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Small Business Administration (SBA) Business Loan Program Rule Changes in the 118th Congress: Background and Summary

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Small Business Administration (SBA) Business Loan Program Rule Changes in the 118th Congress

In April 2023, the Small Business Administration (SBA) finalized two major rules revising regulations related to its business loan programs. The new rules made significant changes to the 7(a) loan guarantee program, under which the SBA provides partial loan guarantees to approved private lenders to facilitate loans to small businesses that cannot otherwise access credit. Some changes made by the new rules would also affect the SBA’s organization and other programs. Major changes to SBA programs made by these rules include the following:

- **Reopening applications for new Small Business Lending Companies (SBLCs) for the first time since 1982.** Most 7(a) lenders are federally regulated depository institutions (banks and credit unions). The SBA licenses a small number of nondepository loan funds to participate in the 7(a) program as SBLCs. Supporters argue that SBLCs have expanded the program’s reach and serve disadvantaged borrowers better than some traditional lenders. Opponents are concerned that permitting new SBLCs into the program could increase program risk, especially if financial technology (fintech) lenders are allowed to participate.
- **Creating of a new type of entity—Community Advantage Small Business Lending Companies (CA SBLCs)—to make the Community Advantage Pilot Program (CA pilot) permanent.** The CA pilot started in 2011 as a temporary pilot program, and has since been extended multiple times. The CA pilot allows nontraditional lenders (such as nonprofit organizations) to participate in the 7(a) program, and also eases some loan requirements (e.g., it allows more flexible collateral). Congress has not provided statutory authorization for the CA pilot. The SBA sunset the CA pilot on October 31, 2023, and transitioned CA pilot lenders to become CA SBLCs. Supporters say this change made the CA pilot permanent and provides certainty to previously active and prospective lenders. Opponents criticize the new rules for not including other key features of the CA pilot, such as the underserved market lending requirement, and prefer that the CA pilot be made permanent through an act of Congress.
- **Increasing the workload of the SBA’s Office of Credit Risk Management (OCRM) by expanding the number of SBA-supervised lenders.** For banks and credit unions that participate in the SBA’s programs, the OCRM only supervises their participation in SBA programs, while other federal regulators conduct overall supervision. For entities without a federal regulator (such as SBLCs and CA pilot lenders), the OCRM supervises both their participation in SBA programs and their overall safety and soundness. Supporters say there are benefits to having more nontraditional lenders in the SBA’s programs and that the OCRM has the resources to supervise them. Opponents argue that the OCRM is already understaffed and giving it more work without expanding the office will result in lower-quality supervision, which may increase program risk.
- **Changes to certain business loan program requirements, including the removal of the requirement for a loan authorization and changes to underwriting standards and borrower affiliation rules.** Supporters argue that these requirements were unnecessary, duplicative, and difficult to implement. Opponents are concerned that changes in the loan authorization and underwriting standards may increase program risk and that the changes to affiliation rules may allow large businesses to benefit from programs meant for small businesses.

These changes have generated substantial feedback from Members of Congress. The House and Senate small business committees both held oversight hearings on the rule changes, and Members have sent multiple letters to the SBA, including a letter from Senate Committee on Small Business and Entrepreneurship leadership and a “four corners” letter from House and Senate small business committee leadership.

Partly in reaction to the SBA’s final rules, the Senate Committee on Small Business and Entrepreneurship reported legislation related to SBA business loan programs. A section-by-section summary of S. 2482 is in the table below. A comparable House bill has yet to be introduced. The House rejected an appropriations bill amendment (H.Amdt. 672) that would have blocked the SBA from implementing the CA SBLC program.

Section-By-Section Summary of Key Provisions in S. 2482

Section	Summary
Community Advantage Loan Program Section 101	<p>This section would provide permanent statutory authorization to a Community Advantage Loan Program that is broadly similar to the Community Advantage Pilot Program (which was temporary and has expired).</p> <p>Similar to CA pilot: maximum loan amount for most lenders would be \$350,000; provides a path for nontraditional, mission-oriented lenders to participate; CA program lenders must make 60% of their loans in underserved markets; higher threshold for requiring collateral; CA program lenders must maintain a loan loss reserve account.</p> <p>Different from CA pilot: higher loan guarantee rate for loans of \$350,000 or less (80%-90%); allows up to eight “experienced lenders” to make CA program loans of up to \$750,000; the SBA must conduct training and outreach to current and prospective CA program lenders.</p>
Lending Criteria Section 203	<p>This section would codify the simplified lending criteria from the rulemaking for 7(a) loans of \$350,000 or less and for all 504 loans. It would codify lending criteria similar to those in effect before the rulemaking for 7(a) loans of more than \$350,000. It would also prevent the SBA from requiring a lender to consider an applicant’s “character and reputation,” which may include an applicant’s criminal record. Lenders may consider an applicant’s character and reputation if they choose to do so.</p>
Affiliation and Franchise Directory Section 204	<p>This section would codify the previous affiliation standards, including the principle of control, for the 7(a) program. For the 504 program, it would codify affiliation standards similar to the SBA’s revised affiliation standards. This section would also require the SBA to publish a franchise directory to assist lenders in determining the eligibility of franchisees.</p>
Loan Authorization Section 205	<p>This section would codify the requirement that the SBA issue a loan authorization prior to a lender making a guaranteed loan. This requirement was removed by the SBA rulemaking.</p>
Oversight of Small Business Lending Companies Section 206	<p>This section would codify the maximum number of SBLC licenses at 17 (3 more than before the rulemaking). This section would also codify several authorities and duties related to SBLCs for the OCRM: (1) the OCRM may revoke an SBLC license for certain causes; (2) the OCRM must conduct annual stress tests of each SBLC’s loan portfolio, including for interest rate risk; (3) SBLCs must comply with Bank Secrecy Act, Know Your Customer, and Anti-Money Laundering laws.</p>
Office of Credit Risk Management Section 207	<p>This section would make two changes to the OCRM: (1) It would reorganize the SBA to have the director of OCRM report directly to the SBA Administrator, removing it from the Office of Capital Access; and (2) It would require the OCRM to report certain data on early defaults of 7(a) loans in its annual report to Congress.</p>
Denied Loan or Loan Modification Request Section 208	<p>This section would return the SBA’s loan denial reconsideration process to the process in effect before the rulemaking, in which the director of the Office of Financial Assistance makes the final decision for SBA, and the SBA Administrator may not intervene in any decision on a reconsideration.</p>
Direct Lending Section 209	<p>This section would require the SBA to notify Congress at least 60 days before starting any direct lending (where the SBA itself is the lender) business loan program or pilot program.</p>
Restriction on Refinancing Debt Section 210	<p>This section would prevent 7(a) lenders from processing any 7(a) loan that would refinance debt held by that lender using delegated authority. It would still be possible to use a 7(a) loan to refinance debt held by the lender, but the section would require those loans to be completed through regular processing, where the SBA makes the final credit decision.</p>
GAO Study Section 211	<p>This section would require three GAO studies: (1) on the effectiveness and fraud prevention strategies for using alternative credit models for smaller 7(a) loans; (2) an audit of the OCRM; and (3) a survey of 7(a) lender practices regarding borrower criminal history for underwriting private loans.</p>

Source: CRS analysis of S. 2482 (as reported).

Notes: Please see full report for a detailed description of each section. CA=Community Advantage; GAO=U.S. Government Accountability Office; OCRM=Office of Credit Risk Management; SBA=Small Business Administration; SBLC=Small Business Lending company.

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The Small Business Administration (SBA) provides a variety of programs to assist entrepreneurs with starting, operating, and expanding small businesses. Several SBA programs support small business formation and expansion by helping businesses access capital. The agency’s largest capital-access program is the 7(a) loan guarantee program. The program derives its name from Section 7(a) of the Small Business Act (P.L. 85-536, as amended), which authorizes the SBA to provide and guarantee business loans to American small businesses.

The 7(a) program operates through loan guarantees. The SBA approves private lenders to participate in the program, and these lenders make loans to qualifying small businesses. If a lender and a loan meet SBA requirements, then the loan may qualify for an SBA loan guarantee, which ensures that the agency will purchase the unpaid guaranteed portion of the loan if the borrower defaults. This reduces the lender’s risk, thereby potentially making lending to risky borrowers more appealing to private lenders.¹

Within the 7(a) program, the Community Advantage Pilot Program provided SBA-guaranteed loans through nontraditional lenders to assist small businesses in underserved markets. Separately, Small Business Lending Companies are nondepository lenders that are licensed to make 7(a) loans. Within the SBA, the Office of Credit Risk Management supervises SBA lenders and analyzes overall risk within the 7(a) program.

