

December 18, 2018

Via Electronic Submission

The Honorable Linda McMahon
Administrator
United States Small Business Administration
409 Third Street Southwest
Washington, DC 20416

Re: Proposed Revisions to Express Loan Programs; Affiliation Standards (RIN 3245-AG74)

Dear Administrator McMahon:

The American Bankers Association¹ wishes to express our appreciation for the ability to comment on the proposed rule issued by the U.S. Small Business Administration (SBA) that seeks to amend several regulations concerning its business loan programs.

Small businesses are an engine of growth and job creation for the U.S. economy and they require safe and reliable funding. The SBA loan programs are an important part of business lending for many banks. These programs help fill a critical gap, particularly for early stage businesses that need access to longer-term loans. The guarantee helps reduce the risk and capital required for banks and facilitates loans that might never have been made without this important level of support.

Preserving ongoing, cost effective, and easily accessible government guaranteed loan programs for small businesses remains a top priority of ABA. As part of our ongoing mission, this letter focuses on four areas of concern with this proposed rule, which, if left unchanged, will cause unintended and significant harm to small businesses across the country.

This letter focuses on four critical issues in the proposed rule:

- Credit Elsewhere and Personal Resources;
- Permissible Fees;
- Lender Responsibility When Purchasing 7(a) Loans from the FDIC; and
- Reforms to Affiliation Principles.

If SBA fails to make changes to these areas of the proposed rule, we will see a reduction in access to capital for those small businesses that need it most, and an overall decrease in economic growth.

¹ The American Bankers Association is the voice of the nation's \$18 trillion banking industry, which is comprised of small, regional, and large banks that together employ more than 2 million people, safeguard \$13 trillion in deposits, and extend nearly \$10 trillion in loans.

Credit Elsewhere and Personal Resources

ABA urges the SBA to reconsider its proposed revisions to the personal resource test due to the significant additional expense to the lender to comply, while providing potentially little additional assurance with the SBA regarding personal resources. These proposed changes will likely make the loan program less attractive to borrowers, thereby eliminating those most in need of an SBA loan from taking advantage of the programs.

Under the proposed rule, the SBA expands the definition of the personal resources test to require lenders to “analyze the resources of individuals and entities that own 20 percent or more of the Applicant business in order to determine if any of the owners have liquid assets available that can provide some or all of the desired financing.”² The addition of “entities” to the test creates a new, ambiguous standard that will be difficult for lenders to apply.

In addition to lenders’ concerns regarding the ambiguity or subjectivity to the inclusion of “entities” to the personal resource test, the new 20 percent threshold will also cause issues with taking needed working capital out of other businesses, or in this case, entities with other operational concerns beyond just a loan application. Moreover, seasonal businesses or other temporary high-liquidity events could distort the applicant’s/owner’s “normal” liquidity position.

Like other portions of this proposed rule, these changes will hurt the smallest borrowers the most. Those applicants seeking loans up to and including \$350,000 will be frozen out of access to capital as the change will add significant additional cost to the lender on a marginally profitable loan product. Simply put, many lenders in rural and small communities will no longer be able to provide loans at the lowest threshold amounts.

ABA also objects to the inclusion of new language that requires every loan with an exception to the personal resources test to be processed by the Loan Guaranty Processing Center (LGPC). This revision unnecessarily complicates the applicant’s experience and extends the origination process. Further, the SBA already has the ability to challenge a lender’s judgement in wrap-up.

For these reasons, ABA encourages the SBA to strike “entities,” reconsider the 20 percent threshold, and remove the requirement that exceptions to the personal resources test go through the LGPC.

Permissible Fees

While there is some variance in views among ABA’s membership on permissible fees, they generally prefer free market solutions. The proposed rule fails to consider the complexity of a transaction, but instead just places an arbitrary threshold in place. Limiting agent fees as

² Express Loan Programs; Affiliation Standards 83 Fed. Reg. 49001, 49006 (proposed Sept. 28, 2018) (to be codified at 13 CFR 120.102).

proposed will ultimately harm small businesses most in need of access to the SBA loan programs.

Efforts to limit such fees inevitably result in the emergence of business models developed for the purpose of finding ways to work around such limits. In this digital age, a simple internet search can put a potential borrower in direct contact with authorized SBA lenders. They can also contact lenders through the SBA's lender match referral tool. However, if small business borrowers prefer to pay likely higher fees because of the benefits from using an Agent, the market should regulate the cost of these services – not the SBA.

If the SBA places an arbitrary limit on fees, it will prevent lenders from spending the necessary resources to make small business loans. Fee caps make the low profitability that much smaller and makes offering loans below \$350,000 that less attractive. This change in turn will drive lenders away from making these smaller dollar loans.

In addition to the cap on permissible fees, SBA's elimination of the "two-master" rule is ambiguous in intent. Loan service provider (LSPs) and lenders can provide different services and different fees to a prospective borrower. Much like the cap on fees, elimination of this rule could lead to a reduction in smaller loans being made because many community banks rely on agents or other third parties to find small businesses in need of loans.

For the reasons stated above, ABA suggests the SBA reconsider its approach to capping fees as well as its proposed elimination of the "two-master" rule. When taken together, these changes will likely result in increased market uncertainty and decreased access to capital for small businesses, particularly those seeking loans of \$350,000 or below.

