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TAKING ON MORE RISK: EXAMINING THE SBA'S CHANGES TO THE 7(A) LENDING PROGRAM PART II

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

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TAKING ON MORE RISK: EXAMINING THE SBA'S CHANGES TO THE 7(A) LENDING PROGRAM PART II

WEDNESDAY, MAY 17, 2023

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 10:03 a.m., in Room 2360, Rayburn House Office Building, Hon. Roger Williams [chairman of the Committee] presiding.

Present: Representatives Williams, Luetkemeyer, Stauber, Meuser. Van Duyne, Molinaro, Alford, Crane, Bean, Velázquez, Landsman, McGarvey, Gluesenkamp Perez, Scholten, Thanedar, Chu, and Davids.

Chairman WILLIAMS. I now call the Committee on Small Business to order.

Without objection, the Chair is authorized to declare a recess of the Committee at any time.

The Committee is here today to hear testimony about proposed changes to the 7(a) loan program and how it will affect lenders and borrowers.

Thank you all, again, for being here to testify today. I now recognize myself for my opening statement.

I want to welcome you all again into today's hearing, which will focus on the Small Business Administration changes to the 7(a) loan program. At last week's full Committee hearing on this vital issue with the SBA, many of our questions went unanswered. So I hope today we can serve as a constructive conversation on how these changes add unnecessary risk and threaten the 7(a) Program's long-term integrity.

Just 1 day after our hearing last week, Associate Administrator Patrick Kelly, who testified before us, was dismissed from the agency. While the circumstances around his departure are still not clear, there are two logical suggestions.

First, his contempt for the basic congressional oversight was apparent, and the SBA did not think his behavior was appropriate for the agency. Or second, he submitted his resignation months ago and the SBA decided to send someone to testify on these major rule changes knowing that he could be parting ways with the agency shortly after. Kind of a lame-duck witness. Whichever scenario is accurate, both of these are extremely concerning as we do our congressional due diligence over these new rules.

Members of this Committee on both sides of the aisle still have unanswered questions regarding these changes and are concerned that the SBA is continuing to move forward without the leadership in place to help make these transitions as smooth as possible.

This concern is not only bipartisan here on this Committee, but also is shared by our colleagues in the Senate. Yesterday, I, along with Ranking Member Velázquez, Chairman Cardin, and Ranking Member Ernst joined a pen letter together to Administrator Guzman saying it is our collective belief that, at the very least, it is best to find a new permanent head of the Office of Capital Access before we begin these changes and before they go into effect.

Finalizing the proposed rule represents the most significant changes to the program in decades, and I hope that we will be able to have a productive discussion about how the changes to the lending criteria will add more risk to the taxpayer-backed loan portfolio and how these changes will weaken the credit elsewhere test and take the SBA away from being the lender of last resort.

In addition, I hope to discuss SBA's capabilities as a regulator and if they are properly equipped to take on this increased responsibility, and also if the proper guardrails have been installed since the agency let billions of taxpayer dollars be stolen from the pandemic loan programs.

For decades, the 7(a) program has been operating on a bipartisan basis to help business get off the ground with their capital needs. Unfortunately, I am afraid that these changes will lead to a greater default rate that will rely on the program to continue to be subsidized by Congress in order to remain in existence.

I am not alone in raising these concerns. The SBA's Inspector General himself testified before this Committee and noted that there are significant challenges that the agency will face in managing the increased loan volume going forward as well as the significant shortages of staff within the department that oversees this program. So we can not allow the SBA to get these rules wrong.

I will once again call on the Biden administration to slow down until we can properly determine how these changes will work in practice. And without objection, I would like to submit statements for the record from ABA, QNA, and NAFCU regarding these rule changes.

I want to thank you all again for being here with us today, and I am looking forward to a more constructive conversation today.

And with that, I will yield to our distinguished Ranking Member from New York, Ms. Velázquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman, for bringing us back together on this important topic.

I would like to start by entering into the record the fact that money from taxpayers was stolen because the Trump administration didn't put in place the guardrails that were needed in order to protect taxpayers' money. I want to be fair in terms of that qualification.

In just one week, there have been quite a few developments, so I look forward to our discussion. As we have already detailed, the SBA issued two final rulemakings that have substantial implications for critical lending programs. Not only do the rules make significant modifications, the interplay between them and the pro-

grams to which they apply are vast and complicated. Not every program will be impacted in the same ways.

Last week, much of our hearing focused on the 7(a) program and rightly so because it is the agency's flagship initiative, providing nearly $15 billion in loans to small firms all over the nation.

Today, I am hoping to hear what these rules mean for another program, the 504 CDC loan guaranty program, which is administered through nonprofit CDCs. The 504 program provides long-term fixed rate financing for major assets such as land, buildings, and equipment.

Through a 100 percent SBA guaranty venture, the CDC provides up to 40 percent of financing, while a third-party lender provides at least 50 percent, leaving the applicant with at least 10 percent of the financing. Last year, the 504 program delivered over $9.2 billion in capital access, and so far this year, it is needing $4 billion.

As one of our own Members has stated in previous hearings, the 504 program can be slow and complicated, making it right for an improved streamline process. The affiliation rule helps bring some improvements that I welcome by the industry and borrowers alike.

The disparity between the rulemaking's application to the SBA lending programs highlights just why this committee is taking a deep dive into these policy changes. It is incumbent upon us to look at every aspect of what the details truly mean and their potential consequences, good or bad. SBA instituted these rules to address persistent gaps in access to capital as part of the Biden administration's broader economic agenda.

As I have continuously stated, increasing access to capital for underserved entrepreneurs remains my top priority, but I would be remiss in my obligation to borrowers and program integrity if I didn't do my due diligence. And that is why we are here again today—to listen to the industry stakeholders and understand their views of the rules on the programs they participate in.

Ensuring the businesses owned by women, people of color, and underserved groups have the resources needed to succeed is an important goal, and I look forward to hearing another perspective of SBA's actions. I remain committed to filling the gaps in the market in a bipartisan and thoughtful way and pledge to work with SBA stakeholders and my colleagues on the House and Senate Committees to find a solution.

Thank you, Mr. Chairman. I yield back.

Chairman WILLIAMS. Thank you, Ranking Member Velázquez.

And I will now introduce our witnesses.

I will now introduce our witnesses. And it is my pleasure and privilege to introduce our first witness, Mr. Tony Wilkinson.

Mr. Wilkinson has served as the president and CEO of the National Association of Government Guaranteed Lenders in Frisco, Texas for more than 30 years. And prior to joining NAGGL, Mr. Wilkinson spent 13 years with the Stillwater National Bank as senior vice president and was responsible for the bank's SBA lending activities. Mr. Wilkinson is a graduate of Oklahoma State University, home of the cowboys, right?

And, Mr. Wilkinson, thank you for being here today. We look forward to the conversation ahead.

I now recognize—Meuser is not here, and he was going to introduce you, Mr. Kassar. So I am going to do it in a Texas way, okay? All right.

Our next witness is Mr. Ami Kassar. Mr. Kassar is the founder and CEO of MultiFunding LLC located in Ambler, Pennsylvania. Mr. Kassar has dedicated the last two decades of his career to ensuring that businessowners and entrepreneurs get the best possible financing to grow their businesses. He knows far too well the impact that poor financing choices have on the ability for a small business to grow.

In his work as a public speaker and as a founder and CEO of MultiFunding LLC, Mr. Kassar has helped thousands of businessowners and entrepreneurs structure their debt to optimize growth and in turn help to create tens of thousands of jobs. Mr. Kassar is a graduate of Brandeis University and the University of Southern California where he received his master's in business administration.

Mr. Kassar, thank you for being here today, and we look forward to the conversation ahead.

Next, our next witness is Alice Frazier. Ms. Frazier serves as president and CEO of Bank of Charles Town in Charles Town, West Virginia. She also has recently been appointed to the board of directors of the Federal Reserve Bank of Richmond.

Including her current position with BCT, Ms. Frazier has over 32 years of local banking experience, including with Cardinal Financial Corporation as executive vice president and chief operating officer, BB&T as senior vice president in Loudoun County, and Middleburg Financial Corporation as chief financial officer and chief operating officer, which is where Ms. Frazier began her banking career. Prior to that, she worked for 4 years in public accounting with a national and regional firm.

Ms. Frazier is a graduate of Stonier. Is that how you say it? Stonier Graduate School of Banking and Radford University.

Ms. Frazier, thank you for being here today, and we look forward to the conversation ahead with you.

And I now recognize the Ranking Member from New York, Ms. Velázquez, to briefly introduce our last witness appearing before us today.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

It is my pleasure today to welcome back to our committee Mr. Manny Flores, President and Chief Executive Officer of SomerCor, an SBA Certified Development Company located in Chicago, Illinois.

In addition to making 504 loans, SomerCor is an active lender in the SBA Community Advantage Pilot Program and a Member of the National Association of Development Companies, or NADCO.

Mr. Flores first joined SomerCor as a Board Member in 2016 and was appointed to his current role in 2018. Prior to SomerCor, he held elected office as a Chicago city Councilmember and served as Director and Acting Secretary of the Illinois Department of Financial and Professional Regulation.

We are glad to have you with us today. Welcome.

I yield back.

Chairman WILLIAMS. Thank you, Ranking Member Velázquez.

And we appreciate all of you, again, being here today.

Now, before I recognize the witnesses, I would like to remind all of you that your oral testimony is restricted to 5 minutes in length. If you see the light turn red in front of you, it means your 5 minutes have concluded, and you should wrap up your testimony. And if you don't wrap it up, I will beat on the gavel, and you will get the idea, okay?

So with that, I now recognize Mr. Wilkinson for his 5-minute opening remarks.

STATEMENTS OF TONY WILKINSON, PRESIDENT & CEO, NAGGL; AMI KASSAR, FOUNDER & CEO, MULTIFUNDING LLC; ALICE FRAZIER, PRESIDENT & CEO, BANK OF CHARLES TOWN; AND MANUEL FLORES, PRESIDENT & CEO, SOMERCOR

STATEMENT OF TONY WILKINSON

Mr. WILKINSON. Thank you, Mr. Chairman, Ranking Member Velázquez, and Members of the Committee.

Let me start by saying, Mr. Chairman, I agree with your opening statement. In the 36 years I have been NAGGL's CEO, I have never seen changes more sweeping and potentially damaging.

SBA is removing long-standing underwriting guardrails that have assured prudent lending in the 7(a) program, while simultaneously adding an unlimited number of nonfederally regulated lenders. Worse, SBA will serve as primary regulator for these new entities, a role that it is not equipped for.

SBA's stated intent for these changes is laudable, increase access to capital for underserved markets, and streamline processes. The lending industry wholeheartedly supports those goals, but the recent rules do not achieve what SBA is setting out to do.

And the biggest change between the proposed and final rules, SBA removed any mention of underserved markets from the regulatory language. SBA's data shows that in fiscal year 2022 more than 75 percent of all loans are estimated to be small-dollar loans, 68 percent of all loans going to underserved markets, far exceeding SBA's 43 percent goal, and nearly one-third of all loans going to minority-owned businesses. There is always room for progress, but these numbers don't show the market failure that SBA has described.

First, on underwriting, the rules remove guidelines that ensure lender behavior and portfolio performance stay at an acceptable level. SBA has described the new standard as "do what you do", leaving it up to lenders to determine what is prudent. I fear that removing these guardrails creates a race to the bottom in credit quality.

Today's 7(a) loans are not funded by taxpayer dollars because current loss rates assure that the borrower and lender fees cover the cost of loans. Removing the underwriting guardrails mean that losses could increase, and Congress either will have to raise fees on borrowers and lenders or provide an appropriation; otherwise, this program shuts down. A lose-lose.

After throwing out the rule book, SBA is telling the new, nonfederally-regulated lenders—presumably fintech—that they can do

whatever they think is prudent. SBA said in 2021 rules that it could not be the primary regulator for more lenders because it will lack the oversight capability and cited an increased risk to the agency.

Just 22 months and later and with no evidence of changed capacity, SBA has reversed itself. And despite SBA's assertion that it will add just three additional regular SBLC licenses, the truth is, it is just three for now. The rule doesn't have any limits. And SBA is also adding mission lenders currently participating in the Community Advantage Pilot Program as SBLCs, which is more than 100 entities.

The capacity and resources of SBA's oversight functions both fall short. Funding has been stagnant for nearly 10 years. There is a failure to even meet current oversight requirements, and the IG identified staff vacancies of 40 percent, just to name a few concerns.

But even with more resources, SBA still lacks the regulatory framework necessary to oversee lenders on an enterprise risk level. This is made worse because the final rule removed the restriction that limited SBLCs to only making SBA loans, increasing the oversight burden significantly.

Currently, SBA does not regulate for Bank Secrecy Act or Know Your Customer or even the most basic consumer protections. And the rules go even further. SBA now allows a business to qualify as small, even if it is controlled by a large business. It will be the large business, not the small, that will be the primary beneficiary of an SBA loan.

SBA also drastically altered the credit elsewhere to nothing more than a check-the-box exercise, inviting fraud like we saw in PPP. And now SBA allows borrowers with significant personal wealth to qualify for loans, flying in the face of the statutory mandate to only give a 7(a) loan to borrowers who could not get credit elsewhere.

Finally, politicizing SBA decisions should concern everyone. Under the affiliation rule, the SBA administrator can now reverse a loan denial. This change allows politics to seep into determining SBA loans. And the biggest concern, the harm to borrowers, particularly the underserved, who would be faced with higher fees, the possibility of receiving loans they cannot repay, and lenders who have no federal regulator that ensures consumer protections.

This Treasury Department, Mr. Clyburn, House Oversight Committee, the IG community, and more all point out significant concerns with the concepts and the underlying rules, yet SBA has not heeded any warnings. Lenders are not concerned about competition, nor is this about being anti-fintech, but SBA is not inviting fintech into the program we all know and trust. SBA is inviting fintech into a very changed program devoid of guardrails.

I am profoundly opposed to imprudent changes that could harm underserved markets and damage the 7(a) loan program. Participating in a government program requires responsible stewardship, especially when the current portfolio is nearly $107 billion in outstanding principal balances with the government liable for roughly 75 percent of that. Congress should require strong guardrails when the federal government is the backstop.

While SBA could change course, I see little evidence it will, especially when it has repeatedly ignored congressional and industry concerns. I implore you to legislatively act because the future of this program might very well depend on Congress reversing these rules. Otherwise, the program that fuels mainstream America will be in jeopardy and our most vulnerable small businesses harmed. Thank you.

Chairman WILLIAMS. Thank you. Right on time. I appreciate that.

Next, I will recognize Mr. Kassar for his 5-minute opening remarks.

STATEMENT OF AMI KASSAR

Mr. KASSAR. Thank you for the honor of testifying today to share my thoughts on the changes to the SBA program that deeply concern me.

My name is Ami Kassar, and I am the founder and CEO of MultiFunding LLC, a loan brokerage and consultancy company based in the suburbs of Philadelphia. Since 2010, my team and I have heard the stories of thousands of entrepreneurs over the years. In our work, we strongly recommend the SBA 7(a) program and have helped borrowers receive nearly $400 million of 7(a) loans nationwide.

There are three primary points I want to leave you with today. First, traditional SBA 7(a) lending has few similarities to the EIDL program or the Restaurant Revitalization Fund that we heard about last week.

Secondly, when entrepreneurs take loans without a clear path to pay them back, there can be devastating consequences for both the lenders and the entrepreneurs. All of the proposed SBA changes will make it much easier to get a loan, leaving many to take loans before they are ready for them.

And finally, if you make wholesale changes to the SBA 7(a) program all at once, it will be impossible to understand the impact of each change.

Let's begin with comparing the 7(a) program to the EIDL program and Restaurant Revitalization Fund, which was a common thread of testimony in front of this Committee last week.

The Restaurant Revitalization Fund was a grant program. It did not issue loans, and recipients did not have to repay the grants. Therefore, comparing this program to the 7(a) program is nonsensical to me. The EIDL program is a story that requires unpacking.

First, 378 billion was lent to 3.9 million small businesses without proof of economic injury. The repayment data has barely started to come in. That said, I suspect we will learn a lot from EIDL loans about what happens when you lend money to businessowners who don't have a clear plan to pay it back. And this is what I fear will happen if we simplify SBA lending.

In this spirit, I want to share a story with you. One night during the pandemic, I was asked to teach a virtual SBA class for a female entrepreneurship group at an African American church in Philadelphia. About a dozen women who were trying to get side hustles off the ground attended.

As the session began, I quickly realized that the last thing these entrepreneurs needed was a loan. You see, like many entrepreneurs, they thought they needed more money to get started than they did. But in every case, there were far less expensive ways to get their concept off the ground than they thought.

One woman wanted to start a business baking desserts for restaurants that didn't offer them. She was convinced she needed to borrow $50,000 to open a kitchen. She had yet to consider that she could prove her concept by baking in her home kitchen or renting a kitchen during off-hours at a local restaurant to get started.

But here is the thing. If an unregulated fintech lender offered these budding entrepreneurs an SBA loan that will land in their bank accounts in a few days, every one of these entrepreneurs would jump on the opportunity. Is that what we want for the SBA program?

In today's world, borrowers write business plans, build projections, and make business cases for their needs. They have to have their books in order. Now, the SBA wants to throw much of this out of the window. It is a recipe for disaster and will lead to much higher delinquencies, in my opinion. And a delinquent debt to the United States Government is not a good mark on a budding entrepreneur's resume.

I am all for change, but you take significant risk if you make too much change too quickly. Broadening access to capital is a worthy goal. But now the SBA proposes changing too much, too soon in an uncontrolled environment. If all these changes go forward as it looks like they will, I predict we will return to this room in 2 years to try to explain the growing default rates. And the problem will be we won't be able to understand the root causes because of all the vast changes being made all at once.

I remember some important lessons from science class in high school. If you are going to try and experiment, test one variable at a time. You cannot read the results if you try everything at once. The checks and balances of the SBA system can be exceedingly frustrating, but they help borrowers and lenders in the long run.

We are in the business of issuing loans insured by the U.S. taxpayer. This is not a responsibility we take lightly. With these simultaneous changes, we risk blowing up a long-standing healthy program, like the SBA, that positively impacts our economy.

I implore Congress to slow down the SBA train that has already left the station and create a more cautious path for the SBA in the future. Let's evolve and grow and try new things but in a measured and thoughtful way. Thank you very much.

Chairman WILLIAMS. Thank you. Good job on the timing.

And now, I would like to recognize Ms. Frazier for her 5-minute opening remarks.

STATEMENT OF ALICE FRAZIER

Ms. FRAZIER. Chairman Williams, and Ranking Member Velázquez, and Members of the Committee, I am Alice Frazier, president and CEO of Bank of Charles Town, a $790 million community bank serving the markets of West Virginia, Maryland, and Virginia.

I testify today on behalf of the Independent Community Bankers of America where I am Chair of the Bank Operations Committee and a Member of the Board.

My bank has been an SBA lender for over 40 years, and I am proud to say that more than half of the SBA loans over the past 18 months were made to minorities or women borrowers. And we share with this Committee the goal of preserving and protecting the integrity of the SBA 7(a) program, while continuing to make prudent loans to smaller and underserved businesses.

The new SBA rules, which were rushed through the process without any input from Congress or industry, will undermine this critical goal. And we recommend the agency hit the pause button, convene a working group of existing SBA lenders to determine how we can better align the program with the SBA mission of reaching the smallest businesses and entrepreneurs.

Current lenders know where the challenges lie and should be given the opportunity to craft a program that works better. We believe the SBA's new small business lending company rule, which would admit nonbank financial technology companies or fintechs to the 7(a) program, is a serious threat to its integrity.

And moreover, the new affiliation rule and revisions to the SOP appear to be specifically designed to accommodate nonbank fintechs. Online-only lending can never be a substitute for on-the-ground community bank lending. The business model of a nonbank fintech that snap approval and rejection of a loan and quick disbursement of funds is often not in the borrower's best interest.

We have a client who had previously obtained two quickly-disbursed fintech loans of less than $30,000 each. The fintech provided no counseling on how to put that money to good use. In fact, he was overpaying himself, resulting in losses each year. He won a Navy contract, but couldn't find a lender because of his losses. And we worked with him to help him understand what lenders look for in reviewing a credit application. And ultimately, we were able to secure for him a $150,000 SBA loan.

You see, the community bank model is really quite different. We partner with our small business borrowers and are vested in the long-term growth and success. The reality is that once the loan is funded, that relationship has really only just begun. We provide practical, real-world business counseling and networking opportunities, particularly for start-ups, in a way that can never be matched by an online-only lender.

The best thing for an underserved borrower is to work with a lender that is committed to their success. A small African American 8(a) government contractor applied to us for a $150,000 loan. She had recently won a couple contracts, but her low credit score made it impossible for us to approve her loan application at that time. And rather than just turn her away, we worked with her for over a year and a half to increase her credit score and then celebrated when we were able to give her an SBA loan. I cannot imagine a nonbank fintech lender standing by a loan applicant for a year and a half.

We are committed to working with this Committee and the SBA to ensure the 7(a) program is reaching the smallest underserved borrowers. But I also think we should appreciate what the program

is already achieving. For example, according to the SBA's own data, 68 percent of the loans in fiscal year 2022 were made to underserved borrowers. This far exceeds the agency's target of 43 percent. And also in fiscal year 2022, one in three 7(a) loans were to minority-owned businesses.

I fully expect nonbank fintech loans to have a higher default rate and higher incidents of fraud, similar to the results of the Paycheck Protection Program. The cost associated with more defaults and fraud will drive fees higher and make the program more costly and less accessible.

We urge this Committee to exercise robust oversight on the 7(a) program with the goal of safeguarding its integrity. Thank you, again, for this opportunity to share my perspective, and I am happy to answer any questions you may have.

Chairman WILLIAMS. Thank you very much, Ms. Frazier. Good job.

I now recognize the witness, Mr. Flores, for his 5-minute opening remarks.

STATEMENT OF MANUEL FLORES

Mr. FLORES. Chairman Williams, Ranking Member Velázquez, and distinguished Members of the Committee, thank you for having me today.

My name is Manuel Flores, and I am the president and CEO of SomerCor, a Certified Development Company based in Chicago, Illinois, a Member of the National Association of Development Companies. I am honored to represent the CDC industry to discuss rule changes affecting the lending programs at the Small Business Administration.

CDCs are nonprofit organizations certified by the SBA who meet our economic development mission through the delivery of the SBA's premier economic development program, the 504 loan program, as well as the 7(a) Community Advantage Pilot Program, the microloan program, and other federal and state initiatives.

My comments today will focus particularly on the affiliation and lending criteria as it relates to the 504 program. The 504 loan program is a prime example of the successful public-private partnership with a loan structure that pairs the CDC—which provides up to 40 percent of the financing for an eligible project through 100 percent SBA-backed venture—with a banking partner, typically, which provides 50 percent of the financing, thus requiring only a 10 percent down payment from the small business borrower.

The program finances commercial real estate, including construction costs and equipment, with terms of 10, 20, and 25 years at a fixed below-market interest rate. An important cornerstone and differentiator of the 504 loan program is its economic development mission. To be eligible for a 504 loan, the project must create jobs or meet a public policy or community development goal.

The result is a zero-subsidy program that has served more than 175,000 small businesses, provided more than $100 billion into ventures, and leveraged private sector financing for an estimated total investment of more than $250 billion in local economic development, all at no cost to the taxpayers.

In addition, the 504 programs have a collective performance of a 0.5 percent charge-off rate over the last decade. This is in part a result of the multi-stop underwriting and approval process that includes loan review by the CDC, a third-party lender, and the SBA. Combine the extensive oversight of CDCs by the SBA with the underwriting and approval process of the 504 program, and it becomes clear why it performs so well.

Unfortunately, despite some of the program's successes, the 504 program can be weighed down by a complex approval process that can adversely affect the borrower. The CDC lending industry has advocated for regulatory changes to create efficiencies in the approval process for over a decade, including many of the adjustments to affiliation and underwriting included in the recent final rule.

Now, NADCO largely supports the intent of these changes, which will provide CDCs the flexibility to be reasonable while continuing to use prudent underwriting practices that focus on ensuring repayment ability.

As you consider congressional action in response to these rules, I offer the following recommendations. First, there are several lending programs that the SBA impacted by these rules who operate differently, and a one-size-fits-all approach is not the best way to expand small business lending. It is important to continue differentiating the programs and approaching their implementation through this lens.

Second, while Congress continues to weigh the rules and their impact, the CDC lending industry and our banking partners need time and open communication with the SBA to understand these changes. Trainings, open dialogue, and a collaborative approach is integral for industry participants to understand and adapt to the rule changes without fear of being penalized.

Finally, I would like to also draw attention to a program change initiated by Congress, but for which the SBA has not yet published a final rule. The Economic Aid Act enacted in 2020 made integral changes to the 504 Debt Refinance Program. It is critical the SBA remove administrative barriers that restrict borrower access to the program and release a final rule as soon as possible.

These changes made in the Economic Aid Act are particularly important in the current interest rate environment where the lower fixed rate of the 504 program can provide enormous cost savings to small businesses.

The CDC lending industry cares deeply about maintaining our role as a trusted partner for small business success. We will continue to focus on our collaboration and communication with the SBA and Congress to meet our collective goal of making lending programs like the 504 easier, faster, and more secure in support of a strong small business ecosystem nationwide.

I appreciate the opportunity to testify this morning. I look forward to answering any questions.

Chairman WILLIAMS. Thank you very much. Good job. Plagiarism is an evil thing.

Mr. FLORES. I was inspired, Chairman.

Chairman WILLIAMS. Well, I thank all of you. Good job.

And we will move now to the Member questions under the 5-minute rule, and I recognize myself for 5 minutes.

Mr. Wilkinson, given your extensive experience with the SBA programs, I wanted to start off by asking you to quickly clarify a few statements that former SBA official Patrick Kelly made at our hearing last week.

He said that the changes to the 7(a) lending program are not terribly new but would simply put the program in line with the SBA's Express loan program.

So, Mr. Wilkinson, can you describe why this comparison by the SBA is not accurate?

Mr. WILKINSON. Until recently, the SBA Express program has been limited to $350,000 in size. The expansion of doing what you do up to a $5 million loan size is a vastly different approach.

I would also add that we would have a little bit of a concern about the loss rate that has been seen in the Express portfolio. It has got a 50 percent guaranty, so you would intuitively think you would have a lower loss rate, and that has not been the case. It is running about two times the loss rate that the regular 7(a) program is.

Chairman WILLIAMS. Okay. He also claimed that as part of their oversight of small business lending companies, they give lenders guidance on how they should be compliant with the Bank Secrecy Act and other anti-money laundering laws.

So have any of your Members received guidance on how to fulfill these requirements from the SBA?

Mr. WILKINSON. No.

Chairman WILLIAMS. Okay. And finally, Mr. Wilkinson, can you clarify what would need to happen to keep the program operational if loan defaults were drastically increased?

Mr. WILKINSON. Well, we are hopeful that this Committee will address that through legislation, putting back in the guardrails that have been there for decades to make sure that the underwriting guidelines stay in place and we keep lenders between the lines.

Chairman WILLIAMS. Don't try to fix what is not broken.

Mr. WILKINSON. Correct.

Chairman WILLIAMS. Thank you for those answers.

I also sit on the Financial Services Committee, as several of us do here, and for the last few weeks, we have been discussing the recent wave of bank failures.

So, Mr. Kassar, can you describe the similarities you see with the fall of Silicon Valley Bank to what the SBA is attempting to do by increasing access to capital to small businesses that might not be ready for prime time? And you have talked about that.

Mr. KASSAR. I have seen a lot of term sheets from Silicon Valley Bank over the years. And for the life of me, I don't understand how they make the loans that they do. I don't know other lenders who could match them.

So a loose credit culture, I believe, is part of what the problem was, that cultural program at Silicon Valley Bank, and I am concerned that a loose credit culture at the SBA will lead us sadly to think about SBA and SVB in the same sentence in a couple years if we completely loosen so many of the guardrails.

Chairman WILLIAMS. All right.

Now, yesterday, the Ranking Member and I sent a letter along with Chairman Cardin and Ranking Member Ernst in the Senate to the SBA asking for them to pause on attempting or implementing these rules until a full-time head of the Office of Capital Access is installed.

Ms. Frazier, you touched on that. But do you think this would be a good idea given the expected—unexpected departure of the former associated Members who sat in that seat last week? And can you describe outstanding questions you still have about the new rules?

Ms. FRAZIER. Thank you. Well, given that the new rules were rushed and just recently put out, many of us as lenders are still trying to absorb what is in them and how would they be affected. So the pause—not only a pause would be necessary, but I think also gathering existing lenders together that have experience with the current SBA rules and reflect upon what could be changed to make it simpler, but maintain prudent lending standards.

And I would also recommend not only the pause, but should the changes go into—any changes go into effect, give it time for the current lenders to process and absorb them and see the impact before we allow any more small businesses lending companies into the program.

Chairman WILLIAMS. Thank you very much.

I now recognize the Ranking Member for 5 minutes of questions.

Ms. Velázquez.

Ms. VELÁZQUEZ. Yes.

Mr. Flores, your testimony demonstrated it is important to differentiate the 504 and the 7(a) loan programs, which are both impacted by the rules we are discussing today, and you yourself stated that in your opening statement.

The 504 loan program is an economic development program with job creation goals. Can you walk us through the 504 underwriting process and why you believe the changes in the affiliation rule will benefit 504 loan borrowers?

Mr. FLORES. So, Ranking Member Velázquez, thank you for your question. Thank you for your question.

The 504 loan underwriting process is unique because it includes three different parties and multilayers of underwriting and examination, all with a goal of ensuring borrower solvency.

So you have the Certified Development Company with staff who has expertise in underwriting also governed by policies and procedures, risk weighting, and concentration tracking, all which have to meet SBA requirements, which also includes independent loan review by a loan committee as well as the board.

In addition to the CDC, you have a lending partner, typically a bank, that will also have to follow its own loan procedures, safety and soundness, prudent lending. I need not remind this Committee here that banks are also regulated by banking regulators. I was a former banking regulator for State-chartered institutions. And then you also have the SBA that also reviews the loans for the purposes of, again, underwriting and then also eligibility requirements.

Ms. VELÁZQUEZ. I have a lot of questions, so please be brief.

Mr. FLORES. Oh, apologies.

So a very thorough process, Ranking Member.

Ms. VELÁZQUEZ. Okay. Thank you.

As lenders, borrowers, and even those of us here in Congress try to get up to speed on the details of these two rules on the SOP, I understand mistakes will be made.

What has your interaction with the SBA been like? Have they tried to explain the details of the rules to your organization in order to help you comply?

Mr. FLORES. So a lot of the changes that we are seeing, frankly, have come from years of communication with the SBA in engagement with the CDC industry. And just as recently as last week, we had a number of meetings with the SBA leadership and other Members to reflect upon some of the changes.

That being said, I do believe, Ranking Member Velázquez, that it is prudent that the SBA continue to gauge the industry. I agree with the notion of openness, transparency, and collaboration in making sure that all of the stakeholders understand the changes so that we can do our jobs in helping small businesses access these amazing programs.

Ms. VELÁZQUEZ. Thank you. Thank you.

Mr. Wilkinson, I am sure you are aware I have been advocating for more small-dollar loans, those from 50- to 150,000. There has been a decline, about a 50 percent decline in those type of loans.

My question is, why is it that lenders are not making these loans?

Mr. WILKINSON. Well, I think from where we sit, you know, 50 percent of our loan approvals by number of loans are $150,000 or less. So those are small-dollar loans.

In any given year, based on economics or lender business models, those numbers changes. They fluctuate. And if you go back 5 years, we had a couple of major SBA Express lenders exit the program, so you saw a decline in small-dollar loans at that point in time.

But if you go look today, you'll see our small-dollar loans are coming back up. I think the fee waivers are playing an important role.

Ms. VELÁZQUEZ. We have issues with the data, right, that is coming to us from SBA itself.

What would you say to those that say that this is simply about market competition? How do you respond to that?

Mr. WILKINSON. It couldn't be further from the truth. Banks can enter this program today, leave tomorrow. We get banks entering all the time.

Ms. VELÁZQUEZ. In terms of myself as Ranking Member of this committee and as Chair of this committee for 30 years now, I have been advocating for the smaller of the small businesses. And for those small loans from 50- to 150,000, the truth of the matter is that there is a decline. I want to make this effort a reality to get loans to underserved businesses who need it the most.

My question is, how can we achieve this goal using the rules as a framework?

Mr. WILKINSON. Well, first of all, I was starting down the path of—the fee waivers are working right now. We are seeing an uptick in small-dollar loans. We are seeing an increase in $150,000 and under. We are running ahead of last year's pace by—goodness, we

are 25 percent ahead of last year's pace on loans of $150,000 and under. So we are making progress.

We could expand the microloan lender network because they are specifically focused on loans of $50,000 and under, and they add the technical assistance component. And then perhaps if we gave lenders some credit in their PARRiS reviews if they did a specific percentage of loans under 150,000.

Ms. VELAZQUEZ. Thank you.

I yield back.

Chairman WILLIAMS. Thank you very much.

Next, I now recognize Mr. Luetkemeyer from the great State of Missouri for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Welcome to the panelists.

Mr. Wilkinson, let me start with you this morning. I have got in front of me this morning a copy of the Federal Register which publishes rules and regulations that are promulgated by different agencies.

The particular pages I have in front of me are with regards to the Small Business Administration, and they say—and I quote, the SBLCs are nondepository lending institutions authorized by SBA only to make loans pursuant to section 7(a) of the Small Business Act and loans to intermediaries and SBA's microloan program, which says only those kind of loans.

But then it says later on that SBA agrees with the previous paragraph, which mentions that they are going to do away with that, and it says, we will revise the paragraph by removing the word "only" to make it clear that SBLCs and Community Advantage SBLCs may participate in other lines of business in addition to 7(a) lending or making loans to intermediaries.

Mr. Wilkinson, what is the impact of that?

Mr. WILKINSON. Well, I have huge concerns about that because this change—as you note, there is now nothing in the regulation to prohibit an SBLC from making other types of loans or engaging in other business products.

More importantly, this change significantly would add to the SBA's oversight burden, since when it is evaluating institutional safety and soundness, they would now have to be up to speed on all the other related lines.

Mr. LUETKEMEYER. What is the mission of an SBLC?

Mr. WILKINSON. Mission of an SBLC?

Mr. LUETKEMEYER. Yeah.

Mr. WILKINSON. Well, currently, the SBLCs are standalone separate corporations that only do 7(a) loans.

Mr. LUETKEMEYER. Okay. So what they are going to do is they are going to make these mini-banks. Is that where we are going to be? Is that another way to frame it?

Mr. WILKINSON. That is another way to frame it.

Mr. LUETKEMEYER. So, Ms. Frazier, you are a banker. Do you like this competition? Having the SBA be the new bank lender in your community for small businesses, when they are supposed to be the lender of last resort, and now they are your main competition. How do you think about that?

Ms. FRAZIER. I don't think very highly of it, quite frankly.

As I testified before, when the direct lending was being proposed from that perspective—is that what you miss and what many—what many of us are saying here is the relationship and the coaching and the counseling many of these borrowers need in this process—and they need the education towards their financials—and to create an online process that scored, and the decision is made against a few metrics or factors, you don't achieve what I believe is what everyone desires as a successful entrepreneurship and business.

So I am not excited about that kind of competition, only because I think it diminishes really what the SBA is trying to achieve.

Mr. LUETKEMEYER. Well, it would seem to me that what would happen is you will turn somebody down because they are not creditworthy or they have got a problem, and they are going to run across to an SBLC who now has no criteria.

Last week, we talked about this with Mr. Kelly. And they don't have Know Your Customer stuff. We don't have all these other things in place that, during the PPP program, really differentiated between the banks and the fintechs and how they were able to get the funds out the door and be able to do this.

