contract support, and reimbursement to the Treasury Office of the Inspector General for program audits, were \$5,393,000 in FY2011, and estimated to be \$6,230,000 in FY2012 and \$6,629,000 in FY2013. See U.S. Department of the Treasury, “State Small Business Credit Initiative: FY2013 President’s Budget Submission,” p. 8, at <http://www.treasury.gov/about/budget-performance/Documents/16%20-%20FY%202013%20SSBCI%20CJ.pdf>.

Islands, the U.S. Virgin Islands, and, in some instances, municipalities are eligible for funding, with the amount available to each state, territory, and municipality determined by a formula contained in the act (described later in this section).

Application Process

To receive SSBCI funding, states, American Samoa, the District of Columbia, Guam, Puerto Rico, the Northern Mariana Islands, and the U.S. Virgin Islands were required to file a notice of intent to apply for funding with Treasury by November 26, 2010. After filing a notice of intent to apply for funding, they were required to submit to Treasury an application for funding by June 27, 2011.

Municipalities were allowed to apply for funding, but only in the event their state did not participate in the program. Municipalities were eligible to apply for funding up to the total amount of their state's SSBCI allotment, with the final approved amounts apportioned based on their proportionate share of the population of all approved municipal applicants in that state, based on the most recent available decennial census.⁴⁶ Eligible municipalities were required to submit to Treasury an application for funding by September 27, 2011.

The application for funding requested information concerning such items as

- the amount requested;
- how the funds are to be used (state capital access program, collateral support program, loan participation program, loan guarantee program, venture capital program, or other small business support program);
- confirmation that at a minimum, \$1 of public investment will result in at least \$1 of new private credit; that there is a reasonable expectation that the funding will result in new small business lending of at least 10 times the amount of the SSBCI federal contribution; that the funding targets small businesses with 500 employees or less, does not support borrowers that have more than 750 employees, targets loans with an average principal of \$5 million or less, and does not extend credit support to loans that exceed \$20 million;
- documentation describing the operational capacity, skills, and experience of the applicant's management team in operating capital access and other small business capital support programs;
- documentation describing the internal accounting and administrative control systems used to safeguard against waste, loss, unauthorized use, and misappropriation; and
- documentation describing how the participant planned to use the funds "to provide access to capital for small businesses (1) in low- and moderate-income

⁴⁶ 12 U.S.C. §5703(d)(6). If more than three municipalities or combinations of municipalities from the same state are approved, Treasury is required to allocate federal funds to the three municipalities (or combination of municipalities) with the largest populations. See 12 U.S.C. §5703(d)(5).

communities, (2) in minority communities, (3) in other underserved communities, and to (4) women- and minority-owned small businesses.”⁴⁷

The Funding Formula

The SSBCI funding formula takes into account the number of jobs and job losses for each state in proportion to the aggregate number of jobs and job losses nationally. Specifically, it is based on the average of (1) the number of individuals employed in each state in December 2007 compared to the number of individuals employed in each state in December 2008; and (2) the number of individuals unemployed in each state in December 2009 compared to the number of individuals unemployed nationally in December 2009. After accounting for Treasury’s anticipated administrative costs, each participating state is guaranteed a minimum allotment of 0.9% of available funding (\$13,168,350).⁴⁸

Funding is provided in three installments (called tranches), each approximately one-third of the participant’s approved allotment. The first tranche is provided “immediately following the receipt of the fully signed Allocation Agreement.”⁴⁹ Allotment agreements describe how states are to comply with program requirements and are signed after the state’s application is approved.

Prior to the receipt of the second and third tranches, each state must certify that it has expended, transferred, or obligated at least 80% of the previous disbursement to, or for the account of, one or more approved state programs.⁵⁰ Treasury is authorized to recoup misused funds should the state be found in default of the allocation agreement and may terminate any portion of an allotment that Treasury has not disbursed within two years of the date on which the allocation agreement with the state was signed. By statute, all SSBCI allocation agreements expire on March 31, 2017.

State-by-State Allotments

Forty-eight of the 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, the Northern Marianas Islands, and the U.S. Virgin Islands submitted an application to participate in the program by the June 27, 2011, deadline. Collectively, they requested approximately \$1.4 billion in funding.⁵¹ North Dakota and Wyoming did not apply. Alaska later withdrew its application. Five municipalities (one in Alaska, two in North Dakota, and two in Wyoming) subsequently requested \$39.5 million in SSBCI funding.⁵² Funding was allotted to Anchorage, Alaska (\$13,168,350); a Laramie, Wyoming, led consortium of 17 municipalities (\$13,168,350);

⁴⁷ U.S. Department of the Treasury, “State Small Business Credit Initiative: Application,” at <http://www.treasury.gov/resource-center/sb-programs/Documents/SSBCI%20Application.pdf>.

⁴⁸ Treasury anticipates that its total administrative costs over the lifetime of the SSBCI program will be about \$36.85 million.

⁴⁹ U.S. Department of the Treasury, “State Small Business Credit Initiative: Frequently Asked Questions,” at <http://www.treasury.gov/resource-center/sb-programs/Pages/ssbci-faqs.aspx#gen3>.

⁵⁰ Ibid.

⁵¹ Applicants were entitled to the funding provided by the SSBCI formula. American Samoa requested \$10,418,500. The minimum SSBCI allotment is \$13,168,350. All other applicants requested the amount provided by the SSBCI formula. See U.S. Government Accountability Office, *State Small Business Credit Initiative*, GAO-12-173, December 7, 2011, p. 9, at <http://www.gao.gov/assets/590/586727.pdf>.

⁵² Ibid.

a Mandan, North Dakota, led consortium of 37 municipalities and an Indian tribe (\$9,710,768); and a Carrington, North Dakota, led consortium of 36 municipalities (\$3,457,582).

Table 1 shows the amount of SSBCI funding awarded to each state and territory (hereinafter states), and the types of small business investment programs supported. As shown on **Table 1**, California received the largest allotment (\$167.75 million) and American Samoa, which requested less than the minimum guaranteed allotment, received the smallest allotment (\$10.5 million).

Twenty-six states use SSBCI funding to support a capital access program, 35 support a loan participation program, 18 support a loan guarantee program, 16 support a collateral support program, 32 support a venture capital program, and 9 support another type of small business credit or equity program.

As mentioned previously, most states received their initial tranche in FY2011, totaling about \$366 million in SSBCI funds. Treasury transferred another \$172 million in SSBCI funds to states in FY2012 (for a total of \$538 million) and anticipated transferring about \$551 million in SSBCI funding to states in FY2013 and the remaining \$380 million in FY2014.⁵³

Most states are expected to receive their second tranche of SSBCI funds by the end of FY2013, and their third tranche by the end of FY2014, depending on how quickly they expend, transfer, or obligate their SSBCI funds.⁵⁴

States may use up to 5% of their initial tranche, and up to 3% of their second and third tranches, for administrative expenses related to implementing an approved small business investment program. They are also subject to several reporting requirements. For example, they must submit to Treasury quarterly reports describing the use of allocated funds for each approved program, including the total amount of allocated funds used for direct and indirect administrative costs, the total amount of allocated funds used, the amount of program income generated, and the amount of charge-offs against the federal contributions to the reserve funds set aside for any approved CAP. They are also required to submit annual reports to Treasury, by March 31 of each year, containing, among other things, transaction-level data for each loan or investment made with SSBCI funds for that year.⁵⁵

Table 1. SSBCI Programs

Participant	Allotment (\$ millions)	Capital Access Program	Loan Participation	Loan Guarantee	Collateral Support	Venture Capital	Other
Alabama	\$31.301	X	X	X			
Alaska, Anchorage	\$13.168					X	
American Samoa	\$10.500				X		

⁵³ U.S. Office of Management and Budget, “Budget of the U.S. Government, FY2014: Department of the Treasury, Appendix,” p. 991, at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/tre.pdf>.