In April 2023, the SBA finalized two major rules revising regulations related to its business loan programs. The new rules made significant changes to the 7(a) loan guarantee program, including changes affecting the Community Advantage Pilot Program, Small Business Lending Companies, and the Office of Credit Risk Management.

This report first provides a more detailed overview of these programs, followed by a summary of the recent rules changes that would modify aspects of the programs. It then concludes with a summary of the legislative response, including a section-by-section summary of S. 2482.

Background on Select SBA Business Lending Programs

To provide context to the SBA final rules and introduced legislation, this section provides background on some features of the Community Advantage Pilot Program, Small Business Lending Companies, and the Office of Credit Risk Management.

Community Advantage Pilot Program (CA Pilot)

The Community Advantage Pilot Program (CA pilot) was a subprogram within the 7(a) loan guarantee program. It was intended “to meet the credit, management, and technical assistance needs of small businesses in underserved markets.”² The CA pilot’s goals were to

- increase access to credit for small businesses located in underserved markets;
- expand points of access to the SBA 7(a) loan program by allowing nontraditional, mission-oriented lenders to participate;

¹ For more about the 7(a) program, see CRS Report R41146, *Small Business Administration 7(a) Loan Guaranty Program*, by Robert Jay Dilger and Anthony A. Cilluffo.

² Small Business Administration (SBA), *Community Advantage Participant Guide*, May 31, 2022, p. 6, <https://www.sba.gov/document/support-community-advantage-participant-guide>.

- provide management and technical assistance to small businesses as needed; and
- manage portfolio risk.³

The SBA created the CA pilot in 2011 using its authority to create temporary pilot programs.⁴ The CA pilot was originally set to expire on March 15, 2014, but the agency subsequently extended and modified the program. The CA pilot was last extended by SBA through September 30, 2024,⁵ but the SBA sunset the program on October 31, 2023.⁶ To date, Congress has not provided permanent statutory authorization for the CA pilot.

Requirements for CA pilot lenders differed from those for 7(a) program lenders. Whereas 7(a) program lenders are generally federally regulated depository institutions (banks or credit unions), CA pilot lenders were often nonprofit community development organizations. Four types of entities could apply to be CA pilot lenders:

- SBA-authorized Certified Development Companies (CDCs);
- SBA-authorized Microloan Program Intermediaries;
- SBA-authorized Intermediary Lending Pilot Program Intermediaries; and
- non-federally regulated Community Development Financial Institutions (CDFIs) certified by the Department of the Treasury.⁷

As of April 2022, there were 108 approved CA pilot lenders, 96 of which had at least one outstanding CA pilot loan.⁸

The SBA was the primary federal regulator for CA pilot lenders. The Office of Credit Risk Management (OCRM) supervised CA pilot lenders. OCRM supervision included both the CA pilot lenders' participation in SBA programs, as well as their overall financial conditions and capitalization levels. This level of OCRM supervision differed from the 7(a) loan program, in which lenders are supervised by the office only for their participation in the 7(a) program while another federal regulator supervises their overall financial conditions.

Unlike most 7(a) lenders, CA pilot lenders were required to maintain a loan loss reserve account (LLRA). Given the expected greater risk of CA pilot loans, the LLRA was intended to cover losses from defaulted loans. For CA pilot loans approved on or after October 1, 2018, the LLRA had to contain a minimum of 5% of the unguaranteed portion of the lender's CA pilot loan portfolio, plus 5% of the guaranteed portion of any CA pilot loans that the lender sold on the secondary market.⁹

³ Ibid.

⁴ SBA, "Community Advantage Pilot Program," 76 *Federal Register* 9626, February 18, 2011. In identifying this authority, SBA referenced 15 U.S.C. §636(a)(25) and 13 C.F.R. §120.3.

⁵ SBA, "Community Advantage Pilot Program," 87 *Federal Register* 19165, April 1, 2022.

⁶ SBA, "Community Advantage Pilot Program," 88 *Federal Register* 69003, October 5, 2023.

⁷ SBA, *Community Advantage Participant Guide*, p. 6.

⁸ SBA, "Community Advantage Pilot Program," 87 *Federal Register* 19165, April 1, 2022.

⁹ SBA, "Community Advantage Pilot Program," 83 *Federal Register* 46237, September 12, 2018.

Lenders were required to make 60% of their CA pilot loans to borrowers in underserved markets. For the CA pilot, the SBA defined businesses in underserved markets as

- businesses located in Low-to-Moderate Income (LMI) communities, Empowerment Zones and Enterprise Communities (EZ/EC), Historically Underutilized Business Zones (HUBZones), Promise Zones, Opportunity Zones, or Rural Areas;
- new businesses (those in operation for less than two years);
- businesses that are 51% or more owned and controlled by one or more veterans; and
- businesses where more than 50% of the full-time workforce is low income or resides in an LMI census tract.¹⁰

CA pilot loans were 7(a) loans and were therefore subject to all general 7(a) program requirements, except for specific exceptions.¹¹ Loan terms, interest rates, and guarantee percentages were generally similar to those of similar 7(a) loans. However, the maximum amount for a CA pilot loan was \$350,000, compared with \$5 million for standard 7(a) loans.

During the life of the CA pilot, 8,553 CA pilot loans were approved, totaling \$1.2 billion.¹² In FY2023, 800 CA pilot loans were approved, with a total amount of \$141 million and average size of about \$177,000.¹³

Small Business Lending Companies (SBLCs)

Most lenders approved to participate in the SBA's 7(a) program are federally regulated depository institutions, either banks or credit unions. The SBA supervises depository institutions' participation in the 7(a) program, but those institutions' overall financial conditions and capitalization requirements continue to be supervised by their primary federal regulators, such as the Office of the Comptroller of the Currency (OCC) or the Federal Deposit Insurance Corporation (FDIC).¹⁴

The SBA allows a limited number of nondepository institutions, called Small Business Lending Companies (SBLCs), to participate in the 7(a) program. The SBA is the primary federal regulator for SBLCs' overall financial conditions and capitalizations,¹⁵ in addition to their participation in the 7(a) program. The OCRM is the lead office for lender supervision and enforcement.¹⁶

The number of SBLCs participating in the 7(a) program has stayed at 14 since January 1982. At that time, the SBA determined that it "should no longer authorize the participation of additional [SBLCs] since SBA does not have adequate resources to service and supervise effectively

¹⁰ SBA, *Community Advantage Participant Guide*, p. 7.

¹¹ SBA, *Community Advantage Participant Guide*, p. 7.

¹² Data for FY2011 through FY2016 from CRS Report R41146, *Small Business Administration 7(a) Loan Guaranty Program*. Data for FY2017 through the program's end in early FY2024 (all data are as of December 10, 2023) are from SBA, "7(a) and 504 Summary Report," accessed December 11, 2023, <https://careports.sba.gov/views/7a504Summary/Report>.

¹³ This includes five Community Advantage Revolving Lines of Credit. SBA, "7(a) and 504 Summary Report."

¹⁴ For more on federal bank supervision generally, see CRS Report R46648, *Bank Supervision by Federal Regulators: Overview and Policy Issues*, by David W. Perkins.

¹⁵ 15 U.S.C. §650.

¹⁶ SBA, "Supervision and Enforcement," SOP 50 53 (2), January 1, 2021, p. 10.

additional [SBLCs].”¹⁷ To participate in the 7(a) program as an SBLC, an entity must acquire one of the 14 SBLC licenses from an existing SBLC. Since the moratorium on accepting additional SBLC applications took effect in January 1982, there have been more than 60 transfers of the existing 14 SBLC licenses.¹⁸

Although the 14 SBLCs constitute a small share of all active 7(a) lenders, SBLCs are often active in the program. According to SBA data, there were 1,601 lenders who made at least one loan with an SBA 7(a) guarantee during FY2022. Combined, the 14 SBLCs made 3,097 loans with a 7(a) guarantee (6% of the 47,678 total 7(a) loans) for a total of \$2.1 billion (8% of the \$25.7 billion total). There were 2 SBLCs among the 10 lenders with the largest 7(a) loan approval amounts during FY2022.¹⁹

SBA’s Office of Credit Risk Management (OCRM)

The Office of Credit Risk Management (OCRM) is the lead SBA office for supervision and enforcement of entities in all SBA business loan programs, including the 7(a) and 504 loan guarantee and Microloan programs.²⁰ The OCRM is part of the Office of Capital Access (OCA), and the director of OCRM reports to the Associate Administrator for Capital Access.