We found that the fintechs were basically the problem children with the PPP program with the way that they did not do the oversight that they really needed to do with regards to their customers.

So it looks to me like we have got a real problem with direct lending here, especially when at the SBA—when the EIDL program was fraught with fraud. And so now we are going to make them a direct lender in multiple areas.

Ms. FRAZIER. Right. Not a good thing because the relationship isn't long-standing. It is, package up a portfolio, sell it, service it, and you miss the opportunity to really develop business and help with economic success.

Mr. LUETKEMEYER. Mr. Kassar, would you like to elaborate a little bit on that? I think you said a minute ago something about loose credit culture. This, to me, is our whole problem.

It is that SBA does not know how to do direct lending. It is proven by the programs that they have, the losses they have sustained. They don't do their due diligence on underwriting. And now, suddenly, they want to expand those programs and be in direct competition with the banks who we already know do it right. And so now, it looks to me like we are going to wind up putting a big burden on the taxpayers to underwrite this whole situation.

Would you like to comment on that?

Mr. KASSAR. Absolutely. In addition to the prior point you are making, if these new SBLCs can do any other kinds of loans, if for whatever reason a borrower does not qualify for an SBA loan, they can quickly move the mover to a high-interest, very expensive loan that many—not all, but many of these fintechs are doing that creates a high-speed debt treadmill, which is——

Mr. LUETKEMEYER. One more quick question.

Where are the SBLCs going to get their funds to loan? If they are going to expand their loan program, where do they get the money for that?

Mr. KASSAR. They might get them from private lines from banks.

Mr. LUETKEMEYER. I yield back. Thank you, Mr. Chairman.

Chairman WILLIAMS. Next, I now recognize Mr. McGarvey from the great State of Kentucky for 5 minutes.

Mr. MCGARVEY. Thank you, Mr. Chairman.

Thank you all for being here today and talking about this incredibly important issue.

Last Congress, after an extensive investigation into the Paycheck Protection Program, the House's Subcommittee on the Coronavirus Crisis found that fintech and other nondepository institutions failed to establish systems that would stop obvious and preventable fraud and profited off of processing fees for each loan they completed, leaving little incentive to find the fraud.

The Subcommittee issued a report in December recommending that, quote, any plans by SBA to again open 7(a) to fintechs and other unregulated, nondepository institutions must be accompanied by a well-defined, more rigorous, and better-resourced initial review process, and that such entities should be subject to continuous monitoring to confirm their adherence to SBA rules.

Mr. Wilkinson, you talked a little bit about this in your opening statement. I just want to go a little bit more in depth with you on it.

Do you feel that the rule changes proposed by the SBA are just that: Well-defined, more rigorous, and provide a better-resourced initial review process?

Mr. WILKINSON. No, they're not. They are devoid of any guardrails. SBA lacks the capacity to be the prudential regulator for the new SBLCs. So, no, I disagree that they have done a good job here.

Mr. MCGARVEY. What do you think should be happening?

Mr. WILKINSON. Well, there is a whole long list. First of all, many of the guardrails should remain in place.

I would tell you that when the fintech group came to lobby us, they asked for higher interest rates. They asked for the ability to charge higher fees. They got that. It is in the new SOP. They asked for the ability—and I am sorry. Mr. Luetkemeyer just left—they asked for the ability to sell 100 percent of the loan, not just the guaranteed piece.

So there is a program underway at SBA to allow fintechs to sell a significant portion of the loan. That is where they are going to get their funding. And they asked for us to help them get rid of the credit elsewhere test. And at that point in time, we knew we were not going to be on the same page with these folks. So the fintech groups that are trying to get in right now have a vastly different idea of what this program should look like than we do.

Mr. MCGARVEY. And tell me, what is the practical effect of that, to people looking for SBA loans?

Mr. WILKINSON. Well, I suspect that there will be more folks that will get the loans, many of whom probably shouldn't. It is going to be down to an algorithm that is done online.

And the practical effect for us sitting in this room is you are going to see significant increases in loss rates, which is going to put an upward pressure on the cost of the program. And we will all be right back in here talking about how we are going to raise fees on borrowers and lenders, or are we going to be able to come up with an appropriation, with the discussion being—you are doing riskier

lending. Why should you guys appropriate money? And that is going to be a hard one to defend.

But rest assured, losses are going to significantly increase with these rule changes.

Mr. MCGARVEY. I appreciate your input and insight into that.

And obviously one of the things I am concerned about—you have heard Ranking Member Velázquez talk about this—is making sure that people who need these loans, particularly the smallest of the small businesses, the people who are underserved, the people who have not had access to capital get that type of access to capital.

It is clear that fraud was an issue with the fintechs. So we have established that. I don't think you are seeing a debate in this Committee. But we also know they did reach more women and minorities than traditional lenders did.

So, Mr. Flores, what changes do you think are out there that you would propose to current rules to allow for lenders to serve more diverse and underserved populations while also protecting borrowers?

Mr. FLORES. You know, that is what makes the Certified Development Company network very unique, is that we are about economic development. So our charge is to make sure that not only are we informing and educating the public about small business lending, but in particular, also providing technical assistance and partnership with other organizations.

And our mission is to make sure that we not only promote the SBA lending programs, but that we do it in a way where the borrower is able to actually derive the whole benefit of that loan.

So a lot of work goes into engagement and communication, and it is done in partnership with the Small Business Administration and individual CDCs, other economic development organizations.

I just—again, I would hearken back to the comments that I made as a former banking regulator as well, is that the Small Business Administration working with the industry is critical in making sure that we are able to track the performance of these programs objectively and also to not lose sight that, at the end of the day, while we may have deep concerns about, you know, whether or not the new guidelines may impact certain types of loans, that we not forget about the need—the gap that exists with regard to access to capital for minority-owned businesses and rural-based enterprises.

We have small businesses that need this access to capital, and I think we can balance both prudence with increased access to groups that have been historically left behind in terms of access to capital.

Mr. MCGARVEY. Thank you very much. I would love to ask more questions. I appreciate the conversation that we are having here today. But I am out of time.

So, Mr. Chairman, I yield back.

Chairman WILLIAMS. Thank you very much.

I now recognize Ms. Van Duyne from the great State of Texas for 5 minutes.

Ms. VAN DUYNE. Thank you very much, Mr. Chairman, and thank you for holding this important hearing highlighting how this proposed rule change will be detrimental to small businesses across

the country and will lead to an increased risk to the American taxpayer.

Just 4 weeks ago, we had the SBA Inspector General in this room, where he shared the same concern we are hearing today. It is clear that the SBA is in no position to take on additional responsibilities.

From allowing fraud to run rampant in pandemic relief programs to this unprecedented weakening of lending standards in the 7(a) lending program, I am deeply worried by the Small Business Administration's pattern of incompetence and seemingly disdain for taxpayers.

One major concern with this rule is the change to credit available elsewhere, which requires that a lender look elsewhere for credit before looking at the SBA for funding. As for this proposed rule, SBA eliminated the requirement of providing the reason and is instead moving towards a loan volume over loan quality.

So, Mr. Wilkinson, I appreciate you being here, and I appreciate the testimony that you have provided so far in your answers to a number of questions. But I am the Co-chair of the Congressional Franchise Caucus, and I am particularly concerned by the impact of this rule on our franchised small businesses, which are a vital part of our economy, especially in North Texas.

Seeing as the SBA is going to stop publicizing the franchising directory that allowed lenders to quickly reference whether an entity qualifies for an SBA loan, are you concerned that this will make lenders more hesitant to lend to franchisees?

Mr. WILKINSON. It absolutely will. And you are correct that the Franchise Directory is no longer being maintained on the SBA website. We instructed our lenders to download the latest list of approved franchisors the day before they discontinued it so lenders could still review—go back to that Directory to see who would still be eligible.

But correct. There is going to be a lot of lenders who are going to be very hesitant based on the new rules to engage in franchise financing.

Ms. VAN DUYNE. I appreciate that.

In the recently-issued SOP, which takes effect on August 1, SBA revised the requirements regarding what a lender has to do to prove that the loan complies with what the statute requires, which says a borrower can't get a 7(a) loan if they can obtain credit elsewhere.

Mr. Wilkinson, what did SBA change about credit elsewhere, and why do we need to know about these changes? What do we need to know about these changes?

Mr. WILKINSON. Two important changes.

First of all, every time you make an SBA loan today, you have to have a narrative in the credit file to specifically say why that borrower cannot obtain credit elsewhere. It has got to be detailed out.

The rule change has been made, in my opinion, to benefit the fintech group, who wants a computer-driven algorithm low-touch program, so they have made this a check-the-box exercise. So all you have to do is, as the lender, is check a box, and it is done.

Secondly, they have changed the personal resources test. Beforehand, if a borrower had significant personal wealth, that would be a source of funds that we would say had to be tapped first before borrowing through a SBA loan. That has been changed. So personal wealth is no longer an issue. So, yeah, rich people can get 7(a) loans.

Ms. VAN DUYNE. I appreciate you saying that.

Mr. Kassar, you had mentioned earlier that not everybody who applies for a loan needs a loan.

If we are going to turn to basically just checking a box now, do you think that the SBA or that these fintech lenders are going to able to provide the same type of quality of service that you can by walking through everybody who applies for a loan, whether or not they need it, the level that they need it, and whether they can pay it back?

Mr. KASSAR. Absolutely not. Remember that SBA lending, it is a work of passion, often more art than science. So it is underserved or served borrowers across the spectrum.

The first thing you have to really ask them and understand is, what is this money for? What do you want to do with it? What is your plan? How do you propose to make more money with this loan than it is going to cost you to service?

Ms. VAN DUYNE. So you are saying you don't treat everybody the same?

Mr. KASSAR. I am not saying you don't treat everyone the same. What I am saying is that you have to have a thoughtful conversation with a borrower to begin to understand what is the root of their ask. Do they have a good reason for not needing this money? And if they don't, you have to counsel them to take some time and do some planning and some thinking, and then come back to the table when they are ready.

Ms. VAN DUYNE. So you think that the personalized service is of a greater value than just checking the box——

Mr. KASSAR. 100,000 percent.

Ms. VAN DUYNE. Do you think that actually helps people not have to borrow beyond their means?

Mr. KASSAR. 100,000 percent.

Ms. VAN DUYNE. Do you think that actually helps them to be better small businessowners?

Mr. KASSAR. 100,000 percent. If you borrow too much money too quickly or without a plan, you get into trouble.

Ms. VAN DUYNE. And do you think that the SBA is actually providing that with this change in service?

Mr. KASSAR. Absolutely not. They are trying to streamline it and make it quick, fast, and automated.

Ms. VAN DUYNE. I appreciate that.

I have one quick question. During my Oversight hearing with IG Weir, Mr. Weir shared his concerns with self-certification, and now the SBA is moving forward with self-certification for the credit elsewhere test.

Mr. Wilkinson, how do you think this effect will—how do you think this will affect lender behavior?

Mr. WILKINSON. Well, it is going to make it much easier for fraud to enter the program.

I think—we are instructing our lenders to—when SBA says "do what you do", we are telling them do what you should do because there is going to be a point in time in the future——

Chairman WILLIAMS. Time is up.

Ms. VAN DUYNE. All right. Thank you very much.

I yield back.

Chairman WILLIAMS. I now recognize Ms. Gluesenkamp Perez from the great State of Washington for 5 minutes.

Ms. GLUESENKAMP PEREZ. Thank you, Mr. Chair. Mr. Flores, thank you for being with us today. I know this is a hearing nominally on the 7(a) program, but I want to first address the 504 lending program.

So before I came to Congress, I actually own a small business and got a 504 loan. It took me a year to do. It was about the size of a phonebook. I know you share of my goal of creating efficiencies in the 504 program to streamline the process for small businessowners. The affiliation rules changes the underwriting criteria for both the 7(a) and 504.

So am I correct to say that there are multiple layers of underwriting and examination of the 502 program?

Mr. FLORES. So, Congresswoman, if you recall from the process, you were dealing with a certified development company, a third party lender, and also the SBA. The SBA actually had to review all the work that was done and then ultimately decide whether or not it was a worthy loan. So there are multilayers just by virtue of the structure of the program, which is very unique. And, again, I want to reenforce the differentiates—the 504, it is a differentiator between the 7(a).

But beyond that, as you recall, and I do want to reference, you know, you referred to just the process that there are certain complexities built in that we believe that with some of these changes, it will make it easier for that borrower to access this amazing program without, again, compromising any level of integrity or oversight over the loan program.

Again, we want to make prudent loans. It is everyone's best interest to make sure that the 504 loan program continues to succeed as it has and to provide greater access to capital for small businesses.

Ms. GLUESENKAMP PEREZ. So how exactly do the affiliation rule reforms fit into the multiple layers of the 504 program approval process and streamline it for small businesses?

Mr. FLORES. So a couple of things. I reference one particular story where you had relatives who were given the opportunity to own a couple of the restaurants—actually, the father started. Ultimately, then, a couple of the siblings wanted to move forward on a particular project, and the third sibling did not want to share particular financials that were required under the SOP.

And it ultimately led to a particular situation where the project couldn't go forward because one of the siblings did not—who was not involved in this other new venture wanted to put forth financials.

Ultimately, the family got together and cooperated. But, again, that was a situation where you had this very unique complex proc-

ess that didn't really apply to that particular situation. It almost deprived that family from being able to access the 504 loan.

With regards to franchises, again, one of the challenges that a lot of franchisees have to manage is getting—showing, demonstrating that the franchise is not going to have some level of ownership in the particular business going forward.

So now where you have that removal, there is no issue with regards to control. Now, it makes it easier for that small business to move forward if it is a franchisee.

So the whole notion here is to make sure that we are providing guardrails, but guardrails that apply to what is really happening with regards to the small business needing the capital for their particular business need and moving forward.

Again, I would say that the process in place with CDC working in partnership with a third party lender and the SBA, you have layers of oversight to protect the integrity of the program.

Ms. GLUESENKAMP PEREZ. Thank you. Mr. Wilkinson, it is go to see you again. Could you speak to how the 7(a) programs structures differ from the 504 program?

Mr. WILKINSON. So our structure is a guarantee program. So the lender makes the loan with a percentage of that loan guaranteed by the SBA. But the lender actually funds the entire loan.

Ms. GLUESENKAMP PEREZ. So is it safe to say that the reforms that benefit one SBA program may not work for another SBA program?

Mr. WILKINSON. They may not.

Ms. GLUESENKAMP PEREZ. Yeah, and thank you for that insight. I agree that we should not being painting these with an overly broad brush. In this last minute, I would love to hear some insight on what we can do to streamline the 504 and make sure that those dollars are getting to small businessowners that need it. Ms. Frazier, if you have thoughts on that.

Ms. FRAZIER. Thank you. I think the reference to the phonebook is quite adequate. And I think it is overwhelming at times from borrowers who are maybe not as sophisticated and have borrowed money for commercial real estate and their property before.

So I think anything we can do to help streamline but not lose prudent underwriting standards in the process would be helpful. Even the documentation, getting that down to something that folks can absorb and understand, and it is simplified, and I think those types of things would be helpful from the process.

Ms. GLUESENKAMP PEREZ. Thank you. Mr. Chair, I yield back.

Chairman WILLIAMS. Thank you very much. I now recognize Mr. Bean from Florida, the great state of Florida for 5 minutes.

Mr. BEAN. Thank you very much, Mr. Chairman. Good morning to you. Good morning, Small Business Committee. Good morning, panelists, we are glad to have you here. I have only been here 22 weeks. I am a new guy, 22 weeks, and I have discovered that this place is crazy town. It is crazy town. Because only in crazy town can a government agency come and have an abysmal record of losing taxpayer money, and then come and say, Hey, we want more

money, and we want to ease the standards of giving it away more frequently.

Yesterday, in crazy town, I was on a committee and spent 4 hours listening why it is a great thing that we would give away taxpayer moneys in the form of student loans; why that is a great thing. And then even finding out—and this was in crazy town—a big sizable part of those student loans didn't even go for tuition, they want for trips and cars and stereos. How about that? But that is what happened in crazy town.

So and as a former banker—I know there is some bankers up there—it is just unfathomable that we would ever forgive a loan after the person agreed this is the terms of the agreement without even trying back. So it is a toss-up for the panelists. Are we in crazy town? Who wants to answer that question? Are we in crazy town? Is this crazy town?

Mr. WILKINSON. I would love to take that question.

Mr. BEAN. Jump in, my friend. Welcome to crazy town.

Mr. WILKINSON. Well, thank you for that question. I would tell you that over the last several decades that I have been involved with this program, we have taken steps as we have seen lender behavior—and borrower behavior as well—to put guardrails in place at SBA to make sure that this program operates on a sound basis. We view this as a three-legged stool with the lenders, the borrowers, and the federal government representing the taxpayer. We need it to work for all three of us.

And so I would say over the last, especially the last two decades, you can go look at our performance, and it has been really, really good. In the last probably five fiscal years, our charge-off rates have been running under a half a percent. I think it is a very well-managed program. It is working for the taxpayer, it is working for the borrower, and it is working for the lender.

So I think in this being particular case, the 7(a) program, as the Chairman said, it is not broken. It is working just fine.

Mr. BEAN. So to make these moves, we wouldn't be going to crazy town? Is that your testimony today before we are going to crazy town making these changes?

Mr. WILKINSON. I believe these changes will lead to significantly higher losses in the 7(a) program.

Mr. BEAN. Very good. Mr. Kassar, you have been sitting there. I want you to jump in. I want you to jump in because it used to matter, criteria used to matter. And I made loans myself a small bank in northeast Florida. And it used to matter, could the customer pay us back? That was the number one question my boss and my committee—can they pay us back? That was important. I had to answer that. But it seems the SBA is less concerned about getting paid back, but is that what they do in crazy town? Mr. Kassar, welcome.

Mr. KASSAR. Thanks for having me. Listen, one of the things I have loved about SBA lending, being involved in it for the last almost decade and a half is that it hasn't felt like crazy town until now.

So to the point, we have had a balancing act, and it has worked for all the parties involved. And it has helped tens of thousands or hundreds of thousands of businessowners and entrepreneurs. But

it feels like crazy town when you say we are going to throw it all up, we are going to change it all up all at once. That feels like crazy town to me.

Mr. BEAN. And then you got to add this to the mix. After their horrible report card, and it is just—they do it with a smile and say, okay, we have done such a horrible job, give us more, and let us ease the standards so we can get more taxpayer funded programs out the door. And then, like I said, in the committee yesterday, let's just forgive all debt. But that is what they do in crazy town.

Mr. KASSAR. I think it is super important to note, though, the conventional SBA 7(a) lending that has been around for decades is not the EIDL program, we are not the PPP, we are not the restaurant revitalization fund. And that is starting to get a little crazy town when you are comparing them, because you are comparing dramatically different programs. And you have to be really careful to separate those guardrails.

Mr. BEAN. Gotcha. Typically, Ms. Alice, it would matter if the borrower could pay us back, but we are in crazy town. So should it matter that the borrower could pay us back, Ms. Alice?

Ms. FRAZIER. It should always matter. And one of the things that you know as a former banker that you are looking for some skin in the game from the borrower as well. And that is part of the new rules is there is no necessary reason to show any skin of the game from that perspective. And that is part of paying it back from that perspective. I would also say to become a preferred lender, you have to prove yourself trustworthy and to be trusted with what the government is allowing you to do on their behalf. And in that point we all take that very pridefully. And to remove these rules, it is not the same anymore.

Mr. BEAN. Amen. Ladies and gentlemen, thank y'all so much for coming forward. And welcome to crazy town. Mr. Chairman, I yield back.

Mr. MEUSER. [Presiding.] The gentleman yields back. I now recognize Ms. Scholten from Michigan for 5 minutes.

Ms. SCHOLTEN. Thank you so much, Mr. Chair. And thank you to all of our witnesses for coming today. We truly appreciate your testimony. I said this last week to Mr. Kelley, but, of course, it bears repeating today, that these rules are nuanced. And now that the SBA has finalized them, it is up to Congress to do the necessary oversight of the SBA to make sure that they are implemented correctly. And we do have concerns, as you have heard today.

So my first question is for Mr. Frazier. In your testimony, you state that the best thing for an underserved borrower is to work with a lender that is committed to their success. I completely agree. I have seen this first hand. I have heard from financial institutions in my district about their concerns regarding Fintechs that may become authorized SBA lenders under this new finalized rule. One of the top concerns I have heard about.

What services does your bank offer underserved borrowers that a Fintech cannot? And what guardrails do you think the SBA should have in place to ensure predatory lenders are not allowed to participate in the SBA program?

Ms. FRAZIER. For our bank, I will speak for us, is we are involved with a number of initiatives locally. Through chambers, there are typically some programs focused on women and minority borrowers to help educate them. We also work closely with the NAACP organizations, et cetera. And then we also have education programs that we hold for our, you know, local clients and the prospects. But I don't think that I am unique in that. I believe most of our community banks across the nation do the same thing because we are committed to the communities we serve overall.

And I am concerned from the Fintech perspective, it is not about what you are doing to actually help the economics and help the businesses grow, and help them use the money appropriately and to get the right size loan that is appropriate that they don't go too far into debt. And in that situation, this is where the banker becomes more of a partner to them than necessarily just a place to get money. And that partnership lasts for a long time and can serve all very well.

Ms. SCHOLTEN. Okay. Thank you. I apologize for saying "Mr." at the outset. Or maybe you didn't hear me.

Ms. FRAZIER. I will just let that slide.

Ms. SCHOLTEN. Good for you. I get called "Mr." all the time, actually. I don't mind. So I have a second question, another concern that I have heard from financial institutions in institutions in my district is changes to the underwriting criteria the SBA is making in the affiliation rule. This is also a topic that Mr. Kelley discussed at length last week.

Ms. Flores—I am kidding—Mr. Flores, my question is for you. In your testimony, you express support for the intent behind the SBA's changes to the underwriting standards. From your perspective, how significantly do you think the underwriting standards will change because of the affiliation rule? How will these changes to underwriting criteria impact the level of consistency in local evaluating and processing?

Mr. FLORES. Thank you. So from our perspective, we are going to continue to use our prudent lending practices. We have guidelines, we have policies and procedure that we have to vet from our own internal loan committee board of directors as well as the SBA. We are still going to be using the five Cs of credit, capacity, capital, collateral, conditions, character. And, frankly, the three, you know, there has been discussions of moving from nine to three various credit factors.

But if you take a look at the actual SOP, the language of the SOP. And I quote: Lenders and CDCs must use appropriate and prudent generally acceptable commercial credit analysis, processes, and procedures consistent with those used for their similarly sized nonSBA guaranteed commercial loans. Lenders, CDCs, SBAs may use the business credit score model.

When we read that, we are looking at, okay, also our banking partner has to make sure that they are following their rules and procedures. They can't run afoul those procedures because they will get in trouble or banking regulator. The SBA itself, OCRUM. We are going to have to be—we are going to be measured and gauged by whether or not we are following our own policies and procedures, and if we are also being prudent in our lending.

Now, the streamlining here is to, in my opinion, and the opinion of many in the CDC industry here is how do we make it easier and less burdensome on the small businessowners so that they don't have to come in with a telephone book, as it was just described earlier, and where it frankly doesn't have to take a whole year? Think about what happens in the real world. You have small businesses who want to make investments. And sometimes—and at the end of the day, time is money, and time is opportunity. But here with the 504 program, it is not just about what is in the best interest for that small business, it is also about the impact that we have in creating more jobs, bringing the local investment. So it is in everyone's best interest to make sure that the 504 loan program gets in the hand of the small business borrower in a shorter timeframe responsibly. And then the benefit here is you are also seeing more investment in our communities and greater access to minority-owned businesses and rural-based enterprises.

Ms. SCHOLTEN. Thank you. I appreciate that testimony. I yield back the reminder of my time. Thank you.

Mr. MEUSER. The gentlewoman yields back. I now recognize myself for 5 minutes. I thank you all again for being here.

Chairman Williams mentioned the letter earlier that was just sent, I believe in the last couple of days, also signed by Ranking Member Velázquez and the Ranking Member and Chairman from the Senate to the SBA stating that this program needs to be needs to be delayed due to the lead person on this Patrick Kelley no longer being with the SBA. We are all sitting here stating, and your concern is that potentially unworthy businesses will be receiving loans and will increase your subsidy rate for the program, and among other things, obviously.

So clearly this is a bipartisan understanding that they are moving forward in real serious haste, which could have real serious ramifications on taxpayers as well as yourselves. Is there anything about this that you find reasonable? Is there anything about this initiative that could work for you that you think actually can be a positive thing? Anything at all? I am going to ask you, Ms. Frazier.

Ms. FRAZIER. Well, certainly. Thank you for that question. But certainly there are pieces in there that could help smooth the process, make it easier to get credit there. But I think taken as a whole——

Mr. MEUSER. Right.

Ms. FRAZIER.—it is too much risk.

Mr. MEUSER. Okay.

Ms. FRAZIER. And so it needs to be dissected. You need to get—I really recommend as part of the ICBA, bring lenders in and dissect it——

Mr. MEUSER. Right.

Ms. FRAZIER.—and pick the best parts——

Mr. MEUSER. Right.

Ms. FRAZIER.—so that we remain prudent. That we keep—safe the monies that are put out there and do the right things for the borrowers.

Mr. MEUSER. Good. Absolutely. Then and I am absolutely favorable to that, and that is exactly how we should proceed.

Mr. Kassar, good to see you. Thanks for making the trip down from Pennsylvania. I make that route quite a bit myself. You stated that the SBA is focused on a misguided solution in your testimony, broadening access to capital, and burdening future generations of taxpayers with the fallout. You seem to have some existential concerns about the 7(a) program due to this initiative. Could you expand on that?

Mr. KASSAR. Sure, again, I think there are many elements that could be terrific. I think there should be some role for Fintech. It is very careful to put Fintech in one category. Fintech is a broad industry with different players, with different philosophies. Better use of technology in the program at different stages is good. What is dangerous here is doing it all at once.

Mr. MEUSER. Yeah.

Mr. KASSAR. And because—I don't know if the SBA has produced any forecasts about what will happen to default rates——

Mr. MEUSER. Right.

Mr. KASSAR.—as a result of these changes, and if they have one, I don't know how they did it. So if we say we are going to try this for this quarter, and then we will be able to measure it, and then we will add this element next quarter, and this element next quarter, you will start to see and understand what is working or not. To say that the SBA program shouldn't evolve and innovate and change or leverage technology——

Mr. MEUSER. Sure.

Mr. KASSAR.—I think is irresponsible. But to do it all at once——

Mr. MEUSER. Right.

Mr. KASSAR.—like the big crazy science experiment——

Mr. MEUSER. Right.

Mr. KASSAR.—I think creates a lot of risk.

Mr. MEUSER. And as businesspeople and entrepreneurs, I can understand that you all would have that sentiment.

Mr. Wilkinson, let me ask you this, the 7(a) loan program statistics looked like for smaller dollar loans and underserved market loans, the SBA stated that the 7(a) program does not succeed in underserved market lending. Do you want to comment on that? Is the 7(a) program working as effectively as it should be right now.

Mr. WILKINSON. Well, you know, we can always do more, but we have got just over 50 percent of our loans and loans under $150,000, and with SBA's new definition of small-dollar loans being at $500,000, about three-quarters of our units. That is a significant portion of our portfolio are in small-dollar loans. You also have to keep in mind that it is the larger transactions that pay the cost for the smaller ones. And so we got to have a pretty good mix of both.

Mr. MEUSER. Right. Okay. And last week the former Associate Administrator Patrick Kelley told the committee that all the concerns amounted to a lot of fuss that has been made about banks being upset about three Fintech companies being included in the program. What do you have to say about that comment.

Mr. WILKINSON. Well, we welcome in lenders to this program all the time. We would be happy to have quality lenders who are capitalized, who understand the rules and regulations of the SBA program, and who are appropriately regulated.

Mr. MEUSER. Sure.

Mr. WILKINSON. What we don't want is lenders who don't know what they are doing that aren't appropriately regulated abusing program. But I would echo Mr. Kassar's comments about Fintech. We have a number of Fintechs that work with our lenders today. We have a Fintech who is a lender. They went out, and they bought a bank. They are capitalized, they are regulated by OCC, and they are a good corporate partner.

Mr. MEUSER. Thank you. Mr. Flores, I want to ask you something quick. Your testimony described the 504 program as successful public, private partnership. What did you mean by that, and you have got one second to elaborate.

Mr. FLORES. Banks, private lenders, CDCs, SBA with a support of Congress. That is winning calculation.

Mr. MEUSER. All right. Thank you very much. I yield back.

I now recognize Ms. Chu from California for 5 minutes.

Ms. CHU. Mr. Flores, I want to make it clear that I share many of the concerns raised today particularly around unregulated entities being able to make loans when there is still questions regarding fraud and PPP. But I also want to ensure that a response to these rules is nuanced and recognizes the positive impact these rules will have on lending in underserved communities.

For example, you testified that the affiliation and lending criteria rule implements some welcome changes to the 504 Community Development Program. And, in fact, CDCs had specifically asked for these changes to be applied to the 504 program after they were first applied in April of last year to Community Advantage Lenders. As a CDC that makes both 504 and community advantage loans, can you discuss how the changes to the affiliation in lending criteria will help lenders like you better fulfill your mission of reaching underserved businesses? And, in fact, you have an example in your testimony about a specialty food brand that you had loaned to for the property, and then 10 years later they sought additional financing, but they had grown and had 40 affiliates. And the burden of providing documentation on 40 different affiliates, many with no direct ties to the business seeking financing was too arduous to close a loan. So how would it be different with these rules?

Mr. FLORES. What it does is it makes it, it loosens up. Again, not loosens it—it makes it easier in a more streamline efficient way for us to determine whether or not the borrower is meeting the spirit of being able to access the 504 loan program. Knowing that we are providing some very favorable terms to that borrower; to provide that access to capital; to create job to make local investments. And the particular story that you just referenced, it was sad to see here a very successful business operator who had a dream. We provided an SBA 504 loan. That individual continued to grow their business, meet other unrelated investments. But because of those older rules had to—was asked about all of these other unrelated essentially entrepreneurial endeavors. And then now, the individual said, you know, I just simply have no time to comply with all these requests. I am talking away. I do not have time in order to be able to make additional investment. And that was a real lost opportunity.

I just want to reinforce, again, that we are talking about—you know, that is why it is important to differentiate between the 7(a) and the 504 loan program. And I want to make that clear here. And that differentiation is important so that as we are thinking through of how to apply the rules, we have to look at them from the perspective of the difference between the two programs.

Again, I want to also reinforce just the customer service experience and how critical that is. If you have customers who don't have faith in the program, they are not going to come to the SBA for the 504 loan. They are going to say, hey, I am going to look for a more expensive, more—a different option because it is easier. You know, and what does that mean? It also has a negative effect, frankly, on our lending partners. If our lending partners or the bankers or other private lenders believe that it is too onerous to do a 504 loan, they are not going to help us promote the 504 loan. They are going to say to their borrower, hey, you should do something else because it is going to be easier and faster for you.

Ms. CHU. Mr. Flores, your testimony also urges sufficient time and communication from SBA so that lenders could understand and implement all the changes to the two rules. As we know, since the final rules came out in April, the SBA has released a number of agency notices laying out various lender and program requirements in a piecemeal fashion. There has been a lot of twist and turns in this. And then last week the SBA released a 400-plus page SOP, which lenders have to review and comply with by August 1. So that takes only 2 months away.

So do SBA lenders, particularly, smaller mission-based lenders like CDCs, which may have fewer resources to navigate various program changes, do they need more time from SBA to implement these new rules? And what specific additional resources do you need from SBA as you seek to become compliant with these new rules.

Mr. FLORES. So as a former regulator, when I dealt with banks and other financial service institutions that were impacted by changes that we were making as an agency, engagement with the industry was always part of the process. I do give the SBA some positive remarks in terms of some of the already engagement that they have undertaken with us. However, I do think that we still need a continuous open dialogue. I think we need to continue to have actual meetings, technical assistance, and providing that a reasonable on-boarding ramp—and not just for certified development companies, but also for our lending partners.

Ms. CHU. Thank you. I yield back.

Mr. MEUSER. The gentlelady yields back. I now recognize Mr. Alford from Missouri for 5 minutes.

Mr. ALFORD. Thank you, Mr. Chairman, and Ranking Member Velázquez for holding this important hearing today. And thank you to our witnesses for coming in today. I really appreciate it.

One of this committee's core functions is to conduct oversight as a small business administration. I am glad to be hear today with my colleagues to continue that and discuss the Biden-Harris administration SBA's disastrous rules that really compromise the soundness of the 7(a) program and puts taxpayers and small busi-

nesses at risk. Like many of my colleagues, I am worried that the SBA is not able effectively regulate this space and this activity.

As a previous small business owner, I know how important capital is to small business, and I also understand access to capital can be a challenge especially in districts like mine which really has banking deserts. So let me be clear, I am not anti-Fintech, but I am against the rules that decrease standards and increase risks threatening the integrity of the current system and leaving taxpayers on the hook when something goes wrong. The SBA released procedural notices about these rules the night before last week's hearing, the night before, leaving us zero time to review them.

I am here to tell you today, Americans deserve better than that. They deserve better than the fly-by-night Biden-Harris SBA, which is why I am pleased to learn that the departure of the SBA official chiefly responsible for these rules who is with us last week. Mr. Kelley's blatant disrespect to this committee and its Members last week showed a disregard for Congress, and it showed a disregard for small businessowners. It also underscores the importance of congressional oversight. So and unelected bureaucrat cannot shamelessly advance an agenda.

Now, with no one at the helm of the SBA's Office of Capital Access, adding to the vacancy the offices already have, which are many, the Biden-Harris administration must put a pause on these rules and do it today.

Mr. Wilkinson, if you Google federal financial regulators, the SBA does not show up, nor does the SBA show up in a March 2020 congressional research service report titled: Who regulates whom, an overview of the U.S. Financial Regulatory Framework. The SBA is not a financial regulator. But if a Fintech only participates in a 7(a) lending program, you will be sole federal regulator. Fintechs facilitated so much PPP fraud as well.

Mr. Wilkinson, given your experience and perspective with 7(a), should this committee and taxpayers trust the SBA as the sole federal regulator of Fintechs in this program, why or why not?

Mr. WILKINSON. At this point in time, no. I am a fan of the job, the effort, the folks in the Office of Credit Risk Management at SBA are doing, but they are understaffed they are underresourced. They are 40 percent understaffed right now. They have got so many vacancies. It will be hard for them to catch up. I think the will is there to be a regulator, but they are not given the resources to do so. But they also don't have the framework to be the prudential regulator like an OCC or FDIC. SBA is really good at looking at transactional risk, looking at the loan, but they are not looking at the capitalization and the interest rate risk and the other interest bucket that will be looked at by a prudential regulator.

Mr. ALFORD. Mr. Wilkinson, we have been told that this is a Biden-Harris administration effort. But Joe Biden said he wants to increase regulations for banks while at the same time this rule removes most underwriting and prudent lending standards. What reason is the FBA giving for saying something that directly conflicts with the White House.

Mr. WILKINSON. That is an interesting question, because most of the other warning signals are coming up are warning to go slow

with the addition of Fintech. Yet SBA is, I guess, hanging their hat on the PPP program where they are saying that Fintechs were able to reach down into more underserved markets. But the PPP program was not a loan program; it was a grant program. It was very—there was no underwriting to it. It was if you made your payroll, you got your loan forgiven. End of story. This is a vastly different program. You have got to underwrite it to see whether the borrower can be paid and then service it going forward. Probably not something that would be high on the Fintech list.

Mr. ALFORD. Thank you. Mr. Frazier, I am greatly concerned SBA is not prepared to handle this. The Inspector General report published March 21 just a few weeks ago noted oversight staffing levels in the Office of Credit Risk Management decreased from 42 to 26 employees, 38 percent. This staff reduction could affect SBA's fiscal 2023 goals for oversight reviews which helps ensure lending compliance with program requirements.