⁵⁴ Ibid.

⁵⁵ U.S. Department of the Treasury, “Guidelines for State Small Business Credit Initiative (October 21, 2011),” p. 20, at <http://www.treasury.gov/resource-center/sb-programs/Documents/SSBCI%20Policy%20Guidelines.pdf>.

Participant	Allotment (\$ millions)	Capital Access Program	Loan Participation	Loan Guarantee	Collateral Support	Venture Capital	Other
Arizona	\$18.204		X			X	
Arkansas	\$13.168	X	X	X		X	
California	\$167.755	X	X	X	X		
Colorado	\$17.233	X			X		
Connecticut	\$13.301	X					
Delaware	\$13.168	X	X				
District of Columbia	\$13.168				X		
Florida	\$97.622	X	X	X		X	X
Georgia	\$47.808	X		X			X
Guam	\$13.168	X	X	X			
Hawaii	\$13.168					X	
Idaho	\$13.168				X		
Illinois	\$78.365	X	X		X	X	X
Indiana	\$34.339	X				X	
Iowa	\$13.168	X	X			X	
Kansas	\$13.168		X			X	
Kentucky	\$15.487	X	X		X		
Louisiana	\$13.168			X		X	
Maine	\$13.168		X			X	X
Maryland	\$23.025		X	X		X	
Massachusetts	\$22.023	X	X				
Michigan	\$79.157	X	X		X	X	
Minnesota	\$15.463	X	X	X			
Mississippi	\$13.168			X			
Missouri	\$26.930		X			X	
Montana	\$13.168		X				
Nebraska	\$13.168		X			X	
Nevada	\$13.803				X		X
New Hampshire	\$13.168	X	X	X	X	X	
New Jersey	\$33.760		X	X		X	X
New Mexico	\$13.168		X				
New York	\$55.351	X				X	X
North Carolina	\$46.061	X	X			X	

Participant	Allotment (\$ millions)	Capital Access Program	Loan Participation	Loan Guarantee	Collateral Support	Venture Capital	Other
North Dakota, Mandan & Carrington consortiums	\$13.168		X ^a		X	X	
Northern Mariana Islands	\$13.168		X	X			
Ohio	\$55.138	X			X	X	
Oklahoma	\$13.168					X	
Oregon	\$16.516	X	X	X			
Pennsylvania	\$29.241		X			X	X
Puerto Rico	\$14.540		X			X	
Rhode Island	\$13.168					X	
South Carolina	\$17.990	X	X				
South Dakota	\$13.168		X				
Tennessee	\$29.672					X	
Texas	\$46.553					X	
Utah	\$13.168		X	X		X	
Vermont	\$13.168		X				
Virgin Islands	\$13.168			X	X		X
Virginia	\$17.953	X	X		X		
Washington	\$19.722	X	X			X	
West Virginia	\$13.168	X	X	X	X	X	
Wisconsin	\$22.363	X		X		X	
Wyoming, Laramie consortium ^b	\$13.168				X	X	

Source: U.S. Department of Treasury, “State Programs Funded by SSBCI,” at <http://www.treasury.gov/resource-center/sb-programs/Pages/ssbci.aspx>; and U.S. Government Accountability Office, *State Small Business Credit Initiative*, GAO-12-173, December 7, 2011.

- a. The Mandan, North Dakota, led consortium of 37 municipalities and an Indian tribe was allotted \$9.71 million to administer a Loan Participation Program. The Carrington, North Dakota, led consortium of 36 municipalities was allotted \$3.4 million to administer a Collateral Support program and a Venture Capital program.
- b. The Laramie, Wyoming, led consortium includes 17 municipalities.

Recent Audits, Evaluation Reports, and Program Adjustments

P.L. 111-240 requires the Government Accountability Office (GAO) to perform an annual audit of the SSBCI program. In addition, the act requires the Office of Inspector General (OIG) of the

Department of Treasury to conduct, supervise, and coordinate audits and investigations into the use of SSBCI funds. GAO released its first annual audit of the program on December 7, 2011, and its second annual audit of the program on December 5, 2012. Treasury's OIG released its first evaluation report of Treasury's implementation of the SSBCI on August 5, 2011, and its first audit of a state's use of SSBCI funds (California) on May 24, 2012. As of December 18, 2013, Treasury's OIG had completed audits of 13 states' use of SSBCI funds (California, Montana, Vermont, Michigan, Texas, New Jersey, Delaware, Massachusetts, Alabama, Missouri, Washington, Kansas, and Florida).⁵⁶

GAO's 2011 Audit

GAO noted in its 2011 SSBCI audit that Treasury's early implementation efforts were appropriately focused on establishing the application process and the process for distributing initial installments of funds to recipients as quickly as possible.⁵⁷ Left unstated was that Treasury was establishing policy guidelines and paperwork requirements for the program essentially from scratch. Also, states reported that nearly one-half of their SSBCI investment programs were new.⁵⁸ This suggests that at least some states had limited prior experience operating and overseeing many of their small business investment programs.⁵⁹

GAO found that Treasury issued an initial set of policy guidelines and application materials via its website on December 21, 2010, and "was able to review, approve and obtain signed allocation agreements with and distribute first installments of funds to two states in January 2011."⁶⁰ In response to feedback from states, the SBA, and other federal agencies, Treasury decided to revise its policy guidelines and application paperwork "to better articulate what documentation was required for both the application and review processes."⁶¹ Revised policy guidelines and modifications to the allocation agreements were issued in April 2011. The two previously approved states were asked to sign an amended allocation agreement that incorporated the revisions.

GAO reported that several states indicated that they had delayed submitting their SSBCI applications until Treasury issued its final application guidance, and 37 states submitted their applications in June 2011, the final month that applications were allowed. Although some states had postponed the submission of their applications, GAO found that "despite the delay in

⁵⁶ U.S. Department of the Treasury, Office of the Inspector General, Small Business Lending Fund Program Oversight Office, "Small Business Lending Fund Oversight Reports," at <http://www.treasury.gov/about/organizational-structure/ig/Pages/Office-of-Small-Business-Lending-Fund-Program-Oversight.aspx>.

⁵⁷ U.S. Government Accountability Office, *State Small Business Credit Initiative*, GAO-12-173, December 7, 2011, p. 21, at <http://www.gao.gov/assets/590/586727.pdf>.

⁵⁸ *Ibid.*, p. 11.

⁵⁹ An independent analysis of the SSBCI program funded by Treasury recommended that "Future federal venture capital initiatives should require relevant program-specific training for VC program managers. VC program managers empowered by state government leaders range from novice to expert with respect to their preparedness to manage VC programs, and therefore need a common baseline of knowledge about options for design and operation of a state venture capital program." See Cromwell Schmisser LLC, "Information and Observations on State Venture Capital Programs: Report for the U.S. Department of the Treasury and Interested Parties in the State Small Business Credit Initiative (SSBCI)," February 2013, p. 6, at <http://www.treasury.gov/resource-center/sb-programs/Documents/VC%20Report.pdf>.

⁶⁰ *Ibid.*, p. 14.

