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United States Senate
COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP
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March 6, 2023

The Honorable Isabella Casillas Guzman
Administrator
U.S. Small Business Administration
409 3rd Street, SW
Washington, D.C. 20416

Dear Administrator Guzman,

As the Chair and Ranking Member of the U.S. Senate Committee on Small Business and Entrepreneurship, we write to express our concerns about the U.S. Small Business Administration's (SBA) two proposed rules: The Affiliation and Lending Criteria for the SBA Business Loan Programs, 87 FR 64724, and Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization, 87 FR 66963.

While we support expanding access to capital for small businesses and reaching underserved borrowers, the benefits of implementing the proposed rules must be balanced against the risks they pose to the long-term health of SBA's lending programs. The proposed rules establish broad and sweeping changes that do not reflect congressional input or authorization. In particular, changes to the current underwriting standards have the potential to make the program vulnerable to predatory lending practices.

The Affiliation proposed rule would amend current credit analysis requirements and remove prudent lending guardrails on the $35 billion 7(a) Loan Program. Current guardrails ensure that lenders make responsible underwriting decisions, protect small businesses from loans that may become financially burdensome, and protect taxpayers from the costs of significant loan losses. If enacted, the proposed rule would no longer require that lenders consider several critical factors that help determine whether borrowers can repay their loans. While we appreciate that SBA would maintain requirements that applicants be creditworthy and that loans be sound as to reasonably assure repayment, we are concerned that without SBA providing minimum standardized underwriting and credit analysis requirements, the use of inconsistent standards by different lenders without proper guardrails may fail to properly mitigate risk and could create predatory lending vulnerabilities in SBA's largest loan portfolios.

While lenders are granted this type of flexibility in the Community Advantage and 7(a) Express loan programs to support lending to underserved communities these programs are limited to small loans of $500,000 or less. Expanding this to much larger loans of up to $5 million poses a greater risk to the integrity of the program given that it is widely considered

necessary to use more stringent standards for larger loans. These initiatives could negatively impact these important federal programs that support small business borrowers who struggle to access capital through conventional loans.

In addition to the proposed underwriting changes, we are concerned that the changes proposed to current affiliation standards could permit large businesses to exploit these programs that are intended only to serve small businesses. The changes included in the rule could easily permit a large firm that effectively controls a smaller business to take advantage of lower capital costs made possible by the SBA guarantee. We urge the agency not to weaken the affiliation rules in a manner that makes it easier for larger companies to improperly benefit from SBA programs.

When defending its decision to propose rules that depart from longstanding underwriting standards, the SBA has made the assertion that Congress's decision to temporarily loosen some standards during the COVID-19 pandemic served as a precedent of larger, more fundamental changes to SBA lending programs once the pandemic passed. While our decision to afford lenders greater flexibilities in response to an unprecedented crisis was appropriate given the circumstances, we reject the idea that these measures were intended to carry over permanently or that they reflect our preferred policy direction. Let us be clear, Congress has not authorized any loosening of prudent underwriting or affiliation standards.

The Affiliation rule is accompanied by an equally significant and sweeping rule that would lift the 40-year moratorium and allow for more non-federally regulated lenders to participate in the 7(a) Loan Program as Small Business Lending Companies (SBLCs). In addition to lifting the moratorium, the SBA also proposes to create a new category of mission-based SBLCs. While we understand and support the goal of increasing mission-based lending to ensure that underserved communities have access to capital, we feel that the proposed rule does not outline important details for mission-based lending or how these changes will impact the Community Advantage program.

Taken together, the proposed changes seem to be intended to make 7(a) lending more accessible to non-federally regulated, non-depository financial technology companies, or "fintechs." These proposals come just as the Select Subcommittee on the Coronavirus Crisis published a report on December 1, 2022, attributing billions of fraudulent PPP loans to fintechs operating without fraud controls or an adequate regulatory framework. We acknowledge that SBA has responded to the report by taking steps to either suspend or further investigate some of the named entities. While there are currently some fintech lenders in the 7(a) program, they must comply with current 7(a) guardrails. However, we are worried that SBA continues to press forward with a strategy aimed at granting more fintech entities access to the 7(a) program without taking into account the risks these types of entities pose to consumer protection or program integrity.

The proposed rules are also silent on a unified regulatory framework for SBLCs compared to other 7(a) lenders. We are concerned that SBA, and particularly its Office of Credit Risk Management (OCRM) would be tasked with overseeing an unlimited number of non-

federally regulated entities. Presently, OCRM does not implement any of the primary regulator guidelines meant to ensure the safety and soundness of its lenders, such as stress testing and other requirements intended to protect borrowers, lenders, and taxpayers. These measures include Bank Secrecy Act, Know Your Customer, and anti-money laundering requirements. The proposed rule does not address whether oversight of every new SBLC that is not otherwise subject to these critical controls would be SBA's responsibility, but if this is the case, we question whether SBA has the capacity and resources to carry out this additional duty.

