Guidelines for State Small Business Credit Initiative
(Date: October 21, 2011)

I. Overview

On September 27, 2010, President Obama signed into law the Small Business Jobs Act of 2010 (the "Act") to help increase credit availability for small businesses. The Act created the State Small Business Credit Initiative (SSBCI) and appropriated $1.5 billion to be used by the U.S. Department of the Treasury ("Treasury") to provide direct support to states for use in programs designed to increase access to credit for small businesses. Pursuant to the Act, Treasury allocated funds to all fifty states along with the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of Northern Mariana Islands, Guam, American Samoa, and the United States Virgin Islands according to a statutory formula that takes into account a state's job losses in proportion to the aggregate job losses of all states. Under the Act, each state or territory was guaranteed a minimum allocation of 0.9 percent of the $1.5 billion.

II. Eligible Programs

The SSBCI provides funding for two state program categories: capital access programs ("CAPs") and other credit support programs ("OCSPs").

CAPs provide portfolio insurance for business loans based on a separate loan loss reserve fund for each participating financial institution. The reserve fund will be used to provide portfolio insurance for all loans enrolled in the CAP by participating financial institutions. To enroll a loan in the CAP, both the lender and the borrower of the loan make insurance premium payments to the reserve fund. The state also must make a payment to the reserve fund for each loan to match the insurance premium. Under the Act, states may use the federal funds allocated to them under the Act to make their matching contributions to the reserve fund. Under the Act, for a loan to be eligible for enrollment in the CAP, the borrower must have 500 employees (as defined in 13 C.F.R. Part 121.106) or less and the loan cannot exceed $5 million.

OCSPs include collateral support programs, loan participation programs, state-sponsored venture capital programs, loan guarantee programs or similar programs.[1] Under the Act, OCSPs must target an average borrower or investee size of 500 employees (as defined in 13 CFR Part 121.106) or less and cannot extend credit support to borrowers with more than 750

[1] Collateral support programs help viable businesses that are struggling to get credit because the value of the collateral they hold has fallen, possibly due to the decline in commercial real estate values. These programs – which set aside funds to augment collateral the borrower already holds – provide banks greater confidence in extending credit to these borrowers, particularly in some of the communities hardest hit by the economic downturn. Loan participation programs entail risk sharing among financial institution lenders and the participating state**.** State-sponsored venture capital programs typically entail joint public-private investment programs focused on "seeding" small businesses with high-growth-potential.

employees. The OCSP must target loans or investments with an average principal amount of $5 million or less and cannot extend credit for loans with principal amounts in excess of $20 million nor participate in an investment in which the resulting equity instrument is in excess of $20 million.

OCSPs also include qualifying loan or swap funding facilities, which are contractual arrangements between a participating state and a private financial entity. Under such facilities, the state delivers funds to the private financial entity as collateral; that entity, in turn, provides funding to the state. The full amount resulting from the arrangement, less any fees or other costs of the arrangement, is contributed to, or for the account of, an approved state program.

III. Allocations

Each state that is approved for participation in the SSBCI will receive its allocation of funds in three disbursements as follows: 33 percent, 33 percent and 34 percent. As a precondition to receipt of the second and third disbursements, the state must, among other things, certify to Treasury that it has expended, transferred or obligated 80 percent or more of the last-disbursed one-third disbursement of allocated funds to or for the account of one or more approved state programs. The certification must be signed by an official of the state with oversight responsibility for the approved state program(s).

The requirement that the federal funds be disbursed in three increments, and the related certification requirement, will not apply with respect to federal funds used for a qualifying loan or swap funding facility.

IV. Approving States for Participation

Before a state's program is approved for participation in the SSBCI, the applicant must demonstrate that all actions required under state law have been taken to delegate administrative responsibility for the program to a specific department, agency or political subdivision of the state. The term "agency" includes state government corporations and other instrumentalities of the state. The applicant will be required to submit a short narrative statement from the governor of the state, or chief executive of the territory, describing such actions and attach any relevant documentation in support of that statement. The narrative statement will need to be signed by the governor of the state or chief executive of the territory and an official of the state with oversight responsibility for the state program(s) for which federal funds are being requested.

V. Municipalities

The Act provides municipalities of a state special permission to apply directly for funding under the SSBCI if: (1) that state did not file a notice of intent by November 26, 2010; or (2) that state filed a notice of intent by November 26, 2010, but does not submit a complete application for approval of a state program by close of business on June 27, 2011. For municipalities in states that did not submit a timely notice of intent to participate, Treasury will begin accepting applications at the same time as states. Municipalities in states that do not submit a timely application must submit their applications no later than close of business on September 27, 2011, pursuant to the Act. The same approval criteria and program requirements that are applicable to a state will generally apply to each municipality that is granted special permission.

