

**IMPROVING ACCESS TO CAPITAL IN UNDER-  
SERVED COMMUNITIES: THE COMMUNITY AD-  
VANTAGE PROGRAM, MICROLOANS, AND  
OTHER SBA INITIATIVES**

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**HEARING**  
BEFORE THE  
**COMMITTEE ON SMALL BUSINESS  
AND ENTREPRENEURSHIP**  
OF THE  
**UNITED STATES SENATE**  
ONE HUNDRED SEVENTEENTH CONGRESS  
SECOND SESSION

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COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP  
ONE HUNDRED SEVENTEENTH CONGRESS

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**WEDNESDAY, DECEMBER 14, 2022**

UNITED STATES SENATE,  
COMMITTEE ON SMALL BUSINESS  
AND ENTREPRENEURSHIP,  
*Washington, DC.*

The Committee met, pursuant to notice, at 2:28 p.m., in Room 428A, Russell Senate Office Building, Hon. Ben Cardin, Chairman of the Committee, presiding.

Present: Senators Cardin, Booker, Hirono, Rosen, Ernst, Young, Hawley, and Marshall.

**OPENING STATEMENT OF CHAIRMAN CARDIN**

Chairman CARDIN. The Small Business Committee will come to order.

I just wanted to acknowledge first this will be our last hearing of the 117th Congress, and I just really want to take this opportunity to thank the dedicated staff, both the Majority and the Republican staff, on this Committee for the work that they have done. This Committee, particularly during COVID-19 but as a legacy of COVID-19, handled a lot of responsibilities. Its portfolio increased dramatically, and it has one of the smallest staffs of any of the standing committees in the United States Senate. And I just really want to thank them for their dedication and work and the cooperation that we have received from the Majority and Minority staffs working together to get many major bills to the finish line.

I am reminded that the SBIR/STTR programs were not an easy assignment. We have half a dozen bills that have made their way through our Committee and are going to make their way to the President for signature. This has been a very productive Congress for the Small Business and Entrepreneurship Committee, and I just really want to thank my members as well as our dedicated staff.

We are continuing today with a very distinguished panel of witnesses, and I am really pleased that Senator Marshall is stepping in to be the Ranking Member for today's hearing. He has been a loyal member of this Committee, very actively engaged during the 117th Congress. So, Senator Marshall, wonderful to have you here today.

Today, the Senate Small Business and Entrepreneurship Committee will consider a hearing on “Improving Access to Capital in Underserved Communities.” Access to capital is the lifeblood of any business but is especially critical to small businesses. For too long, underserved and underbanked businesses have not had equal access to these resources. It is an enduring problem.

While large banks approve 60 percent of the loans sought by White small business owners, minority small businesses have a lower rate of approval. Banks approved just 50 percent of loans sought by the Hispanic small business owners and 29 percent of those sought by Black owners. Inequities like these were made worse during the pandemic, making it significantly more difficult for minority businesses to absorb financial shocks.

According to a study by the Federal Reserve Bank of New York, about 58 percent of Black-owned businesses were at risk of financial distress prior to the pandemic as compared to 27 percent of White-owned businesses. This is why leveling the playing field and improving access to capital for underserved communities is a top priority and why I am constantly looking for ways to improve the Small Business Administration’s lending program.

As many of you know, the 7(a) loan guarantee program is SBA’s flagship lending program. Last year, SBA approved over 47,000 7(a) loans totaling over \$25 billion. This is an enormous amount of capital going to so many borrowers who would otherwise be unable to access capital elsewhere.

However, of those 7(a) loans, only 4 percent went to Black business owners and 15 percent to women business owners. Though this is better than it has been in past years, we must do, and should do, much better. That is why I am a proud supporter of the Community Advantage program.

Community Advantage was created in 2011 to address the credit gap in underserved markets. The program allows mission oriented, nonprofit lenders to make 7(a) loans up to \$350,000 focusing on economic development for underbanked small business owners. Compared to the regular 7(a), Black business owners received 20 percent of the Community Advantage loans and women owned businesses, 32 percent.

Although a smaller, more targeted program, the Community Advantage program clearly does an excellent job of addressing the credit gap and is a key tool to our mission to improve access to capital for underserved small business owners and entrepreneurs.

I have introduced legislation to make the Community Advantage program permanent. This will provide stability to enable more lenders to enter the program and ultimately reach more entrepreneurs and small businesses in their communities. I am hopeful that it will become a permanent SBA program in the next Congress.

The Microloan program is another SBA initiative that reaches various demographic groups that would otherwise not be served by the private sector or even by the SBA’s own 7(a) program, playing an important role in providing credit to the smallest, underbanked small business owners and entrepreneurs.

In fiscal year 2022, 45 percent of all Microloans went to women-owned businesses, 14 percent to Hispanic-owned businesses, and 35

percent to Black-owned businesses. Microloan borrowers generally have the most difficult time accessing capital elsewhere. Less than one-third report that they would have been able to find acceptable financing from other sources.

These lending programs are critical in addressing the existing credit gap for minority and women small business owners in particular. I look forward to hearing from our witnesses about how we can improve these programs and adopt innovative solutions to provide access to capital to those currently left out of the system.

This hearing will also explore two recent rule changes proposed by the SBA. According to the SBA, the purpose of these two changes is to bring more lenders into the market, creating more opportunities for small-dollar loans and reaching more underserved communities. It is clear that lenders must do more to reach the underserved small businesses. We saw too often with the PPP that these small businesses did not have the same financial connections and resources as larger ones did, and they were excluded from the critical relief or had to wait a longer time in order to get their help.

It is important that we recognize these inequities in our capital access programs and in the small business ecosystem more broadly and, even more importantly, that we work to address them. I support the SBA's efforts in their work to level the playing field for small business owners and entrepreneurs.

I understand that there are many concerns about these proposed changes, and while I fully support the objectives and the goals in mind, I share some of these concerns. We need to ensure that we address these inequities and better serve small business owners without undermining important guardrails. Guardrails are essential. They protect borrowers, the lenders, and the integrity of the programs.

We also need to think through these proposed changes and ensure that they will actually increase small-dollar loans and address the credit gap without unintended consequences or harm to small business owners we aim to help. The public comment period on the proposed changes is now open, and I encourage everyone with questions or concerns to make their voices heard.

I wholeheartedly agree with the SBA that we must do better in reaching our underserved entrepreneurs. However, I also feel strongly that we must go about this in a transparent and informed way, and I welcome discussion about the impact of these changes. I look forward to working with the SBA, the lenders, underserved entrepreneurs, and the small business community, and other stakeholders on this issue.

I want to thank our witnesses for being here today, and I look forward to their testimony. But first, if I might, I am going to yield to the Ranking Republican Member, Senator Marshall.

#### **OPENING STATEMENT OF SENATOR MARSHALL**

Senator MARSHALL. Well, thank you, Mr. Chairman, and let me also add my thanks to Ranking Member Paul for giving me the honor of sitting in this chair. And let me add my thanks, along with yours, to the Committee staff as we close out the Congress for all their hard work and let me add also my thanks to the witnesses

for coming today, taking time out of your day to get here and share your wisdom.

It is an honor to serve as Ranking Member for today's important hearing as we examine how the Small Business Administration can best serve small businesses' capital needs, especially for borrowers in underserved communities.

Access to capital is always a top issue facing Kansas small business owners and businesses throughout the country. After hosting several roundtable discussions with minority-owned Kansas businesses, it is clear that our entrepreneurs have solid business ideas and plans to grow but often lack the resources or connections they need to get a business off the ground.

I frequently hear concerns that the SBA's lending programs are cumbersome for our community lenders and are filled with bureaucratic red tape for the borrowers, who often give up very early in the process. Due to the high-risk status of any new venture and this lengthy application, many banks have decided to stay on the sidelines. Indeed, entrepreneurs need streamlined access to capital so they can focus more on their businesses and not paperwork.

But some things must be working as SBA approved a blockbuster number of loans in fiscal years 2021 and 2022. According to SBA's data, in fiscal year 2021, the 7(a) loan program administered more than 50,000 loans for more than \$36 billion of which 30 percent of the dollars went to minority owned small businesses. In total, these 2021 numbers represent an increase of \$13 billion from 2019 in approved 7(a) loans. These numbers are promising for the lending programs, but more can be done, and I am committed to finding solutions with my colleagues so we can provide more opportunities to entrepreneurs across the nation. This is exactly what will turn our economy around and provide more high-paying jobs for all Americans.

However, when changing these programs, we cannot forget to maintain strong due diligence standards while still maintaining simplicity. As these programs are government-backed loans, it is essential that prudent lending standards are in place to ensure taxpayers are not footing the bill on risky loans. The 7(a) loan program has generally operated at zero subsidy, meaning the program administers fees to offset any loan losses.

Recently, the SBA announced two proposed rules that would alter the underwriting and standard practices in the 7(a) and 504 programs. One rule would also lift a 40-year moratorium on how many non-Federally regulated lenders the SBA can oversee. While I hope this allows more access to capital, it is concerning to me that the current administration is changing significant lending policies without input from Congress. It is also concerning that the SBA may not be able to adequately provide oversight and examinations of these new SBA lenders through the SBA's Office of Credit Risk Management under these new rules.

Many have seen these rule changes as an opportunity to allow fintech lenders into SBA's traditional lending programs. While it is encouraging to see the SBA is attempting to take steps to diversify its lending pool, it is troubling they are coupling it with loosening program standards.

Fintechs had the opportunity to participate in the Paycheck Protection Program, but recent reports have shown fintech is responsible for a disproportionate amount of PPP fraud compared to more traditional, local lenders like community banks and credit unions. Many of the fintechs in PPP had not been subject to the Bank Secrecy Act and Know Your Customer compliance requirements, which led to fraudulent PPP applications being processed. These are major concerns that, while automation may streamline certain processes, critical vetting and eligibility checks will be left behind and replaced by a high-volume business model with the addition of fintechs in lending programs.

SBA loan procedures can often be improved, but it is the key technical assistance to borrowers that differentiates SBA lending and ensures that the borrower is not in a predatory loan that they will have difficulty paying back. In light of the findings on fintech fraud in PPP, Congress needs to first examine letting fintechs into new Federal lending programs before the SBA implements these very significant changes. Thankfully, we will have the opportunity to start the conversations today.

I am looking forward to hearing from our witnesses today, who are experts on the fraud and wrongdoing in PPP loans as well as SBA mission lenders who can speak in detail about how they help underserved communities and the impacts these new policy changes will have on program risk.

Again, I believe we can do both. Making the process simpler and streamlined will bring in more lenders. Yet, we must maintain the integrity of the programs.

Thank you. I yield back.

Chairman CARDIN. Thank you, Senator Marshall. I certainly agree with your comments, though. We have to make sure we have accountability, and we have to expand the opportunities to make it easier for small businesses to access the SBA programs. So, thank you very much for your comments.

We now look forward to hearing from our distinguished panel. Let me introduce you, and then we will go from my left to right.

First, Jon Gaines is the Vice President of Business Services and Finance at Wisconsin Women's Business Initiative Corporation. That organization has become a highly successful Microloan and Community Advantage lender. They do great work in this area, and I look forward to hearing from Mr. Gaines about his organization's experience with these programs and discussing what we can do to make them better.

We will next hear from Nick Schwellenbach, a senior investigator at the Project on Government Oversight. He joined POGO in February of 2017 and was previous a communications director at the U.S. Office of Special Counsel, the main Federal agency in charge of protecting whistleblowers.

Next we have Robert Villarreal, Chief External Affairs Officer at CDC Small Business Finance. Under his leadership, the organization has become the nation's largest Community Advantage lender. CDC Business Finance also lends in my home State of Maryland. I always mention that. They do excellent work in supporting smaller lenders, and I look forward to hearing your testimony.

And then lastly, we will hear from a person I had the privilege of hearing from earlier last week, Annemarie Murphy, who is President of the SBA Lending for First Bank of the Lake, where she directs all facets of government-guaranteed lending. As part of her current role, Ms. Murphy successfully launched a Veterans Initiative Team to target lending activities to our nation's veterans and tripled the volume and space within the first year. Quite a record.

We will start with Mr. Gaines.

**STATEMENT OF JON GAINES, VICE PRESIDENT, BUSINESS SERVICES AND FINANCE, WISCONSIN WOMEN'S BUSINESS INITIATIVE CORPORATION, MILWAUKEE, WISCONSIN**

Mr. GAINES. Well, good afternoon, Chairman Cardin, Ranking Member Paul, Dr. Marshall. My name is Jon Gaines, and I am the VP of Finance for Wisconsin Women's Business Initiative Corporation. We call it, internally, WWBIC.

Thank you for the opportunity to testify today as an intermediary lender of the SBA loan program and on its success of microlenders like our organization in delivering financial services to underserved small businesses. I am pleased to testify on behalf of WWBIC and the Friends of the SBA Microloan Program, an association of Microloan intermediaries that advocate basically for the program.

A brief bit about WWBIC. We are a leading, innovative, state-wide economic development corporation birthed out of the Women's Economic Empowerment Movement and began operations in 1987, providing business development services to start-ups, micro enterprises, and small businesses, with a primary focus on women, minorities, people of low wealth and incomes, and most recently, veterans and military-connected families. We open doors of opportunity by providing direct lending and access to fair and responsible capital, quality and responsible lending, and one-to-one technical business assistance and coaching to increase financial wellness.

In 2005, WWBIC entered the SBA Microloan program, and I will talk a little bit more about that later, but we are certainly excited about the success so far of the SBA Microloan program and certainly what it has done in terms of working with folks within our State as well in terms of fostering economic growth.

WWBIC has about 65 employees. We have five regions across the State of Wisconsin, and we are really excited about the work that we do, in quality small business lending and financial training.

A little bit about the SBA program. It is the largest Federal program exclusively targeted to support the credit needs of very, very small businesses and self-proprietorships. Through a network of community banks, and nonprofit intermediaries, the SBA program provides small-dollar loans and technical assistance to small businesses that cannot—I repeat, cannot secure credit from conventional lenders or other SBA based programs related to loan guarantees, of which most of those borrowers are, again, ladies, low-wealth individuals, veterans, and minority entrepreneurs.

Those entrepreneurs—the intermediaries ourselves, we then leverage those funds with state, local, and other private dollars to

basically provide Microloans and business development services and resources to small businesses. You may know, Microloan proceeds may only be used for working capital and the acquisition of materials, supplies, furniture, fixtures, equipment, those types of things.

Intermediary lenders participating in the SBA Microloan program receive two streams of funding from the SBA: a direct loan to the intermediary lender that is used to capitalize a revolving loan fund and grant funds to help support the costs of providing technical assistance to business borrowers.

As we said before, SBA Microloan intermediaries serve the smallest of the smallest businesses that are out there. The program allows intermediaries to make loans up to \$50,000. However, the average SBA Microloan is about a little over \$14,400 as of fiscal year 2020. Currently, there are about 150 active Microloan intermediaries serving 49 states, the District of Columbia, and Puerto Rico as well.

WWBIC's SBA Microloan program effects began, again as I noted, in 2005. Since we have been a part of the SBA Microloan program, we have deployed a little over 940 loans totaling \$20.6 million, with an average loan size in that Microloan pool of about \$22,000. So, again, very small dollars there.

The small business borrowers of our program provide tangible benefits in the communities that we serve. Our logo at WWBIC—I will say more our mantra—"one team, one mission, one WWBIC," our service approach, is we really work to listen, serve, and nurture novice small business owners who are my neighbors and also live in communities we call home.

I could talk about more statistics, but I would rather talk about a couple stories if I can. I want to share a brief story about Heather Varney. Heather Varney owns a company called Aeroforce Logistics. It is a start-up veteran- and women-owned business located in Milwaukee.

Heather learned to be a resourceful problem-solver and a good communicator at an early age. While in the Marine Corps, she experienced a bad accident and was forced to change jobs due to the injury and began focusing on sourcing aviation parts. She became the parts-finder, if you will, for the Marine Corps and ultimately continues adding growth by serving U.S. Government entities and large corporations, actually, that needed additional aerospace materials and aerospace equipment while really working on her focus to make sure she ensured working around the small business contracting and utilization goals she had in place.

How did WWBIC help? We helped directly with her first loan ever, an SBA Microloan for \$50,000, which covered a portion of her start-up costs. Her business grew very, very rapidly, and within six months she repaid that loan and graduated to, as we call it, moving to a commercial lender, which we definitely work to extend those parts for businesses as well.

Heather shared briefly about WWBIC. This is a quick quote: "They helped us when traditional banking could not, and they are also very well known in the community and also help with making connections, which again are important facets of the Microloan program."

My second example I would like to talk briefly about, Lakesha Davis. Lakesha Davis is the owner of Lovingkindness AFH, LLC, which again is a minority- and women-owned business in Racine, Wisconsin. Lakesha fled a domestic violence situation and also homelessness as well and wanted to help other folks facing similar circumstances.

WWBIC got directly involved. We lent her less than \$50,000 in capital to start her business and provided substantial pre-loan technical assistance, for example, helping her create her business plan, pitching her business idea with other individuals, working to build her confidence, working specifically to help her learn and really use QuickBooks in her business, and certainly last, but not least, finding mentors and connecting with other resources, which we all know are important with any business.

Currently, Lakesha plans to scale her business to own 25 percent of the houses in the area where she actually has her current business and then ultimately, once that process happens, expand to other states as well.

Lakesha shared a lot: “When I started my first business with WWBIC, I was a big pile of mush, and that was okay. My head was full of uncertainty, but as I followed the step-by-step instructions you guys shared with me, things began to get a lot more clear. Not only did I learn how business works, but I also learned self-confidence, how to believe in myself, and also how to get others on board with my ideas. WWBIC truly helped me turn my business dream into the reality.”

So, as we say, the Microloan program does help with putting businesses to work.

And finishing here, there continues to be a great demand for Microloans and raising the cap on intermediary loans, which will allow high-performing intermediaries to secure additional resources to assist small businesses in their communities. Waiving requirements for technical assistance matching will make more intermediary resources available to businesses. Current law limits to 50 percent the use of TA, technical assistance, grants for pre-loan technical assistance and the use of consultants. We urge the Committee to consider extending or making these provisions permanent.

We also strongly support, again, eliminating the 50 percent limit—

Chairman CARDIN. If you could summarize the rest of your statement, we appreciate it.

Mr. GAINES. I will. In other words, thank you again for your time today and listening to our story. And again, it is important. TA is important; the Microloan program is important to the success of businesses in our community but also across the nation as well. Thank you.

[The prepared statement of Mr. Gaines follows:]



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Lending • Coaching*

**COMMITTEE HEARING**

*“Improving access to capital in  
underserved communities:  
the Community Advantage Program, the  
Microloan Program,  
and other SBA initiatives”*

*Testimony by:*

**Jon Gaines, Vice President Business Services  
& Finance at the Wisconsin Women's  
Business Initiative Corporation**  
Wednesday, December 14th, 2:30pm ET



**Written Testimony by Jon Gaines**

*"Improving access to capital in underserved communities:  
the Community Advantage Program, the Microloan Program, and other SBA initiatives"  
Wednesday, December 14, 2022, 2:30 P.M. (ET)*

Good afternoon, my name is Jon Gaines and I work for the Wisconsin Women's Business Initiative Corporation also known as WWBIC. Thank you for the opportunity to testify today as an intermediary lender to the SBA Microloan Program, and on the success of microlenders like our organization in delivering financial services to underserved low-income urban, rural, minority, veteran, and woman-owned small businesses. I am pleased to testify on behalf of WWBIC and the Friends of the SBA Microloan Program, an association of Microloan intermediaries that advocates for the program.

For almost 13 years I have had the honor of serving as the Vice President of Business Services and Finance for WWBIC. WWBIC has been a leading innovative statewide economic development corporation that is "Putting Dreams to Work" for over 35 years by assisting micro enterprise & small businesses. WWBIC's primary focus is on women, minorities, lower-wealth individuals, and veterans/military connected families. WWBIC opens doors of opportunity by providing direct lending and access to fair and responsible capital; quality business training; and one-on-one technical business assistance and coaching to increase financial wellness.

WWBIC has fiercely championed its mission by operating in five regions with over 65 staff. Offering services statewide in Wisconsin; WWBIC channels its activities through two primary lines of business: small business lending (ranging from \$1,000 to \$350,000) & technical assistance/financial training. In over thirty-five years of impact, WWBIC has assisted over 72,000 individuals; loaned almost \$100 million to small business borrowers; helped entrepreneurs create and retain over 21,000 jobs; and started, strengthened, or expanded almost 9,000 businesses.

In 2021 alone, WWBIC served over 5,400 unduplicated clients; held a loan portfolio of approximately \$23 million with over 900 loans; and in 2020 and 2021 provided over \$8.3 million of forgivable loans, Paycheck Protection Program (PPP) and direct pass-through grants to hundreds of small business owners. Keeping small businesses alive while allowing them to transform and leverage new ways for sustainability and growth. WWBIC is advancing hope and opportunity to entrepreneurs.

As Vice President of Business Services & Finance, I bring over 25 years of accounting, finance, and operations management experience. I served on the finance committee of Opportunity Finance Network, the industry association of CDFIs, and on the board of directors of the Wisconsin Institute of Certified Public Accountants until 2020. I was named CFO of the Year by the Milwaukee Business Journal in 2016. Prior to joining WWBIC in 2010, I was the vice president of administration and finance at Wisconsin's largest exposition center. I earned a Bachelor of Science degree from St. Augustine's University in Raleigh, NC, and an Executive Master's in Business Administration from the University of Wisconsin-Milwaukee.

I continue to actively participate in our community and have extended my outreach to the community as a member of the Greater Milwaukee chapter of the National Association of Black Accountants. I also sit on the Wisconsin Institute of Certified Public Accountants Education Foundation and on the governance committee of the Central City Cyberschool of Milwaukee, which serves children in and near the Westlawn housing project.



**Written Testimony by Jon Gaines**

*“Improving access to capital in underserved communities:  
the Community Advantage Program, the Microloan Program, and other SBA initiatives”  
Wednesday, December 14, 2022, 2:30 P.M. (ET)*

**Small Business Administration (SBA) Microloan Program History**

The Small Business Administration (SBA) Microloan Program is the largest federal program exclusively targeted to supporting the credit needs of very small businesses and sole proprietorships. Through a network of community-based, non-profit Intermediaries, the SBA Microloan program provides small-dollar loans and technical assistance to small businesses that cannot secure credit from conventional lenders or other SBA guaranteed loans: including many women, low-wealth, veteran, and minority entrepreneurs. The Intermediaries then leverage these funds with state, local, and private resources to provide microloans and other business development resources to small businesses.

The SBA Microloan Program was authorized in 1991 (PL 102-140) to provide small loans and technical assistance (TA) to businesses that conventional lenders were and remain unable to finance for a variety of reasons including the lack of sufficient collateral or business experience. Working through a network of non-profit community based intermediary lenders, the SBA Microloan Program is able to finance and support new and emerging businesses in urban and rural communities and eventually move these businesses into the economic mainstream as bankable ventures.

Conventional banks cannot serve this profile of small businesses. Making a small business loan is time-intensive and requires resources to underwrite and service, especially for microloans. Moreover, a hallmark of the Microloan program is the ongoing technical assistance needed to help underserved entrepreneurs succeed at every step of their business’s development.

The Microloan program serves small businesses that encounter difficulty in gaining access to from conventional lenders. By serving entrepreneurs that operate start-up and new businesses, lack sufficient collateral, or have limited or poor credit histories, the SBA Microloan program fills a gap in the private market.

An Urban Institute survey of SBA 7(a), 504/Certified Development Company (504/CDC), Small Business Investment Company (SBIC), and Microloan borrowers conducted in 2007 found that Microloan borrowers reported having the most difficulty in finding acceptable financing elsewhere. Less than one-third (31%) of Microloan borrowers reported that they would have been able to find acceptable financing elsewhere, compared with 35% of SBIC borrowers, 40% of 7(a) borrowers, and 48% of 504/CDC borrowers.<sup>1</sup>

Intermediary lenders participating in the SBA Microloan Program receive two streams of funding from the SBA: a direct SBA loan to the intermediary lender that is used to capitalize a revolving business loan fund, and grant funds to help support costs associated with providing technical assistance to business borrowers.

