SMALL BUSINESS INVESTOR ALLIANCE

April 28, 2014

Via Electronic Mail

Agency Clearance Officer
Curtis Rich
Small Business Administration
409 3rd Street SW, 5th Floor
Washington D.C. 20416

SBA Desk Officer
Wendy Liberante
Office of Information & Regulatory Affairs
Office of Management & Budget
New Executive Office Building
Washington, D.C. 20503

Re: Reporting and Recordkeeping Requirements under OMB Review: (SBIC Financial Reports, OMB Control Number 3245-0063) & (Portfolio Financing OMB Control Number 3245-0078)

Dear Mr. Rich & Ms. Liberante:

The Small Business Investor Alliance ("SBIA") is the premier organization of lower middle market private equity funds, small business investment companies ("SBICs"), limited partner ("LP") investors in these funds, and business development companies ("BDCs"). SBIA represents and advocates on behalf of 400 funds in the lower middle market space, including over 200 SBICs and 23 BDCs that utilize the SBIC program.

SBIA appreciates the opportunity to provide feedback to the Small Business Administration ("SBA") and Office of Management & Budget ("OMB") on the proposed revisions to SBA Form 468 for partnerships and corporations and SBA Form 1031 (collectively "Proposed Changes").

SBIA is pleased to offer the following comments on the Proposed Changes:

1) SBIA Supports the Proposed Changes Although Believes Many of The Requested Information is Duplicative In Nature

SBIA has reviewed the Proposed Changes and has solicited feedback from our SBIC members, as well as tax, accounting and fund administrator experts that provide professional services to SBICs. Listed below are the changes that have been made to Forms 468 and 1031 and our comments regarding each of the Proposed Changes.

a) Form 1031: Portfolio Financing Report

Change: **New data collection regarding SBIR/STTR programs:** New Question 17b in Part B of Form 1031 will ask respondents to check a box to indicate that the reported financing is in a portfolio company with an underlying technology that received Small Business Innovation Research (SBIR) and the Small Business Technology Transfer (STTR) programs.

SBIA Comment: SBIA and our members have no concerns with the addition of this new check box.

b) Form 468: SBIC Financial Reports

Change 1: **Deletion of Part II a (Schedule of Regulatory & Leverage Capital):** Deletion of Part IIa from Forms 468.2 (annual) and 468.3 (quarterly) for partnerships, and deletion of lines 14 and 15 of Part IIa from Forms 468.1 (annual) and 468.4 (quarterly) for corporations.

SBIA Comment: SBIA and our members have no concerns with the deletion of this section.

Change 2: **Schedule 1 Changes (Loans & Investments)/Creation of New Schedule 8 (Unaudited Portfolio Company Information):** Removes portfolio company information designated as "unaudited" and moves it to a separate schedule that will be designated as "unaudited" in its entirety. This new schedule will be called Schedule 8. The goal is to lower audit costs for SBICs which were caused by the mixing of "audited" and "unaudited" information in the Schedule.

SBIA Comment: Schedule 8 has already been implemented into the Form 468 web application and has been required to be completed by SBICs since the first quarter of 2013 in the calendar year. SBICs and the general public were not provided the opportunity to comment on these new requirements in advance of their implementation. SBIA and our members believe it would be more helpful to the SBA and SBIC program participants if changes to forms specific to the SBIC program were released for feedback from the industry before implementation.

While SBIA and our membership appreciate the effort to lower audit costs for SBICs by eliminating the mixing of audited and unaudited information in one Schedule, the new Schedule 8 includes a number of redundant fields, requires excess manual data entry and provides very little user ability for the SBA. A number of fields in Schedule 8 are redundant and duplicative, including information that is already provided on Form 1031. For example, some of the financial information in Section B of Form 1031 is the same as that required on new Schedule 8. If the SBIC is investing in a new portfolio company, then it would make sense to provide this financial information on Form 1031 at the time it is filed. SBIA and its members would support the elimination of Schedule 8 and the replacement of it with an uploaded spreadsheet from Microsoft Excel, along with associated guidance to ensure the SBA receives this information in a usable and uniform format. This approach would eliminate unnecessary and duplicative data entry and provide an easy and useful format by which the data could be manipulated. SBA analysts would also benefit from the usability of the excel format rather than a PDF of Schedule 8.

Change 3: **Change of Information Presented in New Schedule 8:** As indicated above, a new Schedule 8 will be created with existing information provided in Schedule 1. However, some of the information required in Schedule 1 currently will be changed in the following way:

- **Removal of "rounds of financing/waterfall" fields previously in Schedule 1:** Schedule 8 removes the Rounds of financing/waterfall fields and allows SBICs to upload a PDF copy of this information in any layout they have available. Once information has been uploaded for a given portfolio company, SBICs will not need to submit unless there is a material change, such as a new round of financing.

