

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/SB 1130

SPONSOR: Banking and Insurance Committee and Senator Latvala

SUBJECT: Certified Capital Companies

DATE: March 19, 2001      REVISED: 3/21/01 \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Johnson</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Favorable/CS</u>
2.	<u>Maclure</u>	<u>Maclure</u>	<u>CM</u>	<u>Fav/3 amendments</u>
3.	_____	_____	<u>FT</u>	_____
4.	_____	_____	<u>AGG</u>	_____
5.	_____	_____	<u>AP</u>	_____
6.	_____	_____	_____	_____

## I. Summary:

This committee substitute would amend the Certified Capital Company Act, s. 288.99, F.S., and would expand the pool of tax credits available for investments by a certified capital company (CAPCO) in qualified businesses by creating a second program. The second program would provide \$250 million in insurance premium tax credits, not to exceed \$25 million annually. The committee substitute also provides the following changes to the Certified Capital Company Act:

1. Defines the limits for the annual tax credit and the total tax credit;
2. Establishes investment milestones for the second pool of funds;
3. Adds the requirement for a CAPCO to raise money from two or more certified investors;
4. Revises the definition of an early-stage technology business;
5. Revises the definition of a “qualified distribution” to exclude the payment of costs or expenses to a certified investor and limits the costs and expenses related to the formation and syndication of the certified capital company;
6. Defines and establishes “Program One” and “Program Two” to distinguish between the existing funding pool and the new funding pool;
7. Establishes application and certification deadlines; incorporates offering materials for solicitation of investments in material that must be provided to the Department of Banking and Finance (department) during certification; and allows the department to make an initial analysis of the CAPCO’s business plan prior to its certification;
8. Requires a company seeking certification as a certified capital company to submit an audit report of the financial statements of the company for the 90 days prior to, rather than after, the date the application is submitted to the department;
9. Establishes a cap on an insurance company’s ownership of a CAPCO’s equity ownership;

10. Sets the deadline for application for allocation and sets forth the formula for allocation in the event that Program Two is over-subscribed;
11. Authorizes the department to impose a late fee on renewal applications submitted after the deadline; and
12. Authorizes the department to levy a fine if an insurance company does not invest the full amount to which it committed during fundraising.

This committee substitute substantially amends section 288.99, Florida Statutes.

## **II. Present Situation:**

The Certified Capital Company Act (act), s. 288.99, F.S., was created in 1998 to establish a mechanism to provide financing (i.e., venture capital) via certified capital companies (CAPCOs), for qualified small businesses. This act is intended to increase the number of Florida-based venture capitalists, to facilitate access to institutional investors for smaller companies, and to create high-paying, high-skilled jobs.

Under current law, corporations, partnerships, or limited liability companies could apply for certification as a CAPCO on or before December 1, 1998. CAPCOs are venture capital firms that provide early-stage capital to other businesses. CAPCOs certified by the Department of Banking and Finance (department) are eligible to receive contributions of capital from insurers (or other investors).

Insurance companies (or other investors), in turn, can receive a credit against state premium taxes for each dollar contributed to a CAPCO, at the rate of 10 percent a year for 10 years, beginning with the premium tax filings for the year 2000. The purpose of this tax credit is to encourage insurance companies to invest in certified capital companies, which in turn, will make investments in qualified small businesses. Under the current program, the total amount of tax credits may not exceed \$15 million annually. Further, the tax credits allowed under the program are subject to an aggregate cap of \$150 million.

Three entities are responsible for administration of the CAPCO program. The Department of Banking and Finance is responsible for certification and decertification. The Department of Revenue oversees the tax credit filings and conducts tax audits. The Office of Tourism, Trade, and Economic Development (OTTED) was responsible for the initial allocation of premium tax credits and is responsible for preparing an annual report on the CAPCO program.

### **Certification Requirements**

To be considered for certification, a CAPCO must have net capital of at least \$500,000 and at least two of its principals must demonstrate five years experience in making venture capital investments, and submit an application to the Department of Banking and Finance, along with a \$7,500 application fee.

To remain certified, CAPCOs are required to meet investment benchmarks. At least 30 percent of CAPCO funds must be invested in businesses headquartered in and with their principal business operations in Florida ("qualified businesses") by December 31, 2001. By December 31,

2002, at least 40 percent of CAPCO funds must be invested in qualified businesses. By December 31, 2003, at least 50 percent of CAPCO funds must be invested in qualified businesses. At least 50 percent of such qualified investments must be invested in early-stage technology businesses. "Qualified business," means a small business (determined by rules of the U.S. Small Business Administration) headquartered in Florida and with its principal business operations in Florida. A qualified business must certify that it is unable to obtain conventional financing and that it has fewer than 200 employees, at least 75 percent of who are employed in Florida. A qualified business does not include a business predominantly engaged in retail sales, real estate development, insurance, banking, lending, oil and gas exploration, or engaged in professional services provided by accountants, lawyers, or physicians.