The SBA describes its general approach to credit risk management as follows:

The Agency initially seeks to educate and work with Participants using graduated processes for the Participant to reduce risk and come into compliance before taking any enforcement action. Specifically, SBA educates Participants on SBA Loan Program Requirements through SOPs, notices, webinar/teleconference training, and at conferences. In addition, when SBA identifies risk or noncompliance through monitoring or reviews, SBA generally seeks to work with the Participant through a corrective action process or Increased Supervision to address SBA concerns. As a result, most Participants come into compliance, reduce risk, and avoid facing enforcement actions. SBA generally takes enforcement action only when the Participant cannot sufficiently reduce risk, cannot correct serious noncompliance, or does not have the willingness or ability to correct.²¹

The OCRM is authorized by the Small Business Act.²² The act specifies that the office will supervise lenders in the SBA’s business loan programs, but imposes relatively few specific requirements for that supervision. The OCRM must conduct an annual risk analysis of the SBA’s 7(a) loan portfolio and submit the report to Congress.²³ More specific provisions related to the OCRM’s risk management strategy are provided in regulation and SBA standard operating procedures.²⁴

¹⁷ SBA, “Business Loan Policy; Small Business Lending Companies,” 46 *Federal Register* 41523, August 17, 1981.

¹⁸ SBA, “Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization,” 88 *Federal Register* 21890, April 12, 2023.

¹⁹ CRS analysis of SBA, “7(a) and 504 Lender Report,” accessed June 5, 2023, <https://careports.sba.gov/views/7a504LenderReport/LenderReport?%3Aembed=yes&%3Atoolbar=no>.

²⁰ SBA, “Supervision and Enforcement,” SOP 50 53 (2), January 1, 2021, p. 10. A separate office, the Office of SBIC Examinations within the SBA’s Investment Division, supervises Small Business Investment Companies. See SBA, “Oversight and Regulations of SBICs Investment Division,” SOP 10 06, May 8, 2007.

²¹ SBA, “Supervision and Enforcement,” SOP 50 53 (2), January 1, 2021, pp. 5-6.

²² 15 U.S.C. §657t.

²³ 15 U.S.C. §657t(h).

²⁴ SBA, “Supervision and Enforcement,” SOP 50 53 (2), January 1, 2021. For regulatory provisions specific to lender oversight, see 13 C.F.R. §120.1000 *et seq.* and 13 C.F.R. §120.460 *et seq.*

The OCRM uses a risk-based strategy to monitor and manage risk within the SBA’s business loan programs. The office determines the frequency and intensity of its reviews and examinations of SBA lenders by considering several factors. Among those factors, it considers the results of monitoring, the sizes of lenders’ SBA loan portfolios, the results of previous reviews or examinations, and lenders’ responsiveness in addressing deficiencies raised in previous reviews and examinations.²⁵ The SBA describes its oversight process as being “risk-based to best utilize resources” and using “graduated processes” to move from routine monitoring to intensive monitoring to enforcement actions.²⁶

Once the OCRM has selected a lender for review, it examines the lender’s portfolio performance, operations within SBA programs, credit administration, and compliance with loan program requirements.²⁷ For 7(a) lenders, OCRM uses its “PARRiS” methodology. PARRiS components are

- P—Portfolio performance;
- A—Asset management;
- R—Regulatory compliance;
- Ri—Risk management; and
- S—Special items.

The components each include several qualitative and quantitative subcomponents. Each component is scored on a scale from 1 (lower risk) to 5 (higher risk).²⁸

The SBA is the primary federal regulator for SBA-supervised lenders, including SBLCs and CA pilot lenders. The OCRM conducts safety and soundness examinations of SBA-supervised lenders, considering factors such as capital adequacy, asset quality, management quality (such as internal controls and loan portfolio management), earnings, liquidity, and compliance with loan program requirements.²⁹ This is broader than the office’s standard PARRiS review, because it also includes the lender’s non-SBA operations.

Lenders are required to pay fees to the SBA for the cost of OCRM examinations and reviews.³⁰ Those fees may cover the costs of reviewing SBA lenders and additional expenses the SBA incurs in carrying out other lender oversight activities. Each lender is billed for the exact cost of actions particular to it, as well as a share of 7(a) portfolio-wide monitoring costs (prorated by the lender’s share of the total outstanding 7(a) portfolio).

The SBA’s reported costs of its credit risk management program were \$35 million in FY2022. It expects those costs to rise to \$40 million in FY2023 and \$47 million in FY2024. In FY2022, the OCRM received \$19 million in fee income. The SBA expected OCRM fee income to decrease to \$15 million for FY2023 and FY2024. Those fees fund 9 full-time equivalent (FTE) OCRM employees conducting lender oversight.³¹ As of November 2022, the office had a total of 29 FTE employees (including the 9 fee-supported positions).³² In FY2022, the OCRM conducted 810

²⁵ 13 C.F.R. §120.1051.

²⁶ SBA, “Supervision and Enforcement,” SOP 50 53 (2), January 1, 2021, pp. 6.

²⁷ 13 C.F.R. §120.1050(a), <https://www.ecfr.gov/current/title-13/section-120.1051>.

²⁸ SBA, “Supervision and Enforcement,” SOP 50 53 (2), January 1, 2021, pp. 10.

²⁹ 13 C.F.R. §120.1050(b).

³⁰ 13 C.F.R. §120.1070.

³¹ SBA, *FY 2024 Congressional Budget Justification [and] FY 2022 Annual Performance Report*, March 13, 2023, <https://www.sba.gov/document/report-congressional-budget-justification-annual-performance-report>.

³² SBA Office of Congressional and Legislative Affairs, correspondence with the author.

risk-based reviews of 7(a) lenders and Certified Development Companies (CDCs, operating in the Section 504 loan guarantee program). About half (420, 52%) of those were “mid-level” targeted risk-based reviews, requiring “examination of loan files and analysis of specific components of the loan lifecycle.”³³

Some observers believe the OCRM should be an independent office within the SBA. They argue that having the OCRM within the OCA may create a conflict of interest.³⁴ The OCA “actively recruits” additional 7(a) lenders. However, the number of 7(a) lenders fell by 17% from FY2017 to FY2022, and the SBA missed its performance target for the number of 7(a) lenders in every year from FY2017 to FY2022.³⁵ The OCRM supervises and, if necessary, undertakes enforcement actions against SBA lenders. One enforcement measure at the office’s disposal is removal of a lender from SBA programs. Supporters of the current organizational structure may argue that locating the OCRM within the OCA allows for greater knowledge sharing and centralization of program expertise.

The U.S. Government Accountability Office (GAO) examined certain SBA lender oversight functions in a 2002 report and recommended that the SBA Administrator “separate lender oversight functions and responsibilities from OCA.” GAO said that the change “would provide an oversight office with greater autonomy within SBA to match the growing importance of lender oversight” to certain SBA activities. The SBA did not separate the lender oversight office, but took other actions (such as establishing a Lender Oversight Committee) that increased the independence of the lender oversight office.³⁶

SBA Rules Finalized in April 2023

While the major rules that the SBA finalized in April 2023 relate to its access-to-capital programs, the most direct effects are on the 7(a) loan guarantee program, including on the CA pilot and SBLCs. Other changes in the final rules, such as changes to affiliation standards and removal of the requirement for a loan authorization, would affect SBA business loan programs broadly and are discussed in this report’s section on “Affiliation and Lending Criteria.”

SBLC Licenses and Loan Authorization Requirement

On April 12, 2023, the SBA finalized a rule (88 *Federal Register* 21890; effective May 12, 2023) that made several changes to its business loan programs.³⁷ The final rule allows the SBA to add additional SBLC licenses; creates a new type of entity—Community Advantage SBLCs—to provide a path to permanency for the CA pilot; and removes the requirement for a loan

³³ SBA, *FY 2024 Congressional Budget Justification [and] FY 2022 Annual Performance Report*, March 13, 2023, pp. 43-44.

³⁴ For instance, see U.S. Government Accountability Office, *Small Business Administration: Progress Made but Improvements Needed in Lender Oversight*, GAO-03-90, December 9, 2022, <https://www.gao.gov/products/gao-03-90>.

³⁵ The SBA states this is because of “the trend toward continual bank mergers,” which “negatively impact[s] the number of active lending partners providing 7(a) loans.” SBA, *FY 2024 Congressional Budget Justification [and] FY 2022 Annual Performance Report*, March 13, 2023, pp. 37.

³⁶ U.S. Government Accountability Office, *Small Business Administration: Progress Made but Improvements Needed in Lender Oversight*, GAO-03-90, December 9, 2022, <https://www.gao.gov/products/gao-03-90>.