⁶¹ *Ibid.*

providing application guidance, applicants generally viewed Treasury officials as helpful throughout the application process—providing answers to most questions immediately and determining answers as soon as possible when not readily available.”⁶²

GAO also found that Treasury finalized its disbursement procedures for second and third installments of SSBCI funds at the beginning of November 2011. Treasury officials reported that despite this delay, no state, at that time, had expended 80% of its initial disbursement to support loans or investments to small businesses. However, GAO noted that while Treasury was finalizing the disbursement procedures “states were potentially delayed in receiving their remaining SSBCI funding.”⁶³ GAO noted that one state that they contacted reported that they were ready for their second installment before Treasury had finalized the disbursement procedures, but were told by Treasury officials that they would have to wait until the disbursement procedures were finalized.⁶⁴

GAO concluded its audit by noting that Treasury had not yet developed performance measures for the SSBCI program. GAO noted that “measuring performance allows organizations to track progress toward their goals and gives managers crucial information on which to base decisions” and “until such measures are developed and implemented Treasury will not be in a position to determine whether the SSBCI program is effective in achieving its goals.”⁶⁵

Treasury’s Response to GAO’s 2011 Audit: Performance Measures

In response to GAO’s audit, in January 2012, Treasury adopted three performance goals to measure its administration of the program and four performance indicators to measure SSBCI outcomes.

The following three performance goals reflect Treasury’s role in administering the program, which includes evaluating the eligibility of participating states and approved state programs; providing program oversight, including compliance with the act’s provisions, SSBCI policy guidelines, and the terms and conditions of the allocation agreements; and providing on-going technical assistance related to the program’s implementation:

- 90% of requests for modifications to allocation agreements are approved or rejected within 90 days of receiving a final submission;
- 90% of requests for subsequent disbursements under existing allocation agreements are approved or rejected within 90 days of receipt of a formal submission; and
- 90% of quarterly reports are received within 5 days of the deadline.⁶⁶

Treasury is tracking these performance goals continuously and reports 12-month data to the Office of Management and Budget annually as part of its annual budget submission.

⁶² Ibid., pp. 14, 15.

⁶³ Ibid., p. 16.

⁶⁴ Ibid.

⁶⁵ Ibid., p. 21.

⁶⁶ U.S. Treasury, “Correspondence with the author,” June 22, 2012. For the first two goals, the measurement period starts once all required documentation from the requesting participating state is received.

The following four performance indicators were established to serve as “benchmarks for any future programs of a similar nature to the SSBCI”:⁶⁷

- the amount of SSBCI funds used over time, as reported on SSBCI quarterly reports;
- the volume and dollar amounts of loans or investments supported by SSBCI funds, as reported on SSBCI annual reports;
- the amount of private sector leverage, as reported on SSBCI annual reports; and
- the estimated number of jobs created or retained, as reported on SSBCI annual reports.

Treasury reports performance data internally to the Assistant Secretary of Financial Institutions on an annual basis. Treasury also noted that these outcomes are not directly within its control, given that it approves and provides funding for state loan and investment programs, while the participating states are responsible for designing, establishing, and implementing the state programs. Also, Treasury noted that

the results of these outcomes are highly dependent on exogenous factors such as the demand for credit in a given locality and the quality of the small business borrowers’ requests for such funds. Establishing these indicators for lending and investing activity as performance goals would imply that Treasury has direct control where none exists. Nonetheless, measuring these outcomes will be integral to assessing the relative utility of federal support for these state programs and informing future policy direction.⁶⁸

GAO’s 2012 Audit

GAO’s second annual audit of the SSBCI, issued on December 5, 2012, found that as of June 30, 2012, Treasury had transferred \$468 million in SSBCI funds to states (about one-third of total SSBCI funds), and states had disbursed about \$150 million of that amount (about 10% of total SSBCI funds). GAO reported that the states they interviewed said that “disbursing funds was much faster for state programs that were in existence before SSBCI because the infrastructure was already in place and lenders were already familiar with the programs” but that “some states implementing new programs told us that it could take time to use the funds because they had to conduct extensive outreach to lenders to make them aware of the programs and encourage them to commit to small business lending.”⁶⁹

GAO noted that Treasury is authorized to revoke any portion of a participating state’s allocated SSBCI funds that had not been transferred to the state by the end of the two-year anniversary of the state’s approval to participate in the SSBCI. GAO noted that Treasury has not developed a written policy on how it will use this authority, that most of the participating states’ two-year period will end sometime in 2013, and “it is still unknown if they all will be able to use their

⁶⁷ Ibid.

⁶⁸ Ibid.

⁶⁹ U.S. Government Accountability Office, *Small Business Lending: Opportunities Exist to Improve Performance Reporting of Treasury’s Programs*, GAO-13-76, December 5, 2012, p. 22, at <http://www.gao.gov/assets/660/650555.pdf>.

funds in the time to obtain the third and final disbursement within this time frame.”⁷⁰ GAO noted that although Treasury officials had indicated at an October 2012 conference attended by many SSBCI participants that “Treasury did not currently plan to exercise this authority in the near future,” GAO argued that “when states are required to spend federal funds to meet a statutory deadline or specific program requirements, agencies should provide guidance to the states on what they should expect if they are unable to meet the deadline.”⁷¹ In the absence of a formal written policy on this matter, GAO asserted that it was unclear how Treasury would use this authority in a consistent manner.

GAO also acknowledged that, in response to its first annual audit of the SSBCI, Treasury had created performance measures “to help monitor and measure the effectiveness of SSBCI.”⁷² However, GAO noted that Treasury “has not yet determined how and when it will make this information public.”⁷³ GAO argued that “we recognize that it is still early in the program and results vary greatly across the program participants for a variety of reasons,” but “Treasury should make information publicly available concerning its performance indicators” because “performance information is an important tool for policymakers, particularly as Congress reviews and considers programs to assist small businesses going forward.”⁷⁴

Treasury’s Response to GAO’s 2012 Audit: Written Policy Guidance and Publishing Performance Measures

In June 2013, Treasury responded to GAO’s recommendation for written policy guidance concerning the Treasury’s discretionary authority to revoke a participating state’s allocated SSBCI funds that had not been transferred to the state by the end of the two-year anniversary of the state’s approval to participate in the SSBCI by disseminating, by email, a “Frequently Asked Question” (FAQ) narrative on the topic to all participating states. Treasury also discussed its policy guidance on this subject at the national SSBCI conference held on June 3 and 4, 2013.⁷⁵

Treasury issued the following policy guidance on this subject:

Treasury will deem any Participating State that submits its second disbursement request by June 30, 2015 and qualifies to receive that disbursement to have made sufficient progress in implementing its Approved State Programs. For such a Participating State, Treasury will not terminate the availability of any Allocated Funds that remain un-transferred as of that date, and the Participating State will retain access to the full amount of its Allocated Funds for the duration of the Allocation Time Period, which is March 31, 2017. For any Participating State that Treasury determines has not qualified for its second disbursement of Allocated Funds through a submission made by June 30, 2015, Treasury expects to conduct an analysis of the Participating State’s progress in implementing its SSBCI programs at that time to determine

⁷⁰ Ibid., p. 24.

⁷¹ Ibid., p. 25.

⁷² Ibid., p. 40.

⁷³ Ibid.

⁷⁴ Ibid., pp. 40-41.