VI. Approving State CAPs

a. *Federal Contribution* -- Under the Act, approved CAPs are eligible for federal contributions to their reserve fund in an amount equal to the amount of the insurance premiums paid by the borrower and the financial institution lender to the reserve fund as calculated on a loan-by-loan basis. A participating state may use the federal contribution to make its contribution to the reserve fund. Accordingly, the federal contribution may be used to match the borrower/lender contribution at a level of 1:1. The state may supplement the federal contribution with state and/or private funds if it chooses.

b. *CAP Program Requirements*

i. Experience and Capacity – Each state should exercise due care to determine that financial institutions participating in the SSBCI possess sufficient commercial lending experience, financial and managerial capacity, and operational skills to meet the objectives as set forth in the Act. Each state shall apply the same standards for participation in the SSBCI program to all classes of lenders. As required by the Act, states shall consult with the appropriate federal banking agency or, as appropriate, the Community Development Financial Institution Fund. The following documents and certifications may be used by states to determine adequacy of financial and managerial capacity for all classes of private lenders:

TYPE OF INSTITUTION	***RATINGS AND REGULATORY REPORTS***	***PERFORMANCE REPORTS***	***SELF-CERTIFICATION***
Banks (including CDFI banks)		• *Uniform Banking Performance Report (UBPR) showing that commercial loans and leases comprise a significant part of the institution's assets.* • *A UBPR peer group analysis showing that the institution's percentage of non-current loans and*	*Self-certification that the financial institution is not operating under any supervisory enforcement action.*

		leases does not exceed its peer group average (UBPR reports may be obtained for any bank online on the public website www.ffiec.gov/UBPR.htm for no charge.)	
Credit Unions (including CDFI Credit Unions)		• *Financial Performance Reports (FPRs) from the NCUA.*	*Self-certification that the institution is not operating under any supervisory enforcement action.*
Community Development Financial Institutions (excluding banks and credit unions)	• *A review of the CDFI's CARS ratings.*	• *Annual Report with audited financial statements.*	

ii. Lender Capital at Risk – For any loan enrolled in a CAP, the state shall require the financial institution lender to have a meaningful amount of its own capital at risk in the loan. Consistent with OMB Circular No. A-129, "Policies for Federal Credit Programs and Non-Tax Receivables," CAP programs in which private lenders bear 20 percent or more of the loss from a default will satisfy this requirement. States with CAP programs for which the state government bears more than 80 percent of any loss must articulate in the application exceptional circumstances as to why the private sector is unable to bear a greater share of the risk.

iii. Loan Purpose Requirements and Prohibitions – As required by Section 3005(e)(7) of the Act, for each loan enrolled in a state CAP, the participating state shall 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.

Each financial institution lender must obtain an assurance from the borrower affirming:

1. The loan proceeds must be used for a "business purpose." A business purpose includes, but is not limited to, start up costs, working capital, business procurement, franchise fees, equipment, inventory, as well as the purchase, construction

renovation or tenant improvements of an eligible place of business that is not for passive real estate investment purposes. The definition of business purpose excludes activities that relate to acquiring or holding passive investments such as commercial real estate ownership, the purchase of securities; and lobbying activities as defined in Section 3 (7) of the Lobbying Disclosure Act of 1995, P.L. 104-65, as amended.

2. The loan proceeds will not be used to:
    a. repay a delinquent federal or state income taxes unless the borrower has a payment plan in place with the relevant taxing authority; or

    b. repay taxes held in trust or escrow, e.g. payroll or sales taxes; or

    c. reimburse funds owed to any owner, including any equity injection or injection of capital for the business' continuance; or

    d. purchase any portion of the ownership interest of any owner of the business.

3. The borrower is not:
    a. an executive officer, director, or principal shareholder of the financial institution lender; or

    b. a member of the immediate family of an executive officer, director, or principal shareholder of the financial institution lenders; or

    c. a related interest of an such executive officer, director, principal shareholder, or member of the immediate family.

For the purposes of these three borrower restrictions, the terms "executive officer", "director", "principal shareholder", "immediate family", and "related interest" refer to the same relationship to a financial institution lender as the relationship described in part 215 of title 12 of the Code of Federal Regulations, or any successor to such part.

4. The borrower[2] is not:
    a. a business engaged in speculative activities that develop profits from fluctuations in price rather than through normal course of trade, such as wildcatting for oil and dealing in commodities futures, unless those activities are incidental to the regular activities of the business and part of a legitimate risk management strategy to guard against price fluctuations related to the

[2] Note: Permissible borrowers include state-designated charitable, religious, or other non-profit or eleemosynary institutions, government-owned corporations, consumer and marketing cooperatives, and faith-based organizations provided the loan is for a "business purpose" as defined above.

regular activities of the business; or

b. a business that earns more than half of its annual net revenue from lending activities; unless the business is a non-bank or non-bank holding company certified as a Community Development Financial Institution; or

c. a business engaged in pyramid sales, where a participant's primary incentive is based on the sales made by an ever-increasing number of participants; or

d. a business engaged in activities that are prohibited by federal law or applicable law in the jurisdiction where the business is located or conducted. (Included in these activities is the production, servicing, or distribution of otherwise legal products that are to be used in connection with an illegal activity, such as selling drug paraphernalia or operating a motel that knowingly permits illegal prostitution); or

e. a business engaged in gambling enterprises, unless the business earns less than 33% of its annual net revenue from lottery sales.

