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December 27, 2022

Dianna Seaborn
Director, Office of Financial Assistance, Office of Capital Access
Small Business Administration
409 3rd Street, SW
Washington, DC 20416

RE: Affiliation and Lending Criteria for the SBA Business Loan Programs (RIN 3245-AH87)

Dear Ms. Seaborn:

Thank you for the opportunity to provide feedback on the Small Business Administration's (SBA) proposed changes to the 7(a), 504 and related Loan Programs. The signatories to this letter, which include community development credit unions across the country, appreciate SBA's willingness to update the 7(a) Loan Program requirements and urge the agency to begin a more comprehensive update process to make the 7(a) Loan Program more accessible to and responsive to the needs of very small businesses and the small community development credit unions that serve them. Of the proposed changes, some will effectively support the SBA's goal of updating the Loan Programs to adapt to changing technological and economic conditions. Others may have unintended consequences, like facilitating the participation of high-cost or predatory lenders in the Loan Programs.

<u>About Inclusiv</u>

Inclusiv is the national association of CDFI and MDI credit unions with a network of close to 500 members in 48 states, DC and Puerto Rico. These grassroots community development credit unions (CDCUs) are financial cooperatives owned and controlled by their members with a mission of financial inclusion and equitable economic growth. Inclusiv is the certified CDFI intermediary for CDFI and MDI credit unions, and as such we raise and deploy capital and provide technical and program support to increase the capacity of CDCUs to serve low-income people and communities.

<u>SBA Loan Programs Must Meet the Needs of Small Businesses and the Community Development Lenders that Serve Them</u>

Community development credit unions that participate in SBA's 7(a) and 7(a) Express Loan Programs have long reported that the Programs do not meet the needs of the very small businesses they serve and that the Program process is slow and creates significant administrative burden. The delays in approval and the administrative burden of participating in the program discourage both small businesses and under-resourced lenders from participating.

The devasting effects of the COVID-19 pandemic on small businesses have made it more important than ever that the SBA address these problems and ensure its Loan Programs reach very small businesses, especially those owned by people of color. During the pandemic Black businesses suffered an initial closure rate of 40% and Latino businesses, 37%, compared to 17% for white-owned businesses. To begin to remedy these disparities, the SBA must focus on reaching sole proprietors (90% of all Black-owned businesses are sole proprietorships) and other very small business that are typically served by community development credit unions that are able and willing to support small business as they incorporate and begin to grow.

If SBA seeks to increase participation in the Loan Programs, a few key changes would incentivize participation by smaller, less-resourced lenders that focus on serving sole proprietors, ITIN holders, and other small business owners who are excluded from the mainstream financial system.

- Allow CDFI credit unions, which are CDFI-certified, not-for-profit financial cooperatives, to participate in the Community Advantage Program. Limiting the Program to non-depository CDFIs unduly limits the reach of the Program and excludes hundreds of institutions with deep connections in low-income communities, immigrant communities and communities of color from offering this well-designed product to their members.
- Increase the guarantee offered in the 7(a) Express Loan Program from 50% to 85% for loans of $150,000 or less to incentivize more lenders to use the program and increase access to capital for the smallest businesses that would otherwise struggle to secure responsible financing.
- The SBA should also offer more certainty to lenders regarding the 7(a) Express guarantees as too often SBA denies guarantees for loans that lenders believe meet the 7(a) Express criteria. Indeed, NCUA examiners have recommended that credit unions reserve against 7(a) Express loans as though the loans are not guaranteed at all.
- Invest in staffing the 7(a) Loan Program to reduce turnaround time for loans submitted. The current turnaround time of two to three months makes it difficult to offer loans on a timeframe that meet small businesses' needs. Focusing on speeding up guarantee approvals for loans under $150,000 would be a good place to start to increase the participation of very small business in 7(a).
- Remove collateral requirements for loans of $150,000 or less to reduce administrative burden.
- Help small lenders build capacity to participate in SBA Loan Programs by providing technical assistance grants for lenders. Lenders that serve very small businesses often do not generate enough interest income from small loans of $25,000 - $150,000 to cover the full cost of administering an SBA-guaranteed small business lending program. This disincentivizes the very lenders SBA should be most focused on supporting from participating in Loan Programs.