⁷⁵ U.S. Department of the Treasury, State Small Business Credit Initiative Office, “Email correspondence with the author,” July 9, 2013.

whether Treasury should exercise its authority to terminate the availability of un-transferred funds.⁷⁶

GAO reported in its 2012 audit that Treasury officials acknowledged the importance of making at least some SSBCI performance information available for policymakers, but that Treasury had not yet decided what specific information to share or how it will be presented because “they want to make sure the information reflects the outcomes in an appropriate manner.”⁷⁷ Treasury officials also informed GAO that they hoped to develop a method for sharing this information publicly after they have had time to review the second annual reports that will be completed by the states in 2013.⁷⁸

On July 9, 2013, a Treasury official informed CRS that “Treasury is currently sampling the 2012 Annual Reports submitted by Participating States for accuracy and compliance. Treasury expects to release the performance data as soon as the sampling and data verification is complete and the report is cleared for publication.”⁷⁹

Treasury’s Inspector General Evaluation Reports

On August 5, 2011, Treasury’s OIG issued its first evaluation report examining the SSBCI program.⁸⁰ On the opening page, the OIG praised Treasury officials for “seeking our assistance during the developmental stage of the program.”⁸¹ The OIG noted in the report that Treasury officials had previously made several revisions to the SSBCI’s initial policy guidelines, allocation agreement, and application materials following consultation with the OIG, including modifying “the SSBCI application to require that applicants detail their oversight and compliance regimes prior to receiving program approval.”⁸²

After examining Treasury’s policy guidelines and allocation agreement between Treasury and participating states, the OIG made nine recommendations for improvements. For example, the OIG recommended that Treasury improve the understanding of state oversight responsibilities by more clearly defining what is meant by the terms “supervision and oversight and accountability; and set minimum standards for participating state oversight of SSBCI recipients, including defining a participating state’s role in overseeing compliance with loan use requirements and restrictions.”⁸³ The OIG also recommended that Treasury “either modify the allocation agreement or amend the policy guidelines to require participating states to make a representation that it is

⁷⁶ Ibid.

⁷⁷ U.S. Government Accountability Office, *Small Business Lending: Opportunities Exist to Improve Performance Reporting of Treasury’s Programs*, GAO-13-76, December 5, 2012, p. 35, at <http://www.gao.gov/assets/660/650555.pdf>.

⁷⁸ Ibid.

⁷⁹ U.S. Department of the Treasury, State Small Business Credit Initiative Office, “E-mail correspondence with the author,” July 9, 2013.

⁸⁰ U.S. Department of the Treasury, Office of Inspector General, “State Small Business Credit Initiative: Treasury Needs to Strengthen State Accountability for Use of Funds,” August 5, 2011, at <http://www.treasury.gov/about/organizational-structure/ig/Pages/by-date-2011.aspx>.

⁸¹ Ibid., p. 1.

⁸² Ibid., p. 14.

⁸³ Ibid., p. 19.

aware of, monitoring, and enforcing compliance with the policy guidelines and other restrictions applicable to the other participants [lenders and borrowers] in the program.”⁸⁴

Treasury took several immediate actions to address the OIG’s recommendations. For example, in response to the recommendation that Treasury more clearly define the terms “supervision and oversight and accountability” and to establish minimum standards for participating state oversight of SSBCI recipients, Treasury revised its SSBCI “Frequently Asked Questions” document on its website “to combine all applicable oversight requirements in one place” and “elaborate on the specific duty that each provision imposes upon the participating state.”⁸⁵ In addition, Treasury also took into consideration the OIG’s recommendations as it developed its SSBCI National Standards for Compliance and Oversight document, which was released on May 15, 2012.⁸⁶

Treasury’s Inspector General Use of SSBCI Funds Audit Reports

On May 24, 2012, Treasury’s OIG released the first of a planned series of audits of state use of SSBCI funds, starting with California.⁸⁷ As mentioned previously, as of December 18, 2013, Treasury’s OIG had completed audits of 13 states’ use of SSBCI funds (California, Montana, Vermont, Michigan, Texas, New Jersey, Delaware, Massachusetts, Alabama, Missouri, Washington, Kansas, and Florida).⁸⁸

In each audit, Treasury’s OIG reviewed a judgmental sample of small business loans or investments to “determine whether [the loans or investments] complied with program requirements for loan use, capital at risk, and other restrictions.”⁸⁹ Treasury’s OIG then determined if there were “any instances of reckless or intentional misuse.”⁹⁰ Treasury is required to recoup any funds that the OIG identifies as intentionally or recklessly misused.⁹¹ To date, only Texas was found to be in full compliance with all SSBCI requirements.⁹²

⁸⁴ Ibid., p. 20.

⁸⁵ Ibid. p. 10.

⁸⁶ U.S. Department of the Treasury, “SSBCI National Standards for Compliance and Oversight,” May 15, 2012, at <http://www.treasury.gov/resource-center/sb-programs/Pages/ssbcia.aspx>.

⁸⁷ U.S. Department of the Treasury, Office of Inspector General, “Small Business Lending Fund: California Needs to Improve Its Oversight of Programs Participating in the State Small Business Credit Initiative,” May 24, 2012, at <http://www.treasury.gov/about/organizational-structure/ig/Agency%20Documents/OIG-SBLF-12-003.pdf>.

⁸⁸ U.S. Department of the Treasury, Office of Inspector General, Small Business Lending Fund Program Oversight Office, “Small Business Lending Fund Oversight Reports,” at <http://www.treasury.gov/about/organizational-structure/ig/Pages/Office-of-Small-Business-Lending-Fund-Program-Oversight.aspx>.

⁸⁹ U.S. Department of the Treasury, Office of Inspector General, “Small Business Lending Fund: California Needs to Improve Its Oversight of Programs Participating in the State Small Business Credit Initiative,” May 24, 2012, p. 2, at <http://www.treasury.gov/about/organizational-structure/ig/Agency%20Documents/OIG-SBLF-12-003.pdf>.

⁹⁰ U.S. Department of the Treasury, Office of Inspector General, Small Business Lending Fund Program Oversight Office, “Fiscal Year 2013 Audit Work Plan,” pp. 12-29, at <http://www.treasury.gov/about/organizational-structure/ig/Pages/Office-of-Small-Business-Lending-Fund-Program-Oversight.aspx>.

⁹¹ Ibid.

⁹² U.S. Department of the Treasury, Office of Inspector General, “State Small Business Credit Initiative: Texas’ Use of Federal Funds for Other Credit Support Programs,” p. 2, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG-SBLF-13-003.pdf>.

California

Treasury's OIG determined that California had used the majority of the \$3.6 million in SSBCI loans it examined properly, but identified \$133,250 in loan loss reserves funded under California's Small Business Loan Guarantee Program that did not comply with SSBCI program requirements.⁹³ The OIG indicated that these non-compliant expenditures "constitute a 'reckless' misuse of funds as defined by Treasury guidance, which under the provisions of the Small Business Jobs Act must be recouped."⁹⁴ The OIG also identified \$160,988 in administrative expenses charged to the SSBCI program that were "not adequately supported by actual expenses incurred or with proper documentation to validate the costs claimed."⁹⁵ The OIG also reported that "42 or approximately 58%, of the 73 loans we tested lacked all of the required borrower and lender assurances."⁹⁶

Treasury agreed to recoup from California the \$133,250 in loan loss reserves identified by the OIG as a reckless misuse of funds; required California to provide additional supporting documentation for its SSBCI administrative expenses; and required California program officials to address missing borrower and lender certifications and assurances. Treasury subsequently noted that any loans still missing required assurances and certifications had been un-enrolled, and all other certification issues had been resolved.⁹⁷

Montana

Treasury's OIG found that Montana had misused \$2.73 million of the \$4.9 million in SSBCI funds it examined because the funds were used for passive real estate investments and the refinancing of prior debt, which "are prohibited under the Small Business Jobs Act or SSBCI Policy Guidelines."⁹⁸ The OIG also found that \$3,426 in personnel costs incurred for administering SSBCI funds were not allowable or allocable because the costs were not properly supported as required by OMB Circular A-87.⁹⁹

The OIG "did not find the misuse of funds to be intentional or reckless as Montana sought guidance from Treasury before enrolling the loans."¹⁰⁰ The OIG reported that Treasury officials did not provide definitive guidance on the permissibility of passive real estate loans and informed Montana that refinancing prior debt to the same lender was allowable if the prior debt had matured and new underwriting has occurred. The OIG noted that Treasury attempted to clarify the Small Business Job Act's prohibition on the refinancing of prior debt by defining "refinancing,"

⁹³ U.S. Department of the Treasury, Office of Inspector General, "Small Business Lending Fund: California Needs to Improve Its Oversight of Programs Participating in the State Small Business Credit Initiative," May 24, 2012, p. 3, at <http://www.treasury.gov/about/organizational-structure/ig/Agency%20Documents/OIG-SBLF-12-003.pdf>.