<sup>1</sup> Christopher Hayes, An Assessment of the Small Business Administration’s Loan and Investment Programs: Survey of Assisted Businesses (Washington: The Urban Institute, January 2008), p. 5, at *(link on next page)* [https://www.urban.org/research/publication/assessment-small-business-administration-loan-and-investment-performance/view/full\\_report](https://www.urban.org/research/publication/assessment-small-business-administration-loan-and-investment-performance/view/full_report)



**Written Testimony by Jon Gaines**

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Wednesday, December 14, 2022, 2:30 P.M. (ET)*

Direct SBA loans to the intermediary lender carry a 10-year term with a fixed interest rate based on the five-year Treasury note and the lender must contribute a non-federal match equal to 15% of the SBA dollars borrowed in addition to maintaining a loan loss reserve equal to 15% of the lenders outstanding small business loans.

Intermediary lenders are eligible to receive SBA technical assistance (TA) grants on an annual basis. The amount of the TA grant is based on the number of loans made in the previous year, the lender's outstanding debt to SBA, and the availability of appropriated funds. To receive a TA grant a lender must also contribute a match of nonfederal funds equal to 25% of the TA grant.

The SBA charges intermediaries an interest rate that is based on the five-year Treasury rate, adjusted to the nearest one-eighth percent (called the Base Rate), less 1.25% if the intermediary maintains an historic portfolio of Microloans averaging more than \$10,000, and less 2.0% if the intermediary maintains an historic portfolio of Microloans averaging \$10,000 or less. The Base Rate, after adjustment, is called the Intermediary's Cost of Funds. The Intermediary's Cost of Funds is initially calculated one year from the date of the note and is reviewed annually and adjusted as necessary (called recasting). The interest rate cannot be less than zero.

Intermediaries are required to contribute not less than 15% of the loan amount in cash from nonfederal sources and, as security for repayment of the loan, must provide the SBA first lien position on all notes receivable from any microloans issued under the program. Unlike the SBA's 7(a) and 504/CDC loan guarantee programs, the SBA does not charge intermediaries upfront or ongoing service fees under the Microloan program.

Intermediaries are required to deposit the proceeds from the SBA's loans, their 15% contribution, and payments from their Microloan borrowers into a Microloan Revolving Fund. Intermediaries may only withdraw from this account funds necessary to make microloans to borrowers, repay the SBA, and establish and maintain a Loan Loss Reserve Fund to pay any shortage in the Microloan Revolving Fund caused by delinquencies or losses on its microloans. They are required, until they have been in the program for at least five years, to maintain a balance in the Loan Loss Reserve Fund equal to 15% of the outstanding balance of the notes receivable from their Microloan borrowers.

After five years, if the intermediary's average annual loss rate during the preceding five years is less than 15% and no other factors exist that may impair the intermediary's ability to repay its obligations to the SBA, the SBA Administrator may reduce the required balance in the intermediary's Loan Loss Reserve Fund to the intermediary's average annual loss rate during the preceding five years, but not less than 10% of the portfolio. Intermediaries are required to maintain their Loan Loss Reserve Fund until they have repaid all obligations owed to the SBA.



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**Small Business Administration (SBA) Microlending Impact**

Intermediaries serve the smallest of small businesses. While the program allows intermediaries to make loans up to \$50,000, the average SBA Microloan was \$14,435 in FY 2020. Currently, there are some 150 active Microloan intermediaries, serving 49 states, the District of Columbia, and Puerto Rico.<sup>2</sup>

In FY 2021, intermediaries made 4,514 loans to small businesses, totaling more than \$74.7 million. Of this amount, over two-thirds went to minority entrepreneurs. Existing businesses accounted for 63% of the loans made, over 48 percent went to women-owned businesses and almost 37 percent to startups. This financing led to the creation of 7,500 jobs and the retention of an additional 10,000 jobs.

Through FY 2021, intermediary lenders have used SBA Microloan funds to originate more than \$1.39 billion in loans to small businesses that have created 130,000 jobs and retained over 200,000 jobs since the program's inception in 1992. Of this total, more than \$260 million supported rural businesses and more than \$470 million went to minority entrepreneurs. An additional \$61.4 million has been lent to veteran entrepreneurs, and more than \$440 million has been lent to more than 43,000 woman-owned businesses.<sup>3</sup> Despite intermediaries serving "at risk" small businesses, the SBA Microloan program has a historical cumulative default rate of less than 2 percent.

The SBA Microloan program is an important tool to ensure that the full spectrum of small businesses and entrepreneurs have access to the capital and technical assistance needed for business survival and growth. Historically, it has cost \$1,700 per job supported by the program. Microloan proceeds may be used only for working capital and acquisition of materials, supplies, furniture, fixtures, and equipment.

For over 17 years, the Wisconsin Women's Business Initiative Corporation (WWBIC) has been at the table as one of the 150 active Microloan intermediaries, serving the State of Wisconsin offering SBA Microloans. WWBIC has been a leading innovative statewide economic development corporation that is "Putting Dreams to Work" for over 35 years by assisting micro enterprise & small businesses.

**Wisconsin Women's Business Initiative Corporation (WWBIC) History**

WWBIC was born out of the women's economic empowerment and microlending movement. A group of concerned community leaders started WWBIC in response to the Women's Business Ownership Act of 1988, as a nonprofit organization serving women entrepreneurs. Initially as a Small Business Administration (SBA) Women's Business Center (WBC) and Microlender, many emerging entrepreneurs came to WWBIC with similar needs. To meet the calling, in 1994 WWBIC launched business training programming and expanded the target market to include low-wealth and minority entrepreneurs.

In 1998, WWBIC became Wisconsin's first nonprofit certified and funded Community Development Financial Institution (CDFI) and has since been continuously certified and funded by the U.S. Department

<sup>2</sup> Nationwide Loan Report Data provided by SBA staff to the *Friends of the SBA Microloan Program* on March 5, 2020.

<sup>3</sup> *ibid.*



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of the Treasury. In 1999, the Financial Capability (now known as Financial Wellness) initiative was launched because so many of the micro business clients experienced credit issues compounded by the blending of personal and business finances. The creation of an asset-building component that offers individuals a structured program in which 4 to 1 dollars are matched to double their savings, allowing them to make a first-time home purchase, open a business, pay for college, or pay down debt.

The smallest and most fragile businesses, who would not even qualify for WWBIC financing, access capital through KIVA, an online crowdfunding platform making 0% interest loans up to \$15,000 to micro business owners. WWBIC serves as a KIVA Trustee, vetting micro entrepreneurs and helping them qualify for crowdfunding through a web-based global platform. KIVA borrowers reflect the target markets of women, minorities, and lower wealth individuals. WWBIC and the City of Milwaukee launched KIVA@WWBIC City of Milwaukee in February of 2015. In 2018, WWBIC launched KIVA@WWBIC City of Madison and in 2019, KIVA@WWBIC City of West Allis. In October of 2022, KIVA@ SE was launched to create opportunities for clients in the Racine, Kenosha, & Beloit area. WWBIC leads the nation in matched KIVA loans.

In 2018, WWBIC opened the Northeast Women’s Business Center in Appleton. Also in 2018, WWBIC received a highly competitive multi-year grant to host the Veterans Business Outreach Center (VBOC@WWBIC) serving veterans and military family members in Wisconsin, Illinois, and Minnesota. In 2020, WWBIC achieved aligned growth and furthered rural expansion through a \$750,000 multi-year grant from the SBA to open a new Southwest Women’s Business Center in La Crosse. WWBIC’s currently has five SBA Women’s Business Centers which serve Greater Milwaukee, South Central Wisconsin, Southwest Wisconsin, Northeast Wisconsin, and Southeast Wisconsin.

WWBIC has received national accolades for accomplishments including the Small Business Administration Jody C. Raskind Mission Lender of the Year Award and the prestigious SBA National Women’s Business Center Service Excellence Award. The SBA has named WWBIC the national Wisconsin Microlender of the Year every year since 2002; and recognizes WWBIC as one of the largest SBA Community Advantage Lenders in the U.S.

Since 2012, WWBIC has been rated by Aeris, the nationally recognized information service for community investors. WWBIC is one of 10% of all Community Development Financial Institutions (CDFIs) to be Aeris-rated. Aeris provides comprehensive, third-party assessments of CDFIs’ loan funds, financial strength, performance, and impact. WWBIC’s current Aeris Rating is A-\*\*\* which represents an upgrade over our previous rating, reflecting organizational improvements that were initiated as a result of our previous rating. WWBIC is confident that our ongoing collaboration with Aeris will continue to accelerate achievement of our strategic business plan priorities and positive economic impact.

**Wisconsin Women’s Business Initiative Corporation (WWBIC) Case of Need**

Microbusiness can provide an economic lifeline for underserved communities and WWBIC’s programming can offer new hope for rural entrepreneurs, particularly women, lower wealth individuals, and people of color. Too many Americans have been denied the opportunity to become small business



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owners because they lacked the required capital to do so. Traditional banking institutions reported a year-over-year decline in small business lending with the end of the Paycheck Protection Program even while credit usage by small businesses remained stable and demand for new credit increased during the same time period. Banks also tightened their credit standards for small businesses, especially for new business owners.<sup>4</sup>

According to the most recent data by the Federal Reserve, the average loan amount for a new small business loan from a traditional bank is \$593,000.<sup>5</sup> Requests for capital below this amount are often ignored by traditional banks and lenders, with CDFIs and SBA Microloan and Community Advantage lenders covering this gap up to \$350,000; meaning a gap of \$243,000 potential exists.

Microlenders offer businesses assistance, which a bank both cannot afford and cannot offer because of lender liability. In fact, most Microloan requests come from businesses who either cannot get bank financing or cannot get bank financing without the participation of a Microlender. Finally, many banks support the Microloan program because it leads to stronger businesses that will ultimately become bankable customers.

The decrease in small business financing to low-income business owners highlight a need for nonbank financial institutions like WWBIC with flexible underwriting, low fees or no fees, low and fixed interest rates and development services. WWBIC's Target Markets experience significant economic distress of poverty, income, and unemployment. These challenges prevent access to traditional financing, as clients often have few assets, poor credit ratings, and may lack social connections to wealthier potential investors.

WWBIC serves an array of clients from those that are thinking about starting a business to those with established, successful businesses who are in need of additional financing to grow their businesses. WWBIC offers an assortment of training opportunities to suit entrepreneurs at any level. Most loan clients come looking for financing, but frequently their success is attributable to the combination of financing and technical assistance. WWBIC focuses on providing a holistic approach for fair and responsible capital by offering: business training; pre & post business technical assistance; and access to financial products (business lending).

**Wisconsin Women's Business Initiative Corporation (WWBIC) Holistic Approach**

**Business Training**

WWBIC is a leader and innovator in entrepreneur business training. WWBIC offers trainings to promote financial acumen and in starting, sustaining, and growing a business for entrepreneurs at various levels. Information and registration are listed on website and sessions are offered in English and Spanish.

Entrepreneurship training topics include financial management, technology, operations, marketing, and other aspects of successful operation. Trainings are offered throughout the state through WWBIC's

<sup>4</sup> *Small Business Lending Survey*, Kansas City Fed, October 2022

<sup>5</sup> *Survey of Terms of Business Lending*, Federal Reserve System, 2017



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network of five regional offices offering a hybrid approach to ensure access to all. Solid business planning, personal money management, strong management skills, and access to markets are vital for both individual and business success.

**Pre & Post Business Technical Assistance**

WWBIC’s extremely pro-active model for providing technical assistance to loan clients mitigates the risk of lending to unbankable borrowers. Prior to receiving a loan, clients receive one-on-one counseling, which can include evaluating or creating a business plan and understanding financial and operational constraints. SBA microlenders also receive accounting, human resource management, and information on research in their industry. WWBIC provides pre-loan technical assistance through group training sessions as well as one-on-one consultations.

A WWBIC “Small Business Consultant” staff member is assigned to each loan client immediately upon loan closure and begins providing post-loan technical assistance that continues during the life of the loan, up to ten years. Clients also have access to WWBIC’s Initiate Portal to access online technical assistance 24/7. WWBIC offers credit counseling and credit repair to help individuals qualify for a small business loan. In addition, the small business consultants leverage the local community expertise of more than 400 volunteers in professional fields (including banking, law, and accounting) who work one-on-one as coaches and mentors to WWBIC clients. To best help the borrower better market their business and be successful, WWBIC can even work with a client who is having financial and/or repayment difficulty.

**Business Lending**

WWBIC’s access to capital initiatives provide a continuum of options to best meet business borrower needs, ranging from \$1,000 to \$350,000. WWBIC’s programs include very small loans through a collaboration with Kiva, microloans up to \$50,000, lines of credit, and larger loans up to \$350,000 – many of which have an SBA Community Advantage guarantee. There is also a piloted a nano-grant program and small equity investments for defined businesses. In addition to managing its own portfolio, WWBIC also supports a small number of other entities with the underwriting and management of their microloan activities.

Both WWBIC’s business and micro loans can be used for starting or expanding a business, purchase of or repair of machinery or equipment, furniture and fixtures, inventory, supplies and working capital. The targeted and typical profile of a WWBIC microloan client is low or moderate income, has experienced personal financial setbacks, credit history issues, is financially insecure, may be working a low-wage job with no opportunity for advancement, and is at a point in life where starting a business may be the best of few options. These smaller, riskier loans are often under-secured and require a high level of business technical assistance in order to be sustainable.

WWBIC offers lines of credit to more established clients to supplement their term loans to address cash flow management needs. The two most common barriers for our low-income clients are lack of basic financial acumen and lack of a formal business plan. We have extensive programming around these topics. Approximately half of our pre-loan clients need individual counseling or one-on-one business and



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technical assistance to become loan ready. A personal relationship encourages timely repayments to us and other creditors.

The rate for both Micro and Business loans ranges from 8-10% (with some special limited funds at 2%.) Fees range from \$500 for micro loans to \$1,500 for business loans; SBA Community Advantage loans require up to a 2.5% packaging fee for a \$350,000 loan. Flexibility features include collateralization requirements, smaller down payments & lower equity contributions than banks require.

WWBIC underwrites on projected business cash flows & debt service coverage (not simply collateral & credit score) character, & ability to repay the debt. WWBIC lends to low credit scorers in special circumstances like medical debt or divorce, & to those at least 18 months past bankruptcy discharge if low score or bankruptcy was not due to credit abuse. More than 50% of WWBIC loans finance startups in higher-risk sectors (restaurants, retail, jewelry stores, building trades & childcare.)

#### **Financial Capability**

WWBIC was an early adopter of the personal financial capability training now widely promoted by banks and other organizations. WWBIC was named a "Legacy Award" recipient in the 2014 Governor's Financial Literacy Awards. WWBIC offers a multi-part Make Your Money Talk classroom education series covering personal finances. Graduates who income-qualify can open a matched savings account to save for one or more of select assets: first-time home purchase, starting or expanding a business, vehicle expenses, debt repayment, or returning to school for post-secondary education. One-on-one financial educational counseling helps clients create and maintain personal budgets. Through the WWBIC-led Wisconsin Saves public awareness campaign, participants save money that might otherwise go to check cashing firms and payday lenders.

#### **Veterans Programming**

WWBIC has always provided support to veterans and military-connected families since its inception. However, in 2018 WWBIC expanded these services through a five-year commitment from the SBA's Veterans Business Outreach Center (VBOC) program. Outreach, training, veteran-focused loans and technical assistance are provided on military bases and in community locations throughout a three-state area -- Wisconsin, Minnesota, Illinois.

#### **Wisconsin Women's Business Initiative Corporation (WWBIC)'s history with Federally funded programs**

##### **Small Business Administration (SBA) Programs Currently Administered**

- Microlender — Technical Assistance (TA) and microloans up to \$50K. (2005 – Present)
- PRIME- Training and technical assistance (TA) to disadvantaged entrepreneurs. (2002 - Present).
- Community Advantage Lender — Loans ranging from \$50K - \$350K to small businesses who cannot obtain traditional financing. (2015 – Present)
- Office of Women's Business Ownership — Workshops/training, 1:1 counseling and capital to



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female entrepreneurs and small business owners. (2004 – Present)

- Office of Women’s Business Ownership CARES Act — Training/counseling, TA, and loans/access to capital to help businesses recover from the COVID-19 pandemic. (2020 – 2021)
- Veterans Business Outreach Center - Outreach, training, veteran-focused loans and technical assistance (2015 – Present).

**Additional Federal Programs Currently Administered**

- U.S. Department of Treasury: CDFI Fund Grants and Loans — Technical assistance, 1:1 counseling and access to capital up to \$1 million (2002 – Present).
- U.S. Department of Treasury: CDFI CORE Rapid Response — A loan fund to assist small businesses with training, counseling, and technical assistance impacted by the COVID-19 pandemic (2021 – Present).
- U.S. Department of Agriculture: Rural Microentrepreneur Assistant Program – Provides loans and grants to Microenterprise Development Organizations. Helps microenterprise startup and growth through a revolving fund with training and technical assistance to microloan borrowers and micro entrepreneurs (2010 to Present).
- U.S. Department of Agriculture: Rural Development Business Grants – Technical assistance and training for small rural businesses with has fewer than 50 new workers and less than \$1 million in gross revenue (2015 to present).
- U.S. DHHS: Office of Community Services – Community Economic Development – Projects aimed at business development opportunities and creating employment for individuals with low-wealth located in geographic areas with a demonstrated need for the proposed project. (2015- Present)
- U.S DHHS: Assets for Independence – Financial Assistance Award – Enable disadvantaged families to build assets through training, technical assistance, and Individual Development Accounts (2015 – 2020)

**Wisconsin Women’s Business Initiative Corporation (WWBIC) as an SBA Community Advantage and Micro Lender**

WWBIC participates in the SBA Community Advantage Program for SBA 7(a) loans of up to \$350,000. The SBA offers an 85% guarantee on loans up to \$150,000 and a 75% guarantee on loans greater than \$150,000. The program mitigates credit risk and allows WWBIC to lend to higher risk borrowers and reduce Loan Loss Reserve expenses.

The 7(a) Community Advantage (CA) program was created in 2011 to expand access to SBA-guaranteed loans. The SBA encourages lenders to deliver technical assistance with CA loans whenever possible but does not compensate lenders for the cost of providing TA. WWBIC provides TA as a holistic approach to allow for the business to succeed. CA lenders have to deliver at least 60% of the CA loans to businesses in ‘underserved markets,’ currently defined as: Empowerment Zones and Enterprise Communities, HUBZones, Low-to-Moderate Income communities (LMI), Opportunity Zones, rural areas, startups, and veteran-owned businesses.



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Since WWBIC's deployment of the SBA CA program in 2015, WWBIC originated 285 loans at \$21.3 million, of that 155 have been paid in full at \$7.7 million with 19 being charged off at \$1.2 million. Since 2015, WWBIC has closed a total of 44 loans greater than \$100,000.

WWBIC's SBA Microloan program began in 2005. Since the program launched, WWBIC's loan team has deployed 941 microloans for at \$20.6 million, with an average loan size of \$21,891.60. The pandemic altered the scope of microlending with immediate relief for small businesses through grants and forgivable loans. In 2018 (pre-pandemic), WWBIC deployed \$1.4 million dollars in SBA Microloan funding and \$980,000 was deployed in 2019. Pre-pandemic an average SBA Microloan was \$27,000. In 2020 during the onset of the pandemic, there was \$372,000 in SBA microloans, \$656,125 in 2021, and \$530,000 in 2022 deployed. WWBIC has served on average, 63% of SBA Microloan clients as female; 46% low to moderate income, and 26% minorities.

Through the SBA Microloan program, WWBIC has been able to provide pre/post loan technical assistance to these entrepreneurs and business owners. The pre loan TA includes topics such as business plan, financial projection, budgeting, business formation, licenses and permits while the post loan TA will focus one on one counseling on business operations/ expansion to business owners after receiving the microloans. The pre/post TA is critical to ensure a long-term success/minimize loss for entrepreneurs and microenterprises/small businesses.

**Wisconsin Women's Business Initiative Corporation (WWBIC) Microlending Impact**

The small business borrowers of this program provide tangible benefits for their communities. It is one thing for me to read the statistics and tell you what we do, but it is truly an honor to now share "who" we serve. I hear daily through our team meetings and clients I have had the honor of talking with; that microlending offers clients low interest rates, achievable loan amounts, community-based lending, technical assistance, and support through the process to achieve their dreams. We are one team, one mission, one WWBIC where we are there to listen, serve, and nurture novice small business owners who are my neighbors and live in the communities we call home.

**Aeroforce Logistics- Start-up, Veteran, and Woman Owned Business (Milwaukee, Wisconsin)**

Heather Varney learned to be a resourceful problem solver and a good communicator at an early age. While in the Marine Corps, she experienced a bad accident, which had a galvanizing effect. She decided that if there was something she wanted to do, she was going to do it regardless of what got in the way. Forced to change jobs in the Marine Corps due to her injury, Heather learned a new side of aviation: the parts side. She developed a passion for being the "parts finder" for the Marine Corps and every job after that, finding great joy when helping others. Aeroforce Logistics exists to provide solutions to ensure U.S. Government (USG) entities or large-business concerns obtain needed aerospace materials and equipment in a mission-focused and cost-effective manner while achieving small business subcontracting and utilization goals. WWBIC was able to assist Aeroforce Logistics by providing its first business loan of \$50,000 through the SBA Microloan. The money assisted Heather with some of the business start-up costs, and within six months, the loan was paid off as Aeroforce grew and "graduated" to a commercial



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lender, "WWBIC helped us when traditional banking couldn't. They are also very well known in the community and help with making connections," explained Heather Varney.

Lovingkindness AFH LLC – Woman & Minority Owned Business (Racine, Wisconsin)

After fleeing domestic violence and successfully moving from homelessness to homeownership, Lakesha Davis wanted to help others on a similar journey. She wanted to provide them with an experience different from the transitional centers she spent time in. With a loan from WWBIC Lakesha founded Lovingkindness AFH LLC to create a place of refuge for those seeking help from a desperate situation. Today Lovingkindness is a transitional, shared living home aimed at reducing homelessness and addressing a lack of affordable housing. It offers safe, affordable co-living housing that is fully furnished with all utilities paid. In addition to a loan of under \$50,000, WWBIC also provided a series of classes that helped Lakesha create a business plan, pitch her business with confidence, learn Quickbooks, develop relationships with mentors and consultants, and connect with other resources. She plans to scale her business to own 25 percent of the homes within a five-block radius of its current location, and then to expand to other states. "When I started my first class with WWBIC, I was a big pile of mush and that was okay. My head was full of uncertainty but as I followed the step-by-step instructions things begin to get clearer," said Lakesha. "Not only did I learn how business works, I also learned self-confidence. I learned how to believe in myself and get others on board with my idea. If you are serious about becoming a business owner WWBIC is the way to go. They have truly turned my business dream into reality."

Antigua Latin Inspired Kitchen -- Woman & Minority Owned Business (West Allis, Wisconsin)

Citlali Mendieta-Ramos grew up with the delectable aroma of simmering spices at her dad's restaurant, Rey Sol, on Milwaukee's South Side. It became her dream to raise her family the same way. With WWBIC's assistance, she was able to open the doors to her own fine dining establishment, Antigua Latin Inspired Kitchen which opened in the heart of West Allis in 2006. Antigua started as a café offering breakfast and lunch. Now 16 years later, it has evolved to a full-service restaurant and full-service offsite caterer. In addition, they offer hand-on cooking classes and are developing a line of food products to sell wholesale. In the fall of 2018, Antigua relocated to a bigger facility to help keep up with the growth of catering services. In 2022, Citlali have grown their catering side of their business and have a product line of frozen food offerings. "I could not have opened my restaurant without WWBIC. WWBIC's assistance with marketing and developing my business plan gave me the tools to grow this business" says Citlali Mendieta-Ramos.

Appropriations and Program Financing

The Microloan program received a Congressional appropriation of \$6 million for loan credit subsidies to support up to \$110 million in Microloans in FY2022. In addition, the appropriations for Microloan Technical Assistance totaled \$37 million. These grants are awarded to selected Microloan intermediaries to provide Microloan borrowers and prospective borrowers with marketing, management, and technical training assistance.

The SBA FY 23 budget for the Microloan program includes \$6 million in budget authority, which supports \$110 million in loans to intermediaries and \$41 million in technical assistance grants.



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The Coronavirus Pandemic continues to disrupt the work of on entrepreneurs and small businesses. Not only must they contend with supply issues, but new factors –higher interest rates and tightening credit – present emerging challenges. More than ever, SBA Microloans are an important source of patient capital for very small businesses. For that reason, we supported:

In April 2021, the House passed H.R. 1502, the *Microloan Improvement Act of 2021*. This legislation makes a number of improvements to the Microloan program, including:

(1) Interest Rates for Intermediaries

- Changes the definition of small loans from \$7,500 to \$10,000. Intermediaries with loans averaging the small loan rate qualify for SBA Microloans with an interest rate of 2 percentage points below the Treasury rate.