SBIA Comment: SBIA supports the removal of the "rounds of financing/waterfall" fields, as this information is redundant information that is already included in Schedule 1 on Form 468. However, if the SBA is requiring this information a second time, SBIA believes submittal in Microsoft Excel format would provide greater usability and utility to SBA analysts than a PDF version. SBIA members have indicated that PDF format condenses this information to a text size that is difficult for analysts to read, which often results in this information being requested again by the analyst in Excel format on an individual basis. Previous versions of this section (last provided in 4Q 2012) required waterfalls and cap tables to be provided in an Excel format. In 2013, PDF format was required by the SBA. SBIA would support either not requiring this document to be provided to the SBA or providing a method through the SBA's web platform to allow submittal in Excel format.

In addition to the usability and redundancy of this information being provided, there is also concern about the definition of what a "material change" would consist of, beyond merely a new round of financing as explained on the form. SBA should clarify what "material changes" should be included in the form, through future guidance in Q&A's or preferably in an updated version of the instructions from the SBA for completing Form 468.

- **Removal of fields applicable to portfolio companies in Office of Liquidation:** SBICs can upload a PDF copy of this information in any layout they have available. The following fields will be removed: Negative covenants (ROFR/COA/Other); Board Rights (Whether the SBIC holds a Board seat, has board observation rights or appoints the Board Chairperson); and, Other Rights (Whether the SBIC has any of the following rights: Veto and Springing).

SBIA Comment: SBIA supports the removal of fields applicable to portfolio companies in the Office of Liquidation.

Change 4: **Annual Form 468.2 (Partnerships Only), Schedule 9 (Cumulative Investment Performance):** In Annual Form 468.2, which is completed by partnerships, current Schedule 5 will be renumbered as Schedule 9, so it will be grouped with other unaudited information. This schedule will be designated as "unaudited" to reduce SBIC compliance costs. This information will be required only on a going-forward basis. This information will now only be required annually, rather than quarterly. The schedule will apply only to partnership SBICs with issued leverage or outstanding leverage commitments.

SBIA Comment: SBIA has no concerns with the renumbering of Schedule 5 as Schedule 9. SBIA supports the requirement that this information now only be required annually rather than quarterly, in the hope this may have some impact on compliance cost and time associated with completing the forms. Schedule 9 was implemented and required to be completed at the 4Q 2013 filing for SBICs. SBIA would have appreciated if this Schedule was released for comment before implementation into the new Form 468 and would recommend the SBA do so in the future to ensure effective implementation and industry feedback.

General SBIA Comments on Form 468: A significant amount of the information provided in Form 468 is duplicative to that required in Form 1031, thereby increasing the time and expense associated with completing the forms. SBA should clarify a number of issues by reformulating and re-issuing the Form 468 instructions, rather than issuing periodic Q&As to address these issues. SBIA members have experienced significant problems to the technology and web-based platform for submitting these forms, issues that still have not been adequately remedied. SBICs are subjected to additional costs in terms of time and expense due to the still troubled web-based platform. The concept is correct, but the implementation that started off as a disaster is still in need of improvement. It is important to note that if data is going to be submitted to the SBA it should be for a purpose. Unfortunately, SBA analysts cannot use this technology system to help them analyze and regulate effectively or efficiently. The web-based platform is not useful for advanced analytics, does not allow documents to be downloaded and does not even allow analysts to look at job growth in specific funds. The functionality of the system also does not allow analysts to edit any information and only provides them the ability to print out the forms in the form of a PDF. In addition to the problems with the web-based system, in fact, likely because of those very problems, SBICs must provide all of the information in Forms 468 and 1031 in hard copy, sending via mail, large packages of these forms. Because the Form 468 platform is still troubled, these paper submissions often have notes on them as to what the filing is supposed to contain, but does not because the Form 468 is incapable of receiving the information. SBIA encourages the SBA and OMB to re-evaluate and take action on these issues to ensure a more usable and effective electronic system for all parties. Using a web-based, uploaded system is necessary and shows progress, but the system has to work for both SBICs and the SBA.