³⁷ SBA, “Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization,” 88 *Federal Register* 21890, April 12, 2023, <https://www.federalregister.gov/documents/2023/04/12/2023-07181/small-business-lending-company-sbhc-moratorium-rescission-and-removal-of-the-requirement-for-a-loan>.

authorization when processing a 7(a) or 504 loan. The SBA issued the corresponding proposed rule on November 7, 2022 (87 *Federal Register* 66963).³⁸

SBLC Moratorium Rescission

The final rule lifted the moratorium on licensing new SBLCs, allowing new SBLCs into the program. The SBA stated that it “determined that certain markets where there are capital market gaps continue to struggle to obtain financing on non-predatory terms.” The agency anticipates licensing and approving 3 additional SBLCs, bringing the total to 17.³⁹ There is no limit in regulation on the number of additional SBLC licenses the SBA can create in the future.

The final rule allows the SBA to accept new SBLCs from time to time when it determines that there is a market need and it has the capacity to supervise additional SBLCs. The SBA can do this by issuing a *Federal Register* notice announcing an application period.⁴⁰ The SBA stated that this will enable it to respond to market conditions and oversight capacity while providing public notice.⁴¹ On May 22, 2023, the SBA announced an application period for new SBLC licenses from June 1, 2023, to July 31, 2023.⁴² It issued three new SBLC licenses on November 1, 2023.⁴³

A variety of observers have expressed concern that licensing additional SBLCs will allow financial technology firms (fintechs) to participate as 7(a) program lenders.⁴⁴ In the proposed rule, the SBA stated that

[M]any non-traditional lenders participated in SBA’s Paycheck Protection Program (PPP), which provided billions of dollars to small businesses during the economic upheaval caused by the COVID-19 pandemic. Based on the success of the PPP, removing the moratorium on licensing new SBLCs and [Community Advantage] SBLCs opens opportunities for more non-traditional lenders to participate in the 7(a) Loan Program, providing additional sources of capital to America’s small businesses and targeting gaps in the credit market.⁴⁵

Granting additional SBLC licenses will increase the OCRM’s lender oversight costs. The SBA has stated that each OCRM risk management analyst position can supervise seven SBLCs (either standard SBLCs or Community Advantage SBLCs). The SBA prices each risk management

³⁸ SBA, “Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization,” 87 *Federal Register* 66963, November 7, 2022, <https://www.federalregister.gov/documents/2022/11/07/2022-23597/small-business-lending-company-sblc-moratorium-rescission-and-removal-of-the-requirement-for-a-loan>.

³⁹ SBA, “Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization,” 87 *Federal Register* 66963, November 7, 2022.

⁴⁰ SBA, “Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization,” 88 *Federal Register* 21890, April 12, 2023.

⁴¹ SBA, “Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization,” 87 *Federal Register* 66963, November 7, 2022.

⁴² SBA, “Small Business Lending Company Application Process,” 88 *Federal Register* 32623, May 22, 2023.

⁴³ SBA, “Biden-Harris Administration Takes Historic Step in Expanding Access to Capital and Filling Lending Gaps in Underserved Communities,” press release 23-86, November 1, 2023, <https://www.sba.gov/article/2023/11/01/biden-harris-administration-takes-historic-step-expanding-access-capital-filling-lending-gaps>.

⁴⁴ See, for instance, Chairman Benjamin Cardin and Ranking Member Joni Ernst, “Letter to the Honorable Isabella Casillas Guzman, SBA Administrator,” March 6, 2023, https://www.ernst.senate.gov/imo/media/doc/cardin_and_ernst_letter_to_sba_re_proposed_rulespdf.pdf; John Reosti, “SBA finalizes rule to open flagship 7(a) program to fintechs,” *American Banker*, April 16, 2023, <https://www.americanbanker.com/news/sba-finalizes-rule-to-open-flagship-7a-program-to-fintechs>.

⁴⁵ SBA, “Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization,” 87 *Federal Register* 66963, November 7, 2022.

analyst at the federal pay rate for full-time employees at GS-14, Step 10 (\$164,102 per employee per year in the Washington, DC, area) plus 100% of that cost for benefits and additional costs, for an annual cost of \$328,204 per employee per year to supervise seven SBLCs.⁴⁶

Community Advantage SBLCs⁴⁷

The SBA's final rule made the CA pilot permanent by transitioning previously active CA pilot lenders to a new type of entity, Community Advantage SBLCs (CA SBLCs). Responding to "many comments" on the proposed rule that it should make the CA pilot permanent instead of creating CA SBLCs, the SBA stated that "the nature of a pilot program is that it is a temporary program."⁴⁸ The final rule sunset the CA pilot and transitioned previously active CA pilot lenders to become CA SBLCs.

Generally, CA SBLCs are subject to the same regulations and SBA supervision as regular SBLCs. Whereas CA pilot lenders were subject to a loan maximum of \$350,000, there is no maximum loan amount in regulation for loans made by CA SBLCs. However, the SBA stated that CA SBLCs will still be subject to the administrative requirements⁴⁹ that were in effect during the CA pilot, including the \$350,000 loan maximum.⁵⁰

There are several differences between CA SBLCs and the general 7(a) program:

- CA SBLCs must either be nonprofit organizations or, if not nonprofit organizations, former CA pilot lenders.
- CA SBLCs are exempt from the requirement for SBLCs to maintain certain types of fidelity insurance of at least \$2 million. Instead, the SBA Administrator will set fidelity insurance requirement for CA SBLCs.
- CA SBLCs are exempt from minimum capital requirements for SBLCs in regulation. Instead, the SBA Administrator will set minimum capital requirements at the Administrator's discretion.
- CA SBLCs must maintain an LLRA. A CA SBLC will need to deposit a share of its outstanding loan principal balance into its account to cover potential loan losses. CA pilot lenders were subject to a similar requirement, but no other 7(a) lender must maintain an LLRA. The amount CA SBLCs must deposit in the accounts will be determined by the SBA Administrator at the SBA Administrator's discretion.
- CA SBLCs may be affiliated with a CDC. CDCs are SBA-supervised entities that participate in the SBA Section 504 loan guarantee program. The CA pilot also allowed CDCs to affiliate with CA pilot lenders.

There is no requirement in regulation for a CA SBLC's share of lending to underserved markets. In the CA pilot, lenders were required to make 60% of their loans in underserved markets.

⁴⁶ Ibid.

⁴⁷ In the proposed rule, Community Advantage SBLCs were called Mission-Based SBLCs.

⁴⁸ SBA, "Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization," 88 *Federal Register* 21890, April 12, 2023.

⁴⁹ Administrative requirements are SBA-imposed program requirements that lenders agree to follow as a condition of participating in the program, such as standard operating procedures (SOPs). SBA can change administrative requirements without needing the same process as with regulation changes.

⁵⁰ SBA, "Community Advantage Small Business Lending Company Conversion," SBA Information Notice 5000-846918, May 1, 2023, <https://www.sba.gov/sites/sbagov/files/2023-05/5000-846918.pdf>.

Instead, the SBA requires each CA SBLC to identify a capital market gap and the share of its total loans it will devote to that gap when applying to be a CA SBLC. Then, “SBA will determine, in its sole discretion, whether the proposed capital market gap is acceptable and the percentage of loans made in that market on the basis of whether SBA agrees there is a need in the target market.”⁵¹ The SBA told CA pilot lenders transitioning to become CA SBLCs that, as CA SBLCs, they will continue to be required to make a minimum of 60% of their loans in underserved markets.⁵²

The final rule permits the SBA to accept new CA SBLCs from time to time when it determines that there is a market need and it has the capacity to supervise additional CA SBLCs. It may do this by issuing a *Federal Register* notice announcing an application period. The SBA stated that this will enable it to respond to market conditions and its oversight capacity while providing public notice.⁵³

Pursuant to the final rule, the SBA issued a notice to CA pilot lenders on May 1, 2023, notifying them that the SBA would automatically begin the process to transition them to CA SBLCs. The SBA sent CA pilot lenders a form to complete and return to the agency to complete the transition. The SBA sunset the CA pilot on September 30, 2023;⁵⁴ any CA lenders that did not complete the transition to be CA SBLCs by that date cannot continue to make 7(a) loans.⁵⁵

Removal of the Requirement for a Loan Authorization

Under previous regulations, a loan authorization was “the written agreement between the SBA and the Lender providing the terms and conditions under which SBA will guarantee a business loan.”⁵⁶ Loan authorization was typically the last step in approving a 7(a) or 504 loan, and the written document included all relevant information about the loan, including loan conditions, lender fees payable to the SBA, use of proceeds, loan collateral, guarantees, and additional information. Loan authorization information was collected from data entered elsewhere in the SBA’s loan systems and loan applications.