(2) Lines of Credit

- Authorizing the use of microloans for lines of credit.

(3) Extended Repayment Terms

- Modifies loan terms to a maximum of 7 years for loans of \$10,000 or less, and to a maximum of 10 years for loans that are greater than \$10,000.

(4) Credit Reporting

- A credit reporting process is established to ensure intermediaries are able to provide the major credit reporting agencies with information about borrowers relevant to credit reporting, such as the borrower’s payment activity on the loan.

(5) 1/55 rule

- Eliminates the 1/55 rule and simply leaves in place the existing ceiling of 300 intermediaries able to be funded. Under current law, SBA may only make available the lesser of \$800,000 or 1/55 of the amount appropriated for microloans for the first two quarters of the fiscal year. This creates an administrative bottleneck for the agency and a paperwork problem for intermediaries. In order to continue to address the needs of underutilized states, the amendment reserves 15 percent of the appropriation for the first two quarters of the fiscal year for those states.

**Other Recommendations**

P.L. 116-260, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (Division N, Title III of the Consolidated Appropriations Act of 2021), among other provisions, waived the Microloan Technical Assistance program’s matching requirement in FY 2021 and limitations on the pre-loan technical assistance and consulting and increased the Microloan intermediaries’ aggregate loan amount after their first year of participation in the program from \$6 million to \$10 million in FY 2021. The aggregate loan amount was reset to \$7 million on October 1, 2021.

There continues to be great demand for Microloans and raising the cap on intermediary loans will allow high-performing intermediaries to secure additional resources to assist small businesses in their communities. Waiving requirements for technical assistance matching will make more intermediary resources available to businesses. Current law limits to 50% the use of technical assistance grants for pre-



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loan technical assistance and the use of consultants. We urge the Committee to consider extending or making these provisions permanent.

We strongly support eliminating the 50% limit. In the almost 30 years the SBA Microloan Program has been in existence, the program has grown to 150 active intermediary lenders that have made more than \$ 1 billion in loans to more than 85,500 small businesses across America. One of the chief reasons for the success of the program is the technical assistance provided by intermediaries. The waiver provided in FY 2021 allowed intermediaries more flexibility in how – and when – we support our borrowers and work to ensure their success. Intermediaries contend that the 50/50 limit is a burden and seems arbitrary relative to the realities and needs regarding pre-loan and post-loan TA. Currently, every hour of TA must be bucketed and tracked by quarter.

Underwriting a new borrower is a critical part of the microloan program. Our experience is that pre-loan technical assistance is the most important factor in successful lending. Businesses that come through our door receive assistance with their business plan, financial systems, bookkeeping, and their overall operations. This sort of technical assistance is invaluable to both borrowers and WWBIC (as a lender).

Thank you for your time today and for hearing our story as well as those who our story is all about. The voices we need to hear like Heather, Lakesha, and Citlali. Those I am proud to call my neighbors and my community members. Please join us as we continue "Putting Dreams to Work".

Chairman CARDIN. Mr. Gaines, thank you for your testimony.  
Mr. Schwellenbach.

**STATEMENT OF NICK SCHWELLENBACH, SENIOR INVESTIGATOR, PROJECT ON GOVERNMENT OVERSIGHT, WASHINGTON, D.C.**

Mr. SCHWELLENBACH. Chairman Cardin, Ranking Member Marshall, and other Senators on the Committee, Senator Ernst, thank you for inviting me today to discuss the role of financial technology companies, also known as fintech companies, and fraud in the Paycheck Protection Program during today's hearing on underserved communities and their access to capital.

At the Project on Government Oversight, or POGO, I have investigated fraud and potential fraud in the PPP for over two years, but before I say more, research has shown fintech lenders and associated companies did much to help underserved communities access PPP loans. According to one paper, fintech lenders made a larger share of their loans to Black-owned businesses compared to traditional lenders.

POGO does not currently have a position on proposed rules from the SBA, one of which would give fintech lenders opportunities to participate in agency lending programs beyond the PPP. But as a general proposition, it may benefit historically disadvantaged and underbanked communities if nontraditional lenders, such as fintechs, can participate.

But at the same time, fintech companies did not always facilitate lending to those the PPP was intended to serve. Many set on defrauding the program successfully used fintechs to divert money. The SBA must have sufficient safeguards to ensure fintechs and other lenders do not enable high rates of fraud. Fraud can reduce the amount of funding available for legitimate businesses seeking access to capital.

All that said, fraud concerns should not stop the government from trying to access the very real equity issues that impede underserved communities' access to capital.

Now let me talk more about the fraud work that I and others have done looking at fintechs. In October, 2020, POGO highlighted that a disproportionate number of PPP loans that the Justice Department had alleged were fraudulent were processed by fintech lenders. Specifically, we identified 97 PPP loans that were allegedly fraudulently obtained up until that point in time—this is late 2020—and many cases have been brought since then.

About half of those approved loans involved seven fintech companies and banks working closely with fintechs. Those seven processed disproportionately fewer PPP loans even though their loans were disproportionately among those that the DOJ was alleging were fraudulent.

POGO's work was also informed by a whistleblower inside a fintech lending company, who I cannot divulge their identity, who told us that her company did not have "much incentive to do oversight" because the funds were coming from the government, the rules governing the PPP were lax, and each loan processed benefited lenders who collected a fee. In short, they did not have any skin in the game. It was not their money, it was the government's,

and there were a lot of financial incentives to process many loans quickly.

In addition to POGO's work, University of Texas researchers earlier this year found that PPP loans processed by fintech lenders were much more likely to be accompanied by suspicious indicators than loans processed by traditional banks and credit unions. There are some notable exceptions, though. The UT researchers found that PPP loans processed by some fintech lenders actually had particularly low rates of potential fraud.

So this points to varying underwriting practices by fintechs and other lenders participating in the PPP. Some fintechs appear to have engaged in rigorous underwriting practices, resulting in lower potential fraud rates, while others did not.

Why the wide variance? That is because of the lax rules governing the program, such as relying on loan applicants' self certification and a lot of confusion about what the program's requirements entailed, including compliance with the Bank Secretary Act and Know Your Customer requirements.

Given that some fintechs are not associated with high rates of fraud, it does not appear that there is an inherent flaw within fintechs as a group, but it appears that the government did not do enough to ensure that all nontraditional lenders and all lenders participating in the PPP had sufficient anti-fraud controls either in house or through their service providers.

Earlier this month, the House Select Subcommittee on the Coronavirus Crisis issued a report that I urge the Committee to review that examined fintechs and their role in fraud in the PPP.

If the PPP goes forward with its proposal, it has an opportunity to learn lessons from 2020. Unlike those chaotic days, the government can take deliberate steps now to get this right or get a better balance before the next big disaster strikes. The SBA should be commended for seeking ways to expand access to capital, but the Committee should also exercise its oversight to ensure that there are not high rates of fraud.

I have included more details and considerations in my written testimony, and I am happy to take any questions you have.

[The prepared statement of Mr. Schwellenbach follows:]



**Testimony of Nick Schwellenbach, Senior Investigator, Project On Government Oversight  
before the United States Senate Committee on Small Business and Entrepreneurship  
on “Improving Access to Capital in Underserved Communities: The Community  
Advantage Program, Microloans, and other SBA Initiatives”  
December 14, 2022**

Chairman Cardin, Ranking Member Paul, and members of the Committee, thank you for inviting me today to discuss the role of financial technology (“fintech”) companies and fraud in the Paycheck Protection Program (PPP) within the context of today’s hearing on underserved communities and their access to capital. I work as a senior investigator at the nonprofit Project On Government Oversight, or POGO. I have investigated fraud and potential fraud in the Paycheck Protection Program for over two years and have written several reports detailing my findings.<sup>1</sup>

Founded in 1981, POGO is a nonpartisan independent watchdog that investigates and exposes waste, corruption, abuse of power, and when the government fails to serve the public or silences those who report wrongdoing. We champion reforms to achieve a more effective, ethical, and accountable federal government that safeguards constitutional principles.

Before I say more, I should be clear that research has shown fintech lenders and associated companies did much to help underserved communities access PPP loans.<sup>2</sup> “Fintech lenders made

<sup>1</sup> Nick Schwellenbach, Neil Gordon, Sean Moulton, and Leslie Garvey, “The Great Pandemic Swindle: Feds Botched Review of Billions in Suspect Loans,” Project On Government Oversight, October 6, 2022, <https://www.pogo.org/investigation/2022/10/the-great-pandemic-swindle-feds-botched-review-of-billions-in-suspect-ppp-loans>; Nick Schwellenbach and Ryan Summers, “Red Flags: The First Year of COVID-19 Loan Fraud Cases,” Project On Government Oversight, April 15, 2021, <https://www.pogo.org/investigation/2021/04/red-flags-the-first-year-of-covid-19-loan-fraud-cases>; Nick Schwellenbach, “Spike in Suspected Business Loan Fraud Reports Coincided with Paycheck Protection Program,” Project On Government Oversight, September 10, 2020, <https://www.pogo.org/investigation/2020/09/spike-in-suspected-business-loan-fraud-reports-coincided-with-paycheck-protection-program>.

<sup>2</sup> “Fintech” is short for financial technology, but even traditional banks have long had a robust online presence, and financial technology is widely utilized. In the context of this discussion, fintech includes lenders that the Small Business Administration officially designated as Paycheck Protection Program “fintech” lenders; banks originating PPP loans that were closely associated with fintech service providers to process PPP loan applications; and those fintech service providers. Others have similarly used broader formulations. For instance, “Fintech lenders: All lenders officially designated as such by the [Small Business Administration]. We further include online lenders who originate primarily for or via fintech partners or platforms, online lenders founded since 2005, and online lenders that received venture capital (VC) investment.” Sabrina T. Howell et al., National Bureau of Economic Research, *Lender Automation and Racial Disparities in Credit Access*, Working Paper 29364 (October 2021; Revised November 2022), 10 of the PDF, [https://www.nber.org/system/files/working\\_papers/w29364/w29364.pdf](https://www.nber.org/system/files/working_papers/w29364/w29364.pdf); A recent House select subcommittee on the coronavirus crisis examines fintechs as both lenders themselves and as lender service providers (LSPs). “Fintechs, acting as both lenders and LSPs, became prominent in the PPP. By the end of 2021, the vast majority of the largest PPP lenders, by both value and volume (nine out of ten), were fintechs or fintech-partnered lenders.” Staff of House Committee on Oversight and Reform, Select Subcommittee on the Coronavirus Crisis, 117th Cong., “*We Are Not the Fraud Police*”: *How Fintechs Facilitated Fraud in the Paycheck*

a larger share of their loans to Black-owned businesses compared to traditional lenders,” according to a paper published by the National Bureau of Economic Research.<sup>3</sup> Another paper studying the PPP published by the National Bureau of Economic Research found that “FinTech is disproportionately used in ZIP codes with fewer bank branches, lower incomes, and a larger minority share of the population.”<sup>4</sup>

POGO does not currently have a position on proposed rules from the Small Business Administration (SBA), one of which would give fintech lenders opportunities to participate in the agency’s lending programs beyond the PPP.<sup>5</sup> But as a general proposition, it may benefit historically disadvantaged and underbanked communities if nontraditional lenders, including fintech companies, can participate in SBA lending programs.

At the same time, fintech companies did not always facilitate lending to those the Paycheck Protection Program was intended to serve.<sup>6</sup> Many set on defrauding the program successfully utilized fintechs to divert money.

The SBA must have sufficient safeguards to ensure fintech companies — and other lenders — do not enable high rates of fraud.<sup>7</sup> In discretionary programs like the PPP, where funds are fixed by appropriation, fraud reduces the amount of federal funding available for legitimate businesses seeking access to capital. There is up to an estimated \$100 billion in PPP fraud.<sup>8</sup> If that federal

*Protection Program* (Committee Print 2022), 17, [https://coronavirus.house.gov/sites/democrats.coronavirus.house.gov/files/2022\\_12\\_01%20How%20Fintechs%20Facilitated%20Fraud%20in%20the%20Paycheck%20Protection%20Program\\_0.pdf](https://coronavirus.house.gov/sites/democrats.coronavirus.house.gov/files/2022_12_01%20How%20Fintechs%20Facilitated%20Fraud%20in%20the%20Paycheck%20Protection%20Program_0.pdf).

<sup>3</sup> Howell et al., “Lender Automation and Racial Disparities in Credit Access,” 51 of the PDF [see note 2].

<sup>4</sup> Isil Erel and Jack Liebersohn, National Bureau of Economic Research, *Does Fintech Substitute for Banks? Evidence from the Paycheck Protection Program*, Working Paper 27659 (August 2020, Revised December 2020), 2 of PDF, [https://www.nber.org/system/files/working\\_papers/w27659/w27659.pdf](https://www.nber.org/system/files/working_papers/w27659/w27659.pdf).

<sup>5</sup> Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization, 87 Fed. Reg. (proposed 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>.

<sup>6</sup> The PPP was meant for most legitimate small businesses active before February 15, 2020, but certain markets were supposed to be priorities. “It is the sense of the Senate that the Administrator should issue guidance to lenders and agents to ensure that the processing and disbursement of covered loans prioritizes small business concerns and entities in underserved and rural markets, including veterans and members of the military community, small business concerns owned and controlled by socially and economically disadvantaged individuals (as defined in section 8(d)(3)(C)), women, and businesses in operation for less than 2 years.” Coronavirus Aid, Relief, and Economic Security Act of 2020, Pub. Law 116-136, 134, Stat. 293 (2020), <https://www.congress.gov/bills/116/116th-congress/house-bill/748/text>.

<sup>7</sup> The SBA’s Office of Inspector General has found broader shortcomings when it comes to the agency’s oversight of lenders and supporting entities. According to its October 2022 report on the SBA’s top challenges, “Our previous audits have found SBA has not adequately recognized or managed significant lender weaknesses.” In addition, “Previous OIG audits have also shown that SBA did not effectively identify and track third-party agent involvement in its 7(a) and 504 loan portfolios. Tracking such agents is crucial in managing the portfolios because many lenders rely on the services of fee-based and other third-party agents to help originate, close, service, and liquidate SBA loans.” Small Business Administration Office of Inspector General, *Top Management and Performance Challenges Facing the Small Business Administration in Fiscal Year 2023*, Report 23-01 (2022), 28 of PDF, [https://www.sba.gov/sites/default/files/2022-10/SBA%20OIG%20Report%2023-01\\_0.pdf](https://www.sba.gov/sites/default/files/2022-10/SBA%20OIG%20Report%2023-01_0.pdf).

<sup>8</sup> Andrew Keiper, Perry Charamonte and David Spunt, “COVID-19 relief fraud led to billions in taxpayer-funded Paycheck Protection Program loans lost,” *Fox Business*, May 9, 2022, <https://www.foxbusiness.com/politics/covid-relief-fraud-ppp-billions-taxpayer-funded-paycheck-protection-program-loans>.

estimate is correct, that would mean \$1 out of every \$8 in the PPP, or 12.5%, was lost — more than high-end estimates of Medicare fraud.<sup>9</sup>

The SBA's Office of Inspector General wrote earlier this year that the fraud levels in the PPP are "unprecedented."<sup>10</sup> Indeed, just last week, the SBA suspended major fintech companies from further work with the agency as part of its efforts "to address the fraud and weak controls that were so prevalent at the onset of the PPP."<sup>11</sup>

But fraud concerns should not stop the government from trying to address the very real equity issues that impede underserved communities' access to capital.

#### Fintech and PPP Fraud

In October 2020, POGO and *Bloomberg News* — independently and within hours of each other — highlighted that a disproportionate number of PPP loans that the Justice Department alleged were obtained through fraud had been processed by fintech lenders.<sup>12</sup>

Using court records and Small Business Administration data, POGO was able to identify the lenders for 97 PPP loans that were allegedly fraudulently obtained. Of those 97 loans, we found that 48 — nearly half of the approved loans involved in these alleged schemes — were obtained via one of seven fintech companies, and banks working closely with those fintech companies. Those seven fintech companies and associated banks processed 13% of the 5.2 million PPP loans that were issued up to that point in time.<sup>13</sup>

POGO's work was also informed by a whistleblower at a fintech lending company who told us that their company did not have "much incentive to do oversight" because the funds were coming from the government, the rules governing the PPP were lax, and each PPP loan processed benefited lenders, who collected a fee.<sup>14</sup>

<sup>9</sup> Jon Greenberg, "Medicare fraud rate is 8 to 10 percent, says Roskam of Illinois," PolitiFact, June 17, 2013, <https://www.politifact.com/factchecks/2013/jun/17/peter-roskam/rep-roskam-says-medicare-fraud-rate-8-10-percent/>.

<sup>10</sup> Small Business Administration Office of Inspector General, *SBA's Handling of Potentially Fraudulent Paycheck Protection Program Loans*, Report 22-13 (2022), 5 of the PDF, <https://www.oversight.gov/sites/default/files/oig-reports/SBA/SBA-OIG-Report-22-13.pdf>.

<sup>11</sup> Small Business Administration, "U.S. Small Business Administration Statement on the House Select Subcommittee on the Coronavirus Crisis Report Concerning Fraud in the Paycheck Protection Program," December 8, 2022, <https://www.sba.gov/article/2022/dec/08/us-small-business-administration-statement-house-select-subcommittee-coronavirus-crisis-report>.

<sup>12</sup> Ryan Summers and Nick Schwellenbach, "Lamborghini, Strip Clubs, Bogus Companies, and Lies: The First 56 Paycheck Protection Fraud Cases," Project On Government Oversight, October 8, 2020, <https://www.pogo.org/investigation/2020/10/lamborghini-strip-clubs-bogus-companies-and-lies>; Michelle F. Davis, "PPP Scammers Made Fintech Companies Their Lenders of Choice," Bloomberg, October 7, 2020, <https://www.bloomberg.com/news/articles/2020-10-07/ppp-loans-scammers-used-fintech-companies-to-carry-out-fraud>.

<sup>13</sup> Summers and Schwellenbach, "Lamborghini, Strip Clubs, Bogus Companies, and Lies" [see note 11].

<sup>14</sup> Summers and Schwellenbach, "Lamborghini, Strip Clubs, Bogus Companies, and Lies" [see note 11].

Additional reporting, studies, and investigations have added to the picture over the last two years.<sup>15</sup>

Researchers at the University of Texas at Austin found that PPP loans processed by fintech lenders were generally more likely to be accompanied by suspicious indicators than loans processed by traditional banks and credit unions. However, there are some exceptions. The University of Texas researchers found that PPP loans processed by three well-established fintech lenders – Capital One, Square, and Intuit – had particularly low rates of indicators of potential fraud.<sup>16</sup>

The variance in fraud rates points to varying underwriting practices by fintech and other lenders participating in the PPP.<sup>17</sup> Some fintech lenders appear to have engaged in more rigorous underwriting practices, including conducting due diligence on prospective clients and complying with Know Your Customer rules, which resulted in lower potential fraud rates.<sup>18</sup> The wide variance in practices was enabled by lax rules governing the PPP program, which relied on loan applicants' self-certification rather than verifying the accuracy of documentation and tax information applicants provided in support of their loan requests.<sup>19</sup> As the Government Accountability Office wrote in June 2020, "to streamline the process, SBA required minimal

<sup>15</sup> Meghan Bobrowsky and Ben Wieder, "Quickie lender Kabbage doled out billions in PPP loans. A number of borrowers raised red flags," *Miami Herald*, September 10, 2020, <http://web.archive.org/web/20201030160905/https://www.miamiherald.com/news/state/florida/article245599035.html>; Derek Willis and Lydia DePillis, "Hundreds of PPP Loans Went to Fake Farms in Absurd Places," *ProPublica*, May 18, 2021, <https://www.propublica.org/article/ppp-farms>.

<sup>16</sup> John M. Griffin, Samuel Kruger, and Prateek Mahajan, "Did FinTech Lenders Facilitate PPP Fraud?" *Journal of Finance*, (Forthcoming; Revised August 15, 2022), 12, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3906395](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3906395).

<sup>17</sup> Underwriting involves assessing and verifying identities and income and finances using official documentation. "The SBA's Interim Final Rule lists four actions a lender must take when underwriting PPP loans: (1) confirm receipt of borrower certifications contained in the PPP borrower application form; (2) confirm receipt of information demonstrating that a borrower had employees for whom the borrower paid salaries and payroll taxes on or around February 15, 2020; (3) confirm the dollar amount of average monthly payroll costs for the preceding calendar year by reviewing the payroll documentation submitted with the borrower's application; and (4) follow applicable BSA requirements." Robert L. Carothers and Graham H. Ryan, "Litigation and Regulatory Risks to Banks from Paycheck Protection Program," *National Law Review*, May 21, 2020, <https://www.natlawreview.com/article/litigation-and-regulatory-risks-to-banks-paycheck-protection-program>.

<sup>18</sup> This may be due to varying interpretations by lenders of what the Bank Secrecy Act requirements entailed. As the GAO stated in a footnote: "Because of the limited loan underwriting, lenders and SBA have less information from applicants to detect errors or fraud. For standard loans under SBA's 7(a) program, borrowers have to provide documentation that includes a completed application, personal and business financial statements, and income tax returns. However, the initial interim final rule's requirement that lenders follow applicable Bank Secrecy Act requirements may require lenders to collect additional identifying information from borrowers before approving a PPP loan. (The Bank Secrecy Act and its implementing regulations generally require financial institutions, including banks, to collect and retain various records of customer transactions, verify customers' identities, maintain anti-money laundering compliance programs, and report suspicious transactions.)" [Emphasis added] Government Accountability Office, *COVID-19: Opportunities to Improve Federal Response and Recovery Efforts*, GAO-20-625 (2020), 47 of the PDF, <https://www.gao.gov/assets/gao-20-625.pdf>.

<sup>19</sup> "In 91% of the reviewed cases applicants created, forged, or altered supporting documentation (e.g., IRS forms, payroll information, and bank statements). In 100% of cases, applicants misrepresented self-certifications on their PPP application." Pandemic Response Accountability Committee, *Small Business Administration Paycheck Protection Program Phase III Controls*, January 21, 2022, 11 of the PDF, <https://www.oversight.gov/sites/default/files/oiig-reports/PRAC/SBAFraudControlsFinal02Jan21.pdf>.

loan underwriting from lenders — limited to actions such as confirming receipt of borrower certifications and supporting payroll documentation — leaving the program more susceptible to fraudulent applications.”<sup>20</sup>

Earlier this month, the House Select Subcommittee on the Coronavirus Crisis issued a report on the role of fintechs in PPP fraud. The report stated that “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.”<sup>21</sup> I urge this Committee and the SBA to review that report, as it contains troubling details about the practices of some of the major fintech players that participated in the PPP.

#### **The SBA’s Role in Evaluating Fintech Lenders**

Given that some fintechs are *not* associated with high rates of potential PPP fraud, it seems unlikely that there is some inherent flaw within the fintech model that makes these lenders more susceptible to abuse. Rather, evidence suggests that the government did not do enough to ensure that nontraditional lenders participating in the PPP had sufficient anti-fraud controls in place.

If the SBA goes forward with its proposal to broaden participation in its lending programs beyond traditional lenders, it has an opportunity to learn lessons from 2020. Unlike the chaotic days in March and April 2020, now is a time when Congress and the SBA can take deliberate steps to get this right before the next big disaster strikes.

In the spring of 2020, fintech industry groups successfully lobbied the government to allow their participation in the Paycheck Protection Program.<sup>22</sup> The SBA issued interim rules governing the PPP on April 2, 2020 — the day before the program began accepting loan applications.

There were good reasons for expanding participation: In the spring of 2020, when rates of unemployment were skyrocketing, speed was of the essence. Expanding participation to more lenders meant more loans could be processed more quickly, and funds could potentially be disbursed more equitably.

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) gave the federal government, specifically the Treasury secretary in consultation with SBA, the authority to open participation in the PPP to “Additional Lenders,” and gave them the authority to issue “regulations and guidance.”<sup>23</sup>

<sup>20</sup> Government Accountability Office, *COVID-19: Opportunities to Improve Federal Response and Recovery Efforts*, 47 of the PDF [see note 17].

<sup>21</sup> Staff of House Committee on Oversight and Reform, Select Subcommittee on the Coronavirus Crisis, 117th Cong., “We Are Not the Fraud Police,” 9 [see note 2].

<sup>22</sup> Staff of House Committee on Oversight and Reform, Select Subcommittee on the Coronavirus Crisis, 117th Cong., “We Are Not the Fraud Police,” 14-15 [see note 2].