How do questions surrounding the SBA's competency affect what lenders do and the small businesses that rely on these loans?

Ms. FRAZIER. As we talked about many times already today, there is a necessity to gain that access to capital for the businesses in a timely fashion, but not at the risk of prudent underwriting and not at the risk of doing things. But, however, if their office is not appropriately staffed, it does put the whole process into great risk.

Mr. ALFORD. Thank you. We are out of time. Again, I call on the Biden administration to put a pause on these rules today. Mr. Chairman, I yield back.

Mr. MEUSER. The gentleman yields back. The Chair now recognizes Mr. Thanedar from Michigan for 5 minutes.

Mr. THANEDAR. Thank you, Chairman. According to Federal Reserve Bank of Chicago, the small businessowners in my district are routinely denied loans due to lower credit scores, lack of sufficient collateral, and lacking access to banking services.

In 2022, two out of three businessowners who sought credit did not receive the full amount they requested. To that end, I believe small businessowners should have access to more responsible lenders.

My question to Mr. Flores is the SBA has spoken at length about the need to increase lending opportunities for underserved small businesses as the reason for these two rules. But nowhere in either of these rules does it state a requirement to lend to small businesses in underserved markets. How do you guarantee that smaller loans are being made and targeting the small businesses in the communities we are all trying to reach? Mr. Flores.

Mr. FLORES. Thank you. Again, I reference the Certified Development Company and its framework and its mission as an economic development set of organizations is our commitment to ensure access to capital, and not only to work with businesses that had been operating for a few years and have a track record, but also for those who are trying to get there. And so what that means is being very proactive and engaged, working with the small business development centers that are also part of the SBA network—organization such as score—and also local chambers of commerce and other units of government, locally, that are focused on providing programs that help grow that small business ecosystem. The

Community Advantage Loan Program is one such program, as well as others.

So, you know, a number of Certified Development Companies, our community advantage lenders, we are committed to continuing that program in our organization, and we believe that there is an opportunity here to continue to grow that initiative. We are obviously open to other ideas. And, obviously, there is a very robust debate here and concern. And I appreciate that. I think that there is a way for us to balance risk and at the same time prioritize that access to capital to folks who had been historically left out and also rural-based enterprises. There are folks in central and southern Illinois, for instance, who have less opportunities. How do we make sure that those entrepreneurs aren't left behind? We think programs like the premier advantage program can be effective.

Mr. THANEDAR. Thank you. Now, most of the fraud that offered during the PPP loan scheme undertaken by the SBA came from Fintech companies. I feel without strong oversight regulations, bad actors might fraudulently take advantage of small businessowners seeking loans.

Ms. Frazier, in your testimony you state nonbank Fintech lending is no substitute for community bank lending. Can you expand on the statement? What services does your bank provide that a Fintech cannot?

Ms. FRAZIER. Well, on the basis of a Fintech is through the web and through the internet. And, oftentimes, there may not be even someone to speak to. Answers are given all electronically. As noted by many of us here, you know, it is about the business plan; it is about being able to sit with the borrower and to speak with them about what are the plans; how do you see this growing; what happens if you don't reach those goals; how will you pay the loan back? And I think that those elements are missing. And I believe, in a community bank world, that personal relationship is there and is guiding them. And if things go south for a business, and they do, the bank is able to work with them to really help them through those troubled times. And I think that is where the difference belongs.

Mr. THANEDAR. Thank you, and I yield back.

Chairman WILLIAMS. Next, I now recognize Mr. Crane from the great state of Arizona for 5 minutes.

Mr. CRANE. Thank you, Mr. Chairman. Thank you all for coming today. Last week I asked Mr. Patrick Kelley, I raised a concern that these rule changes would leave taxpayers on the hook to bail off the SBA. Along those same lines, Mr. Kassar, you mentioned default rates to Mr. Meuser. Do you believe these rules will lead to more or fewer defaults on government-backed loans?

Mr. KASSAR. It is hard to imagine a scenario where these would lead to significantly higher defaults because of the complete loosening of controls. And the danger is we won't understand what levers created them. Because so many levers are being pulled and changed at the same time.

Mr. CRANE. Yeah, you mentioned that a couple of minutes ago. If that is the case, sir, who will eventually be on the hook to bail out the SBA?

Mr. KASSAR. The taxpayers or the small businesses we will levy heavier fees against them to continue the program.

Mr. CRANE. Mr. Frazier, how would you rate the SBA's customer service? Is it easier to get in contact and receive answers from them when a problem arises? Ms. Frazier, I am so sorry. We are not playing some sick joke on you, ma'am. I apologize.

Ms. FRAZIER. All good here.

Mr. CRANE. There are long weeks up here.

Ms. FRAZIER. I completely understand. Thank you. You know, I believe that having the right relationships within the SBA helps facilitate quick and easy answers, but it can be difficult at times just given the current staffing situations.

Mr. CRANE. Thank you, ma'am. Mr. Kassar, finally, are you concerned these rule changes could allow lenders to focus more on maximizing their own fees by increased loan volume rather than focusing on quality of loans given?

Mr. KASSAR. Absolutely.

Mr. CRANE. Thank you. You know, Mr. Kassar, you said a second ago, you are talking about this crazy science experiment if we are doing this smartly as an entrepreneur would do it, we would take one step at a time, and then we would evaluate it. Is that correct?

Mr. KASSAR. Yeah, though, sometimes entrepreneurs are crazy scientist.

Mr. CRANE. That is true. We are. But I think the reason that we take one step at a time if we are being wise and smart and a little bit of cautious is so that we don't sink the boat. Is that correct?

Mr. KASSAR. A hundred percent. Lending is a carefully—you have to think very carefully. There are a lot of levers.

Mr. CRANE. You know why they don't care how many elements we take on at one time, right?

Mr. KASSAR. I have my theories.

Mr. CRANE. Because it is not their money. It is the American people's money. They don't care. It is obvious. That is one of the things I have noticed since I have been up here, they could care less. It is so easy to spend somebody else's money. That is why this administration just put out a budget, it was another, close $7 trillion.

And that is the thing that bothers me about this. My colleague over here, Mr. Thanedar, we just came from Homeland Security together, and he was talking about, hey, some of my constituents, they don't have enough capital or collateral. Well, maybe they don't need a loan then. Maybe they need to be working on their business, their business plan to get to a point where they can actually have enough capital, enough collateral where they can actually secure a loan. Because that is one of the things going on in this country, we live in such an entitlement country now where it is like people don't feel like they need to pay anything back. And who is always on the hook for it.

Mr. KASSAR. There is another element to this program which is part of the vicious cycle, which is many borrowers today, particularly, underserved have opportunities on the internet to get money in their bank in 24 to 48 hours. And it is so enticing. Many of them

come from Fintech lenders. We have to be careful not to call Fintech all at once. And so sometimes they will get one, and they will get another, and they will get another, and it becomes a vicious cycle. And then they come to us because—and it is—often it is too late to help. So some of the issues that has to be thought about in my opinion by Congress about serving entrepreneurs is what is happening on the other side of the coin? Where are they getting their money today, and often times are going to the other side because it is simpler and faster. And that also leads to devastating consequences.

Mr. CRANE. Well, what I will tell this panel is I represent Arizona's Second Congressional District. It is a very rural district. We have a lot of hardworking folks in my district. You know, so I know that they probably don't have the same access to capital that some of these more metropolitan districts do. But all I will say is as a country when you are $32 trillion in debt, there needs to be a return to fiscal responsibility. And I just don't see that with this program. I don't see that with these rules changes. And for that reason I don't support it. Thank you Mr. Chairman, I yield back.

Chairman WILLIAMS. Thank you very much. I next recognize Mr. Molinaro from the great state of New York for 5 minutes.

Mr. MOLINARO. Thank you, Mr. Chairman. Thank you all for being here. I am happy that I was here for Mr. Crane's comments because it does, in fact, set up what I think is ultimately the problem. I am old enough—although I may not look it—to remember when we were all living fat and happy and encouraging access to capital for home purchasing to underserved communities. A noble and important goal that led to a mortgage crisis that we have not rebounded from since. And I couldn't think of a less apt organization than the SBA to manage a less restrictive and more irresponsible set of new rules. And this is not me being political. I spent the last 12 years as a county leader, lived through COVID and PPP, and I can absolutely say, local chambers of commerce, local business organizations, they all share the exact same concerns that we are voicing today. The SBA, despite its relationships, despite partnerships for not for profits and partners in the community just is inadequate to do and to manage what they are proposing in those rule changes. And so I want to start, in fact, with the underserved populations. Because I think actually the SBA does a reasonably good job partnering to provide access to capital to underserved communities.

And so, Ms. Frazier, you spoke a little bit about the 7(a) lending program demonstrates strong lending patterns already to underserved borrowers. One in three 7(a) loans were to minority-owned businesses. So with the SBA's complete overhaul of the program, would you give us some idea how these rules could negatively impact what we already do somewhat successfully to serve those underserved populations? What is the risk that we open with these rule changes?

Ms. FRAZIER. Thank you. And I am going to go back once against that oftentimes another loan or a loan is not what the borrower needs or what the new businessowner needs. Oftentimes, they need coaching, they need counselling, they need to have a better business plan and work through that. And I don't believe

unleashing very loose credit standards is going to be effective to ensuring the integrity of the program, but also ensuring economic viability for the underserved.

Mr. MOLINARO. And so despite coming from New York State, meaning most people think it is an urban place—I represent rural communities all throughout upstate New York, and access to capital is a concern. And we do have difficulty, small businesses, accessing. So your point what the SBA is doing is eliminating all of or basically throwing out the guide rails that would protect us in the case of fraud and abuse.

And, Mr. Wilkinson, you and I spoke yesterday. So thanks for that conversation. To avoid what we know or to help avoid the circumstances of fraud and abuse here, what protections or rules should the SBA keep in order to provide the appropriate integrity 7(a) lending? And I kind of asked this of you yesterday. What are some of the rules that do make sense that this should not be thrown out.

Mr. WILKINSON. Sure. There is a list of eight or nine criteria that were in regulation that have been taken out. We would suggest that those be put back in statutorily. But I want to go back to the previous question and just note that year to date we have got about 24 percent of our borrowers who do not note on their loan application a particular race. So our loans to minorities are most likely underreported. We probably have a much better track record than the numbers present.

Mr. MOLINARO. So SBA doing a better job in recording, report, and then transparency. I know Mr. Chairman believes, as we do as a committee, the SBA should be more forthcoming with much of its data. And, by the way, I would say out loud the SBA should be more forthcoming in its interaction with the industry and the development of these rules, which does lend us to some concern and certainly frightens us.

Mr. WILKINSON. A conversation just like this before the rules were implemented would have been very helpful.

Mr. MOLINARO. Yeah, I am concerned about the conversation that the SBA may have had with the folks who benefit from the rule changes before the rule changes. But I am just saying that as a happenstance. Perhaps it may or may not have occurred.

Before I finish up, Mr. Kassar, is it a fair assessment to say that without the appropriate regulations and clear defined requirements, it will ultimately be extremely difficult to determine if borrowers are acting in good faith or not? There are bad actors. They will act badly. That is a known fact in humanity.

Mr. KASSAR. A hundred percent.

Mr. MOLINARO. Thank you, Mr. Chairman, I yield back.

Chairman WILLIAMS. Thank you. Next, I want to recognize Mr. Stauber from great state of Minnesota for 5 minutes.

Mr. STAUBER. Thank you very much, Mr. Chair. I want to thank the panel for joining us today as well as for the important role that you play in supporting our small businesses. Like you, I have serious concerns over the misguided 7(a) loan program rules that the Biden administration has put forth. As I shared during last week's hearing, the 7(a) loan program has been instrumental in helping to grow small businesses, which I believe are the en-

gines of innovation in our economy. I am committed to upholding the integrity and fiscal solemnness of this program. Information shared by the SBA and the supplemental guidance and its final SBLC rule indicated that the SBA only intends licences to three new SBLCs, and that it expects these three new SBLCs to make a total of 425 loans over the next 4 years. However, the final SBLC rule does not contain any limit on the number of new SBLCs that can receive a license.

Mr. Wilkinson, how many license for nonfederally regulated lenders do you think the SBA will actually grant?

Mr. WILKINSON. Well, that is unknown. In the narrative, they said they were only going to do three, but in the actual regulatory language, there is no limit.

Mr. STAUBER. What do you expect these new lenders, loan activity to be? Do you think the figures provided by the SBA are accurate?

Mr. WILKINSON. No, sir, I do not. I think they are low by a significant amount.

Mr. STAUBER. Thank you. Ms. Frazier, approximately, how many financial industry regulators oversee the operations of a community bank like the Bank of Charlestown.

Ms. FRAZIER. I actually have three. I will speak for myself. We have the state regulator, West Virginia and the FDIC. And then our holding company also has the Federal Reserve. So for most community banks, two to three. As well as aside from that, the SBA does come in and do their own oversight and regulation of what we have done by looking at the loans.

Mr. STAUBER. Do you believe the Small Business Administration has supervision and regulatory expertise and bandwidth on power of the comptroller of the currency, FDIC, or Federal Reserve?

Ms. FRAZIER. No, I don't believe they are prepared for that. Taking on not only just reviewing the credit files for whether or not they agree with the SOPs, but understanding the whole processes, controls, and the way, the company, the capital, and the things related to any company and nonbank Fintech would have.

Mr. STAUBER. You know, during our hearing last week, when I pressed Mr. Kelley, he tried to explain that the SBA will have the ability to provide the necessary supervision and oversight to the nonfederally regulated Fintech companies that will flood the 7(a) program under the Biden administration's new rules. This is even as new loan activity far outpaces the unrealistic figures the SBA has provided.

Just yesterday, I sat down with a group of small community bankers from across northern Minnesota who shared their concern that the SBA is not capable of overseeing these Fintech companies in the 7(a) program, particularly given the SBA's track with PPP. And you all know it is approaching $900 billion in fraud and counting.

I trust my local community banks to be responsible 7(a) lenders due in part to the layers of supervision and scrutiny that they face from several different financial industry regulators. They also live and work in the communities they serve and have deeply personal

relationships with the small businesses they help grow and support.

I, unfortunately, cannot say the same of Fintech companies. I agree with my local lenders in Minnesota and worry that the uneven lax oversight of Fintech sector entering the 7(a) program will put the entire program at risk. And I want to thank the local community banks who kept us afloat during the pandemic. Had it not been for our community banks, I believe this nation will be in dire straits today. Thank you. Mr. Chair, I yield back.

Chairman WILLIAMS. Thank you very much. And while we have a minute to go, I just want to reinforce what my colleague said about the community banks. We have talked about this, but I compare what you all did to what our bomber plants did and our manufacturing plants did in World War II. They turned it around overnight and got our country going. Y'all did the same thing, getting money injected in the economy that actually brought a return on investment back to America. So I want to thank you for that.

I also want to thank the witnesses, all of you today, for being here and appearing before us. Without objection, Members have 5 legislative days to submit additional materials and written questions for the witnesses to the Chair, which will be forwarded to the witnesses. So I ask the witnesses to please respond promptly when that happens. And if there is no further business, without objection, the committee is adjourned.

[Whereupon, at 11:55 a.m., the committee was adjourned.]

APPENDIX



"Taking on More Risk: Examining the SBA's Changes to the 7(a) Lending Program Part II"

Testimony before the House Committee on Small Business

May 17, 2022

Submitted by

Anthony R. Wilkinson

President and CEO

National Association of Government Guaranteed Lenders (NAGGL)

Frisco, Texas

Anthony R. Wilkinson | CEO and President | NAGGL | Frisco, Texas

Chairman Williams, Ranking Member Velázquez, and Members of the Committee— my name is Tony Wilkinson and I have served as the CEO and President of the National Association of Government Guaranteed Lenders (NAGGL) since December 1987. NAGGL is a national trade association of approximately 1,000 banks, credit unions, non-depository lenders, mission lenders, CDFIs, and other entities that participate in the Small Business Administration's 7(a) loan guarantee program—NAGGL represents all types of lenders. And our lender members are responsible for at least 80% of the total 7(a) loans made each year.

I want to thank both this Committee and its Senate counterpart for the thoughtful consideration that each is giving to the sweeping changes that the Small Business Administration is currently implementing for its loan programs and the grave dangers that these changes pose to the 7(a) program, the millions of small businesses supported by 7(a) loans, and to the American taxpayer. I am grateful to be able to add my thoughts to that consideration.

On behalf of NAGGL's members, I want to assure you that we strongly support the stated intention of the 7(a) program changes – increasing access to capital for America's small businesses, especially those in underserved markets and those needing smaller loans, and streamlining program processes. Unfortunately, however, we do not believe that the changes being implemented will achieve those goals, and, in fact, we have serious concerns that they actually may undermine the integrity of the program.

And let me say upfront that our concerns are not rooted in any desire to protect current lenders from additional competition or to bar different types of lenders from joining the program. Rather, our concerns remain consistent with those that we stated in our public comment letters when the rule-changes were originally proposed – that the changes will threaten programmatic integrity and potentially harm the most vulnerable small business borrowers. We will provide those letters for the hearing record.

As a result of changes made in the two Final Rules that took effect last week, SBA is both removing the long-standing guardrails that have assured prudent lending in the 7(a) program and, at the same time, opening the program to additional non-federally regulated lenders. In my 40-year career in this program, I have never seen such sweeping changes that provide more of a recipe for disaster.

And, although we still are digesting the additional changes that SBA continues to make through piecemeal program notices and a new standard operating procedures manual (SOP) slated to take effect on August 1, it is already clear that the guidance provided in those documents will only serve to exacerbate our original concerns.

When considered in their entireties, it becomes apparent that SBA's regulatory and policy changes will likely lead to higher losses in the program, leading to increased program costs. This domino effect would result in increasing the cost of access to capital for the very borrowers we all seek to aid. NAGGL's decades of experience in this program tells us that SBA's recent changes need to be reconsidered and that a different approach is needed – one that better balances the risks and rewards that will come with this sweeping redesign of the 7(a) program.

Anthony R. Wilkinson | CEO and President | NAGGL | Frisco, Texas

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The Overview: Loosening Prudent Lending Guardrails Simultaneously with Opening the Program to an Unlimited Number of Non-Federally Regulated Lenders Without Providing Adequate Oversight

SBA's historic and sweeping changes to morph the 7(a) Loan Program from its previous prudent lending structure and usher in an unlimited number of non-federally regulated lenders comes from two new rules: *Affiliation and Lender Criteria for the SBA Business Loan Programs* (87 FR 64724) ("Affiliation Rule") and *Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization* (88 FR 21890) ("SBLC Rule"). Individually, each of these rules is concerning. But when taken together, the concerns are multiplied.

As noted, any analysis of the rules must include an understanding of the further changes to the 7(a) program included in the newly issued notices and SOP 50 10 7, which provide more detailed guidance regarding how the program changes will be implemented by SBA and by 7(a) lenders.

First, the Affiliation Rule removes from SBA's regulatory framework the consistent, well-established underwriting guidelines all 7(a) lenders have been required to follow for years and now allows lenders to follow the same processes and procedures that they use for their similarly-sized non-SBA guaranteed commercial loans. In calls that SBA hosted for lenders and in several recent presentations made to lenders, SBA itself has described this policy as telling lenders to "do what you do".

This is not streamlining. This is wholesale removal of the guidelines that have served this program well for decades and have ensured that both lender behavior and portfolio performance stays at an acceptable level. Every principle included in the now-deleted list of underwriting criteria was put there to address a specific concern or in response to a past lender behavior that both the industry and the SBA believed needed to be corrected. I believe that removing these guardrails could create a race to the bottom in terms of the conditions that individual lenders will impose on individual loans.

Congress, particularly this Committee, has a vested interest in assuring that there are prudent lending standards clearly spelled out. I know that Congress expects that lenders will be good stewards of a program that offers the backing of the federal government for up to 75, 85 or even 90 percent of any defaulted loan (with the guaranty percentage depending on loan size and whether the loan supports international trade). The current 7(a) loan portfolio includes nearly $107 billion in outstanding principal loan balances, with the government being liable for approximately 75 percent of that amount.

And here it is important to remember that the performance of a federally-guaranteed loan program is critical to both mitigating taxpayer risk and keeping access to the program affordable for small business borrowers. Currently, the low loss rates in the 7(a) loan program assure that the fees from lenders and borrowers are sufficient to cover the estimated cost of making loans

each Fiscal Year (FY) (the "subsidy rate"). In other words, the current performance of loans made through the 7(a) program does not require Congressional appropriation or taxpayer dollars.

However, if losses increase, then the estimated costs of making 7(a) loans will also increase. This domino effect will not happen right away. Typically, losses occur three to five years after the loan has been originated. And these increased costs would have to be covered by either Congress passing legislation to statutorily increase the maximum fee limitations on small business borrowers and lenders, or by an appropriation of taxpayer dollars. Either option is an undesirable outcome. But if estimated loan costs go up to the point where existing fees no longer cover the costs, unless one of those solutions were to be provided, the 7(a) Loan Program would shut down without a means to cover anticipated program costs by virtue of the Anti-Deficiency Act.

SBA is creating a bare-minimum approach to lending standards, thus increasing risk tolerance which will increase losses. So, unless the Agency takes steps to address these issues or Congress addresses these changes in legislation, then in a few years, when the predicted loan losses have materialized, Congress, SBA, and the industry will be looking for a way to prevent a 7(a) program shutdown.

And it is into this new environment where lenders generally are now permitted to do whatever they believe is prudent that SBA, through the SBLC Rule, is simultaneously lifting the existing forty-year moratorium to license additional non-federally regulated lenders (Small Business Lending Companies or "SBLCs") to make 7(a) loans. This follows more than four decades of SBA having capped the number of SBLCs at 14 licenses because of its own concerns about the agency's ability to serve as the primary regulator for otherwise non-federally regulated entities. In fact, as recently as January 2021 as part of another rulemaking, SBA indicated that increasing the number of SBLC licenses would exceed its oversight capabilities and pose unacceptable risk to the Agency. Now, in a complete reversal without any evidence of changed capacity, SBA has finalized rules that will allow a potentially unlimited number of additional non-federally regulated lenders into the 7(a) program. In the background information to the rules, SBA stated that it believes it has the capacity to add three additional licenses *now*, but the actual regulatory language is silent as to the number of licenses that ultimately can be issued. SBA has cleared the way to admit any number of SBLCs in the future – not the "slow and steady" approach that has been described.

Here is the real merging of the consequences of the Final Rules: SBA is bringing in non-federally regulated lenders on an unlimited basis into a now seriously morphed program where most of the basic guardrails have been removed, telling these new non-federally regulated lenders to do what *they* think is best.

When a lender is directed simply to follow procedures it would use for its similarly sized non-SBA-guaranteed commercial loans, the likely result is that federally regulated lenders will continue to operate based on the requirements imposed on them by their primary federal regulators, while non-federally regulated lenders will not have such limitations. Therefore, for non-federally regulated lenders making 7(a) loans, there is now a very different and loosened set of criteria, and their new primary regulator, SBA, is saying do whatever you think is prudent.

SBA has indicated that it will review a new entrant's lending policy when it applies for a SBLC license in order to ensure that the new SBLC will be making loans prudently. But we have yet to see what licensing criteria SBA will establish to govern the selection process. And what will really matter is whether SBA will have the resources and the capacity to closely monitor the lenders for which it is the primary regulator and to enforce corrective actions when deemed necessary and appropriate. This will require more than just reviewing an up-front policy in a SBLC's application or even looking at a sample of loans every other year, as the current SBLC exam process generally requires. And because this will exceed SBA's current oversight structure and capacity, it appears that there is a great likelihood for a starkly uneven playing field between federally regulated and non-federally regulated entities participating as 7(a) lenders. The result will be a lack of consistency in how the program is delivered, which can impact both program integrity and the way different borrowers are assisted through the program.

To put this into perspective it is important to remember that SBA currently serves as the primary regulator for 14 "regular" SBLCs and slightly more than 100 Community Advantage (CA) Pilot Program lenders, a mission-based lending subset of the 7(a) loan program that has existed since 2011. SBA also is the primary regulator for another approximately 270 Certified Development Companies (CDCs) that deliver the Agency's 504 loan program, some of which are also CA lenders. However, despite this set of oversight responsibilities, the Agency really has never been equipped to be a primary regulator. This deficiency has been somewhat mitigated by the fact that SBA only serves as the primary regulator for this relatively limited group, with most of these lenders previously operating under fairly restrictive guidelines before these recent rule changes.

Opening the door for an unlimited number of lenders supervised only by SBA will change this dynamic in a number of ways. First, the SBLC Rule makes a very significant change by allowing the regular SBLCs, including those that will be new to the program, to now be able to have other lines of business besides making 7(a) lending and making loans to microloan intermediaries, a lifting of an important guardrail. The final SBLC Rule made this change although this concept had not been mentioned in the SBLC Proposed Rule. SBLCs making non-SBA loans has never been permitted before because, presumably, it requires SBA to now provide oversight for more than just 7(a) lending if SBA is going to be a primary regulator of these entities. As a primary regulator, SBA would need and want to ensure the lender is properly monitored in all its lines of business to ensure safety and soundness of the 7(a) loans generated by that lender. SBA does not have this kind of oversight capacity, yet these changes would necessitate it. Most concerning to me is that SBA has not addressed this additional burden, nor is there an existing framework for SBA to perform such regulatory functions.

In addition to adding more regular SBLCs to the program which we already have discussed, the SBLC Rule adds a new category of SBLCs, which the Final Rule calls Community Advantage (CA) SBLCs, a change from the designation of Mission-Based SBLCs that was in the Proposed Rule. While a recent notice limits CA SBLCs to making loans of $350,000 and less and continues to require that 60 percent of their loans go to borrowers in underserved markets, which we will discuss in greater detail later, those restrictions do not appear in the regulatory text. So, it is difficult to know how much any future program changes could increase the burden on SBA to oversee these lenders. Also, given the way that the 7(a) program requirements have been changed, we expect that the new regular SBLCs most likely will be lenders that, following their

current business practices, rely on algorithms and automation to generate a high volume of loans. So, it is difficult to know whether SBA's estimate in the regulations that the three new SBLCs will only add 425 loans per year for the first four years will actually hold up, or whether that loan volume could be significantly higher – thus increasing the oversight burden on SBA.

More loans for more small businesses is a good thing—but not when SBA has just said to all lenders "do what you do" and lacks the resources to properly oversee the activities of the lenders that it regulates. SBA does not have the resources, the capacity, or even an existing regulatory framework to serve as a prudential regulator for an unlimited number of Fintech entities.

This concern over SBA's oversight capacity is specifically identified in a March 21, 2023 white paper, "*7(a) Loan Program During SBA's Response to the COVID-19 Pandemic*." While focused on assessing SBA's response during the pandemic as it relates to its management of the 7(a) program and its portfolio, the report offers an invaluable insight into the state of SBA's Office of Credit Risk Management (OCRM) which is responsible for SBA oversight functions. The report states that OCRM is significantly understaffed, and that as of August 24, 2022, OCRM "staffing levels decreased from 42 to 26 employees," a decline of 38%. As a result of a shortage of oversight staff and resources, the OIG notes that OCRM has shifted to "streamlined lender reviews instead of full scope reviews." The report goes on to note the deficiencies in these streamlined reviews given that they are limited and data-driven and do not include an assessment of loan files or have the full comprehensive review components of full scope reviews. In FYs 2015 to 2017, the IG notes that OCRM did not conduct over 30% of its planned reviews of high-risk lenders and raises concerns that current oversight goals may not be met given the current shortage of oversight staff.

Here it is important to note the contrast between the way the OIG report depicts OCRM's resources and the way that the SBLC Rule depicts OCRM's capacity. On the one hand, the OIG notes significant staffing shortages and issues with the current oversight burden. On the other hand, SBA asserts that OCRM is fully able to take on the significant new oversight responsibilities that lifting the SBLC moratorium will bring.

OCRM resources have also been an ongoing concern. For every fiscal year since 2014, there has been a $12 million set-aside out of SBA's annual Salaries & Expenses account from Congressional appropriations mandated to go toward "oversight activities." But, during the period that this amount has remained unchanged, the overall 7(a) Loan Program's authorization cap has nearly doubled, and OCRM has added PPP and other responsibilities to its oversight mandate. And, as we understand it, the oversight carve-out is not distributed solely to OCRM at its discretion—rather, it appears to also be distributed to the other divisions within SBA that provide some form of administrative or other support of the OCRM function, e.g., the offices of general counsel, information technology, financial operations, etc. It is hard to understand how SBA, in proposing these sweeping changes, would fail to even include in its President's Budget Request or in any other context, a request for additional resources.

However, additional funding still would not overcome the major concern that arises from the fact that SBA has always relied upon the vast majority of its lenders having a primary federal regulator and so has never attempted to create a similar framework for the lenders for which it

serves as primary regulator. This leaves SBA without a wholistic structure necessary for it to act as the primary regulator for additional lenders and to conduct the necessary compliance and risk assessment at the institutional level.

NAGGL also continues to have concerns regarding whether the lenders for which SBA serves as the primary regulator are monitored by SBA for compliance with Bank Secrecy Act/Know your Customer/Anti Money Laundering standards. In its letter to the Senate Small Business Committee dated March 20, SBA states that "All 7(a) lenders, including SBLCs, are required to comply with the named requirements and that SBLCs are also responsible for and evaluated on compliance with: Truth in Lending, state by state usury laws, Equal Credit Opportunity, and the Gramm-Leach Bliley Act." It is true that the Know Your Customer (KYC) statute, a cornerstone of fraud mitigation compliance in the financial services world, extends to Fintech and existing SBLCs based on the overarching definition of creditors that need to comply. But this is not the case for broader Bank Secrecy Act (BSA) and Anti Money Laundering (AML) standards. Even so, the salient point for this Committee and Congress is not that non-federally regulated creditors are required to comply with some fragments of these fraud mitigation concepts. The issue of concern here is whether SBA is *regulating* the lenders for which it is the primary regulator for these critical compliance concepts of fraud mitigation and the basic consumer protection laws which SBA enumerated. While SBA states that lenders are required to comply with BSA/KYC/AML and that the agency evaluates lenders on consumer protection laws, NAGGL has not found any written guidance on any of these concepts in regulations, SOPs, notices, or other program requirements.

As you are aware, SBA/OCRM does monitor transactional risk in the 7(a) program through the Loan/Lender Monitoring System (L/LMS) that scores every 7(a) lender's portfolio on a quarterly basis and applies the tenets of a system called PARRiS that monitors lender and loan performance in the 7(a) program. L/LMS informs the frequency of lender reviews based on lenders' loan volume, including periodically reviewing a sample of loans for compliance with SBA policies. And it is our understanding that currently OCRM performs Safety and Soundness exams only once every other year on existing SBLCs. However, monitoring loan performance is only a very small part of being a primary regulator, and missing from SBA's approach are the very necessary ways that the federal regulators monitor lenders for institutional risk and compliance with the major components of both consumer protections and risk mitigation concepts.

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Policy Notices and SOP Guidance Issued by SBA to Implement the Regulatory Amendments and Make Other Non-Regulatory Changes to the 7(a) Program:

The lending industry is still digesting the various notices and the new SOP, all of which were issued just last week in the hours right before and after the hearing on these issues before this Committee. But it is clear that the changes in these additional piecemeal documents go well beyond what was included in the regulations and actually exacerbate our concerns about the changes being made to the 7(a) program.

As of the date when this testimony is being prepared, SBA has issued a number of documents intended to implement the regulatory amendments and to make other changes to 7(a) Program Requirements that are not covered in program regulations. These include:

- *Information Notice 5000-846818, Community Advantage Small Business Lending Company Conversion* (effective 5/1/2023);
- *Procedural Notice 5000-846607, Implementation of the Final Rule on Affiliation and Lending Criteria for the SBA Business Loan Programs (88 FR 21074, effective May 11, 2023)* (notice effective 5/9/2023);
- Procedural Notice 5000-846991, *Implementation of Removal of the Loan Authorization in accordance with the Final Rule on Small Business Lending Company (SBLC) Moratorium Recission and Removal of the Requirement for a Loan Authorization (88 FR 21890, effective 5/12/2023)* (notice effective 5/12/2023);
- Information Notice 5000-847027, *Issuance of SOP 50 10 7* (effective 5/10/2023); and,
- SOP 50 10 7 (slated to take effect on 8/1/2023).

As to implementation of the regulatory changes, it appears that the recently released guidance and updated SOP attempt, on their surface, to provide additional details and to mitigate at least some of the risk appeared to have been created by the rule-changes.

For example, the notice implementing the final Affiliation Rule generally limits the removal of the underwriting criteria to loans of $500,000 and under. This interpretation of the regulations makes some sense from a risk mitigation perspective. On the other hand, small loans are estimated to be more than 75% of all 7(a) loans made every FY—in other words, the majority of the portfolio still will have the newly imposed loosened guardrails.

And there are still valid and significant concerns related to increasing program risk even with this latest carve-out on smaller loans, especially as it relates to the policy notice's revised collateral and equity injection requirements, or lack thereof, for small loans and the exemptions made on both underwriting and equity injections for larger loans. For instance, SBA no longer specifies a mandatory equity injection (previously 10 percent) for any size loan made to a start-up business, and no longer specifically requires lenders to verify an equity injection unless they would do so for their own similar conventional loans. In addition, for loans over $500,000, for loans made for complete changes of ownership, SBA provides additional discretion for a lender to decide to allow less than the current 10 percent mandatory equity injection. The new guidance also appears to allow lenders, regardless of loan size, to apply the "do what you do" standards when underwriting loans when loan proceeds will be used to refinance existing debt, conditions that could be of concern from a prudent lending standpoint.

In addition, among the most important of the non-regulatory changes included in the just-released guidance are changes that would increase the maximum size of a 7(a) Small Loan from $350,000 to $500,000, and would raise, from $25,000 to $50,000 the threshold below which SBA will not require any collateral to secure the 7(a) loan.

Of particular concern is the significant changes to the requirements relating to the determination that credit is not available elsewhere, the foundational principle of 7(a) lending. By statute, 7(a)

loans can only go to a borrower who could not receive credit conventionally on reasonable terms and conditions from non-Federal, non-State and non-local government sources. Historically, lenders have been required to document in each loan file the reason why the applicant could not obtain credit elsewhere. This is important—it assures that the SBA loan program is not competing with the private-sector. It means that SBA 7(a) loans are going to those borrowers who meet the program's very specific public policy purpose. Shockingly, the new SOP transforms, for the first time, the credit elsewhere to a check-the-box automated process without requiring written justification in the lender's credit memo. The fraud mitigation antenna of every Member of Congress should be raised by these changes. This is especially true given the recent issues relating to PPP check-the-box exercises and the IG community's warnings that these practices in government programs can result in higher levels of fraud.

In addition, the SOP removes from consideration as a possible source of funding, the personal liquidity of the business owners – which means that the door has been opened for individuals with substantial personal resources to qualify for SBA-backed loans. SBA's rationale for this change is that the "personal resources from owners enhance SBA's ability to mitigate loan losses" by virtue of the personal guaranties provided by the owners. While that may be true, depending on whether the assets would still be available if there was a loan default, it also further illustrates why the personal liquidity of the business owners should continue to be an issue for consideration when deciding whether the loan applicant could obtain credit elsewhere.

Relegating important guardrails and concepts to SOPs, notices and other guidance outside of regulation, which could include informal documents such as FAQs, is a slippery slope. This strategy leaves the door open for this Administration and any future Administration to easily change critical policies unburdened by any requirement to solicit industry input or provide advance notice. If underwriting criteria, for instance, is a hallmark of protecting the program, then it should NOT be stripped from the more formal regulatory framework and allowed to be adapted or altered on a whim by policy notices or SOP revisions. And, since regulations take precedence over Policy Notices and SOPs, the conflict between the Final Rule and the implementing guidance documents which are slightly more prescriptive, creates both confusion and even possible loopholes for lenders who want to do what they do on all loans.

