Statement for the Record

On Behalf of the

American Bankers Association

Before the

House Small Business Committee

May 17, 2023

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The American Bankers Association (ABA) appreciates the opportunity to provide a Statement for the Record for this hearing, *Taking on More Risk: Examining the SBA's Changes to the 7(a) Lending Program Part II*. ABA is the voice of the nation's $23.6 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $19.2 trillion in deposits and extend $12.2 trillion in loans.

On behalf of our member banks 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 finalized rules: *Affiliation and Lending Criteria for the SBA Business Loan Programs* ("Affiliation Rule") and *Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization* ("SBLC Rule"). In the SBLC Rule, SBA lifted the moratorium on the number of nondepository 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 "Community Advantage SBLCs." SBA stated that the purpose for removing the moratorium is to expand capital opportunities for underserved businesses. In the Affiliation Rule, SBA loosened the 7(a) program's requirements for how lenders underwrite loans and how borrowers may use loan funds.

Together, these major regulatory changes lay out a detrimental shift in the 7(a) lending program. Both final rules remove or modify long-existing prudent lending standards which have ensured programmatic integrity for decades. It is into this framework of loosened lending standards that the SBLC Rule also opens SBA's flagship 7(a) program to a potentially unlimited number of SBLC lenders, including non-bank financial technology (fintech) companies, which would be regulated at the federal level solely by SBA. SBA's stated intention for these sweeping changes is to aid traditionally underserved borrowers, a laudable goal that our association supports. However, as explained more fully below and in the comment we submitted in SBA's rulemaking process,[1] these changes may negatively impact the performance of loans made under the 7(a) Program, threaten the integrity of the program, and lead to increased borrower and lender fees. Consequently, the changes could unintentionally harm the very borrowers that SBA is trying to aid.

[1] Comment of Am. Bankers Ass'n, *Affiliation and Lending Criteria for the SBA Business Loan Programs*; *Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization* (filed Dec. 27, 2022), https://www.aba.com/advocacy/policy-analysis/sba-proposed-rules-to-lift-moratorium-on-nondepository-lenders.

Because Congress has a vested interest and oversight responsibility in ensuring the integrity of SBA's cornerstone loan program, we urge Congress to consider potential legislative and Appropriations responses to the final rules.

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

- We are concerned that the rules will not actually promote mission lending. The new SBLCs, like the existing SBLCs, are not subject to any requirements to serve underserved borrowers or to make small-dollar loans. While the rule creates a new category of Community Advantage SBLCs to focus on mission lending, it fails to present any clear set of defined or consistent mission-lending requirements for these entities. In fact, the final rule removed the requirement, present in SBA's proposal, that would have required Community Advantage SBLCs to make a certain percentage of its loans in an identified capital market gap. Instead, SBA stated in the final rule that the Administrator "will determine the specific market requirements, if any, that apply to Community Advantage SBLCs . . . ."[2]

- In lifting the moratorium, SBA has assumed supervisory responsibilities over the new non-federally regulated lenders that SBA will accept into the 7(a) program. OCRM will 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. As evidence, SBA's Office of Inspector General (OIG) found that nondepository lenders in SBA's loan programs currently are subject to "limited SBA oversight" until a loan default occurs.[3] A separate SBA OIG audit "identified additional significant issues regarding internal control weaknesses for lender oversight."[4] As described in detail in the next section, we are concerned about the potential for imprudent lending behavior that presents risk to both borrowers and the performance of SBA's 7(a) portfolio.

- We are concerned that SBA failed to promulgate 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. 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. 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 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.

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[2] Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization, 88 Fed. Reg. 21,890, 21,894 (Apr. 12, 2023).

[3] U.S. Small Bus. Admin., Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration in Fiscal Year 2020, at 8 (2019), https://www.sba.gov/sites/default/files/2019-10/SBA-OIG-Report-20-01_0.pdf.

[4] *Id.*

- While the rule includes supplementary information indicating that SBA intends to approve only three new "regular" SBLCs *right now*, the actual regulatory language *does not limit* SBA's ability to add an unlimited number of SBLC licenses at any time in the agency's sole discretion. The final rule also does not limit the number of 7(a) loans each new SBLC may make nor establish a lower maximum loan size appropriate for entities new to 7(a) lending. The absence of a limit on the number of new entrants to the 7(a) program or loans these institutions could make is imprudent, in light of SBA's existing challenges with providing effective oversight to nondepository lenders, as described above.