<sup>23</sup> As directed by the CARES Act, the Treasury secretary in consultation with the SBA administrator and the head of the Farm Credit Administration were responsible for setting criteria to approve lenders that were not federally insured depository institutions or credit unions, or farm credit system institutions. 15 U.S.C. § 9008 (2020), <https://uscode.house.gov/view.xhtml?path=/prelim@title15/chapter116&edition=prelim>.

The criteria established by the Treasury Department and SBA required that participating lenders comply with the Bank Secrecy Act, an anti-money laundering law that mandates lenders conduct due diligence and comply with Know Your Customer (KYC) rules.

As the then-SBA administrator made clear in a press release issued on April 2, 2020, lenders would be “using their own systems and processes to make these loans.”<sup>24</sup>

Those systems and processes varied. The SBA told the Pandemic Response Accountability Committee that “the more rigorously that PPP lenders applied KYC requirements, the more likely that individual loan fraud issues, like identity theft, would be identified.”<sup>25</sup>

But some lenders and their lending partners did not apply those requirements rigorously — and thus enabled fraud.<sup>26</sup>

#### Some Key Questions and Considerations

The case studies provided by the House report also highlight some of the limitations of the SBA’s approach to PPP loan distribution. For example, the agency did not collect and share information when lenders rejected PPP loan applications. According to the Pandemic Response Accountability Committee, the collection and distribution of such data could have reduced “instances of applicants’ ‘shopping’ for weaker internal controls among lenders. This approach may have allowed lenders with less sophisticated fraud detection controls to leverage the more effective controls of other SBA lenders.”<sup>27</sup>

As the SBA considers the role of fintech companies in future initiatives, there is much to be learned by reviewing the role of fintechs in PPP program fraud. Revisiting the guidelines provided to these lenders and determining how they might be strengthened to prevent future fraud is the first step to ensuring that the agency is best prepared to increase access to capital in underserved communities in a way that is both effective and sustainable.

We recommend the following questions as part of such a review:

- Did the Treasury Department and the SBA craft sufficient anti-fraud criteria for fintech lenders that wanted to participate in the Paycheck Protection Program?

<sup>24</sup> Small Business Administration, “With \$349 Billion in Emergency Small Business Capital Cleared, SBA and Treasury Begin Unprecedented Public-Private Mobilization Effort to Distribute Funds,” April 2, 2020, <https://www.sba.gov/article/2020/apr/02/349-billion-emergency-small-business-capital-cleared-sba-treasury-begin-unprecedented-public-private-0>.

<sup>25</sup> Pandemic Response Accountability Committee, *Small Business Administration Paycheck Protection Program Phase III Controls*, 9 of the PDF [see note 18].

<sup>26</sup> The fintech Womply has even asserted these requirements did not apply to it. Staff of House Committee on Oversight and Reform, Select Subcommittee on the Coronavirus Crisis, “We Are Not the Fraud Police,” 62 [see note 2].

<sup>27</sup> Pandemic Response Accountability Committee, *Small Business Administration Paycheck Protection Program Phase III Controls*, 14 of the PDF [see note 18].

- How did Treasury and SBA evaluate these fintech lenders against the established criteria?
- How would the SBA's requirements for Small Business Lending Companies authorized under the SBA's proposed rule differ from the criteria for participating lenders in the PPP?
- How would the SBA's requirements for Small Business Lending Companies authorized under the SBA's proposed rule compare to the regulatory requirements that apply to traditional depository institutions?
- Is compliance with the SBA's requirements sufficient to prevent high rates of fraud?
- Do the SBA's requirements apply to third-party service providers working for lenders?
- Does the SBA have sufficient resources and authorities to assess whether entities comply with its requirements both initially and through continual monitoring?
- How can the SBA ensure that its participating lenders can equitably and in a timely way provide access to capital to customers they have never before done business with while rigorously complying with Know Your Customer requirements?
- Are there investments in loan application and verification systems that the government should pursue before the next disaster strikes that would lower fraud risks while enabling widespread and speedy lending to historically underserved and underbanked communities?

The SBA should be commended for seeking ways to expand access to capital through its lending programs, but the committee should exercise its oversight authority to ensure the agency is taking prudent steps to reduce high fraud rates and ensure funds are not diverted from the communities they are meant to serve.



Chairman CARDIN. Thank you very much for your testimony.  
Mr. Villarreal.

**STATEMENT OF ROBERT VILLARREAL, CHIEF EXTERNAL AFFAIRS OFFICER, MOMENTUS CAPITAL—CDC SMALL BUSINESS FINANCE, CHULA VISTA, CALIFORNIA**

Mr. VILLARREAL. Thank you, Chairman Cardin, Ranking Member Paul, Senator Marshall, Senator Ernst. I am honored to testify before you today on behalf of Momentus Capital—CDC Small Business Finance as well as the Mission Lenders Working Group. I want to thank the Committee for convening this hearing and for the opportunity to discuss how we can work together to ensure underestimated communities can access the capital and support they need to thrive.

CDC Small Business Finance is part of the Momentus Capital Family of organizations, a mission-driven financial services firm which provides a continuum of social knowledge and financial capital. We are proud of our track record and in 44 years have delivered over \$22 billion in capital under commercial real estate and small business lending, supporting 240,000 jobs.

I am here also representing, as I mentioned, the Mission Lenders Working Group, which advocates and provides a voice for SBA Community Advantage lenders, a program I am here to talk about today. The SBA Community Advantage Pilot Program, or CA, as we call it, was launched in February of 2011, and for the first time SBA's flagship 7(a) program expanded the points of access that small business owners had for getting loans from mission-focused financial institutions with experience lending in economically underestimated markets.

Now there are a number of requirements Community Advantage lenders must follow, and in the 11-year history of the program there has been a number of changes. Most recently, the SBA worked with the mission lenders in revising the Community Advantage Participant Guide, our standard operating procedure—our SOP—which included increasing the maximum loan amount from \$250,000 to \$350,000 and streamlining lending requirements. We thank and applaud SBA, particularly the current leadership, for making these improvements to the program, and they have made a difference.

Now overall, in the 11-year history of the program, since 2011, there has been a billion dollars of lending under Community Advantage, helping 7,000 small businesses. Our organization, CDC Small Business Finance, has done 1,200 of those loans for \$178 million and, yes, Senator, about a dozen for about \$1.2 million in the great state of Maryland.

More important, one of the successes of Community Advantage has been its reach into the Black and Latino small business community. As the Senator mentioned, in 2022, 20 percent of Community Advantage loans went to Black entrepreneurs as opposed to about 4 to 7 percent on the traditional 7(a), and for Latino entrepreneurs it was 16 percent under Community Advantage versus 10 percent under the regular 7(a) lending.

For start-ups, Community Advantage lends almost three times more than the traditional 7(a), and that is the engine of the Amer-

ican economy. So we are really financing those new small businesses and those start-ups under Community Advantage.

That is why I am happy and I am here to thank Chairman Cardin for the introduction of the Community Advantage Loan Program Permanency Act of 2022. This legislation not only seeks to codify and strengthen the Community Advantage loan program; it also recognizes the need to institutionalize mission lending as part of SBA's overall mission to aid, counsel, assist, and protect the interest of America's small business concerns.

While the bill creates permanency for the Community Advantage program, it also expands the program to cover both economically and socially disadvantaged small businesses. As I mentioned before, the great work we have done in reaching Black and Latino small businesses, that was not even a target market. Senator Cardin's bill makes that a target market, and we think that and other key provisions will really allow Community Advantage lenders to drive deep into communities that are underserved and underestimated.

Senator Cardin, Congresswoman Chu, who have been a strong advocate of Community Advantage, both understand that Community Advantage is a critical SBA program enabling small-dollar lending that is intentionally targeted to small businesses in underserved communities, and we thank them for their leadership and encourage members of this Committee to support the bill.

In my last minute, I do want to make at least one comment on the SBA's proposed rule on small business lending companies. As mentioned, this rule is going to lift, or proposes to lift, the 40-year moratorium and add more than the 14 current small business lending companies, or SBLCs, and the SBA is doing this per the proposed rule to drive deeper and to reach capital market gaps. We applaud them for that. We want more capital to small businesses in underserved communities and rural communities.

They plan to do this by introducing two new types of SBLCs, or at least one new type, and then opening it up. One is a mission SBLC, and that will allow a Community Advantage lender, like ourselves, to now become an SBLC. They also propose to allow, at the start, three new for-profit SBLCs.

Now in the proposal, they are stating that the mission SBLCs will have a lot of requirements to make sure we reach underserved communities. Remember, these are organizations that already have been doing this for decades and for years.

On the other hand, for the new for-profit SBLCs, there are no—I think the mention was guardrails. There are no guardrails for these new SBLCs. So we urge the SBA to really take a look at this, and if they really want to reach the underserved and to make this work, there needs to be some stronger guidelines ensuring that these new SBLCs reach the underserved communities that are identified.

Thank you very much, and I am happy to answer any questions.  
[The prepared statement of Mr. Villarreal follows:]

**momentus  
capital.**



**Small Business Finance**

part of the momentus capital family.

Testimony of  
Robert Villarreal  
Chief External Affairs Officer  
Momentus Capital  
CDC Small Business Finance

Submitted to  
Senate Committee on Small Business & Entrepreneurship

December 14, 2022

"Improving Access to Capital in Underserved Communities: The Community Advantage Program, Microloans and other SBA Initiatives"

Chairman Cardin, Ranking Member Paul, and Members of the Committee, I am honored to testify before you today on behalf of Momentus Capital and CDC Small Business Finance (CDCSBF) and the Mission Lenders Working Group. I want to thank the committee for convening this hearing to discuss improving access to capital in underserved communities.

CDCSBF is part of the Momentus Capital family of organizations. Momentus Capital is a mission-driven financial services firm that puts all of its resources into marshaling capital to support the vision communities have for themselves. CDCSBF is also the leading mission-based, SBA lender in the nation. For the federal fiscal year that just ended on September 30, 2022, CDCSBF was once again the number one SBA 504 lender (dollars) and number one Community Advantage lender for both units and dollars.

Over its 44-year history CDCSBF has provided over \$22 billion in commercial real estate and small business loans, creating/retaining over 240,000 jobs.

I am also representing the Mission Lenders Working Group (MLWG), which I am a founding member of and which advocates and provides a voice for SBA Community Advantage Lenders. The Mission Lenders Working Group is a national network of SBA-certified Community Advantage (CA) non-traditional small business lenders including SBA Certified

Development Companies (CDCs) and Treasury-certified Community Development Financial Institutions (CDFIs) located in urban and rural areas across the country. Members see their organizations as a coalition and stewards of the SBA Community Advantage Loan Guaranty Pilot program with a shared commitment to financing, supporting, and sustaining underserved and underbanked small businesses.

In these written comments I will review:

- The origins and mission of the Community Advantage (CA) Pilot Program.
- The impacts and successes of the CA Program as well as some of the challenges faced by participating CA lenders (*industry-wide and from the perspective of CDCSBF as a CA lender*).
- How the *Community Advantage Loan Program Permanency Act of 2022, sponsored by Chairman Cardin*, would strengthen the CA program; and
- Finally, I'd like to share some thoughts and recommendations regarding the proposed rule released by the SBA on the Small Business Lending Companies (SBLC)

**Background on the Community Advantage (CA) Loan Guaranty Pilot: Its Origin and Mission**

The SBA Community Advantage Pilot Program was launched on February 15, 2011. For the first time, the SBA's flagship 7(a) program expanded the points of access that small business owners had for getting loans from mission-focused financial institutions with experience lending to minority, women-owned, and start-up companies in economically challenged markets along with their management and technical assistance expertise, to help make their borrowers successful.<sup>1</sup> This was an acknowledgment that the lending industry needed to do a better job in providing small-dollar loans to businesses in underserved communities, or those businesses classified as "emerging markets."

The program's goals, per the initial Community Advantage Participant Guide issued by the SBA, were:

- To increase access to credit for small businesses in underserved markets;
- To expand points of access to SBA 7(a) loans by engaging non-traditional mission lenders with experience working in underserved markets;
- To provide management and technical assistance to small businesses as needed; and
- To manage portfolio risk by utilizing the underwriting knowledge of mission lenders with successful track records lending in underserved markets.

As noted above, the critical component of the program was to expand the 7(a) program to mission lenders. The SBA defined mission lenders as falling into one of three groups: SBA-certified development companies (CDCs); SBA microlenders; and Community Development Financial Institutions (CDFIs). The Administration understood that these lenders were best positioned to meet the capital needs of the underserved business populations not being met by traditional SBA lenders. Mission lenders have a deep knowledge of their communities,

<sup>1</sup> SBA, "Community Advantage Pilot Program," 76 Federal Register 9627, February 18, 2011; and SBA, "SBA Announces New Initiatives Aimed at Increasing Lending in Underserved Communities," December 15, 2010, at <https://www.sba.gov/content/sba-announces-new-initiatives-aimed-increasing-lending-underserved-communities> <https://portage.life/print/?article=4112>

are accountable to their communities via resident representation on their board of directors, and, as an explicit purpose and mission, assist small businesses that are located in underserved areas or are owned by women and minority entrepreneurs.

To ensure that the underserved markets were met, SBA required that CA lenders make 60% of their loans to a designated Target Market. The Target Markets consist of:

- Businesses located in Low-to-Moderate Income (LMI) communities
- Businesses where more than 50% of the full-time workforce is low-income or reside in LMI census tracts
- Empowerment Zones and Enterprise Communities
- HUB Zones & Promise Zones
- New "start-up businesses (Firms less than two years in business)
- Businesses eligible for SBA Veteran's Advantage
- Business located in Opportunity Zones (added 10/1/2018)
- Rural Areas ((added 10/1/2018)

Accordingly, the CA program offers access to 7(a) guaranteed lending to these institutions, which in turn increases access points to the 7(a) program for small firms who would struggle to access an SB loan from a bank.

Since the launch of the program, there have been additional changes, which are highlighted in the attachment called "SBA Community Advantage Pilot Program Timeline" (please see attachment). Highlights include program extensions in November 2012, December 2015, and April 2022. Throughout the first several months of 2022, SBA worked with the industry in revising the CA Participant Guide, which included increasing the maximum loan amount from \$250,000 to \$350,000 and streamlining lending requirements. We thank and applaud SBA for making these improvements to the program.

#### **Impacts and Successes of the Community Advantage Program**

Since the CA pilot launched, the SBA has approved a total of \$1,050,734,400 in CA loans to 7,673 businesses with an average loan size of \$139,000.

Both CA and conventional 7(a) lending fell during the pandemic as lenders shifted their focus to processing PPP loans. In FY 2020, SBA lending started to pick up with CA lenders continuing to target a significant portion of their lending to underserved markets. In FY 2022, 717 CA loans were approved for an average loan size of \$158,995, representing an increase in CA loan approval of 21 percent.

In FY 2022, 7(a) lenders made 47,678 loans through the program totaling over \$25.6 billion, for an average loan size of \$538,903. On April 27, 2022, Administrator Isabella Guzman's testimony before the Committee mentioned the importance of small-dollar lending, and the 7(a) program data revealed a gap in the program's coverage. For instance, the number of 7(a) loans of \$150,000 or less declined by almost 52 percent since FY 2016, and the number of 7(a) loans of \$50,000 or less declined by nearly 58 percent. In turn, the average 7(a) loan size increased steadily since FY 2016, increasing by more than 87 percent.<sup>2</sup>

<sup>2</sup> Memo from U.S. House of Representatives Chairwoman Nydia Velazquez on the Full Committee Hybrid Hearing: "SBA Management Review: Office of Capital Access" [https://smallbusiness.house.gov/uploadedfiles/05-18-22\\_hearing\\_memo.pdf](https://smallbusiness.house.gov/uploadedfiles/05-18-22_hearing_memo.pdf)

**7(a) Lending Activity**

Fiscal Year	Approved Loans	Approved Dollars
2022	47,678	\$ 25,693,805,700
2021	51,856	\$ 36,536,756,800
2020	42,302	\$ 22,550,171,700
2019	51,907	\$ 23,175,811,000
2018	60,354	\$ 25,372,539,100
2017	62,430	\$ 25,447,458,500
<b>2016</b>	<b>64,074</b>	<b>\$ 24,130,000,000</b>

**Community Advantage**

Fiscal Year	Approved Loans	Approved Dollars
2022	717	\$ 113,999,400
2021	565	\$ 82,834,100
2020	538	\$ 76,214,700
2019	947	\$ 133,813,400
2018	1,118	\$ 157,529,200
2017	1,043	\$ 137,595,500
<b>2016</b>	<b>988</b>	<b>\$ 123,020,000</b>

Resource: SBA 7(a) Connect Quarterly Update, October 11, 2022

The Mission Lenders Working Group analyzed the SBA's FOIA data on the 7(a) Program and CA from FY2016-FY2022. The comparative data charts are below. While 7(a) lenders have steadily increased their lending to minority and women-owned businesses, CA lenders outpace lending to historically underserved communities. CA lenders particularly lend more to Black entrepreneurs, Hispanic entrepreneurs, and women-owned and startup businesses based on the FOIA Data for Fiscal Years 2012-2022. Of note, in the FY2020 Congressional Budget Justification, SBA recognized that the CA program "reached significantly more women and minorities than the traditional 7(a) loan program."<sup>3</sup>

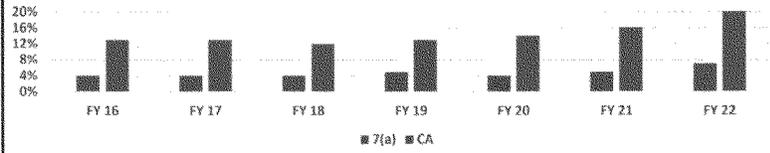
Over the last ten years, experienced CDCs, CDFIs, and Microlenders participating in the CA pilot have demonstrated their expertise, skill, and capacity as lenders and their ability to finance and support businesses that traditional lenders, including conventional 7(a) lenders, are unable to serve. Compared to 7(a) financing, CA mission lenders have consistently and significantly outpaced lending to Black, Hispanic, and women-owned businesses as well as Veteran-owned businesses and start-ups.

<sup>3</sup> U.S. Small Bus. Admin., FY2020 Congressional Budget Justification and FY2018 Annual Performance Report (2019).

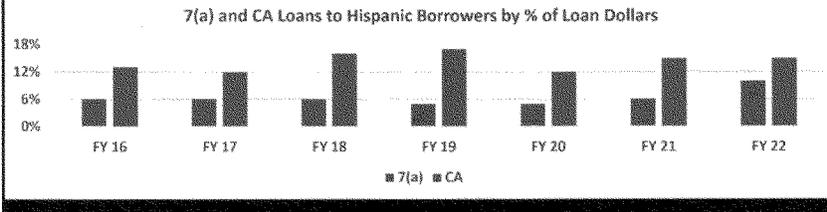
**SBA Backed Lending to Black-Owned Businesses –**  
 Approved 7(a) Lending vs Approved CA Lending – FY 16-FY 22  
 7(a) and CA Loans to Black Businesses by % of Loan Dollars



7(a) and CA Loans to Black Businesses by % of Loan Count



**SBA Backed Lending to Hispanic-Owned Businesses –**  
 Approved 7(a) Lending vs Approved CA lending –FY 16-FY 22  
 7(a) and CA Loans to Hispanic Borrowers by % of Loan Dollars



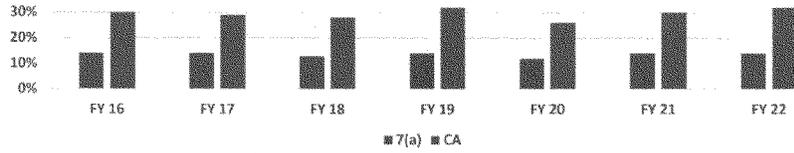
7(a) and CA Loans to Hispanic Borrowers by % of Loan Count



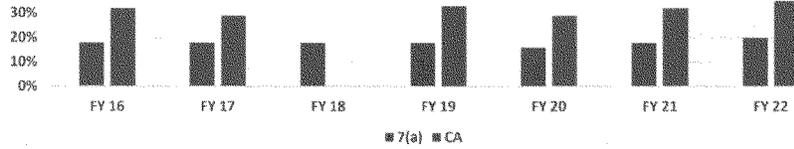
**SBA Backed Lending to Women-Owned Businesses (>50%)**

Approved 7(a) Lending vs Approved CA lending – FY 16-FY 22

7(a) and CA Loans to Women-Owned Businesses by % Loan Dollars



7(a) and CA Loans to Women-Owned Businesses by % Loan Count

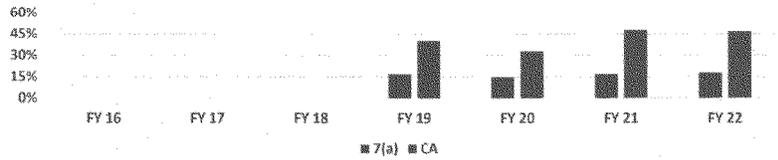


**SBA Backed Lending to Startup Businesses –**  
Approved 7(a) Lending vs Approved CA lending – FY 16-FY 22

7(a) and CA Loans to Startups by % Loan Dollars

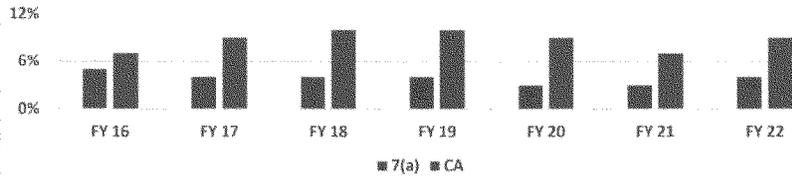


7(a) and CA Loans to Startups by % Loan Count

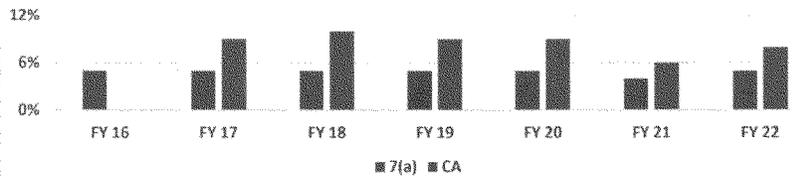


**SBA Backed Lending to Veteran-Owned Businesses-**  
 Approved 7(a) Lending vs Approved CA lending – FY 16-FY 22

7(a) and CA Loans to Veteran-Owned Businesses by % Loan Dollars

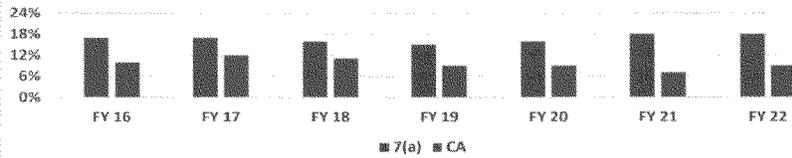


7(a) and CA Loans to Veteran-Owned Businesses by % Loan Count

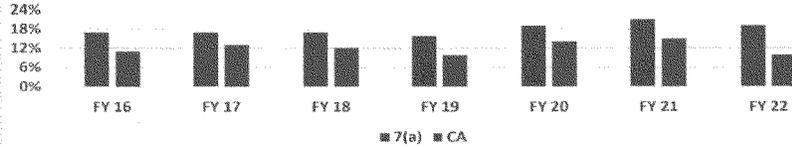


**SBA Backed Lending to Rural Businesses<sup>4</sup>-**  
 Approved 7(a) Lending vs Approved CA lending – FY 16-FY 22

7(a) and CA Loans to Rural Businesses by % Loan Dollars



7(a) and CA Loans to Rural Businesses by % Loan Count



<sup>4</sup> On October 1, 2018 the SBA expanded the underserved market definition for CA to include rural areas.

Additionally, analyzing the FOIA data from FY2016-FY2022 in a given year, the majority of 7(a) lenders make just twenty 7(a) loans or fewer.

**FY 2018**

- 761 lenders (51%) made 5 7(a) loans or fewer.
- 972 lenders (65%) made 10 7(a) loans or fewer.
- 1164 lenders (78%) made 20 7(a) loans or fewer.

**FY 2019**

- 766 lenders (53%) made 5 7(a) loans or fewer.
- 963 lenders (67%) made 10 7(a) loans or fewer.
- 1150 lenders (80%) made 20 7(a) loans or fewer.

We share the above information to illustrate that while some in the administration have been critical that CA lenders are doing too few loans, the data indicates that two-thirds of 7(a) lenders make less than ten loans per year. Finally, we want to remind congressional leaders and SBA that mission-lenders were critical partners during the pandemic, in deploying PPP loans and providing technical assistance to America's small businesses. CDCSBF funded nearly 6,000 PPP loans on its own, for approximately \$275 million. Our median loan was approximately \$20,000 and we provided thousands of hours of free technical assistance. One small business client wrote to us:

*This is the best I have been treated since I initially started this process with the banks when it all began. I am grateful for the chance to work with all of you. Even if there are no additional funds, at least I feel like I was seen.*

At the end of the day that is what differentiates us as mission lenders; we SEE the clients that traditional lenders overlook and under value.