Other Key Changes Made by SBA's Final Rules

Let's dive into the details not covered above. Unfortunately, this sweeping deregulation of the 7(a) Loan Program does not stop with the issues framed above. Both the Affiliation Rule and the SBLC Rule also change many nuanced elements of the 7(a) Loan Program of which this Committee should be aware.

Opening SBA Loans to Large Businesses

The changes to SBA's affiliation requirements contained in the final Affiliation Rule are also concerning in that they remove the majority of the requirements related to how a small business

applicant is considered to be affiliated with a possibly larger business. Of greatest significance is the removal of examining control of one entity over another as a basis for affiliation. Consider management contracts or franchise and license agreements—these are all common business constructs that, in some cases, exert so much control and influence that the small business is actually a mere arm of the larger corporation, rather than a truly independent small business entity. However, these relationships will no longer be considered when determining affiliation, a massive change from pre-rule change requirements.

This Committee has recently considered these very issues. In 2018, the SBA OIG and the Office of Capital Access were called to testify before this Committee on issues relating to loans made to poultry farmers who were found to be affiliated with large poultry corporations. The IG said at the time the larger entities exercised such excessive control that the small business should not have been eligible for a SBA loan; however, SBA had told lenders these types of borrowers were eligible. On a bipartisan basis, Members of this Committee expressed serious concern that SBA loans were made to large corporations indirectly and even questioned whether credit elsewhere was met. And even more recently, PPP found itself in an affiliation-related debate when large, publicly-traded companies received PPP grants, and despite statute originally permitting those grants under the loosened guidelines, both Congress and the court of public opinion had very different takes on whether such companies should be receiving SBA-backed assistance. Both this Committee and the lending industry have been here before.

The Politicization of SBA Lending

I am also concerned about the politicization of the processes around 7(a) loans that have, up until now, remained squarely within the bounds of career staff, but which would now be determined by political appointees. In the Affiliation Rule, SBA revises regulations to allow final reconsideration decisions regarding loan denials or loan modification requests to be made either by the Director, Office of Financial Assistance, as currently allowed, or by the Director's designee(s), both career positions. Note that this would only occur when a lender submits a loan for SBA's approval through a non-delegated process that is used by lenders to gain extra clarity on loan approvals or by lenders without delegated authority to make 7(a) loans. But the rule change also adds new language allowing the SBA Administrator discretion to review a reconsideration request and make the final Agency decision, though the SOP is silent on this concept.

This handing-over of unprecedented power to political appointees at the SBA should be worrisome for both sides of the aisle—Administrations change, political appointees change, and each, regardless of party, brings their own politically-driven goals. We should never politicize a program that aims to support Main Street America, and this change allows politics to seep into determining SBA loan approvals.

Removal of Loan Authorization and the Lender Uncertainty

Historically, SBA has required that a separate loan authorization be generated for each 7(a) loan. The authorization spells out all of the terms and conditions under which the lender is making the loan to the borrower, and under which SBA is guaranteeing the loan for the lender and is

executed by both the lender and by SBA (with the lender signing on behalf of SBA, but subject to later view, for loans processed on a delegated basis).

The final SBLC Rule removes the term "authorization" wherever it appears in the regulations. That change took effect on 5/12/2023, and, while SBA has indicated that it will provide some substitute document, presumably to be generated by the 7(a) loan automation system, E-Tran, to reflect the mutually agreed-to terms and conditions for the individual loan, to date, SBA has not provided that alternative document. This has put lenders into a quandary since, in addition to cementing the terms and conditions under which the loan is made and guaranteed, the authorization document is relied on for various purposes, including providing the exact language that should appear in the SBA loan note (or lender equivalent) and resolving any issues that may arise about the loan terms if it is being sold in the secondary market. NAGGL agrees with SBA that the previous process for generating a loan authorization could be bulky. But, however the new document is to be named and generated, it is essential that that process occur immediately and that the new form include all of the terms and conditions lenders believe are necessary to assure that the loan will be legally enforceable and that the SBA guaranty can be relied upon. Therefore, we hope that SBA will move quickly and will consult with lenders to ensure that any new form meets their needs.

Lending to Underserved Markets: SBA's Stated Intent, NAGGL's Concerns with the Final Rules' Lack of Focus on Underserved Borrowers, and Current 7(a) Lending to Underserved Communities

One of the single most significant changes between the Proposed Rules and the Final Rules was the complete removal of any mention of lending to underserved markets or making small dollar loans. This makes it appear that the stated intent of the regulatory changes no longer is supported by regulatory language, but rather just becomes a more amorphous concept based on the assumption that lifting guardrails and licensing more lenders will somehow result in more loans going to the entrepreneurs who need them most.

SBA acknowledges that creation of the Community Advantage (CA) category of SBLCs is intended as a means of making the CA Pilot Program which has existed as a pilot since 2011, permanent. This raises the question of whether SBA has the authority to provide any sort of path to permanency for a pilot program. But more concerning for this discussion is that here too, in the regulatory language, SBA has removed any mention of a focus on underserved markets.

However, the recent information notice, *Community Advantage Small Business Lending Company Conversion*, did add some context to the parameters around CA SBLC participation. Except for the changes specifically cited in the notice, the new CA SBLCs will follow current CA Pilot Program requirements as outlined in the current version of the *Community Advantage Participant Guide*. This includes having authority to make loans of $350,000 and less and adhering to the requirement that at least 60% of the number of CA loans closed by the lender

meet the underserved market requirements currently in place for the CA Pilot Program. But the notice indicates that SBA will provide further guidance on SBA Loan Program Requirements for CA SBLCs through additional SBA notices and/or SOPs.

While NAGGL has previously expressed its support for making the CA Pilot Program permanent, we have serious concerns about the appropriateness of doing that through an Agency regulation and a notice. As we previously discussed regarding SBA's underwriting criteria, we worry that what was done by regulation and less formal guidance could be as easily undone if there is a change of Administrator, or even just a change of philosophy within the Agency. If I were a CA lender, I would now feel as if I was on even less stable footing than in a pilot program that had continued to enjoy SBA backing for over a decade. For this reason, we continue to support legislative action to make the CA Pilot Program permanent in order to give CA participants the security of statutory authorization.

Turning to the regular SBLCs, it is interesting to note that while SBA's stated goal for lifting the SBLC moratorium was to incentivize underserved lending, neither the Proposed or Final SBLC Rule contains any requirements for the newly added regular SBLCs to focus on smaller loans or to target underserved markets. Rather, there seems to be an assumption that the new regular SBLCs, which presumably will include Fintech, will make small dollar loans because in the Paycheck Protection Program (PPP), the majority of the fully forgivable "loans" delivered by fintech were in smaller amounts as compared to traditional lenders. Since no underwriting was involved in PPP, and no repayment was intended, PPP performance should never be cited as an appropriate means for predicting 7(a) loan performance. Also, it is important to note, that even though SBA has indicated that allowing additional SBLC licenses will result in more small dollar loans, neither the Final Rule, nor any other guidance issued to date restrict, in any way, the maximum size loan that a regular SBLC can make.

The odd linkage between Fintech and underserved markets is even more confusing given this Administration's and other leading Democrats' own findings about Fintech. This Treasury Department and Representative Clyburn have both issued scathing reports about Fintech's role in larger market risks and in facilitating PPP fraud in the very weeks surrounding the release of the SBA's rules when first proposed. In addition, it has been investigated by Representative Cleaver, CFPB, and others whether Fintech utilizes predatory practices that actually target underserved borrowers.

NAGGL and the 7(a) lending industry applaud SBA's stated mission of focusing on small dollar loans and underserved markets. In fact, 7(a) lending and the program's reach line up exactly with an industry focused on small dollar loans and underserved markets.

According to SBA's own data, in FY22, the 7(a) Loan Program delivered the following:

- FY22 was the highest gross volume year of 7(a) lending in the program's history at $26.9 billion, with the exception of FY21 during which Congress mandated stimulus provisions of fee waivers and higher guarantees to stimulate volume during a global pandemic and which expired at the end of FY21—FY21 is falsely inflated anomaly data.
- Roughly 50% of all loans made were $150,000 or smaller.

- Roughly 70% of all loans made were $350,000 or smaller.
- It is estimated that more than 75% of all loans made are small dollar loans, or $500,000 or smaller, which is the new threshold SBA just set to define small dollar loans (SBA does not publicly provide a breakdown of loans made from $500,000 or smaller).
- Only 7% of all loans made were the largest loans of $2 million or larger.
- SBA's Congressional Budget Justification set the target goal for 7(a) lending to underserved markets at 43%, and actual 7(a) lending in FY22 to underserved markets was 68% of all loans made, far exceeding SBA's goal.
- One-third of all loans were to minority borrowers—a number that's steadily on the rise.
- 25% of our borrowers didn't identify their race or ethnicity, so the actual percentage of loans to minorities is likely higher than the statistics indicate.
- African Americans are the fastest growing demographic in the program, with nearly $1 billion in loans last year alone—nearly a 60% increase since FY17. And so far this year, loans to African Americans are up 52% in units and 72% in dollars compared to last year.
- Hispanics totaled $1.85 billion—more than a 27% increase since FY17. And so far this year, loans to Hispanics are up 91% in units and 98% in dollars compared to last year.
- Loans in rural areas totaled roughly 20% of all loans.

These trends continue in FY23 statistics provided by SBA, year to date, and the current average loan size in the portfolio is roughly $475,000, below the small dollar loan threshold amount of $500,000.

We can always do more, but we cannot call these statistics market failures, as has sometimes been described by SBA.

We note that the gross number of units in loans $150,000 and under fell by roughly 13,500 loans over the past 5 years. But during that time, at least two of the nation's largest banks stepped back from participating in SBA Express lending, a 7(a) sub-program that only allows small dollar loans, and a global pandemic put the smallest loans on the sidelines as borrowers either were not seeking small amounts of capital to expand and grow a business or pursued PPP, EIDL, and other stimulus programs. There are always going to be fluctuations in raw numbers year to year. But, in the last 5 years, these types of ebbs and flows are well-explained by macro circumstances and overinflating these statistical shifts fails to recognize that the delta between FY17 and FY22 on loans $350,000 and under (well below the small dollar loan threshold of $500,000) has actually only fluctuated from 74% to 68% of the whole portfolio, respectively. This is not a story of a market failure in small dollar loans.

NAGGL's Stance on Alternative Lenders and How to Move Forward

An argument has been made that those who oppose the program changes are doing so as a rejection of Fintech in the program. That just isn't the case.

However, part of the problem is that there is no single definition of the term "Fintech". That term is used in many different ways, covering everything from the technology that the financial services industry uses to interact with customers, including extending credit, to designating a particular group of lenders involved in financial services by calling them "Fintech". As to the first definition, not only do current 7(a) lenders not eschew technology, they embrace it with most lenders in the U.S. today, relying to greater or lesser degrees on technology and automation to support their customers and their programs. As to the second definition, the 7(a) industry already includes lenders that could be categorized as Fintech. So, it is a disservice to say that the 7(a) industry opposes opening the 7(a) program to greater use of, or participation by, Fintech. Instead, what we are urging is a more appropriate balancing of the potential risks of moving to greater automation and the addition of more non-federally regulated lenders against the benefits to be achieved by making those changes.

Several years ago, I personally led NAGGL to stake the position of welcoming with open arms credit unions into the 7(a) Loan Program when SBA proposed those changes That was because I understood the goal of a government program is to aid and assist small business by attracting the widest variety of appropriately regulated financial entities to participate as program lenders. In addition to the types of Fintech-like entities and the majority of the active SBLCs already included in our membership, NAGGL also represents mission-based lenders, such as CDFIs and non-profit Community Advantage lenders who make loans in the 7(a) Loan Program's Community Advantage Pilot Program. Both NAGGL and the 7(a) industry welcome any lender who will be a good steward of a government program which has the appropriate guardrails and regulator capacity.

So, the concern with these rules is not, and never has been, about Fintech or fear of competition. The concern with these rules is that it has removed the guardrails while bringing in entities that have no prudential regulator and SBA is unable to monitor and regulate these entities appropriately. SBA is not proposing to bring in non-federally regulated entities to the program we all know and trust. Rather, SBA is proposing to bring in non-federally regulated entities to a program now simultaneously stripped of many of the long-standing rules.

I honestly believe that because of these rule changes, at some point in the future this program will be performing at a loss rate that is not sustainable without Congress drastically increasing borrower and lender fees or providing taxpayer dollars. If neither happens, the program shuts down. We should all want this program to remain available for the borrowers for whom this program provides the only reasonable access to credit.

And this doesn't even begin to scratch the surface on the impacts to the small business borrowers. When a program becomes more expensive for borrowers and lenders because losses are increased, underserved borrowers get left behind in a program that has suddenly become cost prohibitive. In addition, SBA's lack of a regulatory framework may also threaten the most vulnerable borrowers given that SBA does not have guidance or oversight requirements surrounding some of the most basic consumer protection laws for the SBLCs it regulates. SBA does not have the means to know if its SBLCs are complying with Truth in Lending, Equal Credit Opportunity Act, and other cornerstones of borrower protections.

But even more damaging is that SBA is permitting, even encouraging, lenders to make the loan, rather than encumber them with underwriting criteria. When those kinds of guardrails are removed, it is likely that there will be a high volume of originations, especially from the non-federally regulated lenders that are not held to the higher standards imposed by the Federal Reserve, the FDIC, or the OCC. But if those lenders are not prioritizing repayment ability, a concept which is strengthened by considering all of the underwriting criteria now removed by SBA, then the result could be that borrowers are receiving loans that might not have sound repayment ability. Making a loan to a business owner who cannot repay the loan does not do that borrower any favors – it actually could ruin their life.

Finally, I would be remiss if I did not also state that, even if I agreed with every change that SBA is making – which, clearly, I do not – the Agency just is not ready to implement the regulatory changes. As noted above, SBA has not yet been able to provide a document to replace the traditional 7(a) loan authorization. In addition, SBA has not finalized the pre-eligibility SBA automation system that was discussed in testimony before this Committee, and in other discussions. SBA also has indicated that it will be providing some sort of automated pre-approval eligibility screening. And, again as far as we know, as of this date, that process has not been communicated to lenders, and would be hard to imagine is ready for roll-out as we speak. Finally, and most importantly, the only guidance that lenders have regarding implementation of the changes is what has been included in the written documents, including the new SOP 50 10 7 that will not take effect until 8/1/2023. This leaves lenders at a loss to understand what is now required of them and how they can ensure that they are operating in accordance with SBA requirements. Clearly, SBA needs to complete these implementation tasks. And SBA should have provided training for lenders before the Final Rules and other requirements took effect.

For all of the reasons cited in this testimony, and especially because of SBA's lack of readiness, I implore this Committee to act quickly to reverse these rules changes through a bipartisan legislative approach. Otherwise, SBA is inviting in the exact kind of behavior and risk that could erode the 7(a) Loan Program's performance and reputation, and even harm the very borrowers they are intending to help. My concern is and always will be about programmatic viability and integrity.

Thank you for the opportunity to testify, and I look forward to continuing the dialogue on these critical topics.

Ami Kassar

Written Testimony

"Taking on More Risk: Examining the SBA's Changes to the 7(a) Lending Program Part II"

May 17, 2023

House Small Business Committee

My name is Ami Kassar, and I am the founder and CEO of MultiFunding LLC, a loan brokerage and consultancy company based in the suburbs of Philadelphia. Since 2010, my team and I have heard the stories of thousands of entrepreneurs over the years. In our work, we strongly recommend the SBA 7(a) loan program and have helped borrowers receive nearly $400M of SBA 7(a) loans nationwide.

In a press release last week, **Administrator Isabella Casillas Guzman**, head of the **U.S. Small Business Administration (SBA)**, stated, "The Biden-Harris Administration recognizes that small businesses are the drivers of our economy, and that to participate in the opportunities created by the President's Invest in America agenda, that they need capital to start, grow, and be resilient. The ongoing modernization of SBA's loan programs will help ensure more borrowers can get funded through a broader network of lenders so they can help build a strengthened American economy that innovates, manufactures, and provides the products and services that make our lives better across Main Street."

The press release continues that the SBA recognizes that small businesses, particularly those owned by individuals in underserved communities who are highly entrepreneurial, still face longstanding barriers in accessing capital needed to start or grow their businesses.

And to this end, SBA is in the middle of wholesale simultaneous changes to the plumbing, infrastructure, and wiring of the flagship SBA 7(a) program, opening the program to unregulated fintech lenders who will be able to play under different rules than regulated lenders.

Two broad assumptions made in this announcement are deeply concerning to me.

The first assumption is that SBA is taking lessons learned from the EIDL, PPP, and the Restaurant Revitalization Program and applying them to wholesale changes they are making in the longstanding SBA 7(a) program. Unfortunately, this is a dangerous comparison as the programs have almost no similarities.

The second assumption is that more accessible access to capital under the SBA program is good. However, in many cases, access to capital without proper scaffolding, such as mentoring and support for a budding entrepreneur, will lead to a disaster.

The final point I leave you with today is that too many changes too quickly to the SBA program in an uncontrolled environment will lead to the inability to understand what will drive higher default rates.

The devil, as they say, is in the details. That adage dates back to the 19th century, long before Covid-19, PPP loans, or even the Small Business Administration. But, most importantly, it was coined long before the advent of fintech. These popular internet-based alternative lenders grew exponentially in prominence when the SBA implemented the Paycheck Protection Program early in the Pandemic.

That has inspired a well-intended—but, in my opinion, ill-considered—overhaul of the 7(a) loan program to open traditional SBA loans to fintechs. But, unfortunately, there is good reason to be cautious about handing out SBLC licenses. The federal government annually backs an average of roughly 73% of the approximate $26 billion lent through the SBA's 7(a) program. That requires a litany of rules and controls, or so it was thought, and the number of licenses has been stuck at just 14 since 1982.

Because small and micro businesses desperately needed cash when the Pandemic hit, the rules allowed all types of lenders into the SBA delivery system, paving the way for fintechs to originate them. Of course, some of that easing led to acts of fraud—borrowing for boats and planes and businesses that did not exist—but the fintechs were also quite helpful in getting money out to a lot of those smaller businesses that were unable to get the attention of the big banks they were dealing with or unable to satisfy the regulations in place pre-Covid.

According to The Federal Reserve Bank of New York, Black-owned firms applied to fintech lenders more than twice as often as white, Asian, and Hispanic-owned firms. In addition, Fintech lenders, a recent analysis by the Federal Reserve Bank of New York found, are more likely to service loans with businesses that do not have an established relationship with a traditional bank.

The intent is clear: to issue more loans to underserved businesses and entrepreneurs.

The problem: those pesky details.

The notion has spread that they could repeat that success under more normal circumstances. But, unfortunately, opening the SBA door to fintechs will spell disaster for the borrowers they purport to help. You see, regular SBA lending is nothing like PPP lending. In typical SBA lending, many rules and regulations must be followed and considered, ultimately protecting the borrower and the taxpayers.

SBA is throwing out so many of these rules and nuances to meet the speed and efficiency that fintechs like to leverage. By their very nature, fintechs are not equipped to address the stringent regulations of traditional SBA loans. The fintechs' success and profitability during the Pandemic were the offshoots of expediency. The government needed to get cash out the door and—to some extent—was willing to live with the consequences. As a result, there has been significant fraud, where the government and taxpayers may or may not be able to get their money back.

The SBA is dramatically loosening the regulatory requirements for SBA loans, intent or relaxing them to ease access to capital through fintech.

Who Are These FinTech Lenders Anyway?

Have you ever met an entrepreneur or small-business owner in a cash flow pinch? Unfortunately, I understand these situations all too well. Faced with fear and anxiety, many entrepreneurs turn to the internet, where "alternative lenders" offer them loans or advances with the money promised to land in their bank account in 24 to 48 hours. Often, entrepreneurs think their problems are solved and jump on the offer.

Sadly, though, in most cases, they have just locked themselves onto a high-speed, high-interest-rate treadmill that can be impossible to escape. These online financiers typically demand rapid repayment and daily withdrawals from their borrowers' accounts. Then, as the cash flow pressures mount, more lenders start calling with "enticing" new offers to give them some extra runway. Before long, the borrowers are in over their heads.

I have repeatedly seen the impact of these loans and advances at my company, MultiFunding; MultiFunding's mission and purpose is to help entrepreneurs find the best loan options and alternatives to help them grow and stay in control of their businesses. We have learned that SBA-backed products are often the best solution, and we leverage this program in about 95 percent of our work.

When a business owner calls us in a cash flow pinch, we do everything we can to steer them away from these loans and advances. Instead, we encourage them to look at payables they can stretch or expenses they can cut. With proper counsel and support, there is often a better option than the alternative lenders. Unfortunately, we also regularly get phone calls from business owners and entrepreneurs already caught in a debt trap. At that point, it's often too late, and we can do nothing to help. It's heartbreaking because the problem should never have gotten that bad.

Why We Should All Be Concerned

The Small Business Administration's new rules and program changes should concern everybody. If you are in the middle of a loan application and the detailed rules accompanying it, sometimes you want to pull your hair out. At MultiFunding, we live this reality with our clients every single day.

While the lending system can be maddening, it is based on some profound logic. It does take work to get an SBA loan, but this protects borrowers and lenders. You need to have your financial house in order to get a good loan. With the proper controls around the process, borrowers significantly increase the likelihood of being able to repay it.

Lending decisions should be made based on the company's ability to repay the money. If you give out too much money too early to companies, they will likely waste it, and the problems will accelerate as they have to start paying it back. That's part of what went wrong at Silicon Valley Bank.

Of course, all the rules and regulations protect the lenders as well. It's pretty simple – lenders need to be paid back to keep their institutions safe and to be able to keep cycling money through the economy, helping businesses grow and expand. Safe banks are well-diversified and carefully managed against too much risk. Unfortunately, those complaining about how hard it is to get a loan sometimes forget that banks are businesses, too.

All of this is simple. And yet, it needs to be clarified whether these basic lending tenets are part of the current changes to the SBA. Instead, their mission focuses on broadening access to capital while leaving the potential fallout to future generations of taxpayers.

We saw this philosophy with the rollout of the EIDL program during COVID.

One lesson we will learn from EIDL is the danger of lending money to business owners without a clear plan about how they will repay it, which is about to happen again if we make SBA lending so simple.

The Wall Street Journal recently published an article titled "Pandemic Loans Are Coming Due, But Some Businesses Aren't Ready to Repay." During the Pandemic, the SBA issued about $390 billion in Economic Injury Disaster Loans to approximately 4 million small businesses. These were low-interest, 30-year loans with payments deferred for two years. As those payments come due, some business owners argue that they did not fully understand the terms of the loans and that as the economy weakens, they are not well positioned to repay the loans. Business owners must know these loans are an IOU to the U.S. government.

Unfortunately, the problems with the EIDL program are just beginning, and they could take decades to unwind. To understand the complexity of the issues, you have to look at the origins of the EIDL program and how the government tried to adapt it to cope with the Pandemic. Long before Covid, the EIDL program was designed to assist businesses in a relatively small geographical area when a specific disaster damaged them. The government would step in to offer long-term, low-rate loans to help the companies to rebuild.

When Covid hit, the SBA had little idea what to do. First, there needed to be infrastructure to support a mass EIDL rollout across the country. And so, they retrofitted the program for Covid and introduced it in stages. In the first round, the SBA offered loans up to $150,000 with minimal documentation requirements. And then, over time, they moved the loan amounts to $500,000 and eventually $2 million.

While it's terrific that the government got 4 million loans out the door, they were issued without proof of economic injury. Yes, some businesses that got the loans were genuinely decimated by Covid and needed every penny. But many companies thrived during Covid and jumped on these loans out of FOMO (fear of missing out). I have heard some crazy stories about how the money was used: including buying jets, paying off divorce settlements, and investing in cryptocurrency. And there were plenty of companies that were in terrible financial shape before Covid and saw these loans as an opportunity to refinance debt, stretch out terms, and take another shot at solving long-existing issues.

Despite explicit terms in the loan agreements about how the money could be used to recover from the Pandemic, the reality is that the use of funds was and remains a free-for-all. As a result, the chances of ever being audited by the SBA are slim to none.

And now, payments are coming due, and some borrowers are crying foul. As the Wall Street Journal points out, some borrowers claim they thought EIDL loans, like the Paycheck Protection Program loans, wouldn't have to be paid back. Other borrowers say they didn't realize that interest would accrue on the loans while payments were deferred, which means the businesses now owe more money than they realized. Still, others say that with a possible recession looming, their businesses are in worse shape today than when they took the disaster loans and are unprepared to make payments.

Respectfully, it's time to start paying back the debt. Typical SBA loans amortize over ten years at much higher rates than 30-year EIDL loans. As a result, payments are relatively low, and borrowers cannot keep kicking the can down the road.

Borrowers need to realize that the time may come when they need to borrow money again. If their business still has a balance on its EIDL loan, the day of reckoning will have arrived. Under the terms of the EIDL loan, the SBA has a lien on the business, and the new lender will require the SBA to subordinate that lien before issuing a new loan. Therefore, the new lender will ask the first line of questioning: What did you do with your EIDL money? Did you use it for authorized purposes? If not, that will raise a character issue that could endanger the new loan. If you do get through these questions, next up will be the SBA officer who has to approve the subordination request.

The mission of serving underserved entrepreneurs

Let me be clear: I am 100 percent in favor of creating the infrastructure and scaffolding to give everyone who wants to start a company in this country their best possible chance of success. This goal is essential and critical to economic equality and our future. And it's a BHAG—a big hairy audacious goal—that will not be solved overnight. It will take at least a decade if not more, to make a difference.

The proposal to allow alternative lenders into the SBA program with lighter rules and regulations needs to be revised. We need to slow down and refocus.

Fast access to capital is not the answer to the problems of most small businesses. When you take a loan, you need to pay it back. And if you don't have a solid business plan and team around you to support your loan, the chances are excellent that you will fail. Moreover, a delinquent debt to the United States government is not a good mark on a budding entrepreneur's resume.

Likewise, if delinquencies rise, the SBA program, which currently runs with zero government subsidy, could be put at risk. That would damage many other small businesses—not to mention our economy. Most importantly, if we want to help underserved entrepreneurs, there are better ways to do it.

We need to double, triple, or quadruple the resources we put into underserved communities to help with entrepreneurship. And we need to make this a combined effort of government, private enterprise, and academia. Just as we have Teach for America, we need more programs that expose college graduates to entrepreneurship.

One night during the Pandemic, I was asked to teach a virtual SBA class for a female entrepreneurship group at an African American church. About a dozen women on Zoom were trying to get side hustles off the ground. The session was supposed to last an hour, and my SBA slide deck was ready.

As the session began, I quickly realized that the last thing these entrepreneurs needed was a loan. You see, like many entrepreneurs, they thought they needed more money to get started than they did. So the PowerPoint was never opened that night. Instead, we worked for hours, breaking down their plans individually. In every case, there were more straightforward and less expensive ways to test their concept and get it off the ground.

For example, one woman wanted to start a business baking desserts for restaurants. However, she was convinced she needed to borrow $50,000 to open a kitchen. In addition, she had yet to consider that she could prove her concept by baking in her home kitchen or renting a kitchen during off hours at a local restaurant.

But here's the thing: if a fintech lender offered these budding entrepreneurs an SBA loan that would land in their bank accounts in a few days, everyone would jump on it. And then, if the loans were approved, most women would have a liability on their hands that they still needed to prepare to handle.

In Conclusion

I am all for change – but you take significant risk if too much change is made too quickly. Broadening access to capital is a worthy goal. But the current SBA administration proposes changing too much too soon in an uncontrolled environment.

If all these changes go forward, we will return to this room in two years, trying to explain the growing default rates. And the problem will be we won't be able to understand the root causes because of the vast changes being made all at once.

I remember some 101 lessons from science classes in high school. If you're going to try an experiment, test one variable at a time. You cannot read the results if you try everything at once.

If we have learned anything from the lessons of SVB in the last few weeks, it's that outliers in the lending system create problems that ripple throughout the economy. SVB was not a well-run bank with a sound credit culture. Their lending standards were loose, they didn't worry about the risk on their balance sheet, and I still need to figure out how the regulators let them get away with it. They thought their model was invincible until one day, it wasn't.

Sadly, unless someone reins in these broad SBA changes, commentators will discuss the SBA and SVB in the same sentence in a few years. This would be a horrible outcome for the SBA, a program that has served the interests of small businesses so well for decades without costing the taxpayers money.



Testimony of

Alice P. Frazier

President and Chief Executive Officer

Bank of Charles Town

On behalf of the

Independent Community Bankers of America

Before the

United States House of Representatives

Committee on Small Business

Hearing on

"Taking on More Risk: Examining the SBA's Changes to the 7(a) Program, Part II"

May 17, 2023

Washington, D.C.

Opening

Chairman Williams, Ranking Member Velázquez, and members of the Committee, I am Alice P. Frazier, President and CEO of the Bank of Charles Town, headquartered in Charles Town, West Virginia. I testify today on behalf of the Independent Community Bankers of America where I am Chair of the Bank Operations Committee and a member of the Board.

Our Story

The Bank of Charles Town, or BCT, was founded in 1871 in Jefferson County, West Virginia by a group of 38 farmers, orchardists, and business leaders who believed a locally based bank would create an economic and stabilizing influence in Jefferson County. Thousands of community banks around the country were founded on that same vision. Today, BCT is a $790 million asset community bank with 121 employees serving the Eastern Panhandle of West Virginia as well as Hagerstown, Maryland and Loudoun County, Virginia.

BCT has been an SBA lender for over 40 years. I'm proud to say that more than half of our SBA loans over the past 18 months were made to minority or women borrowers. We share with this committee the goal of preserving and protecting the integrity of the SBA 7(a) program while continuing to make prudent loans to smaller and underserved businesses.

Hit the "Pause Button" on New Rules That Imperil the 7(a) Program

The new SBA rules, which were rushed through the process without input from Congress or industry, will undermine this critical goal. We recommend the agency hit the pause button, convene a working group of existing SBA lenders to determine how we can better align the program with the SBA mission of reaching the smallest businesses and entrepreneurs. Current lenders know where the challenges lie and should be given the opportunity to craft a program that works better.

We believe that the SBA's new Small Business Lending Company rule, which will admit nonbank financial technology companies, or fintechs, to the 7(a) program, is a serious threat to

its integrity. Moreover, the new affiliation rule and revisions to the SOP appear to be specifically designed to accommodate nonbank fintechs.

Nonbank Fintech Lending is no Substitute for Community Bank Lending

Online-only lending can never be a substitute for on-the-ground community bank lending. The business model of a nonbank fintech -- snap approval or rejection of loan and quick disbursement of funds – is often not in the borrower's best interest.

We have a client who had previously obtained two small, quickly disbursed, fintech loans of less than $30,000 each. The fintech provided no counseling on how to put that money to good use. In fact, he was overpaying himself, resulting in losses year after year. He won a Navy contract but couldn't find a lender because of his losses. We worked with him to help him understand what lenders look for in reviewing a credit application. Ultimately, we were able to secure for him a $150,000 SBA loan to support the Navy contract.

The community bank model is quite different. We partner with our small business borrowers and are vested in their long-term growth and success. The reality is that once the loan is funded the relationship is only just beginning. We provide practical, real world business counseling and networking opportunities, particularly for startups, in a way that can never be matched by an online-only lender.

The best thing for an underserved borrower is to work with a lender that is committed to their success. Recently, a small, African American, 8(a) government contractor applied to us for a $150,000 loan. She had recently won a couple of contracts, but her low credit score made it impossible for us to approve her loan application at that time. Rather than turn her away, we worked with her for a year and a half to increase her credit score, and celebrated when we were able to give her an SBA loan. I cannot imagine a nonbank fintech lender standing by a loan applicant for a year and a half.

SBA Data Shows Strong Lending to Underserved Borrowers

We are committed to working with this committee and the SBA to ensure the 7(a) program is reaching the smallest, underserved borrowers. But I also think we should appreciate what the program is already achieving. For example, according to the SBA's own data, 68 percent of loans in FY 2022 were made to underserved borrowers. This far exceeds the agency's target of 42 percent of loans. Also in FY 2022, one in three 7(a) loans were to minority-owned businesses.

Nonbank Fintech Lending Likely to Result in Higher Defaults and Fraud

I fully expect nonbank fintech loans to have a higher default rate and higher incidence of fraud, similar to the results of the Paycheck Protection Program.

The costs associated with more defaults and fraud will drive fees higher and make the program more costly and less accessible to borrowers. We urge this committee to exercise robust oversight of the 7(a) program with a goal of safeguarding its integrity.

Conclusion

Thank you again for the opportunity to offer my perspective. I'm happy to answer any questions you may have.



Taking on More Risk: Examining the SBA's Changes to the 7(a) Lending Program Part II

Testimony before the U.S. House of Representatives
Committee on Small Business

May 17, 2023

Submitted by:
Manuel Flores
President & Chief Executive Officer
SomerCor 504, Inc
Chicago, IL

Chairman Williams, Ranking Member Velázquez, and distinguished members of the Committee; good morning and thank you for having me today. My name is Manuel Flores and I am the President and CEO of SomerCor, a Certified Development Company (CDC) based in Chicago, Illinois. SomerCor is a long-time member of the National Association of Development Companies (NADCO) and I am honored to represent the CDC industry before you today to discuss rule changes affecting the lending programs at the Small Business Administration (SBA).

CDCs are non-profit organizations certified by the SBA whose mission is economic development in local communities. We meet this mission through delivery of the SBA's premier economic development program, the 504 Loan Program, as well as the 7(a) Community Advantage Pilot Program, and the Microloan Program. Many CDCs also deliver other federal programs through the U.S. Treasury, the U.S. Department of Commerce, and U.S. Department of Agriculture, and CDCs were designated Community Financial Institutions (CFIs) to do our part to provide critical capital to small businesses during the COVID-19 pandemic. Finally, CDCs deliver a variety of state and local programs and resources to meet the needs of the businesses we serve. In fact, CDCs are required to provide investments in economic development initiatives in their area of operations beyond their participation in the SBA 504 program.[1]

To use SomerCor as an example, we are one of the nation's larger CDCs by annual loan volume – we have originated more than $1.73 billion in 504 loans since our inception with a current loan portfolio of $498 million – and we also participate in the SBA's Community Advantage (CA) loan program. In addition, SomerCor administers the Small Business Improvement Fund (SBIF) and Neighborhood Opportunity Fund (NOF) grant programs on behalf of the City of Chicago. The SBIF and NOF programs provide place-based grants to assist

[1] Standard Operating Procedure 50 10 6 – Part 1, Section B, Ch 1, pg. 66 SOP 50 10 6 FINAL 8.7.20 LOCKED_0.docx (live.com)

small businesses making permanent building and property improvements to catalyze new neighborhood investment in lower income communities in Chicago. The NOF program specifically is part of a neighborhood investment initiative referred to as INVEST South/West, a private-public partnership between city departments, philanthropy, community leaders, and corporate partners to bring investment to commercial corridors on Chicago's South and West sides. In total, SomerCor has helped the City of Chicago disburse more than $133 million to 2,040 small businesses.

I provide this background as context for sharing the CDC perspective on the changes being made in the two final rules issued by the SBA on April 10, 2023, and April 12, 2023: the *Affiliation and Lending Criteria for the SBA Business Loan Programs*[2] and the *Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization.*[3] My comments will focus particularly on the affiliation and lending criteria rule as it relates to the 504 loan program, which has been in existence in different iterations since the inception of the SBA and for whom the affiliation rule will apply.

The 504 Loan Program is a prime example of a successful public private partnership with a typical structure that pairs a CDC – who provides 40 percent of the loan through a 100 percent SBA-backed debenture – with a banking partner who provides 50 percent of the loan, thus requiring only a 10 percent equity injection from the small business borrower. The program finances commercial real estate and equipment with terms of 10, 20, and 25 years, and especially important in today's economic environment, a fixed interest rate that allows small businesses to plan for the future.