⁹⁴ Ibid.

⁹⁵ Ibid.

⁹⁶ Ibid.

⁹⁷ Ibid., pp. 13-14.

⁹⁸ U.S. Department of the Treasury, Office of Inspector General, "State Small Business Credit Initiative: Montana's Use of Funds Received from the State Small Business Credit Initiative," September 27, 2012, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIGSBLF12006.pdf>.

⁹⁹ Ibid.

¹⁰⁰ Ibid., pp. 2, 9.

which is not defined in the act. The OIG challenged Treasury's conclusion "that the statutory prohibition on refinancing the same lenders' loans pertained only to existing debt that had not yet matured and that refinancing debt after it matures constitutes 'refunding,' a permitted use."¹⁰¹ The OIG noted that there were no references in the Small Business Jobs Act or in Treasury's SSBCI Policy Guidelines concerning "re-funding."¹⁰²

Treasury agreed to notify participating states that loans for passive real estate are considered a misuse of funds and encourage them to review their loan enrollments to ensure compliance with guidance that was in place at the time the loans were made.¹⁰³ Treasury also agreed to "provide a clear and rigorous analysis documenting how Treasury concluded that some refinancing of existing debt from the same lender, or "re-funding," is consistent with the statutory language, or amend the program procedural guidance to remove that possibility."¹⁰⁴ Treasury also found that Montana was unable to provide the necessary documentation for the \$3,426 in personnel costs cited by the OIG in its review of the state's SSBCI administrative expenses and that those costs would be disallowed.¹⁰⁵

Vermont

Treasury's OIG examined 26 loans issued under Vermont's four SSBCI programs and found that Vermont's interest rate subsidy program (\$931,000 in SSBCI funding) did not comply with the requirements established by its Allocation Agreement with Treasury.¹⁰⁶ Because the state estimated its interest rate subsidies, Treasury's OIG found that Vermont's quarterly reports to Treasury "do not reflect the State's actual use of funds for the program" and, therefore, "the State cannot provide Treasury with accurate information for measuring the leverage achieved with SSBCI funds."¹⁰⁷ The OIG recommended that Treasury require Vermont to provide a sub-accounting of all the funds transferred in connection with the interest rate subsidy program as well as program income generated from the use of such funds. In addition, the OIG recommended that Treasury determine whether Vermont "is in general default of its Allocation Agreement due to its non-compliance with accounting and lender/borrower assurance requirements, and whether future funding to the State should be reduced, suspended, or terminated."¹⁰⁸ The OIG also found that \$216,820 in administrative expenses charged to the SSBCI program did not comply with program guidance.¹⁰⁹

Treasury agreed to require Vermont to provide a sub-accounting of all the funds transferred in connection with the interest rate subsidy program as well as all program income generated from

¹⁰¹ Ibid., p. 3.

¹⁰² Ibid., p. 12.

¹⁰³ Ibid., p. 16.

¹⁰⁴ Ibid.

¹⁰⁵ Ibid., p. 18.

¹⁰⁶ U.S. Department of the Treasury, Office of Inspector General, "State Small Business Credit Initiative: Vermont's Use of Federal Funds for Capital Access and Credit Support Programs," November 30, 2012, p. 2, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG-SBLF-13-001.pdf>.

¹⁰⁷ Ibid, pp. 2-3.

¹⁰⁸ Ibid., pp. 3-4.

¹⁰⁹ Ibid., p. 3.

the use of such funds.¹¹⁰ Treasury also agreed to determine whether “there has been a general event of default under Vermont’s Allocation Agreement resulting from the State’s non-compliance with the grants management common rule or lender/borrower assurance requirements” and, “if such an event has occurred and has not been adequately cured, determine whether it warrants a reduction, suspension, or termination of future funding to the State.”¹¹¹ Treasury also agreed to disallow the \$216,820 in administrative expenses charged to the SSBCI program by Vermont unless the state provides supporting documentation in accordance with OMB Circular A-87.¹¹²

Michigan

Treasury’s OIG found that Michigan had used the majority of the \$38.5 million in SSBCI loans it examined properly, but identified “approximately \$2.524 million in misuse of which \$2.5 million was used to finance lender purchase transactions that did not involve extensions of additional credit to borrowers; \$3,000 supported a partner buy-out, a prohibited use; and \$21,000 was used to pay the CAP insurance premium on a loan closed and funded prior to Michigan’s acceptance into the SSBCI program and Treasury’s allocation of funds to the State.”¹¹³ The OIG found that the \$21,000 used to pay the CAP insurance premium was a “reckless” misuse of funds that must be recouped. Although the OIG did not find the \$2.5 million used to finance lender purchase transactions that did not involve extensions of additional credit to borrowers as a “reckless” misuse of funds, it did question whether the purchase transactions “are consistent with the intent of the [Small Business Jobs] Act to help small businesses expand, grow, and create jobs.”¹¹⁴ It recommended that Treasury develop guidance for such transactions. In addition, the OIG found \$8,506 in administrative expenses charged to the SSBCI program that were incurred prior to the date Michigan was approved to participate in the program and notified of its SSBCI allocation and recommended that those expenses be disallowed.¹¹⁵

Treasury agreed to issue guidance to address the conditions under which loan purchase transactions would be permitted.¹¹⁶ Treasury also agreed to recoup the \$21,000 used to pay the CAP insurance premium on a loan closed and funded prior to Michigan’s acceptance into the SSBCI program and Treasury’s allocation of funds to the state and to disallow the \$8,506 in administrative expenses that were incurred prior to the date Michigan was approved to participate in the program and notified of its SSBCI allocation.¹¹⁷

¹¹⁰ Ibid., p. 15.

¹¹¹ Ibid.

¹¹² Ibid., p. 14.

¹¹³ U.S. Department of the Treasury, Office of Inspector General, “State Small Business Credit Initiative: Michigan’s Use of Federal Funds for Capital Access and Other Credit Support Programs,” December 13, 2012, pp. 2-3, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG-SBLF-13-002.pdf>.

¹¹⁴ Ibid., p. 3.

¹¹⁵ Ibid.

¹¹⁶ Ibid., p. 13.

¹¹⁷ Ibid., pp. 15-16.

Texas

Treasury's OIG examined five investments, totaling \$6.3 million, financed by the Texas Small Business Venture Capital Program and found the program in full compliance with all SSBCI requirements. The OIG credited the state's "success in ensuring full compliance with SSBCI requirements" to the state's "use of a checklist to evaluate compliance with program requirements prior to the completion of each transaction."¹¹⁸

Massachusetts

Treasury's OIG contracted with an independent certified public accounting firm to audit Massachusetts' use of SSBCI funds. As of June 30, 2012, Massachusetts had obligated or spent approximately \$6.6 million of the SSBCI funds disbursed, including \$4 million for the Massachusetts Growth Capital Corporation (MGCC) Loan Participation Program, \$2.1 million for the Massachusetts Business Development Corporation (MBDC) Loan Participation Program, and \$211,000 for the Massachusetts Capital Access Program (MCAP). The Commonwealth also incurred approximately \$321,000 in administrative costs.

