



December 18, 2018

William Manger
Associate Administrator for the Office of Capital Access
Office of Financial Assistance
Office of Capital Access
US Small Business Administration
409 Third Street SW
Washington, DC 20416

Re: Notice of Proposed Rulemaking on Express Loan Programs; Affiliation Standards
RIN 3245-AG74

Dear Mr. Manger:

The Office of Advocacy of the U.S. Small Business Administration (Advocacy) submits these comments on the Small Business Administration's (SBA) proposed rulemaking on *Express Loan Programs; Affiliation Standards*.¹ Advocacy is concerned that the proposed fee caps, personal resources test and affiliation rules may be burdensome to small financial institutions and may interfere with small business access to credit. Advocacy encourages SBA to perform additional business outreach with the industries that may be impacted by the proposal to determine the best way to implement changes that will achieve SBA's goals without being unduly burdensome.

Advocacy Background

Advocacy was established pursuant to Pub. L. 94-305 to represent the views of small entities before federal agencies and Congress. Advocacy is an independent office within the U.S. Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The RFA,² as amended by the SBREFA,³ gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are

¹ 83 *Federal Register* 49001, March 9, 2018.

² 5 U.S.C. § 601 et seq.

³ Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).

required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.

The Small Business Jobs Act of 2010 requires agencies to give every appropriate consideration to comments provided by Advocacy.⁴ The agency must include, in any explanation or discussion accompanying the final rule's publication in the Federal Register, the agency's response to written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.⁵

The Office of Advocacy performs outreach through roundtables, conference calls and other means to develop its position on important issues such as this one. Advocacy held a roundtable on November 8, 2018. The proposed rule was on the agenda. Advocacy also contacted trade associations after the roundtable to discuss the proposal further.

The Proposed Rule

On September 28, 2018, SBA published a notice of proposed rulemaking on *Express Loan Programs; Affiliation Programs*. The Express Loan Program is established under section 7(a) of the Small Business Act.⁶ Under SBA Express, designated lenders are allowed to use their own analyses, procedures, and documentation in making, closing, servicing, and liquidating SBA Express Loans. The proposal amends various regulations governing its business loan programs, including the SBA Express and Export Express Loan Programs and the Microloan and Development Company (Section 504) loan programs. Among other things, it would incorporate into the regulations governing the 7(a) Loan Program the requirements specifically applicable to the SBA Express and Export Express Loan Programs and add a new regulation to require certain owners of the small business applicant to inject excess liquid assets into the business to reduce the amount of SBA-guaranteed funds that otherwise would be needed. The proposal would also revise the regulations concerning allowable fees for the 7(a) Loan Program to limit the fees payable by the small business applicant and to clarify what SBA considers reasonable with respect to such fees. Furthermore, the proposed rule would modify the affiliation principles applicable to SBA's financial assistance programs to include additional circumstances when a small business applicant will be deemed to be affiliated with another entity for purposes of determining the small business applicant's size and amend the regulation identifying when the size status of an applicant for financial assistance is determined with respect to applications under the SBA Express and Export Express Loan Programs.⁷ The Office of Advocacy asserts that the proposed rule may have unintended consequences that may inadvertently harm small entities.

The Proposed Fee Caps May Be Problematic for Small Lenders and Their Customers

Currently, lenders can collect a reasonable fee for services and agents of a loan applicant can charge a fee of no more than two percent for "Referral" and two percent for "Packaging" services for loans between \$50,000 to \$1,000,000. The proposed rule will limit the fee that a

⁴ Small Business Jobs Act of 2010 (PL 111-240) § 1601.

⁵ Id.

⁶ Public Law 85-536, Sec. 7(a); 15 U.S.C. § 636(a)

⁷ 83 Fed. Reg. at 49002-49003.

lender can charge to \$2,500 for a loan up to and including \$350,000 and no more than \$5,000 for a loan over \$350,000. The proposed rule will also reduce the fee that agents may charge. It will combine and reduce the fees to 2.5 percent of the loan or a maximum of \$7,000.⁸

Although the fee caps will reduce the fees that small businesses pay to obtain a loan, some argue that the proposed caps will hurt small banks and possibly eliminate the incentives to facilitate small SBA loans that small businesses need. According to the Independent Community Bankers of America (ICBA), some small banks use agents because the small banks do not have the in-house capacity to market SBA loans. At the point at which it becomes not economically feasible for agents to participate in the process, the small banks that rely on them may no longer be able to offer SBA loans. This may be especially problematic in small rural communities.