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[2] Federal Register :: Affiliation and Lending Criteria for the SBA Business Loan Programs
[3] Federal Register :: Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization

The most important aspect of the 504 Loan Program is its purpose: the program's mission is economic development, and in order for a borrower to be eligible for a loan, they must create jobs or meet a public policy or community development goal. Public policy and community development goals include revitalizing a business district, assisting manufacturers, improving, diversifying, or stabilizing the economy of the locality, expanding exports and more.[4] The result is a zero-subsidy program that has served more than 175,000 small businesses, provided more than $100 billion in 504 financing, and leveraged private sector financing for an estimated total investment of more than $250 billion in local economic development across the nation.[5] The program's fees have covered the costs associated with the program for years, allowing this vital economic development initiative to provide integral capital to businesses at no cost to taxpayers. In fact, the 504 program – including the 504 debt refinance options within the program – have a collective performance of a 0.5 percent charge-off rate over the last decade.[6] SomerCor is in line with that standard as our current portfolio charge-off rate for the last 12 months is 0.45 percent.

What I have outlined is a governmental anomaly – a program that meets critical gaps in private sector lending that creates jobs, builds healthy communities, and does so without taxpayer dollars. Unfortunately, despite program success, the 504 program is weighed down by a complex approval process that can have an adverse effect on borrowers. NADCO and the CDC lending industry have advocated for years for regulatory changes to create efficiencies in the approval process to get capital into the hands of small business owners faster while maintaining the integrity of the program. These conversations have been ongoing for more than a decade and covered many of the adjustments to affiliation and underwriting the SBA made in its recent final

[4] Dilger, Robert Jay. (Updated June 16, 2022) Small Business Administration 504/CDC Loan Guaranty Program. Congressional Research Service, 7-8. R41184.pdf (fas.org)
[5] 7(a) & 504 FOIA - Dataset - U.S. Small Business Administration (SBA) | Open Data
[6] Appendix: 10-Year 504 Charge-Off Chart

rule. As a result, NADCO and the CDC lending industry have largely supported the intent of the changes included in the affiliation rule – to create bright line parameters for underwriting and affiliation determination that will allow CDCs the flexibility to be reasonable, while continuing to use prudent underwriting practices and maintain requirements to focus on ensuring repayment ability.

The previous affiliation reporting requirements for the 504 program have had a direct impact on SomerCor's small business borrowers. For example, a specialty food brand partnered with us to finance a commercial real estate purchase with renovations. Ten years after the first successful project, the company returned seeking financing for an additional property. This family business had grown during that decade and the owner now participated in new endeavors, separate from the food brand. The burden of providing documentation on forty different affiliates, many with no direct ties to the business seeking financing, was too arduous to close the loan.

Affiliation is just one part of the recent rule making changes to the SBA's lending programs. The rule also addresses lending criteria and the underwriting process for SBA program loans, including the 504 loan. The structure of the 504 loan means the loan is underwritten by a CDC (complying with all SBA requirements), which includes an independent review and approval by the CDC's Loan Committee and Board before the loan is submitted to the SBA. CDC board members and Loan Committee members are approved by the SBA, and must include at least two members with commercial lending experience. The third-party lender (typically a bank) that is providing the 50 percent financing in a 504 loan project will also conduct its own underwriting process in compliance with its internal credit policies and applicable bank safety and soundness lending practices. Moreover, SBA staff conducts its own review for eligibility and

credit before approving the loan package. This process is unique to the 504 program and provides multiple layers of underwriting and examination to ensure solvency of the borrower to the greatest extent possible.

In addition to the multi-step underwriting and approval process, the 504 program is offered solely through CDCs, for whom SBA is the primary regulator. To provide context around the depth of oversight the CDC lending industry currently experiences, I am including an excerpt from NADCO's comment letter on the *Affiliation and Lending Criteria for the SBA Business Loan Programs* rule dated December 12, 2022:

> "*The Agency is the primary regulator and conducts rigorous oversight of CDCs, including – but not limited to – a biennial review of each CDCs risk rating, historical performance measures (e.g. default rate, purchase rate and loss rate), and portfolio compliance; quarterly Loan and Lender Monitoring System (L/LMS) analysis of the outstanding balance of each CDCs portfolio; specific reviews and biennial reapproval for CDCs who have Accredited Lenders Program (ALP) or Premier Certified Lenders Program (PCLP) status; an extensive Annual Report to SBA covering every aspect of CDC activity from operations of the CDC to loan portfolio metrics; and more.*"

Combine the extensive oversight of CDCs with the underwriting and approval process of the 504 program and it becomes clear why the 504 program and its debt refinancing offerings perform so well.

As I conclude my testimony, I want to acknowledge the difficult job Congress has in processing and balancing feedback from all parties who have a stake in these rule changes. I appreciate your thoughtful approach to hearing from all industry participants before determining next steps. As you consider congressional action, I offer the following recommendations:

- First, there are several lending programs at SBA impacted by these rules who operate differently and perhaps a one-size-fits-all approach is not the best way to address serving more borrowers who are struggling to access capital. The SBA's lending programs have different parameters, including eligibility requirements, terms, use of proceeds, and more. At a time when Congress has repeatedly discussed modernizing the SBA to best meet the needs of not only today's entrepreneurs, but tomorrow's, it is important to continue differentiating the programs and approaching their rules, and administrative and legislative governing, through this lens.
- Second, while Congress continues to weigh the rules and their impact, the CDC lending industry and our banking partners need time and open communication with the SBA to understand the changes as they are currently being implemented. The SBA released Standard Operating Procedure (SOP) 50 10 7[7] on May 10, 2023, which is intended to provide the guidance lenders need to operate in compliance with the new rules. The SOP is effective beginning on August 1, 2023, and it is my strong opinion that trainings, open dialogue, and a collaborative approach is integral to the ability of industry participants to understand, learn, and adapt to the rule changes. Our goal is to keep our focus on providing capital opportunities to as many small businesses as possible. In order to do that we need the training, tools, and time to digest and incorporate the new rules and SOP without fear of being penalized during that process.
- Finally, the discussion today is based on rules that seek to serve more small businesses through SBA's lending programs and industry response to these efforts. In addition to the two most recent final rules, SBA is considering a final rule pertaining to changes to the

[7] SOP_50_10_7_effective_08.01.docx (live.com)

504 debt refinance without expansion program made in the *Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act* (P.L. 116-260) passed in December of 2020. In this law, Congress revised the requirements for refinancing debt in the 504 loan program to expand small business access to, and use of, this critical capital resource. To illustrate congressional intent of the law, the Senate Small Business and Entrepreneurship Committee released a section-by-section guide to the Economic Aid Act, which states the statute, "(e)nhances the 504 refinancing rules in order to create reciprocity for refinancing between 504 and 7(a) programs."[8]

It is clear the legislative intent of the statute was to create parity in the ability to refinance existing debt under either the 504 or 7(a) loan programs – both should be equally accessible and guided by what is in the best interest of the small business borrower, while protecting program integrity. As SBA considers comments submitted in September 2021, it is critical they remove administrative barriers not included in the law that restrict the ability of borrowers to access the program and release a final rule as soon as possible. The changes made in the Economic Aid Act are particularly important in the current interest rate environment where the much lower fixed rate of the 504 program can provide enormous cost savings to small businesses.

The CDC lending industry cares deeply about maintaining our role as a trusted partner for small business success and take seriously the integrity of the programs we serve so they remain options for small businesses for years to come. We will continue to focus on collaboration and communication with SBA and Congress to meet our collective goal of making lending programs, like the 504, easier, faster, and more secure in support of a strong small business ecosystem

[8] Attachment: *Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues*, Section-by-Section

nationwide. I sincerely appreciate the opportunity to testify this morning, and I look forward to answering any questions.

Appendix: 10-Year 504 Charge-off Chart

10 Year 504 Charge Off Data for 504 Refi, Refinance, 504 Regular, ALP and PCL Loans

	Funded Loans				Charged Off Loans				
Delivery Type	# of Loans	% of #'s of Loans	$ of Loans	% of $ of Loans	# of Loans	% of #'s of Loans	$ of Loans	% of $ of Loans	Loss Ratio
504	16,724	28.03%	$12,750,918,540	28.24%	161	41.18%	$108,900,877	46.27%	0.9%
504 Refinance	1,966	3.29%	$1,046,895,000	4.53%	3	0.77%	$2,333,397	0.99%	0.1%
504REFI	1,180	1.94%	$1,123,331,000	2.49%	24	6.14%	$15,653,807	6.65%	1.4%
ALP	39,473	66.15%	$28,938,737,290	64.08%	203	51.92%	$108,479,669	46.09%	0.4%
PCLP	350	0.59%	$300,093,000	0.66%		0.00%	$0	0.00%	0.0%
Grand Total	**59,673**	**100.00%**	**$45,159,854,830**	**100.00%**	**391**	**100.00%**	**$235,366,750**	**100.00%**	**0.5%**

Explanation:
The loans funded and charged off by type of 504 loan (504 Refi and Refinance) and delivery method (504 Regular, ALP, PCLP) over the ten year period from 10/1/12 to 9/30/23.
Example: Line 1, 504 (Regular) shows 16,724 loans funded (28.03% of all loans funded) for $12.8 billion (28.24% of loan dollars funded). 161 loans were charged off
(41.18% of loans charged off) totalling $1.08 million in losses (46.27% of all losses). The loss rate was 0.9% (dollars lost divided by dollars lent).

NOTE: 504REFI Original Refinance Program (2010-2012)
504 Refinance Current Refinance Program (2016-Present)

PLEASE NOTE: DATA IS DERIVED FROM INFORMATION SUPPLIED BY THE SBA. THE DATA TABLES EXCEED 180,000 LINES AND MAY INCLUDE ERRORS, OMMISSIONS OR "UNKNOWN" DATA.

Question 1: Mr. Flores, much of the May 17, 2023, hearing entitled, "Taking on More Risk: Examining the SBA's Changes to the 7(a) Lending Program Part II," focused on the SBA's *Affiliation and Lending Criteria for the SBA Business Loan Programs* final rule impacting the 504 and 7(a) programs. At the time of the hearing, the SBA had just released Standard Operating Procedure (SOP) 50 10 7, which implements the changes made in the final rule. Can you provide any pertinent information gleaned from further examination of the SOP that informs topics covered in the hearing?

Follow-Up Question: Specifically, does the SOP address concerns about prudent underwriting guardrails for larger loans while streamlining underwriting for smaller dollar loans? If so, how?

Since the May 17, 2023 hearing, the Small Business Administration (SBA) dialogued with the certified development company (CDC) industry to address issues with the original SOP and committed to addressing industry concerns with the guidance. Subsequently, SBA released an updated SOP 50 10 7.1 on October 30, 2023.

In the updated SOP, SBA provides the following introductory paragraph with regard to the underwriting process for 504 loans:

> *"Certified Development Companies (CDCs) must analyze each application in a commercially reasonable manner, consistent with prudent lending standards. The analysis must be acceptable to SLPC. On 504 loans, the cash flow of the Applicant is the primary source of repayment, not any expected recovery from the liquidation of collateral. Thus, if the CDC's financial analysis demonstrates that the Applicant lacks reasonable assurance of repayment in a timely manner from the cash flow of the business, the loan request must be declined, regardless of the collateral available. The credit strengths and weaknesses of the proposed project must be identified and discussed by the CDC along with any mitigating factors."*

It is important to note that SBA has not adopted methods such as credit scoring for smaller dollar 504 loans. Each loan must adhere to the above criteria, which is further outlined in pages 306-319 of SOP 50 10 7.1.

To that end, the May hearing included a broad discussion about the ways in which the SBA **did** streamline underwriting in their *Affiliation and Lending Criteria for the SBA Business Loan Programs* final rule, including concerns about SBA removing prudent guidelines from the underwriting process. Below is a chart that illustrates the old underwriting criteria and the new criteria.

	OLD			NEW
1	Character, reputation, and credit history (pg. 312)		1	The credit score or credit history of the applicant (and the Operating Company, if applicable), its Associates and any guarantors
2	Experience and depth of management (pg. 312)		2	The earnings or cashflow of the applicant
3	Strength of the business (pgs. 307-8, pgs. 311-13)		3	Where applicable, any equity or collateral of the applicant
4	Past earnings, projected cash flow, and future prospects (pgs. 307-8)			
5	Ability to repay the loan with earnings from the business (pgs. 307-8)			
6	Sufficient invested equity to operate on a sound financial basis (pgs. 311-12)			
7	Potential for long-term success (pgs. 311-12)			
8	Nature and value of collateral (pgs. 314-16)			
9	The effect any affiliates may have on the ultimate repayment ability of the applicant (pgs. 311, 313)			

The color coding in the chart and the assigned page numbers indicate the manner in which the old criteria remain under the umbrella of the new criteria found in SOP 50 10 7.1 and must be included in the credit memorandum of each 504 loan. The SOP makes clear prudent underwriting is required with a primary focus on the reasonable assurance of repayment for all 504 loans.

Statement for the Record

On Behalf of the

American Bankers Association

Before the

House Small Business Committee

May 17, 2023

Statement for the Record

On Behalf of the

American Bankers Association

Before the

House Small Business Committee

May 17, 2023

The American Bankers Association (ABA) appreciates the opportunity to provide a Statement for the Record for this hearing, *Taking on More Risk: Examining the SBA's Changes to the 7(a) Lending Program Part II.* ABA is the voice of the nation's $23.6 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $19.2 trillion in deposits and extend $12.2 trillion in loans.

On behalf of our member banks participating in the U.S. Small Business Administration (SBA) 7(a) loan program, we write to make you aware of our serious concerns regarding SBA's recently finalized rules: *Affiliation and Lending Criteria for the SBA Business Loan Programs* ("Affiliation Rule") and *Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization* ("SBLC Rule"). In the SBLC Rule, SBA lifted the moratorium on the number of nondepository institutions (called Small Business Lending Companies or SBLCs) that can make loans under the 7(a) program and to create a new type of SBLC called "Community Advantage SBLCs." SBA stated that the purpose for removing the moratorium is to expand capital opportunities for underserved businesses. In the Affiliation Rule, SBA loosened the 7(a) program's requirements for how lenders underwrite loans and how borrowers may use loan funds.

Together, these major regulatory changes lay out a detrimental shift in the 7(a) lending program. Both final rules remove or modify long-existing prudent lending standards which have ensured programmatic integrity for decades. It is into this framework of loosened lending standards that the SBLC Rule also opens SBA's flagship 7(a) program to a potentially unlimited number of SBLC lenders, including non-bank financial technology (fintech) companies, which would be regulated at the federal level solely by SBA. SBA's stated intention for these sweeping changes is to aid traditionally underserved borrowers, a laudable goal that our association supports. However, as explained more fully below and in the comment we submitted in SBA's rulemaking process,[1] these changes may negatively impact the performance of loans made under the 7(a) Program, threaten the integrity of the program, and lead to increased borrower and lender fees. Consequently, the changes could unintentionally harm the very borrowers that SBA is trying to aid.

[1] Comment of Am. Bankers Ass'n, *Affiliation and Lending Criteria for the SBA Business Loan Programs*; *Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization* (filed Dec. 27, 2022), https://www.aba.com/advocacy/policy-analysis/sba-proposed-rules-to-lift-moratorium-on-nondepository-lenders.

Because Congress has a vested interest and oversight responsibility in ensuring the integrity of SBA's cornerstone loan program, we urge Congress to consider potential legislative and Appropriations responses to the final rules.

Specifically, our concerns include, but are not limited to, the following list:

- We are concerned that the rules will not actually promote mission lending. The new SBLCs, like the existing SBLCs, are not subject to any requirements to serve underserved borrowers or to make small-dollar loans. While the rule creates a new category of Community Advantage SBLCs to focus on mission lending, it fails to present any clear set of defined or consistent mission-lending requirements for these entities. In fact, the final rule removed the requirement, present in SBA's proposal, that would have required Community Advantage SBLCs to make a certain percentage of its loans in an identified capital market gap. Instead, SBA stated in the final rule that the Administrator "will determine the specific market requirements, if any, that apply to Community Advantage SBLCs . . . ."[2]

- In lifting the moratorium, SBA has assumed supervisory responsibilities over the new non-federally regulated lenders that SBA will accept into the 7(a) program. OCRM will serve as the primary regulator for every new SBLC, and SBA states that it has adequate staffing and funding to supervise three additional "regular" SBLCs, or non-mission lending entities, at this time. However, SBA's belief in its supervisory capacity is not in line with SBA lenders' experience that OCRM is operating at its maximum capacity, given its existing responsibilities, low staffing, and limited resources. As evidence, SBA's Office of Inspector General (OIG) found that nondepository lenders in SBA's loan programs currently are subject to "limited SBA oversight" until a loan default occurs.[3] A separate SBA OIG audit "identified additional significant issues regarding internal control weaknesses for lender oversight."[4] As described in detail in the next section, we are concerned about the potential for imprudent lending behavior that presents risk to both borrowers and the performance of SBA's 7(a) portfolio.

- We are concerned that SBA failed to promulgate any regulatory requirements that would attempt to mirror, for the new SBLCs, the federal regulatory and compliance requirements imposed on depository institutions that are supervised by a Federal banking agency. Hallmarks of prudent lending – including compliance with Bank Secrecy Act and Anti-Money Laundering requirements, concentration caps, safety and soundness parameters, stress test parameters, and other regulatory criteria to promote prudent lending – apply to every 7(a) lending decision made by a federally-regulated bank. However, none of those requirements are set out by SBA. Rather, SBA states that a lender should follow its federal regulator's requirements. And while SBA does review and monitor lenders' SBA loan practices and performance, it does not attempt to replicate the extensive supervisory framework that the federal banking agencies have in place which governs all federally-regulated lender behavior, *including* a federally-regulated lender's SBA lending behavior. A complete absence of any federal regulatory standards for new unregulated entities is deeply worrisome.

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[2] Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization, 88 Fed. Reg. 21,890, 21,894 (Apr. 12, 2023).
[3] U.S. Small Bus. Admin., Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration in Fiscal Year 2020, at 8 (2019), https://www.sba.gov/sites/default/files/2019-10/SBA-OIG-Report-20-01_0.pdf.
[4] *Id.*

- While the rule includes supplementary information indicating that SBA intends to approve only three new "regular" SBLCs *right now*, the actual regulatory language *does not limit* SBA's ability to add an unlimited number of SBLC licenses at any time in the agency's sole discretion. The final rule also does not limit the number of 7(a) loans each new SBLC may make nor establish a lower maximum loan size appropriate for entities new to 7(a) lending. The absence of a limit on the number of new entrants to the 7(a) program or loans these institutions could make is imprudent, in light of SBA's existing challenges with providing effective oversight to nondepository lenders, as described above.

- Our concern over the lack of regulatory requirements for SBLCs in the SBLC Rule is deepened by the Affiliation Rule's sweeping changes to long-held prudent lending standards in the 7(a) program. The Affiliation Rule would largely remove these prudent lending guardrails. Specifically, the Affiliation Rule removes the detailed list of nine factors that lenders were required to consider when determining whether a loan applicant is creditworthy. As a substitute for the existing credit analysis factors, SBA amended the regulations to require lenders to use "appropriate and prudent generally acceptable commercial credit analysis processes and procedures consistent with those used for their similarly-sized, non-SBA guaranteed, commercial loans." SBA also allows a lender to use a "business credit scoring model" and may consider the applicant's credit score or credit history, the applicant's earnings or cash flow, or the applicant's equity or collateral.[5]

  The underwriting standards in place prior to the Affiliation Rule preserve the integrity of the 7(a) Program and the performance of the 7(a) portfolio by ensuring that only creditworthy applicants receive 7(a) loans. As stated above, these standards are particularly important for ensuring nondepository institutions, which are not federally supervised, follow prudent underwriting standards. If a lender is directed to follow underwriting procedures that it would use for its similarly sized, non-SBA-guaranteed loans, as SBA has proposed, federally-supervised depository lenders will continue to make 7(a) loans based on the requirements imposed on them by their prudential regulator, while non-federally supervised lenders—i.e., nondepository fintech lenders—will have no such guardrails to ensure sound lending. No borrower benefits when it receives a loan for which it cannot make repayment. SBA's current underwriting standards help the agency maintain the performance of the 7(a) portfolio and the integrity of the 7(a) Program. If portfolio performance is not maintained because of relaxed lending requirements, SBA may need to increase fees for borrowers and lenders to cover the rising costs of the portfolio. This would harm the underserved small business borrowers that SBA and ABA's member banks seek to serve through the 7(a) Program.

- We are also concerned that SBA is expanding the number of SBLCs and loosening underwriting standards when recent reports indicate SBA did not identify and stop widespread fraud by nondepository fintech companies in the Paycheck Protection Program. The report issued by Congress' Select Subcommittee on the Coronavirus Crisis last December found that fintech lenders participating in the PPP "approved a high

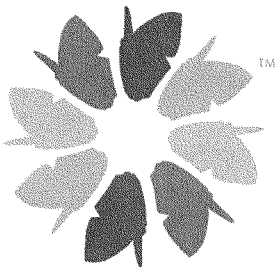
[5] *Affiliation and Lending Criteria for the SBA Business Loan Programs*, 88 Fed. Reg. 21,074, 21,085 (Apr. 10, 2023), https://www.govinfo.gov/content/pkg/FR-2023-04-10/pdf/2023-07173.pdf. By a procedural notice issued on May 9, 2023, SBA is requiring more robust underwriting criteria for 7(a) loans greater than $500,000 – i.e., criteria that are similar, but not identical, to the nine-factor test that the 7(a) final rules removed. U.S. Small Bus. Admin., SBA Procedural Notice, No. 5000-846607 (May 9, 2023). But this enhanced underwriting requirement does not apply to loans of $500,000 or less. These smaller loans may be riskier because they are typically provided to smaller businesses.

volume of fraudulent PPP loan applications" in part because of relaxed SBA protocols and procedures.[6] The report cautions, "Congress and the SBA should consider carefully whether unregulated businesses such as fintechs, many of which are not subject to the same regulations as financial institutions, should be permitted to play a leading role in future federal lending programs."[7] We agree.

We urge Congress to consider potential legislative responses to the SBLC and Affiliation Final Rule that would limit the risk that these rules pose to the solvency and integrity of the 7(a) program. ABA stands ready to work with Congress to achieve this aim.

[6] Select Subcommittee on the Coronavirus Crisis, "We Are Not the Fraud Police": How Fintechs Facilitated Fraud in the Paycheck Protection Program 1 & 7 (2022), https://coronavirus.house.gov/sites/democrats.coronavirus.house.gov/files/2022.12.01%20How%20Fintechs%20Facilitated%20Fraud%20in%20the%20Paycheck%20Protection%20Program.pdf [hereinafter, Select Subcommittee Report]. In addition, a Bloomberg analysis of Department of Justice data found that 75% of loans made under the PPP that were associated with fraud were connected to a fintech lender even though those companies arranged only 15% of PPP loans overall. *See* Michelle F. Davis, *PPP Scammers Made Fintech Companies Their Lenders of Choice*, *Bloomberg* (Oct. 7, 2020), https://www.bloomberg.com/news/articles/2020-10-07/ppp-loans-scammers-used-fintech-companies-to-carry-out-fraud?leadSource=uverify%20wall.

[7] Select Subcommittee Report, *supra* note 6, at 7.



C·A·M·E·O

Testimony for the Record

On Behalf of

California Association for Micro Enterprise Opportunity (CAMEO)

House Committee on Small Business

"Examining the SBA's Changes to the 7(a) Lending Program Part II"

May 17, 2023

The California Association for Micro Enterprise Opportunity (CAMEO) submits the following letter for the record by the Responsible Business Lending Coalition to the Small Business Administration (SBA) regarding the Small Business Lending Company (SBLC) regulation. CAMEO supports the suggestions and recommendations of the Coalition regarding necessary changes to the final rule.

We respectfully suggest the Committee urge SBA to incorporate the standards from the "Responsible Financing Practices" in the U.S. Treasury Department's new CDFI Certification Application into this new regulation, including transparent pricing standards that are based on the *Small Business Lending Disclosure Act of 2021*.

CAMEO is California's statewide micro-business network made up of over 395 organizations, agencies, and individuals dedicated to furthering micro-business development in California with small and micro-business financing such as loans and credit, technical assistance and business management training. We build capacity and expand resources for our members. We also educate the public on the economic impacts of micro-business through public awareness and advocacy at the local, state and federal level to support the growth of micro-business, start-ups, and entrepreneurs.



RESPONSIBLE BUSINESS
LENDING COALITION

January 6, 2023

Dianna Seaborn
Director, Office of Financial Assistance
U.S. Small Business Administration
409 3rd St SW
Washington, DC 20416

RE: Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization (RIN 3245-AH92)

Dear Director Seaborn:

The small business financing market is in a time of transition. Innovative approaches to lending offer the potential for more inclusive, convenient, and affordable access to capital for small businesses. At the same time, irresponsible small business lending practices have become prevalent, threatening both the stability of small businesses and opportunities to develop positive financing innovations. The Responsible Business Lending Coalition (RBLC)[1] submits this letter in response to the proposed rule issued by the Small Business Administration (SBA) that would lift the moratorium on issuing new Small Business Lending Company (SBLC) licenses and would also create a new category of SBLCs - referred to as "Mission-Based SBLCs."

We applaud the SBA's focus on innovation and inclusivity. New approaches to small business lending by providers including responsible fintechs, community development financial institutions (CDFIs), and other nontraditional lenders, as well as conventional banks, are already showing results in serving entrepreneurs in communities that have been overlooked for too long. At the same time, we are concerned that it would be devastating for small businesses if the SBA were to grant 7(a) licenses to lenders who also sell irresponsible financing.

[1] Responsible Business Lending Coalition member organizations include: Accion Opportunity Fund, the Aspen Institute, Camino Financial, Community Investment Management, Funding Circle, LendingClub, National Association for Latino Community Asset Builders, Opportunity Finance Network, and Small Business Majority.

As the SBA considers this proposed rule and others, the RBLC urges the SBA to require a lender to adhere to responsible small business financing practice standards not only on SBA loans but across all of a lender's financing operations, as a prerequisite to securing a new SBA 7(a) lending license.

In support of this central recommendation, in the following letter we share three points:

I. Irresponsible lenders should not be given the SBA's imprimatur of legitimacy.

II. If irresponsible lenders are given the opportunity, their SBA loans could be used as "bait" to draw small businesses into an ecosystem without safeguards to prevent high-cost, irresponsible lending.

III. By establishing responsible lending standards, such as those adopted by signatories of the Small Business Borrowers' Bill of Rights, the SBA would join the U.S. Treasury in seeking to require that a provider demonstrate responsible small business lending practices in order to engage in the State Small Business Credit Initiative (SSBCI) and/or seek certification as a CDFI.

The RBLC is a unique coalition spanning nonprofit and for-profit lenders, investors, and small business advocates that share a commitment to innovation in small business lending and serious concerns about the rise of irresponsible small business lending. The RBLC's members came together because, regardless of differences as nonprofit and for-profits, CDFIs, fintechs, and banks, we all believe that responsible innovation can improve financing for small businesses and we hope to hasten that progress. We believe that all types of financing providers, including banks, nonbanks, fintechs, CDFIs, and others, can and should offer innovative and responsible financing that helps small businesses succeed, especially businesses in historically underserved and underbanked communities.

The RBLC members also came together out of concern about the rise of irresponsible innovation in small business lending practices. Many of the new lending practices are presented as "innovations," but in fact are adaptations of long-used irresponsible practices recognizable from the payday lending and pre-crisis subprime mortgage lending industries. The RBLC works to drive financing practices that are responsible and innovative, and we work to promote a small business financing landscape that is inclusive and built on transparency, fairness, and centering the rights of borrowers in the lending process.

The RBLC created the *Small Business Borrowers' Bill of Rights*[2] (BBoR) in 2015 as the first cross-sector consensus on the rights that small business owners deserve and the practices that financing providers, brokers, and lead generators should employ to uphold those rights. Since the release of the BBoR, over 100 institutions have committed to upholding these responsible lending practices. Key elements of the BBoR have been enacted into law in New York State and in California, Legislators have also introduced, or plan to introduce and pass similar bills based

[2] Attached in full, and available at: http://www.borrowersbillofrights.org/bill-of-rights.html

on the Small Business Borrowers' Bill of Rights in New Jersey, Maryland, Connecticut, North Carolina, Pennsylvania. On the national stage, members of Congress introduced a federal bill in the 117th Congress. The US Treasury Department included responsible lending provisions in the SSBCI program and in the most recent CDFI certification application , following advocacy from the RBLC and hundreds of partner organizations including small businesses, local chambers of commerce, civil rights groups, advocacy nonprofits, banks, and fintechs.

We believe the SBA can advance its goals of promoting more inclusive credit access, competition, and responsible innovation by requiring **any** lender seeking an SBA lending license to **adhere** to responsible lending practices based on those outlined in the BBoR. The BBoR is organized into the following six Rights, listed below and described in more detail in Attachment A and Attachment B:

1. The Right to Transparent Pricing and Terms
2. The Right to Non-Abusive Products
3. The Right to Responsible Underwriting
4. The Right to Fair Treatment from Brokers
5. The Right to Inclusive Credit Access
6. The Right to Fair Collections Practices

I. Irresponsible lenders should not be given the SBA's imprimatur of legitimacy

We encourage the SBA to address and seek to curtail the rise of predatory practices as it considers this proposed rule. According to the Notice, the SBLC proposal is intended to help SBA further its goal of expanding capital opportunities for underserved markets and underserved businesses that "continue to struggle to obtain financing on non-predatory terms." In this section, we highlight six categories of irresponsible practices we believe merit the SBA's attention when considering applicants seeking an SBLC license.

1. Transparency

Some nonbank lenders offer affordable, responsible products online in a manner that demonstrates how innovation can improve the status quo and increase access to financing in a responsible manner. In contrast, there are nonbank lenders offering products that routinely charge annual percentage rates (APRs) of over 40% while never disclosing these APRsto the small business customer. For example, research by Accion Opportunity Fund (AOF) and the Woodstock Institute have identified widespread use of financing with APRs reaching over 50%, and into the triple digits.[3] The small businesses borrowing at these high costs may be able to access capital at much lower prices from more responsible lenders, or even their credit card, but

[3] St. Louis, Weaver, Donaker Brown, and McShane, Opportunity Fund, "Unaffordable and Unsustainable: The New Business Lending on Main Street," May 2016.
https://www.opportunityfund.org/wpcontent/uploads/2019/09/Unaffordable-and-Unsustainable-The-New-Business-Lending-on-Main-Street_Opportunity-Fund-Research-Report_May-2016.pdf, and Woodstock Institute, "Analysis of Small Business Loan Terms," July 2016. Woodstock Institute, "ANALYSIS OF BUSINESS LOAN TERMS."
https://woodstockinst.org/wp-content/uploads/2016/07/Woodstock_Analysis_of_Online_SB_Loan_Terms.pdf

have not had the opportunity to make an informed decision because the APR was not disclosed in the documents they were presented by the initial provider.

The first right presented in the BBoR, The Right to Transparent Pricing and Terms, establishes standards to address these shortcomings of transparency. Lenders that adhere to the BBoR disclose the APR, loan amount, payment amount, term, upfront or scheduled charges, collateral requirements, and prepayment charges, to provide a small business owner with the information they need to comparison shop.

APR is a crucial element for any disclosure because it is the only pricing metric that enables cost comparison across products of different term lengths, amounts, and structures. APR is known to small business owners because it is already mandated for consumer financing products under the federal Truth-in-Lending Act (TILA). Unfortunately, federal TILA protections do not extend to small business owners.

In California and New York, the RBLC worked with small business, civil rights, and advocacy groups to pass and enact commercial disclosure laws that require disclosure of the APR by nonbank financing providers. These state legislative efforts were widely supported, and generally opposed only by the financing companies that charge high APRs and did not want to disclose APRs to their small business customers.

Requiring a lender to clearly disclose APR (as prescribed in the BBoR) as a prerequisite to securing an SBA license would be consistent with the SBA's goal of increasing healthy competition among small business financing providers. The absence of transparent pricing disclosure in today's small business financing market, limits the ability of businesses to make price comparisons which means competition is often based on other terms, such as speed and ease of application process. If the SBA requires new licensees to transparently disclose prices, small business owners would be able to make informed decisions and competition would be enhanced.

2. Abusive Product Structures

The second right presented in the *BBoR* is the Right to Non-Abusive Products. Too often, high costs are paired with product structures that are not in the best interests of the small business borrower. Commonly, higher-cost, shorter-term loans are sold to a borrower with the provider expecting the funds to be re-borrowed over and over again on a long-term basis, akin to payday loan debt cycle. For example, the CEO of one prominent fintech lender celebrated in a conference keynote speech that his small business customers "take 20 loans over 4 to 5 years, 4 to 5 loans a year, every year."[4] If a small business is borrowing short-term 6-month loans with APRs in the high double digits four to five times a year, this suggests the product is a poor fit for the borrower and a longer-term, lower-cost product would be more appropriate. No business

[4] deBanked, "Boiler Rooms Are Not Brands, Kabbage CEO Says," April 2018. https://debanked.com/2018/04/boiler-rooms-are-not-brands-kabbage-ceo-says/

model built on encouraging repeat use of high-cost, short-term financing to meet a long-term need deserves the support of the SBA.

The BBoR includes provisions to prevent debt traps, double-charging fees in a practice called "double dipping," hidden prepayment charges, and the mis-marketing of products against their appropriate use, such as marketing high-cost, short-term credit for long-term use.

3. Responsible Underwriting

The third right presented in the BBoR is the Right to Responsible Underwriting. Some of the newer financing practices presented as "innovations" include underwriting approaches and payment structures that fail to align the interests of lender and borrower.

Some traditional lending structures may naturally align the interests of lenders and borrowers. If a lender is only repaid on a monthly basis and if the borrower's revenues are insufficient to make loan payments after their necessary expenses, the lender may not get paid. The lender is exposed to risk if the small business borrower does not have the ability to repay.

In contrast, some new financing products are underwritten based on a small business's gross revenues alone, without regard to expenses and net profitability--the basis for assessing ability to repay. These revenue-based financing products, including merchant cash advances and similarly structured loans, rely on repayment mechanisms that take payment directly from the small business's revenue stream, such as its payments processing system, often on a daily basis.

This practice insulates the lender from repercussions that could stem from making a loan that a small business does not have the ability to repay. The lender gets access to the small business' revenue first, before the small business has the opportunity to spend that money. If the remaining revenue is insufficient for the small business to cover rent, payroll or other necessary expenses, the lender still gets paid. This creates the potential for misaligned interests between the lender and borrower, because the lender can make money by making unaffordable loans.

The BBoR does not prohibit lenders from using merchant cash advance-style products. Rather, it requires that providers of financing products that do not align the interests of lender and borrower conduct a basic ability-to-pay analysis. This requirement is simply to calculate a debt service coverage ratio. If the debt service coverage ratio is less than 1.00, indicating that the required financing payments are larger than the small business's gross revenues, the lender is to verify, through some form of due diligence, that the borrower can repay all of its debt and remain profitable or has a credible path to profitability.

The Right to Responsible Underwriting portion of the BBoR also addresses the importance of responsible credit reporting and the right to "right sized financing." The BBoR calls on providers to uphold a borrower's right to responsible credit reporting in order to help a borrower build a credit profile, facilitate a business's ability to access credit in the future, and assist a lender in effectively underwriting a business's next round of credit. The requirement for right-sized

financing requires lenders to solicit a small business' request for financing of a specific size, rather than automatically offering the maximum amount of credit the borrower would qualify for to entice small businesses into taking on the greatest possible debt.