The accounting firm reviewed the state's administrative costs and a randomly selected sample of 35 state SSBCI transactions (3 loan participation loans and 32 capital access loans) to determine their compliance with SSBCI requirements. The audit found that Massachusetts charged \$200,000 in administrative costs to the SSBCI program that did not comply with program guidance and Massachusetts did not include in its quarterly reports to Treasury \$51,248 of program income. The audit also found that 34 of the 35 transactions were in compliance with program requirements. The accounting firm noted that a transaction for \$237,000 made by the MBDC Loan Participation Program appeared to be prohibited by SSBCI Policy Guidelines because it involved an SBA-guaranteed loan. Massachusetts officials "reported that they believed that the loan in question was compliant with program requirements because Treasury's SSBCI Policy Guidelines prohibit the enrollment of only the unguaranteed portions of federally-guaranteed loans" and "the prohibition on credit enhancement did not pertain to the guaranteed portion of federally-guaranteed loans."¹¹⁹ In addition, the audit found that Massachusetts did not obtain complete borrower and lender assurances for 89% of the loans reviewed by the time of loan closing.¹²⁰

The OIG recommended that Treasury "revise its program guidance to make the enrollment of federally-guaranteed loans a clear prohibition, disallow \$200,000 in administrative expenses unless the Commonwealth can provide adequate support for such costs, and require the Commonwealth to demonstrate that it has a compliant system for allocating administrative costs."¹²¹ The OIG also recommended "that Treasury determine whether there has been a general

¹¹⁸ U.S. Department of the Treasury, Office of Inspector General, "State Small Business Credit Initiative: Texas' Use of Federal Funds for Other Credit Support Programs," January 29, 2013, p. 2, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG-SBLF-13-003.pdf>.

¹¹⁹ *Ibid.*, p. 7.

¹²⁰ U.S. Department of the Treasury, Office of Inspector General, "State Small Business Credit Initiative: Massachusetts' Use of Federal Funds for Capital Access and Other Credit Support Programs," May 14, 2013, pp. 1-3, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIGSBLF13007.pdf>.

¹²¹ *Ibid.*, p. 3.

event of default of the Allocation Agreement resulting from Massachusetts' non-compliance with lender/borrower assurance requirements, materially inaccurate certifications, and failure to report program income."¹²²

In response to the OIG's recommendations, Treasury indicated that it was in the process of revising its program guidance on the enrollment of federally-guaranteed loans, and will determine whether Massachusetts has adequately cured its non-compliance with program requirements and whether additional action is warranted. Also, Massachusetts clarified that while it reported \$200,000 in administrative expenses, it did not charge the SSBCI fund for them, and does not intend to seek reimbursement from SSBCI for these expenses. Massachusetts also reported that many of the transactions examined during the audit "were made in the early stage of the SSBCI program, before suggested reporting forms were promulgated by Treasury."¹²³

Delaware

Treasury's OIG found that as of September 30, 2012, Delaware had obligated or spent approximately \$4.1 million of its first SSBCI disbursement of \$4.3 million – \$80,883 for 36 loans enrolled in the Delaware Access Program and approximately \$4 million for 14 loans enrolled in the Delaware Strategic Fund (DSF) Loan Program. The OIG reviewed a random sample of 26 loans (19 from the Delaware Access Program and 7 from the DSF Loan Program) that were enrolled as of September 30, 2012, to determine if they were in compliance with program requirements.¹²⁴

The OIG did not identify any instances of intentional or reckless misuse of funds. However, it did find that while Delaware obtained most borrower and lender assurances at loan closing, these assurances did not contain all required affirmations.¹²⁵ Several assurances were also missing signatures or dates. In addition, the OIG found that Treasury became aware of Delaware's noncompliance with the assurance requirements in May 2012, but it was not until October 2012 that Treasury directed Delaware's officials to obtain the missing assurances for each loan. By November 2012, Delaware had retroactively obtained the missing assurances.

The OIG recommended that Treasury "examine the reasons why appropriate and timely actions were not taken to address Delaware's compliance and certification issues, and take appropriate actions to strengthen its compliance monitoring and enforcement of program requirements."¹²⁶ In response to this recommendation, Treasury reported that it "is in the process of adjusting the quarterly certification process to cover circumstances where a participating state has a known

¹²² Ibid.

¹²³ Ibid., p. 19.

¹²⁴ U.S. Department of the Treasury, Office of Inspector General, "State Small Business Credit Initiative: Delaware's Use of Federal Funds for Capital Access and Other Credit Support Programs," March 29, 2013, p. 11, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIGSBLF13006.pdf>.

¹²⁵ Participating states must require the financial institution lender to obtain an assurance from each borrower stating that the loan proceeds will not be used for an impermissible purpose under the SSBCI Program. For example, the loan proceeds must be used for an approved "business purpose" and the loan proceeds cannot be used to: repay a delinquent federal or state income taxes unless the borrower has a payment plan in place with the relevant taxing authority; repay taxes held in trust or escrow; reimburse funds owed to any owner, including any equity injection or injection of capital for the business' continuance; or purchase any portion of the ownership interest of any owner of the business.

¹²⁶ Ibid., p. 3.

unresolved item of noncompliance.”¹²⁷ Also, Delaware officials reported that they had implemented “additional precautions, including random audits of SSBCI loans, to ensure compliance with use of proceeds, capital-at-risk, and assurance requirements.”¹²⁸

New Jersey

Treasury’s OIG contracted with an independent certified public accounting firm to audit New Jersey’s use of SSBCI funds.¹²⁹ The accounting firm found that as of June 30, 2012, New Jersey had spent about \$2.9 million of its first SSBCI disbursement of \$11.1 million – \$1.76 million for two loan participations, \$675,000 for a credit guarantee, and \$500,000 for a direct loan.¹³⁰

The accounting firm reviewed all four transactions and determined that New Jersey complied with all program requirements in administering the \$2.9 million in SSBCI funds. The OIG concluded that New Jersey’s “success in ensuring full compliance was attributable to several best practices that the New Jersey Economic Development Authority [which administers New Jersey’s SSBCI program] employed to enhance its program oversight,” including the use of a “SSBCI Application Eligibility Criteria Checklist” that “listed each of the required SSBCI assurances and specific SSBCI program requirements which had to be completed and signed prior to each transaction.”¹³¹

Alabama

Treasury’s OIG contracted with an independent certified public accounting firm to audit Alabama’s use of SSBCI funds. The accounting firm reviewed all 14 loans enrolled in Alabama’s Loan Guarantee Program, totaling approximately \$3.8 million, made between the signing of the SSBCI Allocation Agreement on August 24, 2011, and June 30, 2012. The accounting firm also reviewed the \$45,172 in administrative expenses Alabama charged against SSBCI funds during that time period to ensure they were allowable, reasonable, and allocable.

The audit found that Alabama complied with all program requirements in administering the \$3.8 million of SSBCI funds used as of June 30, 2012. The OIG attributed “the state’s success in ensuring full compliance” to the Alabama Department of Economic and Community Affairs’ requirement that a checklist containing SSBCI requirements be completed prior to each loan enrollment to ensure that the loan was in full compliance with SSBCI requirements.¹³² The audit also found that Alabama had overstated the amount of SSBCI funds used by approximately \$1 million on its March 31, 2012, Quarterly Report, and by approximately \$4 million on its June 30, 2012, Quarterly Report. The OIG indicated that the error occurred because Alabama incorrectly

¹²⁷ Ibid., p. 4.

¹²⁸ Ibid., pp. 3-4.

¹²⁹ U.S. Department of the Treasury, Office of Inspector General, “State Small Business Credit Initiative: New Jersey’s Use of Federal Funds for Other Credit Support Programs,” February 27, 2013, p. 2, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIGSBLF13005.pdf>.

¹³⁰ Ibid., p. 4.

¹³¹ Ibid., p. 8.

