Walker, Mike

From: Chloe Coniaris <cconiaris@advantagecap.com>
Sent: Friday, February 28, 2020 1:57 PM
To: Rules Coordinator
Cc: Michael Johnson; Talmadge Singer; Ryan Brennan; Tony Toups; Lopes Matthew; Jordan, Brian; Gomes Lisha
Subject: [EXTERNAL] Advantage Capital Comments: Proposed RI SBDF Rules
Attachments: Advantage Capital Comments to Proposed RI SBDF Rules1.pdf

Dear Mr. Walker,

On behalf of Advantage Capital, please accept our comments to the proposed Rhode Island Small Business Development Fund regulations. These comments are intended to supplement the oral testimony I provided to Commerce at the 2/18/20 public hearing.

We welcome the opportunity to discuss any of our comments by phone or in person with Commerce when convenient. If you have any further questions, please do not hesitate to reach out.

Thanks and have a great weekend.

Best,

Chloe Coniaris

ADVANTAGE
CAPITAL

Attn: Michael Walker
The Rhode Island Commerce Corporation
315 Iron Horse Way, Suite 101
Providence, Rhode Island 02908
rulescoordinator@commerceri.com

February 27, 2020

Re: Proposed Rules and Regulations for the Rhode Island Small Business Development Fund ("RISBDF Program") released February 7, 2020 (the "Proposed Rules")

Mr. Walker:

Please accept these written comments to the Proposed Rules on behalf of Advantage Capital that supplement the oral testimony provided by Chloe Coniaris at the 2/18/20 public hearing.

1. "Bond" requirement: As Ms. Coniaris mentioned in her testimony, the inclusion of Section 8.14 of the Proposed Rules and the requirement that an applicant obtain a surety bond or financial guarantee that would cover tax credit recapture for failing to achieve certain economic impacts deals a fatal blow to efforts to raise capital under the Rhode Island Program. Whether such a guarantee would even be available is questionable, and its cost would no doubt (either in premium or collateral) match the amount of credits awarded.

While the Corporation certainly should work to ensure that the state maintains every reasonable protection afforded to it by the legislation with respect to a program like this, it must do so within the confines of the authorizing legislation. The governing legislation explicitly authorizes and enables Commerce to claw back all or a portion of the tax credits associated with a small business development fund, if that fund (1) fails to invest 100% of its investment authority in qualified investments within three years, (2) fails to maintain that level of investing in eligible businesses until the end of the statutory compliance period, (3) makes a distribution or payment that drives its capital (qualified investments, cash and marketable securities) below 100% of its investment authority, (4) fails to make required investments in minority business enterprises or (5) invests in certain non-qualified businesses (Section 42-64.33-5(a)). This recapture is enforced on the taxpayer investor who uses the credits on its Rhode Island tax return. The state bears little to no risk of failing to recover any recaptured amount due to the nature of the ultimate users of these credits. Users will be large insurance companies that will continue to be subject to premium tax in Rhode Island. If credits are recaptured, they can be assessed a deficit payment liability, and normal tax collection processes and rules would be available to the state to recover the recaptured amount. **That said, if the Corporation were to require that a bond or guarantee be provided that secured payment in instances of recapture for reasons enumerated in the statute, we believe that could be acquired at a reasonable cost.**

What would result in an unreasonable cost and goes beyond the scope of the authorizing statute is the reduction or recapture of tax credits for the failure to produce certain economic impacts and the requirement of a bond or financial guarantee to cover any such reduction or recapture. The governing legislation directly deals with the failure to meet projected economic impacts in Section 42-64.33-5(f), pursuant to which the state becomes entitled to share in certain distributions from the small business development fund if the jobs actually created and retained by its qualified investments fall short of those projected in its application. The legislature understood the nature of projected results and chose to impose a sharing in distributions for any missed economic results as opposed to a credit reduction.

This makes complete sense given the inherent risky nature of the investments small business development funds are designed to make. The legislature chose not to devalue the very incentive it was creating by allowing it to be recaptured or reduced in cases where the job numbers were lower than originally projected. That would be shortsighted and self-defeating. A clear recapture penalty was included for those things that a small business development fund has control over, but in recognition of the risk it takes in investing in unaffiliated small businesses, the legislature did not impose recapture for impact reasons, as future economic impacts are largely beyond the direct control of the small business development fund. Fund managers have every incentive to pick good investments that will result in strong economic impact not only to avoid the distribution penalty provisions but also because it is usually the most financial successful companies and investment that produce the highest levels of job growth and revenue impact in a state.