4. Fair Treatment from Brokers

The fourth right presented in the BBoR is the Right to Fair Treatment from Brokers and is based on the lessons learned from the pre-2008 subprime mortgage market and how to avoid repeating or allowing the practices that lead to the widespread devastation of vulnerable homeowners. Brokers may steer small businesses into financing products that pay the brokers the highest fees. These may be more expensive, less responsible products than the small business may qualify for. These concerns are addressed by upholding a borrowers' Right to Fair Treatment from Brokers.

5. Inclusive Credit Access

The Right to Inclusive Credit Access is the fifth right of the BBoR. We applaud the SBA's focus on expanding services to small businesses in underserved communities. Responsible lending standards are even more important when products have a disproportionately greater impact on vulnerable communities. Financial inclusion must consider the quality of the products being targeted to underserved populations in the name of "innovation" and increasing "access" to underserved markets. Some of the most notorious predatory subprime mortgage lenders were once celebrated as agents of financial inclusion and innovation. The Right to Inclusive Credit Access confronts this issue in a holistic, nuanced way.

6. Fair Collection Practices

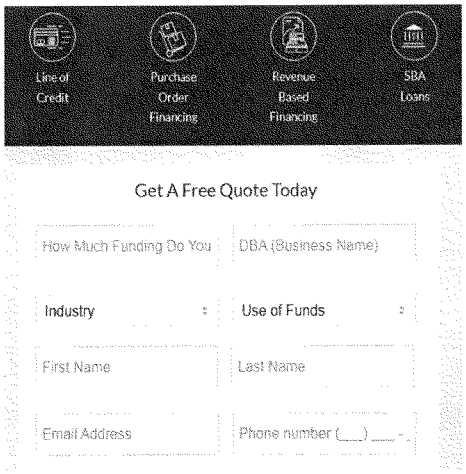
The Right to Fair Collection Practices is the sixth right of the BBoR, and it prohibits abusive confessions of judgment and requires responsible collection practices. The degree of abuses of small business borrowers in collections practices became widely known to the public in a series of articles published in Bloomberg entitled, "Sign Here to Lose Everything."[5] For many small business owners, the news had come too late.

II. SBA loans must not be used as "bait" to draw small businesses into an ecosystem without safeguards to prevent irresponsible, high-cost financing.

An SBA 7(a) loan is an inherently responsible product under the pricing and loan structure requirements of the SBA. The SBA must not overlook the reality that a new 7(a) licensee may offer other, non-SBA financing products that pose a concern. If given a 7(a) license by the SBA, a financing company offering irresponsible, high-cost products would very likely use the potential of an SBA loan to lure small businesses into an ecosystem where they are sold high-cost financing.

[5] Bloomberg, "Sign Here to Lose Everything," Nov 20, 2018. https://www.bloomberg.com/confessions-of-judgment

This risk is demonstrated by the reference to SBA loans on the websites of some high-cost financing companies today, to draw in small business applicants. Below is a screenshot from the website of a larger merchant cash advance financing company. As you can see, above the "Get a Free Quote Today" lead generation box, "SBA Loans" are promoted alongside "Revenue Based Financing," a term used here to refer to merchant cash advances.



Of the small businesses who fill out this form, what percentage will end up in a responsible SBA loan, and what percentage will end up in a high-cost merchant cash advance? And how many more small businesses would this merchant cash advance company be able to draw into their applicant process if they had the legitimacy of being truly licensed by the SBA?

Selling high-cost, short-term financing is more lucrative than selling SBA loans. As a result, if a high-cost lender gets an SBA license, their incentive will be to continue marketing high-cost loans. To demonstrate the higher margins available from selling high-cost financing, consider that it is common practice for brokers to be paid a 15% commission to place a small business in a high-cost, short-term advance or loan, while the commission to place the same small business in an SBA loan is likely to be just 1%. Although the SBA loan is a better product, the financial incentives would remain for financing companies to put customers into the higher-margin product. These high-cost loans could be detrimental not only to small business customers, but also potentially to the SBA portfolio. High-cost financing would be sold not only to borrowers who do not qualify for SBA, but also to SBA borrowers. If a provider of high-cost loans is given an SBA license, one would expect to see those high-cost loans offered alongside SBA products, to SBA borrowers, as bridge loans or working capital loans. The financial stress of this financing may have the potential to degrade the SBA portfolio.

III. By establishing responsible lending standards, such as those adopted by signatories of the Small Business Borrowers' Bill of Rights, the SBA would join the U.S. Treasury Department in seeking to require that a provider demonstrate that responsible small business lending practices in order to engage in SSBCI and or seek certification as a CDFI.

To build responsible lending standards into licensing processes, the SBA could incorporate standards of the Small Business Borrowers' Bill of Rights into its regulatory procedures. The U.S. Treasury Department has established some precedent by referencing responsible lending practices when developing guidance for the SSBCI and seeking information on responsible lending practices from providers seeking CDFI certification.

In 2021, the U.S. Treasury Department incorporated elements of the BBoR into the SSBCI Policy Guidelines, following the RBLC's extensive advocacy. SSBCI rules require that SSBCI-supported transactions "may not include any of the following: (1) confessions of judgment or (2) prepayment or 'double-dipping' fees," and incorporated requirements for the transparent disclosure of certain terms.[6] The SSBCI rules also incorporated a rate cap, which the RBLC supported in the context of government-guaranteed credit but is not a requirement under the BBoRand not something we are suggesting the SBA adopt at this time. Nonetheless, the SSBCI program represents the first incorporation of the BBoR into federal lending regulations.

Late in 2022, the U.S. Treasury Department released a revised draft CDFI certification application which includes a series of questions for applicants that provide small business loan products. The revised draft asks applicants to disclose, in writing, information about the financing products offered to small businesses including whether the providers discloses the APR, total loan amount, the "periodic" payment due, and total finance charges over the life of the loan. If a financing company applying for CDFI certification answers "NO" to any of the disclosure questions, the financing company is deemed ineligible for CDFI certification.

For the SBA's review and consideration, we are submitting a copy of the Small Business Borrowers' Bill of Rights (Attachment A) as well as a copy of the BBoR Attestation Form and Worksheet for Lenders (Attachment B). The worksheet includes guidance for calculating APR as well as guidance for calculating the estimated APR for financing products without a fixed term, consistent with the requirements of the California and New York small business truth in lending laws.

We appreciate the opportunity to comment on the proposed rule and encourage the SBA to consider adapting and adopting RBLC documents for use as responsible lending standards required as a pre-condition for new licenses contemplated in this proposed rule, and to consider requiring all SBA-backed lenders to adhere to these responsible practices as well. Several RBLC member organizations have submitted their own letters in response to the proposed rule and these

[6] U.S. Department of the Treasury State Small Business Credit Initiative Capital Program Policy Guidelines, Pg. 41, Revised December 15, 2021.
https://home.treasury.gov/system/files/136/SSBCI-Capital-Program-Policy-Guidelines.pdf

letters reinforce our collective request that SBA establish and enforce responsible small business financing practices.

Sincerely,

The Responsible Business Lending Coalition

Members include:
Accion Opportunity Fund
The Aspen Institute
Camino Financial
Community Investment Management
Funding Circle
LendingClub
National Association for Latino Community Asset Builders
Opportunity Finance Network
Small Business Majority

Attachment A: Small Business Borrowers' Bill of Rights

SMALL BUSINESS BORROWERS' BILL OF RIGHTS

Small Business Borrowers' Bill of Rights, 2021[1]

The way small businesses borrow money is being transformed. Innovation is creating faster and easier ways to borrow and increasing access to credit in communities that have historically been underserved. However, irresponsible practices have grown as well. The transformation in small business financing that we are experiencing will achieve its potential only if it is built on transparency, fairness, and putting the rights of borrowers at the center of the lending process.[2] This *Small Business Borrowers' Bill of Rights* identifies six fundamental financing rights that we believe all small businesses deserve. These rights are not yet protected by law, in most cases. We encourage the entire small business financing industry to join us in upholding these rights.

1. The Right to Transparent Pricing and Terms

You have a right to see the cost and terms of any financing being offered in writing, in a form that is *clear*, *conspicuous*, *complete*, and *easy to compare* with other options, so that you can make the best decision for your business.

In order to protect your Right to Transparent Pricing and Terms, lenders and brokers must uphold the following practices:

- **Transparent Rate** – Disclose the Annual Percentage Rate ("APR").[3]

[1] The Small Business Borrowers Bill of Rights has been updated in the December of 2020 to incorporate feedback and learnings since the previous revision in 2017. The Small Business Borrowers' Bill of Rights was first launched in August 2015.

[2] The term "loan" and related terms used here, such as "lending," are intended to be interpreted in the broadest sense to refer to all business financing, including loans, lines of credit, merchant cash advances, factoring, and similar products offered and provided to U.S. small businesses. Similarly, the terms "lender" and "borrower" are intended to be interpreted in the broadest sense to include, in the case of lenders, merchant cash advance providers and credit marketplaces that facilitate loans on behalf of lenders.

[3] The annual percentage rate ("APR") is the total cost of financing, including interest, fees, and other required charges, annualized and expressed as a single percentage number. APR is the only established metric that enables informed price comparisons between products of different types, amounts, and term lengths. This is why APR has become the long-standing price metric that people are familiar with, vetted over 50 years of the Truth in Lending Act. An "Estimated APR" should be used for financing such as merchant cash advances, factoring, and similar products with variable term lengths. For a more detailed description of APR calculation, please see the *Small Business Borrowers' Bill of Rights* attestation forms.

- **Clear Comparison** – Present the following seven key terms clearly and prominently, in writing, to the borrower whenever a specific loan offer is presented or summarized for the borrower, such as in a term sheet, offer summary, or equivalent. This complete disclosure should be re-presented if the loan offer changes.

  1. Loan amount, and total amount provided after deducting fees or charges
  2. APR, or Estimated APR in the case of products with variable term lengths
  3. Payment amount and frequency, including the actual or estimated total payment amount per month if payment frequency is other than monthly.
  4. Term or estimated term
  5. All upfront and scheduled charges
  6. Collateral requirements
  7. Any financing charge potentially due at prepayment

  The *Small Business Borrowers' Bill of Rights* does not mandate a standardized form for these disclosures. Where the formatting of these disclosures is not mandated by state law, lenders may use their own designs that are consistent with the *Small Business Borrowers' Bill of Rights*.

- **Plain-English Terms** – Describe all key terms in an easy-to-understand manner. Do not, at any stage of the financing process, use percentages or the term "rate" to describe pricing in metrics that are not the actual interest rate or APR but may be reasonably mistaken for an interest rate or APR. Pricing described as a "factor rate," "simple interest rate," or other novel forms of percentage rates may be easily misunderstood to be interest rates or APRs, but mask that the actual interest rate or APR is much higher.

2. The Right to Non-Abusive Products

You have a right to loan products that will not trap you in an expensive cycle of re-borrowing. Lenders' profitability should come from your success, not from your failure to repay the loan according to its original terms.

In order to protect your Right to Non-Abusive Products, lenders must uphold the following practices:

- **No Debt Traps** – If the borrower is unable to repay an existing loan, extend new credit only if due diligence indicates that the borrower's situation has changed, enabling them to repay the new loan.
- **No "Double Dipping"** – Do not double-charge the borrower. When offering additional financing with a fixed repayment amount to an existing borrower, if requiring their outstanding financing from this same provider to be repaid, forgive any unpaid fixed charges on the borrower's outstanding balance.

- **No Hidden Prepayment Charges –** If, in the event of prepayment, the borrower will be required to pay financing charges other than interest accrued since the last payment, disclose these charges as "prepayment charges." Also disclose any additional charges or fees added in the case of prepayment as "prepayment penalties." Disclose (a) the potential amount of these prepayment charges and penalties in any loan offer summaries, and (b) the actual prepayment charge and penalties at the time of any prepayment. In the case of financing with payments that vary as a percentage of the borrower's sales, a payoff event is considered prepayment if the borrower states the intent to pay off the financing, or in any event of refinancing.
- **Appropriate Product** – Match loan product design and loan product use. If presenting a loan product as designed for one use, do not encourage borrowing behavior contrary to that use. For example, short-term products may be well suited for short term use, but not for ongoing, long-term recurring use. Long-term products with prepayment penalties may be well suited for long-term use, but not for short-term needs.
- **Pressure Free** – Allow borrowers a reasonable time to consider their loan options free from pressure or artificial timelines.
- **Fair Prepayment** – If a borrower requests to prepay or refinance a loan, provide any information required for prepayment within two business days of the borrower's request. To enable small businesses to access the most appropriate financing, the final payoff amount should not vary based on the source of funds used for payoff, funds from a third-party should be considered equivalent to funds from the borrower.
- **Responsive Complaint Management** – If a complaint is submitted requesting action or a response, provide a confirmation of receipt in writing within five days. When possible, research and resolve the complaint in a timely manner.

3. The Right to Responsible Underwriting

You have a right to work with lenders who will set you up for success, not failure. High loss rates should not be accepted by lenders simply as a cost of business to be passed on to you in the form of high rates or fees.

In order to protect your Right to Responsible Underwriting, lenders must uphold the following practices:

- **Believe in the Borrower** – Offer financing only with high confidence that the borrower can repay its *entire* debt burden without defaulting or re-borrowing.
- **Alignment of Interests** – Lenders who receive repayment directly from the borrower's gross sales must also verify, through documents, data from third parties, and/or due diligence, that the borrower can repay all debt and remain profitable, or that it has a credible path to profitability. Lenders should not make loans that the borrower cannot truly afford, even if the lender can find a way to be repaid.

- **Right-sized Financing** – Size loans to meet the borrower's need, rather than to maximize the lender's or broker/lead generator's revenue. Seek to offer the borrower the size of loan that they need, rather than offering the largest amount they could qualify for.
- **Responsible Credit Reporting** – Report loan repayment information to major credit bureaus and consult credit data when underwriting a loan. Such reporting enables other lenders to responsibly underwrite the borrower and helps the borrower build a credit profile that may facilitate access to more affordable loans in the future. Lenders must inform the borrower and any guarantors if they intend to report loan repayment performance to guarantors' credit bureaus only in certain circumstances, such as after a default.

4. The Right to Fair Treatment from Brokers and Lead Generators

You have a right to transparency, honesty, and impartiality in all of your interactions with brokers and lead generators.

In order to protect your Right to Fair Treatment from Brokers, brokers and lead generators must offer:

- **Transparent Loan Options** – Disclose all loan options for which the borrower qualifies through the broker or lead generator's services, indicating the lowest APR option.
- **Transparent Compensation** – Disclose all compensation paid to the broker or lead generator, by either the lender or borrower, in connection with each loan offer presented.
- **Disclosure of Broker Incentives** – Disclose the broker's or lead generator's fee structure and any other financial incentives they have, including whether they receive higher fees for brokering certain loans. Brokers or lead generators who have not legally agreed to act in the best interests of the potential borrower may not state they are acting in the best interest of the potential borrower.
- **No Fees for Failure** – No brokering or related fees can be charged to the potential borrower if the broker or lead generator is unable to find them a loan and if the borrower does not accept a loan secured through their services.
- **Responsive Complaint Management** – If a complaint is submitted requesting action or a response, provide a confirmation of receipt in writing within five days. When possible, research and resolve the complaint in a timely manner.

5. The Right to Inclusive Credit Access

You have a right to fair and equal treatment when seeking a loan.

In order to protect your Right to Inclusive Credit Access, lenders and brokers must uphold:

- **Non-Discrimination** – Uphold the letter and intent of fair lending laws, including the Equal Credit Opportunity Act. Do not discriminate against small business owners on the basis of race, color, religion, national origin, gender identity, marital status, age, or sexual orientation.

6. The Right to Fair Collection Practices

You have a right to be treated fairly and respectfully throughout a collections process. Collections on defaulted loans should not be used by lenders as a primary source of repayment.

In order to protect your Right to Fair Collections Practices, lenders must uphold the following practices:

- **Fair Treatment** – Abide by the intent of the Fair Debt Collection Practices Act and provide borrowers similar protections as described in that Act.
- **Fair Agreements** – Do not utilize confessions of judgement or equivalent legal agreements by which a borrower preemptively agrees to lose disputes with the lender.[4]
- **Responsible Oversight** – Diligently vet and oversee the collections practices of third-party collectors and debt buyers. Do not work with collectors or debt buyers who fail to treat borrowers fairly.
- **Accurate Information** – Transmit accurate, current, and complete information about the loan to third-party collectors and debt buyers.

[4] Lenders currently utilizing confessions of judgement (COJ) are granted 180 days from the date of signing their attestation form to comply with the COJ prohibition. A limited exception to the prohibition is provided for certain Small Business Administration (SBA) loans, for which SBA requires a COJ clause (borrowers based in MD, VA, and PA). The Responsible Business Lending Coalition urges the SBA to remove all COJ requirements, both optional and mandated, from SBA loan documents moving forward.

RESPONSIBLE BUSINESS LENDING COALITION

Small Business Borrowers' Bill of Rights

Attestation Form and Attestation Worksheet for Lenders and Marketplaces, 2021[1]

In order for a lender or marketplace to become a signatory of the Small Business Borrowers' Bill of Rights, its chief executive must attest that it abides by all practices described in the Small Business Borrowers' Bill of Rights by completing both the **Attestation Form** and the **Attestation Worksheet** below, and, if requested, promptly provide additional documentation evidencing compliance with any or all of the enumerated practices (the "**Supporting Documents**"). The Supporting Documents shall be in a form acceptable to the Responsible Business Lending Coalition. Once completed, the Attestation Form, Attestation Worksheet and, if applicable, any Supporting Documents should be emailed to bbor@borrowersbillofrights.org.

[1] The Small Business Borrowers Bill of Rights has been updated in December, 2020 to incorporate feedback and learning since the previous revision in 2017. The Small Business Borrowers' Bill of Rights was first launched in August 2015.

Small Business Borrowers' Bill of Rights (2021)
Attestation Form for Lenders and Credit Marketplaces

Summary of Attestation

By checking the boxes below, I affirm that my organization actively supports and adheres to the *Small Business Borrowers' Bill of Rights* and abides by all of the practices described in the attached Attestation Worksheet:

- ❑ The Right to Transparent Pricing and Terms
- ❑ The Right to Non-Abusive Products
- ❑ The Right to Responsible Underwriting
- ❑ The Right to Inclusive Credit Access
- ❑ The Right to Fair Collections Practices

Note: You must be able to truthfully check all five boxes to be deemed a Signatory of the Small Business Borrowers' Bill of Rights and thereby eligible to have your organization's logo appear on the Small Business Borrowers' Bill of Rights website, www.BorrowersBillofRights.org.

Terms of this Attestation

a. I have read and understand the *Small Business Borrowers' Bill of Rights.*

b. I have completed the attached Attestation Worksheet, indicating in writing that my organization abides by *all* of the enumerated practices.

c. If requested by the Responsible Business Lending Coalition, I have provided or will promptly provide (as the case may be) all Supporting Documents (as such term is defined on the cover page of this Attestation Form) in a form acceptable to the Responsible Business Lending Coalition.

d. By completing this Attestation Form and attesting that my organization abides by *all* of the enumerated practices in the attached Attestation Worksheet, I consent to having this Attestation Form and my organization's logo posted on the Small Business Borrowers' Bill of Rights Website.

e. I understand that this Attestation Form and my organization's logo may be removed from the Small Business Borrowers' Bill of Rights website if (i) my organization does not complete and submit a satisfactory updated Attestation Form within one calendar year from the date of my signature below, and (ii) each successive year thereafter, or (iii) if my organization ceases to abide by this Attestation or (iv) if, after receiving a request from the Responsible Business Lending Coalition, my organization fails to promptly provide any Supporting Documents or provides inadequate Supporting Documents (as applicable).

f. I agree, on behalf of my organization, that my organization assents to and will be bound by the Terms of Use for the Small Business Borrowers' Bill of Rights website.

g. Anyone with questions for my organization regarding this Attestation Form completed by my organization can contact the following individual (include name, title, email address, and phone number): _____

h. I attest that the information above is accurate and represents the standard practices for all financing products and services offered through my organization to small businesses. Furthermore, I hereby certify that I am authorized to sign this Attestation Form on behalf of my organization.

_____
Organization Name

_____
Chief Executive Signature

_____
Chief Executive Name

_____
Date

Small Business Borrowers' Bill of Rights, 2021
Attestation Worksheet for Lenders and Marketplaces

In order for an organization to become a signatory it must attest that it abides by the Small Business Borrowers' Bill of Rights by having its chief executive complete this worksheet by checking each box below indicating that his or her organization abides by each of the practices set forth below.[2] Questions regarding the form can be directed to bbor@borrowersbillofrights.org.

The Right to Transparent Pricing and Terms

☐ **Transparent Rate**

Disclose the Annual Percentage Rate (APR), or Estimated APR in the case of variable-term financing.

APR is the total cost of financing, including interest, fees, and other required charges, annualized and expressed as a single percentage number. This enables apples-to-apples price comparison between financing of different amounts and term lengths.

APR disclosure for small business financing may be required under state laws including California's SB 1235 and New York's Small Business Truth in Lending Act, which are based on the federal Truth in Lending Act. Where these state laws do not apply, APR should be calculated according to the Truth in Lending Act, as implemented in Regulation Z §1026.22, including the following guidelines:

- When disclosed, APR should not be of lesser prominence than any other term in the disclosure.
- For merchant cash advances and other sales-based financing, the estimated APR, payment amounts, and term disclosed should be calculated based on the projections for repayment that are used in underwriting the financing.
- For lines of credit and similar open-ended financing, APR should be calculated to include fees by assuming that the borrower draws the full amount on the origination date, and makes the minimum payments required.
- For factoring financing, the projected timing of payment should be established by the due date of the accounts receivable factored or based on data for the historical payment behavior of the firm named on the accounts receivable factored.
- If payment amounts vary, APR should be calculated based on the projected payment amounts, rather than an average payment amount.
- If a rate is promotional or introductory, the term sheet or its equivalent should clearly state this, and how the rate could change in the future.
- For assistance in calculating APR using standard formulas in programs such as Microsoft Excel, please see Appendix: "Sample APR Calculation Formulas."

[2] The term "loan" and related terms used here such as "lending" are intended to be interpreted in the broadest sense possible so as to include loans, lines of credit, merchant cash advances, and similar products offered and provided to U.S. small businesses, whether or not such credit products are characterized legally or otherwise as loans. Similarly, the terms "lender" and "borrower" are intended to be interpreted in the broadest sense possible so as to include, in the case of lenders, credit marketplaces that facilitate loans on behalf of lenders, cash advance providers, factors, and all manner of persons providing financing to U.S. small businesses or evaluating the creditworthiness of such small businesses in connection with providing financing, and, in the case of borrowers, all U.S. small businesses who seek or obtain financing.

☐ **Clear Comparison**

Present the following seven key terms listed clearly and prominently, in writing, to the borrower whenever a specific loan offer is presented or summarized for the borrower, such as in a term sheet, offer summary, or equivalent:

1. Loan amount, and total amount provided after deducting fees or charges
2. APR or Estimated APR
3. Payment amount and frequency, including the actual or estimated total payment amount per month if payment frequency is other than monthly
4. Term or estimated term
5. All upfront and scheduled charges
6. Collateral requirements
7. Any financing charge potentially due at prepayment

The Small Business Borrowers' Bill of Rights does not mandate a standardized form for these disclosures. Where the formatting of these disclosures is not mandated by state law, lenders may use their own designs that include these seven key terms, as described here in the Transparent Rate and Clear Comparison sections.

☐ I have included in this Attestation, as a Supporting Document, a screenshot or other document demonstrating disclosure of these seven terms to borrowers in the manner described here in the Transparent Rate, Clear Comparison, and Plain-English Terms sections.

☐ I have included in this Attestation, as a Supporting Document, a short description of when the screenshot or other disclosure documents I have included are presented to the borrower, and when any other summaries of loan terms are disclosed.

☐ **Plain-English Terms**

Describe all key terms in an easy-to-understand manner. Do not, at any stage of the financing process, use percentages or the term "rate" to describe pricing metrics that are not the actual interest rate or APR. Pricing described as a "factor rate," "simple interest rate," or other novel forms of percentage rates may be easily misunderstood to be interest rates or APRs, but mask that the actual interest rate or APR is much higher.

The Right to Non-Abusive Products

☐ **No Debt Traps**

If a borrower is unable to repay an existing loan, extend new credit only if due diligence indicates that the borrower's situation has changed, enabling them to repay a new loan.[3]

☐ **No "Double Dipping"**

Do not double-charge the borrower. When offering additional financing with a fixed-fee as the

[3] Government loan programs, such as the PPP, with defined underwriting approaches are also compliant.

primary financing charge to an existing borrower, if requiring their outstanding financing to be repaid forgive any unpaid fixed charges on the borrower's outstanding balance.

☐ **No Hidden Prepayment Charges**

- If, in the event of prepayment, the borrower will be required to pay financing charges other than interest accrued since the last payment, disclose these charges as "prepayment charges." Disclose any additional charges of fees added in the case of prepayment as "prepayment penalties."
- Disclose (a) the potential amount of these prepayment charges and penalties in any loan offer summaries, and (b) the actual prepayment charges and penalties at the time of any prepayment.
- In the case of financing with payments that vary as a percentage of the borrower's sales, a payoff event is considered prepayment if the borrower states the intent to pay off the financing, or in any event of refinancing.

☐ **Appropriate Product**

Match loan product design and loan product use. If presenting a loan product as designed for one use, do not encourage borrowing behavior contrary to that use. Short-term products may be well suited for short term use, but not for long-term recurring use. Long-term products with prepayment penalties may be well suited for long-term use, but not for short-term needs.

☐ **Pressure Free**

Allow potential borrowers to consider their credit options free from pressure or artificial timelines.

☐ **Fair Prepayment**

- If a borrower requests to prepay or refinance a loan, provide any information required for the prepayment within two business days of the borrower's request.
- Final payoff amount should not vary based on the source of funds used for payoff, funds from a third-party should be considered equivalent to funds from the borrower.

☐ **Responsive Complaint Management**

If a borrower complaint is submitted requesting action or a response, provide a confirmation of receipt in writing within five days when possible, and research and resolve the issue in a timely manner.

The Right to Responsible Underwriting

☐ **Believe in the Borrower**

Offer financing only with high confidence that the borrower can repay its *entire* debt burden without defaulting or re-borrowing.

☐ **Alignment of Interests**

Lenders should not make loans that the borrower cannot truly afford, even if the lender can find a way to be repaid. If the lender receives repayment directly the borrower's gross sales (i.e. credit card or payments processing or daily payments) before the borrower has the opportunity to pay for their required operating expenses, the lender must also verify, through documents, data from third parties,

and/or due diligence, that the borrower can repay all debt and remain profitable (i.e. a debt service coverage ratio of greater than 1.00), or that it has a credible path to profitability.

☐ **Right-sized Financing**

Size loans to meet the borrower's need, rather than to maximize the lender's or broker/lead generator's revenue. Seek to offer the borrower the size of loan that they need, rather than automatically offering the maximum amount they qualify for.

☐ **Responsible Credit Reporting**

Report loan repayment information to major credit bureaus and consult credit data when underwriting a loan. Such reporting enables other lenders to responsibly underwrite the borrower and helps the borrower build a credit profile that may facilitate access to more affordable loans in the future. Lenders must inform the borrower and any guarantors if they intend to report loan repayment performance to guarantors' credit bureaus only in certain circumstances, such as after a default.

The Right to Inclusive Credit Access

☐ **Non-Discrimination**

Uphold the letter and intent of fair lending laws, including the Equal Credit Opportunity Act. Do not discriminate against small business owners on the basis of race, color, religion, national origin, gender identity, marital status, age, sexual orientation.

The Right to Fair Collection Practices

☐ **Fair Treatment**

Abide by the letter and intent of the Fair Debt Collection Practices Act and provide borrowers similar protections as described in that Act.

☐ **Fair Agreements**

Do not utilize confessions of judgement or equivalent legal agreements by which a borrower preemptively agrees to lose disputes with the lender.[4]

☐ **Responsible Oversight**

- Diligently vet and oversee the collections practices of third-party collectors and debt buyers.
- Do not work with collectors or debt buyers who fail to treat borrowers fairly.

☐ **Accurate Information**

Transmit accurate, current, and complete information about the loan to third-party collectors and debt buyers.

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[4] Lenders currently utilizing confessions of judgement (COJ) are granted 180 days from the date of signing this attestation form to comply with the COJ prohibition. A limited exception to the prohibition is provided for certain Small Business Administration (SBA) loans, for which SBA requires a COJ clause (borrowers based in MD, VA, and PA). The Responsible Business Lending Coalition urges the SBA to remove all COJ requirements, both optional and mandated, from SBA loan documents moving forward.

Appendix: Sample APR Calculation Formulas

APR calculation can be made simple by using standard formulas in common spreadsheet software programs. If used correctly, the following formulas in Microsoft Excel or Google Sheets can calculate APR for loans, merchant cash advances, lines of credit, factoring, and other types of financing, consistent with the Truth in Lending Act formulas in Regulation Z. Other formulas and calculators not shown here also calculate APR accurately; the formulas below are provided as one resource. To confirm that any specific application of these formulas complies with legal requirements, please consult with legal counsel.

1. **For financing products with payments of equal amounts paid at equal intervals**
This may be appropriate for most loans, lines of credit, and merchant cash advances with flat sales projections and payments made daily, weekly, bi-weekly, or monthly.

> *APR = RATE (Number of payments, payment amount as a negative number, disbursed amount after fees deducted) * Number of payment periods in one year to annualize*

2. **For financing products with payments of differing amounts paid at equal intervals**
This may be appropriate for loans with scheduled payments of different amounts, or for merchant cash advances considering sales projections that rise or fall over the payment period and with payments made daily, weekly, bi-weekly, monthly. It can also be used to include periods when charges are compounded but no payment is made.
This formula may be used for standard factoring financing by including the amount disbursed to the small business in the first cell, followed by cells with values of zero for each period in which charges are compounded but no payment is made, and a final payment cell when the invoice is paid representing the value of the invoice minus any amount not refunded to the small business.

> *APR = IRR (select a series of cells indicating the flow of money, with the disbursed amount in the first cell, followed by cells representing the total payments in each subsequent payment period as negative numbers) * Number of payment periods in one year to annualize*

3. **For financing products paid at irregular intervals**
This may be appropriate for financing paid on weekdays only, skipping weekends, for example.

> *APR = ((XIRR (select a series of cells in two columns with the first column indicating the flow of payments, with the disbursed amount in the first cell as a positive number and payments back to the financing provider in subsequent cells as negative numbers, and the second column indicating the corresponding dates of each disbursement or payment) +1)^(1/365)-1)*365*

Credit Union National Association
CUNA

Jim Nussle
President & CEO

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99 M Street SE
Suite 300
Washington, DC 20003-3799

May 10, 2023

The Honorable Roger Williams
Chairman
Committee on Small Business
United States House of Representatives
Washington, DC 20515

The Honorable Nydia Velazquez
Ranking Member
Committee on Small Business
United States House of Representatives
Washington, DC 20515

Dear Chairman Williams and Ranking Member Velazquez:

On behalf of the Credit Union National Association ("CUNA"), I am writing regarding the Committee's hearing, *Taking on More Risk: Examining the SBA'S Change to the 7(a) Lending Program Part I.* CUNA represents America's credit unions and their more than 135 million members.

CUNA strongly opposes the latest proposed changes to the 7(a) loan program by the Small Business Administration (SBA). Credit unions participate in this critical loan program and will be negatively impacted by the two proposed rules: the (i) Affiliation and Lending Criteria for the SBA Business Loan Programs, 87 FR 64724 ("Affiliation Proposed Rule"), and (ii) Small Business Lending Company ("SBLC") Moratorium Rescission and Removal of the Requirement for a Loan Authorization, 87 FR 66963 ("SBLC Proposed Rule")

Both the Affiliation Proposed Rule and the SBLC Proposed Rule propose the removal or modification of well-established lending standards, which have ensured programmatic integrity for decades. One highly significant impact, among others, of the proposed loosened lending standards set forth in the SBLC Proposed Rule is SBA's apparent intention to open up the 7(a) loan program to an unlimited number of non-federally regulated lenders without material guardrails or any defined focus on or nexus to SBA's mission lending, despite SBA stating that the primary intention of the proposed rules is to aid underserved borrowers.

CUNA supports SBA's stated goals in proposing these regulatory changes: (i) aiding traditionally underserved borrowers as well as (ii) increasing the availability of 7(a) loans and the numbers of participating lenders so that more small businesses can gain access to SBA loans.

However, we believe that the proposed changes may not actually help ease minority and underserved communities' access to SBA funding, and in fact, could unintentionally harm the very borrowers that SBA is trying to support. Furthermore, we believe that the combined impacts of these proposed changes could lead to additional negative impacts on various stakeholders, including, but not limited to, current and future borrowers of SBA loans, by lowering material standards related to underwriting and portfolio performance.

On behalf of America's credit unions and their more than 135 million members, thank you for holding this important hearing to examine the 7(a) program and considering our views on this issue.

Sincerely,

Jim Nussle
President and CEO

NADCO
National Association of Development Companies

December 12, 2022

Dianna Seaborn, Director
Office of Financial Assistance
U.S. Small Business Administration
409 Third Street SW
Washington, DC 20416

RE: RIN 3245-AH87
Document ID: SBA-2022-0012-001
Affiliation and Lending Criteria for the SBA Business Loan Programs

Dear Ms. Seaborn:

The National Association of Development Companies (NADCO), on behalf of the Certified Development Company (CDC) industry, submits these comments in response to the U.S. Small Business Administration's (SBAs) Proposed Rule titled "Affiliation and Lending Criteria for the SBA Business Loan Programs (RIN 3245-AH87)."

Background

NADCO provides comments specific to CDCs and their involvement in SBA programs as mission-based lenders focused on promoting economic development through job creation. CDCs are non-profit lenders approved by SBA to participate in specific agency loan programs, including the 504 Loan Program, the Community Advantage (CA) Pilot Program, and the Microloan Program. The Agency is the primary regulator and conducts rigorous oversight of CDCs, including – but not limited to – a biennial review of each CDCs risk rating, historical performance measures (e.g. default rate, purchase rate and loss rate), and portfolio compliance; quarterly Loan and Lender Monitoring System (L/LMS) analysis of the outstanding balance of each CDCs portfolio; specific reviews and biennial reapproval for CDCs who have Accredited Lenders Program (ALP) or Premier Certified Lenders Program (PCLP) status; an extensive Annual Report to SBA covering every aspect of CDC activity from operations of the CDC to loan portfolio metrics; and more.

CDCs are by design economic developers, which is a primary reason that in addition to the myriad of other federal, state, and local programs they offer, they all have in common delivery of the SBA's 504 Loan Program. The 504 program is SBA's only program for which economic development in the form of job creation or meeting public policy or community development goals are requirements for eligibility, which differentiates it from other SBA capital access programs for which credit elsewhere (including consideration of personal resources) is a statutory determinant for eligibility. Additionally, the 504 Loan Program is focused on economic development through the purchase of commercial real estate and capital equipment, in essence, fixed assets.

The Community Advantage Loan Program is also delivered by non-profit entities, which includes nearly 50 CDCs, many who have delivered the program since its inception in 2011. This program is also mission-driven with 60% of loans made in underserved communities, encapsulating rural, HUBZone, low-to-moderate income, and new businesses. Many of the changes SBA proposes in this rule were introduced

for the Community Advantage Loan Program on April 29, 2022 (87 FR 25398), which NADCO supported in comments submitted to the Agency on May 24, 2022. At that time, NADCO encouraged SBA to extend many of these reforms to the 504 Loan Program.