**CDC Small Business Finance's Impacts as a CA Lender**

CDC Small Business Finance was the second approved lender in the country, following Kentucky Highlands, when the program was launched and also had the first CA loan approved in the program.

Since the launch of the CA pilot in 2011 CDC Small Business has been "all in" as a CA lender and advocate for the program. Through the conclusion of the last fiscal year-end (9/30/2022), CDCSBF had funded 1,277 CA loans for \$178 million in loans to underserved businesses. These CA loans resulted in over 4,800 jobs being created and preserved.

CDCSBF is only one of two CA lenders that has a national license, which has allowed us to provide loans at a wider scale. While the majority of our lending has been in the state of California, we have provided loans in 27 states and the District of Columbia. This also includes twelve loans in Maryland for just over \$1 million and 75% of these loans went to Entrepreneurs of Color.

Being a CA lender with a national license has allowed us to reach more underserved businesses and to collaborate with local partners, including other mission lenders, utilizing the SBA technology called Lender Match, which connects small businesses to lenders. We believe this is one of the better SBA programs applying the use of technology to serve small businesses, and we applaud SBA for the program and its upgrades over the years.

I am also proud to report that over 38% of CDCSBF's CA loans have been to Entrepreneurs of Color, even though this is not identified by SBA as an Underserved Target Market per the CA pilot. Overall, 65% of CDCSBF's CA loans have gone to businesses in an SBA designated CA Target Market (the minimum requirement is 60%), with the majority of our loans going to enterprises that have been in business for less than two years. In fact, nearly 40% of our CA loans are to pre-revenue businesses (pure start-ups), which is a category of businesses that traditional financial institutions, including conventional 7(a) lenders, are reluctant to lend to and for which we have developed a deep understanding and an ability to underwrite. I would also note that most non-traditional financial technology companies (fintechs) do not lend to pre-revenue start-ups, as they rely on data driven underwriting to evaluate a borrower and start-up ventures, particularly underserved entrepreneurs, cannot provide that data.

**The Challenge for Community Advantage**

CDCSBF and MLWF supported the changes introduced earlier this year to the CA Program. We worked with the SBA to implement changes that speed loan processing and the delivery of capital to underserved communities. Reforms included:

- Extending the pilot program for two years (to September 30, 2024)
- Removing the temporary moratorium on new CA Lender Participation Applications
- Granting delegated authority to all CA lenders
- Modification to Lending Criteria to simplify and streamline underwriting and approval of CA applications, including authorizing the use of business credit scoring models
- Modifying regulations to provide equitable access under SBA programs and economic opportunities to justice-involved individuals
- Increasing the maximum CA loan size from \$250,000 to \$350,000
- Revising fee methodology and maximum interim rate to encourage greater lender participation in the CA Loan Program
- Revising collateral requirements to increase the speed capital being delivered to small businesses while decreasing overall costs to the CA Lender and borrower
- Allowing revolving lines of credit to better meet the evolving capital needs of small businesses
- Revising the requirements for hazard insurance
- Simplifying affiliation principles

These reforms were important and appreciated by the industry. In fact, since the loan size was raised to \$350,000, CDCSBF has Approved 20 loans over \$250,000 for \$6.4 million. These loans will create 93 jobs and 16 of the loans were to businesses less than two years in business. 7 have been to veterans and nearly two-thirds to other underserved communities.

However, there is a need for continued reforms and changes to the program to increase lending by current CA lenders and encourage new lenders into the program. First and foremost is the extension of the program beyond the current two-year sunset of September 30, 2024. The multiple extensions of the program, over different administrations, along with changing operating rules, have made it problematic for lenders to commit to the program. No large for-profit financial institution would tolerate such programmatic changes, yet mission lenders are expected to continue to reach the hardest to serve and adapt to the changing rules, which are more restrictive than to other 7(a) lenders.

The SBA has also never defined or specified what success looks like in terms of acceptable or unacceptable risks. Under the program, mission-based CA lenders were asked to serve the hardest-to-reach markets. While there is an expectation of higher losses, that has never been publicly defined and presented to the CA lenders. A conversation with SBA and agreeing upon the success of the program would assist in further defining the program for new lenders and likely increase participation.

Some additional reforms, improvements, suggestions and clarifications include:

- We believe it imperative to have SBA's full support for Congressional action to make Community Advantage a permanent program.
- The Loan Processing Center still holds these small loans to the \$350K+ standard underwriting SOP requirements – this is a burden and not necessary for the small loan size for example
- Access to the Federal Reserve Discount Window: During PPP, SBA-approved lenders including non-depository institution lenders, were eligible to participate in the PPPLF. This included SBA-qualified PPP lenders, banks, credit unions, Community Development Financial Institutions, members of the Farm Credit System, and small business lending companies licensed by the SBA. This would be an excellent option for so many CA lenders that need access to capital for the CA program.
- Loan Loss Reserve Requirements: Chairman Cardin's legislation, Community Advantage Loan Program Permanency Act of 2022 outlines significant improvements and clarity to the Community Advantage program. Many of the 110+ CA lenders have been active since June 2011 and have a proven track record of managing the Loan Loss Reserve Requirements
- Lender policy does not require Life Insurance for these small loans – but the Loan Processing Center won't accept that explanation and requires underwriting to justify
- Community Advantage lending is very story-based underwriting – explaining why the poor credit history occurred, how it is improving and why it makes sense to give them a chance – But the Loan Processing Center seems to still focus on FICO score and any event of collection account, delinquency and pushes back, regardless of story explanation, and implies "lack of reasonable assurance of repayment"
- Projections and Breakeven – Center still expects "historical" 3 year for existing businesses even though these are small loans
- Business Personal Property (BPP) insurance – we justify not requiring BPP on some small loans when the use of proceeds is not for FF&E and/or Tenant improvements and the balance sheet does not have significant assets to be replaced and in each case we get push back to add the BPP insurance – seems like it is just an Authorization template mindset – not taking into consideration the information for each credit
- A reduction in the minimum CA program SBSS Score – from 140 to 130
- The ability for Community Advantage Lenders to provide 100% financing for all types of use of proceeds. Meaning that for Start-ups no 10% required equity injection and Change in Ownership no required equity injection. The rationale behind this is not that the borrowers are unprepared to start or run a business, but rather that the monies they have saved be left in their hands/control as available liquidity for unforeseen events/bumps in the road

- CA Program Credit Elsewhere – eliminate credit elsewhere test for CA lenders or at a minimum clarify and ease the burden associated with satisfying the test. CA lenders are already required to target underserved markets and underserved business, which do not have access to traditional financial resources

As has been discussed above, the CA program fills a critical gap in access to financing of up to \$350,000 for entrepreneurs in underserved communities. By allowing experienced, mission-oriented lenders to utilize the 7(a) loan guarantee, the SBA is promoting access to the affordable capital and technical assistance that mission-based lenders like us need to launch and expand and uplift our nation's economy.

**The Community Advantage Loan Program Permanency Act of 2022**

CDCSBF and the MLWG commend Senator Cardin (and Representative Chu's bill in the House) for exemplifying true leadership and commitment to small businesses with the introduction of The Community Advantage Loan Program Permanency Act of 2022,<sup>5</sup> which seeks to codify and strengthen the Community Advantage (CA) Loan Guarantee Program. The bill recognizes the need to institutionalize mission lending as part of the SBA's mission to "aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns."

This bill would create permanency for the Community Advantage program, which has operated as a pilot program since 2011, and expands the program to cover both economically and socially disadvantaged small businesses, including those owned by women and people of color, and requires a minimum threshold of 70% of loans made in these target markets by CA lenders. It would also require SBA to provide technical assistance and training to mission lenders by existing, seasoned non-profit mission lenders. We also know that data is critical to understanding the successes and areas for improvement. The bill's requirement of weekly reporting as well as annually to Congress on the program's performance, including demographic data disaggregated by racial subgroups, is an essential tool.

Furthermore, the legislation codifies the Network Partner model in order to expand the reach and benefits of CA lending into more underserved markets without necessarily increasing the number of CA lenders. CDCSBF has some modest experience in working with the previous version of the partnership model (Community Advantage Associates), and the Network Partner model as presented in the bill is an improvement on the previous model.

Additional features of the legislation include the ability to graduate a CA lender into a 7a loan with ease when the business borrower is ready – and this continues to build a pipeline of bankable businesses in underserved markets and at the same time frees up CA lenders capital to make new loans to unbanked businesses. The legislation further identifies that a covered institution is not eligible to receive delegated authority from the Administration under the program until the covered institution has approved and fully disbursed not less than 10 loans under the program and the Administration has evaluated the ability of the covered institution to fulfill program requirements.

We know that small businesses are the backbone of the U.S. economy, and yet many entrepreneurs lack access to safe, responsible capital. Research from the Federal Reserve Bank found that 62% of surveyed small firms were denied or discouraged from seeking the financing they needed to grow or maintain their business.<sup>5</sup> These small firms reported low

<sup>5</sup> <https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2018/sbcs-nonemployer-firms-report.pdf>

credit scores and insufficient credit history as the main barriers to credit access.<sup>6</sup> The Small Business Administration and its programs and partners help entrepreneurs overcome these barriers by providing business coaching, lender referrals, and guaranteed lending programs.

Mission Lenders understand that CA is the only SBA program enabling small-dollar lending intentionally targeted to small businesses in underserved communities, including low-to-moderate income (LMI) areas, rural areas, veteran-owned businesses, and startups. With the steady decline of community and small bank branches in recent years, CDFIs and other mission lenders play an important role in ensuring that small businesses are not left behind. Without the CA program, many underserved entrepreneurs would be left unable to secure the financing they need to create and sustain jobs and contribute to a vibrant Main Street economy.

Granting this successful pilot program authorization under the Small Business Act will provide lenders with the assurance needed to invest in the necessary staffing and systems to maintain and grow their CA lending portfolios. This assurance will enable CA lenders to bolster their CA activity just as lending to small businesses overall, and particularly to businesses that are traditionally underserved.

**Comments on the SBA's Proposed Rule on Small Business Lending Companies (SBLCs)**

On November 7, 2022, the SBA issued a proposed rule<sup>7</sup> that if implemented would lift the moratorium on licensing new Small Business Lending Companies (SBLC) and would create a new type of SBLC license for not-for profit, Mission-Based SBLCs, intended to help SBA fill "capital market gaps" identified by SBA.

While we share the SBA's commitment to bridging the gaps that for too long has prevented aspiring entrepreneurs and small businesses from accessing the financing they need to launch and sustain their enterprises, particularly businesses in underserved and underbanked markets, we have concerns with the SBA's proposal and specifically questions about how the SBA's proposal would increase SBA-backed lending to the underserved communities and entrepreneurs that The Agency is looking to serve - those "struggling to obtain financing on non-predatory terms."

CDCSBF and our lending partners in the Mission Lenders Working Group (MLWG) are committed to working with the SBA to increase SBA-backed lending to underserved markets and increase the efficiency of SBA lending while at the same time making sure every SBA customer is getting a loan that is "right sized, priced and structured to its business needs." We want to make sure underbanked businesses have access to responsible financing and are not left without options other than "the easy to access, high, priced predatory products."

Under the Proposed Rule, the SBA would lift the moratorium on new SBLC licenses. This would allow SBA to issue new SBLC licenses to for-profit, non-depository lenders and recognizing the oversight costs associated with bringing on new SBLCs, the SBA would assign only 3 new additional licenses to start. The proposed rule would also create a new type of SBLC license, a Mission-Based SBLC (Mission SBLC), for non-profit, non-depository institutions that would be required to lend to businesses in underserved markets. The rule

<sup>6</sup> <https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2018/sbcs-nonemployer-firms-report.pdf>

<sup>7</sup> Small Business Lending Company Moratorium Rescission and Removal of the Requirement for a Loan Authorization" (RIN 3245-AH92)

states that an existing CA lender “in good standing” can apply for a Mission SBLC license but the rule leaves it to the SBA’s discretion to determine what constitutes a “CA lender in good standing.” SBA also states that since Mission SBLCs are already regulated as CA lenders, it has the capacity to regulate Mission SBLCs as they are not increasing the total number of entities supervised.

Lifting the moratorium and adding non-mission SBLCs, on its surface, does not necessarily improve access to mission lending for underserved communities. SBA is proposing to impose additional requirements on Mission-Based SBLCs “to ensure that Mission-Based SBLCs fill identified capital market gaps and provide targeted financial assistance to underserved communities. However, while the SBA proposal is designed to address “certain markets where there are capital market gaps” the proposal does not identify the specific market gaps that Mission SBLCs are expected to target, and the rule does not establish a percentage of loans to be made in a target market. Unless the SBA clearly and intentionally identifies the underserved market gaps that it is seeking to reach there will be no way to evaluate the success of the proposed rule. And the proposed rule would not require or even request a new for-profit SBLC to target lending to an underserved capital market or markets, which is contrary to SBA’s stated goal and may have adverse impacts on programmatic integrity.

Similar to the current Community Advantage program, SBA, to “ensure that Mission-Based SBLCs fill identified capital market gaps and provide targeted financial assistance to underserved communities,” proposes to place additional restrictions, requirements and burdens on mission SBLCs, which already have historical track records of lending to underserved communities and individuals. Yet as noted above, it is proposing no restrictions on the three new non-mission-based SBLCs. We have serious doubts and concerns that for-profit, non-mission lenders will provide the level of outreach and service that mission lenders provide.

We believe SBA is focused on increasing loan volume as opposed to ensuring that businesses in underserved or undercapitalized markets get the right sized, structured, and priced loan. Ensuring the businesses have access to capital is critical – but so is ensuring that they have access to financing that leaves them better off than they were before – and mission lenders also understand that some businesses are not ready for a loan, even if the Artificial Intelligence Algorithm says otherwise.

For the duration of the CA program, participating lenders have been “recommended” to provide Technical Assistance (TA) to their clients in the program. While SBA recommends or encourages TA, it is core to how mission-lenders operate and work with their clients. We have provided hundreds of hours to our clients, as have other lenders in the MLWG. And while we assume this will be a continued condition to transition from CA lender to Mission SBLC, no such requirement is being proposed for the three new non-mission SBLCs. As many studies have demonstrated, TA is the “secret sauce” of mission lenders, and which provides for their clients’ success and minimizes loan loss.

It is also unclear how the proposed rule will promote mission lending when so many programmatic details are not addressed (i.e., geography, maximum loan size, target markets, etc.). As a current CA lender that has the capacity and willingness to participate in the full SBLC program, the rules as proposed leave too many details to be approved by SBA personnel on a lender-by-lender basis, thus creating separate guidelines for each lender. SBA promotes this individualized approach as flexible in order to fill specific market gaps, yet it lacks clarity for current CA lenders evaluating the program. Further, while we have a

level of trust and confidence in the current leadership at SBA, current leadership will change and the rules and requirements for the Mission-Based SBLC could change. This has been clearly evidenced by our experience in the Community Advantage Program.

Per language in the proposed rule, we understand that based on the success of the Paycheck Protection Program (PPP), “removing the moratorium on licensing new SBLCs and Mission-Based 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.” However, one need only refer to the recent report and recommendation from the report of the Select sub-committee on the Corona Virus that should give serious pause and concern before allowing new “non-traditional lenders” into the 7(a) program. In fact, the report recommends that congress should continue to fund (mission) community lenders, so they can increase their capacity to directly serve underserved communities. Moreover, the report states that Congress should consider additional federal regulations for non-bank/non-depository lenders, such as being considered under this proposed rule. [Report Reveals Fintechs Facilitated PPP Fraud | House Select Subcommittee on the Coronavirus Crisis.](#)

Rather than issuing new for-profit SBLC licenses in order to expand SBA-backed lending into underserved markets, we encourage the SBA to elevate the CA pilot and promote the work of CA lenders

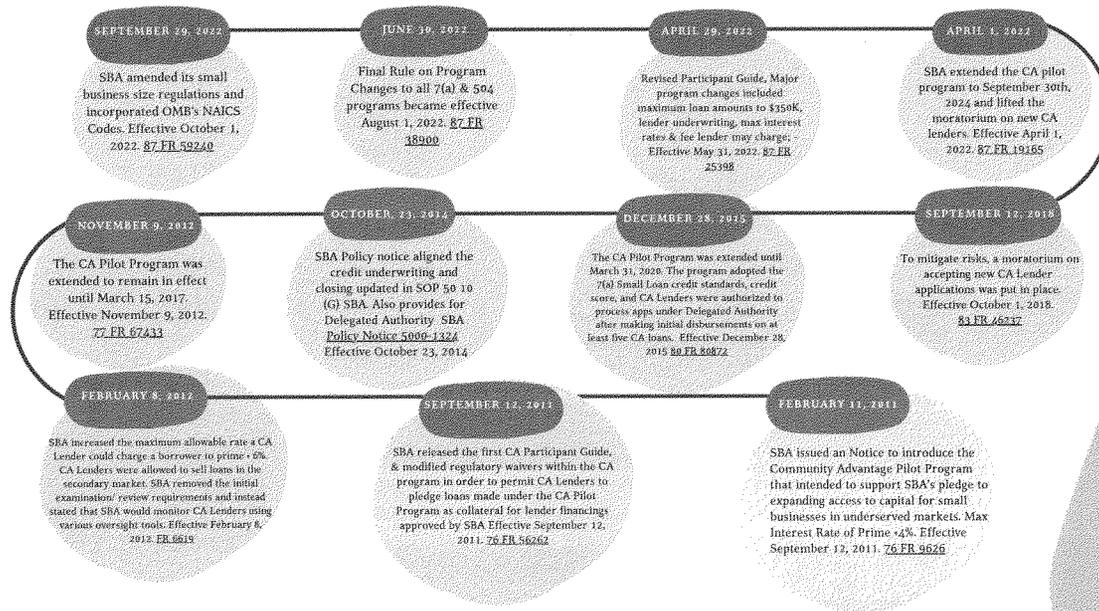
- Immediately extend the CA Pilot program for five years or more and support Congressional efforts to codify CA, as proposed in the *Community Advantage Loan Program Permanency Act of 2022*. The current extension to September 2024, is not sufficient for a prudent mission lender to want to invest in a program with only two years of runway
- SBA should publicly support the proposed bill which makes CA permanent
- SBA could make further regulatory reforms to the CA program as described above. While the changes made earlier this year were extremely helpful, additional changes to the program will allow lenders to reach deeper into underserved markets
- Work with Congress so that CA lenders have access to grant funds to support the TA provided to the small businesses with which it supports under the CA program. This could include accessing the PRIME Program or changes to the SBA Microloan Program

Finally, we *take issue with the following statement made by SBA* in the proposed rule:

“SBA considered leaving the regulations unchanged and relying upon the CA Pilot Loan Program to address the needs of access to capital in underserved markets; however, the low historic loan volume and lack of any CA loan activity in some rural and underserved geographic areas makes this an unviable alternative.”

This statement suggests that the SBA has given up on CA – and we think that is the wrong approach. We urge the SBA to lean into the CA program and work to strengthen it beyond the changes made earlier this year. The Cardin bill does that. We certainly hope that the mission SBLC is not a harbinger that the SBA is going to eliminate the CA program. We believe that a robust CA program can exist alongside a mission SBLC program, if that is the direction the SBA takes.

# SBA COMMUNITY ADVANTAGE PILOT PROGRAM TIMELINE



Mission Lenders Working Group

This timeline was developed by the Mission Lenders Working Group (MLWG) Staff in October 2022. The MLWG is a coalition of SBA-certified Community Advantage (CA) lenders from across the country with a shared commitment to financing, supporting, and sustaining underserved and underbanked small businesses. For more info check our the MLWG website at [missionlenders.net](http://missionlenders.net) or scan the QR code.



ATTACHMENT

Chairman CARDIN. Well, thank you for your testimony, particularly the nice things you said about my bill. I appreciate that very much.

Ms. Murphy.

**STATEMENT OF ANNEMARIE MURPHY, EXECUTIVE VICE PRESIDENT, PRESIDENT OF SBA LENDING, FIRST BANK OF THE LAKE, GREENVILLE, SOUTH CAROLINA**

Ms. MURPHY. Chairman Cardin, Ranking Member Marshall, and members of the Committee, my name is Annemarie Murphy, and I am President of SBA Lending for First Bank of the Lake, a small community bank.

Lenders can, and need, to do more in reaching underserved markets, but let us look at some facts. Because of the program's statutory "credit elsewhere" mandate, every 7(a) loan serves a borrower that would otherwise be left behind by banks conventional lending policies. We are inherently a mission program.

Let us look at stats from last year in 7(a). Roughly 50 percent of all loans were \$150,000 or smaller. More than two thirds of all loans were \$350,000 or smaller. One-third of all loans were to minority borrowers, a number that has been steadily on the rise. Twenty-five percent of our borrowers did not identify their race or ethnicity, so the actual percentage of loans to minorities is likely higher than the statistics indicate.

African Americans are the fastest growing demographic in the program, with nearly \$1 billion in loans last year alone, with nearly a 60 percent increase since FY '17, and so far this year, loans to African Americans are up 52 percent in units and 72 percent in dollars compared to last year.

Hispanics totaled \$1.5 billion, more than a 27 percent increase since FY '17, and so far this year, loans to Hispanics are up 91 percent in units and 98 percent in dollars compared to last year.

Our loans in rural areas totaled roughly 20 percent of all loans.

Into this success story, SBA is proposing to change the 7(a) program with the stated intention to aid underserved markets. We agree with this intent. Increasing mission lending and welcoming more lenders into SBA is good. Our concerns have nothing to do with competition. Our concern is about the unintended consequences of harming underserved borrowers and damaging program integrity.

SBA proposed two new regulations. The affiliation rule proposes to remove the specific, longstanding, prudent credit criteria, and the SBLC rule would invite an unlimited number of non-Federally regulated entities, including fintechs, into a program that would then be devoid of lender guardrails.

Rather than test these new concepts in a gradual fashion or invite fintech to take part in 7(a) using current prudent lending standards, SBA has veered in the opposite direction, morphing the 7(a) program to fit the fintech business model. SBA did not include any specific mission requirements for these new lenders to make any loans to underserved markets even though that was the stated intent. SBA did not include any framework for these non-Federally regulated entities that would mirror Federal regulatory standards

like anti-money laundering or Bank Secrecy Act to protect against fraud.

SBA proposes the removal of well-established underwriting standards that protect taxpayers from excessive losses. Past experience indicates that without these underwriting standards losses would rise. As a result, Congress may have to increase fees on the very borrowers we are trying to help or provide appropriations to cover increased losses from risky underwriting.

SBA says it will approve three new non-mission lenders right now, but the actual rule allows an unlimited number and unlimited loan volume. SBA says it has the capacity to monitor these additional entities, but lenders know SBA's oversight resources are already stretched too thin.

And, SBA would permit political appointees to decide critical program requirements.

Over the past seven months, Treasury, OCC, CFPB, the House Financial Services and Senate Banking Committees have all expressed serious concerns about fintech in financial activities without oversight. Most explosive is the Select Subcommittee on the Coronavirus Crisis report released this month, which revealed how fintechs' inexcusable misconduct resulted in tens of billions of dollars of fraudulent loans. SBA wants to duplicate the perceived successes of PPP and 7(a). These fraud results are the last thing we should recreate.

Congress and this Administration have valid and substantive concerns with fintech. So why is SBA rushing to invite fintech into 7(a) without limitations of any kind while simultaneously eliminating many of the program's lending standards? If ever there was a need to press pause on an issue that raises more concerns than answers, it is now.

Let us reach more borrowers by exploring innovative solutions, but SBA should not be making changes to the detriment of borrowers or the integrity of the 7(a) program, and they should not be ignoring valuable resources that already exist in Community Advantage. Congress should make it permanent, and SBA should be leaning into their existing mission lenders who have mission requirements and let the rule changes from May take effect that would further aid mission lending.

Over the past two years, the 7(a) loan program delivered almost \$62 billion to almost 100,000 borrowers, with over \$19.3 billion going directly to minority borrowers. Let us preserve that impact.

Thank you, and I will take any questions.