¹³² U.S. Department of the Treasury, Office of Inspector General, “State Small Business Credit Initiative: Alabama’s Use of Federal Funds for Capital Access and Other Credit Support Programs,” June 4, 2013, p. 2, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIGSBLF13008.pdf>.

included private lender contributions to loan loss reserves for loans guaranteed with SSBCI funds. However, because the inaccuracies were identified by Treasury and corrected prior to the audit, the OIG made no recommendations concerning the error.¹³³

Missouri

Treasury's OIG contracted with an independent certified public accounting firm to audit Missouri's use of SSBCI funds. The accounting firm reviewed all 17 SSBCI transactions between the signing of the SSBCI Allocation Agreement on May 23, 2011, and March 31, 2012. These transactions included 16 investments, totaling \$6.6 million, by the Missouri Innovation, Development, and Entrepreneurship Advancement (IDEA) Fund and one loan, totaling \$511,135, by the Grow Missouri Loan Fund. The accounting firm also reviewed the \$151,568 in administrative expenses Missouri charged against SSBCI funds during that time period to ensure they were allowable, reasonable, and allocable. Because the audit of the IDEA Fund revealed a prohibited party relationship, the audit's scope was expanded to include seven additional IDEA Fund transactions made between April 1, 2012, and September 30, 2012, "to determine whether additional prohibited party relationships existed."¹³⁴

The OIG found that Missouri "properly used over 96% of the \$7.3 million in SSBCI funds expended, and that all related administrative costs were compliant with program requirements."¹³⁵ However, the audit revealed that a \$240,000 venture capital investment made by the IDEA Fund "constituted a reckless misuse of funds, as defined by Treasury" because a director of the board that approved the investment "had a prohibited party relationship with the company that received the investment based on the director's controlling interest in the investee."¹³⁶ The director had recused herself from the vote approving the investment. The OIG noted that the board should have known that prohibited party relationships are not allowed because the SSBCI Policy Guidelines "require every borrower and investee receiving funds to certify that such a relationship did not exist."¹³⁷ The OIG recommended that Treasury recoup the \$240,000 investment. Missouri disagreed with the OIG's finding that it "recklessly misused funds" arguing that the board was in compliance with its own conflict of interest policy and that the relationship with the "potentially interested Director" was "disclosed repeatedly in the application materials which were provided to the Board" and that the investment "was made on the merits through a rigorous and independent process."¹³⁸ Nonetheless, Missouri took measures "to remedy the situation and prevent similar issues in the future."¹³⁹ For example, the board administering the IDEA Fund "replenished the SSBCI program account in the amount of the misused funds and unenrolled the transaction," amended its conflict of interest policy to comply with the SSBCI

¹³³ Ibid., pp. 1-2.

¹³⁴ U.S. Department of the Treasury, Office of Inspector General, "State Small Business Credit Initiative: Missouri's Use of Federal Funds for Other Credit Support Programs," July 24, 2013, p. 2, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIGSBLF13009.pdf>.

¹³⁵ Ibid., p. 3.

¹³⁶ Ibid.

¹³⁷ Ibid.

¹³⁸ Ibid., p. 26.

¹³⁹ Ibid., p. 22.

guidelines on conflicts of interest, and created a checklist to ensure that each transaction supported by SSBCI funds is in compliance with the SSBCI guidelines on conflicts of interest.¹⁴⁰

Treasury agreed to recoup the \$240,000 from Missouri. Treasury also agreed to “determine whether Missouri has adequately cured its non-compliance with the related party prohibition, requirements for assurances, and certification filings” and if further action is warranted.¹⁴¹

Washington

Treasury’s OIG contracted with an independent certified public accounting firm to audit Washington’s use of SSBCI funds. The accounting firm reviewed all of the state’s \$5.3 million in SSBCI loans issued by Washington’s Enterprise Cascadia Loan Participation Program and all of the \$1.7 million in investments issued by the state’s W Fund Venture Capital Program between the signing of the SSBCI Allocation Agreement on October 31, 2011, and June 30, 2012. The accounting firm also reviewed the \$92,291 in administrative expenses Washington charged against SSBCI funds during that time period to ensure they were allowable, reasonable, and allocable.¹⁴²

The audit determined that all \$7.1 million in loans and venture capital investments “complied with SSBCI program requirements and restrictions, and that borrower and lender assurances were complete and timely.”¹⁴³ However, the audit found that the \$92,291 in administrative expenses reported to Treasury “was overstated by \$5,779 as a result of an accounting change [comprised of payroll costs for administration of the SSBCI program that were incurred during the reporting period, but subsequently transferred to an alternative funding source] that was not reflected in the state’s SSBCI Quarterly Report.”¹⁴⁴ When the auditors brought the overstatement to their attention, Washington officials notified Treasury of the need to adjust their SSBCI Quarterly Report to reflect the cost transfer. Treasury “advised Washington that it would authorize the adjustment upon completion of the OIG’s audit.”¹⁴⁵

Kansas

Treasury’s OIG contracted with an independent certified public accounting firm to audit Kansas’s use of SSBCI funds. The accounting firm reviewed all of the state’s \$1.53 million in SSBCI loans issued by the Kansas Capital Multiplier Loan Fund and all of the \$696,950 in investments issued by the Kansas Capital Multiplier Venture Fund between the signing of the SSBCI Allocation Agreement on June 28, 2011, and March 31, 2012. The accounting firm also reviewed the \$14,585 in administrative expenses Kansas charged against SSBCI funds during that time period to ensure they were allowable, reasonable, and allocable.

¹⁴⁰ Ibid.

¹⁴¹ Ibid.

¹⁴² U.S. Department of the Treasury, Office of Inspector General, “State Small Business Credit Initiative: Washington’s Use of Federal Funds for Capital Access and Other Credit Support Programs,” August 15, 2013, pp. 1, 2, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG-SBLF-13-011.pdf>.

¹⁴³ Ibid., p. 2.

¹⁴⁴ Ibid.

¹⁴⁵ Ibid., p. 7.

The audit found that Kansas “appropriately used most of the SSBCI funds it had expended,” but questioned three \$250,000 loans that were issued to affiliated entities as part of a \$31 million aggregate financial arrangement.¹⁴⁶ The OIG noted that there is a \$20 million cap on SSBCI loans made under other credit support programs (OCSBs) and that Treasury’s guidance “does not address how the cap should be applied when funds are used to make companion loans comprising a larger financial package or where multiple loans are made to affiliated entities.”¹⁴⁷ The OIG recommended that Treasury clarify the requirement that SSBCI funds not be used to support loans that exceed a principal amount of \$20 million. Treasury agreed to revise the SSBCI Policy Guidelines to clarify the requirement.¹⁴⁸

The audit also found that Kansas inaccurately reported in its March 31, 2012, SSBCI Quarterly Report a \$173,822 advance for administrative costs issued to NetWork Kansas (a non-profit entity which, among other activities, administers the Kansas Capital Multiplier Loan Fund and the Kansas Capital Multiplier Venture Fund) as a loan; and that \$29,247 of that advance was not subsequently reported as administrative expenses in the state’s June 30, 2012, SSBCI Quarterly Report because those spent funds were previously incorrectly reported as a loan.¹⁴⁹ The audit also found that \$13,181 of the \$29,247 should be disallowed by Treasury because the funds were used to pay audit and tax consulting costs which were not properly allocated through a cost allocation plan or an indirect cost proposal as required by OMB Circular A-87.¹⁵⁰ Treasury agreed to work with Kansas “to correct its quarterly statements, remove the \$13,181 in disallowed audit and tax consulting costs from the State’s quarterly reports, and review Kansas’ cost allocation plan for administrative costs.”¹⁵¹

Florida

Treasury’s OIG reviewed all 7 SSBCI venture capital investments, totaling \$37 million, issued by the Florida Venture Capital Program; and all 17 SSBCI loans, totaling approximately \$14.6 million, issued by the Florida Loan Participation Program (11 loans, totaling \$9.75 million), Florida Direct Loans Program (1 loan, totaling \$3.5 million), Florida Loan Guarantee Program (3 loans, totaling \$1.37 million), and Florida Capital Access Program (2 loans, totaling \$780) between the signing of the SSBCI Allocation Agreement on August 24, 2011, and December 31,

¹⁴⁶ U.S. Department of the Treasury, Office of Inspector General, “State Small Business Credit Initiative: Kansas’ Use of Federal Funds for Other Credit Support Programs,” September 5, 2013, p. 2, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG-SBLF-13-013.pdf>.