NADCO's comments below are reflective of the manner in which CDCs operate within the SBA ecosystem, the unique parameters of the programs they deliver, and are consistent with comments made to the Agency previously. **NADCO has long advocated for simplification and streamlining of SBA's 504 Loan Program and Community Advantage Loan Program to promote speed, consistency, and certainty for small business access to capital.**

Given this background, NADCO offers the following –

Section 120.130—Restrictions on Uses of Proceeds
Current § 120.202 restricts Borrowers from using 7(a) loan proceeds to purchase a portion of a business or a portion of another owner's interest. SBA proposes to revise this section to allow Borrowers to use 7(a) loan proceeds to fund partial changes of ownership in addition to full changes of ownership.

> *NADCO supports SBA's desire to assist small businesses and provide a path to ownership for employees. While no such regulatory restriction on partial change of ownership projects exists in* § 120.884 for *SBA's 504 Loan Program, SBA has historically used Standard Operating Procedure (SOP) guidance to allow full change of ownership projects in 504. SBA has not historically allowed 504 to fund partial change of ownership projects. NADCO recommends that SBA change its guidance to allow the 504 Loan Program to finance full or partial change of ownership projects provided those projects are supported by underlying fixed assets.*

Section 120.150—What are SBA's lending criteria?
Current § 120.150 states that SBA's lending criteria for 7(a) and 504 loans requires that the applicant (including the Operating Company) must be creditworthy; loans must be so sound as to reasonably assure repayment; and SBA will consider nine specific factors in its lending criteria. The factors consist of: (a) Character, reputation, and credit history of the applicant (and the Operating Company, if applicable), its Associates, and guarantors; (b) Experience and depth of management; (c) Strength of the business; (d) Past earnings, projected cash flow, and future prospects; (e) Ability to repay the loan with earnings from the business; (f) Sufficient invested equity to operate on a sound financial basis; (g) Potential for long-term success; (h) Nature and value of collateral (although inadequate collateral will not be the sole reason for denial of a loan request); and (i) The effect any affiliates (as defined in part 121 of this chapter) may have on the ultimate repayment ability of the applicant.

SBA proposes to revise this regulation by retaining the requirement that the applicant (including an Operating Company) must be creditworthy and that loans must be so sound as to reasonably assure repayment and streamlining the nine specific factors in its lending criteria to three specific criteria when approving loans: (a) The credit score or credit history of the applicant (and the Operating Company, if applicable), its Associates and any guarantors; (b) The earnings or cashflow of the applicant; or (c) where applicable, any equity or collateral of the applicant.

SBA is also incorporating into the regulation a new requirement that Lenders and Certified Development Companies (CDCs) must use appropriate and prudent generally acceptable commercial credit analysis processes and procedures consistent with those used for their similarly sized, non-SBA guaranteed commercial loans. The rule also adds language to § 120.150 to permit Lenders, CDCs, and SBA to use a

business credit scoring model to streamline loan underwriting. Lenders and CDCs may use SBA's Small Business Scoring Service (SBSS) credit scoring model. Lenders and CDCs may also use other credit scoring models; however, when doing so, Lenders and CDCs must be able to validate the credit scoring model and must document with appropriate statistical methodologies that their credit analysis procedures are predictive of loan performance, and they must provide that documentation to SBA upon request and during oversight reviews.

NADCO supported SBA's recent streamlining of lending requirements for the Community Advantage (CA) Loan Program [implemented in April 2022 via Federal Register Notice Vol. 87, No. 63 and via Federal Register Notice Vol. 87, No. 83], as these changes expanded access to the CA program's delivery of critical capital through small loans to underserved communities. CDCs have participated in the Community Advantage Loan Program since its inception in 2011. Historically, approximately 40-50 CDCs have delivered the program as part of our mission-based lending ethos, representing over 40% of total CA lenders and over 60% of CA lending dollars.

NADCO supports SBA's desire to extend the simplification and modernization of its lending requirements to the 504 Loan Program, while also embracing new technology to allow generally acceptable commercial credit analysis processes and procedures, including loan scoring models, to streamline underwriting. NADCO strongly encourages SBA to continue its focus on prudent lending standards while balancing program access with portfolio performance and program integrity.

For 504 Loan Program purposes, NADCO specifically supports SBA removing the requirement to consider character and reputation because as SBA stated in the proposed rule, "the lending industry commonly uses the terms character and credit history interchangeably." Credit history is a more objective, empirical measure than the amorphous concepts of "character" and "reputation." SBA's proposed change would focus more appropriately on current conditions more indicative of creditworthiness rather than minor infractions in an applicant's past.

NADCO is concerned that SBA may use this change to implement a minimum credit score for all loans and recommends that SBA make clear in SOP guidance that CDCs are able to use mitigating factors when a credit score is impaired for explainable reasons. NADCO recommends that SBA retain the consideration of "experience and depth of management" in its lending criteria, as this is particularly important for start-up or new businesses – NADCO acknowledges that management strength can be implied by the financial performance of existing businesses, but it should be a separate consideration for start-up or new businesses where underwriting is based in part on management skills and projections.

Section 120.160—Loan Conditions

Current § 120.160(c) states that for 7(a) and 504 loans, SBA requires hazard insurance on all collateral and does not distinguish this requirement by loan size. In the proposed rule, SBA is modifying the requirement for hazard insurance for all 7(a) and 504 loans $150,000 and under to create flexibility for SBA Lenders to mirror their hazard insurance requirements for their similarly sized non-SBA loans. SBA proposes revising this regulation to state that SBA requires hazard insurance for loans greater than $150,000.

NADCO supported SBA making this change in the Community Advantage Loan Program for small loans to underserved communities. As NADCO has long advocated for SBA to simply and

streamline the 504 Loan Program, we support this change for 504 loans, as it allows for CDC flexibility to meet the needs of the small business Applicant more cost-effectively. To the extent that the CDC believes that hazard insurance is necessary for small loans secured by real estate, the proposed rule still allows that flexibility.

NADCO has advocated for SBA to grant similar flexibility for life insurance for the 504 Loan Program and recommends that SBA not automatically require life insurance for single owner businesses, allowing the CDC and Applicant to make the case that life insurance is not necessary, even for sole proprietorships and single member LLCs. In situations where life insurance is deemed necessary for these entities, if SBA's collateral gap calculation is less than a minimum threshold (i.e., $50,000), NADCO advocates for SBA to simply waive the requirement for life insurance altogether as this cost can be onerous for small business owners while providing minimal risk to SBA.

Section 120.193—Reconsideration After Denial

Under current regulation § 120.193, the Director of the Office of Financial Assistance (OFA) makes all reconsideration decisions. To facilitate fair and expeditious reconsiderations, SBA is proposing to grant the OFA Director the ability to delegate decision making to designees – for 7(a) loan applications, the Director's designee would include the Chief, 7(a) Loan Policy; for 504 loans, the Director's designee would include the Chief, 504 Loan Policy. From time to time, SBA may change the designee(s) and would do so in accordance with published Delegations of Authority.

NADCO supports this proposed change.

Section 120.202—Restrictions on Loans for Changes of Ownership

Current § 120.202 restricts Borrowers from using 7(a) loan proceeds to purchase a portion of a business or a portion of another owner's interest. SBA proposes to revise this section to allow Borrowers to use 7(a) loan proceeds to fund partial changes of ownership in addition to full changes of ownership.

This proposed change is contemplated in conjunction with SBA's proposed change to § 120.130 as outlined above. As stated above, NADCO supports SBA's desire to assist small businesses and provide a path to ownership for employees. While no such regulatory restriction exists in SBA's 504 Loan Program, SBA has historically used Standard Operating Procedure (SOP) guidance to restrict partial change of ownership projects in 504. NADCO recommends that SBA change its SOP guidance to allow the 504 Loan Program to finance full or partial change of ownership projects provided those projects are supported by underlying fixed assets.

Section 121.301—What size standards and affiliation principles are applicable to financial assistance programs?

SBA's proposed rule seeks to streamline SBA's affiliation criteria under § 121.301 for all of its business loan programs, including 504 and 7(a). SBA proposes to specifically remove the principle of control of one entity over another as a separate basis for finding affiliation because the concept of control has proven particularly burdensome for applicants and lenders to understand and implement.

NADCO supported SBA's streamlining and modernizing affiliation principles in the Community Advantage Loan Program in April 2022 and advocated for SBA to extend those changes to the 504 Loan Program as part of our long-term goal of program simplification.

To use SBA's words, existing affiliation rules are "particularly burdensome for applicants and lenders to understand and implement." Additionally, the complexity has led to inconsistent interpretation and implementation by all parties in the loan approval process. SBA's proposal would create a "bright line" test that CDCs and small businesses can easily understand and implement.

With respect to the individual revisions to § 121.301 –

1. *NADCO supports SBA's proposed revisions to affiliation based on ownership in § 121.301(f)(1).*
2. *NADCO supports SBA's proposed revisions to affiliation based on stock options, convertible securities, and agreements to merge in § 121.301(f)(2).*
3. *NADCO supports SBA's proposed elimination of affiliation based on management in § 121.301(f)(3). NADCO also supports SBA's statement that "it [SBA] should not interfere in a business owner's right to enter into a service agreement with a management company." To the extent that SBA requires review and approval of management agreements for loan program requirements (i.e., passive business activity), NADCO expects SBA will continue its current guidance established in existing Standard Operating Procedures (SOP).*
4. *NADCO supports SBA's proposed elimination of affiliation based on identity of interest in § 121.301(f)(4). NADCO agrees with SBA that the existing requirement is "inherently unfair and impractical" when a close relative is not a principal of the Applicant business.*
5. *NADCO supports SBA's proposed elimination of affiliation based on franchise and license agreement in § 121.301(f)(5); however, NADCO does not support elimination of the SBA Franchise Directory and SBA's approval of compliance with loan program requirements (i.e., business model eligibility). The current franchise review and approval process for business model eligibility has evolved over time and is working well for CDCs, Third Party Lenders, and small business Applicants. Keeping SBA involvement in the approval of business model eligibility will assure consistency and avoid second guessing through SBA's oversight activities, including Payment Integrity Information Act of 2019 (PIIA) audits and CDC reviews. NADCO recommends that SBA continue reviewing all franchise and license agreements for compliance with Loan Program Requirements and publishing that data on the Franchise Directory to provide transparent assurance to CDCs, Third Party Lenders, and small business Applicants.*

NADCO appreciates the opportunity to provide these comments and welcomes additional collaboration with SBA to create additional efficiencies in the 504 Loan Program.

Sincerely,

D. Wayne Williams

Wayne Williams
Executive Vice President
Regulatory Affairs & Training

NADCO
National Association of Development Companies

January 6, 2023

Dianna Seaborn, Director
Office of Financial Assistance
U.S. Small Business Administration
409 Third Street SW
Washington, DC 20416

RE: RIN 3245-AH92
Document ID: SBA-2022-0013-001
Small Business Lending Company Moratorium Rescission and Removal of the Requirement for a Loan Authorization

Dear Ms. Seaborn:

The National Association of Development Companies (NADCO), on behalf of the Certified Development Company (CDC) industry, submits these comments in response to the U.S. Small Business Administration's (SBAs) Proposed Rule titled "Small Business Lending Company Moratorium Rescission and Removal of the Requirement for a Loan Authorization" (RIN 3245-AH92).

Improving access to capital to underserved communities has long been a shared priority of NADCO and its members and the SBA. NADCO does not believe that this proposed rule will achieve our common goal, and therefore, we cannot support the proposed rule as presented. We welcome dialogue with agency leadership to develop solutions to meet our common objectives.

Background
NADCO supported and applauded SBA's CA program reforms announced in April 2022, as those revisions were made in consultation with mission lenders to speed loan processing, delivery of capital of underserved communities, and encourage greater lender participation. Specific reforms included –

1. Extending the pilot program for two years (to September 30, 2024)
2. Removing the temporary moratorium on new CA Lender Participation Applications
3. Granting delegated authority to experienced CA lenders
4. Modifying Lending Criteria to simplify and streamline underwriting and approval of CA applications, including authorizing the use of business credit scoring models
5. Modifying regulations to provide equitable access under SBA programs and economic opportunities to justice-involved individuals
6. Increasing the maximum CA loan size from $250,000 to $350,000
7. Revising fee methodology and maximum interim rate to encourage greater lender participation in the CA Loan Program
8. Revising collateral requirements to increase the speed of capital being delivered to small businesses while decreasing overall costs to the CA Lender and borrower
9. Allowing revolving lines of credit to better meet the evolving capital needs of small businesses
10. Revising the requirements for hazard insurance
11. Simplifying affiliation principles

NADCO has long advocated for the CA Loan Program to be made permanent either through congressional action or through SBA's long-term extension of the pilot program (i.e., a 10-year

extension). The current program sunset of September 30, 2024 is a barrier to entry for new lenders. NADCO continues advocating for additional reforms to increase lender participation and better meet the capital needs of underserved communities, including –

1. SBA supporting Congressional action to make Community Advantage a permanent program
2. As an interim measure, SBA extending the pilot program until September 30, 2034, to encourage greater lender participation
3. Increasing the maximum SBA guarantee
4. Expanding CDC access to sources of liquidity
5. Expanding CA program eligibility to socially and economically disadvantaged businesses, such as businesses owned and controlled by women and minorities
6. Expanding CA program training for CA lenders new to SBA lending, SBA district office staff, and other resource partners to continue safeguarding programmatic integrity
7. SBA making grants available to CA lenders to support delivery of technical assistance, which is a crucial component of the CA program and critical to the success of CA borrowers and meeting the needs of underserved communities
8. Implementing streamlined, limited documentation closings for CA Loans of $100,000 or less [similar to what SBA allows in SBA 7(a) Express]; including –
    a. No life insurance required for CA loans of $50,000 or less
    b. Simplified verification of use of proceeds and equity injection

Given this background, our objections to the proposed rule include –

1. SBLC Moratorium Rescission

SBA proposes to lift the moratorium on new Small Business Lending Companies (SBLCs). This will allow new for-profit SBLCs into the program. SBA will also create a new type of non-profit Mission-Based SBLC, which SBA purports will help bridge financing gaps, particularly in underserved communities. Based on current oversight capacity, SBA anticipates it has the ability to approve three new SBLCs in total (regular for profit SBLC and Mission-Based SBLC).

Lifting Moratorium on SBLCs to Promote Mission Lending

1. *Lifting the moratorium and adding non-mission SBLCs does not improve access to mission lending for underserved communities. SBA's stated goal of this proposed rule is to address "certain markets where there are capital market gaps (that) struggle to obtain financing on non-predatory terms," particularly underserved communities. SBA imposes additional requirements on Mission-Based SBLCs "to ensure that Mission-Based SBLCs fill identified capital market gaps and provide targeted financial assistance to underserved communities." SBA does not impose **any** mission-based requirements on non-Mission-Based SBLCs, which is contrary to the goals outlined in the proposed rule and may have adverse impacts on programmatic integrity.*

   For example, as proposed, both regular and Mission-Based SBLCs would operate within the SBA 7(a) Loan Program. Because there is no limit to the number of SBLCs SBA could potentially add to participate in 7(a) lending, borrowers in underserved communities may experience disruptions in their ability to access capital through the 7(a) program if for-profit SBLCs lend at a rate to which the authorization cap is reached and the program is shut down, which would require an act of Congress to address.

Additionally, the expected cost of SBA's capital access programs is determined by SBA in conjunction with the Office of Management and Budget (OMB) and released in the President's budget request each year. There are many factors that determine the subsidy and whether a cost will be associated with each program, including economic conditions, expected loan cohort performance, and more.

Unfettered access to the 7(a) Loan Program by for-profit SBLCs may result in subsidy costs to the program necessitating not only the elimination of fee waivers for small dollar and veteran borrowers, but higher fees for all borrowers. Borrowers will suffer any unintended consequences of lifting the moratorium on SBLCs.

2. *By removing the moratorium on new SBLCs (both regular and Mission-Based), SBA can increase the number of SBLCs at any time with a notice in the Federal Register "to respond to market conditions and oversight capacity." However, the proposed rule does not detail how SBA will prioritize the approval of new non-profit Mission-Based SBLCs over new regular for-profit SBLCs. Without such detail and priority, lifting the moratorium will not achieve SBA's stated goal to increase lending capacity in underserved communities.*

3. *It is unclear how the proposed rule will advance mission lending when so many programmatic details are not addressed (i.e., geography, maximum loan size, target markets, etc.). The rule leaves those details to be approved by SBA personnel on a lender-by-lender basis, thus creating separate guidelines for each lender. SBA promotes this individualized approach as flexible in order to fill specific market gaps, yet it lacks transparency, creates inconsistency for small business borrowers, and places added responsibilities on an already overburdened agency to devise, approve, and monitor individualized lender compliance. To encourage mission lending, NADCO supports SBA making further reforms to the Community Advantage Loan Program which already has the requisite programmatic framework.*

4. *The proposed rule is absent specificity and transparency around Mission-Based Small Business Lending Companies (SBLCs) and the transition of existing CA lenders to this new category. SBA proposes to "allow CA Lenders an opportunity to apply to permanently participate in the 7(a) Loan Program as a Mission-Based SBLC while continuing to meet the needs of underserved communities." However, the proposed rule provides no details on this "application" process and no assurance that all existing CA lenders will be granted the new Mission-Based SBLC designation. Depending on how implemented, transitioning existing CA lenders could be costly and time-consuming to lenders and inhibit their ability to serve borrowers. The rule also contains no details on an application process for new Mission-Based SBLCs not coming from the CA loan program. Further, SBA removed the temporary moratorium on new CA Lenders in April 2022 [Federal Register Notice Vol. 87, No. 63] to encourage greater lender participation in the CA program, but the proposed rule states that SBA "has capacity to authorize three new SBLC Licenses" and "SBA anticipates approving three SBLCs, including Mission-Based SBLCs, in the full first year after this proposed rule becomes effective." This would restrict adding new mission lenders when no such restriction exists in the CA Loan Program today. This is contrary to the April 2022 changes allowing increased lender participation in the CA Loan Program.*

Impact on Community Advantage Pilot Program and Meeting the Capital Needs of Underserved Communities

1. *SBA's April 2022 reforms to the CA Loan Program included lifting the moratorium on new lenders and extending the program until September 30, 2024. Lenders considering CA program participation must balance the cost of investing in a new program versus the uncertainty of the program ever becoming permanent. Without such certainty, new lenders are reluctant to invest in the program. As SBA stated in the proposed rule when discussing new SBLC lenders, "newly established SBLCs take up to five years to reach the current lending activity sustained by established SBLC license holders." In contrast, SBA's reforms to the CA loan program have only been in place since April 2022. Rather than being "an unviable alternative" for increasing volume in underserved lending, CA simply needs time. Additionally, had SBA paired its program reforms with a longer extension of the pilot, lenders would have more certainty to justify the investment in a program to deliver much-needed capital to underserved communities.*

2. *The proposed rule does not address NADCO's other recommendations to improve the Community Advantage Loan Program, including increasing the maximum SBA guarantee, expanding CDC access to liquidity, streamlining closing documentation, expanding training, and making grants available to assist with much-needed technical assistance that is critical to underserved communities.*

3. *The proposed rule is silent on capital requirements for Mission-Based SBLCs, which could impede existing CA lenders from transitioning to a Mission-Based SBLC designation and deter new lenders from applying for this program. For context, the current SBLC capital requirement is $5 million. Additionally, under the proposed rule, SBA requires an existing CDC currently providing CA loans to form a new affiliated non-profit entity to apply to serve as the proposed Mission-Based SBLC. This requirement creates costs and additional burdens for existing CA lenders to transition to the Mission-Based SBLC designation defeating the goals of the proposed rule.*

4. *Per the proposed rule, Mission-Based SBLCs will be subject to a minimum $10,000 initial safety and soundness examination at the time of application and ongoing safety and soundness examinations at least once every two years. "Additionally, SBA conducts targeted reviews of loan files in between regularly scheduled safety and soundness exams. The total biennial cost of these risk-based reviews is currently $50,000 to $150,000 per institution, with review costs correlated to the size of the SBLC's loan portfolio." As mission-based non-profit lenders, CA lenders pay oversight fees commensurate with the size of their CA loan portfolios and associated risk; whereas traditional SBLCs are for-profit lenders not subject to SBA's mission lending mandates, have significantly larger portfolios, and can make loans up to $5 million. This proposal creates another cost pain point for mission-based lenders and may force smaller CA lenders to exit the program, which is counterproductive to the goal of increasing lending to underserved communities.*

2. Removal of the Requirement for a Loan Authorization

SBA is proposing to remove the requirement for a Loan Authorization in its 504 and 7(a) Loan Programs. Both the 7(a) Loan Program and the 504 Loan Program currently require a Loan Authorization providing the terms and conditions under which SBA will make or guarantee business loans. The terms and

conditions of each loan are also submitted into E-Tran by the SBA Lender through the submission of the loan application data and conditions. SBA has decided this dual entry of information is a duplication of effort and creates an opportunity for a mismatch of information between two sources of the loan terms and conditions. SBA proposes to eliminate the requirement for a separate Authorization and to instead rely on the use of the terms and conditions of the loan application as submitted by the SBA Lender into E-Tran.

> *NADCO does not support the elimination of the Loan Authorization for the 504 Loan Program or the Community Advantage Loan Program. The loan authorization in the 504 Loan Program is relied upon by the CDC, the Interim Lender, the Third Party Lender, and the Borrower to provide a detailed outline of the terms and conditions under which SBA will guarantee the 504 debenture and allow for closing and funding of the 504 loan to pay off a portion of any interim financing. All parties use this document as a roadmap for the closing process of the interim financing, the third party financing, and the 504 loan.*
>
> *In a commercial real estate transaction, sellers rely on a buyer's ability to arrange the financing needed to consummate the purchase. Buyers traditionally provide a seller with a commitment letter to evidence the certainty that the buyer has been approved for any necessary financing. While not a commitment to lend, the SBA Authorization for a 504 loan provides the certainty to all parties that project financing has been reviewed and approved by the SBA, and that upon successful completion of the project and fulfillment of the terms of the Authorization, SBA will allow the CDC to close and fund the 504 loan and payoff the interim financing. For that reason, an Authorization is critical to the transaction.*
>
> *NADCO and CDCs have collaborated with SBA on eliminating the "wizard" interface for generating authorizations for 504 loans and creating a mechanism that allows a CDC to populate an authorization directly from data stored in ETRAN. SBA introduced this functionality in May 2022, and technology providers launched a direct interface with ETRAN in September 2022, further streamlining the creation of an authorization from ETRAN data. The rule's stated purpose for eliminating the loan authorization is to preclude "dual entry of information," as that is a "duplication of effort and creates an opportunity for a mismatch of information between two sources of the loan terms and conditions" [the ETRAN loan data and the authorization]. However, SBA's recently introduced 504 ETRAN authorization, now coupled with CDC technology provider interface, created directly from ETRAN data sources, has addressed SBA's "duplication" concern for the 504 Loan Program.*

NADCO appreciates the opportunity to provide these comments and welcomes additional collaboration with SBA to improve efficiency and effectiveness in the agency's 504 and CA loan programs.

Sincerely,

D. Wayne Williams

Wayne Williams
Executive Vice President
Regulatory Affairs & Training

NADCO
National Association of Development Companies

September 20, 2021
UPDATE 9/23/2021 – see page 6

Linda Reilly
Chief, 504 Program Branch
Office of Financial Assistance
U.S. Small Business Administration
409 Third Street SW
Washington, DC 20416

RE: RIN: 3245-AH78
Interim Final Rule
Debt Refinancing in the 504 Loan Program

Dear Ms. Reilly:

The National Association of Development Companies (NADCO), on behalf of the Certified Development Company (CDC) industry, submits these comments in response to the U.S. Small Business Administration's (SBAs) interim final rule ("IFR") titled, "Debt Refinancing in the 504 Loan Program," (RIN: 3245-AH78). NADCO appreciates the opportunity to comment on these crucial changes to SBAs 504 loan program. It has always been our belief that 504 regulations should not only protect the integrity of the program, but also improve avenues for CDCs to promote economic development through job creation guided by the best interests of the small businesses we all serve. Our comments are based on this philosophy, which we know you share.

Congress reauthorized and made permanent the 504 debt refinance without expansion program under Section 521 of Division E of the Consolidated Appropriations Act, 2016. Since its reimplementation, Congress has authorized a $7.5 billion cap for the loan program. However, the program has historically been underutilized, due in part to conditions and limitations placed on the program by SBA in its regulations and policy guidance. In the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues" Act ("Economic Aid Act"), Congress revised the requirements for refinancing debt in the 504 loan program to expand small business access to, and use of, this critical capital resource.

The Senate Small Business and Entrepreneurship Committee released a section-by-section guide to the Economic Aid Act, Division N, Title III: Continuing the Paycheck Protection Program and Other Small Business Support. In "Section 328: Low-Interest Refinancing" of that section-by-section guide, the Committee states the statute, "(e)nhances the 504 refinancing rules in order to create reciprocity for refinancing between 504 and 7(a) programs." It is clear the legislative intent of the statute was to create parity in the ability to refinance existing debt under either the 504 or 7(a) loan programs – both should be equally accessible and guided by what is in the best interest of the small business borrower, while protecting program integrity.

SBA initially implemented the 504 debt refinance without expansion program through an interim final rule on May 26, 2016, and a final rule on June 6, 2018. As originally authorized by Congress and implemented by SBA, "(t)he Debt Refinancing Program shall be in effect only in those fiscal years during

which the cost to the Federal Government of making guarantees under the Debt Refinancing Program and under the 504 Loan Program is zero." SBA introduced conditions that limited and restricted the usability of the debt refinancing program under this "zero cost" requirement. The Economic Aid Act removed the "zero cost" requirement. While remaining cognizant of prudent underwriting and program integrity, NADCO believes that certain program guidance can be revised to increase access and usability.

NADCO's comments focus on suggested changes to the Interim Final Rule and policy guidance, which we believe will simplify the program, making it more accessible and efficient without adding undue risk –

13 CFR 120.882(g)(3)

NADCO has two specific recommendations in this section. First, NADCO recommends that SBA not include in regulation any conditions or requirements that restrict or limit the ability to refinance a loan that is subject to a guarantee by a Federal agency or department since no such conditions or restrictions exist in statute. NADCO recommends SBA use similar language the agency previously used in regulations for the 504 debt refinance with expansion program at 13 CFR 120.882(e)(3) – there, SBA simply states, "Existing 7(a) and 504 loans may be refinanced under this section in accordance with SBA policies or procedures." Using the same language in 13 CFR 120.882(g)(3) would prevent unnecessary restrictive conditions from being incorporated into regulation and will provide the agency with maximum flexibility to allow refinancing through policy guidance that is in the best interest of the small business borrower.

Second, NADCO recommends removal from policy and procedure guidance the written verification of the existing 7(a) lender's inability or unwillingness to modify the current payment schedule as a requirement to allowing the refinance of an existing 7(a) loan. NADCO takes strong exception to the limitations that SBA is imposing on the CDCs ability to refinance an existing 7(a) loan in Section 120.882(g)(3)(ii) and in its SOP Policy Notice 5000-808830, paragraph 10.e)ii) –

> "An existing 7(a) loan may be refinanced if the CDC verifies in writing that the present lender is either unwilling or unable to modify the current payment schedule. In the case of same institution debt, if the Third Party Lender or the CDC affiliate as authorized under § 120.820 is the 7(a) lender, the loan will be eligible for 504 refinancing only if the lender is unable to modify the terms of the existing loan because a secondary market investor will not agree to modified terms."

Just like the ability to refinance an existing 504 loan in § 120.882(g)(3)(i), the ability to refinance an existing 7(a) loan should be unfettered and guided by what is in the best interest of the small business applicant. In § 120.882(g)(3)(iii), SBA establishes a "substantial benefits test" for the refinance of existing government-guaranteed debt that already assures the debt refinance is advantageous to the small business borrower. Any further restrictions only benefit the best interest of the 7(a) lender, potentially a secondary market investor, and not the small business applicant. To expand upon this point, the written verification requirement should be removed from the IFR and policy guidance for the following reasons:

1. This requirement is not in the best interest of the small business borrower. The small business borrower should be able to obtain the loan product that best meets the needs of his/her business. This requirement essentially takes that choice away from the borrower, if his/her existing 7(a) lender will not issue a written verification.

2. This requirement continues to allow an advantage for the 7(a) program over the 504 program, which effectively nullifies the parity that was the original intent of the law. This rule essentially provides a "first right of refusal" to the existing 7(a) lender, which is neither customary nor reasonable in the commercial lending industry and puts the onus on the small business borrower to advocate in their best interest. We have already heard from small business borrowers that, prior to issuing a written verification, existing 7(a) lenders are requiring the small business borrower to submit a full application for credit review. This adds unnecessary time and complexity to the refinance process, serves the interest of the existing 7(a) lender, and does not promote the best interests of the small business borrower.
3. SBA is already adding a "substantial benefits test" to the refinancing of existing government-guaranteed debt in Section 120.882(g)(3)(iii), which ensures the debt refinance is beneficial to the small business borrower.

13 CFR 120.882(e)(3)
NADCO recommends that SBA remove this same "written verification" restriction/limitation from the 504 debt refinance with expansion program at 13 CFR 120.882(e)(3) when refinancing an existing 7(a) loan for all the same reasons outlined above. Additionally, SBA has always required a "substantial benefits test" in 13 CFR 120.882(e)(5), which ensures the debt refinance is beneficial to the small business applicant.

13 CFR 120.882(g)(6)(i)
NADCO recommends that SBA remove the restriction that if a Borrower's application includes a request to finance Eligible Business Expenses, "the portion of the Refinancing Project provided by the 504 loan and the Third Party Loan may be no more than 85% of the fair market value of the fixed assets that will serve as collateral and the Borrower may receive no more than 20% of the fair market value of the Eligible Fixed Asset(s) securing the Qualified Debt for Eligible Business Expenses."

No such restrictions or limitations exist in statute – not in the original enabling legislation in Section 521 of Division E of the Consolidated Appropriations Act, 2016 nor the revised statutory language in Division N, Title III, Section 328 of the Economic Aid Act. SBA implemented this limitation in regulation and policy guidance in part to address the original statutory requirement that the Debt Refinancing Program must operate at "zero cost," which was eliminated in the Economic Aid Act. In its Final Rule published in the **Federal Register**, Vol. 83, No. 88 on May 7, 2018, SBA stated –

> "When SBA first implemented the reauthorized Debt Refinancing Program in 2016, SBA applied a maximum 75% loan-to-value (LTV) for any project that financed business expenses and limited such financing of business expenses to no more than 25% of the value of the Eligible Fixed Asset(s) securing the Qualified Debt. See Policy Notice 5000–1382, effective May 26, 2016. Thirty-six commenters expressed concerns that the 75% LTV was severely restrictive and would impair utilization of the program, and many urged SBA to allow for a 90% LTV for all Refinancing Projects. SBA considered these comments and decided to revise 13 CFR 120.882(g)(6)(i) to allow a maximum LTV of 85% for any project that includes the financing of Eligible Business Expenses. SBA concludes that this higher LTV will provide increased access to credit without adding undue risk to SBA...In addition, with the statutory requirement that SBA maintain the Debt Refinancing Program at zero subsidy in order for the program to be in effect during any fiscal year, SBA must be diligent in placing prudent controls on the program to mitigate SBA's risk and exposure. Accordingly, SBA has decided to limit the portion of the financing that may be for business expenses to 20% of the value of the Eligible Fixed Asset(s). In addition, if the Refinancing Project

includes the financing of Eligible Business Expenses, SBA will not accept as collateral any fixed assets other than the Eligible Fixed Asset(s) securing the Qualified Debt. Accordingly, SBA is revising 13 CFR 120.882(g)(6)(i) and (ii) and the definition of "Refinancing Project" in 13 CFR 120.882(g)(15)."

The restriction has continued to impair program utilization. In the Interim Final Rule published in **Federal Register**, Vol. 86, No. 143, July 29, 2021, and despite a program authorization of $7.5 billion, SBAs own data shows the depressed utilization of the 504 Debt Refinancing Program due in part to restrictions imposed by SBA beyond statutory language or legislative intent –

504 Debt Refi Without Expansion – Unit & Dollar Volume by FY				
FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
45	266	181	166	386
$41,598,000	$289,491,000	$154,745,000	$156,114,000	$374,749,000

NADCO recommends removal of the restriction for the following reasons –

1. The restriction is not authorized in law and is a barrier for small businesses to utilize the program.
2. The SBA acknowledged user concerns in its May 2018 Final Rule that the restriction was limiting and impaired utilization of the program. While SBA revised the restriction in the Final Rule to increase the maximum LTV from 75% to 85%, the agency reduced the financing of Eligible Business Expenses from 25% to 20%, further impairing program utilization.
3. The legislative intent of the Economic Aid Act was to increase program access and utilization, as well as to create "reciprocity for refinancing between 504 and 7(a) programs;" no such restriction exists in the 7(a) loan program.
4. The Economic Aid Act removed the requirement that the 504 Debt Refinancing Program operate at "zero cost," which SBA used as justification for imposing this restriction as outlined above. Though this requirement was removed, it is important to note that the program has performed well over time, allowing SBA to drop its Congressionally-mandated supplemental annual guarantee fee each year since program launch in May 2016 – dropping from 4.4 basis points at program launch to 1.15 basis points for fiscal year 2022. Removing this requirement, and subsequent restrictions based on the "zero cost" requirement, do not jeopardize the integrity of the program.

NADCO believes removing this restriction will improve program access and utilization without adding undue risk to SBA. In fact, during the COVID-19 pandemic, allowing small business borrowers to access equity in fixed assets to fund working capital and business operating expenses provided much-needed relief and stability as businesses recover and position themselves for future growth. Through September 10, 2021, 606 borrowers have been approved for 504 debt refinance projects totaling $621,358,000.[1] This is a significant increase from prior years, further demonstrating the need for low-cost, long-term, fixed rate financing for small businesses to reposition their balance sheets for immediate relief and growth.

13 CFR 120.882(g)(6)(ii)

NADCO recommends that SBA broaden the definition of Eligible Business Expenses to include "or other obligations of the business." In its Final Rule published in the **Federal Register**, Vol. 83, No. 88, May 7,

[1] Source – *SBA Weekly Approvals Report for 9/10/2021*

2018, SBA specifically removed the phrase, "or other obligations of the business," from the definition of Eligible Business Expenses, "to clarify that, except as described below, other debt of the business is not included as Eligible Business Expense." SBA clarified that business credit card debt and business line of credit debt could be included as an Eligible Business Expense if the credit card and business line were in the name of the Applicant small business and the Applicant certified that the credit card debt and business line of credit debt were incurred exclusively for business related purposes. By removing "other obligations of the business," SBA specifically excluded other debt obligations that were not business credit card or business line of credit debts. In fact, in its regulations at 13 CFR 120.882(g)(6)(ii), SBA specified that "Debt is not included as an Eligible Business Expense, except debt that was incurred with a credit card or business line of credit...."

NADCO recommends broadening the definition of Eligible Business Expenses to also include any other debt of the business that is not Qualified Debt. For example, under current regulations and policy, a small business that has a permanent working capital term loan secured by a second mortgage on its company headquarters building cannot refinance that loan in the 504 Debt Refinancing Program – the permanent working capital loan does not meet the requirements of Qualified Debt, as it was not used to acquire Eligible Fixed Assets, and it is not a business line of credit or business credit card qualifying as Eligible Business Expenses. So, the small business is unable to refinance this debt even though it is secured by Eligible Fixed Assets. And, to compound the dilemma, the small business can refinance its existing first mortgage loan if that loan meets all conditions of Qualified Debt and can even obtain new funds for Eligible Business Expenses, but the lender of the existing second mortgage must agree to subordinate its second mortgage to the 504 debt refinancing project. In the commercial banking industry, it is highly unlikely that a lender will agree to such a subordination or a diminishing of its lien position. Therefore, the small business borrower is precluded from accessing and using the 504 Debt Refinancing Program to consolidate its debt and potentially benefit from long-term, low-cost fixed rate financing to better position the business for the future.