2) SBA Should Seek Industry and User Feedback Before Implementing Changes to SBA Forms To Ensure More Effective Implementation

As indicated above, a number of the Proposed Changes have already been implemented into Form 468 prior to the issuance of this notice to OMB. For instance, the new Schedule 8 has been required to be completed by SBICs since the first quarter of 2013, while Schedule 9 was required to be completed in the fourth quarter of 2013. Given that these changes were first put out for comment in March 2014, SBICs and their service providers were not able to provide valuable feedback to ensure a smooth adoption of the Proposed Changes. SBIA believes that the industry can provide significant assistance to the SBA in implementing proposed changes to existing forms and technology platforms if they are consulted before their implementation. The comment process provides the basis to provide helpful feedback to ensure systems work adequately and address the reality of those actually completing the required forms. SBIA would strongly encourage SBA to work with us to Beta test systems before they go online, saving SBA and SBICs time and money. SBIA strongly urges the SBA to consult the industry and end users of forms and systems before implementation in the future.

3) SBA Has Significant Issues With Its Technology and Electronic Filing Systems for the SBIC Program & Must Clarify Various Instructions

SBICs have experienced numerous difficulties in utilizing the SBA's new web based system for filing Forms 468 and Form 1031 as well as other forms. This has resulted in increased time expenditure for form completion, frustration by users, and associated increased compliance costs in terms of fees charged by accounting firms and fund administrators. The SBA and OMB should take steps to improve the following issues, many of which could likely be resolved by SBA Operations personnel or SBA technical staff:

a) <u>Clarification Needed:</u>

- <u>Investment Rate of Return (IRR) Fields on Annual Partnership Form 468:</u> The SBA should clarify which calculation is required for the fields for Net IRR and Gross IRR on Page 1 of the Annual Partnership Form 468. Many SBICs and their accounting firms have been confounded by how these numbers should be calculated. Guidance from the SBA has indicated that SBICs should use the information from their GAAP financial statements. However, the information on the GAAP financial statements only includes the IRR received by the limited partners in the funds. Additionally, many funds do not issue GAAP financial statements. If the fund is profitable, there may be significant carried interest passed along to the general partner of the fund, which would impact the numbers of the IRR. It remains unclear to SBICs what Net IRR includes, which is problematic for SBICs, and likely resulting in a lack of uniform data for the SBA. The SBA should give additional guidance on this issue to SBICs.

- <u>Update of Form 468 and Form 1031 Instructions:</u> Given these and other changes that have been made to Forms 468 and 1031, the SBA should update the form instructions. User release notes, system instructions and FAQ's are not sufficient in terms of a replacement for an update to the form instructions.

b) Electronic/System Related Issues:

- System Interface Needed: The SBIC web based platform needs a "system interface" to connect it with other industry applications. The industry overall has moved to the use of various systems, including:
  - CRM applications and portals for investor communications,
  - Loan and investment portfolio software for servicing, monitoring and reporting;
  - Financial reporting for reporting to investors and other regulatory agencies; and,
  - Accounting software programs.

  For all the benefits that these various systems provide, there is no method to transfer this information into the SBIC web based platform, resulting in SBICs and their service providers being reduced to manual entry of data and the inherent loss of data integrity, inefficiencies and time delays in reporting, as well as associated additional compliance costs.

- SBA Should Re-Form Testing and User Interface Groups: The SBA has occassionaly sought industry input for the initial testing of electronic and web based system. However this appears this has been very inconsistent and often done too late in the process. It is critical that this be done on a regular basis to bring a broader pool of expertise into this process with feedback, both positive and negative, used to improve and streamline the SBIC web based platform.

- Issues with Editing of Form 1031 in SBIC Web Platform & Population of Form 468: SBICs are required to file a Form 1031 whenever a deal is completed. This form includes a significant amount of information about the deal. When the Form 468 is completed (annually and quarterly), the web-based system automatically populates the fields in Form 468 with information from the prior Form 1031s that have been filed. While this is helpful, unfortunately, if the Form 1031 is inaccurate, the information in the Form 468 is also inaccurate. A particular issue is the field that covers the "series" and "type" of financing is not able to be edited by users submitting the form. This results in SBICs having to delete the previously filed Form 1031, which can take up to a week to complete. The SBA should reform the system to allow an original Form 1031 to be amended on the web based system and for the internal database to be updated.

- Issues with Automatic Population of Forms: The SBIC web based system has a number of issues with the automatic population of various fields of Form 468. For example, interest income is required to be inputted on page 4p of Form 468. Once this information is inputted, it automatically populates a field on page 5p of Form 468. The problem is that the field on page 4p includes interest income that is received on an accrual basis, whereas the field on page 5p is in terms of cash flow. Due to the differences in where these numbers are produced, it is likely they may be different numbers. This is also a concern in regard to pre-populated numbers in connection with cash flow information. These numbers are perennially pre-populating inaccurately. The SBA should eliminate the pre-population of these fields in the SBA web based system.

