MEMORANDUM

TO: Jesse Saglio, President & COO
FROM: Scott Sawyer, Esq.
RE: Small Business Development Fund Rules and Regulations Public Hearing
DATE: February 21, 2020

As you are aware, the Rhode Island Commerce Corporation ("Corporation") is in the process of rulemaking pursuant to the Administrative Procedures Act relative to promulgation of rules and regulations ("Rules and Regulations") for a tax credit program under the Small Business Development Fund Act ("SBDF"). After posting a Public Notice of Proposed Rulemaking, the Corporation advertised a public hearing on February 7, 2020, and I presided over a public hearing held on February 18, 2020 at 4:30 p.m. at the office of the Corporation. Nine people attended the public hearing, and five of those nine people provided comment, which is summarized below.

1. Carling Dinkler, Enhanced Capital.

Carling Dinkler, a Vice President at Enhanced Capital ("EC"), noted EC and the Corporation's shared goal of supporting small businesses. Mr. Dinkler discussed EC's background in investing in small business, indicating that it has invested $3 billion through six hundred different projects or businesses in over thirty-five states during the past 20 years. He submitted a letter for consideration.

Mr. Dinkler discussed prior legacy capital formation programs and noted that the criticisms of older programs have been addressed in the SBDF. For instance, he stated, unlike the SBDF, earlier programs did not require job and revenue projections, mandate that all capital be invested, ensure that debt investments have certain minimum durations, ensure that fund managers put money into the fund, and ensure that one hundred percent of the capital is invested throughout the compliance term. He requested that the cost/benefit analysis conducted relative to the SBDF include the results from Connecticut's InvestCT program, which is similar to the SBDF and, according to the Connecticut's Department of Economic and Community Development ("CDECD"), has created 2,262 jobs and a a net positive effect on Connecticut's revenue.

Mr. Dinkler addressed the bonding requirement in the Rules and Regulations, claiming that it is not contemplated or required under the SBDF. According to the regulatory analysis, he stated, a bond is anticipated to cost between $193,500 and $967,000 per year per fund, which is a significant cost on the fund managers. He claimed that because funds must invest one hundred percent of their capital before tax credits can be issued, a bond is unnecessary. He also suggested that the amount of the bond should be the difference of tax credits claimed and the revenue impact associated with the investments.

Mr. Dinkler also commented on the requirement in the Rules and Regulations relative to referral and refusal letters from banks. He stated that under the Rules and Regulations, funds were precluded from issuing revolving lines of credit or other senior, secured debt unless the business receives a referral or refusal letter from a qualified bank that is signed under oath by the Chief

Executive Officer of the bank or an equivalent officer. This is difficult, he claimed, to get from larger banks, such as JP Morgan. He suggested that, alternatively, a simple letter from a bank or an affidavit from an applicant should be sufficient.

Mr. Dinkler also commented on the Rules and Regulation's requirement that a fund demonstrate compliance with the 2020 global investment performance standards ("GIPS"). This is not required under the SBDF, he claimed. He stated that EC is audited by Ernest and Young and has a detailed track record of impact investments, which have been made through EC's small business investment company, a federal licensure given by the Small Business Administration; its community development entity, which is a designation given by the United States Treasury; and through highly competitive federal new market tax credits. Mr. Dinkler noted that EC is also a registered investment advisor as licensed through the Securities and Exchange Commission. Mr. Dinkler noted that the Corporation's regulatory analysis states that GIPS compliance would take about an hour at $25 per hour. However, he claimed that EC has had conversations with third-party firms, who have confirmed that GIPS is not applicable to the investments that EC has previously made. He further claimed that non-GIPS compliance at the level dictated by the Rules and Regulations could cost upward of $30,000. He asked that the Corporation confirm that some investments are acceptable before EC were to incur such a high cost, and that the Corporation's cost/benefit analysis be updated to reflect these numbers.

Lastly, Mr. Dinkler address the certification process under the Rules and Regulations. He stated that the Corporation's ability to approve or deny certain qualified investments may affect the timeline that funds have to make their investments.

2. Chloe Coniaris – Advantage Capital.

Chloe Coniaris, an Associate at Advantage Capital ("AC"), described AC's twenty-eight year investment history in seven hundred seventy emerging small businesses, which cumulatively totaled $3.1 billion. She indicated that such investments have supported over 80,000 jobs and created over 60,000 jobs in over thirty states, including the District of Columbia.

