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Modified Volcker Rule Benefits SBICs

Fund managers operating under the **U.S. Small Business Administration's** Small Business Investment Company program expect to flourish under the **Obama Administration's** proposed "Volcker Rule."

The bullish outlook marks a sharp shift in sentiment. When President Obama first said in a Jan. 21 speech that he would seek to stop U.S. banks from investing in or sponsoring private equity funds, among other activities, the thought was that those institutions would have to retreat from their traditional roles as primary backers of SBIC vehicles.

But when the **U.S. Treasury Department** sent a more-detailed set of provisions to the **U.S. Congress** on March 3, it carved out exemptions for SBIC contributions and "investments designed primarily to promote the public welfare." Not only does that mean SBIC funds would be able to continue soliciting banks for capital, it means their offerings would be one of the only ways for U.S. financial institutions to gain exposure to private equity products. It could even spur the creation of new SBIC offerings.

Indeed, the Treasury draft would still ban banks from running or backing most private equity vehicles or hedge funds. It would also bar them from proprietary trading, and would impose market-share limits. "I think this language will be a boon for SBIC funds," said **Mark Kromkowski**, a partner at Chicago law firm **McGuireWoods**. "You will have [non-SBIC] fund managers set up the functional equivalent of SBIC sidecar funds solely for financial institutions to make investments in them."

The change reflects a lobbying push that followed Obama's speech. In the most high-profile of those efforts, **Patriot Capital** co-founder **Charles McCusker** testified at a joint hearing of the House Financial Services Committee and the House Small

Business Committee on Feb. 26 that the rule would choke off funding to small businesses.

McCusker added that the Treasury should encourage banks to invest in SBIC funds as a means of assuring financing for small businesses, given that the volume of direct loans available from financial institutions has fallen sharply amid the global financial crisis. The first step, he said, would be to clarify that existing legislation allows banks to claim Community Reinvestment Act credits when they invest in SBIC vehicles.

McCusker also set his sights on some of a \$30 billion chunk of the Treasury's Troubled Asset Relief Program that the Obama Administration has proposed to make available for small-business lending programs at community banks. "If just 3% of that were allocated to community banks to invest directly in SBICs, that capital can be leveraged by the SBA and in turn invested in companies providing long-term investment capital," he told the House committees.

SBIC advocates are additionally pushing for fund contributions to be exempt from capital-gains taxes, which would further boost their appeal for banks.

The Volcker Rule, named for White House advisor and former **Federal Reserve** chairman **Paul Volcker**, is being touted as a means of reducing risk in the financial system. However, Senate Banking Committee Chairman **Christopher Dodd** (D-Conn.) has signaled that he might push for a narrower version of the proposal to be incorporated into broader reforms already in development.

SBIC funds raise money from private-sector backers for investments in small businesses, then boost their buying power with SBA loans. ❖

