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Written Testimony

"Taking on More Risk: Examining the SBA's Changes to the 7(a) Lending Program Part II"

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My name is Ami Kassar, and I am the founder and CEO of MultiFunding LLC, a loan brokerage and consultancy company based in the suburbs of Philadelphia. Since 2010, my team and I have heard the stories of thousands of entrepreneurs over the years. In our work, we strongly recommend the SBA 7(a) loan program and have helped borrowers receive nearly $400M of SBA 7(a) loans nationwide.

In a press release last week, **Administrator Isabella Casillas Guzman**, head of the **U.S. Small Business Administration (SBA)**, stated, "The Biden-Harris Administration recognizes that small businesses are the drivers of our economy, and that to participate in the opportunities created by the President's Invest in America agenda, that they need capital to start, grow, and be resilient. The ongoing modernization of SBA's loan programs will help ensure more borrowers can get funded through a broader network of lenders so they can help build a strengthened American economy that innovates, manufactures, and provides the products and services that make our lives better across Main Street."

The press release continues that the SBA recognizes that small businesses, particularly those owned by individuals in underserved communities who are highly entrepreneurial, still face longstanding barriers in accessing capital needed to start or grow their businesses.

And to this end, SBA is in the middle of wholesale simultaneous changes to the plumbing, infrastructure, and wiring of the flagship SBA 7(a) program, opening the program to unregulated fintech lenders who will be able to play under different rules than regulated lenders.

Two broad assumptions made in this announcement are deeply concerning to me.

The first assumption is that SBA is taking lessons learned from the EIDL, PPP, and the Restaurant Revitalization Program and applying them to wholesale changes they are making in the longstanding SBA 7(a) program. Unfortunately, this is a dangerous comparison as the programs have almost no similarities.

The second assumption is that more accessible access to capital under the SBA program is good. However, in many cases, access to capital without proper scaffolding, such as mentoring and support for a budding entrepreneur, will lead to a disaster.

The final point I leave you with today is that too many changes too quickly to the SBA program in an uncontrolled environment will lead to the inability to understand what will drive higher default rates.

The devil, as they say, is in the details. That adage dates back to the 19th century, long before Covid-19, PPP loans, or even the Small Business Administration. But, most importantly, it was coined long before the advent of fintech. These popular internet-based alternative lenders grew exponentially in prominence when the SBA implemented the Paycheck Protection Program early in the Pandemic.

That has inspired a well-intended—but, in my opinion, ill-considered—overhaul of the 7(a) loan program to open traditional SBA loans to fintechs. But, unfortunately, there is good reason to be cautious about handing out SBLC licenses. The federal government annually backs an average of roughly 73% of the approximate $26 billion lent through the SBA's 7(a) program. That requires a litany of rules and controls, or so it was thought, and the number of licenses has been stuck at just 14 since 1982.

Because small and micro businesses desperately needed cash when the Pandemic hit, the rules allowed all types of lenders into the SBA delivery system, paving the way for fintechs to originate them. Of course, some of that easing led to acts of fraud—borrowing for boats and planes and businesses that did not exist—but the fintechs were also quite helpful in getting money out to a lot of those smaller businesses that were unable to get the attention of the big banks they were dealing with or unable to satisfy the regulations in place pre-Covid.

According to The Federal Reserve Bank of New York, Black-owned firms applied to fintech lenders more than twice as often as white, Asian, and Hispanic-owned firms. In addition, Fintech lenders, a recent analysis by the Federal Reserve Bank of New York found, are more likely to service loans with businesses that do not have an established relationship with a traditional bank.

The intent is clear: to issue more loans to underserved businesses and entrepreneurs.

The problem: those pesky details.

The notion has spread that they could repeat that success under more normal circumstances. But, unfortunately, opening the SBA door to fintechs will spell disaster for the borrowers they purport to help. You see, regular SBA lending is nothing like PPP lending. In typical SBA lending, many rules and regulations must be followed and considered, ultimately protecting the borrower and the taxpayers.

SBA is throwing out so many of these rules and nuances to meet the speed and efficiency that fintechs like to leverage. By their very nature, fintechs are not equipped to address the stringent regulations of traditional SBA loans. The fintechs' success and profitability during the Pandemic were the offshoots of expediency. The government needed to get cash out the door and—to some extent—was willing to live with the consequences. As a result, there has been significant fraud, where the government and taxpayers may or may not be able to get their money back.

The SBA is dramatically loosening the regulatory requirements for SBA loans, intent or relaxing them to ease access to capital through fintech.

Who Are These FinTech Lenders Anyway?