Ms. Coniaris described the success of the InvestCT program, which the SBDF was modeled after, noting that AC's investment of $115.3 million in forty-three companies in that program enabled the creation of five hundred forty-four jobs and the retention of 1,404 jobs. AC's investment, she claimed, also attracted additional third-party capital in the amount of $198.2 million. She noted the CDECD's positive audit of the InvestCT program, the program's reauthorization, and the addition of certain safeguards in the InvestCT program, similar to those in the SBDF, which distinguish it from prior, unsuccessful, similar programs that AC did not participate in. Ms. Coniaris mentioned the Maine New Markets Tax Credit program, which enabled the creation of seven hundred seventy-three jobs and the retention of five hundred eighty jobs, and noted the Finance Authority of Maine's positive audit of the program in 2017, which found a positive fiscal impact of $15.8 million.

Ms. Coniaris noted the vetting process for the SBDF in the General Assembly, and noted AC's disagreement with two requirements of the Rules and Regulations—the bonding requirement, and the GIPS requirement—which, she asserted, were not contemplated in the SBDF.

After describing the bonding requirement, she claimed that the SBDF already provides protections to the State without a bond; namely, that the State has the ability to recoup tax credits if a fund fails to meet its positive economic impacts identified in the fund's application. In this regard, she claimed, the State bears little to no risk irrespective of a bond. She also stated that the subjective reasons for a recoupment of tax credits make it difficult to raise capital as investors will not—with certainty—be able to identify how the tax credits may be at risk of recapture or disallowance. Ms. Coniaris also noted that risk to the State is mitigated by the penalties that are already prescribed in the SBDF, regardless of a bond, if a fund fails to satisfy its job creation or retention goals. She stated that the bonding requirement is a regulatory overreach and will impede fund raising efforts, in addition to being cost-preventative as the cost of the bond will likely exceed the value of the incentives offered. She recommended that the bond amount be limited to any amounts payable under Section 8.17 of the Rules and Regulations and any tax credits recaptured pursuant to § 42-64-33.5 of the SBDF.

Ms. Coniaris claimed that the GIPS requirement in the Rules and Regulations is impractical because the SBDF already contains strong safeguards, such as the measurement of an applicant's investment track record of investments of at least $100 million in nonpublic companies. She stated that this ensures the expertise, experience, and depth of fundraising necessary to make prudent investment decisions. She noted AC's objection to the imposition of GIPS standards to the funds that made investments in the past because it is unreasonable to demonstrate compliance retroactively as the GIPS standards did not take effect until 2020. She indicated that it would be reasonable, however, to make GIPS standards applicable prospectively.

3. **Mackenzie Ledet – Stonehenge Capital.**

Mackenzie Ledet, a Director at Stonehenge Capital ("SC"), appeared on behalf of Stonehenge Capital, LLC, and noted SC's twenty year investment history in small businesses and SC's investment pillars of partnership, trust, and endurance. Ms. Ledet identified SC's headquarters in Baton Rouge, Louisiana, its offices in Columbus, Ohio and Dallas, Texas, and satellite locations in Connecticut, New York, Georgia, and Mississippi. She explained that since the SBDF's enactment, SC has submitted two applications for approval to the Corporation. She noted that SC was not a part of the legislative process that resulted in the enactment of the SBDF.

Ms. Ledet cited the SBDF, claiming that the Corporation could implement reasonable rules and regulations to carry out the intent of the SBDF; however, she stated, the Rules and Regulations are not reasonable and do not advance the intent and purpose of the SBDF. She stated that the Rules and Regulations unreasonably and unnecessarily expand the safeguards prescribed in the SBDF as set forth below.

First, Ms. Ledet claimed that the Rules and Regulations use of a positive economic impact as determined by a third party as a prerequisite to applying for the program contravenes the intent of the SBDF, which is to attract capital to places that it would not normally be invested. It also, she stated, is contrary to the language of the SBDF, which (1) imposes monetary penalties for failure to cause a positive economic impact that outweigh or offset the cost of any tax credit awarded; and (2) was modeled after the successful InvestCT program.

Second, Ms. Ledet stated that while the Rules and Regulations claim to set "appropriate" standards for which a tax credit program should be conducted, they neither disclose those standards nor indicate whether those standards are applicable to other tax credit programs.

Third, Ms. Ledet claimed that the Rules and Regulations, which claim to assure that tax credits can be reclaimed or recouped for failure to cause a positive economic impact, also contravene the SBDF's specific recapture provisions for failure to meet certain milestones based upon deployment and investment of capital. She stated that the Rules and Regulations unnecessarily expand those provisions of the SBDF by requiring a bond through which tax credits can be recouped, the cost of which could be up to $1 million, making the program useless. By way of example, Ms. Ledet stated that an investment of $20 million would yield a bond cost between $7 and $10 million. She asserted that this cost is not commercially reasonable, makes the program ineffective, and is not within the intent or the scope of the SBDF. The bond requirement, she explained, is in addition to other costs, such as closing, management, and transactional fees that cannot be accounted for because of the SBDF's requirement that one hundred percent of the capital must be invested in small business.

