December 2, 2022

The Honorable Ben Cardin
Chairman
Committee on Small Business & Entrepreneurship
United States Senate
Washington, D.C. 20515

The Honorable Rand Paul
Ranking Member
Committee on Small Business & Entrepreneurship
United States Senate
Washington, D.C. 20515

The Honorable Nydia Velázquez
Chairwoman
Committee on Small Business
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Blaine Luetkemeyer
Ranking Member
Committee on Small Business
U.S. House of Representatives
Washington, D.C. 20515

Dear Senator Cardin, Senator Paul, Representative Velázquez, and Representative Luetkemeyer:

As the leading organizations representing virtually all of the thousands of lenders 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 released Proposed Rules: *Affiliation and Lending Criteria for the SBA Business Loan Programs*, 87 FR 64724 ("Affiliation Proposed Rule") and *Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization*, 87 FR 66963 ("SBLC Proposed Rule").

In the SBLC Proposed Rule, SBA proposes to lift the moratorium on the number of non-federally regulated 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 "Mission-Based SBLCs." SBA indicates that the purpose for removing the moratorium for all types of SBLCs would be to fill a capital market gap for underserved markets identified by SBA. In the Affiliation Proposed Rule, SBA proposes to loosen or remove the 7(a) program's requirements for how lenders underwrite loans and how borrowers may use loan funds.

Together, these major regulatory proposals lay out a detrimental shift in the 7(a) lending program. Both propose removal or modification of long-existing prudent lending standards which have ensured programmatic integrity for decades. It is into this framework of significantly loosened lending standards that the SBLC Proposed Rule also intends to open SBA's flagship 7(a) program to a potentially unlimited number of SBLC lenders, including non-bank financial technology companies, or "FinTechs," that would be regulated solely by SBA. SBA's stated intention for these sweeping changes is to aid traditionally underserved borrowers, a laudable goal which our organizations and our thousands of SBA lending partners fully support. However, we believe that the changes, as proposed, will not actually help minority and underserved communities, and could unintentionally harm the very borrowers that SBA is trying to aid.

While any single component included in these proposed rules could present its own concerns, the combination of these changes gives us great pause and elevates our need to closely coordinate with Congress. We also will raise these concerns with the SBA in the comments we submit in the agency's rulemaking process. Because we recognize that Congress has a vested interest and oversight responsibility in ensuring the integrity of SBA's cornerstone loan program, we urge Congress to engage quickly.

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

- We are concerned that the proposed rules will not actually promote mission lending. As proposed, the new SBLCs, like the existing SBLCs, would not be subject to any requirements to serve underserved borrowers. And while the proposed rule creates a new category of Mission-Based SBLCs to focus on mission lending, it fails to present any clear set of defined or consistent mission-lending requirements for these entities. Instead, the proposed rule states that SBA political appointees will establish participation parameters on a lender-by-lender basis without any minimum requirements and without clearly describing how these Mission-Based SBLCs would fill market gaps. In addition, the requirements that Mission-Based SBLCs form separate non-profit corporations could present such financial and legal barriers that it may be difficult for the intended non-profit mission entities to participate as envisioned. Finally, it would appear that if an entity is not already participating in SBA's Community Advantage (CA) pilot program, SBA has provided no details or pathway regarding how new entities, such as non-profit CDFIs, would be permitted to apply for a license. These are concerning conclusions that need to be addressed if the SBA wants to encourage more lenders to focus on mission lending.

- In proposing to lift the moratorium, SBA would assume supervisory responsibilities over the new non-federally regulated lenders. We believe that SBA's Office of Credit Risk Management (OCRM) lacks the resources to take on additional supervisory responsibility. OCRM would 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.

- We are concerned that SBA failed to propose 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 or the National Credit Union Administration (NCUA). Given that SBA proposes to serve as primary regulator to an unlimited number of additional non-federally regulated lenders, we are deeply worried about the potential for imprudent lending behavior that could lead to risk to both borrowers and the performance of SBA's 7(a) portfolio. 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 or credit union. 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 and NCUA 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.

- While the proposed rule includes supplementary information indicating that SBA intends to approve only three new "regular" SBLCs *right now*, the actual proposed regulatory language *does not limit* SBA's ability to add an unlimited number of SBLC licenses at any time that the agency sees fit. The unlimited scope of licenses and lack of any cap on the number of loans that could be generated by these new SBLCs is far different from testing a new concept in a gradual and prudent fashion.

- Our concern over the lack of regulatory requirements for SBLCs in the SBLC Proposed Rule is deepened by the Affiliation Proposed Rule's sweeping changes to long-held prudent lending standards in SBA's largest loan program. The Affiliation Proposed Rule would largely remove these prudent lending guardrails. Specifically, the Affiliation Proposed Rule proposes to remove the detailed list of factors to be considered when lenders are determining whether a loan applicant is creditworthy. As a substitute for the existing credit analysis factors, SBA proposes to amend the regulations to require lenders and Certified Development Companies 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."[1]

  While simplification is always welcome, the wholesale stripping of prudent lending standards is worrisome. Congress and SBA put in place the current guardrails to maintain programmatic integrity in direct response to imprudent lender behavior or poor portfolio performance. If a lender is directed simply to follow procedures it would use for its similarly sized non-SBA-guaranteed loans, the likely result is that federally-regulated lenders will continue to operate based on the requirements imposed on them by their prudential regulator while non-federally regulated lenders will have no such limitations.