In its Interim Final Rule dated May 25, 2016, SBA previously allowed this junior lien debt to be considered part of Eligible Business Expenses, just like business credit card debt and business line of credit debt. However, SBA eliminated this allowance for junior lien debt in its Final Rule dated May 7, 2018, thereby decreasing small business access to and usability of the 504 Debt Refinancing Program. NADCO recommends SBA reverse this position.

13 CFR 120.882(g)(7)

NADCO recommends SBA clarify in its policies and procedures that a partial refinance of any Qualified Debt is allowed, including a partial refinance of an existing government-guaranteed debt or conventional debt. SBA's Interim Final Rule (IFR) retained 13 CFR 120.882(g)(7) requiring –

> "(7) If the qualified debt is not fully satisfied by the funding provided by the Refinancing Project, the lender of the qualified debt must take one of the following actions, or some combination thereof, to address the deficiency:
>
> (i) Forgiveness of all or part of the deficiency;
>
> (ii) Acceptance of payment by the Borrower, or
>
> (iii) Acceptance of a Note executed by the Borrower for the balance, or any portion of the balance. Such Note must be subordinate to the 504 loan if the Note and the 504 loan are secured by any of the same collateral. The Note is subject to any other restrictions that SBA may establish to protect its creditor position, including standby requirements;"

It is clear from the regulatory language that SBA has historically allowed and continues to allow a partial refinance of a Qualified Debt. The portion of an existing indebtedness that meets the conditions of Qualified Debt can be refinanced in the 504 Debt Refinancing Program, and the remaining portion of the existing indebtedness that, "is not fully satisfied by the funding provided by the Refinancing Project," must be addressed according to the actions outlined by SBA in the regulation.

For example, a small business acquired its company headquarters facility with a conventional bank loan secured by a first mortgage on the property. The conventional lender advanced funds to allow the small business to acquire the property and include permanent working capital to help fund a new product line the business was launching when it moved into this new location. 75% of the loan proceeds were used for the purchase of the property with the remaining 25% funding the permanent working capital. Under existing regulation and policy, among other requirements, SBA requires that to be a Qualified Debt, "substantially all (85% or more) of the proceeds of the indebtedness were used to acquire land, including a building situated thereon, to construct a building thereon, or to purchase equipment. The assets acquired must be eligible for financing under the 504 loan program." In the current example, only 75% of the loan funds were used for 504-eligible purposes. Under current policy and procedures, SBA would deem the current loan ineligible to be refinanced in the 504 Debt Refinancing Program, as the entire loan must meet the 85% requirement, or the entire loan is ineligible. However, it is clear from SBAs own regulations that that portion of the indebtedness that meets the 85% test should be eligible for refinancing under 504 and the remaining balance should be addressed through one, or some combination, of the three deficiency options outlined in 13 CFR 120.882(g)(7). In fact, SBA applies this partial refinancing methodology now to the partial refinance of an existing 7(a) loan in SBA Policy Notice 5000-808830, paragraph 10.a.(1)e)ii), which states in part that, "...The existing 7(a) loan may be refinanced in whole or in part."

NADCO recommends that SBA simply apply this same policy guidance to refinancing conventional debts in the 504 Debt Refinancing Program and allow partial refinances of all Qualified Debt.

UPDATE – 9/23/2021
13 CFR 120.882(e)(1) and definition of "Qualified Debt" in 13 CFR 120.882(g)(16)
NADCO recommends that SBA modify its definition for debt eligible to refinance in the 504 loan program [for 504 debt refinance with expansion program at 13 CFR 120.882(e)(1) and for the 504 debt refinance without expansion program at 13 CFR 120.882(g)(16)] by lowering its "substantially all" (85% or more) standard to a "majority" standard (51% or more).

The Small Business Investment Act establishes in law the following requirements related to this matter –

> For 504 debt refinance with expansion, Section 502(7)(B)(i) –
> "[t]he proceeds of the indebtedness were used to acquire land, including a building situated thereon, to construct a building thereon, or to purchase equipment;"
>
> For 504 debt refinance without expansion, Section 328 of the Economic Aid Act updates Section 502(7)(C) of the Small Business Investment Act with the amended Section 502(7)(C)(i)((III)(cc) –
> "The term 'qualified debt" means indebtedness – the proceeds of which were used to acquire an eligible fixed asset;"

In both cases, SBA has chosen to implement in regulation and policy, a "substantially all" standard meaning "almost all" or "nearly all" of the proceeds, and a Borrower will satisfy this standard when it used at least 85% of the proceeds of the existing debt "to acquire land, including a building situated thereon, to construct a building thereon, or to purchase equipment" (for 504 debt refinance with expansion) or "to acquire an Eligible Fixed Asset" (for 504 debt refinance without expansion). SBA applies this standard to the original loan used to acquire, construct, or purchase the asset.

NADCO recommends that SBA lower in regulation and policy the "substantially all" standard (85% or more) to a "majority" standard of 51% or more. We believe this change will promote increased access to and utilization of both 504 debt refinancing programs without adding undue risk to SBA while honoring the original intent of the law.

Conclusion
NADCO has no comment on any other parts of the Interim Final Rule not specifically addressed above and welcomes these changes, as they will improve the accessibility and utilization of the 504 Debt Refinancing Programs to the benefit of small businesses and entrepreneurs across the country.

We appreciate the opportunity to provide these comments.

Sincerely,

Wayne Williams
Executive Vice President
Regulatory Affairs & Training

"Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues"
SECTION-BY-SECTION

Division N, Title III: Continuing the Paycheck Protection Program and Other Small Business Support

(starts on p. 2042 of the attached formatted bill text)

Section 301; 302: Short Title; Definitions.

Section 303: Emergency Rulemaking Authority.

- Requires the SBA Administrator to establish regulations to carry out this title no later than 10 days after enactment, which is the date of the President's signature.

Section 304: Additional Eligible Expenses.

- Makes the following expenses allowable and forgivable uses for Paycheck Protection Program (PPP) funds:
  - Covered expenditures for operations. Payment for any software, cloud computing, and other human resources and accounting needs.
  - Covered property damage costs. Costs related to property damage due to public disturbances that occurred during 2020 that are not covered by insurance.
  - Covered supplier costs. Payments to a supplier pursuant to a contract, purchase order, or order for goods that was in effect prior to taking out the loan and was essential to the recipient's operations at the time at which the expenditure was made. Supplier costs of perishable goods can be made before or during the life of the loan.
  - Covered worker protection expenditure. Investments in personal protective equipment and other adaptive costs to help a loan recipient comply with federal health and safety guidelines or any equivalent State and local guidance related to COVID-19 during the period between March 1, 2020, and the end of the national emergency declaration.
- Allows loans made under PPP before, on, or after the enactment of this act to be eligible to utilize the expanded forgivable expenses except borrowers that already had their loans forgiven.

Section 305: Strengthened Hold Harmless.

- Provides that a lender may rely on any certification or documentation submitted by a borrower for an initial or second draw PPP loan and specifies that no enforcement action may be taken against the lender and that the lender shall not be subject to any penalties relating to loan origination or forgiveness if (1) the lender acts in good faith relating to loan origination or forgiveness; and (2) all relevant federal, state, local and other statutory and regulatory requirements are satisfied.

Section 306: Selection of Covered Period for Forgiveness.

- Allows the borrower to elect a covered period ending at the point of the borrower's choosing between 8 and 24 weeks after loan origination.

Section 307: Simplified Application.

- Creates a simplified application process for loans under $150,000 such that:
  - A borrower shall receive forgiveness if a borrower signs and submits to the lender a certification that is not more than one page in length that includes: (1) a description of the number of employees the borrower was able to retain because of the covered loan; (2) the estimated total amount of the loan spent on payroll costs; and, (3) the total loan amount. The borrower must also attest that the borrower accurately provided the required certification and complied with PPP loan requirements.

The SBA must provide this certification form within 24 days of enactment and may not require additional materials unless necessary to substantiate revenue loss requirements or satisfy relevant statutory or regulatory requirements. Additionally, borrowers are required to retain relevant records related to employment for four years and other records for three years. The Administrator may review and audit these loans to ensure against fraud.

- At the discretion of the borrower, the borrower may complete and submit demographic information for all PPP loans.
- The SBA must submit to the Senate and House Small Business Committees a report 45 days after enactment detailing their review and forgiveness audit plan to mitigate risk of fraud and provide monthly reviews and audit updates thereafter.
- These provisions apply to loans made before, on, or after the date of enactment, including the forgiveness of the loan.

Section 308: Specific Group Insurance Payments as Payroll Costs.

- Clarifies that other employer-provided group insurance benefits are included in payroll costs. This includes group life, disability, vision, or dental insurance.
- Applies to loans made before, on, or after the date of enactment, including the forgiveness of the loan.

Section 309: Demographic Information.

- Requires the SBA to include a voluntary demographic information section on the loan origination application for initial PPP loans and second draw PPP loans. All PPP loan applications after enactment must include this section.

Section 310: Clarification of and Additional Limitations on Eligibility.

- Clarifies that a business or organization that was not in operation on February 15, 2020 shall not be eligible for an initial PPP loan and a second draw PPP loan.
- Prohibits eligible entities that receive a grant under the Shuttered Venue Operator Grants from obtaining a PPP loan.

Section 311: Paycheck Protection Program Second Draw Loans.

- Creates a second PPP loan called a "PPP second draw" loan for smaller and harder-hit businesses, with a maximum new loan amount of $2 million.
- Eligibility. In order to receive a PPP loan under this section, an eligible entity must:
  - Employ not more than 300 employees;
  - Have used or will use the full amount of its first PPP loan; and
  - Demonstrate at least a 25% reduction in gross receipts in the first, second, or third quarter of 2020 relative to the same 2019 quarter. Provides applicable timelines for businesses that were not in operation in Q1, Q2, Q3, and Q4 of 2019. Applications submitted on or after January 1, 2021 are eligible to utilize the gross receipts from the fourth quarter of 2020.
- Eligible entities include businesses, certain non-profit organizations, housing cooperatives, veterans' organizations, tribal businesses, self-employed individuals, sole proprietors, independent contractors, and small agricultural co-operatives.
- Ineligible entities include: (1) entities listed in 13 C.F.R. 120.110 and subsequent regulations except entities which have otherwise been made eligible by statute or PPP implementation guidance, including nonprofits and religious organizations; (2) entities involved in political and lobbying activities including engaging in advocacy in areas such as public policy or political strategy or otherwise describes itself as a think tank in any public document, entities affiliated with entities in the People's Republic of China; (3) registrants under the Foreign Agents Registration Act; and, (4) entities that receive a grant under the Shuttered Venue Operator Grant program.
- Loan terms. In general, borrowers may receive a loan amount of up to 2.5X the average monthly payroll

costs during the year prior to the loan or the previous calendar up to a maximum of $2 million, subject to the following exceptions:

- Seasonal employers may calculate their maximum loan amount based on a 12-week period beginning February 15, 2019 through February 15, 2020.
- New entities may receive loans of up to 2.5X the sum of their average monthly payroll costs.
- Entities in industries assigned to NAICS code 72 (Accommodations and Food Services) may receive loans of up to 3.5X average monthly payroll costs.
- Businesses with multiple locations that are eligible entities under the initial PPP requirements may employ not more than 300 employees per physical location.
- Waiver of affiliation rules that applied during initial PPP loans apply to a second loan.
- An eligible entity may only receive one PPP second draw loan.
- Fees are waived for both borrowers and lenders.
- For loans of not more than $150,000, the entity may submit a certification attesting that the entity meets the revenue loss requirements on or before the date the entity submits its loan forgiveness application and non-profit and veterans' organizations may utilize gross receipts to calculate their revenue loss standard.

- Loan forgiveness. Borrowers of a PPP second draw loan are eligible for loan forgiveness equal to the sum of their payroll costs, as well as covered mortgage, rent, and utility payments, covered operations expenditures, covered property damage costs, covered supplier costs, and covered worker protection expenditures incurred during the covered period. Full forgiveness will still require the same 60/40 allocation between payroll and non- payroll costs that applies to initial PPP loans.
- Lender eligibility. A lender approved to make loans under initial PPP loans may make covered loans under the same terms and conditions as the initial loans.
- Lender compensation. The Administrator is authorized to reimburse a lender as follows: (1) For loans up to $50,000, the lender processing fee will be the lesser of 50% of the principal amount or $2,500: (2) for loans between $50,000 and $350,000, the lender fee will be 5%; and, (3) for loans $350,000 and above, the lender fee will be 3%.
- Guidance to prioritize underserved communities. The Administrator is directed to issue guidance addressing barriers to access to capital for underserved communities no later than 10 days after enactment.
- Standard Procedures. SBA is directed to allow lenders to approve loans made under this paragraph utilizing existing program guidance and standard operating procedure, to the maximum extent possible, as the standard SBA 7(a) program.
- Churches and religion organizations. The statute expresses the sense of Congress that the Administrator's guidance clarifying the eligibility of churches and religious organizations was proper and prohibits the application of regulations otherwise rendering ineligible businesses principally engaged in teaching, instructing, counseling, or indoctrinating religion or religious beliefs. It also codifies that the prohibition on eligibility in 13 CRF 120.110(k) shall not apply for initial and second draw loans.
- Application of Exemption Based on Employee. Existing safe harbors on restoring FTE and salaries and wages are extended. Specifically, the statute applies the rule of reducing loan forgiveness for the borrower reducing the number of employees retained and reducing employees' salaries in excess of 25%. Allows the SBA and Treasury Department to jointly modify any date in section 7(a)(d) consistent with the purposes of PPP.

Section 312: Increased Ability for Paycheck Protection Program Borrowers to Reapply for a PPP Loan or Request an Increase in Loan Amount

- Requires the Administrator to release guidance to lenders within 17 days of enactment that allows borrowers that returned all or part of their PPP loan to reapply for the maximum amount applicable on loans where forgiveness has not been paid. Additionally, this section allows borrowers whose loan calculations have increased due to changes in interim final

rules to work with lenders to modify their loan amounts regardless of whether the loan has been fully disbursed, or whether SBA Form 1502 already has been submitted.

Section 313: Calculation of Maximum Loan Amount for Farmers and Ranchers under the Paycheck Protection Program.

- Establishes a specific loan calculation for the first round of PPP loans for farmers and ranchers that: (1) operate as a sole proprietor, independent contractor, self-employed individual; (2) report income and expenses on a Schedule F; and (3) were in business as of February 15, 2020. These entities may utilize their gross income in 2019 as reported on a Schedule F. Lenders may recalculate loans that have been previously approved to these entities if they would result in a larger PPP loan.
- Applies to PPP loans before, on, or after the date of enactment, except for loans that have already been forgiven.

Section 314: Farm Credit System Institutions.

- Allows Farm Credit System Institutions to be eligible to make loans under PPP. Also allows for a zero risk weight for PPP loans and aligns eased requirements for Farm Credit System Institutions with those of other PPP lenders.
- Applies to any loan made before, on or after enactment including the forgiveness of the loan.

Section 315: Definition of a Seasonal Employer.

- Defines a seasonal employer to be an eligible recipient which: (1) operates for no more than seven months in a year; or, (2) earned no more than 1/3 of its receipts in any six months in the prior calendar year.
- Applies to any loan made before, on or after enactment including the forgiveness of the loan.

Section 316: Housing Cooperatives.

- Extends PPP eligibility to housing cooperatives defined in section 216(b) of the Internal Revenue Code of 1986 that employ no more than 300 employees.

Section 317: Eligibility of News Organizations for Loans under the Paycheck Protection Program.

- Makes eligible FCC license holders and newspapers with more than one physical location, as long as the business has no more than 500 employees per physical location or meets the applicable SBA size standard; and makes eligible section 511 public colleges and universities that have a public broadcasting station if the organization certifies that the loan will support locally focused or emergency information.
- Waives affiliation rules for newspapers, TV and radio broadcasters, and public broadcasters, as long as the organization has no more than 500 employees per physical location or meets the applicable SBA size standard.
- Waives the prohibition against publicly-traded news organizations being eligible if the business certifies that the loan will support locally focused or emergency content.

Section 318: Eligibility of 501(c)(6) and Destination Marketing Organizations for Loans Under the Paycheck Protection Program.

- Expands eligibility to receive a Paycheck Protection Program loan to include the following organizations:
  - 501(c)(6) organizations if:
    - The organization does not receive more than 15% of receipts from lobbying;
    - The lobbying activities do not comprise more than 15% of activities;
    - The cost of lobbying activities of the organization did not exceed $1,000,000 during the most recent tax year that ended prior to February 15, 2020 and
    - The organization has 300 or fewer employees.
    - The organization is not a professional sports leagues or organization with the purpose of

promoting or participating in a political campaign or other political activities.

- Destination Marketing Organizations if:
  - The organization does not receive more than 15% of receipts from lobbying;
  - The lobbying activities do not comprise more than 15% of activities;
  - The organization has 300 or fewer employees; and
  - The destination marketing organization is registered as a 501(c) organization, a quasi-government entity, or a political subdivision of a state or local government.

Section 319: Prohibition on Use of Loan Proceeds for Lobbying Activities.

- Prohibits any eligible entity from using proceeds of the covered loan for lobbying activities, as defined by the Lobbying Disclosure Act; lobbying expenditures related to state or local campaigns; and expenditures to influence the enactment of legislation, appropriations, or regulations.

Section 320: Bankruptcy Provisions.

- Establishes a special procedure in the bankruptcy process if the Administrator determines certain small business debtors are eligible for PPP. This procedure requires court approval for PPP loans to these debtors and requires any such loan be given a super-priority claim in the bankruptcy process, providing additional protection to taxpayers and participating banks. The provisions in this section would take effect only upon a written determination by the Administrator that certain small business debtors are eligible for PPP loans and would sunset two years after the date of enactment.

Section 321: Oversight.

- Requires the SBA to comply with GAO requests within 15 days and requires the SBA to submit a detailed justification to Senate and House Small Business Committees if they are unable to comply with the request. It also would require the Secretary of the Treasury and SBA Administrator to testify within 120 days of enactment of this Act and not less than twice per year for the next two years to the Senate and House Small Business Committees.

Section 322: Conflicts of Interest.

- Requires the President, Vice President, the head of an Executive department, or a Member of Congress as well as their spouses that has received a PPP loan to disclose this status at forgiveness or within 30 days thereafter. It would also prohibit the covered individuals from receiving a loan in the future.

Section 323: Commitment Authority and Appropriations.

- Extends to March 31, 2021, the authority to make commitments under both the extension of round one of PPP and the Second Draw of PPP.
- Sets the joint authorization level for both round one of PPP and the Second Draw of PPP at $806.45 billion.
- Provides clarifying language that bifurcates regular 7(a) and PPP loans (in 7(a) (36) and (37)) to ensure the continued operation of the 7(a) program
- Sets regular 7(a) authorization cap at $75 billion, effective from the date of enactment through September 30, 2021.
- Clarifies that the secondary market cap for FY21 is set to $100 billion for ALL 7(a) loans.
- Provides direct appropriations of:
  - $284.45 billion for PPP, including the following set-asides:
    - Lenders:
      - $15 billion for PPP loans (initial and second draw) issued by community financial institutions, including community development financial institutions (CDFIs) and minority depository intuitions (MDIs);
      - $15 billion for PPP loans (initial and second draw) issued by certain small

depository institutions.

- Borrowers:
  - $35 billion for first-time borrowers, $15 billion of which for smaller, first-time borrowers with 10 or fewer employees, or loans less than $250,000 in low-income areas;
  - $25 billion for second draw PPP loans for smaller borrowers with 10 or fewer employees, or loans less than $250,000 in low-income areas.
- After 25 days, the SBA Administrator may adjust the set-asides as necessary.

- $25 million for the Minority Business Development Centers program under the Minority Business Development Agency (MBDA);
- $50 million for PPP auditing and fraud mitigation purposes;
- $20 billion for the Targeted EIDL Advance program, of which $20 million for the Inspector General;
- $57 million for the Microloan program as described in section 329;
- $1.9 billion to carry out sections 326, 327, and 328, which are the regular 7(a) and 504 stimulus provisions for increased guarantees, increased Express loan size, and fee waivers;
- $3.5 billion for the Debt Relief program as described in section 325;
- $15 billion for grants for live venues as described in section 324.

Section 324: Direct Grants for Shuttered Venue Operators.

- Authorizes $15 billion for the SBA to make grants to eligible live venue operators or promoters, theatrical producers, live performing arts organization operators, museum operators, motion picture theatre operators, or talent representatives who demonstrate a 25% reduction in revenues.

Section 325: Extension of Section 1112 Payments, the debt relief program.

- **Provides $3.5 billion in funding for extension of Section 1112 payments—appropriations available through September 30, 2021.**
- Resumes the payment of principal and interest (P&I) on small business loans guaranteed by the SBA under the 7(a), 504 and Microloan programs, established under Section 1112 of the CARES Act.
- Provides that all borrowers with qualifying loans approved by the SBA prior to the CARES Act will receive an additional three months of P&I, starting in February 2021. Going forward, those payments will be capped at $9,000 per borrower per month.
- Provides that, after the three-month period described above, borrowers considered to be underserved—i.e., the smallest and hardest-hit by the pandemic—will receive an additional five months of P&I payments, also capped at $9,000 per borrower per month. These include:
  - Borrowers with SBA microloans or 7(a) Community Advantage loans
  - Borrowers with any 7(a) or 504 loan in the hardest-hit sectors, as measured by the severity of sector-wide job losses since the start of the pandemic, including all those belong to 2- and 3-digit NAICS categories with the most severe job losses since the start of the pandemic: accommodation and food services (72); arts, entertainment, and recreation (71); educational services (61); mining and logging (213); apparel (315); clothing and clothing accessory stores (448); sporting goods, hobby, book, and music stores (451); air transportation (481); transit and ground passenger transportation (485); scenic and sightseeing transportation (487); publishing industries, except Internet (511); motion picture and sound recording industries (512); broadcasting, except Internet (515); rental and leasing services (532); and personal and laundry services (812).
- Provides SBA payments of P&I on the first 6 months of newly approved loans will resume for all loans approved between February 1 and September 30, 2021, also capped at $9,000 per month.

- Specifies that if the SBA projects that appropriations provided for the debt relief program are insufficient to fund the extensions provided, the Administrator may proportionally reduce the number of months provided in each extension.
- Clarifies eligibility and increases program integrity:
    - SBA payments should be made on any loan approved before the applicable deadline, and debt relief payments should be made only once the loan is fully disbursed.
    - SBA may establish a minimum loan maturity period for each loan product covered under this section to prevent program abuse.
    - Any business or applicant may only receive P&I payments for only one loan approved after CARES Act enactment.
- Requires that SBA place program information on its website, conduct outreach to all borrowers, report monthly to Congress on program spending, and educate lenders, borrowers, SBA district offices, and resources partners about the program.

[Division N, Title II, Subtitle B, **Section 278: Clarification of Tax Treatment of Certain Loan Forgiveness and Other Business Financial Assistance.**]

- Specifies that all Section 1112 payments are considered non-taxable income, which shall apply both retroactively to any payment made to any borrower starting with the enactment of Section 1112 of the CARES Act and prospectively.

Section 326: Modifications to 7(a) Loan Programs: Increased Guarantees and Increased Express Loan Size

- Increases to 90% the loan guarantee on 7(a) loans, including for Community Advantage loans, through September 30, 2021.
- Increases the Express Loan amount from $350,000 to $1 million for the period January 1, 2021 through September 30, 2021, with that amount reverting, on a permanent basis to $500,000 beginning October 1, 2021.
- From the date of enactment through September 30, 2021, temporarily increases from 50% to 75% the Express Loan guaranty percentage for loans of $350,000 and less. The guarantee percentage remains at 50% for SBA Express loans over $350,000. On October 1, 2021, the guarantee reverts to 50% for all Express Loans.

Section 327: Temporary Fee Reductions for 7(a) and 504

- Waives lender and borrower fees for both the 7(a) and 504 loan programs through September 30, 2021. [For 7(a) this includes the up-front guaranty fee and the ongoing fee.]

Section 328: Low-Interest Refinancing.

- Enhances the 504 refinancing rules in order to create reciprocity for refinancing between 504 and 7(a) programs.
- Grants authority through September 30, 2023 for SBA to establish a 504 Express Loan Program for the most experienced successful 504 lenders to expedite 504 loans of less than $500,000.

Section 329: Recovery Assistance under the Microloan Program.

- Enhances the microloan program to increase access to micro capital and technical assistance under the program for businesses impacted by the COVID-19 pandemic.
- Temporarily increases the amount of time that borrowers can repay their loans from 6 to 8 years.
- Temporarily increases the outstanding aggregate amount each intermediary may borrow from $6 million to $10 million to expand their capacities to deploy more capital to small businesses.

- Allows intermediaries to access more technical assistance funding if they serve rural areas.
- Maximizes flexibility and reduces red tape for intermediaries by temporarily waiving the limitations for the technical assistance grants and the 50% limitation on pre-loan technical assistance.
- Provides $50 million in additional funding for Microloan Technical Assistance funding for lenders and $7 million to leverage about $64 million more in microloans to businesses.

Section 330: Extension of Participation in 8(a) Program.

Section 331: Targeted EIDL Advance for Small Business Continuity, Adaptation, and Resiliency.

- Provides additional targeted funding for eligible entities located in low-income communities through the EIDL Advance program included in Section 1110 of the CARES Act.
- Makes entities in low-income communities that received an EIDL Advance under Section 1110 of the CARES Act eligible to receive an amount equal to the difference of what the entity received under the CARES Act and $10,000.
- Provides $10,000 grants to eligible applicants in low-income communities that did not secure grants because funding had run out.

Section 332: Emergency EIDL Grants.

- Extends covered period for Emergency EIDL grants through December 31, 2021.
- Allows more flexibility for the SBA to verify that Emergency EIDL grant applicants have submitted accurate information.
- Extends time for SBA to approve and disburse Emergency EIDL grants from 3 to 21 days.

Section 333: Repeal of EIDL Advance Deduction.

- Repeals section 1110(e)(6) of the CARES Act, which requires PPP borrowers to deduct the amount of their EIDL advance from their PPP forgiveness amount.
- Establishes the Sense of Congress that EIDL Advance borrowers should be made whole without regard to whether those borrowers are eligible for PPP forgiveness.
- Requires the Administrator to issue rules that ensure borrowers are made whole if they received forgiveness and their EIDL grant amount was deducted from the forgiveness amount paid.

Section 334: Flexibility in Deferral of Payments of 7(a) Loans.

- Creates parity between bank-held and secondary market-owned 7(a) loans to seek up to a 1-year deferral.
- Requires SBA to buy back loans if secondary market investors refuse to provide the extended deferral unless the SBA determines the extended deferral would cause a positive subsidy for the Secondary Market Guarantee Program.

Section 335: Documentation Required for Certain Eligible Recipients.

- Allows more flexibility for the Administration to accept documentation beyond that enumerated in the CARES Act to determine eligibility for sole proprietors and the self-employed.

Section 336: Election of 12-week Period by Seasonal Employers.

- Expands the seasonal period to any 12-weeks between February 15, 2019 and February 15, 2020, elected by the borrower.
- Applies to loans before, on, or after the date of enactment, except for loan for which the borrower has already received forgiveness.

Section 337: Inclusion of Certain Refinancing in Nonrecourse Requirements.

- Clarifies non-recourse language to include all eligible uses of proceeds (e.g. refinancing of EIDL loans) to provide the same protections to borrowers if they elect to refinance an EIDL loan

Section 338: Application of Certain Terms through Life of Covered Loan.

- Clarifies that provisions related to (1) fee waivers; (2) personal guarantee waivers; and (3) deferral eligibility continues past the covered period and attaches for the life of the PPP loan.

Section 339: Interest Calculation on Covered Loans.

- Clarifies the interest rate on PPP loans is non-compounding and non-adjustable for all new initial PPP loans and second draw PPP loans.

Section 340: Reimbursement for Processing.

- Provides for PPP lender reimbursement by SBA for new PPP loans.
- Establishes a tiered reimbursement rate for PPP loans: (1) Loans of less than $50,000 that is equal to the lesser of 50% of the loan principal or $2,500; (2) loans of more than $50,000 and not more than $350,000 equal to 5% of the loan principal; (3) loans of more than $350,000 and less than $2,000,000 equal to 3% of the loan principal; and (4) loans of more than $2,000,000 equal to 1%.
- Clarifies lender reimbursement by SBA shall be made no later than 5 days after the reported disbursement (prior language did not include the word "reported").
- Prohibits agencies from requiring lender to repay to SBA its processing fee in any claw-back process, except in cases of lender fraud.
- Clarifies that PPP borrowers who knowingly retained a loan agent may not pay agent fees out of the PPP proceeds. This applies to PPP loan before, on, or after the date of enactment, including during forgiveness of such loan.
- Clarifies that a lender shall only be responsible for paying fees to an agent when the lender directly contracted with the agent for any work performed.

Section 341: Duplication Requirements for Economic Injury Disaster Loan Recipients.

- Clarifies text from underlying CARES to permits borrowers to receive both an EIDL and a PPP loan as long as they are for different purposes by specifying that the period extends from January 31, 2020 through the date on which PPP loans are made available. (Previously the dates referenced in underlying CARES did not technically permit for this duplication.)

Section 342: Prohibition of Eligibility for Publicly Traded Companies.

- Excludes publicly traded companies from PPP eligibility.

Section 343: Covered Period for New PPP Loans.

- Extends the covered period for all first draw PPP loans through March 31, 2021.
- Applies to loans made before, on, or after the date of enactment, including the forgiveness of such loan.

Section 344: Applicable Periods for Proration.

- Clarifies that the applicable period for employee's salaries of $100,000 is to be calculated on an annualized basis as prorated during the period in which compensation is paid or incurred.

Section 345: Extension of Waiver of Matching Funds Requirement under the Women's Business Center (WBC).

- Extends CARES Act waiver of WBC matching funds requirement through June 30, 2021.

Section 346: Clarification of Use of CARES Act Funds for Small Business Development Centers (SBDCs).

- Clarifies that any awards made under this bill are in addition to, and separate from, any amounts appropriated under section 21 of the Small Business Act, and any award made under this bill may be used to complement and support such grant. CARES Act funds and annually appropriated funds can be used and tracked together as one funding stream.
- Prioritizes SBDCs impacted by this accounting issue.

Section 347: GAO Report

- Requires the GAO to report to the House and Senate Small Business Committees no later than 120 days after the date of enactment on the SBA's use of administrative funds made through supplemental appropriations during FY 2020.

Section 348: Effective Date; Applicability.

- Clarifies that, except as noted, the amendments made by this bill shall take effect on the date of enactment and apply to loans and grants made on or after the date of enactment.

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National Association of Federally-Insured Credit Unions

May 16, 2023

The Honorable Roger Williams
Chairman
Committee on Small Business
United States House of Representatives
Washington, DC 20515

The Honorable Nydia Velázquez
Ranking Member
Committee on Small Business
United States House of Representatives
Washington, DC 20515

Re: Tomorrow's Hearing: "Taking on More Risk: Examining the SBA's Changes to the 7(a) Lending Program Part II"

Dear Chairman Williams and Ranking Member Velázquez:

I write to you today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) to share our thoughts on issues of importance to credit unions ahead of tomorrow's hearing, "Taking on More Risk: Examining the SBA's Changes to the 7(a) Lending Program Part II." NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 135 million consumers with personal and small business financial service products. As we have previously communicated to the Committee, NAFCU maintains serious concerns about the Small Business Administration's (SBA) final rules to expand its lending networks and we continue to urge Congress to work to bring about changes.

On April 10th and April 12th, 2023, the SBA published two final rules: (1) Amending regulations governing SBA's 7(a) Loan Program and 504 Loan Program, including regulations on use of proceeds for partial changes of ownership, lending criteria, loan conditions, reconsiderations, and affiliation standards; and (2) Amending its business loan program regulations to lift the moratorium on licensing new Small Business Lending Companies (SBLCs) and add a new type of lending entity called a Community Advantage SBLC, in effect allowing fintech lenders that are only supervised by the SBA's Office of Credit Risk Management to participate in the 7(a) Loan Program. While these are two separate rules, they will have the combined effect of loosening 7(a) lending standards at the same time as opening that program to entities already proven to be more susceptible to fraud than traditional depository institutions overseen by federal prudential regulators. It may be appropriate to reduce 7(a) lending standards for institutions already bound to follow underwriting requirements set by their prudential regulator, but any newly licensed SBLCs will have no such requirements. Fintechs will be participating in an unfamiliar-to-them lending program with few established standards to follow, and subject only to oversight from the SBA that does not include supervision for compliance with Bank Secrecy Act and anti-money laundering requirements, concentration caps, safety and soundness parameters, stress test parameters, and other regulatory criteria to promote prudent lending. The SBA has not demonstrated that it is capable of handling this new oversight.

While these new rules have a laudable goal of trying to increase financial inclusion, we think they miss the mark. As champions of financial inclusion, credit unions have been at the forefront of efforts to increase access to personal and small business financial services for underserved communities. Credit unions have grown their overall business lending portfolio by more than 20 percent this past year, which is nearly identical to the growth rate over the past five years. At the same time, NAFCU has worked tirelessly to ensure that non-depository financial institutions such as fintechs operate on a level playing field with credit unions to protect consumers and small businesses. Unfortunately, we are concerned that these new rules will end up running counter to these efforts by opening the programs to unregulated competition.

Allowing fintechs to participate in 7(a) lending on those grounds will place credit unions and other traditional lenders at a severe competitive disadvantage. For example, recent reporting has seen a fintech lender claim that "businesses can apply in minutes to get a credit line of between $1,000 to $150,000. They are able to do this by automatically obtaining business data and verifying a business' bank account, which can avoid the need for a manual review." The digital lending platform provider admits that "financial technology lenders typically have higher loan approval rates than banks because they have less stringent requirements for small business loans." Non-depository SBLC lenders implementing less stringent underwriting requirements, and with significantly less regulatory compliance cost, will expend fewer resources to offer SBA loans and will therefore be able to offer these loans at more favorable terms. Small businesses will likely gravitate toward these riskier lenders, reducing demand for SBA loans from depository institutions and gradually reducing the number of depository institutions participating in SBA lending. With a greater reliance on fintech lenders, SBA lending programs will be at increased risk of fraud, credit losses, and reputational risk. This could have serious consequences for the long-term health of SBA's flagship 7(a) program.

This risk was clearly demonstrated in the early stages of the pandemic when fintechs participating in the Paycheck Protection Program (PPP) experienced much higher levels of fraud compared to regulated financial institutions. In fact, the Select Subcommittee on the Coronavirus Crisis released a staff report detailing the poor performance of many fintechs in administering the PPP. The report found, among other things, that the rate of fraud among fintech PPP loans was disproportionately high, that fintechs were aware of the fraud but did not have the capabilities to detect and respond to this fraud, that billions of taxpayer dollars were lost to fraud, and that fintechs prioritized high-dollar loans to the exclusion of smaller sized loans.

The bottom line is that credit unions continue to be safe, secure, and reliable lenders that provide access to personal and small business financial services for underserved communities, and these SBA rules will only create more unregulated competition. We oppose allowing fintechs to participate in SBA lending programs without sufficient regulatory oversight. The new Affiliation and SBLC Rules combine to give unregulated fintech lenders an unfair competitive advantage and put consumers, small businesses, and SBA programs themselves at risk of fraud, credit losses, and reputational risk. We are pleased to see the Committee continue to examine this issue, and we urge Congress to use its oversight authority to step

in and bring about changes, including consideration of invoking its Congressional Review Act authority if necessary.

We thank you for the opportunity to share our thoughts and look forward to continuing to work with you on improving the SBA's lending programs. Should you have any questions or require any additional information, please contact me or Lewis Plush, NAFCU's Senior Associate Director of Legislative Affairs, at (703) 258-4981 or lplush@nafcu.org.

Sincerely,

Brad Thaler

Brad Thaler
Vice President of Legislative Affairs

cc: Members of the U.S. House Committee on Small Business