Fourth, Ms. Ledet stated that the SBDF already ensures that taxpayers' dollars are adequately safeguarded and prudently invested by virtue of the SBDF's claw back and recoupment provisions and penalties for failure of a fund to achieve certain milestones. Any additional requirements, she claimed, would be contrary to the provisions of the SBDF.

Lastly, Ms. Ledet described the private sector's need for certainty to raise capital and prudently invest those funds. This certainty, she claimed, is vitiated by the subjective review of the Board of Directors of the Corporation in approving or denying certain applications or investments. She stated that this is also a contravention of the SBDF's intent.

4. **Karl Wadensten – Vibco Vibrators.**

Karl Wadensten, President of Vibco Vibrators ("VV"), identified VV's global offices in the State, Toronto, the United Kingdom, and Australia, which service about 360,000 customers internationally. He described his research on programs similar to the SBDF in other states, and concluded that these programs served a specific need many years ago regarding access to capital and growth of employment. However, recently, he stated, these programs have performed in a lackluster manner. He noted that there are other more effective programs that address access to capital needs. He opined that these programs only serve well-connected businesses and do not adequately address the needs of a State. He commended the Corporation for creating the Rules and Regulations, which ensure that the State's funds are invested in the way intended.

Mr. Wadensten expressed his concerns that the complexity of the SBDF will lead to a lack of transparency; transparency, he stated, is born through simplicity. He stated that generally when a program like the SBDF is first enacted without any safeguards, there will be a non-favorable outcome.

Mr. Wadensten noted that the Corporation's other tax credit programs are premised upon awarding tax credits upon the fulfillment of a promise of performance, such as job creation. He

stated that in his experience, claw backs of incentives are never effective and that any award of tax credits should only be made after performance. He also expressed concerns about the cost of job creation and job retention. He noted a lack of any explanation of any prior speaker as to the national average expenditure to create or retain jobs, which he deems a high cost. He also noted the complexity in determining job retention, which, in his experience, is difficult to monitor. He commended the Corporation for creating milestones for a participant in the SBDF in this regard.

Mr. Wadensten further expressed concern that due to the amount of money at stake, the investors in a fund, such as large insurance companies, are more focused on returns for their investors rather than job creation or investment in small businesses. He noted that Commerce was created to be held accountable for the expenditure of taxpayers' dollars and to do so in a transparent way. One way to accomplish this, he stated, is the bond requirement set forth in the Rules and Regulations.

Lastly, Mr. Wadensten expressed concern about the amount of fees that a fund may charge a small business. In his experience, he stated, the funds charge high, variable rates and fees. He stated that if such fees were endorsed by the State, the small businesses in the State would suffer.

5. **Alan Krinsky – Economic Progress Institute.**

Alan Krinsky, a Senior Policy Analyst at the Economic Progress Institute, noted that the SBDF is pitched as a method of supporting small businesses; however, three decades of experience with "cap co" programs show that they are unsuccessful. These programs, he stated, are all generally the same and remain unchanged on how they function; they are the result of three main companies lobbying for the implementation of these programs in different states and generally have few safeguards, pose little risk to the funds, and cost taxpayers money.

Mr. Krinsky stated that economic development is typically seen as investing money in small businesses; however, that is not how a program like the SBDF works. The applicants, he explained, are not small businesses, but instead funds that raise money through large companies, like insurance companies, to loan to small businesses. He further explained that generally, the funds only loan money to stable, risk-averse business. He noted that performance goals in these programs are typically minimal, and a fund usually promises minimal job creation without any risk of any claw back of recapture of the tax credits. He also stated that the leverage ratio of investing $42 million in tax credits to create $65 million in investment is poor.

Mr. Krinsky described other states' implementation of similar programs, such as Maine, New York, and Alabama, without any success. In Maine, he stated, the state invested $16 million into a similar program, which resulted in a company—which was identified for investment by a fund—closing, causing about two hundred employees to lose their jobs. He also noted that in 2018, New York's Division of Taxation and Finance reported that $400 million in incentives created an investment of $324 million; however, that investment created only one hundred eighty-eight jobs—a cost of over $1 million per job created. He also stated that in 2017, Alabama reported on a similar program and gave that program an "overall grade" of "D."

In closing, Mr. Krinsky stated that he believed that the SBDF is a bad tax credit program for the State, and that the State's taxpayers were better off without the program. He explained that although the Corporation was bound to enact the program pursuant to the SBDF, the Rules and Regulations appear to require great detail on how a program like the SBDF can meet the goals of economic development through discretionary authority to approve or deny certain applications or investments.