If these investment benchmarks are not met, the CAPCO risks decertification. Decertification could result in the forfeiture or recapture of some, or all, of the premium tax credits earned by insurers. The Department of Banking and Finance is required to review each CAPCO annually to verify compliance with this act and to advise the CAPCO as to the eligibility status of its qualified investments.

### **Distributions**

Before a CAPCO may make any distribution to its equity holders, other than a "qualified distribution," the CAPCO must have invested 100 percent of its certified capital in qualified capital investments. A "qualified distribution" of up to 2.5 percent of the CAPCO's capital may be made to equity holders for the costs and expenses of forming, managing, and operating the company, plus reasonable and necessary fees for professional services, such as legal and accounting services. Payments of principal and interest to debt holders may be made without restriction.

A CAPCO is required to pay to the Department of Revenue 10 percent of the portion of distributions to all certified investors (insurers) and equity holders that exceeds the sum of the CAPCO's original certified capital (which includes both equity and debt investments) plus any additional capital contributions to the CAPCO.

### **Allocation of Premium Tax Credits**

The Office of Tourism, Trade, and Economic Development (OTTED) is responsible for allocating premium tax credits to insurers who apply and submit specified documentation. The aggregate amount of premium tax credits that may be allocated for the life of this program is capped at \$150 million. On an annual basis, a CAPCO must file a report with OTTED and the Department of Banking and Finance detailing the investments the CAPCO has received from insurers and the investments it has made in qualified businesses, including the number of jobs created or retained and the average wages of such jobs. The Department of Banking and Finance must conduct an annual review of each CAPCO to determine if it is complying with the requirements of certification and the Department of Revenue may audit the records of CAPCOs and insurer investors.

### **Impact of Florida's CAPCO Program to Date**

According to OTTED, the three companies receiving designation as CAPCOs reported investing more than \$14.6 million in eight qualified businesses between July 1 and December 31, 1999 (the first six months of the CAPCO program). It was reported that these investments created 43 jobs and supported the continuation of 222 jobs. The average wage for those jobs created and supported was \$52,200. Most of the companies receiving the CAPCO investments are early stage technology companies and also reported receiving \$27 million in additional private venture capital funds from other sources. The companies are located in Gainesville, as well as in communities in central and south Florida. In most instances, the average salary paid by these firms is significantly higher than the state average of \$28,189 and the investments in small, high-growth, technology-based businesses contribute to the diversification of the state and local economies.

### **III. Effect of Proposed Changes:**

This committee substitute amends the Certified Capital Company Act, s. 288.99, F.S., and expands the pool of tax credits available for investments by a certified capital company (CAPCO) in qualified businesses by creating a second program. The second program would provide \$250 million in insurance premium tax credits, not to exceed \$25 million annually.

**Section 1.** This section adds to the definition of a "certified capital company" the requirement that the CAPCO receive investments of certified capital from two or more unaffiliated certified investors. This provision is intended to prevent a single certified investor from dominating a CAPCO and to require a CAPCO to seek funding from multiple sources.

The definition of "early stage technology business" is revised to include a business that is *either* involved in activities related to developing initial product or service offerings *or* less than two years old with less than \$3 million in annual revenues for the fiscal year immediately preceding the initial investment by the CAPCO. This change would allow a business that meets all of the other requirements, except for the less-than two-year requirement, to be deemed an early stage technology business. This change recognizes that some companies, such as research and development companies, may be formally incorporated for a substantial period of time before business is actually transacted. Such companies, which otherwise meet the statutory requirements, will not be precluded from receiving CAPCO funds merely because they have been in existence for more than two years.

The definition of "qualified business" is revised to specifically exclude: 1) a company with no historical revenues and either no specific business plan or purpose or that has indicated that its business plan is solely to engage in a merger or acquisition with another company or entity; or 2) any company that has a strategic plan to grow through the acquisition of firms with substantially similar business which would result in the planned net loss of Florida-based jobs over a 12-month period after the acquisition.

The definition of "qualified distribution" is revised to include the payment of reasonable costs and expenses, including professional fees of forming and syndicating a certified capital company, if: 1) such costs are not paid to a certified investor; and 2) the amount of cash and

cash-equivalent assets available to the CAPCO at the time of receipt from investors, after deducting these professional fees, including payments made over time for obligations incurred at the time of receipt of the certified capital, is an amount equal to or greater than 50 percent of the total certified capital allocated to the CAPCO. Management and operating expenses of a CAPCO would be limited to an amount not exceeding 5 percent of the certified capital in any one year, including an annual management fee that does not exceed 2.5 percent of the certified capital.

The definition of “qualified investment” is revised to specifically exclude three types of investments, with exceptions, including any investment in a qualified business or affiliate of a qualified business that exceeds 15 percent of certified capital.