[The prepared statement of Ms. Murphy follows:]

“Improving Access to Capital in Underserved Communities: The  
Community Advantage Program, Microloans, and other SBA Initiatives”

**Testimony before the Senate Committee on Small Business and Entrepreneurship**

**December 14, 2022**

**Submitted by**

**Annemarie Murphy**

**First Bank of the Lake**

**Greenville, South Carolina**

Annemarie Murphy | President of SBA Lending | First Bank of the Lake | Greenville, South Carolina

Chairman Cardin, Ranking Member Paul, and Members of the Committee—my name is Annemarie Murphy and I am currently the President of SBA Lending for First Bank of the Lake, a small community bank. While I operate out of Greenville, South Carolina, the bank is headquartered in Missouri with a national footprint and roughly \$500 million in assets. First Bank of the Lake has a dedicated focus on SBA lending, and we deliver roughly \$228 million in 7(a) loans annually and served on the frontlines of delivering PPP loans across the country. I am tasked with managing all aspects of the bank's SBA lending program, from sales to servicing and liquidation, as well as ensuring compliance with all aspects of the bank's credit and regulatory policies within the government guaranty lending programs.

With more than two decades of multiple roles within the government guaranteed industry, I have seen firsthand how banks can be successful at reaching underserved markets, as well as the ways in which we can improve. I look forward to today's focus on how SBA programs reach underserved communities. It is critical to continue the collective discussion examining how the SBA lending industry can better serve these communities. In doing so, we must also bring to light the pitfalls and misconceptions behind SBA's most recent proposed rules that purport to increase lending to underserved communities, but which have the potential to bring financial harm to our most vulnerable borrowers and the 7(a) loan program as a whole.

#### 7(a) Lending to Underserved Markets

First, I'd like to be clear: as lenders, we can and need to do more in reaching underserved markets. And lenders need to advance more quickly as an industry when it comes to reaching those borrowers that are the most vulnerable. The SBA's loan programs rely on private-sector lenders to deliver loans to America's small businesses, but it is first and foremost a public policy program and that means that all lenders who participate must understand that Congress will continue to prioritize various underserved markets that need to be better reached. And as a small community lender, I am dedicated to improving how we serve our communities. This basic premise is at the heart of all my testimony.

It is also important to note that the 7(a) loan program is inherently a mission program. In the Small Business Act, the 7(a) loan program's core premise of eligibility is to provide access to capital to small business borrowers *who cannot find credit elsewhere* on reasonable terms and conditions. As lenders, we cannot make a 7(a) loan if it does not meet this credit elsewhere requirement, and I personally review with our team that each loan is documented extensively as to why it meets our core credit elsewhere obligation. In other words, by virtue of the Congressional intent for the 7(a) loan program, *every* 7(a) loan serves a borrower that would otherwise be left behind by banks' conventional lending practices, whether that loan is reported as having been delivered to a certain demographic or not.

We also need to understand who the 7(a) loan program currently serves before we can assess how we need to improve. And I am proud to report that the 7(a) loan program as a whole is making progress year over year in many targeted, key underserved markets. Again, as it always bears repeating, we can and should do more—but, as a leader of a team at my bank, I have learned that you cannot expect others to strive to improve if we fail to even acknowledge or value where they currently succeed. Applying this principle to the 7(a) loan program, any

Annemarie Murphy | President of SBA Lending | First Bank of the Lake | Greenville, South Carolina

observer of SBA's own data would quickly see that 7(a) lenders today are reaching underserved markets.

So where does the 7(a) loan portfolio currently stand?

Roughly 50% of all 7(a) loans made in FY22 were \$150,000 or under. Let me underscore this: half of all 7(a) loans are the smallest of the small loans.

68% of all 7(a) loans made in FY22 were \$350,000 or under.

Now that SBA announced small dollar fee waivers for any loan \$500,000 or under, if we consider \$500,000 the benchmark for small dollar loans per SBA's own indications, we would expect the proportion of small dollar loans would increase. SBA does not currently publicly report on loans \$500,000 or below, and instead reports on loans over \$350,000 to \$2 million, so it is impossible to report on exact figures for what SBA now considers small loans.

But, understanding the market and the numbers we are provided (and outlined here), it is safe to say that roughly three out of every four loans made in the 7(a) loan program are small loans.

SBA has statutory discretion to adjust fees for program participants if there is an excess in fee income after taking in the expected cost of 7(a) lending for a given Fiscal Year. Given that SBA has waived all fees for borrowers and lenders for all loans \$500,000 and below for FY23 with this discretion, it is a show of incredible support to small dollar loans that likely over three-quarters of the entire 7(a) portfolio does not pay any fees to obtain access to capital through the SBA 7(a) program.

Roughly one-third of all 7(a) loans in dollars are made to minority populations, and about 30% of all 7(a) units are made to minority populations.

It is likely these numbers are understated as it is critical to note that roughly 25% of all loans made in FY22 went unreported—meaning, the small business borrower chose not to disclose their race, ethnicity, or other demographics to the lender. Remember, as lenders, we cannot force a borrower to report any relevant demographic and we cannot do that for them. There are critical fair lending laws and regulations that require lenders to lend in a color-blind fashion. As a result, the borrower must always opt to self-report and it is not mandated. We also know anecdotally that it is underserved markets and minority borrowers who are most reticent to check a box disclosing their race or ethnicity. In my personal experience as a lender, minority borrowers are worried that somehow that disclosure will lead to a negative outcome for them. While that is a cultural perception we will need to continue to work hard to reverse, it is significant to understand this dynamic at play when evaluating the success of 7(a) lending in minority populations. One-quarter of all loans made, roughly \$6.5 billion in 7(a) loans, went unreported last year, and knowing what we do about minority borrowers' hesitations to self-report, we could likely conclude that lending to minority populations in the 7(a) program is greater than one-third of all loans each year.

Annemarie Murphy | President of SBA Lending | First Bank of the Lake | Greenville, South Carolina

Loans to African-Americans are at an all-time high in the 7(a) loan portfolio and saw the largest jump in lending in FY22 compared to any other minority demographic: rising from 4% (in FY17) to 7% (in FY22) of the total loans made over the past six years and rising from 2% (in FY17) to 4% (in FY22) of the total dollars delivered in the past five years. This is a 39% increase in the number of loans and a 59% increase in dollars over the past six years. In FY22 alone, \$984 million in loans were made to African-American small businesses.

The proportion of loans in the 7(a) portfolio to Hispanics are at an all-time high; 10% of the total loans made and 7% of the total 7(a) dollars in FY22 went to Hispanic borrowers, amounting to \$1.847 billion in loans to Hispanic small businesses last year.

Roughly 20% of 7(a) loans are made to rural populations, and roughly 80% are made to urban populations.

All of this data was provided by SBA's own weekly loan reports published publicly.

And finally, an important note on data and how it can be used to tell a desired story: As is true for comparing any Fiscal Year against another in a program like the 7(a) program, these percentages fluctuate slightly each Fiscal Year based on what our borrowers need and apply for each year. The percentage of all 7(a) loans \$350,000 or under has fluctuated in recent years—in FY17 that percentage was at a high of 74%, in FY21 it dipped to 55%, and now in FY22 we are on a sharp increase once again to 68%.

It is no secret what happened in FY20 and FY21 to cause a dip in *any* sector of lending—a global pandemic that proved earth-shattering for small business. The pandemic kept many borrowers on the sidelines of growth, and therefore kept them from applying for loans. Many of our small business customers applied for capital through the PPP *instead* of a 7(a) loan in those years.

While it is not factually wrong for SBA to say that small dollar loans declined in the height of the pandemic, it doesn't give an accurate portrayal of how numbers can fluctuate month to month and year to year, places far too much emphasis on shifts that amount to a handful of percentage points, and, most importantly, it doesn't acknowledge the *why*. A global pandemic crisis is a pretty good "why" as to a decline in any lending during those two FYs, especially when the federal government was offering, even encouraging, those same borrowers into another program. And SBA's assertion about a small dollar loan problem certainly doesn't acknowledge the sharp upswings we are seeing in small dollar loans now that we are on the other side of delivering PPP.

SBA's own data tells a story of a loan program that is succeeding at delivering small dollar loans and is improving in many key underserved markets.

Why is this important to raise? Over the past several weeks, SBA released two proposed rules, *Affiliation and Lending Criteria for the SBA Business Loan Programs*, 87 FR 64724 ("Affiliation Proposed Rule") and *Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization*, 87 FR 66963 ("SBLC Proposed Rule"). The entire premise of the proposed rules as presented by SBA is to increase mission lending.

Annemarie Murphy | President of SBA Lending | First Bank of the Lake | Greenville, South Carolina

Even Vice President Harris announced from the Department of Treasury that these proposed rules would combat racial equity.

The 7(a) lending industry could not agree more with the *intent* behind these proposed rules—any creative thinking to bring about more mission lending and welcome more lenders into the program is for the better. Lenders are used to competition and even expect it. Competition is healthy and often fuels results that could lead to reaching more borrowers.

But in justifying why the SBA is proposing these rules, the agency has painted a narrative that somehow the 7(a) program is currently failing. SBA even undercuts the Community Advantage pilot program, stating that “the low historic loan volume and lack of any CA loan activity in some rural and underserved geographic areas makes this an unviable alternative.”<sup>1</sup>

The Community Advantage program should be applauded, not criticized. The Community Advantage program should be made permanent, not disregarded. This past May, SBA made significant regulatory changes to Community Advantage to aid the pilot program even further in reaching more borrowers—these new changes should be given a chance to take effect. The Community Advantage program makes a small number of loans that make a profound impact, but SBA has highlighted this number and indicated that it means the Community Advantage program is not succeeding. Even as a small community bank, I only make an average of 200 7(a) loans annually—are those loans not valuable to the underserved borrowers we help? Our underserved borrowers would disagree. I am deeply worried that in a post-PPP world, we have become numb to volume and expect every program to show PPP-like numbers with big, splashy impact—this would be a mistake of enormous proportions.

As a leader of people and a seasoned 7(a) lender, I know this is not the best way to go about change. It is critical that we look at the agency’s data for ourselves so that we can better understand the reality of our reach to small loans. And per SBA’s own data, the 7(a) loan program’s reach to small dollar loans is a success story.

### **SBA’s Proposed Rules**

So, what is included in the proposed rules and how will they impact the underserved communities that they aim to help?

The Affiliation Proposed Rule would loosen or remove the 7(a) program’s requirements for how lenders underwrite loans. The SBLC Proposed Rule would lift the existing forty-year moratorium on the number of non-federally regulated institutions (called Small Business Lending Companies or SBLCs) that can make loans under the 7(a) program and permits SBA to add an unlimited number of SBLCs to the existing 14 licenses. SBA also creates a new type of SBLC called “Mission-Based SBLCs” that are meant to have mission requirements, but which are not specified. In other words, the Affiliation Rule proposes removal of the prudent lending standards I have spent my career relying upon, and the SBLC Rule proposes to bring unregulated

<sup>1</sup> *Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization*, 87 FR 66963, <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>

Annemarie Murphy | President of SBA Lending | First Bank of the Lake | Greenville, South Carolina

entities, such as FinTech, into a program that has now been stripped down of its prudent guardrails.

Let me say upfront: all lenders understand the value of automation and simplification, particularly for underserved borrowers. We are not anti-FinTech and we are not averse to simplifying SBA processes where they can be simplified. What I am profoundly opposed to are imprudent proposals that could harm underserved markets and damage the 7(a) loan program's integrity from both a reputation and performance perspective. I believe these proposals as drafted do just that.

*Mission Lending.* First, the proposals as drafted fail to demonstrate how they will aid mission lending whatsoever. The additional SBLCs, like the existing fourteen licenses, would not have any mission requirements and do not seem to be meant to serve underserved borrowers in any way. The Mission-Based SBLCs, while presumably meant to focus on mission lending, do not have any defined set of mission-lending requirements, leaving it up to the SBA political appointees to establish program parameters on a lender-by-lender basis. As a lender, I worry that borrowers, especially the most vulnerable, will be disadvantaged without clear rules and standards that apply consistently to all lenders—and, as a long-time SBA lender, it is a worrisome shift that there is not one standard rulebook for all participants and that the program rules will be determined on an individualized basis by political appointees.

There are also requirements for Mission-Based SBLCs to form separate non-profit corporations that could present financial and legal barriers for non-profit mission entities that have limited resources. It was also surprising that there was no described pathway for entities which are not currently involved in Community Advantage to become a Mission-SBLC, a glaring omission if the purpose is to bring more lenders into the program. Finally, it is unclear how allowing Community Advantage lenders to make *larger* loans outside of Community Advantage (where the maximum loan amount is capped at \$350,000) helps more *small* dollar loans.

If a proposed rule is built entirely on the premise of aiding underserved markets, it's not a good sign for there to be this many gaps and concerns about how it actually aids those underserved markets.

*Oversight.* As a lender, I am deeply troubled that SBA does not have the oversight capacity to serve as primary regulator for additional SBLCs. The Office of Credit Risk Management (OCRM) serves as the office within SBA responsible for all lender oversight, and, as such, supervises both 7(a) lenders and 504 Community Development Corporations (CDCs). In addition, within the 7(a) program, OCRM serves as the primary regulator for Community Advantage participants and SBLCs, and would continue to serve as primary regulator for any additional SBLC. Given the office's current responsibilities, especially as SBA continues to untangle from a post-PPP world, OCRM is operating at its maximum capacity in my opinion. As a lender, I see firsthand the ways in which OCRM lacks the resources and has limited staff. I hear from my SBLC counterparts that are part of the existing group of licenses discuss how they have waited for many months for their regular review results from OCRM—by law, the Small Business Act requires that OCRM deliver a review to lenders within 60 days or provide notice of their delay in writing. SBA states they currently have the capacity to take on three additional SBLCs without a mission focus—my front row seat would tell me otherwise. SBA states that adding existing Community Advantage participants as SBLCs would not present any additional burden—I would argue that bringing in lenders in a completely different capacity to make loans up to \$5 million when they were formerly capped at \$350,000 absolutely presents an additional supervisory burden.

Annemarie Murphy | President of SBA Lending | First Bank of the Lake | Greenville, South Carolina

*Unlimited Nature.* SBA did not propose a slow and steady test run of bringing FinTech into the 7(a) loan program. The preamble of the proposed rule states that they will bring in three new SBLCs, which are not mission lenders, right now. However, the actual proposed rule allows an unlimited number of SBLCs into the program whenever SBA sees fit.

In addition, rather than impose a cap on volume for the new SBLCs, SBA is silent on this front. This concept of capping volume on new entities or new programs is not new—by statute, any pilot program is capped at 10% of the volume of the overall portfolio. While SBA did not present this expansion as a pilot program, even though it does present a new purpose which would seem to trigger the need for a pilot program classification, it would seem reasonable to present some sort of volume cap. This kind of cap is especially relevant given that the types of entities proposed to enter the program are FinTech, which are built on a lending and business model that relies entirely on very high volume meant to be made at rapid pace.

My concerns about a lack of any limitations are not raised out of fear of competition. Rather, my concerns are two-fold. First, I would expect that most reasonable recommendations would follow the mantra of introducing untested concepts that could present great risk to the portfolio in a gradual fashion. And secondly, we live within the realities of a Congressional program with a Congressionally imposed authorization cap on total program volume each Fiscal Year. The 7(a) loan program may make loans in FY22 only up to \$30 billion—after which, the program would shut down for the remainder of the Fiscal Year. If FinTech brings their current high-volume model to 7(a) lending, we could face a programmatic shutdown mid-Fiscal Year. Again, this is not about existing 7(a) lenders wanting their share of the pie—this is about making sure we understand the limitations of a government guaranteed program, and wanting to ensure we avoid a programmatic shutdown which serves no borrower or lender.

*Regulatory Gap.* As a federally regulated lender, I am worried and surprised that SBA did not propose to require new SBLCs mirror any federal regulatory and compliance requirements imposed on depository institutions that are supervised by a federal banking agency or the National Credit Union Administration (NCUA). Imprudent lending behavior could lead to risk to both borrowers and the performance of SBA's 7(a) portfolio. Every day I go to work, I have to ensure 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. These compliance standards dictate every decision my bank makes in both our conventional and SBA loan portfolios. But not one of these standards is set out by SBA. Instead, I am told by SBA's guidelines that I should follow my federal regulator's requirements. My 7(a) loans are reviewed and monitored by SBA, but the agency does not attempt to replicate what my federal regulator requires. Many of these rules and regulations were put in place to protect the small business owner and guard against imprudent lender behavior.

Why is this significant? If SBA is opening the program in an unlimited fashion to entities that have no federal regulator and plans to serve as primary regulator, we need to understand the basic premise that SBA does not have federal regulator-like standards to apply to these new non-federally regulated entities. In other words, they are not set up to act like a primary regulator in the manner in which the federal regulators are equipped, and the proposed rule does not even

Annemarie Murphy | President of SBA Lending | First Bank of the Lake | Greenville, South Carolina

attempt to remedy this gap. If the goal is to help underserved markets, this regulatory gap should raise concerns, as it is the most basic notion that a prudent regulatory framework protects borrowers.

*Policy Shift.* I am also troubled by the clear direction that SBA is taking the 7(a) loan program—instead of bringing FinTech into the existing program with guardrails, the agency appears to be modifying the program for FinTech, removing guardrails to make 7(a) lending fit into a low-touch model that FinTech currently utilizes. Of particular concern, the Affiliation Proposed Rule removes the detailed list of factors to be considered when lenders are determining whether a loan applicant is creditworthy. As a substitute for the existing credit analysis factors, SBA proposes to amend the regulations to require lenders and CDCs 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.”<sup>2</sup> This has colloquially been described to lenders by SBA as “Do what you would do.”

If a lender is directed simply to follow procedures it would use for its similarly sized non-SBA-guaranteed loans, the likely result is that federally regulated lenders will continue to operate based on the requirements imposed on them by their primary federal regulator while non-federally regulated lenders will have no such limitations. Who is hurt by this? Borrowers, especially in underserved markets.

Imagine all lending entities, including FinTech, being able to “Do what you would do” as the underpinning of all SBA credit analysis and underwriting criteria. As a lender, I can tell you immediately that for non-federally regulated entities, this kind of hall pass on prudent lending guardrails would lead to a different risk tolerance than federally regulated lenders. This equates to higher losses and an impact to overall 7(a) loan portfolio performance.

The current 7(a) loan program has low loss rates and strong performance since the Great Recession. Every lender that participates in the program contributes to this performance—all of our loans combined make up the entire 7(a) portfolio. If even a few handful of lenders begin to make riskier decisions and have higher losses than we currently have, the estimated costs of 7(a) lending will have to increase. This means that fees required of borrowers and lenders will need to be increased to cover higher expected losses. All of the fee waivers at SBA’s discretion would likely be eliminated, and Congress would likely have to increase fees that are currently set in the Small Business Act and already at their statutory maximum. If fees are not increased, Congress would have to provide an appropriation. In the absence of one of those options to cover the cost of the program, the program would shut down. This domino effect will not happen right away. Typically, losses occur three to five years after the loan has been originated.

There are real consequences to greater risk and higher losses. The greater risk is not due to the borrowers being served—the greater risk is because of the types of entities SBA is inviting into the program in an unlimited fashion while simultaneously removing the rulebook. When a program is drastically more expensive for borrowers and lenders because losses are increased, underserved borrowers get left behind in a program that has suddenly become cost prohibitive.

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<sup>2</sup> *Affiliation and Lending Criteria for the SBA Business Loan Programs* (87 FR 64724), <https://www.govinfo.gov/content/pkg/FR-2022-10-26/pdf/2022-23167.pdf>

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*Criminal and Congressional Investigations.* Finally, I am deeply disturbed that SBA is welcoming FinTech into the program in an unlimited fashion with a loosening of rules just as Congress is releasing explosive reports announcing that FinTech was at the center of tens of billions of dollars in fraud because of the lack of prudent behavior and internal guardrails from those entities. But this history of looking into FinTech goes beyond just recent reports.

Congressman Cleaver started a probe in 2017 into how the algorithm at the heart of all FinTech lending could be discriminatory and harm underserved markets, asking the Consumer Financial Protection Bureau (CFPB) to take a closer look.

CFPB issued a statement in May 2022 to affirm that the Equal Credit Opportunity Act (ECOA) that protects borrowers against discrimination applies even to entities that rely purely on an algorithm to make lending decisions, having cited long-standing concerns that algorithm-based lending can lead to black-box credit decisions that have a potentially disparate impact on minority borrowers.

The Department of Treasury under the current Biden Administration released a report just last month titled *Assessing the Impact of New Entrant Non-bank Firms on Competition in Consumer Finance Markets*, which concluded that non-bank firms increase market risk and need enhanced oversight.

Finally, the Select Subcommittee on the Coronavirus Crisis has released troubling conclusions about the role of FinTech in PPP.

In early findings, the Select Subcommittee on the Coronavirus Crisis noted that “Recent reports have found that FinTechs and their bank partners handled 75 percent of the approved PPP loans that have been connected to fraud by DOJ, despite facilitating just 15 percent of PPP loans overall.”<sup>3</sup>

Most recently, on December 1, 2022, in the most stunning example showcasing the need to press pause on bringing FinTech into the 7(a) program, Congressman Clyburn and the Select Subcommittee on the Coronavirus Crisis released a report identifying how FinTech participation in SBA’s PPP resulted in wide-scale fraud.<sup>4</sup> This new report illuminates in detail the ways in which FinTech utilized “inexcusable misconduct” amounting to tens of billions of fraudulent loans, significant harm to the taxpayer, and in many cases, the prioritization of only large loans.<sup>5</sup> The report concludes that “any plans by the SBA to again open 7(a) participation to Fintechs and other unregulated, non-depository institutions must be accompanied by a well-defined, more rigorous, and better-resourced initial review process, and such entities should be subject to continuous monitoring to confirm their adherence to SBA rules and industry best practices.”<sup>6</sup>

<sup>3</sup> <https://coronavirus.house.gov/news/press-releases/select-subcommittee-launches-investigation-role-fintech-industry-ppp-fraud>

<sup>4</sup> *New Select Subcommittee Report Reveals How Fintech Companies Facilitated Fraud In The Paycheck Protection Program*,

<https://coronavirus.house.gov/news/press-releases/clyburn-fintech-fraud-ppp-doj-sba>

<sup>5</sup> *Ibid.*

<sup>6</sup> *Ibid.*

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Congress, the IG community, the Department of Justice, the Department of Treasury, CFPB, and law enforcement all seem to be unified—FinTech is not currently properly regulated, FinTech can pose distinct risks to underserved borrowers, and FinTech brought about what appears to be the largest scale of fraud we've seen in recent decades in the federal government.

SBA appears to be moving in the opposite direction from their counterparts.

As a lender who has served as a long-time steward of the program, this is an impossible contradiction. While investigations into potential criminal behavior by FinTech companies in one federal government program (PPP) are still underway, SBA should not invite FinTech entities into another federal government program before better understanding the role these non-federally regulated entities played in this large-scale fraud.

No other factor is as significant as these recent Congressional findings to lead to the common-sense solution of pressing pause on SBA's proposed rules. A pause would allow for reasonable actions to be taken in response to the Congressional report and to give the opportunity to incorporate Congressional recommendations before moving forward.

This is especially poignant when re-reading SBA's proposed rule now that the Congressional investigation into FinTech in PPP has been released. The SBLC proposed rule reads:

*"many 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 Mission-Based 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."*<sup>7</sup>

How could we possibly still want to move forward with a proposed rule that cites bringing in the supposed success of entities in PPP to the 7(a) loan program when those same types of entities are now at the center of a Congressional report pointing to large scale misconduct?

### **Recommendations**

To further progress 7(a) lending outreach to minority communities, first we need to ensure no harm is done to underserved borrowers and the portfolio, which means pressing pause on SBA's two recently proposed rules through Congressional action. As an industry, many of us have seen this before—it was 2008 right before the Great Recession. The 7(a) loan program helps tens of thousands of borrowers every year and currently injects billions of dollars into minority communities. Let's keep the guardrails we need to ensure prudent lending behavior and address the concerns of Congress and this Administration when it comes to FinTech, especially in the wake of Congressman Clyburn's most recent report.

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

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Next, there are several legislative solutions that have been introduced by Members of this Committee that would greatly improve 7(a) lending's reach to underserved markets if they were to pass. The first is Chairman Cardin's bill that would make Community Advantage permanent, the *Community Advantage Loan Program Permanency Act of 2022*—this is critical to give program participants the assurance that this mission-driven subset of the 7(a) program will be available for the long-term. The second piece of legislation is Senator Ernst's *Child Care Small Business Investment Act*, a targeted bill that would improve access for non-profit childcare providers to utilize the 7(a) loan program and aid many communities, especially rural, that rely on non-profit child care facilities to help working parents gain greater access to quality and affordable care.