5. No principal of the borrowing entity has been convicted of a sex offense against a minor (as such terms are defined in section 111 of the Sex Offender Registration and Notification Act (42 U.S.C. 16911)). For the purposes of this certification, "principal" is defined as "if a sole proprietorship, the proprietor; if a partnership, each managing partner and each partner who is a natural person and holds a 20% or more ownership interest in the partnership; and if a corporation, limited liability company, association or a development company, each director, each of the five most highly compensated executives or officers of the entity, and each natural person who is a direct or indirect holder of 20% or more of the ownership stock or stock equivalent of the entity."

Each participating state must obtain an assurance from the financial institution lender affirming:

1. The loan has not been made in order to place under the protection of the approved state CAP prior debt that is not covered under the approved state CAP and that is or was owed by the borrower to the financial institution lender or to an affiliate of the financial institution lender.

2. The loan is not a refinancing of a loan previously made to that borrower by the financial institution lender or an affiliate of the financial institution lender.

No principal of the financial institution lender has been convicted of a sex offense against a minor (as such terms are defined in section 111 of the Sex Offender Registration and Notification Act (42 U.S.C. 16911)). For the purposes of this certification, "principal" is defined as "if a sole proprietorship, the proprietor; if a partnership, each partner; if a corporation, limited liability company, association or a development company, each director, each of the five most highly compensated executives, officers, or employees of the entity, and each direct or indirect holder of 20% or more of the ownership stock or stock equivalent of the entity."

iv. Relationship to Small Business Administration (SBA) Lending Programs - Under the SSBCI Program, eligible state CAPs may not enroll the unguaranteed portions of SBA-guaranteed loans without the express, prior written consent of the Treasury.

v. Capital Access in Underserved Communities - The Act requires that each application contain a report detailing how the state plans to use the federal contributions to the reserve fund to help provide access to capital for small businesses in low- and moderate-income, minority, and other underserved communities, including women- and minority-owned small businesses. The design of each state's strategy is left to its discretion. While there is no one single approach to what should be in a state's plan, the plans should be sufficient to allow Treasury to evaluate whether the plan is substantive and relevant to local market conditions. The state's plan should include a method for the state to monitor the status of its plans. Treasury will provide further commentary and examples of strategies proposed by states on www.treasury.gov/ssbci.

VII. Approving OCSPs

a. *10:1 Leveraging*

Under the Act, for OCSPs to be eligible for federal funding, a state must demonstrate a "reasonable expectation" that, when considered with all other all approved state programs under the SSBCI, such programs together have the ability to use federal contributions to such programs to generate small business lending at least 10 times the new federal contribution amount.

Treasury refers to this ratio of small business lending to the federal contribution amount as the private leverage ratio. Treasury defines the "private leverage ratio" as the " private financing" caused by and resulting from the SSBCI investment, divided by the "SSBCI funds used". "Private financing" means private financing across all approved state programs and includes all loans or investments from a private source to an eligible borrower or eligible portfolio company, whether occurring at or subsequent to loan/investment closing (subject to the provisions of Annex 7 of the Allocation Agreement), and whether funded or unfunded. It encompasses equity investments, written commitments of future equity investments, term loans, lines of credit, and any new infusions of cash by the borrower.

"SSBCI funds used" are those SSBCI funds that have been (a) deposited with a lender to cover the SSBCI contributions to a CAP reserve fund, (b) disbursed or committed to a specific borrower as part of a loan participation, collateral support, or direct lending program, (c) set aside to cover obligations arising from individual loan guarantees, loan participations, or collateral support agreements to specific borrowers, or (d) invested or committed to be invested in specific businesses, pursuant to a venture capital investment. In the event that the sum of (a) plus (b) plus (c) plus (d) exceeds the participating state's original total allocation (because some of the funds invested have generated program income that has been added to allocated funds), the "SSBCI funds used" shall be the participating state's requested total allocation. SSBCI funds used are distinguishable from funds considered obligated, expended, or transferred.

The "private leverage ratio" can be calculated over three distinct time horizons, at the election of the state:

- First, the "private leverage ratio" may be calculated for a given calendar year. This calculation considers private financing attracted, and SSBCI funds used, only in the calendar year specified. When a state expects that it will be unable to achieve the expected 10:1 "private leverage ratio" by the end of the first annual reporting period following approval for SSBCI funding, the state may elect to provide a projected "private leverage ratio" for each calendar year, in addition to providing a projected "private leverage ratio" for the entire allocation time period, in order to demonstrate how the state will achieve the 10:1 "private leverage ratio" over the 6 years of the allocation time period.

- Second, the "private leverage ratio" may be calculated as a cumulative ratio to reflect all private financing attracted, and all SSBCI funds used, from the approval of SSBCI funding through a specified date, selected by the state. Treasury refers to this ratio as the "cumulative private leverage ratio," and this ratio is calculated each year for the annual report.

- Third, the "private leverage ratio" may be calculated as a cumulative ratio to reflect all private financing attracted, and all SSBCI funds used, from the approval of SSBCI funding through December 31, 2016, the period covered by the last annual report. Treasury refers to this ratio as the "allocation time period private leverage ratio." States should provide this projected "allocation time period private leverage ratio," along with the projected "private leverage ratios" for each calendar year of the allocation time period, if applicable, in their SSBCI application (Note: For the sake of simplicity, the examples provided below generally show the calculation of the overall "allocation time period private leverage ratio," but do not show how the "private leverage ratio" for each calendar year accumulates to this "allocation time period private leverage ratio. The annual ratios are; however, shown in the example for loan guarantee programs).