As leaders of the committee responsible for legislating and overseeing the SBA, we take our role of authorizing programs very seriously. The sweeping changes contained in these two rules would substantially overhaul SBA's lending programs by permitting new program participants and changing the current guardrails of the programs, something that comes dangerously close to authorizing through the regulatory process. We believe that if many of the proposals are to be implemented, they should be through a pilot program rather than through notice-and-comment rulemaking. Specifically, section 7(a)(25)(B) of the Small Business Act defines a pilot program as "any lending program initiative, project, innovation, or other activity not specifically authorized by law." We are concerned that the agency decided not to make these changes into a pilot program. Pilot programs offer inherent guardrails, especially by establishing a 10% cap on the total volume of loans guaranteed in any fiscal year. It also offers Congress the ability to review programs. As part of a pilot, SBA should consider capping the number of new licenses in the regular SBLC program licenses to three instead of an unlimited number.

As authorizers, we have some questions and concerns about the proposed rules. To provide clarity, please submit answers to the following questions no later than March 20, 2023.

1. For non-federally regulated entities that apply for SBLC licenses, how does SBA plan to serve as the primary regulator and provide oversight of these lenders? Will SBA start to apply federal regulator guidelines around safety and soundness, Bank Secrecy Act /Know Your Customer/anti money laundering, and stress testing to these new SBLCs?
2. How can the SBA ensure that the proposed new SBLCs will actually reach more underserved borrowers than the current SBA programs?
3. Currently Community Advantage lenders are required to retain loan loss reserve accounts. Will SBA require a loan loss reserve account for new SBLCs? If so, please provide the amount. If not, please provide the rationale for why this safeguard will not be required of these new entities.
4. What will the lending requirements be for the proposed regular SBLCs and mission-SBLCs?
5. Will there be a minimum requirement that SBLC loans be focused in underserved and rural communities?
6. Will the costs to borrowers for loans of $350,000 or less be comparable to Community Advantage costs?
7. What will happen to Community Advantage lenders that do not wish to set up an SBLC?
8. The affiliation rules provide important guardrails for loans, including those that are made to franchise small businesses. How will removing the affiliation rule around franchises and licensing agreements, as well as doing away with SBA Franchise Directory and

leaving it up to the lenders to determine program requirements are being met, ensure that SBA loan guarantees are going to truly small businesses and not entities that are wholly controlled by a larger firm not eligible for SBA loan guarantees?

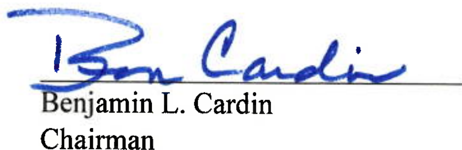
9. The Committee is concerned about the capacity of the SBA to administer these changes. Is every full-time equivalent employee position at OCRM filled? Please provide the official duties of each OCRM employee.
10. How many OCRM full time staffers currently oversee SBLCs whose job responsibilities are solely for the purposes of overseeing SBLCs? How many of these staff are overseeing SBLC's full time on a daily basis? Does the SBA believe this number will need to increase if the SBLC moratorium is lifted?
11. As the SBA seeks to make significant changes to both the underwriting requirements and affiliation rules, at the same time as the agency seeks to lift the moratorium on new SBLCs, why have these initiatives not been proposed as part of a pilot program?

The benefits of implementing programmatic changes must be balanced against the risks that they could bring to SBA lending programs and the taxpayers. The changes proposed in this rule cannot be viewed in isolation. Coupled together, these sweeping regulatory changes could have a negative impact on loan performance causing the program subsidy rates to go up, resulting in higher fees to borrowers and lenders, impacting the ability for future small business borrowers to access the program, and could create a need for Congress to provide additional appropriations to support the costs of the loan programs in the future. It could be challenging for Congress to provide a timely appropriation in the event that a positive subsidy rate results from an increase in risky lending behavior.

Given all of these serious issues, we are asking that you address the concerns outlined here and from others that were provided to SBA through public comment. We urge diligence and restraint from the agency. SBA must strongly consider prudent guardrails that can be demonstrated to be successful, before making changes that could impact the fiscal integrity of overall SBA lending programs. We urge the SBA to work closely with congressional committees. The SBA should address these concerns before publishing final rules.

Thank you for your consideration to this important matter.

Sincerely,



Benjamin L. Cardin
Chairman

Joni K. Ernst
Ranking Member

cc: Shalanda Young, Director of the U.S. Office of Management and Budget
Joseph Carlile, Program Associate Director of the U.S. Office of Management and Budget