We do think that the state has an interest in ensuring that small business development funds live up to their requirements to make any sharing distributions with the state, whether pursuant to Section 42-64.33-5(f) or (g), and to that end, would agree that a bond or guarantee backing up those obligations could be appropriate. Our suggestion would be that the bond or guarantee that is required by the Proposed Rules be limited to (i) any amounts payable under Section 8.17 of the Proposed Rules and (ii) any tax credits recaptured pursuant to Section 42-64-33.5 of the Act, payment for which is not recovered from the taxpayer that actually took the credits on a Rhode Island return.

2. Section 8.5(16)(d) – Definition of "eligible business"

Item (d) of this definition is an expansion of the statutory version of the same definition. While that in itself may be beyond the power of the rulemaking process, we would like to point out that item (d) imposes an ongoing standard versus the definition itself which is intended (both statutorily and in the regulations) to be tested "at the time of Initial Qualified Investment...." This tension is inherent in many similar economic development programs. The federal New Markets Tax Credit (NMTC) Program, for instance, solves this by setting the standard at a "reasonable expectation." If, at the time of its investment, the investor has a reasonable expectation that the business in question will remain in a low-income community (NMTC standard), the investment is qualified and remains qualified. This allows the investor to have confidence that its investment

will count for regulatory purposes even if for unforeseen reasons beyond the investor's control, the business fails to maintain compliance.

Proposal: Change item (d) to read: "the Small Business Development Fund has a reasonable expectation that the eligible business will maintain its Principal Business Operations in the State during the term of the Qualified Investment to such business; and"

3. Section 8.5(32) and (33) – Definitions of "referral letter" and "refusal letter"

The requirement that such letters be signed by the Chief Executive Officer of the Depository Institution is unreasonable. This provision creates a standard that, in all but the smallest banks, is impossible to meet. For instance, the signature of Jamie Dimon, CEO of JPMorgan Chase, would be required for a turn down letter from a business that banks with Chase in Rhode Island. These definitions and requirements are outside the scope of the statute. Though the intention is reasonable, requiring a small business to obtain a letter signed by the CEO of a bank is unlikely, as banks tend to avoid letters of this nature for liability reasons. If a letter is ultimately required as set forth in this regulation, we submit that a letter signed by an authorized lending officer should satisfy the policy goal.

Proposal: Change each definition to read an "authorized lending officer" rather than "Chief Executive Officer."

4. Sections 8.5(36)(c), (d) and (e) – Definition of "revenue impact assessment"

The proviso in item (c) of this definition excludes certain instances when an eligible business can receive credit for Jobs Retained. Similarly, items (d) and (e) exclude instances related to financing construction and real estate acquisition when an eligible business can receive credit for Jobs Created and Jobs Retained. Inclusion of these provisions in the revenue impact assessment ("RIA") definition is awkward because the RIA is forward-looking and a projection in nature. **It seems more appropriate to include these provisions within the definitions of "jobs created" and "jobs retained" as exclusions so that the RIA will be based upon assumptions that take these exclusions into account.** Otherwise, the RIA would be open to a level of individual deal scrutiny that is inappropriate for a model that is designed to project impacts from investments to be made over a 7-year period.

5. Section 8.6(f)-(g)- Irrevocable investor commitments at the time of application

Sections 8.6(f)-(g) require funds to submit with their applications a certificate that "all fundraising has been completed by the Applicant; it has irrevocable commitments and/or investments in place equal to its proposed total of all Capital Investments; the total amount of the capital investments and; a certificate from each Small Business Fund Investor confirming the irrevocable commitment or investment in the Applicant." The requirement that a fund must have completed fundraising at the time of application and have "irrevocable commitments and/or investments" is not included in the statute, goes beyond the scope of the statute and is an unnecessary impediment to fundraising by the fund applicants. The statute already provides that funds

approved by the state will have to raise all required capital within 60 days of being approved- failure to meet this deadline would result in the applicant forfeiting its certification, cause its investment authority to lapse and revert to Commerce to reissue to other applicants and require the applicant to reapply to Commerce for certification. This safeguard protects the state's interests and ensures that funds can successfully fundraise without unnecessary impediments. **We would propose that Sections 8.6 (f)-(g) be stricken from the proposed rules in its entirety.**

6. Section 8.7(10) – Criminal Background Check

The Proposed Rules require the applicant to provide a criminal background check for all executives and managers. **We believe that this should be a written consent of the executives and managers to a background check.** It is odd to require those to be checked to perform the check and appears counterintuitive to the intent behind including this provision.