When a state proposes multiple programs for SSBCI funding, the state must present the "allocation time period private leverage ratio" as a weighted average that takes into account the amount of "private financing" attracted over the allocation time period and the amount of "SSBCI funds used" over the allocation time period. Although the 10:1 private leverage ratio requirement does not apply to states with CAPs only, states with OCPS and CAPs should include, the projected "allocation time period private leverage ratio" in the application, including the leverage expected to be achieved by any state CAPs proposed for SSBCI funding.

The following example demonstrates this weighted average calculation of a projected "allocation time period private leverage ratio":

	CAP	**OCSP - Loan guarantee**	**Total**
Private Financing	$100,000,000	$96,000,000	$196,000,000
SSBCI Funds Used	$4,000,000	$12,000,000	$16,000,000
Private Leverage Ratio	25:1	8:1	12.25:1

The remainder of this section provides additional information about some of the nuances involved in estimating the "allocation time period private leverage ratio" for specific types of SSBCI-eligible programs.

CAPs

In the context of CAP programs, Treasury defines the "allocation time period private leverage ratio" as the "private financing" disbursed or committed to businesses at the CAP loan closing (i.e. funds committed or disbursed by the financial institution enrolling the loan), from the time of allocation through December 31, 2016, divided by the participating state's total SSBCI contributions to CAP reserve funds from the time of allocation through December 31, 2016. States have the option of reporting borrower cash infusions at the time of closing plus any additional private financing that closes at the time of the CAP loan. As an example, if a CAP program enrolls just two loans with the characteristics shown below, the "allocation time period private leverage ratio" for the CAP program would be 30:1, which would be derived as follows:

	Loan A	**Loan B**	**Total**
SSBCI Contribution to Reserve Fund	$4,000	$6,000	$10,000

Private Financing	$100,000	$200,000	$300,000
Private Leverage Ratio	25:1	33.3:1	30:1

In its application, a state may estimate leverage for the CAP program as 1/(the average SSBCI contribution for each loan in percentage terms). For example, if the participating state anticipates that, on average, the total amount of the borrower and lender contribution for each loan will be 4 percent (and therefore the SSBCI contribution also must be 4 percent, since, under the Act, CAPs are eligible for federal contributions to their reserve fund "in an amount equal to" the amount of the insurance premium paid by the borrower and the financial institution lender), the expected private leverage will be 1/.04, or 25:1.

States that have active CAPs may rely on historical data. States that do not have active CAPs may present estimates based on historical data from other states' programs that are being used as models for new CAPs. States establishing new programs also will be required to provide detailed assumptions for their estimates of total enrolled loans, total loan amounts, and the estimated total federal contributions over the lifespan of the SSBCI-assisted program.

<u>State-Sponsored Venture Capital Programs</u>

In the context of state-sponsored venture capital programs, Treasury considers the following to constitute "private financing":

- Equity investments by private sector venture capital funds, seed capital funds, or angel investor networks disbursed or committed to the business as part of the same transaction at closing; plus

- Transaction-level debt from any private sector source disbursed or committed to the business at the closing of the investment using SSBCI funds; plus

- Subject to the provisions in Annex 7 of the Allocation Agreement, subsequent private sector equity or transaction-level debt investments in the businesses receiving SSBCI-supported investment and any borrower cash infusions, provided that these subsequent investments are caused by and resulting from the SSBCI investment. Annex 7 of the Allocation Agreement lays out the factors the state may consider in deciding whether subsequent private sector financing should be included in the private leverage calculation.

As an example, if a state-sponsored venture capital program expects to make 20 venture capital investments to businesses with the aggregate investment profile shown below, the resulting projected “allocation time period private leverage ratio” would be 10:1. This calculation would be derived as follows:

SSBCI Funds Used under the Participating State’s Venture Capital Program	$1,000,000
Other Private Equity Investment at Closing Of SSBCI-Supported Transaction	$3,000,000
Other Private Transaction-Level Debt at Closing Of SSBCI-Supported Transaction	$3,000,000
Subsequent Private Sector Investment[3]	$3,000,000
Total Private Financing	$10,000,000
Private Leverage Ratio	10:1

As with all OCSP programs, states should present a projected “allocation time period private leverage ratio” in their application based on the weighted average of leverage expected to be achieved by all of its OCSP programs, as well as any CAP program proposed for SSBCI funding.

Loan Participation Programs

In the context of loan participation programs, SSBCI considers the total private financing for the loans and any borrower cash infusions to constitute “total private financing”, and the aggregate federal portion of the loans to constitute the “SSBCI funds used”. Subject to the provisions in Annex 7 of the Allocation Agreement, subsequent private sector equity or transaction-level debt investments in the business receiving SSBCI-supported investment may count towards “private financing”, provided that these subsequent investments are caused by and resulting from the SSBCI investment. The following is an example of a private leverage calculation for a loan participation program:

SSBCI Funds Used (aggregate federal participation)	$20,000,000
Private Financing	$60,000,000

[3] Subsequent private sector investment must be caused or resulting from the SSBCI-supported transaction. See Annex 7 of the Allocation Agreement for further details.