The terms “Program One” and “Program Two,” and their respective definitions, are added to distinguish between the \$150 million in premium tax credits issued under s. 288.99, F.S., in 1999 (“Program One”) and the proposed additional \$250 million in tax credits to be issued under the statute after April 1, 2002 (“Program Two”).

### **Certification and Decertification**

The committee substitute sets November 1, 2001, as the deadline by which companies seeking certification as a “certified capital company” under Program Two must file a verified application. The committee substitute also adds the requirement that companies seeking certification submit copies “of any offering materials used or proposed to be used by the applicant in soliciting investments of certified capital from certified investors.” The committee substitute also revises the financial requirements for applicants to require an applicant to document a net worth, rather than a net capital, of \$500,000. A company seeking certification by the Department of Banking and Finance (department) is required to provide an audit report of the financial statements demonstrating \$500,000 in net worth prior to, rather than after, the date the application is submitted to the department.

The committee substitute sets December 31, 2001, as the date on which the department shall grant or deny certification to a Program Two applicant for certification.

As one of the factors that may be considered by the department in determining whether to certify a company, the committee substitute adds whether the applicant’s proposed method of doing business and raising certified capital as described in its offering materials and other materials submitted to the department conforms with the requirements of this act. This provision allows the department to make an initial analysis of the CAPCO’s business plan prior to its certification to ensure that a CAPCO is likely to be in compliance with the provisions of this act and rules adopted by the department.

The committee substitute deletes the requirement that a certified capital company file a copy of the certification with OTTED.

The committee substitute prohibits an insurance company (or its affiliates) from owning (in any manner) 10 percent or more of the equity interests in a CAPCO or from having the right to participate in 10 percent or more of the profits of a CAPCO. This supplements the existing

statutory prohibitions on an insurance company's management or control of the direction of a CAPCO's investments.

The Department of Banking and Finance would be authorized to impose a late fee of \$5,000 in addition to the renewal fee for each CAPCO that fails to pay its renewal fee on or before December 31 of each year. In addition, each CAPCO would be required to submit an audit report on the financial statements on or before April 30 of each year.

### **Investments by CAPCOs**

The committee substitute establishes the investment milestones for the Program Two pool of funds. To remain certified, a Program Two CAPCO must have invested in qualified investments at least: 20 percent of its certified capital by December 31, 2003; 30 percent of its certified capital by December 31, 2004; 40 percent of its certified capital by December 31, 2005; and 50 percent of its certified capital by December 31, 2006.

### **Annual Tax Credit; Maximum Amount; Allocation Process**

The committee substitute establishes a cap of \$250 million on the total tax credits that may be allocated by OTTED under Program Two and a cap of \$25 million per annum on the tax credits that can be earned per annum under Program Two. An insurer would earn a vested credit against premium tax liability of 100 percent of the certified capital invested in the CAPCO, but the insurer could use no more than 10 percent of the tax credit annually. The committee substitute sets the deadlines, respectively, by which each certified CAPCO must apply to OTTED for an allocation of premium tax credits for potential investors and by which OTTED must notify each CAPCO of its share of the total premium tax credits available.

The committee substitute sets forth the formula for calculating the premium tax credits that may be allowed to any one certified investor under Program Two in the event the total amount of capital committed by all certified investors exceeds the aggregate cap on the amount of credits that may be awarded under Program Two.

The committee substitute provides that no allocation of tax credits shall be made to potential investors of a CAPCO under Program Two unless the CAPCO has filed premium tax allocation claims of at least \$15 million. This is similar to the requirement that was imposed for Program One, except the committee substitute deletes language interpreted as requiring the \$15 million threshold to be met after the allocation formula is applied to the situation when the total capital committed by investors exceeds the aggregate cap (\$250 million for Program Two).

The committee substitute authorizes the Department of Banking and Finance to levy a fine, not to exceed \$50,000, if a certified investor does not invest the full amount of certified capital allotted it by the department during the fundraising stage.

### **Annual Tax Credit; Claim Process**

The committee substitute establishes January 31 of each year as the deadline for filing with the department and OTTED required information (e.g., total dollar amount received by certified

capital company, identity of certified investors, amount of certified capital invested, jobs created or retained) for the preceding calendar year ending December 31.

**Section 2.** This section provides that this act will take effect July 1, 2001.

#### **IV. Constitutional Issues:**

##### **A. Municipality/County Mandates Restrictions:**

None.

##### **B. Public Records/Open Meetings Issues:**

None.

##### **C. Trust Funds Restrictions:**

None.

#### **V. Economic Impact and Fiscal Note:**

##### **A. Tax/Fee Issues:**

An insurer would earn a vested credit against premium tax liability of 100 percent of the certified capital invested in the CAPCO, but the insurer could use no more than 10 percent of the tax credit annually. (See B. and C., below, for the impact of the tax credits.)

