WISCONSIN STATE LEGISLATURE COMMITTEE HEARING RECORDS

2003-04

(session year)

Assembly

(Assembly, Senate or Joint)

Committee on Insurance (AC-In)

File Naming Example:

Record of Comm. Proceedings ... RCP

- 05hr_AC-Ed_RCP_pt01a
- 05hr_AC-Ed_RCP_pt01b
- 05hr_AC-Ed_RCP_pt02

COMMITTEE NOTICES ...

- Committee Hearings ... CH (Public Hearing Announcements)
- **
- Committee Reports ... CR
- **
- Executive Sessions ... ES
- **
- Record of Comm. Proceedings ... RCP
- **

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INFORMATION COLLECTED BY COMMITTEE CLERK FOR AND AGAINST PROPOSAL

- Appointments ... Appt
- **

Name:

- Clearinghouse Rules ... CRule
- **
- Hearing Records ... HR (bills and resolutions)
- **03hr_ab0531_AC-In_pt01**
- Miscellaneous ... Misc
- **

SB 249/AB 531 Reformed CAPCO, now known as "WISCAP"

Due to criticisms raised about the existing CAPCO program, the authors have agreed to amend the program as follows:

a. **Expanding the program** This would allow the new WISCAP program to open up to any business entity that pays a corporate income tax, corporate franchise tax or a premium tax. However, there is a threshold of a million dollar investment to ease administrative burdens.
b. **Defeasement and Capital Availability** One of the criticisms of the current CAPCO program is that because of the guarantees made to the investors regarding the return of their investment (defeasement), only 50% of the capital invested is actually available for investment. Under the reform, all WISCAPs would commit to have available no less than 75% of capital raised for investment. This would mirror the capital availability in a traditional venture fund.
c. **Investor Affiliates Allowed to be Certified as a WISCAP** An affiliate of an institutional investor may be certified if that affiliate does not take the investments from their own investor.
d. **Guaranteeing That Wisconsin Will Receive a Share of The Proceeds When Distributions Are made From the WISCAP Program.** Under the current CAPCO law, the State of Wisconsin does not share in the Distributions after 100% of the capital has been invested in qualified businesses. (other than by receiving tax revenue from the jobs created etc.) Under proposed changes in the new legislation, Wisconsin will share in the distributions, receiving 30% of the gains from the investments back to the State of Wisconsin, unless gains are promised to a side-by-side fund, in which case the State of Wisconsin receives 20% of the gains.
e. **Guaranteeing That A Significant Amount of the WISCAP Investments Go To Early Stage Companies.** To make sure that Wisconsin entrepreneurs and recent graduates of our research universities have start up resources available to them, the new WISCAP legislation will now contain a guarantee that *at least* 50% of the first 50% of the funds invested by the WISCAP from its fund will be in early stage businesses. (Therefore, at least 25% of the total when 100% is invested over the life of the program).
f. **Reducing The Administrative Fees Which Can be Charged by WISCAPs.** To address the concern that the CAPCOs were charging excessive administrative fees (even thought those fees did NOT diminish the funds available for investment in Wisconsin businesses), the new legislation puts further limitations on the "qualified distributions" which are allowed. The new language limits the distributions allowed to a WISCAP to the costs of originally forming and syndicating the WISCAP, and then caps the annual management fee for WISCAPs at 2.5% of the total certified capital. If the WISCAP does not meet their investment threshold test, then they cannot charge their administrative fees.
g. **More Transparency and Frequent Reporting to the Department of Commerce.** Under the current CAPCO law, the CAPCOs are required to file a detailed report with the Department once a year concerning their investments and

the amount of capital available at that time. Under the proposed legislation, a report will be required after each investment to the Department within 3 business days, which the Department then has 3 business days to make public (website).

h. **Audits and Reports.** While the current CAPCO law contains a requirement that there be an annual audit of the CAPCO submitted to the Department, the proposed legislation contains language which clarifies that two separate documents are required to be submitted by the WISCAPs to the Department: an audit of the financial statements of the WISCAP, and a report on applying agreed-upon procedures. This change will provide better information to the Department.

i. **Evaluation of Program.** The proposed legislation contains a provision requesting the Joint Legislative Audit Committee to perform a performance evaluation audit of the WISCAP program.