Private Leverage Ratio	3:1

Treasury recognizes that loan participation programs will rarely achieve 10:1 leverage based only on the original loan participation. For this reason, states are allowed to demonstrate how the state will use the allocated funds, combined with funds from principal repayments and program income, to achieve the required 10:1 private leverage ratio by the end of the allocation period. In addition, as with all OCSP programs, states should present a projected "allocation time period private leverage ratio" in their application based on the weighted average of leverage expected to be achieved by all of its OCSP programs, as well as any CAP program proposed for SSBCI funding.

Loan Guarantees

In the context of loan guarantee programs, SSBCI considers the total loan originations and any borrower cash infusions to constitute "private financing", and the aggregate federal contributions to support guarantees to constitute the "SSBCI funds used". The following is an example of a projected "allocation time period private leverage ratio" for a loan guarantee program:

Total Loan Originations	$60,000,000
Amount Guaranteed (Assumes 50% Guarantee)	$30,000,000
SSBCI Funds Used To Support Guarantees	$6,000,000
Private Leverage Ratio	10:1

States that have credit guarantee programs in place may rely on historical data. States that plan to enact new programs may rely on data from other analogous state loan guarantee programs to provide a reasonable estimate of future leverage.

Treasury recognizes that state credit guarantee programs are often subject to state-imposed regulations requiring the program to set aside a specific amount of funds to cover the guarantee obligation. In some cases, these regulations make it difficult for the state to achieve the 10:1 leverage ratio in the early years of the program. (The example above assumes that loans are guaranteed for 50% of the principal amount and that the state must set aside 20% of the value of the guarantee in a cash reserve). When this occurs, the state can demonstrate how the state program will use the allocated funds, combined with funds newly available when loan guarantees expire or the underlying loans are repaid, as well as program income, to achieve the 10:1 private leverage ratio by December 31, 2016.

The following hypothetical example is provided for illustrative purposes only. The hypothetical assumes that a state is eligible for a $13 million allocation, and that the state intends to use all of these funds for a loan guarantee program:

Line		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
1	**New SSBCI funds used to support guarantees**	$2,000,000	$4,000,000	$4,000,000	$3,000,000	$0	$0
2	**SSBCI funds released due to loan repayments and SSBCI program income used to support guarantees**	$0	$500,000	$800,000	$1,500,000	$2,000,000	$2,500,000
3	***Total funds available to support guarantees* (line 1+ line 2)**	*$2,000,000*	*$4,500,000*	*$4,800,000*	*$4,500,000*	*$2,000,000*	*$2,500,000*
4	**Amount guaranteed (assumption: the state must set aside 25% of the amount guaranteed in cash reserves) (line 3/.25)**	$8,000,000	$18,000,000	$19,200,000	$18,000,000	$8,000,000	$10,000,000
5	**Loan originations (assumption: lenders require a 50% guarantee on average to enroll a loan in the program) (line 4/.5)**	$16,000,000	$36,000,000	$38,400,000	$36,000,000	$16,000,000	$20,000,000
6	**Cumulative loan originations (line 5 cumulative)**	$16,000,000	$52,000,000	$90,400,000	$126,400,000	$142,400,000	$162,400,000
7	**Cumulative SSBCI funds used (line 1 cumulative)**	$2,000,000	$6,000,000	$10,000,000	$13,000,000	$13,000,000	$13,000,000
8	**Private leverage ratio for the year (x:1) (line 5/line 1)**	8.00	9.00	9.60	12.00	undefined (denominator is zero)	undefined (denominator is zero)
9	**Cumulative leverage ratio to date (x:1) (line 6/line 7)**	**8.00**	**8.67**	**9.04**	**9.72**	**10.95**	**12.49**

As with all OCSP programs, states should present a projected "allocation time period private leverage ratio" in their application based on the weighted average of leverage expected to be achieved by all of its OCSP programs, as well as any CAP program proposed for SSBCI funding.

Collateral Support Programs

In the context of collateral support programs, Treasury considers the total loan originations and any borrower cash infusions to constitute "private financing", and the aggregate federal contributions to fund the state's collateral support obligations as the "SSBCI funds used". The following is an example of a private leverage calculation for a collateral support program:

Total Loan Originations	$50,000,000
SSBCI Funds Used (Collateral pledged by the state)	$25,000,000
Private Leverage Ratio	2:1

States that have collateral support programs in place may rely on historical data. States that plan to enact new programs may rely on data from other analogous state programs to provide a reasonable estimate of future leverage.

Treasury recognizes that many collateral support programs may not, by themselves, achieve the desired 10:1 private leverage ratio. When this occurs, states should demonstrate how the state program will use the SSBCI funds when combined with funds newly available when collateral support obligations expire or are repaid, as well as program income, contribute to the required 10:1 private leverage ratio by December 31, 2016. In addition, states should present a projected "allocation time period private leverage ratio" in their application based on the weighted average of leverage expected to be achieved by all of its OCSP programs, as well as any CAP program proposed for SSBCI funding.

b. *1:1 Leveraging* -- Section 3006(c) of the Act requires that each OCSP of a participating state, "demonstrate that, at a minimum, $1 of public investment by the state program will cause and result in $1 of new private credit." Participating states calculate their leveraging for purposes of demonstrating the statutorily required 1:1 private leverage ratio within an individual OCSP according to the following formula:

> Cumulative private leverage ratio = [total cumulative private financing generated by the individual approved state OCSP]/[SSBCI funds used by the individual approved state OCSP]

Unlike the 10:1 leveraging expectation described above, this 1:1 leveraging is an eligibility requirement. As a result, Treasury approves OCSPs with the expectation that the design of the program meets the 1:1 leveraging eligibility requirement.

c. *Lender and Investor Capital at Risk* – The state shall require financial institution lenders or investors that receive any form of credit support pursuant to an OCSP that is supported by the SSBCI to have "a meaningful amount of their own capital at risk" in the loan or other credit assistance. For the purposes of SSBCI, Treasury defines a "meaningful amount of their own capital at risk" to be consistent with OMB Circular No. A-129, "Policies for Federal Credit Programs and Non-Tax Receivables." This means that OCSPs in which private lenders or investors bear 20 percent or more of the loss from a default will satisfy the requirement. OCSPs for which the government (state and/or federal) bears more than 80 percent of any loss must articulate exceptional circumstances as to why the private sector is unable to bear a greater share of the risk. Treasury will consider any enhancements that Congress extends to the SBA Section 7(a) Loan Guarantee Program in which financial institution lenders may bear less than 20% of the risk as analogously applicable to OSCPs that are loan guarantees under SSBCI. Under such circumstances, an approved loan guarantee program under the SSBCI may allow financial institution lenders to bear the same amount of risk as similarly situated financial institution lenders under the SBA Section 7(a) Loan Guarantee Program. In addition, the state shall require venture capital funds and angel investor networks receiving SSBCI funds to have a "meaningful amount of its own capital resources at risk." OCSP venture capital or angel investor networks in which the fund or network making the investment decision in the eligible small business bears at least 20 percent of the risk of loss will satisfy this requirement. This requirement applies at the level of the fund that makes the investment in small business, not at the level of a "fund of funds."

d. *Loan or Investment Purpose* -- Consistent with Section 3006(f)(2) of the Act, Treasury may prescribe limitations and prohibitions on loan purposes or investment purposes. For each loan or investment resulting from an approved OCSP, the participating state shall require the financial institution lender or investor to obtain an assurance from each borrower or investee stating that the loan or investment proceeds will not be used for an impermissible purpose under the SSBCI Program.

Each financial institution lender or investor must obtain an assurance from the borrower or investee affirming:

1. The loan or investment proceeds must be used for a "business purpose." A business purpose includes, but is not limited to, start up costs, working capital, business procurement, franchise fees, equipment, inventory, as well as the purchase, construction renovation or tenant improvements of an eligible place of business that is not for passive real estate investment purposes. The definition of business

purpose excludes acquiring or holding passive investments such as commercial real estate ownership, or the purchase of securities; and lobbying activities (as defined in Section 3 (7) of the Lobbying Disclosure Act of 1995, P.L. 104-65, as amended).

2. The loan or investment proceeds will not be used to:

    a. repay a delinquent federal or state income taxes unless the borrower has a payment plan in place with the relevant taxing authority; or

    b. repay taxes held in trust or escrow, e.g. payroll or sales taxes; or

    c. reimburse funds owed to any owner, including any equity injection or injection of capital for the business' continuance; or

    d. purchase any portion of the ownership interest of any owner of the business.

3. The borrower or investee is not:
    a. an executive officer, director, or principal shareholder of the financial institution lender or investor; or

    b. a member of the immediate family of an executive officer, director, or principal shareholder of the financial institution lender or investor; or

    c. a related interest of an such executive officer, director, principal shareholder, or member of the immediate family.

For the purposes of these three borrower restrictions, the terms "executive officer", "director", "principal shareholder", "immediate family", and "related interest" refer to the same relationship to a financial institution lender or investor as the relationship described in part 215 of title 12 of the Code of Federal Regulations, or any successor to such part.

4. The borrower or investee[4] is not:

    a. a business engaged in speculative activities that develop profits from fluctuations in price rather than through normal course of trade, such as wildcatting for oil and dealing in commodities futures, unless those activities are incidental to the regular activities of the business and part of a legitimate risk management strategy to guard against price fluctuations related to the

[4] Note: Permissible borrowers or investees include state-designated charitable, religious, or other non-profit or eleemosynary institutions, government-owned corporations, consumer and marketing cooperatives, and faith-based organizations provided the loan is for a "business purpose" as defined above.

regular activities of the business; or

b. a business that earns more than half of its annual net revenue from lending activities; unless the business is a non-bank or non-bank holding company Community Development Financial Institution; or

c. a business engaged in pyramid sales, where a participant's primary incentive is based on the sales made by an ever-increasing number of participants; or

d. a business engaged in activities that are prohibited by federal law or applicable law in the jurisdiction where the business is located or conducted. (Included in these activities is the production, servicing, or distribution of otherwise legal products that are to be used in connection with an illegal activity, such as selling drug paraphernalia or operating a motel that knowingly permits illegal prostitution); or

e. a business engaged in gambling enterprises, unless the business earns less than 33% of its annual net revenue from lottery sales.