7. Section 8.7(12) – 2020 Global Investment Performance Standards

We strongly object to the imposition of these standards to past funds. It seems highly unreasonable to limit participation in the program to funds that can demonstrate compliance (which itself would is extremely difficult to do) retroactively with a standard that did not go into effect until January 1, 2020. There is no requirement to comply with these standards, and many funds have not chosen to do so at this point. Requiring that any applicant that is certified as a Rhode Island Small Business Development agree to manage that specific fund in compliance with these standards is completely reasonable and one which we would gladly agree to meet.

Proposal: Change 8.7(A)(12) to read: "A signed commitment from an officer of the applicant that, if approved, the applicant will manage the Small Business Development Fund in compliance with the 2020 Global Investment Performance Standards published by the CFA Institute."

8. Section 8.10(D)- Board approval of fund's proposed investments

This section provides that "The Board may condition approval of an Application in its discretion including, but not limited to, requirements for the ongoing review and approval of proposed Qualified Investments for compliance with this Part." While we share the Board's interest in ensuring that funds are making investments in qualified businesses that meet the program's parameters, the addition of this provision is troubling as it may lead to undue political and bureaucratic influence and impact fund investment decisions. Specifically, public policymakers set parameters for private market investment in small businesses, and experienced small business investment firms (SBICs and RBICs) make informed decisions within those parameters as to where the private capital is invested. The provision that allows the Board – above and beyond Commerce – to dictate to the applicants who are authorized to invest capital and each investment throughout the life of the program is beyond the scope of the statute, allows government to pick winners and losers and invites undue political influence. Both the statute and Section 8.13 of the proposed rules already allow for Commerce to approve whether a small business in which a fund proposes to invest is a qualified business within 15 days from receiving

a fund's request for determination. This provision is included because investors often want reassurance if an investment is close to the line of not being qualified- it is not intended to be used for every investment decision. Once a request for approval is submitted to the administrating agency, the proposed investment opportunity has undergone significant underwriting. Any approval period longer than 15 days could severely jeopardize the ability of the small business development funds to move forward with the investment. We would propose that 8.10(D) be eliminated in its entirety or, provide that the Board and Commerce have 15 days from receiving the fund's request for determination to approve the fund's investment. Both changes protect the state and allow funds to have reassurance that proposed investments won't be subject to undue bureaucratic influence or jeopardized from a timing perspective.

Proposal: Strike 8.10(D) in its entirety or change 8.13(C) to read: "The Corporation and Commerce's Board of Directors not later than the fifteenth business day after the date of receipt of a complete Request for Determination, shall notify the Small Business Development Fund of their determination."

9. Sections 8.18(A)(6)-(7), (B)(6)-(7) and (C)(1)-(2) – Employee Information

These sections require a Small Business Development Fund to submit its payroll records and detailed personal information such as the residential address of its employees to the Corporation at initial investment and on an ongoing basis. We object to these reporting requirements as highly intrusive and better met with summary payroll and personnel information provided by the eligible businesses with the Corporation's right to review and audit such information when it believes necessary. Information of this type is some of the most private information that a business maintains with respect to its employees, and turning it over on this detailed level creates serious privacy concerns and potential liability (for the eligible business, the Small Business Development Fund and the state) that seem to outweigh the state's interest in verification. **Our suggestion would be to leave this to selective review and audit by the state and or verification by each business' independent accountant or payroll administrator.**

With these minor changes, we believe that the state can have an effective program running in short order that still allows for the full protections envisioned by the legislature, continues to hold funds to high standards that protect the taxpayer, and addresses Commerce's outstanding concerns. We have over 25 years of investment experience in small businesses around the country, know the investor market well and have a good sense of how a fund like this will operate. We continue to welcome any opportunities to apply this knowledge to potential language or solutions to these issues if that would be helpful to the Corporation. We share the same goals with the state: to drive business growth and jobs in the places that need it the most. We are committed to ensuring that the Rhode Island Small Business Development Fund is a success and hope to move forward in raising a fund and deploying patient, flexible growth capital into Rhode Island's small businesses and startups.

Sincerely,

Chloe Coniaris, Esq.
Advantage Capital