Have you ever met an entrepreneur or small-business owner in a cash flow pinch? Unfortunately, I understand these situations all too well. Faced with fear and anxiety, many entrepreneurs turn to the internet, where “alternative lenders” offer them loans or advances with the money promised to land in their bank account in 24 to 48 hours. Often, entrepreneurs think their problems are solved and jump on the offer.

Sadly, though, in most cases, they have just locked themselves onto a high-speed, high-interest-rate treadmill that can be impossible to escape. These online financiers typically demand rapid repayment and daily withdrawals from their borrowers' accounts. Then, as the cash flow pressures mount, more lenders start calling with “enticing” new offers to give them some extra runway. Before long, the borrowers are in over their heads.

I have repeatedly seen the impact of these loans and advances at my company, MultiFunding; MultiFunding’s mission and purpose is to help entrepreneurs find the best loan options and alternatives to help them grow and stay in control of their businesses. We have learned that SBA-backed products are often the best solution, and we leverage this program in about 95 percent of our work.

When a business owner calls us in a cash flow pinch, we do everything we can to steer them away from these loans and advances. Instead, we encourage them to look at payables they can stretch or expenses they can cut. With proper counsel and support, there is often a better option than the alternative lenders. Unfortunately, we also regularly get phone calls from business owners and entrepreneurs already caught in a debt trap. At that point, it's often too late, and we can do nothing to help. It's heartbreaking because the problem should never have gotten that bad.

Why We Should All Be Concerned

The Small Business Administration's new rules and program changes should concern everybody. If you are in the middle of a loan application and the detailed rules accompanying it, sometimes you want to pull your hair out. At MultiFunding, we live this reality with our clients every single day.

While the lending system can be maddening, it is based on some profound logic. It does take work to get an SBA loan, but this protects borrowers and lenders. You need to have your financial house in order to get a good loan. With the proper controls around the process, borrowers significantly increase the likelihood of being able to repay it.

Lending decisions should be made based on the company's ability to repay the money. If you give out too much money too early to companies, they will likely waste it, and the problems will accelerate as they have to start paying it back. That’s part of what went wrong at Silicon Valley Bank.

Of course, all the rules and regulations protect the lenders as well. It's pretty simple – lenders need to be paid back to keep their institutions safe and to be able to keep cycling money through the economy, helping businesses grow and expand. Safe banks are well-diversified and carefully managed against too much risk. Unfortunately, those complaining about how hard it is to get a loan sometimes forget that banks are businesses, too.

All of this is simple. And yet, it needs to be clarified whether these basic lending tenets are part of the current changes to the SBA. Instead, their mission focuses on broadening access to capital while leaving the potential fallout to future generations of taxpayers.

We saw this philosophy with the rollout of the EIDL program during COVID.

One lesson we will learn from EIDL is the danger of lending money to business owners without a clear plan about how they will repay it, which is about to happen again if we make SBA lending so simple.

The Wall Street Journal recently published an article titled "Pandemic Loans Are Coming Due, But Some Businesses Aren't Ready to Repay." During the Pandemic, the SBA issued about $390 billion in Economic Injury Disaster Loans to approximately 4 million small businesses. These were low-interest, 30-year loans with payments deferred for two years. As those payments come due, some business owners argue that they did not fully understand the terms of the loans and that as the economy weakens, they are not well positioned to repay the loans. Business owners must know these loans are an IOU to the U.S. government.

Unfortunately, the problems with the EIDL program are just beginning, and they could take decades to unwind. To understand the complexity of the issues, you have to look at the origins of the EIDL program and how the government tried to adapt it to cope with the Pandemic. Long before Covid, the EIDL program was designed to assist businesses in a relatively small geographical area when a specific disaster damaged them. The government would step in to offer long-term, low-rate loans to help the companies to rebuild.

When Covid hit, the SBA had little idea what to do. First, there needed to be infrastructure to support a mass EIDL rollout across the country. And so, they retrofitted the program for Covid and introduced it in stages. In the first round, the SBA offered loans up to $150,000 with minimal documentation requirements. And then, over time, they moved the loan amounts to $500,000 and eventually $2 million.

While it's terrific that the government got 4 million loans out the door, they were issued without proof of economic injury. Yes, some businesses that got the loans were genuinely decimated by Covid and needed every penny. But many companies thrived during Covid and jumped on these loans out of FOMO (fear of missing out). I have heard some crazy stories about how the money was used: including buying jets, paying off divorce settlements, and investing in cryptocurrency. And there were plenty of companies that were in terrible financial shape before Covid and saw these loans as an opportunity to refinance debt, stretch out terms, and take another shot at solving long-existing issues.