<u>SBA Should Ensure its Loan Programs Do Not Facilitate Predatory and High-Cost Business Lending</u>
The SBA recently opened the 7(a) Loan Program to unregulated fintech lenders. As new-to-7(a) fintech business lenders with business models focused on speed and volume that serve larger small businesses that are technologically savvy join the program, it is critical the SBA monitor loan cost and quality to ensure its guarantee funds are not being used to facilitate high-cost or predatory lending.

The SBA should be cautious about partnering with fintech small business lenders as they were responsible for originating many fraudulent PPP loans and some engage in predatory business lending. Fintechs appear to be responsible for a meaningful proportion of fraudulent PPP loans and many fintech

PPP lenders did not have basic fraud-protection safeguards in place.[1] One fintech business lender, OnDeck, offers loans with an average interest rate of 49%.[2]

To better support small businesses' access to affordable credit, the SBA should consider the lessons learned from PPP. Community development credit unions not only reached small business owned by people of color more effectively than other lenders, they also made much smaller than average PPP loans, demonstrating they reached businesses other lenders considered too small to bother with. Instead of smoothing the way for fintechs, the SBA should invest in building the capacity of community-based lenders and small business owners. The SBA should provide technical assistance grants to small, community-based lenders that make loans of $150,000 or less, like CDCUs to help them manage SBA Loan Programs so that they can reach more underserved borrowers efficiently. In addition, the SBA should fully staff its local offices and invest in providing training to small business owners to help them become loan-ready.

The SBA's Proposed Changes Will Support Worker Ownership

Now that many baby boomers are retiring and selling their businesses, opportunities for employees to become owners of the businesses at which they work are growing. The SBA's proposed changes to allow 7(a) loan proceeds to finance partial changes in ownership will facilitate employee ownership via ESOPs and the SBA should ensure that the Loan Program criteria support conversions to worker cooperatives as well. Although this change will not affect the majority of SBA lenders, it is an important step forward in supporting employee ownership and wealth building opportunities.

The Proposed Changes to Lending Criteria Are Positive but May Inadvertently Facilitate Predatory Business Lending

The SBA's proposal to allow additional flexibility in permissible commercial credit analysis and business credit scoring models is a positive change that should encourage more lenders to participate in the Loan Programs. As noted above, it is important for the SBA to be cautious about unregulated, non-mission-driven lenders' use of this new flexibility in permissible underwriting practices and to monitor loan quality carefully.

Making Hazard Insurance Optional Increases Risk for the Lender and Borrower

Small businesses tend to be underinsured, so the proposal to make hazard insurance optional for loans of $150,000 or less will increase risk for lenders, borrowers and the SBA. Indeed, most lenders will continue to require hazard insurance even without the SBA requirement.

Reconsideration After Denial

The SBA's proposal to allow the Director of the Office of Financial Assistance of their designee to reconsider denials of loan applications or loan modification requests will help expedite such decisions and allow the SBA to better serve lenders and their small business borrowers.

[1] https://www.npr.org/2022/12/06/1140823783/a-congressional-report-says-financial-technology-companies-fueled-rampant-ppp-fr
[2] https://www.bloomberg.com/graphics/2021-payday-loan-lenders/?leadSource=uverify%20wall

Thank you for the opportunity to comment on these vital Loan Programs. If you have any questions about this comment letter, please contact Alexis Iwanisziw, Senior Vice President of Policy and Communications, at aiwanisziw@inclusiv.org.

Sincerely,

Brooklyn Cooperative Federal Credit Union
Genesee Co-Op Federal Credit Union
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Lower East Side People’s Federal Credit Union
Neighborhood Trust Federal Credit Union
River City Federal Credit Union