The SBA’s final rule removed the requirement that a lender receive an SBA loan authorization document prior to disbursing a loan. In the proposed rule, the SBA stated that lenders said the previous loan authorization process was “cumbersome, outdated, and duplicative” of information entered elsewhere.⁵⁷ The agency decided to remove the loan authorization requirement to reduce administrative burdens on lenders.

In the final rule, the SBA stated that it received 80 public comments regarding the proposal to remove the requirement for a loan authorization. Summarizing those comments, the agency said

The comments were nearly universally opposed to removing the word Authorization, with three comments supporting the proposal and the rest opposing the proposal or requesting

⁵¹ SBA, “Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization,” 87 *Federal Register* 66963, November 7, 2022.

⁵² SBA, “Community Advantage Small Business Lending Company Conversion,” SBA Information Notice 5000-846918, May 1, 2023.

⁵³ SBA, “Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization,” 87 *Federal Register* 66963, November 7, 2022.

⁵⁴ SBA, “Community Advantage Pilot Program,” 88 *Federal Register* 69003, October 5, 2023.

⁵⁵ SBA, “Community Advantage Small Business Lending Company Conversion,” SBA Information Notice 5000-846918, May 1, 2023.

⁵⁶ SBA, “Lender and Development Company Loan Programs,” SOP 50 10 6, October 1, 2020, p. 433.

⁵⁷ SBA, “Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization,” 87 *Federal Register* 66963, November 7, 2022.

modifications. Most comments that opposed the proposal expressed the concern that the Authorization is the document that clearly defines the agreement between the lender and SBA for each transaction and is beneficial in communicating requirements to the borrower, lenders, and SBA. Other comments stated the Authorization serves as a reference document for the life of the loan. Some comments stated borrowers will not know the terms they are agreeing to without an Authorization. Several comments stated that lenders rely on the Authorization as a template or checklist to ensure the lender's compliance with Loan Program Requirements, with one comment stating the Authorization is the gold standard for commercial lending. Several comments stated the Authorization is a roadmap for all closing processes and should not be eliminated without a cohesive and comprehensive replacement. Many comments suggested that if SBA eliminates the Authorization, SBA should develop an alternative document that serves the same purpose but is easier to use.⁵⁸

Affiliation and Lending Criteria

On April 10, 2023, the SBA finalized a rule (88 *Federal Register* 21074; effective May 11, 2023) that made several changes to the affiliation and lending criteria it uses in its business loan programs.⁵⁹ The final rule allows proceeds from a 7(a) loan to be used for a partial change in business ownership; changes underwriting standards for certain 7(a) loans; modifies the borrower affiliation standards used to determine a business's size; and changes the SBA Administrator's powers related to certain loan action reconsiderations. The SBA issued the corresponding proposed rule on October 26, 2022 (87 *Federal Register* 64724).⁶⁰

Partial Changes of Ownership

The final rule allows the proceeds of a 7(a) loan to be used to finance a partial change in ownership. This change allows a borrower to purchase a portion of a business, or a portion of an individual owner's interest in a business. The SBA stated that it identified a credit gap for financing partial changes in ownership, wherein an existing owner or owners can stay on at a business to assist with ownership and management transition. The agency has stated that this problem is particularly acute now due to the "mass retirement of Baby Boomers" and the expected number of businesses that will need to transfer ownership.⁶¹

⁵⁸ SBA, "Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization," 88 *Federal Register* 21890, April 12, 2023.

⁵⁹ SBA, "Affiliation and Lending Criteria for the SBA Business Loan Programs," 88 *Federal Register* 21074, April 10, 2023, <https://www.federalregister.gov/documents/2023/04/10/2023-07173/affiliation-and-lending-criteria-for-the-sba-business-loan-programs>

⁶⁰ SBA, "Affiliation and Lending Criteria for the SBA Business Loan Programs," 87 *Federal Register* 64734, October 26, 2022, <https://www.federalregister.gov/documents/2022/10/26/2022-23167/affiliation-and-lending-criteria-for-the-sba-business-loan-programs>.

SBA also issued a typographical correction to the final rule on April 21, 2023. SBA, "Affiliation and Lending Criteria for the SBA Business Loan Programs; Correction," 88 *Federal Register* 24474, April 21, 2023, <https://www.federalregister.gov/documents/2023/04/21/2023-08396/affiliation-and-lending-criteria-for-the-sba-business-loan-programs-correction>.

⁶¹ SBA, "Affiliation and Lending Criteria for the SBA Business Loan Programs," 87 *Federal Register* 64734, October 26, 2022.

Previously, the proceeds of a 7(a) loan could only be used for three types of ownership changes:

- a complete change in ownership wherein the new owners previously had no interest in a business and acquired 100% of the business;
- a partial change in ownership, wherein existing owners purchased the entire stake of one owner, who was not involved in ownership or management of the business after the transaction; and
- an Employee Stock Ownership Plan (ESOP) purchasing a controlling interest (51% or more) of a business.

The SBA explained the regulation change as an attempt to assist ESOPs and provide a path to ownership for employees. Describing the past several fiscal years, the SBA stated that

Over the past 4 completed fiscal years (FY 2018 through FY 2021), SBA approved 31,940 7(a) loans where loan proceeds were used to affect a change of ownership. ESOP loans (loans to assist an ESOP trust in acquiring 51 percent or more of the equity ownership in the small business concern) accounted for only 17 of the 31,940 loans used for a change of ownership in the four years between FY 2018 and FY 2021, or fewer than five loans per year. Therefore, ESOP loans have not made the anticipated impact in transitioning small businesses to employee ownership as originally intended by the Agency. For these reasons, SBA is moving forward with lifting the prohibition on partial changes of ownership.⁶²

Congress has shown interest in allowing the SBA to finance ESOP purchases. The John S. McCain National Defense Authorization Act for Fiscal Year 2019 (FY2019 NDAA, P.L. 115-232) included provisions related to promoting ESOPs through the SBA's programs.⁶³ Those provisions included allowing 7(a) loan proceeds to be used to finance the purchase of 51% or more of a business by an ESOP (the only allowable partial ownership transaction at that time), and allowing a borrower to use loan proceeds to finance certain transaction costs.

The FY2019 NDAA also authorized the SBA Administrator to waive certain general requirements for ESOP loans. Those requirements included securing personal guarantees from borrowers and requiring a 10% equity injection when an SBA loan was used to finance a change in ownership. The SBA had not previously implemented those authorities, and the final rule did not mention them. However, the SBA implemented those waivers in its revision to the business loan program's standard operating procedures after the rules were finalized.⁶⁴

Changes to Underwriting Standards

The SBA's final rule made several changes to business loan underwriting standards, including broad changes to lending criteria and modifications to requirements for hazard insurance for certain types of loans. These changes affect 7(a) and 504 loans.

⁶² SBA, "Affiliation and Lending Criteria for the SBA Business Loan Programs," 88 *Federal Register* 21074, April 10, 2023.

⁶³ The provisions in P.L. 115-232 were similar to those in H.R. 5236 of the 115th Congress, the Main Street Employee Ownership Act of 2018, which passed the House but did not receive significant action in the Senate. The related provisions in P.L. 115-232 are sometimes referred to as the Main Street Employee Ownership Act.

⁶⁴ SBA, "Lender and Development Company Loan Programs," SOP 50 10 7, August 1, 2023.