Despite explicit terms in the loan agreements about how the money could be used to recover from the Pandemic, the reality is that the use of funds was and remains a free-for-all. As a result, the chances of ever being audited by the SBA are slim to none.

And now, payments are coming due, and some borrowers are crying foul. As the Wall Street Journal points out, some borrowers claim they thought EIDL loans, like the Paycheck Protection Program loans, wouldn't have to be paid back. Other borrowers say they didn't realize that interest would accrue on the loans while payments were deferred, which means the businesses now owe more money than they realized. Still, others say that with a possible recession looming, their businesses are in worse shape today than when they took the disaster loans and are unprepared to make payments.

Respectfully, it's time to start paying back the debt. Typical SBA loans amortize over ten years at much higher rates than 30-year EIDL loans. As a result, payments are relatively low, and borrowers cannot keep kicking the can down the road.

Borrowers need to realize that the time may come when they need to borrow money again. If their business still has a balance on its EIDL loan, the day of reckoning will have arrived. Under the terms of the EIDL loan, the SBA has a lien on the business, and the new lender will require the SBA to subordinate that lien before issuing a new loan. Therefore, the new lender will ask the first line of questioning: What did you do with your EIDL money? Did you use it for authorized purposes? If not, that will raise a character issue that could endanger the new loan. If you do get through these questions, next up will be the SBA officer who has to approve the subordination request.

The mission of serving underserved entrepreneurs

Let me be clear: I am 100 percent in favor of creating the infrastructure and scaffolding to give everyone who wants to start a company in this country their best possible chance of success. This goal is essential and critical to economic equality and our future. And it's a BHAG—a big hairy audacious goal—that will not be solved overnight. It will take at least a decade if not more, to make a difference.

The proposal to allow alternative lenders into the SBA program with lighter rules and regulations needs to be revised. We need to slow down and refocus.

Fast access to capital is not the answer to the problems of most small businesses. When you take a loan, you need to pay it back. And if you don't have a solid business plan and team around you to support your loan, the chances are excellent that you will fail. Moreover, a delinquent debt to the United States government is not a good mark on a budding entrepreneur's resume.

Likewise, if delinquencies rise, the SBA program, which currently runs with zero government subsidy, could be put at risk. That would damage many other small businesses—not to mention our economy. Most importantly, if we want to help underserved entrepreneurs, there are better ways to do it.

We need to double, triple, or quadruple the resources we put into underserved communities to help with entrepreneurship. And we need to make this a combined effort of government, private enterprise, and academia. Just as we have Teach for America, we need more programs that expose college graduates to entrepreneurship.

One night during the Pandemic, I was asked to teach a virtual SBA class for a female entrepreneurship group at an African American church. About a dozen women on Zoom were trying to get side hustles off the ground. The session was supposed to last an hour, and my SBA slide deck was ready.

As the session began, I quickly realized that the last thing these entrepreneurs needed was a loan. You see, like many entrepreneurs, they thought they needed more money to get started than they did. So the PowerPoint was never opened that night. Instead, we worked for hours, breaking down their plans individually. In every case, there were more straightforward and less expensive ways to test their concept and get it off the ground.

For example, one woman wanted to start a business baking desserts for restaurants. However, she was convinced she needed to borrow $50,000 to open a kitchen. In addition, she had yet to consider that she could prove her concept by baking in her home kitchen or renting a kitchen during off hours at a local restaurant.

But here's the thing: if a fintech lender offered these budding entrepreneurs an SBA loan that would land in their bank accounts in a few days, everyone would jump on it. And then, if the loans were approved, most women would have a liability on their hands that they still needed to prepare to handle.

In Conclusion

I am all for change – but you take significant risk if too much change is made too quickly. Broadening access to capital is a worthy goal. But the current SBA administration proposes changing too much too soon in an uncontrolled environment.

If all these changes go forward, we will return to this room in two years, trying to explain the growing default rates. And the problem will be we won't be able to understand the root causes because of the vast changes being made all at once.

I remember some 101 lessons from science classes in high school. If you're going to try an experiment, test one variable at a time. You cannot read the results if you try everything at once.

If we have learned anything from the lessons of SVB in the last few weeks, it's that outliers in the lending system create problems that ripple throughout the economy. SVB was not a well-run bank with a sound credit culture. Their lending standards were loose, they didn't worry about the risk on their balance sheet, and I still need to figure out how the regulators let them get away with it. They thought their model was invincible until one day, it wasn't.

Sadly, unless someone reins in these broad SBA changes, commentators will discuss the SBA and SVB in the same sentence in a few years. This would be a horrible outcome for the SBA, a program that has served the interests of small businesses so well for decades without costing the taxpayers money.