¹⁴⁷ *Ibid.*

¹⁴⁸ *Ibid.*, p. 18. Note: Kansas officials explained that the three loans in question were (1) “made to separate legal entities which were operated as separate businesses at separate locations, but who sold product to a common buyer”; (2) “not contrived to avoid the \$20 million cap on loans”; and (3) “while the similarity in names and inadvertent language in the applications make the independence of the loans more difficult to ascertain, review of the facts shows SSBCI loan support was not to a single loan in excess of \$20 million. Rather, SSBCI funds were used to support separate loans to separate businesses.” See *ibid.*, p. 20.

¹⁴⁹ *Ibid.*, pp. 3, 12, 13.

¹⁵⁰ *Ibid.*, p. 13.

¹⁵¹ *Ibid.*, p. 19. Treasury also agreed to inform Kansas “that the State is required to obtain lender assurances from relevant companion lenders in future transactions, but agrees with Kansas that retroactively collecting companion lender assurances [as was recommended by the OIG] is impractical and unnecessary.” See *ibid.*, p. 18. Treasury agreed to clarify the SSBCI National Standards for Compliance and Oversight document to specify which companion lenders must submit assurances.

2012.¹⁵² The OIG also reviewed the \$378,634 in administrative expenses Florida charged against SSBCI funds during that time period to ensure they were allowable, reasonable, and allocable.

The OIG found that Florida “properly used the majority (92%) of the SSBCI funds it expended” and that “23 of the 24 transactions we sampled were compliant with program guidelines related to prohibited relationships, maximum transaction amounts, use-of-proceeds, capital-at-risk, and other restrictions noted in the Act and SSBCI Guidelines.”¹⁵³ The questionable transaction involved the use of \$4 million in SSBCI funds in a \$34.7 million investment “that involved multiple equity instruments, which we determined exceeded the \$20 million restriction in the Act intended [to] be placed on the amount of credit support that may be extended to a recipient.”¹⁵⁴ The OIG concluded that although two equity instruments were involved [\$4 million from the SSBCI and \$30.7 million from private capital], the transaction constituted one investment package because if the business were to fail, both equity instruments would be affected.”¹⁵⁵ The OIG recommended that Treasury “revise the SSBCI Policy Guidelines to clarify how the \$20 million restriction on credit support should be applied when an investment involves multiple equity instruments.”¹⁵⁶ Treasury agreed to revise the program’s guidance concerning the \$20 million credit support restriction.¹⁵⁷

The OIG also found that Florida had overstated its administrative expenses by approximately \$55,000. Florida officials indicated that the overstatement “occurred because of incorrect selection criteria used to pull administrative cost information from the state accounting system” following the merger of several state agencies. Florida officials informed Treasury of the error, and made adjustments to its administrative expenses to account for the error in its March 31, 2013, SSBCI Quarterly Report.¹⁵⁸

The OIG also found that Florida had “overstated by approximately \$23 million the amount of SSBCI funds that had been obligated because it included FLVCP [Florida Venture Capital Program] reserves that were set aside for future follow-on investments to existing investees.”¹⁵⁹ Florida officials asserted that its reporting of these funds was in compliance with the definitions provided in the SSBCI Policy Guidelines and FAQ documents at the time that the funds were reported.¹⁶⁰ However, state officials also noted that Treasury informed them in February 2013 that “its reserve commitment letters did not meet Treasury’s criteria for designation as obligated funds” and that the state had submitted an updated disbursement request with its second tranche of funding,” which was received in June 2013.¹⁶¹ Subsequently, “Florida adjusted its quarterly statements for June 30, 2012, September 30, 2012, and December 31, 2012, to exclude amounts

¹⁵² U.S. Department of the Treasury, Office of Inspector General, “State Small Business Credit Initiative: Florida’s Use of Federal Funds for Capital Access and Other Credit Support Programs,” November 15, 2013, pp. 1, 13, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG-SBLF-14-002%20Final%20Report%2011%2015%2013%20web.pdf>.

¹⁵³ *Ibid.*, p. 7.

¹⁵⁴ *Ibid.*

¹⁵⁵ *Ibid.*, pp. 7, 8.

¹⁵⁶ *Ibid.*, p. 11.

¹⁵⁷ *Ibid.*, pp. 12, 15.

¹⁵⁸ *Ibid.*, p. 9.

¹⁵⁹ *Ibid.*, p. 4.

¹⁶⁰ *Ibid.*, p. 19.

¹⁶¹ *Ibid.*

shown as obligated pursuant to the FLVCP reserve commitment letters.”¹⁶² Treasury also agreed to determine whether Florida has adequately addressed its reporting of obligated funds and whether additional action is warranted.¹⁶³

Concluding Observations

The SSBCI was enacted as part of a larger effort to enhance the supply of capital to small businesses. Advocates argued that the SSBCI would help to address the recent decline in small business lending and create jobs. Opponents were not convinced that it would enhance small business lending, and worried about the program’s potential cost to the federal treasury.

As mentioned previously, it is still too early to determine the extent of the program’s effect on small business lending. Only about half of the program’s funds have been disbursed, and less than that amount has been obligated or spent by the states. Also, as Treasury has noted, determining the SSBCI’s influence on small business lending is likely to be more suggestive than definitive because differentiating the SSBCI’s effect on small business lending from other, exogenous factors, such as changes in the lender’s local economy and changes in the demand for small business loans, is methodologically challenging, especially given the relatively small amount of financing involved relative to the national market for small business loans. As mentioned previously, the SSBCI’s \$1.5 billion in financing represents less than 0.3% of outstanding non-agricultural small business loans.¹⁶⁴

Treasury’s OIG’s audits of 13 states’ implementation of their SSBCI programs suggests that at least some states may experience, at least initially, some difficulty complying with the program’s administrative requirements, which are designed to reduce the likelihood of loan defaults, investment losses, and fraudulent use of funds. The release of Treasury’s SSBCI National Standards for Compliance and Oversight document, on May 15, 2012, proved useful as states become more familiar with, and accustomed to, the SSBCI’s rules and regulations.¹⁶⁵ However, given the relatively large number of new small business investment programs receiving SSBCI funding, the relatively large number of entities involved in the program (Treasury officials, state officials, potentially hundreds of lenders and investment companies, and potentially thousands of small businesses), program oversight is likely to remain a congressional concern.

¹⁶² *Ibid.*, p. 20.

¹⁶³ *Ibid.*, p. 15.

¹⁶⁴ Federal Deposit Insurance Corporation, “Statistics on Depository Institutions,” at <http://www2.fdic.gov/SDI/main.asp>. As of September 30, 2013, there was \$579,847,320 in outstanding non-agricultural small business loans (defined as the sum of “total loans secured by nonfarm nonresidential properties of \$1,000,000 or less” and “total commercial and industrial loans to U.S. addressees of \$1,000,000 or less”).

¹⁶⁵ U.S. Department of the Treasury, “SSBCI National Standards for Compliance and Oversight,” May 15, 2012, at <http://www.treasury.gov/resource-center/sb-programs/Pages/ssbci.aspx>.

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