5. No principal of the borrowing entity or investee has been convicted of a sex offense against a minor (as such terms are defined in section 111 of the Sex Offender Registration and Notification Act (42 U.S.C. 16911)). For the purposes of this certification, “principal” is defined as “if a sole proprietorship, the proprietor; if a partnership, each partner; if a corporation, limited liability company, association or a development company, each director, each of the five most highly compensated executives, officers, or employees of the entity, and each direct or indirect holder of 20% or more of the ownership stock or stock equivalent of the entity.”

Each participating state must obtain an assurance from the financial institution lender or investor affirming:

1. The loan has not been made in order to place under the protection of the approved State OCSP prior debt or investment that is not covered under the approved OCSP and that is or was owed by the borrower or investee to the financial institution lender or investor or to an affiliate of the financial institution lender or investor.

2. The loan or investment is not a refinancing of a loan or investment previously made to that borrower or investee by the financial institution lender or investor or an affiliate of the financial institution lender or investor.

3. No principal of the financial institution lender or investor has been convicted of a sex offense against a minor (as such terms are defined in section 111 of the Sex Offender

Registration and Notification Act (42 U.S.C. 16911)). For the purposes of this certification, "principal" is defined as "if a sole proprietorship, the proprietor; if a partnership, each partner; if a corporation, limited liability company, association or a development company, each director, each of the five most highly compensated executives, officers, or employees of the entity, and each direct or indirect holder of 20% or more of the ownership stock or stock equivalent of the entity."

e. *Relationship to SBA Lending Programs* --Under the SSBCI, eligible state OCSPs may not enroll the unguaranteed portions of SBA-guaranteed loans without the express, prior written consent of Treasury.

f. *Capital Access in Underserved Communities* - The Act mandates that the Secretary of the Treasury consider the same eligibility criteria for OCSPs as for CAPs to the extent the Secretary determines applicable and appropriate. Accordingly, a state's application for an OCSP must contain a report detailing how the state plans to use the federal contributions to the approved program to help provide access to capital for small businesses in low- and moderate-income, minority, and other underserved communities, including women- and minority-owned small businesses. While there is no one single approach to what should be in a state's plan, the plans should be sufficient to allow Treasury to evaluate whether the plan is substantive and relevant to local market conditions. The state's plan should include a method for the state to monitor the status of its plans. Treasury will provide further commentary and examples of strategies proposed by states on www.treasury.gov/ssbci.

VIII. Additional Considerations for Approving OCSPs

The following metrics are intended to guide states in demonstrating that an OCSP meets reasonable standards of public benefit, sound program design, operational and managerial capacity and financial integrity.

a. In describing the anticipated benefits to the state, its businesses, and its residents to be derived from the federal contributions, applicants should focus on, but not limit their discussion to, the following measures. Estimates may cover the anticipated allocation time period.

1. The projected permanent, full-time workers hired by small business borrowers as a result of receiving SSBCI supported small business loans and investments through the OCSP.

2. The projected number and amount of SSBCI supported small business loans and/or investments closed through the OCSP, including all forms of financing funded,

guaranteed or insured by OCSPs including leases, credit lines and investments.

3. The projected increases in state or local sales, income or other tax revenues resulting from SSBCI supported small business loans and/or investments through the OCSP. These estimates may include taxes paid by both permanent and temporary workers hired as a result of SSBCI support small business loans through the OCSP.

b. The operational capacity, skills, and experience of the management team of the state or OCSP can be demonstrated by any or all of the following metrics:

1. Qualifications and experience of senior management. The OCSP's senior management may include people who have significant credit underwriting or risk management experience with private credit institutions such as banks, commercial finance companies, rating agencies, or insurance companies.

2. Experience of senior management in operating public credit support or capital access programs. The OCSP may demonstrate that it employs personnel with underwriting or credit risk management experience in federal, state, or local small business credit programs (e.g., SBA or state development finance authorities).

3. Adoption of industry best practices. The OCSP may demonstrate that as an organization, it employs industry best practices, such as those listed in Section XI. The adoption of best practices helps to demonstrate the industry knowledge and sophistication of the OCSP management.

c. The capacity of the OCSP to manage increases in the volume of its small business lending or investing can be demonstrated through:

1. Financial strength. An applicant must demonstrate that it possesses adequate financial resources to support the staffing increases and "infrastructure" improvements needed to undertake a significantly increased number of financing transactions.

2. Operational capacity. An applicant must demonstrate that the OCSP has systems, policies and procedures in place to accommodate a significant increased transaction volume.

d. Reasonable assurances that the OCSP has internal accounting and administrative controls systems to guard against waste, loss, unauthorized use, or misappropriation can be demonstrated by the following:

1. Evidence that management conducts, or in the case of a new OCSP, intends to conduct, periodic internal audits.

2. A requirement for annual independent audits (including management letters).

e. The soundness of an OCSP's program design and implementation plan can be demonstrated by:

1. For both new and existing OCSPs, the adoption of established business models and strategies demonstrates soundness of program design. Adoption and use of well-proven approaches to managing the various risks associated with making, insuring or guaranteeing small business strategies and models can be construed as evidence of sound program design.

2. For an existing OCSP, the absence of material weakness or deficiency findings by external auditors demonstrates soundness of program design. Soundness of program design can also be shown through operating results. For example, a management letter citing no significant operational or financial weaknesses can be employed as evidence of appropriate program design.

