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Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

MEMORANDUM

TO: Members, Committee on Small Business

FROM: Committee Majority Staff

DATE: May 12, 2023

RE: Full Committee Hearing Titled: "*Taking on More Risk: Examining the SBA's Changes to the 7(a) Lending Program Part II"*

On **May 17, 2023, at 10:00 A.M. (EST),** the Committee on Small will hold a hearing titled, **"Taking on More Risk: Examining the SBA's Changes to the 7(a) Lending Program Part II."** The meeting will convene in room 2360 of the Rayburn House Office Building. The purpose of this hearing is to examine the Small Business Administration's (SBA) rules that make changes to their flagship 7(a) lending program.

I. Witnesses

- **Mr. Tony Wilkinson,** President and CEO, National Association of Government Guaranteed Lenders (NAGGL)
- **Mr. Ami Kassar,** Founder and CEO, MultiFunding, LLC
- **Ms. Alice Frazier,** President and CEO, Bank of Charles Town
- **Mr. Manuel Flores**, President and CEO, SomerCor

II. Background

The SBA administers several programs to support small businesses—including loan guaranty programs—designed to encourage lenders to provide loans to small businesses "that might not otherwise obtain financing on reasonable terms and conditions."[1] The most well-known program that is offered is the 7(a) Loan Program, which offers government guaranteed loans to eligible

[1] CONG. RESEARCH SERV., R41146, SMALL BUSINESS ADMINISTRATION 7(A) LOAN GUARANTY PROGRAM (last updated Jun. 30, 2022).

small businesses for their short-and long-term working capital needs, refinancing business debt, and purchasing of furniture's, fixtures, and supplies.[2] The SBA does this by guaranteeing between 75 to 85 percent of the total amount of a loan offered to small businesses from a network of private lenders. Should any business default on the loan, the private lender is only liable to cover the loss of the non-guaranteed portion, and the SBA covers the remaining amount.

This is supposed to be a self-sustaining program, meaning it does not require any taxpayer funds to operate. However, if insufficient fees are collected from lenders and borrowers to cover the value of defaulted loans, a direct appropriation from Congress is required to make up the difference. Since this program offers government-backed loans, not every business qualifies for the program. Some the requirements are that the business must operate for a profit, be a small business defined by the SBA, and must prove they could not find credit elsewhere in the private market on similar terms.

In April, the SBA finalized two rules that would make substantial changes to the 7(a) Loan Program. The first rule changes the affiliation and lending criteria for SBA business loan programs. This rule would remove the detailed list of factors to be considered when determining whether a loan applicant is creditworthy, including removing the requirement that character and reputation be considered, and instead allow lenders to "use appropriate and prudent generally acceptable commercial credit analysis process and procedures consistent with those used for their similarly-sized non-SBA guaranteed commercial loans."[3]

Additionally, this rule makes changes to the affiliation principles that lenders reference to determine if a business is eligible for SBA programs. These ensure the government programs target the intended businesses and are not taken advantage of by larger entities. Under this new rule, the SBA will cease publication of the SBA's Franchise Directory that helped lenders quickly and easily determine whether a franchise is eligible for SBA loans and will force lenders to look at each individual company's management structure to determine if an entity is eligible for an SBA loan.

The second rule lifts the moratorium on licensing new Small Business Lending Companies (SBLCs) put in place in 1982 and removed the requirement for a Loan Authorization.[4] The SBA established this moratorium on licensing new SBLCs because it did not have sufficient resources to exercise regulatory oversight of additional license holders.[5] For a group of SBLCs who only participate in the 7(a) Loan Program and do not offer commercial loans, the SBA is the primary regulator. This means if a non-depository lender, such as a FinTech company, applies for an SBLC license, the SBA will be the only agency looking into the safety and soundness of their operations.

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[2] *Funding Programs, 7(a) Loans*, U.S. SMALL BUS. ADMIN., https://www.sba.gov/funding-programs/loans/7a-loans#:~:text=Existing%20borrowers-,What%20is%20a%207(a)%20loan%3F,and%20long%2Dterm%20working%20capital (last visited Apr. 27, 2023).
[3] 88 Fed. Reg. 21074 (Apr. 10, 2023).
[4] 88 Fed. Reg. 21890 (Apr. 12, 2023).
[5] *Id.*; Jason Wiens, *Proposed Rule: Small Business Lending Company (SBLC) (87 FR 66963)*, BIPARTISAN POLICY CTR. (Jan. 25, 2023), https://bipartisanpolicy.org/blog/small-business-lending-company/.

Additionally, this rule will transition Community Advantage Pilot Program participants into permanent 7(a) lenders, add a new type of mission-based lending entity called a Community Advantage SBLC to participate in the 7(a) loan program, and remove the requirement for a Loan Authorization, which provides a single place to locate key information on individual loans.

Since the first hearing that occurred on May 10, 2023, the Associate Administrator of the Office of Capital Access, who testified on that day, is no longer with the Agency. The reason for his departure is unknown at this time. Additionally, the SBA released the Standard Operating Procedures for lenders which gives them guidance on how to implement the new rule changes.

III. Conclusion

There are serious concerns that the SBA is capable of handling these drastic changes to their flagship lending program. While each rule is problematic individually, the combination of the two which will adding more lenders to the program while simultaneously reducing underwriting standards is extremely problematic. Given the level of fraud prevalent in the pandemic lending programs, Congress must ensure that these changes will not threaten the integrity of this program that has been operational for decades.