- Our concern over the lack of regulatory requirements for SBLCs in the SBLC Rule is deepened by the Affiliation Rule's sweeping changes to long-held prudent lending standards in the 7(a) program. The Affiliation Rule would largely remove these prudent lending guardrails. Specifically, the Affiliation Rule removes the detailed list of nine factors that lenders were required to consider when determining whether a loan applicant is creditworthy. As a substitute for the existing credit analysis factors, SBA amended the regulations to require lenders 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." SBA also allows a lender to use a "business credit scoring model" and may consider the applicant's credit score or credit history, the applicant's earnings or cash flow, or the applicant's equity or collateral.[5]

  The underwriting standards in place prior to the Affiliation Rule preserve the integrity of the 7(a) Program and the performance of the 7(a) portfolio by ensuring that only creditworthy applicants receive 7(a) loans. As stated above, these standards are particularly important for ensuring nondepository institutions, which are not federally supervised, follow prudent underwriting standards. If a lender is directed to follow underwriting procedures that it would use for its similarly sized, non-SBA-guaranteed loans, as SBA has proposed, federally-supervised depository lenders will continue to make 7(a) loans based on the requirements imposed on them by their prudential regulator, while non-federally supervised lenders—i.e., nondepository fintech lenders—will have no such guardrails to ensure sound lending. No borrower benefits when it receives a loan for which it cannot make repayment. SBA's current underwriting standards help the agency maintain the performance of the 7(a) portfolio and the integrity of the 7(a) Program. If portfolio performance is not maintained because of relaxed lending requirements, SBA may need to increase fees for borrowers and lenders to cover the rising costs of the portfolio. This would harm the underserved small business borrowers that SBA and ABA's member banks seek to serve through the 7(a) Program.

- We are also concerned that SBA is expanding the number of SBLCs and loosening underwriting standards when recent reports indicate SBA did not identify and stop widespread fraud by nondepository fintech companies in the Paycheck Protection Program. The report issued by Congress' Select Subcommittee on the Coronavirus Crisis last December found that fintech lenders participating in the PPP "approved a high

[5] *Affiliation and Lending Criteria for the SBA Business Loan Programs*, 88 Fed. Reg. 21,074, 21,085 (Apr. 10, 2023), https://www.govinfo.gov/content/pkg/FR-2023-04-10/pdf/2023-07173.pdf. By a procedural notice issued on May 9, 2023, SBA is requiring more robust underwriting criteria for 7(a) loans greater than $500,000 – i.e., criteria that are similar, but not identical, to the nine-factor test that the 7(a) final rules removed. U.S. Small Bus. Admin., SBA Procedural Notice, No. 5000-846607 (May 9, 2023). But this enhanced underwriting requirement does not apply to loans of $500,000 or less. These smaller loans may be riskier because they are typically provided to smaller businesses.

volume of fraudulent PPP loan applications" in part because of relaxed SBA protocols and procedures.[6] The report cautions, "Congress and the SBA should consider carefully whether unregulated businesses such as fintechs, many of which are not subject to the same regulations as financial institutions, should be permitted to play a leading role in future federal lending programs."[7] We agree.

We urge Congress to consider potential legislative responses to the SBLC and Affiliation Final Rule that would limit the risk that these rules pose to the solvency and integrity of the 7(a) program. ABA stands ready to work with Congress to achieve this aim.

[6] Select Subcommittee on the Coronavirus Crisis, "We Are Not the Fraud Police": How Fintechs Facilitated Fraud in the Paycheck Protection Program 1 & 7 (2022), https://coronavirus.house.gov/sites/democrats.coronavirus.house.gov/files/2022.12.01%20How%20Fintechs%20Facilitated%20Fraud%20in%20the%20Paycheck%20Protection%20Program.pdf [hereinafter, Select Subcommittee Report]. In addition, a Bloomberg analysis of Department of Justice data found that 75% of loans made under the PPP that were associated with fraud were connected to a fintech lender even though those companies arranged only 15% of PPP loans overall. *See* Michelle F. Davis, *PPP Scammers Made Fintech Companies Their Lenders of Choice*, *Bloomberg* (Oct. 7, 2020), https://www.bloomberg.com/news/articles/2020-10-07/ppp-loans-scammers-used-fintech-companies-to-carry-out-fraud?leadSource=uverify%20wall.

[7] Select Subcommittee Report, *supra* note 6, at 7.