I would also encourage the facilitation of more informal, roundtable style conversations with existing 7(a) lenders and Congress so that there can be a more wholistic brainstorming of what else we can tangibly do to improve minority lending even further. Ideas such as targeted goals for small dollar loans for each 7(a) lender, and codifying in statute fee waivers for small dollar loans are both issues we should discuss. While hearings are beneficial to placing insight on the record, they rarely facilitate the kind of discussion the industry and Congress could and should have on a regular basis so that ideas such as small dollar loan incentives could be better fleshed out.

Improved reporting and data collection of lending to underserved markets is also a critical piece of how we better our reach—when we have an accurate picture of what kind of lending we do, we can work towards improvement based on facts. As an example, when pulling data collected from our fair lending reporting required of the bank on race, gender, and ethnicity, it did not match with the data we pulled from our bank's SBA data platform. When I investigated further, I found that many of the smaller loans we made utilized what is called a Rollover Business Start Up, or ROBS, which allows a borrower to use money from their 401K toward their required equity injection for the loan. Upon further examination, SBA's data entry platform for lenders does not require that lenders submit any borrower-provided answer on underserved demographics when using a ROBS loan structure. For other loans, SBA's platform requires an entry—even if the borrower does not voluntarily report race or ethnicity, lenders are required to click "N/A." This is not the case for ROBS—lenders in their daily rush can simply click through the platform and not fill out anything, even "N/A." This should be addressed with SBA so that lenders are required to relay to SBA what the borrower opted to fill out. Again, this does not require the borrower to report data on race that would violate fair lending laws and regulations—it simply requires lenders to relay borrower-provided information. These small tweaks, which Chairman Cardin championed in the context of collecting data in PPP, can make small differences that add up. When we don't have an accurate picture, we can't assess our reach accurately.

We also need to better represent these data collection deficiencies in our collective dialogue. At the bottom of every report on loan activity published by the SBA on a weekly basis, SBA states:

*"DISCLAIMER: The information being provided above is derived solely from Agency records that are submitted by the Agency's participant lenders engaged in making SBA loans. This information is collected by the lenders from SBA loan applicants who provide*

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*it on a voluntary basis. It is then forwarded by the lenders to SBA. Since the information is provided by the loan applicants on a voluntary basis, it is not necessarily inclusive of all SBA borrowers, nor can its accuracy be verified by the Agency. Accordingly, SBA cannot make any representation as to the completeness or accuracy of the information provide”<sup>8</sup>*

In other words, SBA asserts demographic data is limited and based entirely on a borrower’s cooperation and disclosure. Perhaps there is more progress to be made for lenders as to how we educate borrowers on why this data is being collected, and perhaps SBA could aid in that improvement.

Finally, I want to share a personal case study from my own institution: nine months ago, I launched a Veterans Initiative Team within First Bank of the Lake to target lending activities to our nation’s veterans. I come from a long-serving military tradition within my immediate family—my father, my husband, my brother, my nephew, and my daughter have all served or are currently serving in the military. My oldest daughter is currently serving in Guam, and I am proud of her service and who she is beyond measure. Because I know this community of underserved borrowers, I was anxious to tackle how my bank approached veterans. I started hiring veterans to create a team of lenders that had served. Once I had staffed with individuals that had a shared experience with the borrowers we were trying to reach, my bank easily tripled its volume in loans to veterans within the first nine months. My bank went from 4% of our loans going to veteran borrowers to 12% of our loans.

When we personally invest in our institution’s approach to underserved markets and shape our teams in a way that the lenders reaching out to underserved borrowers share common ground and experience with those borrowers, I believe we can make enormous gains individual institution by individual institution. And small improvements lead to bigger progress.

Thank you for the opportunity to testify, and I look forward to continuing the dialogue on these critical topics.

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<sup>8</sup> SBA Weekly Lending Reports, <https://www.sba.gov/document/report-2022-weekly-lending-reports>

Chairman CARDIN. Let me thank all four of our witnesses, very constructive testimony, appreciate that, on the existing programs as well as the two proposed rules by the SBA.

And I appreciate the testimony in regards to the Community Advantage program. It clearly is reaching—doing a better job in reaching the underserved communities and with smaller small businesses.

What is the advantage of it being made permanent? The Administration did expand its reach by action earlier this year. What additional advantage would there be if this is a permanent program, Mr. Villarreal?

Mr. VILLARREAL. Thank you for the question, Senator. So the first and foremost thing is, while SBA did extend the program—at that time, I think it was 28 months, so now it is less than 2 years. And we have heard the words “prudent lending” go around a lot. And if you are a mission lender and see that a program has a sunset of now 22 months or 23 months, it does not make any sense to make that investment to become an SBA Community Advantage lender because it takes a lot of resources to do that and it takes time to ramp up. Even in the SBA’s proposed rule change, they talked about the ramp-up period for SBLCs.

So the most critical one is that it gives security to a lender in that it knows the program is going to be around, so that is the primary one. So then it can start to build a team around that and start to build a marketing strategy to get to those.

I think the other one, particularly as it is proposed, Senator, is it allows a greater guarantee for loans under 150, to 90 percent, and then for loans from 150 to 350, of 80 percent.

And why is this important? A lot of the Community Advantage lenders are smaller lenders that can be capital restrained. So the ability to take that guarantee and sell it in the secondary market and recapitalize and get back—if you do a \$100,000 loan and you get back \$90,000, you can continue to recycle that money in your community, and these smaller Community Advantage lenders are not in that wheel of having to go and continuously fundraise and get more money.

So those are two critical things that permanency will do, particularly the way it is written. It will allow Community Advantage lenders to not have to go out and fundraise as much and really make an impact in their community.

Chairman CARDIN. Several of you have mentioned the progress we have made in the 7(a) programs in reaching the traditionally underserved communities, and we have made progress. But one trend line appears to be just the opposite: that is, the size of the loans. Over the years, the average size of a 7(a) loan has grown in dollar amount, not gotten smaller.

And, as we know, the smaller small businesses are the ones who are always more challenged to have the capacity to get a loan. What can we do to target the program more to the smaller small businesses in traditionally underserved communities? Mr. Gaines, do you have some thoughts on that?

Mr. GAINES. Well, thank you again, Senator. Appreciate that question. I think there are certainly a few ideas we can certainly think about right off the bat there because again we are dealing

with—I am going to say small “micro businesses” is probably the best term I would use.

I would say right off the bat, in regards to making it easier, of course, we all know there is importance to have regulation. But the process that we go through in terms of really underwriting the loan, to really make it simpler from the standpoint of actually making it easier to underwrite the loan, makes it quicker for the borrower but also makes it quicker for the lender to basically do the work they need to do to get those funds out to the borrower.

So I would say one thing right off the bat would be simpler. I do not want to say simpler regulation, but I want to say simpler documentation from that standpoint to make it easier to happen.

What other things we could probably—or, other recommendations that could be out there to make it easier for smaller business loans? I think we need to continue to further the outreach that we do as well in regards to working with small businesses just so they know because we are sometimes challenged by language barriers. Speaking briefly, in terms of Wisconsin, you know, two-thirds of our business owners are ladies. We want to make sure that we are doing everything we can to really kind of bridge those cultural divides and really work hard to communicate with folks from a marketing perspective so it makes it easier for small businesses to understand who we are, what we do, and, just as importantly, work with us.

Chairman CARDIN. Thank you. Ms. Murphy, I want to give a shout-out to what you have been able to do in the veteran community. It shows that if you really want to make a difference, if you do the outreach, you can reach a community that has had a challenge in reaching services. So tell us your secret. How did you get those good results in the veteran community?

Ms. MURPHY. Thank you, Chairman Cardin. So what we did was recognize that many of our underserved borrowers want to work with somebody that they feel that they have a shared experience with, someone that they have something in common.

And when we looked at it—I come from a longstanding military family tradition. I will give the shout-out to my daughter who is currently serving in Guam. What we realized was that when we started putting teams together of veterans and then started doing outreach to veteran organizations, having that common experience, all of a sudden our veterans were willing to check the box, to say, “Yes, I am a veteran. Yes, here is my DD214. Yes, I now have the advantage of the no fee for my veteran loan” because they felt comfortable with that person.

So we have expanded that to now include veteran underwriters. We are looking at other operations positions at this point and training veterans who are now separating from service and training them up in SBA lending. And, we are looking to replicate this since we had that success this year. We launched this on January 1st of 2022. So we are not even a full year into it and tripled it. So now we are looking to replicate what we did and start doing that with other underserved markets.

Chairman CARDIN. Thank you.

Mr. Schwellenbach, I just really want to compliment you on your testimony as to the way you framed it. I look forward to your spe-

cific recommendations in regards to modifications of the proposed rule to deal with the guardrails and concerns that you express. You seem very positive about SBA expanding competition but raise an issue we are all concerned about, and that is having adequate protection and accountability. So we look forward to your specific recommendations in that area.

Mr. SCHWELLENBACH. Right. So there is a bit of a gap here. And thank you for the question, Chairman Cardin. So many of the participants in the PPP were traditional depository institutions Federally regulated by the Treasury Department, OCC, and on and on, with ample experience complying with Bank Secrecy Act, Know Your Customer Act—Know Your Customer requirements.

And the PPP was a big experiment in expanding participation to fintech lenders, and to their great credit, you know, they played a major role in helping a lot of underserved and minority-owned and other businesses that had trouble accessing capital get PPP loans. The big downside is a lot of these fintechs just kind of opened the floodgates to fraud.

And many of these fintechs and their supporting companies, companies like Blue Acorn and Womply, they really had no experience or very little experience complying with the Bank Secrecy Act and Know Your Customer requirements prior to the PPP, and suddenly they are processing tens of billions of loan applications.

And I will not go into great detail, but the House Select Subcommittee report is very disturbing. But, really, what it points to is that the SBA was not doing its own due diligence at the front end in allowing many of these companies to participate.

So one thing I did lay out in my testimony is that we need to have sufficient criteria when evaluating companies that want to participate in these programs. Do they have a track record of complying with the Bank Secrecy Act or have they demonstrated that they can comply with the Bank Secrecy Act? And, does the SBA have the capacity to vet them at the front end and then continually monitor them over time to make sure it was not—they are not just passing the test at the front end and then throwing away all their anti-fraud resources to save a buck later on?

And the Select Subcommittee's report goes into great detail about how some of these companies, when they started to flag a number of loans as suspicious and potentially fraudulent, cut back on their automated systems for processing loans. Some of them were throwing reviewers into processing loans without any training at all and looking for signs of potential fraud.

So at the SBA side, you need to have sufficient criteria so that these companies that are not regulated by the Treasury Department or OCC or other Federal entities can meet the standards that traditional banks and credit unions have to meet when it comes to knowing your customer.

The SBA itself flagged hundreds of thousands of loans as potentially fraudulent because it found signs that they were not active businesses before February 15th, 2020. If these lenders were doing their Know Your Customer requirements properly, they would know if these loan applicants existed, you know, before February 15th. It is a very basic thing.

So you know, a lot of this is SBA making sure that the lenders who participate and their supporting companies—that is a really key part of this—comply with these standards and that the standards are high enough.

Chairman CARDIN. Thank you.

Senator Marshall.

Senator MARSHALL. Chairman, I will yield my time to Senator Ernst if that is okay with you.

Senator ERNST. Okay. Great. Thank you, Chairman, and thanks, Ranking Member, very much.

And, Mr. Schwellenbach—did I say it correctly?

Mr. SCHWELLENBACH. That is pretty good. Schwellenbach, yes.

Senator ERNST. Schwellenbach. Thank you. I appreciate it.

No, I do appreciate you talking about the role that fintech firms—financial technology firms—played in distributing funds to our small businesses during PPP. So many of us were involved with the Paycheck Protection Program during COVID-19. I think largely in part it was a great success for our small businesses, but of course, we did run into issues when it came to fraud. And so I am glad that you have had the opportunity to do investigative work in these areas.

We did have unprecedented levels of fraud within the program, which I hate that we have to report that, but that is the way it is. And we need to make sure that there are appropriate guardrails. I think it was close to an estimated amount of a hundred billion dollars of fraud, and so that does have to be corrected.

It is very important that we make sure our underserved communities have equal access to SBA lending programs, but as we are looking at this, we also have to make sure that our taxpayer dollars are being adequately protected from fraud and waste caused by a lack of oversight. So I appreciate you outlining for Chairman Cardin some of those changes that you would like to see and certainly would love to work with you in the future just so that we can strengthen some of those anti-fraud protections, so I just wanted to start off with that.

But then, Ms. Murphy, I would like to go to questions with you, and I really appreciate you talking about our veterans community as well. There are a number of underserved communities, especially as we look at some of the SBA lending programs. I will start with a priority that I have been working on, and then we will move into more of the veterans and some of those underserved communities.

But one of the longstanding priorities that I have had is to expand access to child care for small businesses, especially those that are in the rural and underserved areas that have little or no access to quality child care services. And because of the inability to access child care, it has created these economic barriers for so many people out there, these families that want to return to work, maybe do what they were doing pre-pandemic, but some of their child care is gone.

So earlier this year, I introduced the Childcare DESERTS Act, and that would allow for small businesses to use SBA loans to provide child care services to employees.

And I am also a co-sponsor of the Small Business Child Care Investment Act, which would allow for nonprofit child care providers to access those SBA 7(a) loans, and I am glad you talked about those 7(a)s, really appreciate that.

How could the SBA provide further assistance to eligible SBA lenders to help provide small businesses with access to quality child care in rural or those underserved communities?

Ms. MURPHY. Thank you, Senator Ernst. It is a great question. So the bill would actually need to pass in Congress because the way the SBA program is structured right now it is ineligible for nonprofits.

Senator ERNST. No nonprofits, mm-hmm.

Ms. MURPHY. Mm-hmm. So we would need that to pass, but we would absolutely look forward to sitting down with you and putting something together and seeing what we can do because it is so important, especially for our working families, to have reasonable child care.

Senator ERNST. Mm-hmm. And it is important because in many of our rural areas there are a lot of churches and other nonprofits that really want to expand availability of childcare, but they just lack that access to loans and other types of programs. So I would love to work with you on that.

So I would like to dive in as well to assisting our veterans, of course. I have a daughter who is active duty, serving right now. I am a veteran. We have lots of veterans that live in our communities and are engaging in small business activities.

What more can we do? I know checking the box is great, but what more can we do to get veterans engaged through SBA loan programs?

Ms. MURPHY. A lot of it is the continued outreach. SBA is doing that, and we have been working with many of the Veteran Business Outreach Centers to get in front of veterans and talk to them from a lender perspective of what exactly we need to put together and how we can best serve what they are looking to do as an entrepreneur.

Senator ERNST. Very good. And my time is expired, so I will yield back, but thank you very much.

Thank you, Ranking Member.

Chairman CARDIN. Thank you.

Senator HIRONO.

Senator HIRONO. Thank you, Mr. Chairman.

My focus is on the smaller loan programs that target the minority-owned businesses; that would include women-owned businesses. And I met with—every time I go home, I meet with those businesses who benefitted from the PPP program, and one of the really interesting things is last time when I was talking with two women-owned businesses was that they both started their businesses during the pandemic. They decided that they would start their businesses. So it was a really interesting kind of timing that I had not heard, that people would actually start a business during the pandemic, when businesses were having such a hard time. So I think that they would definitely have benefitted from some of the smaller programs that we have.

So for example, the Community Advantage loan program, about \$104 billion was lent through that program nationwide, and we did not have any of that going to any businesses in Hawaii. However, the Microloan program, with \$63 billion lent out, there was at least one entity, nonprofit entity, in Hawaii that lent something in the order of close to \$500,000 in very small loans.

The idea of increasing the money available for these kinds of really small loans, is that in the cards? I should ask you, Mr. Gaines.

Mr. GAINES. Yeah, thank you, Senator. Definitely a good question there. I certainly think it is important to note that it is always a couple things. I call it trust and then also access to capital, and those are very, very critical when we are talking particularly small loans.

I would say certainly the trust factor is so critical because, again, I am a person that has no idea. I have nowhere to turn. I do not know how to get started.

How can we help them really kind of bridge that gap in terms of moving forward? So we have to continue to work on that piece, and I think we all, as microlenders, are really working hard to—how do we figure out a way to use trust to build those connections, to get folks much more involved and focused in regards to that.

But certainly, I would go right back to, as you would say, Senator, I think it is important. We need to continue to increase the funding available, the capital available. It could be Microloan intermediaries but also other partners as well because, again, there is no way with 150 Microloan intermediaries we can loan all the funds that are needed out there in regards to the communities at large. So it is still critical.

So I would say, yes, we need to increase capital, and we certainly need to use things like trust and other resources to build that out.

Senator HIRONO. So while there is approximately \$100 billion in fraud under the PPP program, do you know if there was this kind of a percentage, kind of fraud, in these smaller Microloan programs?

Mr. GAINES. That is a good question. I do not know the answer to that, Senator.

Senator HIRONO. Anybody? Ms. Murphy.

Ms. MURPHY. I do not know the answer to the Microloan question. However, what I can say is that the guardrails we already have in the 7(a) loan program, they really prevent a lot of fraud. It is never going to be 100 percent perfect, and I cannot tell you what the percentage would be. But we verify the tax returns with the IRS that we receive from the borrower, and right there that stops quite a few people when they find out we are verifying with the IRS themselves.

Senator HIRONO. Are there those kinds of guardrails in the Microloan program and the Community Advantage loan program?

Mr. GAINES. Yes, definitely. Certainly, Senator.

Senator HIRONO. Okay.

Mr. GAINES. Yeah, there are definitely reviews of those.

Senator HIRONO. To me, as I focus on the targeted—these kinds of targeted loans, these programs can use a lot more funding if you

already have these guardrails. So we are not going to see the kind of massive fraud that we saw in PPP.

And it is astounding to me that the kind of fraud in PPP totals \$100 billion when you have these other small programs that do not total much more than what was fraudulently acquired under PPP. So it seems to me that we can do more.

Mr. VILLARREAL. So, Senator, if I can add, as both a microlender, like Jon—and he is also a Community Advantage lender, like ourselves—SBA is our regulator, and we have heard some negativity—a bit about SBA. But they are our regulator, and they are looking at the loans because a lot of them are going through the loan processing center. Not on the SBA Microloan, but for us, every year or every other year, SBA staff does come out and look at our portfolio. So there is some strong oversight.

And in regards to the funding, we think that Senator Cardin's bill, as proposed, would really help. And we would really like to talk about this continuum of capital from SBA microlenders to Community Advantage lenders and then on to traditional financial lenders. So I think that is what this bill could do, and some of the reforms that Jon talked about and the permanency of Community Advantage, I think, would strengthen this ecosystem of support for small businesses.

Senator HIRONO. So I think that makes a lot of sense.

And at the same time, if I can complete my thoughts here, regarding the Microloan program, I did have a nonprofit entity in Hawaii that found this program to be generally, while challenging, very useful. But the one concern they had was the complexity of the reporting requirements from SBA. So when you are dealing with these really small kinds of loans, we can probably make the reporting requirements and maybe other kinds of requirements, while still maintaining the guardrails, much more user-friendly.

Thank you, Mr. Chairman. Thank you.

Chairman CARDIN. Senator Marshall.

Senator MARSHALL. All right. Thank you, Mr. Chairman.

Ms. Murphy, your business model was built upon trying to get to “yes” for your customers. People apply online. They come into your bank. You would like to help them—within, of course, the rules—get to “yes.”

What are some of the major reasons people are unsuccessful qualifying for this loan? Is it credit score, is it they do not have a financial statement or they kind of just drop out because they are overcome with the process?

Ms. MURPHY. That is a great question. So we generally do not have people dropping out because they are overwhelmed with the process. We do focus—as a government guaranteed lender, we do have dedicated resources for the borrower on our team.

Where we find the turndowns is usually, you know, the lack of repayment ability. It comes back to, the core of what we have to do in SBA is the borrower has to be able to repay the loan. So when they send in their financials and the projections and they cannot repay the loan on their projections, or historically, then unfortunately we have to tell them right now “No. We need you to be able to repay this loan.”

When a borrower cannot repay and then there is a default, effectively, they now have a debt collector of the U.S. Government until that is paid in full.

When we look at these two proposed rules, the affiliation rule removing the guardrails around underwriting, around the repayment, the basic premise well-established of how we underwrite, there is a fear that that is where we would have increased program cost because of increased defaults, which hurts the borrower.

Senator MARSHALL. Eventually, it would.

One of the big advantages of a community bank or a credit union is really knowing your customer and being able to—you know, a reputation is still worth something, and you get this, are they hardworking, some of those things. And as you figure out their ability to repay that loan, certainly there are objective measurements.

But if you are a fintech program, do you think that they will be able to assess the ability to repay the loan in the same fashion you will?

Ms. MURPHY. I think it comes back to, again, the well established rules that are already set that the SBA is proposing to remove. With those guardrails down, we just do not know on how these borrowers are going to perform; we do not know what their repayment ability is going to be.

And the reality is, as a Federally regulated lender, as a bank, we will still be doing those things. Our regulators expect us to do those things. So all of a sudden, our borrowers do not have an equal playing field depending on what lender they are talking to. The rules would be different because the rules are not set by SBA anymore.

Senator MARSHALL. Mr. Schwellenbach, as you look at these rules for fintech, do you feel like that they are being held at the same level as community banks and credit unions?

Mr. SCHWELLENBACH. I am not sure exactly how to answer that question, but I will echo my fellow witness. The rules of the program are absolutely critical. If you look at some of the internal correspondence by some of these fintech executives, talking about these high rates of fraud that they were internally seeing during the Paycheck Protection Program, a lot of them were very dismissive of these high rates of fraud because they said “Look, this is on the SBA. The rules are lax. It is on the government.”

So if you have lax or nonexistent rules, you know, how can you expect companies that are participating to stop this?

Senator MARSHALL. So an SBA loan, just by definition, is going to be more risky than a PPP loan for a business that has been open for 5 or 10 years. What would we need to add to beef up the rules that we have seen to try to bring fintech to a level playing surface and to try to make sure we do not have more fraud? What needs to be added?

Mr. SCHWELLENBACH. So I want to start off by saying that there are some really unusual things about the Paycheck Protection Program, and that may be the understatement of the day.

Senator MARSHALL. That is really not my question.

Mr. SCHWELLENBACH. Obviously, it was a huge program. In many ways, it was more of a grant program since such a high percentage of loans were just forgiven.

So at the front end, you know, there was sort of this expectation—

Senator MARSHALL. I am sorry, my question is about the PPP rules. I am saying, going forward, what needs to be added to give us some less rate of fraud and less rate of failure?

Mr. SCHWELLENBACH. Oh, in the PPP rules or the 7(a)? The 7(a).

Senator MARSHALL. The new 7(a) rules for fintech.

Mr. SCHWELLENBACH. So I think you want to keep a lot of the rules in the 7(a) program and not weaken them. You do not want to take them too much in the direction of what you had with PPP. You want to know if the borrower can repay. You want to make sure that the lender who is processing the loan actually verifies that the company seeking the loan actually exists and is an active business and is not someone who is just going to buy a Rolls Royce with the money and flee to another country.

So these lenders, or potential lenders, SBA needs to make sure that they have their ducks in a row, that they have their systems in place, to know their customers.

Senator MARSHALL. Okay. I yield back. Thank you.

Mr. SCHWELLENBACH. And, just one more thing. Even pre-pandemic, the SBA's Inspector General has found that the SBA's Office of Credit Risk Management was not conducting enough oversight over participating lenders, and this is all pre-PPP.

Chairman CARDIN. Well, there is a history about the SBA regulating lenders, and we recognize that. One of the reasons they put the moratorium in effect was because of capacity issues to regulate the number of lenders.

The PPP. We need to understand the challenges that were created, but the Paycheck Protection Program was aimed at getting money out quickly in order to save not only small businesses but our economy.

It was—and I agree with you, Mr. Schwellenbach. It was more of a grant program than a loan program. Although, for smaller small businesses it was a loan, and they had to report it as a loan. And that was, for many, a factor that slowed them down in requesting the help because they did not know whether they could handle it on their books.

So, yes, we have to learn from the experiences under the Paycheck Protection Program, but I think your point about where we were pre-pandemic and what we need to have now that we have a little bit of time to understand what we are doing is to put into the program the proper mission requirements and accountability and oversight.

And, yes, this regulation, these two regulations, are aimed at a limited number of new lenders, but the regulation as written does not restrict it to just a few new lenders. So this could become a model moving forward for competition for lenders, and we have to make sure it is done right. It could far exceed this Administration in its implementation, so we have to make sure we have the proper protections as we start this new program.