j. **Clarifying that a WISCAP Can *Not* Make Distributions Until It Has Invested 100% Of Its Certified Capital.** There was concern that a CAPCO could be decertified without ever investing 100% of its original certified capital. This also ties into a second concern that the CAPCO structure, which sets aside 50% of the capital at the beginning of the program for guarantee purposes with the investing insurance companies, somehow could infringe on the CAPCOs investing 100% of their original capital in companies in Wisconsin. Under proposed changes in the law, WISCAPs can *not* be decertified, nor make distributions, until they have invested 100% of the original certified capital they received in certified investments in Wisconsin.

k. **Mandating That WISCAPs Receive Department of Commerce Approval Before Investing in Certified Businesses in Wisconsin.** Under the old law, CAPCOs only had to notify the Department of Commerce when they were making a certified investment in a business. Under the proposed language, all WISCAPs *must* provide the Department with a description of the proposed investment and the Department will determine if the investment is a qualified investment, and fits within the investment criteria outlined by the WISCAP when it was certified by the Department.

l. **Tightening The Standards For Being Certified as A WISCAP** Under the proposed language, WISCAP applicants would have to not only provide the information which was required in the original law (relating to financial viability etc.), but would also have to submit information showing: all the people who would benefit from the certification; the WISCAPs five year business plan; and the WISCAPs investment strategy, which would include a summary of its investment criteria. This change would allow the Department to determine if the WISCAP had an investment strategy which is compatible with Wisconsin's law before the WISCAP would ever be approved by the Department as a WISCAP.

m. **Tightening the Definition of "Qualified Business"** Under the proposed language, the definition of a qualified investment (qualified business) would be dramatically changed to address concerns related to some of the investments, which were made from the original CAPCO pool of funds. Under the proposed changes, a WISCAP would be precluded from having any financial interest in the business prior to its investment and would be precluded from forming, creating or organizing the business. In addition, the law would further restrict the kinds of businesses, which could receive WISCAP investments. Added to the restrictions already in the law would be restrictions related to business consultants, real estate leasing, lobbying or political consulting, and retail sales (unless approved by the Department).

n. **Clarifying That The Majority of the Investments Must be Made In the Form of Equity.** Although the current CAPCO law contains language requiring that "qualified investments" must be investments made to businesses with a maturity of no less than 5 years, and that the investment can only be made if the company can not obtain conventional financing, new language has been proposed which further clarifies what long term debt instruments qualify, and prohibiting a WISCAP from owning more than 50% (majority control) of a qualified business as a result of its investment, unless approved by the Department.

o. **More Detailed Description of "Nonqualified Investment".** The proposed legislation contains language which specifies in greater detail where funds which have not yet been invested in a qualified business can be held. This further guarantees that the funds will be available for investment in qualified businesses.

p. **Detailed Penalties for WISCAPs If a Company Is No Longer In Compliance With the Law.** The current CAPCO law does not outline any penalty or procedure if a business which was a qualified business is no longer a qualified business. The proposed legislation specifically outlines a timetable for the WISCAPs, whereby an investment held for less than a year before it no longer qualified could NOT be counted by the WISCAP toward its investment requirements under the law. The longer the investment qualifies, the more the investment would help the WISCAP to meet its investment requirements under the law.

q. **Need to adequately fund each possible WISCAP in the next round.** If the amounts available for certification are insufficient so as after proration, the total amount of certified capital that a company would have will be less than $15,000,000, no allocation will be made to that certified capital company. If after proration, no company would have $15,000,000 or more, then the Department may promulgate emergency rules defining an alternate plan.

r. **Mandated Wisconsin Staff and Office.** Under the current law, CAPCOs are not *required* to have Wisconsin offices or staff. The Rules contain such a mandate, but the statutes do not. The proposed legislation contains language, which would place those requirements in the statutes.