The Department of Banking and Finance is authorized to impose a late filing fee of \$5,000 for renewal applications submitted by CAPCOs after December 31.

##### **B. Private Sector Impact:**

Assuming that the proposed tax credits (\$250 million over 10 years) are fully subscribed, insurance companies would be entitled to take tax credits of \$25 million per year against their insurance premium tax filings beginning with the filings made in 2004 for calendar year 2003. A company may carry forward any unused taxes indefinitely.

The committee substitute would not impose any additional costs on the private sector. Companies seeking certification as a CAPCO would continue to pay the \$7,500 application fee to the Department of Banking and Finance.

Expansion of the CAPCO program could result in additional venture capital investing and high-wage job creation in Florida-based technology businesses. Smaller or emerging businesses, including early stage technology businesses, may have access to additional sources of venture capital for start-up or expansion.

Investors in CAPCOs, and the CAPCOs themselves, would have an opportunity to receive positive returns on their investments.

**C. Government Sector Impact:**

The committee substitute specifies that 10 percent of the \$250 million in insurance premium tax credits available for Program Two (the new program) are not available “until annual filings are made in 2004 for calendar year 2003.” For calendar year 2003, insurance companies will make estimated payments in April, June and October of 2003, and a final payment in March of 2004. April and June are in Fiscal Year 2002-03 while October and March are in Fiscal Year 2003-04.

Even though the committee substitute appears to provide that the insurance companies cannot take any of the \$25 million credit until March 2004, insurance companies could reduce their estimated payment for calendar year 2003 based on an anticipated reduction in tax liability due to this credit. If insurance companies reduce their estimated payments in April and June of 2003, the Revenue Estimating Conference estimates that there will be a Fiscal Year 2002-03 General Revenue loss of \$1 million.

If the insurers do *not* reduce their estimated payments in April and June of 2003, then the full \$25 million would be taken on the March 2004 final payment for calendar year 2003. For April and June of 2004, the estimated tax payments would be reduced by \$6.25 million for each month (\$12.5 million total), in anticipation of the credit for the 2004 calendar year. Thus, the total impact for Fiscal Year 2003-04 would be \$37.5 million.<sup>1</sup> The recurring impact for subsequent fiscal years would be \$25 million.

However, this estimate does not include additional tax revenues (sales tax and corporate income tax) that may be generated by new or expanding businesses fostered by this program.

Presently, three companies are certified by the Department of Banking and Finance as certified capital companies. Initially, 15 companies submitted applications for certification in Program One. For purposes of estimating revenues and expenditures for Program Two, the department has assumed that 15 companies would apply and five companies would ultimately be certified. The department provided the following summary of the estimated fiscal impact of the committee substitute:

Program Cost	FY 01-02	FY 02-03	FY 03-04
<b>Estimated Fee Revenues</b>	\$137,500	\$25,000	\$25,000
<b>Estimated Expenditures:</b>			
CAPCO Exam Expenses	10,000	10,000	10,000
Salaries, Benefits, and Expenses (4 positions)	215,660	222,130	235,657
<b>Total Revenues and Expenditures</b>	<b>(\$88,160)</b>	<b>(\$207,130)</b>	<b>(\$220,657)</b>

<sup>1</sup> If insurance companies reduce their estimated payments in April and June of 2003 and the reduction results in a Fiscal Year 2002-03 General Revenue loss of \$1 million, the total impact for Fiscal Year 2003-2004 would be \$36.5 million rather than \$37.5 million. For Fiscal Year 2001-2002, the bill does not result in a net revenue loss, but does result in a reclassification, from a budgeting standpoint, of \$25 million in revenue from “recurring” to “nonrecurring” status – in anticipation of revenue reductions in future years.



**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Amendments:**

#1 by Commerce & Economic Opportunities:

Removes from the bill new language specifying that reasonable costs and expenses of forming and syndicating a certified capital company are not considered a qualified distribution if such costs are paid to a certified investor. The amendment adds language specifying that no more than one insurance company or affiliate thereof may receive a qualified distribution from a certified capital company related to providing a guarantee, indemnity, bond, insurance policy, or other payment undertaking in favor of the certified capital company's investors.

#2 by Commerce & Economic Opportunities:

Removes from the bill new language specifying that no insurance company or any affiliate of an insurance company shall have the right to participate in 10 percent or more of the profits of a certified capital company.

#3 by Commerce & Economic Opportunities:

Increases the cap – from \$25 million to \$37.5 million – on the maximum amount of certified capital for which premium tax allocation claims may be filed on behalf of any certified investor and its affiliates under the new “Program Two” CAPCO funding pool. This change would have the effect of allowing a single investor and its affiliates to access 15 percent of the total available credits, rather than 10 percent under the bill as currently written.