Lender Responsibility When Purchasing 7(a) Loans from the Federal Deposit Insurance Corporation (FDIC)

ABA has concerns with SBA's proposal to revise the section pertaining to lender responsibility when purchasing 7(a) loans from the Federal Deposit Insurance Corporation (FDIC). As written, this change may preclude the SBA from entering into agreements with the FDIC with respect to loan sales or whole bank transfers to affirm the validity of the guarantee at the time of such loan sales or transfers. The current language is satisfactory for a typical transaction between a willing SBA-authorized buyer and a going-concern seller. An FDIC-directed loan sale or whole bank transfer is another matter entirely, and rather than creating the perception that most of the loans will continue to have a valid guarantee, this proposed change would create in the minds of qualified purchasers a presumption that a large number of guarantees will be denied.

This proposed revision would create a strong disincentive for qualified SBA lenders to enter into such transactions and would likely create greater losses to the SBA, and certainly to the FDIC.

For the reasons above, ABA requests that SBA make the necessary changes to this portion of the proposed rule to allow for the concept that notwithstanding the proposed language, the SBA and

the FDIC may enter into agreements to preserve the validity of the guarantee on specific loans involved in loan sales or whole bank transfers.

Reforms to Affiliation Principles

ABA encourages SBA to withdraw its proposed reforms to the affiliation principles. Specifically, ABA has concerns with expanding the definition of “identity of interest,” and reinstating the “totality of the circumstances” test. If SBA implements these changes, they will have severe, and far reaching impacts across several types of small businesses.

Expanding the Definition of Identity of Interest

Since 2016, the SBA has defined “identity of interest” as arising in instances where “close relatives” have substantially identical or identical economic or business interests. This current proposal seeks to expand this standard to include instances where individuals or firms that are economically dependent through contractual or other relationships. Additionally, the proposed expansion would find affiliation in instances where a small business applicant derived 85% of its revenue from another business over the previous three fiscal years.³ When combining these changes, the small business borrower is left with a new reality where their ability to access capital is squeezed and lenders are faced with an uncertain marketplace.

One industry in which these proposed changes will have a crippling impact is agriculture. Due to the current nature of small, family-owned poultry farming operations, SBA would likely be able to find affiliation based upon the expansion of the “identity of interest” test. However, when examining the nature of many existing loans made to these types of farmers, they are independently owned and operated businesses.⁴ These loans are necessary to provide small farmers as many opportunities as possible when financing their operations. If SBA expands the “identity of interest” test beyond its current scope, and ultimately prevents these farmers from obtaining SBA-backed loans, we will see a decrease in access to capital as well as a significant blow to portions of our country’s agriculture economy.

While SBA has specifically gone out of its way to highlight poultry lending when discussing the expanded definition of identity of interest, these changes will impact broad swaths of industries and business relationships, finding affiliation where previously there had been none. For example, SBA could determine affiliation between a security firm and a management company that owns and operates several office buildings. If the security firm derives 85% of its revenue from the management company, under the current proposal, the security firm would be deemed

³ Express Loan Programs; Affiliation Standards 83 Fed. Reg. 49001, 49009 (proposed Sept. 28, 2018) (to be codified at 13 CFR 121.301).

⁴ Examples of the independent nature of these businesses includes, but is not limited to: 1) The small business solely owns the real estate and poultry growing facilities; 2) they are solely responsible for obtaining financing for the business; and 3) the small business is not an employee, agent, or partner of the larger company that purchases their product.

an affiliate and unable to qualify for an SBA loan. However, reaching this conclusion should be considered absurd as the security firm is its own independently operated business.

The example listed above is just one of many scenarios that can be envisioned in which SBA would determine an affiliation and deprive a small business access to capital when it is most needed. Furthermore, the proposed rule fails to lay out adequate ground rules as to when affiliation can be determined. This lack of clarity creates too much uncertainty that could potentially drive many ABA members out of the marketplace for offering SBA loans.

Reinstating the Totality of the Circumstances Test

As part of the proposed rule, SBA suggests that it can utilize the totality of the circumstances test when considering whether to find an affiliation between businesses. Moreover, the rule states that in using this test, SBA may find an affiliation even though no single factor points to that type of relationship. This type of broad analysis is too subjective and fails to create a bright line by which lenders can determine whether the borrower is affiliated.

Not only is this test too vague, but the appeal procedure will also lead to a slowdown in the overall financing process. The overall process will discourage small businesses from seeking additional capital and it will make it harder for lenders to provide that capital.

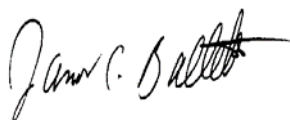
For the reasons stated above, ABA requests that SBA withdraw this portion of the proposed rule. ABA encourages SBA to work with interested stakeholders to address concerns related to likely unintended consequences to ensure continued access to capital for small businesses.

Conclusion

The SBA has always maintained its goal is to protect small businesses while encouraging the strength of the overall economy.⁵ While this proposed rule is well intentioned, it falls short in several areas to uphold the SBA's Mission Statement. Significant revisions must be made to ensure continued access to capital for small businesses and consistent standards for our nation's lenders.

Thank you for your consideration. Please do not hesitate to contact us with any questions or requests for further information.

Sincerely,



James C. Ballentine

⁵*About the SBA*, U.S. Small Business Administration, <https://www.sba.gov/about-sba/what-we-do/mission> (last visited Dec.11, 2018).