IX. Reports

Participating states are required to submit the following reports to Treasury:

a. *Quarterly reports* --Within 30 days after the end of each quarterly reporting period), the state shall deliver to Treasury a quarterly report, which will describe the use of allocated funds for each approved state program on both a quarterly and a cumulative basis, 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.

b. *Annual reports* - By March 31 of each year, beginning March 31, 2012, the participating state shall submit to Treasury an annual report, for the prior calendar year ending December 31st. This annual report must contain transaction-level data for each loan or investment made with SSBCI funds for that year and must also provide information on subsequent private financing for OCSP loans and investments made in prior years when required by Annex 7 of the SSBCI Allocation Agreement . The annual report must also provide information on any qualifying loan or swap funding facility, if applicable.

c. *SF-425 Federal Financial Reports* – SF-425 Federal Financial Reports are to be submitted on an annual basis.

d. *Performance Results* - A summary of the performance results of the participating state's allocation, to be submitted with the participating state's final annual report.

X. Administrative Costs

The SSBCI is governed by the cost standards for state and local governments as proscribed in OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Government," (2 C.F.R. Part 225). The OMB circular contains criteria that must be used to establish chargeable costs (allowable, allocable, and reasonable), and specific information on allowable costs in various cost categories. Participating states will be required to report on their administrative costs on a quarterly basis pursuant to the allocation agreement.

XI. Implementation and Administration

Among its program management and implementation responsibilities, Treasury is required to establish standards for, provide technical assistance to and disseminate best practices to state programs. Knowledge of techniques and strategies applicants currently use in managing their insurance and guarantee programs will be helpful to Treasury in establishing national standards for CAPs and OCSPs, in organizing suitable technical assistance programs, and in recommending best practices designed to improve performance. Thus, Treasury encourages applicants to describe in the application whether and how the following "best practices" for managing credit risk have been explored, tested, or adopted.

a. *Risk-based pricing of loans or insurance premiums* - Setting loan interest rates and insurance premiums to reflect a potential borrower's probability of default is well-established practice for most lenders and insurers. State CAPs and OCSPs often use cash and high quality securities to collateralize guarantees and insurance contracts. Risk-based pricing can help ensure that insurance payments and reserve funds accurately reflect the credit risk of enrolled loan portfolios. Among other benefits, the rationalization of pricing can allay lender fears that changes in underwriting practices will not be adequately reflected in the amount of cash backing a program.

b. *Credit scoring* - Many lenders, both public and private, have employed credit scores—a statistically sound and empirically derived measure of creditworthiness—to standardize processes, control risk and reduce the cost of underwriting. In addition, credit scoring can serve as the common language providing a basis for performance monitoring across programs. For CAPs, using scores to determine the size of borrower/lender CAP premium payments will ensure that loan-loss reserve accounts are adequately funded. For OCSPs, credit scoring can be employed to determine how much capital—in trust accounts or reserve funds—needs to be set aside to cover each guaranteed loan.

c. *Financial modeling* - Shifting economic conditions or changes in lenders, borrowers and credit products can dramatically affect how enrolled loans perform. Financial modeling can help CAP and OCSPs evaluate their performance under various scenarios, including catastrophic increases in loan defaults. Knowledge gained through such "stress testing" can reveal the need for changes in the underwriting, pricing or management of credit risk.

d. *Risk-based capital adequacy standards* **-** Bank regulators require banks to hold capital based on the risk of their assets. For example, small business loans require more capital than Treasury securities. Similarly, under federal law, Congress must appropriate the present value of expected losses for SBA and other federal credit programs. For CAPs and OCSPs, establishing such standards can accurately align the amount of capital that an organization holds with the actual credit risk of enrolled loans. Once again, this can help make sure that programs are neither undercapitalized (and thus unable to meet their obligations) nor overcapitalized (thus unnecessarily limiting credit support capacity).

e. *Reinsurance or other credit risk transfers* - Commercial lenders and insurers can also manage credit risk by transferring it to third parties through reinsurance contracts and other credit risk transfer agreements. Reinsuring or transferring risk offers a major benefit because it allows a CAP or OCSP to increase its capacity without an increase in capitalization.

f. *Standardized reporting* - The collection of detailed transaction-level data allows credit grantors and guarantors to generate reports and analyses by which performance may be evaluated across segments of interest (i.e., geography, type of business, etc.). For CAPs and OCSPs, standardized reporting of transaction-level data will improve lender oversight (e.g., weaker lenders can be identified and assisted) and provide the basis for needed changes in underwriting, pricing, and managing risk.

XII. Limitation to New Extensions of Credit

Funds made available to states under the SSBCI will be permitted only for new extensions of credit or new investments. That is, funds made available to states pursuant to the SSBCI shall not be used to support existing extensions of credit or financing – including but not limited to prior loans, lines of credit or other borrowing –that were previously made available as part of a state small business credit enhancement program.

XIII. Waiver Policy

Treasury reserves the right, at its discretion, to waive or modify any provision of these Policy Guidelines in any case or class of cases. Treasury may do so only with the prior approval of the Under Secretary for Domestic Finance or designated delegate for such purpose, if such action is not inconsistent with law and will not subject the United States to substantial expense or liability.