Advocacy understands that the goal of the proposed rule is to prevent small businesses from being charged onerous fees to obtain an SBA loan. However, Advocacy is concerned that in an effort to address a problem that is being created by a few bad actors (approximately 96 percent of the loans issued had fees that were less than the fees in the proposed rule), SBA may discourage the facilitation and use of SBA's products. Advocacy encourages SBA to consider other alternatives that may be less burdensome to small banks. For example, is it possible to determine whether the small banks and their agents are the bad actors? If they are not, is it possible to exempt them from the fee caps?

The Personal Resources Requirement May Be Problematic for Some Small Businesses

Section 120.102 of the proposed rule would also require certain small business owners to inject excess liquid assets into the business to reduce the amount of SBA-guaranteed funds.⁹ While Advocacy appreciates the importance of a small business owner contributing to the business venture, small banking representatives have expressed concerns about whether the personal resources requirement will limit the resources available to a small business owner in the event of an emergency. Moreover, it may eliminate potential borrowers and be difficult to include in the current underwriting practices of small financial institutions. Advocacy encourages SBA to consider a contribution level that will allow small businesses to have a buffer in the event of unforeseen circumstances. Advocacy further encourages SBA to work with small financial institutions to determine the least disruptive way to implement the changes.

The Proposed Rule on Affiliation

In section 121.301, SBA is proposing several ways to determine affiliation. The proposed rule defines affiliation based on identity of interest if they are economically dependent through contractual or other relationships, common investments where the same individuals or firms own a substantial portion of multiple concerns, economic dependence if the concern derives more than 85 percent of its receipts from another concern over the previous three years. Under the

⁸ Id. At 49006.

⁹ 83 Fed. Reg. at 49013.

proposed rule, affiliation may also arise based on a newly organized concern, a franchise agreement or the totality of the circumstances.¹⁰

Affiliation is a complicated issue.¹¹ However, the affiliation sections of the proposed rule may be vague and confusing to small entities. In addition, the changes may be problematic in small rural communities that rely on contracts with large companies/integrators to buy agricultural goods.¹² Small businesses in rural communities need to be able to obtain SBA loans and small rural banks need to be able to provide them. Advocacy encourages SBA to clarify the proposed rule to address the concerns that small entities convey in their comments on the proposed rule.

Conclusion

The SBA loan program is an extremely important resource for small businesses that need access to capital. While it is important to assure that program is not being abused, it is equally important to assure that regulations are not implemented that may unnecessarily hinder loan availability. Advocacy encourages SBA to perform additional business outreach with the industries that may be impacted by the proposal to determine the best way to implement changes that will achieve SBA's goals without being unduly burdensome.

Thank you for the opportunity to comment on this important proposal and for your consideration of Advocacy's comments. If you have any questions regarding these comments or if Advocacy can be of any assistance, please do not hesitate to contact me or Assistant Chief Counsel Jennifer Smith at (202) 205-6943.

Sincerely,

/s/

Major L. Clark, III
Acting Chief Counsel
Office of Advocacy
U.S. Small Business Administration

Cc: The Hon. Neomi Rao
Administrator, Office of Information and Regulatory Affairs
Office of Management and Budget

¹⁰ Id. at 49017.

¹¹ Advocacy understands that SBA must address the issues raised in an Office of the Inspector General's report; *see* Office of the Inspector General, U.S. Small Business Administration, Report 18-13, Evaluation of SBA 7(a) Loans made to Poultry Farmers, March 6, 2018.

¹² *See*, Letter from the Nebraska Bankers Association to SBA's Office of Financial Assistance, November 15, 2018; *see also*, ICBA's call to Action letter at <https://www.icba.org/advocacy/grassroots-be-heard/actioncenter>