The final rule maintains the requirement that applicants be creditworthy, but changes the business loan lending criteria used to evaluate creditworthiness. Under previous regulations, the SBA considered eight factors:

- the character, reputation, and credit history of the applicant;
- experience and depth of management;
- strength of the business;
- past earnings, projected cash flow, and future prospects;
- ability to repay the loan with business earnings;
- sufficiency of invested equity;
- potential for long-term success; and
- nature and value of collateral.⁶⁵

The new lending criteria require lenders and CDCs (operating in the 504 loan guarantee program) to use “appropriate and prudent generally acceptable commercial credit analysis processes” that they use for their “similarly-sized, non-SBA guaranteed commercial loans.” Lenders, CDCs, and the SBA may use a business credit scoring model (a credit score). Additionally, the final rule mentions three specific factors that lenders, CDCs, and the SBA may consider, as applicable:

- the applicant’s credit score or credit history;
- the applicant’s earnings or cashflow; and
- the applicant’s equity and collateral.⁶⁶

The SBA identified several reasons for making these changes to the lending criteria. The agency stated that the changes aim to simplify underwriting decisions and therefore encourage more lenders to participate in the programs. In the 504 program, the changes may make it easier for CDCs and private lenders to make similar underwriting decisions by allowing CDCs to make their underwriting decisions using the same factors as private lenders. The SBA also stated that the changes, by simplifying underwriting, may encourage lenders to make smaller loans by lowering the up-front application cost.⁶⁷

The changes remove the applicant’s character and reputation from the lending criteria. The SBA stated that it removed this criterion because the “lending industry commonly uses the terms character and credit history interchangeably,” and it is difficult for lenders to define and operationalize a borrower’s reputation.⁶⁸ The agency received public comments on the change. Some commenters were concerned that removing character and reputation from the criteria may not allow lenders to fully consider an applicant’s situation, including past bankruptcies, criminal history, or factors that may mitigate negative marks on a credit report. The SBA replied that the standards in regulation are the minimum standard, and lenders may make their own credit decisions based on their own policies.⁶⁹

⁶⁵ 13 C.F.R. §120.150, prior to changes effective on May 11, 2023.

⁶⁶ SBA, “Affiliation and Lending Criteria for the SBA Business Loan Programs,” 88 *Federal Register* 21074, April 10, 2023.

⁶⁷ SBA, “Affiliation and Lending Criteria for the SBA Business Loan Programs,” 87 *Federal Register* 64734, October 26, 2022.

⁶⁸ *Ibid.*

⁶⁹ SBA, “Affiliation and Lending Criteria for the SBA Business Loan Programs,” 88 *Federal Register* 21074, April 10, 2023.

The SBA removed the requirement that 7(a) and 504 loans of \$500,000 and less obtain hazard insurance on all loan collateral. Prior to the change, the agency required hazard insurance on all loan collateral, regardless of the loan amount, but it determined that the requirement may be burdensome for businesses seeking loans for relatively small amounts.⁷⁰

Borrower Affiliation Rules for Size Standards

The SBA's final rule changed the rules for determining that two or more entities are affiliated for purposes of applying the size standards to determine eligibility. The affiliation standards apply to the 7(a), 504, and Microloan loan programs; the Intermediary Lending Pilot program; the Surety Bond Guarantee program; and Business Disaster Loan programs. Broadly, the final rule removed certain tests from being indicative of affiliation.

Before the regulation changes, affiliation could arise under several factors. The factors considered were⁷¹

- affiliation based on ownership, including control of one entity over another;
- affiliation based on stock options, convertible securities, and agreements to merge;
- affiliation based on management, including control of one entity over another;
- affiliation based on identity of interest between close relatives; and
- affiliation based on franchise and license agreements.

The SBA removed the concept of control of one entity over another as being indicative of affiliation and stated that “the concept of control has proven particularly burdensome for applicants and lenders to understand and implement.”⁷²

The new regulations use an affiliation-based-on-ownership concept. The new affiliation factors are

- affiliation based on ownership, based on the percentage of a business owned; and
- affiliation based on stock options, convertible securities, and agreements to merge.

For affiliation based on ownership, the SBA considers any business that the applicant owns more than 50% of as being affiliated. Any individual or business that owns more than 50% of the applicant is affiliated. If the owning business owns additional businesses, those businesses are also affiliated only if the other businesses operate in the same economic industry (3-digit North American Industry Classification System [NAICS] code, such as “food services and drinking places,” NAICS code 722). If the business does not have any single owner of more than 50% of the business, then the same tests are applied to all owners of 20% or more of the business. In the ownership tests, entities with stock options, convertible securities, and agreements to merge are considered as if they have already exercised their options.

The changes to affiliation standards may be particularly important for businesses that either use a management company or are franchisees. Under previous regulations, common control was

⁷⁰ Ibid.

⁷¹ 13 C.F.R. §121.301, prior to changes on May 11, 2023, and SBA, “Affiliation and Lending Criteria for the SBA Business Loan Programs,” 87 *Federal Register* 64734, October 26, 2022.

⁷² SBA, “Affiliation and Lending Criteria for the SBA Business Loan Programs,” 87 *Federal Register* 64734, October 26, 2022.

indicative of affiliated businesses. This required lenders to carefully evaluate the contractual relationships between a small business and its management company or franchisor, if applicable. For franchises specifically, the SBA published a franchise directory that listed thousands of franchisors and any special considerations (such as collateral restrictions) that lenders must consider when lending to franchisees.⁷³ The agency stated that evaluating the specific contractual control relationships required “understanding and expert consideration of business entity relationships” that are “complex and require judgement calls,” resulting in “inconsistent application” of the concept.⁷⁴

Reconsideration of Loan Application or Modification Denial

In the final rule, the SBA reassigned the authority to rule on applicant or borrower requests for reconsideration of denied loan applications or modification denials. To appeal a denial (unless the denial was based on the size standards), an applicant or borrower must first request a reconsideration from the office that made the decision.

If that office denies a first reconsideration, an applicant or borrower may request an additional reconsideration. Under previous regulations, the director of the Office of Financial Assistance ruled on additional reconsiderations. The final rule’s new regulations allow the director of the Office of Financial Assistance to designate another official to rule on additional reconsiderations. Although the regulations do not specify a designee, the SBA stated that the designees will be the chief of 7(a) loan policy for 7(a) program reconsiderations and the chief of 504 loan policy for 504 program reconsiderations.⁷⁵ The agency stated that this change will allow it to decide on reconsiderations faster. The decision by the director of the Office of Financial Assistance or the director’s designee is final.

The new regulations additionally allow the SBA Administrator, at the Administrator’s sole discretion, to review decisions and issue final decisions. Applicants or borrowers cannot formally appeal to the Administrator. Only the Administrator may choose to review a decision, and there is no obligation for the Administrator to do so.

Congressional Reactions to the New Rules

Congress has expressed significant interest in both SBA final rules. Members from both parties have expressed concerns about the changes, and the small business committees in both chambers have held oversight hearings on the rules. Committee leadership has also sent several official letters to SBA Administrator Isabella Casillas Guzman regarding the rules.⁷⁶

On March 6, 2023, before the SBA finalized the rules, Senate Committee on Small Business and Entrepreneurship then-Chairman Benjamin Cardin and Ranking Member Joni Ernst sent a letter to SBA Administrator Guzman.⁷⁷

⁷³ SBA, “SBA Franchise Directory,” May 11, 2023, <https://www.sba.gov/document/support-sba-franchise-directory>.

⁷⁴ SBA, “Affiliation and Lending Criteria for the SBA Business Loan Programs,” 88 *Federal Register* 21074, April 10, 2023.

⁷⁵ SBA, “Affiliation and Lending Criteria for the SBA Business Loan Programs,” 87 *Federal Register* 64734, October 26, 2022.

⁷⁶ The reactions mentioned and quoted in this section are not comprehensive of all reactions and comments by Members of Congress on the rules.

⁷⁷ Chairman Benjamin Cardin and Ranking Member Joni Ernst, “Letter to the Honorable Isabella Casillas Guzman, SBA Administrator,” March 6, 2023, https://www.ernst.senate.gov/imo/media/doc/cardin_and_ernst_letter_to_sba_re_proposed_rulespdf.pdf.

In the letter, then-Chairman Cardin and Ranking Member Ernst expressed their support for “expanding access to capital for small businesses and reaching underserved borrowers” while expressing concerns about the rules. Specific concerns included that the final rules

- include “broad and sweeping changes that do not reflect congressional input or authorization”;
- change the “current underwriting standards,” which has “the potential to make the program more vulnerable to predatory lending practices”;
- remove from the 7(a) program “prudent lending guardrails” that protected small businesses from “financially burdensome” loans and taxpayers from “the costs of significant loan losses”;
- could “permit large businesses to exploit [SBA business loan] programs that are intended only to serve small businesses”;
- lack “important details for mission-based lending or how [creating CA SBLCs] will impact the Community Advantage program”;
- advance a “strategy aimed at granting more fintech entities access to the 7(a) program without taking into account the risks these types of entities pose to consumer protection or program integrity”; and
- could present oversight challenges for the SBA Office of Credit Risk Management (OCRM), due to the expansion of the number of SBA-supervised lenders (including SBLCs).