- Reversion of Data in Editing Process: Once the entire Form 468 is completed, if any errors are found in the review process, changes or edits will have to be made to the form. Unfortunately, once some fields are changed or accessed (particularly those in the Portfolio Company section), the software then reverts back to the original populated numbers, requiring additional significant review and data entry to ensure the numbers are still accurate. Given the length of Form 468 (some SBICs may have 150 pages to complete), it is common that errors are discovered, resulting in SBICs having to re-review and re-complete the form multiple times. This current process creates significant delays in preparation, review and finalizing these reports. It also results in significant additional compliance costs in terms of payments to accountants and fund administrators. The SBA should take steps to resolve this issue in the web based system.

- Check Totals Page Should be Added to Form 468: It would be helpful for a "check totals" feature to be added to Form 468. This would help SBICs in terms of identifying where errors may have been made in completing the form where a balance sheet might not tie out accurately. This would be useful in ensuring accurate numbers are provided to the SBA.

- Suppress Annual Only Pages From Quarterly Form 468: The SBA should suppress annual only pages from the quarterly Form 468 on the web based system. These pages are not updated or required on a quarterly basis and create significant confusion for SBICs when they are still included in the required submission to SBA.

c) Capital Certificate Issues:

In addition to the SBIC web based reporting on SBA Form 468, we would like to take this opportunity to provide comments on the recently released and subsequently delayed launch of the mandated Capital Certificate application within the SBIC web based application.

The capital certificate submission process at SBA has been unchanged for several years and is used primarily to document the changes in Leverageable and Regulatory Capital. The most important use of this document is to provide updates of increases in Leverageable Capital during the drawdown of SBA leverage to finance SBIC portfolio companies. The "just in time" leverage process is a successful and crucial component to managing operations of an SBIC and we want to thank SBA for its continued efforts in working with the industry to keep this process working efficiently.

We are concerned however, that the established workflow and turn-around times by SBA will now change. Using an untested system with all of the inherent problems identified already on the Form 1031/468 reporting (i.e. manual entry, known and unknown functional problems, system outages) has us concerned that leverage access will become problematic. Interjecting SBA staff into the approval process (once data is uploaded) is interrupting and negatively impacting the work flow for both fund managers and SBA staff. Furthermore, SBIA members have experienced issues with the capital certificate system in that, after inputting the required information, the system produces inaccurate numbers to the SBA. These issues could lead to significant risks in terms of the timing and access to leverage. This is a problem that neither the SBA nor the SBICs drawing leverage wish to experience.

We strongly recommend that until the system is fully tested and both SBA and the industry are able to understand how this will affect the leverage process long-term, the SBA run dual processes for a period of 6 months. During this time frame, the current process of submission and review by SBA should continue for leverage processes while uploads into this new untested system are also completed and reviewed by SBA but not required for leverage draw approval. This will ensure a smooth transition for both the SBA and SBICs drawing down leverage and allow issues in the web based system to be ironed out before full implementation.

d) The Hourly Burden Indicated In The Proposed Changes Is Inaccurate

SBIA has received significant feedback from our members that the information on the "estimated time burden" for completing Forms 468 and 1031 are wildly inaccurate. The SBA should revise the "estimated time burden" as reported to OMB on these approved forms to more accurately reflect the amount of time and effort now required to prepare and finalize these reports. SBIA and our membership are happy to provide revised numbers reflecting the accuracy of the burden. The SBA has provided the following time estimates[1] for completion of these forms:

- Form 468: Estimated Annual Responses: 1,050
- Form 468: Estimated Annual Hour Burden: 26,700 hours
- Form 1031: Estimated Annual Responses: 2,800
- Form 1031: Estimated Annual Hour Burden: 560 hours

SBIA and our members believe the estimated annual hour burden to be much higher than indicated and SBA should change their estimates to reflect the true burden of completing these forms. Research conducted by SBIA and our members indicates that the annual hour burden to complete Form 468 may be underestimated from thirty to fifty percent, without including dealing with the technical difficulties experienced by users. These numbers represent a broad cross-section of the industry.

In conclusion, SBIA appreciates this opportunity to share our thoughts on the Proposed Change and stands willing to discuss our comments and any other ways in which the SBA and OMB can encourage capital formation and job creation in small, mid-size, and emerging businesses.

Sincerely,

Brett Palmer
President
Small Business Investor Alliance

[1] *See* Reporting and Recordkeeping Requirements under OMB Review (Form 468), 79 Fed. Reg. 17222 (March 27, 2014); *see also* Reporting and Recordkeeping Requirements under OMB Review (Form 1031), 79 Fed. Reg. 17221 (March 27, 2014).