Reformed CAPCO, now called WISCAP, Addresses Concerns and Criticisms

Concern with original CAPCO bill	New WISCAP Program
• The CAPCO Program only targets insurance companies for investment.	• WISCAP is open to investments from any business entity that pays corporate income tax, corporate franchise tax or premium tax.
• The CAPCO Program prevents established Wisconsin players like Robert W. Baird from participating because of their insurance company affiliation (intended to prevent self-dealing by eligible investors).	• The new program permits affiliates of eligible investors to form a WISCAP, provided that they raise capital from sources other than their affiliate (retaining the self-dealing prohibition).
• The CAPCO Program has high administrative costs.	• WISCAP puts further limitations on qualified distributions, limiting the costs to original cost of raising capital and a 2.5% management fee.
• The defeasance mechanism to secure bonds sold by CAPCOs reduces the net capital available for investment to 50% of the amount raised.	• The new program requires that WISCAPs have no less available than 75% of the capital raised available for investment (which they will have to achieve by reducing returns promised to investors and/or by putting more of their own capital at risk).
• The standards for becoming certified as a CAPCO are low.	• WISCAP requires identification of all parties that benefit from certification, a 5-year business plan, the investment strategy and investment criteria. Commerce can determine whether the strategy is compatible with the law before the WISCAP would be certified.
• The CAPCOs may be motivated to make lower risk, later stage, short term investments (although most of the dollars went into early stage deals).	• WISCAP requires that 50% of the first 50% will be invested in earlier stage businesses (All the businesses will meet the early stage criteria that had been proposed in AB 524). • WISCAP prohibits short-term investment commitments, requires that the majority of investments must be made in the form of equity and retains the requirement that any debt instruments must be long term with a maturity of at least 5 years.
• The CAPCOs are not always focusing on the sectors where there is a need and where high paying jobs are created.	• WISCAP tightens the definition of what is a qualified business, and restricting what kind of business is eligible. • WISCAP requires approval of an investment strategy and investment criteria before being certified, and Commerce has the ability to determine whether the business was qualified and whether it was consistent with the strategy and criteria prior to the investment.
• If the CAPCOs only have to invest 50%, and then they can pull the rest out in fees and decertify in 10 years.	• WISCAP does not permit distributions or decertification until the WISCAP has invested 100%. If the WISCAP does not meet their investment threshold test, then they can not charge administrative fees.
• CAPCOs can invest in entities they start and control, thus controlling the ability to pay	• The new program prohibits prior financial interest in the business, investing in

themselves back early.	businesses formed, created, or organized by the WISCAP, and is prohibited from owning more than 50% of the business unless approved by Commerce.
• The State of Wisconsin receives no return except for tax revenue from the jobs and economic activity created.	• WISCAP provides 30% of the gains from the investments back to the State of Wisconsin, unless gains are promised to a side-by-side fund, in which case the State of Wisconsin receives 20% of the gains.
• CAPCO does not leverage the amount of capital available, except for the co-investment in companies by other investors.	• The new program provides the ability to offer 10% of the WISCAP gains to investors in a side-by-side fund, providing an incentive for the WISCAP to form a side-by-side fund, and for investors (including tax exempt institutional investors) to invest in a side-by-side fund.
• The current CAPCO law does not define any penalty or procedure if a business violates the required covenants.	• WISCAP has a timetable to reduce or eliminate the ability to count an investment towards the requirement to invest 100% if the company violates its covenants.
• There is a risk that funds waiting for investment could be invested inappropriately by the CAPCOs.	• A more detailed description of a permissible non-qualified investment provides assurance that the funds will be available for investment in qualified businesses.
• The current CAPCO law requires the CAPCO's to report their investment on an annual basis.	• WISCAP managers will be required to report their investments to Commerce within 3 business days, in which Commerce then has 3 days to make available to the public (website).
• Under the current law, the CAPCOs can be operated from outside Wisconsin.	• WISCAP makes this requirement, now a part of the rules, a part of the law.

WISCAP meets the guiding principles of Governor Doyle for his signing

1. **The plan must be affordable:** The cost of the program will be $75 million over ten years of which the tax credits will take an incremental effect (ie fewer credits in the upcoming years and more in the outer years), also less the revenue from tax collections from economic activity generated and the State's share of the program gains.
2. **The plan must target early stage needs:** WISCAP is exclusively targeted on companies with fewer than 100 employees with an emphasis on early stage development.
3. **The plan must be focused on creating jobs at the high end:** WISCAP tightens the definition of a qualified business and requires approval of investment strategies for certification, to provide assurance of delivery on legislative intent.
4. **The money must go towards investment, not administrative fees:** The new program requires that the WISCAPs have 75% of the dollars raised available for investment and tightens the permissible fees and distributions.
5. **The plan should leverage additional resources from the private sector:** WISCAP encourages formation of side-by-side venture capital funds and creates incentives that will attract tax exempt and out of state investors to those funds.