On April 20, 2023, House Committee on Small Business Chairman Roger Williams and Vice Chairman Blaine Luetkemeyer, Oversight Subcommittee Chairman Beth Van Duyne, and Economic Growth Subcommittee Chairman Dan Meuser sent a letter to then-SBA Associate Administrator for Capital Access Patrick Kelley. The letter expressed that the “Committee is gravely concerned that the SBA is unable to handle [the expanded responsibility from the proposed rules] given their failures under the COVID lending programs.” In particular, the letter cited and quoted SBA Inspector General Hannibal “Mike” Ware, who expressed concerns about program integrity if the 7(a) program is expanded to nondepository lenders (such as fintech companies); the SBA has a significantly expanded loan portfolio; and the SBA allows borrowers to self-certify that they could not access credit elsewhere.⁷⁸

On May 10, 2023, House Committee on Small Business Ranking Member Nydia Velázquez issued a press release on the rule changes. Ranking Member Velázquez expressed that “increasing access to capital for underserved entrepreneurs has been and will remain a priority for me.” She also stated that she was “apprehensive about the SBA’s decision to remove many of the longstanding guardrails and program requirements on loan criteria and affiliation standards that have served the 7(a) program well while also lifting its moratorium on the licensing of new SBLCs.” Going forward, she said that the House Committee on Small Business “must ensure [the rule changes] are responsibly implemented and don’t negatively impact the 7(a) program and individual borrowers.”⁷⁹

⁷⁸ Chairman Roger Williams, Vice Chairman Blaine Luetkemeyer, Subcommittee Chairman Beth Van Duyne, and Subcommittee Chairman Dan Meuser, “Letter to Mr. Patrick Kelley, Associate Administrator for Capital Access,” April 20, 2023, https://smallbusiness.house.gov/uploadedfiles/04.21.2023_-_hsbc_letter_to_sba_re_7a_programs.pdf.

⁷⁹ Ranking Member Nydia M. Velázquez, “Velázquez Conducts Oversight of SBA 7(a) Rule Changes During Committee Hearing,” press release, May 10, 2023, <https://democrats-smallbusiness.house.gov/news/documentsingle.aspx?DocumentID=4572>.

The Senate Committee on Small Business and Entrepreneurship held an oversight hearing on the rule changes on April 26, 2023,⁸⁰ and the House Committee on Small Business held two oversight hearings on the rule changes on May 10 and 17, 2023.⁸¹

After the initial oversight hearings in the House and Senate, Associate Administrator for Capital Access Patrick Kelley left the SBA on May 12, 2023. Kelley led the Office of Capital Access, which will be largely responsible for implementing the rule changes. On May 16, 2023, Chairman Cardin, Chairman Williams, Ranking Member Ernst, and Ranking Member Velázquez wrote a letter to SBA Administrator Guzman requesting that the SBA “pause the proposed changes to the lending programs” until a new Associate Administrator for Capital Access is appointed.⁸² The Members said that Kelley’s “unexpected departure” left “a void in the leadership.” The Members also said that the House and Senate small business committee oversight hearings raised “legitimate bipartisan concerns” over “the effects that these new rules could have on the integrity of SBA’s loan programs.” In addition, the Members raised concerns about late or missing guidance to lenders on how to implement the new regulations, and that the vacancy of the Associate Administrator for Capital Access may slow responses to implementation inquiries from stakeholders and congressional oversight.

On July 19, 2023, the Senate Committee on Small Business and Entrepreneurship held a business meeting to mark up several bills. Legislation to address the SBA’s business loan program rules was included in the package of 11 bills that the committee advanced favorably by a vote of 18-1. The bill became S. 2482, and is summarized below.

On the House side, Representative Aaron Bean offered an amendment (H.Amdt. 672) to the FY2024 Financial Services and General Government appropriations bill (H.R. 4664) that would have prevented the SBA from using any funds to “implement, administer, or enforce” the CA SBLC program. The amendment failed by a vote of 205-220.⁸³

Summary of S. 2482

The Community Advantage Program Act of 2023 (S. 2482) is partially in response to the SBA’s final rules. The Senate Committee on Small Business and Entrepreneurship reported the bill on July 25, 2023. The bill was placed on the Senate legislative calendar under general orders. The Senate may or may not take further action on the bill before the end of the 118th Congress. This section provides a section-by-section summary of S. 2482 as reported.

⁸⁰ U.S. Senate, Committee on Small Business and Entrepreneurship, “Oversight of SBA’s Implementation of Final Rules to Expand Access to Capital,” April 26, 2023, <https://www.sbc.senate.gov/public/index.cfm/hearings?ID=279CE4E4-5086-41B8-A5A2-C3391C626D07>.

⁸¹ U.S. House of Representatives, Committee on Small Business, “Taking on More Risk: Examining the SBA’s Changes to the 7(a) Lending Program Part I,” May 10, 2023, <https://smallbusiness.house.gov/calendar/eventsingle.aspx?EventID=405517>, and Committee on Small Business, “Taking on More Risk: Examining the SBA’s Changes to the 7(a) Lending Program Part II,” May 17, 2023, <https://smallbusiness.house.gov/calendar/eventsingle.aspx?EventID=405517>.

⁸² Chairman Benjamin Cardin, Chairman Roger Williams, Ranking Member Joni Ernst, and Ranking Member Nydia Velázquez, “Letter to the Honorable Isabella Casillas Guzman, SBA Administrator,” May 16, 2023, https://smallbusiness.house.gov/uploadedfiles/05.16.2023_-_four_corners_letter_to_sba_re_oca.pdf.

⁸³ U.S. House of Representatives, Office of the Clerk, “Roll Call 631 | Bill Number: H.R. 4664,” November 8, 2023, <https://clerk.house.gov/Votes/2023631>.

Community Advantage Program Act

Title I of the bill would provide permanent statutory authorization to the CA pilot through the Community Advantage Loan Program (CA program).

Section 101: Community Advantage Loan Program (CA program)

Section 101 would provide permanent statutory authorization for the CA program, broadly modeled on the CA pilot. Within the CA program, most lenders certified to participate would be able to make 7(a) loans of up to \$350,000 with higher SBA guarantee rates than similarly sized standard 7(a) loans. CA program lenders would be required to lend to underserved markets and to maintain a loan loss reserve.

This section would require CA program lenders to meet both organization and experience rules to participate. It would require a CA program lender to be (1) a nonprofit CDC participating in the 504 program; (2) a nonprofit Microloan Intermediary; (3) a Community Development Financial Institution (CDFI); or (4) an intermediary participating in the Intermediary Lending Program. The section would also require CA program lenders to demonstrate that they have approved, disbursed, and serviced at least 10 similarly sized loans to small businesses in the preceding 24-month period. However, any lender that participated in the CA pilot and was in good standing on the day before enactment would be automatically transferred to the CA program.

Section 101 would require CA program lenders to make at least 60% of their loans to small businesses in underserved markets. For the CA program, the section would define a small business in an underserved market as

- a small business located in a low- to moderate-income community, a HUBZone, or a rural area;
- a small business with more than 50% of its employees residing in a low- to moderate-income community;
- a new small business that has been in business for two or fewer years;
- a small business owned and controlled by economically disadvantaged individuals, who are members of an identifiable group of individuals who lack adequate access to credit on reasonable terms. The SBA shall conduct an evidence- and literature-based analysis to identify groups of economically disadvantaged individuals, and lenders may petition to add groups of economically disadvantaged individuals; or
- a small business that is owned and controlled by veterans or spouses of veterans.

Loans made by CA program lenders would have special terms compared with standard 7(a) loans. For most lenders, the maximum CA program loan amount would be \$350,000, as it was in the CA pilot, which is lower than the current maximum 7(a) loan of \$5 million. CA program loans would be eligible for a higher loan guarantee than standard 7(a) loans: 90% for CA program loans of \$150,000 or less and 80% for CA program loans greater than \$150,000 and less than \$350,000. Section 101 would limit interest on CA program loans to the rates on similar standard 7(a) loans. For CA program loans, the section would permit lenders to use the same collateral requirement policies that they use for comparable non-SBA-guaranteed business loans. The section would not require lenders to take collateral for CA program loans of \$50,000 or less.

Section 101 would allow the SBA to designate up to eight CA program lenders that had participated in CA pilot for at least five years as “experienced lenders.” The section would allow experienced lenders to make CA program loans of up to \$750,000. However, any CA program

loan of more than \$350,000 would have an SBA guarantee of 75%, the same guarantee rate as in the general 7(a) program. Additionally, the section would require at least 60% of an experienced lender's loans to be of \$350,000 or less.

Section 101 would require CA program lenders to maintain loan loss reserve accounts, as the SBA required of CA pilot lenders. The SBA would calculate the amount it would require each CA program lender to hold in its loan loss reserve based upon the lender's tenure and previous performance in the program, its outstanding lending, and its participation in the secondary market.