  It is paramount to maintain sound portfolio performance and programmatic integrity. And while program performance is important to Congress and lenders, it is also key to assisting borrowers, especially in underserved markets. If portfolio performance is not maintained because of relaxed lending requirements, Congress may need to dramatically increase fees for borrowers and lenders to cover the rising costs of the portfolio. Rather than aiding underserved borrowers, the changes reflected in these proposed rules could instead negatively impact 7(a) portfolio performance to such a degree that borrower and lender fees would have to increase, and underserved borrowers will find the cost of capital through the 7(a) program to be too expensive.

  SBA also has delayed, without explanation, the issuance of the major revision to the Standard Operating Procedure manual (SOP) governing 7(a) and 504 Program loan origination. This SOP implements the broader program guidance and provides the specific requirements for loan processing. Until we see what changes are included in this document, it is impossible to know just how much broader the programmatic changes could be.

- We also are concerned that SBA is acting rashly by proposing to expand the number of SBLCs before the numerous investigations relating to fraud in the Paycheck Protection Program (PPP) have been concluded by Congress, the IG community, the Department of Justice, and law enforcement. While these investigations are ongoing, a number of the early findings indicate a direct correlation between PPP fraud and non-bank Fintech participation in PPP. By way of example, the Select Subcommittee on the Coronavirus Crisis noted that "Recent reports have found that FinTechs and their bank partners handled 75 percent of the approved PPP loans that have been connected to fraud by DOJ, despite facilitating just 15 percent of PPP loans overall."[2] While investigations into potential criminal behavior by FinTech companies in one federal government program (PPP) is still underway, SBA should not invite FinTech entities into another federal government program.

---

[1] *Affiliation and Lending Criteria for the SBA Business Loan Programs* (87 FR 64724), https://www.govinfo.gov/content/pkg/FR-2022-10-26/pdf/2022-23167.pdf
[2] https://coronavirus.house.gov/news/press-releases/select-subcommittee-launches-investigation-role-fintech-industry-ppp-fraud

In addition, the Department of Treasury report, *Assessing the Impact of New Entrant Non-bank Firms on Competition in Consumer Finance Markets*, that was released on November 16, 2022. Specifically, the report concludes that while non-bank firms can increase competition and innovation, they have also increased market risk. The conclusion is that the Treasury has called for enhanced oversight of non-bank firms. It is hard to reconcile the recent Treasury report raising alarms over the same exact institutions to which SBA is proposing to open the 7(a) program.

And in the most stunning example showcasing the need to press pause on bringing FinTech into the 7(a) program, the Select Subcommittee on the Coronavirus Crisis released a report just yesterday, December 1, 2022, identifying how FinTech participation in SBA's PPP resulted in wide-scale fraud.[3] This new report illuminates in detail the ways in which FinTech utilized "inexcusable misconduct" amounting to tens of billions of fraudulent loans, significant harm to the taxpayer, and in many cases, the prioritization of only large loans.[4] No one should want to replicate this in SBA's 7(a) loan program. The report concludes that "any plans by the SBA to again open 7(a) participation to Fintechs and other unregulated, non-depository institutions must be accompanied by a well-defined, more rigorous, and better-resourced initial review process, and such entities should be subject to continuous monitoring to confirm their adherence to SBA rules and industry best practices."[5]

Given these explosive findings have just come to light, pressing pause on allowing these types of entities into the SBA's flagship loan program is more than reasonable. This deferment would allow Congress and SBA to better understand the results of these criminal and Congressional investigations and reports on FinTech's damaging and concerning behavior.

On behalf of millions of American small businesses, we urge you to engage quickly. We appreciate the role that both your Committees and the SBA play in increasing access to capital to underserved markets. We also appreciate your focus on prudent lending standards to maintain portfolio performance and to avoid the need for burdening the American taxpayer through Congressional appropriations or increased fees on program participants.

We support SBA's continued adoption of technology to reach borrowers who traditionally do not have long-standing banking or credit union relationships. We understand that automation and other improvements to lending processes may help the traditionally underserved markets. We welcome further discussions with SBA and Congress as to how such advancements and simplifications can be incorporated into the SBA loan programs. However, there is a difference between simplification and the wholesale removal of prudent lending guardrails. Further, we are concerned that SBA has invited into the agency's largest government guaranteed loan portfolio the same entities that the Administration and Congress are investigating regarding wide-sweeping fraud by FinTech in other SBA programs. And SBA's proposed loosening of prudent lending standards is inconsistent with statements by the Department of the Treasury and Congress urging a more robust regulatory framework for non-bank, non-federally regulated entities.

[3] *New Select Subcommittee Report Reveals How Fintech Companies Facilitated Fraud In The Paycheck Protection Program*, https://coronavirus.house.gov/news/press-releases/clyburn-fintech-fraud-ppp-doj-sba
[4] Ibid.
[5] Ibid.

For all of these reasons, we have serious concerns that the proposed changes to the 7(a) program would not serve borrowers' needs in the way that was envisioned by SBA and described in the supplementary information contained in the Proposed Rules, but, in fact, have the potential to damage the integrity of the 7(a) loan portfolio and harm the traditionally underserved constituencies we all seek to aid. We hope you will join us in urging SBA to pause these sweeping changes to allow for appropriate dialogue and a more reasonable path forward.

Sincerely,

American Bankers Association (ABA)

Consumer Bankers Association (CBA)

Credit Union National Association (CUNA)

Independent Community Bankers of America (ICBA)

National Association of Federal Credit Unions (NAFCU)

National Association of Government Guaranteed Lenders (NAGGL)