Furthermore, Section 101 would require the SBA to conduct certain training and outreach to current and prospective CA program lenders. The section would require the SBA to provide ongoing training to educate CA program lenders on program requirements and guidance to support mission-based lending. It would also require the SBA to train its employees who regularly engage with CA program lenders and borrowers, and to conduct outreach to prospective CA program lenders to promote the program and educate prospective lenders.

Section 101 would also create several CA program-related reporting requirements for the SBA and GAO. The section would require the SBA to publish public weekly lending reports for the CA program that would include information about the characteristics of small business borrowers and loan sizes. It would also require the agency to provide an annual report on the CA program to the congressional small business committees and to make that report available to the public. The section would require the annual report to include information about the previous fiscal year's CA program lending, including demographic information on borrowers, the ages of participating businesses, and businesses' locations in urban or rural areas. The section would also require the annual report to include information comparing CA program loans with standard 7(a) loans, a breakdown of CA program loans by dollar amount, state-by-state data on lending and jobs created or retained, and the contact information of all approved CA program lenders. GAO would have five years to study the CA program and report on how well the program is meeting its purposes, the performance of CA program lenders, and recommendations for improving the program.

Modernizing SBA's Business Loan Programs Act of 2023

Title II of S. 2482 addresses some of the SBA's recent changes to its business lending programs, especially the 7(a) and 504 programs.

Section 201 provides the short title for Title II: the Modernizing SBA's Business Loans Programs Act of 2023.

Section 202 provides congressional findings related to the OCRM, SBLCs, and the CA pilot.

Section 203: Lending Criteria

Section 203 would codify underwriting requirements and lending criteria for the 7(a) and 504 programs. For both programs, and for loans of all sizes, the section would require all borrowers to be creditworthy and all loans to be so sound as to reasonably assure repayment.

Lending criteria for 7(a) loans differ by the amount of the loan. For 7(a) loans of less than \$350,000, Section 203 would largely codify the revised lending criteria issued in the SBA's final rule. It would require lenders to use credit analysis policies similar to those of comparable non-SBA-guaranteed loans. It would allow lenders to use a business credit scoring model, and would require them to consider an applicant's credit score and history, its earnings and cash flow, and its equity and collateral, as well as the effects of the applicant's affiliates.

For 7(a) loans of \$350,000 and more, Section 203 would largely retain the lending criteria from the previous regulations. The lending criteria for these 7(a) loans would consider

- the applicant’s credit history;
- the applicant’s experience and depth of management;
- the applicant’s business strength;
- the applicant’s past earnings, projected cash flow, and future prospects;
- the applicant’s ability to repay the loan with business earnings;
- whether the applicant has sufficient invested equity;
- the applicant’s potential for long-term success;
- the nature and value of the applicant’s collateral; and
- the effect of the applicant’s affiliates.

The section would also codify a provision allowing a 7(a) lender to consider an applicant’s “character and reputation” if the lender chooses to do so, and would prohibit the SBA Administrator from requiring a 7(a) lender to consider the applicant’s character and reputation as part of loan underwriting. The SBA defines “good character” as including a person’s “integrity, candor, and criminal history, if any.”⁸⁴

For 504 loans of all sizes, Section 203 would largely codify the revised lending criteria from the SBA rule. It would continue to require lenders and CDCs to use credit analysis policies similar to those of comparable non-SBA-guaranteed loans when evaluating 504 loans. It would also continue to allow lenders and CDCs to use a business credit scoring model, and require them to consider an applicant’s credit score and history, its earnings and cash flow, and its equity and collateral, as well as the effect of the applicant’s affiliates.

Section 204: Affiliation and Franchise Directory

For 7(a) loans, Section 204 would largely codify the several factors that determined affiliation before the final rule’s regulatory changes. The factors considered were

- affiliation based on ownership, including control of one entity over another;
- affiliation based on stock options, convertible securities, and agreements to merge;
- affiliation based on management, including control of one entity over another;
- affiliation based on identity of interest between close relatives; and
- affiliation based on franchise and license agreements.

For 504 loans, this section would largely codify the revised affiliation standards, as they were finalized by the SBA.

This section would also require the SBA to publish and maintain a franchise directory that lenders may use in determining if a franchisee is eligible for SBA business loan programs. A franchise directory published to meet this requirement would likely be similar to the existing SBA franchise directory.⁸⁵

⁸⁴ SBA, “SBA 7(a) Borrower Information Form,” Form 1919, https://www.sba.gov/sites/sbagov/files/2022-06/Form%201919_10-21-2020-rev%20508%20r2_0.pdf, p.11.

⁸⁵ SBA, “SBA Franchise Directory,” May 11, 2023, <https://www.sba.gov/document/support-sba-franchise-directory>.

Section 205: Loan Authorization

Section 205 would codify a requirement for a loan authorization for both the 7(a) and 504 programs. A loan authorization would be “a written agreement providing the terms and conditions” of a loan and its guarantee.

Section 206: Oversight of Small Business Lending Companies

Section 206 would amend the definition of an SBLC to specify that an SBLC is a for-profit entity that is authorized by the SBA solely to make 7(a) loans.

This section would limit the number of SBLC licenses to 17 and allow the SBA to approve the transfer or sale of SBLC licenses between businesses. All CA SBLCs would lose their authorizations as SBLCs on the date of enactment, but would be automatically designated as CA program lenders under the permanent CA program created by Section 101.

This section would also give the OCRM new responsibilities and authorities related to SBLCs:

- it would give the OCRM authority to revoke an SBLC license for certain reasons related to failure to comply with program requirements, excessive losses, or predatory lending;
- it would require the OCRM to conduct an annual stress test of each SBLC’s portfolio, including a “severely adverse” scenario and considering interest rate risk; and
- it would also require SBLCs to comply with Bank Secrecy Act, Know Your Customer, and Anti-Money Laundering requirements,⁸⁶ and require the OCRM to annually review SBLC compliance with these laws.

Section 207: Office of Credit Risk Management

Section 207 would reorganize the SBA to require the director of OCRM to report directly to the SBA Administrator, thereby removing OCRM from the Office of Capital Access.

This section would also require the OCRM to include in its annual report to Congress about 7(a) portfolio risk

- the number of 7(a) lenders with an early default rate (when a 7(a) loan defaults within 18 months of the initial disbursement) of more than 3%; and
- an analysis of the median and average credit scores of borrowers relating to early defaults, loan guarantee purchases, and charge offs.

Section 208: Denied Loan or Loan Modification Request

Section 208 would largely revert the procedures for reconsideration of 7(a) and 504 loan decisions back to those that were in place before the final rule’s revisions. This section would codify that only the director of the Office of Financial Assistance may make the SBA’s final decision regarding a reconsideration request, and that the SBA Administrator may not intervene or make a final decision in a reconsideration request.

⁸⁶ For an overview of these policies broadly, see CRS In Focus IF11064, *U.S. Efforts to Combat Money Laundering, Terrorist Financing, and Other Illicit Financial Threats: An Overview*, by Rena S. Miller and Liana W. Rosen.

Section 209: Direct Lending

Section 209 would require the SBA to notify Congress at least 60 days before implementing any program or pilot program to make direct loans under 7(a) to small businesses.

Section 210: Restriction on Refinancing Debt

Section 210 would prevent any 7(a) lender from using delegated authority to approve a 7(a) loan that would refinance any debt held by that lender. In delegated authority programs, such as the Preferred Lenders Program (PLP) and SBA Express, lenders receive permission from the SBA to process, evaluate, and approve a 7(a) loan on the agency's behalf. For standard processing loans, the lender receives and assembles the borrower's application, while the SBA evaluates and approves the loan. This section would still allow borrowers to use 7(a) loans to refinance certain debt, but it would require lenders to submit those loans to the SBA for final credit decisions. Under existing program rules, a borrower may not use proceeds from a 7(a) loan to repay or refinance any creditor (not limited to the SBA lender processing the application) who is set to sustain a loss.⁸⁷

Section 211: GAO Studies

Section 211 would require three GAO studies due to Congress within two years of enactment:

- an analysis of using alternative credit models for 7(a) loans of less than \$350,000, focusing on methods to prevent waste, fraud, and abuse and the effectiveness of alternative credit models to reduce barriers to accessing capital for underserved and rural communities;
- an audit of OCRM operations, staffing, and resources, including its activities to implement SBLC oversight required in the bill; and
- a survey of 7(a) lender practices related to their use of applicants' criminal histories in underwriting their own, non-SBA guaranteed commercial loans.

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⁸⁷ 13 C.F.R. §120.201.

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