I want to—I have been told there is another member that is two minutes away, and I want to tell you this: I know this member. And he told us one time he was close by for a vote, will we hold the vote open, and sort of indicated he was at an airport coming

in. What he did not tell us is that he was in an airport in New Jersey coming in. So we will give Senator Booker a few minutes to see if he is here.

We do have a hard stop in about 10 minutes. There is a ceremony in the Rotunda for Speaker Pelosi that I know some of us want to attend.

Senator MARSHALL. Chairman, I want to go hear one of our members speak as well—

Chairman CARDIN. Oh, that is right. We have Senator Shelby speaking.

Senator MARSHALL. Exactly. So, thank you again to all of our witnesses. We do appreciate it. This is a great program and whatever we can do to make it better, so thank you.

Chairman CARDIN. I will take a moment to see if Senator Booker arrives. If not—he said two minutes. We will give him four minutes.

Well, let me—I will follow up on a few other points while we are waiting for Senator Booker. We talked about the Microloan program. We talked about the Community Advantage programs. It really does get smaller loans out there.

So, as I asked Mr. Gaines, how do we encourage smaller lending within the 7(a) program? Banks like to give out larger loans. They would rather give out one large loan than two smaller loans that equal the size of a larger loan. So what can we do to provide additional incentives for our traditional 7(a) program to be more useful to the smaller of the small businesses?

Ms. MURPHY. Was that to me?

Chairman CARDIN. That is to you.

Ms. MURPHY. Okay. Well, there are a few things we can do. So what Congress can do is make Community Advantage permanent. That gets more lenders in, knowing that the program will still be here. Have SBA press pause on these rules and let us get it figured out on the best way to reach more of these underserved borrowers. SBA pull back on the proposed rules, and they can lean into CA.

But specifically, as a lender, what would help is codifying small-dollar loans and keeping those no-fee for our borrowers. That is powerful, especially for our underserved borrowers. Like I said, with the success we have seen with veterans, when they all of a sudden find out that, “Oh, wait, if I do check that box, there is no fee for me,” all of a sudden we are getting more.

And I did want to give you an updated stat on veterans. We are up 47 percent year-to-date in 7(a) with veterans.

Chairman CARDIN. As I said, lenders like you have made a huge difference in that regard. So, really, congratulations to you.

Ms. MURPHY. Thank you, Mr. Chairman.

Chairman CARDIN. We have been joined by one of the most distinguished members of the United States Senate and this Committee, Senator Booker.

Senator BOOKER. I want to say that is a low bar, but. [Laughter.]

I am really grateful. I literally ran over here just to hope to ask you this one question. I just want to say to you again, my staff—every time in my notes, they always say, thank Senator Cardin for the justice-involved entrepreneurs and all the work that we have done together to make things better.

Chairman CARDIN. Yes.

Senator BOOKER. So I am just continually grateful for the leadership of Senator Cardin.

Hello, everybody. So I just appreciate the SBA's incredible efforts on proposed rulemaking to simplify and streamline all the lending applications. I am sure that has been discussed. Too often, entrepreneurs face an overwhelming, bog-down sort of a process that really makes it difficult for them to apply because of the burdensome nature.

But I just want to hone in on one of my issues, which is this deep concern I have for some of the unintended consequences of paring down the affiliation rule and how it could impact the lending market for truly small businesses.

So to be specific, in 2018, the SBA's Office of Inspector General found that the 7(a) lending program was facilitated with a widespread abuse in the poultry industry, with huge multinational poultry corporations pushing small growers into abusive contracts, with funding provided by the 7(a) loan program.

These are awful tournament systems. They are living in—these farmers are living in horrific debt. They are small growers. They are independent on paper but were found by the SBA to have little control over their operations. The larger scale poultry integrators oversaw and dictated every aspect of their functions, from where and how to walk through the houses, the frequency and timing of inspections, and how to record the results. They provided detailed construction specifications for growers' broiler houses, site grading equipment, signage, and other attributes, really down to the smallest aspects of their business they worked at.

So SBA OIG concluded that these practices were so egregious that it was inappropriate for the taxpayer dollar to be subsidizing the poultry industry at all. And across the Federal Government today, from USDA's Proposed Rule on Competition and Market Integrity under the Packers and Stockyards Act, and the Department of Labor's efforts to address worker misclassification in the industry, the Biden administration, I am grateful, is working to crack down on these efforts.

So I guess for the panel, I just—for the SBA, do you think it is appropriate for large corporations to be benefitting from a small lending program? Really, what they are subsidizing is this god-awful process.

And then do you think the proposed rule which would eliminate the requirement to consider control of a company, providing adequate guardrails to ensure these large corporations are continuing to siphon this 7(a) lending program from high growth small businesses and start-ups really to these multinational poultry organizations that are so abusive?

Ms. MURPHY. The simple answer is "no."

Senator BOOKER. That is a great answer. All right. Thank you very much.

Ms. MURPHY. The affiliation rules, as written right now, that we all do have, just like we talked about the well established underwriting requirements that are also as part of the affiliation rule, proposing to be removed, these all were put in there for exactly that reason. There was something that has happened in the past,

and we are now trying to prevent that behavior. SBA, in this rule, is proposing to take all of these out.

Now affiliation was simplified under the Community Advantage Pilot Program back in May, and we are looking to see how is that working.

Senator BOOKER. Okay.

Ms. MURPHY. But Community Advantage loans are limited to \$350,000 and under. So what this does is it would remove affiliation requirements right down to—and we did not talk about it, is the franchise directory. The franchise directory. Right now, the SBA has provided the lenders with a list of all the franchise concepts. They have reviewed the documents and said: Yes, this is not affiliated. This loan is eligible. So you, as a lender, your borrower has control over their own business. They do not have a multinational corporation.

Yes, they tell them what the sign says. Yes, McDonalds is not making hot dogs; they are making burgers. But at the end of the day, SBA is even taking that away now, something that is working really well, and that is being removed as well as part of the proposed rule.

Senator BOOKER. Did you want to comment?

Mr. VILLARREAL. No. I just wanted to say, as Ms. Murphy said, we are a Community Advantage lender, and so SBA is our regulator. But we are capped at \$350,000. We were at 250 until earlier this year. So while it may work under the Community Advantage, which is a smaller loan program, very targeted to entrepreneurs of color, start-ups—half of our loans are to pure start-ups—I think we do need to be cautious about expanding this at this current moment and let us see how it works within the way we are working it with Community Advantage.

Senator BOOKER. I appreciate that because the poultry industry is so abusive to these so-called small, independent businesses and they are preying upon a lot of these programs designed to help independent, small businesses and they have created a system that really is not that.

Sir, thank you.

Chairman CARDIN. Senator Booker, you always add to the hearing. So I appreciate you being here and your questions, and I appreciate your friendship and your service in the United States Senate.

Senator BOOKER. Thank you. Thank you very much, sir. Thank you very much.

Chairman CARDIN. The Committee record will remain open for one week in case members have additional questions that they would ask you to respond to.

We really thank you all, but we are not dismissing you without a request that we will be seeking your guidance as we continue to work on ways to improve the tools available at the SBA as well as responding to the rulemaking that the Administration just recently announced.

And with that, the Committee will stand adjourned. Thank you.  
[Whereupon, at 3:45 p.m., the Committee was adjourned.]



**Question & Answer Responses by Jon Gaines**  
*“Improving access to capital in underserved communities:  
the Community Advantage Program, the Microloan Program, and other SBA initiatives”*  
Wednesday, December 14, 2022, 2:30 P.M. (ET)

 <p><b>Entrepreneurship and Financial Wellness Training • Lending • Coaching</b></p>	<p><b>COMMITTEE HEARING QUESTION &amp; ANSWER</b> <i>“Improving access to capital in underserved communities: the Community Advantage Program, the Microloan Program, and other SBA initiatives”</i></p> <p><i>by:</i> <b>Jon Gaines, Vice President Business Services &amp; Finance at the Wisconsin Women’s Business Initiative Corporation</b></p>
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**Senate Committee on Small Business and Entrepreneurship Hearing  
 December 14, 2022  
 Follow-up questions for Mr. Jon Gaines for the record**

Thank you Senator Cantwell and Senator Rosen for following up on the Small Business and Entrepreneurship Hearing. We appreciate the work you continue to do and for reaching out to ask us more questions. We always welcome you to reach out as we are happy to share details and how we can together -best serve our small business entrepreneurs.

**Questions from Senator Cantwell**

The barriers faced by women-owned small businesses and entrepreneurs have been exacerbated by the pandemic. The lack of access to capital has been one of the greatest barriers to start ups and entrepreneurs, disproportionately affecting women and minority-owned businesses. Nearly 13 million women own companies in the United States, an increase of 21 percent since 2014 and more than double the annual growth rate for all businesses nationwide. Minority-women-owned businesses account for half of all women-owned businesses. The Washington state Women's Business Center served over 1,200 clients and helped start 55 women-owned business in 2021 alone.

As we heard from witnesses in this committee's hearing on Women Entrepreneurs as An Economic Growth Engine for America in October last year, women and minorities may not have the credit scores or the collateral to get a loan – in a post-pandemic world, it will be worse for small businesses that went under and need a re-boot.

**Question 1: How do you see growing the role for these programs to improve the efforts of minority and women entrepreneurs to access capital? How can we improve the ability of these programs to reduce barriers to accessibility?**

In FY 2021, intermediaries made 4,514 loans to small businesses, totaling more than \$74.7 million. Of this amount, over two-thirds went to minority entrepreneurs. Existing businesses accounted for 63 percent of the loans made, over 48 percent went to women-owned businesses and almost 37 percent to startups. This financing led to the creation of 7,500 jobs and the retention of an additional 10,000 jobs.

Through FY 2021, intermediary lenders have used SBA Microloan funds to originate more than \$1.39 billion in loans to small businesses that have created 130,000 jobs and retained over 200,000 jobs since the program's inception in 1992. Of this total, more than \$260 million supported rural businesses and more than \$470 million to went to minority entrepreneurs. An additional \$61.4 million has been lent to veteran entrepreneurs, and more than \$440 million has been lent to more than 43,000 woman-owned businesses.<sup>1</sup>

<sup>1</sup> Ibid.



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Despite intermediaries serving “at risk” small businesses, the SBA Microloan program has a historical cumulative default rate of less than 2 percent.

The SBA Microloan program is an important tool to ensure that the full spectrum of small businesses and entrepreneurs have access to the capital and technical assistance needed for business survival and growth. Historically, it has cost \$1,700 per job supported by the program. Microloan proceeds may be used only for working capital and the acquisition of materials, supplies, furniture, fixtures, and equipment

As I testified, while the program has had great success, there are a number of technical changes that would further enhance program performance and assistance to underserved populations and communities.

**HR 1502, the Microloan Improvement Act, passed by the House in 2022, makes a number of improvements to the Microloan program, which we support, including:**

**(1) Interest Rates for Intermediaries**

- Changes the definition of small loans from \$7,500 to \$10,000. Intermediaries with loans averaging the small loan rate qualify for SBA Microloans with an interest rate 2 percentage points below the Treasury rate.

**(2) Lines of Credit**

- Authorizing the use of microloans for lines of credit.

**(3) Extended Repayment Terms**

- Modifies loan terms to a maximum of 7 years for loans of \$10,000 or less, and to a maximum of 10 years for loans that are greater than \$10,000.

**(4) Credit Reporting**

- A credit reporting process is established to ensure intermediaries are able to provide the major credit reporting agencies with information about borrowers relevant to credit reporting, such as the borrower’s payment activity on the loan.

**(5) 1/55 rule**

- Eliminates the 1/55 rule, and simply leaves in place the existing ceiling of 300 intermediaries able to be funded. Under current law, SBA may only make available the lesser of \$800,000 or 1/55 of the amount appropriated for microloans for the first two quarters of \$800,000 or 1/55 of the amount appropriated for microloans for the first two quarters of the fiscal year. This creates an administrative bottleneck for the agency, and paperwork problem for intermediaries. In order to continue to address the needs of underutilized states, the amendment reserves 15 percent of the appropriation for the first two quarters of the fiscal year for those states.



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**Question 2: Do you have ideas how you can help entrepreneurs in underserved communities learn to navigate financing?**

Small business owners' access to capital has been a major concern, especially for small businesses, microenterprises, and startups. This is especially true of businesses owned by people of color: According to the Joint Center for Political and Economic Studies, 58.1% of Black business owners report facing challenges needed to obtaining capital, with 35.8% of Latino business owners reporting challenges. Only 24.2% of white business owners reported these same challenges. (2022, Exploring Challenges for Small-Business Owners Across Race, Joint Center for Political and Economic Studies). In Wisconsin, the opportunity to access capital is also decreasing, with 54% of FDIC regulated financial institutions closing between 2002 and 2022 in Wisconsin (FDIC State Table Comparison Data, All Insured Institutions Wisconsin September 30, 2022 to All Insured Institutions Wisconsin September 30, 2022). Credit Unions have also seen a similar shrinking with 203 in 2011 shrinking to 113 in 2022 (CUNA State Credit Union Profile, Wisconsin Credit Unions Quarterly Trends Mid-Year 2022 to Wisconsin Credit Union Quarterly Trends Mid-Year 2011).

In Wisconsin, minority owned small businesses report barriers to accessing capital including not understanding the opportunities/requirements available in financing. There is also a feeling of not being heard by traditional banks and financial institutions for both financing as well as technical assistance needs by minority small business owners. In Wisconsin, minority owned small businesses are considerably more likely to use CDFIs and credit unions, who may not have the resources available to fully finance requests or meet the pre-loan and post-loan training and technical assistance needed, especially by startups and entrepreneurs (2022 WEDC Report on the Grant Ethnically Diverse Business Community COVID-19 Response Assessment; 2020 Federal Reserve Bank of Cleveland Community Development Publications 88855 "An Uphill Battle: COVID-19's Outsized Toll on Minority-Owned Firms").

Access to capital is only one factor in the "recipe" for entrepreneurial success, but equally important is the ability to effectively access that capital. New entrepreneurs and microbusiness owners may not be prepared for the scrutiny of a commercial lender and are often turned down for capital for very specific reasons relating to lack of business management experience. WWBIC's Small Business Consultants and Loan Officers provide a great deal of pre-loan assistance to address these reasons. WWBIC works hard to support clients in their requests for capital so they can be ready to apply successfully for financing.

Frequent pre-loan business topics WWBIC addresses:

- How to develop a very specific strategic marketing plan
- How to get repeat business
- How to track cost per lead and cost per service
- How to track profits and expenses



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- Importance of accurate records and ability to produce clear financial statements to track yearly, monthly, quarterly
- Importance of using standard accounting programs such as QuickBooks (often clients may be using Excel spreadsheets or even relying on handwritten notes)

For clients to improve their business acumen and grow their companies, they have to be able to understand and clearly articulate what is required to access capital markets. This includes keeping accurate records, using marketing dollars wisely, having exceptional customer service, reducing operating expenses as the business grows, and diversifying the customer base so that revenues are not heavily dependent on a few customers.

WWBIC also addresses access to capital by providing responsible lending options to small businesses who are traditionally underserved by banks and other financial institutions including women-owned businesses (70% of loans), businesses owned by people of color (61% of loans), and businesses owned by lower wealth individuals (63%).

The CHIPS and Science Act supercharges America's investment in innovation. It also promises new resources and policies to allow historically Black colleges and universities and other minority-serving institutions to participate equitably and genuinely in this research funding, and in the entrepreneurship and economic opportunity it can create.

I believe that this innovation economy can be strengthened by inclusivity and greater diversity.

The SBA can participate in the support of this objective through its lending and capital programs including those we are discussing here today. Even the smallest loans can be the seed funding for a new idea or for a new company to contribute to the innovation supply chain.

Innovative ideas can come from anywhere, anybody. And with CHIPS and Science, we envision technology hubs to be inclusive at all levels of contribution, including early-stage businesses that have something to offer but may not be able to get conventional loans.

**Question 3: Can you to share your views on how the SBA can focus its resource and capital programs to bring more minority individuals and businesses into the innovation economy?**

Microbusiness can provide an economic lifeline for underserved communities and WWBIC's programming can offer new hope for rural entrepreneurs, particularly women, lower wealth individuals, and people of color. Too many Americans have been denied the opportunity to become small business owners because they lacked the required capital to do so. Traditional banking institutions reported a year-over-year decline in small business lending with the end of the Paycheck Protection Program even while credit usage by small businesses remained stable and demand for new credit increased during the same



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time period. Banks also tightened their credit standards for small businesses, especially for new business owners.

According to the most recent data by the Federal Reserve, the average loan amount for a new small business loan from a traditional bank is \$593,000. 5 Requests for capital below this amount are often ignored by traditional banks and lenders, with CDFIs and SBA Microloan and Community Advantage lenders covering this gap up to \$350,000; meaning a gap of \$243,000 potential exists.

Microlenders offer businesses assistance, which a bank both cannot afford and cannot offer because of lender liability. In fact, most Microloan requests come from businesses who either cannot get bank financing or cannot get bank financing without the participation of a Microlender. Finally, many banks support the Microloan program because it leads to stronger businesses that will ultimately become bankable customers.

The decrease in small business financing to low-income business owners highlight a need for nonbank financial institutions like WWBIC with flexible underwriting, low fees or no fees, low and fixed interest rates and development services. WWBIC’s Target Markets experience significant economic distress of poverty, income, and unemployment. These challenges prevent access to traditional financing, as clients often have few assets, poor credit ratings, and may lack social connections to wealthier potential investors.

WWBIC serves an array of clients from those that are thinking about starting a business to those with established, successful businesses who are in need of additional financing to grow their businesses. WWBIC offers an assortment of training opportunities to suit entrepreneurs at any level. Most loan clients come looking for financing, but frequently their success is attributable to the combination of financing and technical assistance. WWBIC focuses on providing a holistic approach for fair and responsible capital by offering: business training; pre & post business technical assistance; and access to financial products (business lending).

**Questions from Senator Rosen**

**Expanding SBA Loan Eligibility**

The pandemic was devastating for our nation’s small businesses, especially in my home state of Nevada. While thankfully the outlook is better now than in 2020 or 2021, I have heard from many of my constituent small business owners that without additional access to capital for their businesses, some could still end up shutting their doors for good.

That is why I’ve made it a priority to ensure that ALL small businesses in Nevada and nationwide can access SBA loans. Last month, I introduced the Fair Access for Cannabis Small Business Act, which



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would ensure that legally operating cannabis small businesses have access to loans and programs provided by the Small Business Administration (SBA).

And earlier this Congress I introduced with Senator Ernst the Small Business Child Care Investment Act, which would allow non-profit child care providers that are small businesses to participate in all SBA loan programs.

**Question 1: Mr. Gaines, how might opening up SBA program eligibility to more businesses help small business owners in underserved communities, particularly those operating minority-owned businesses?**

Many of the technical changes passed by the House in HR 1502 will improve the Microloan program and increase access to underserved communities and businesses.

In addition, P.L. 116-260, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (Division N, Title III of the Consolidated Appropriations Act of 2021), among other provisions, waived the Microloan Technical Assistance program's matching requirement in FY 2021 and limitations on the pre-loan technical assistance and consulting and increased the Microloan intermediaries' aggregate loan amount after their first year of participation in the program from \$6 million to \$10 million in FY 2021. The aggregate loan amount was reset to \$7 million on October 1, 2021.

There continues to be great demand for Microloans and raising the cap on intermediary loans will allow high-performing intermediaries to secure additional resources to assist small business in their communities. Waiving requirements for technical assistance matching will make more intermediary resources available to businesses. Current law limits to 50% the use of technical assistance grants for pre-loan technical assistance and use of consultants. We urge the Committee to consider extending or making these provisions permanent.

**Question 2: How might this enhance the impact of the Certified Development Center (CDC) and the Women Business Initiative Corporation?**

WWBIC's SBA Microloan program began in 2005. Since the program launched, WWBIC's loan team has deployed 941 microloans for at \$20.6 million, with an average loan size of \$21,891.60. The pandemic altered the scope of microlending with immediate relief for small businesses through grants and forgivable loans. In 2018 (pre-pandemic), WWBIC deployed \$1.4 million dollars in SBA Microloan funding and \$980,000 was deployed in 2019. Pre-pandemic an average SBA Microloan was \$27,000. In 2020 during the onset of the pandemic, there was \$372,000 in SBA microloans, \$656,125 in 2021, and \$530,000 in 2022 deployed. WWBIC has served on average, 63% of SBA Microloan clients as female; 46% low to moderate income, and 26% minorities.

Through the SBA Microloan program, WWBIC has been able to provide pre/post loan technical



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assistance to these entrepreneurs and business owners. The pre loan TA includes topics such as business plan, financial projection, budgeting, business formation, licenses and permits while the post loan TA will focus one on one counseling on business operations/ expansion to business owners after receiving the microloans. The pre/post TA is critical to ensure a long-term success/minimize loss for entrepreneurs and microenterprises/small businesses.

WWBIC has fiercely championed its mission by operating in five regions with over 65 staff. Offering services statewide in Wisconsin; WWBIC channels its activities through two primary lines of business: small business lending (ranging from \$1,000 to \$350,000) & technical assistance/financial training. In over thirty-five years of impact, WWBIC has assisted over 72,000 individuals; loaned almost \$100 million to small business borrowers; helped entrepreneurs create and retain over 21,000 jobs; and started, strengthened, or expanded almost 9,000 businesses.

In 2021 alone, WWBIC served over 5,400 unduplicated clients; held a loan portfolio of approximately \$23 million with over 900 loans; and in 2020 and 2021 provided over \$8.3 million of forgivable loans, Paycheck Protection Program (PPP) and direct pass-through grants to hundreds of small business owners. Keeping small businesses alive while allowing them to transform and leverage new ways for sustainability and growth. WWBIC is advancing hope and opportunity for entrepreneurs.

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Expanding Online Resources for Small Business Owners

As a result of the pandemic, small businesses have relied more and more on online tools, ranging from teleworking to e-commerce. It is important that the federal government meets small business owners where they are, including via expansion of digital interactions between small businesses, SBA's resource partners, and other independent entities to SBA.

That is why, I introduced the One Stop Shop for Small Business Licensing Act. This bipartisan legislation requires the Small Business Administration (SBA) to create a centralized web portal for local, state, and federal licensing and business permit information and materials for small businesses. This portal would make it easier for aspiring small business owners to access the proper tools to start and register their business, taking one major hurdle out of the way from accessing the capital needed for ensuring their business thrives.

Mr. Gaines, I have heard from small businesses about the need for more digital tools and counseling through the SBA and its private entities.

**Question 3 & 4: Is either the Certified Development Center or Women Business Initiative Corporation considering making investments to increase online access for small business owners to business counseling? And, are there similar plans to provide small business startups more online tools to help them navigate often confusing compliance requirements?**



**Question & Answer Responses by Jon Gaines**  
*“Improving access to capital in underserved communities:  
 the Community Advantage Program, the Microloan Program, and other SBA initiatives”*  
 Wednesday, December 14, 2022, 2:30 P.M. (ET)

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Investing in technology for WWBIC clients will also invest in the future of a more diverse field of entrepreneurs thus creating more equitable opportunities for aspiring business owners. Third party research recently reported every dollar WWBIC invests in a small business; results in \$22 economic activity. For serving over 5,000 clients per year as well as providing Statewide services; WWBIC is making putting priority to intentionally deploy & design a technology roadmap that keeps clients, stakeholders, donors, funders, and partner first.

The economic crisis of Covid-19 changed our world and is pushing for technology platforms that streamline standardization, drive financial inclusion, and continue to focus on more equitable economic growth. Covid 19 introduced remote work, technical assistance provided virtually, and borrowers transitioned to electronic payments. Staff pivoted to working remotely while gathering and inputting data, providing technical assistance, deploying funds, collecting payments, and servicing loans all from the convenience of a computer. Barriers were identified by clients with no access to technology, internet, or streamlined services. WWBIC pivoted and sought funding for technology tools and training for training sessions, laptops, and scholarships. To best accommodate clients and their changing needs, WWBIC deployed many application platforms to drive the operational workflow (loan servicing, business training/technical assistance, human resource functions including payroll, reporting/analytics).

WWBIC’s online “on demand” classes continue to gain momentum in both urban and rural areas. A new dimension to our small business consulting model in 2018 is our online technical assistance Initiate Portal online 24/7. The Portal provides 100% of clients with 24/7 access to technical assistance and powerful coaching tools. For WWBIC, the Portal improves operation efficiency and helps standardizes our approach to client service. Under the guidance of their assigned WWBIC Small Business Consultant, the portal offers more than 200 specific, in-depth resources: videos, calculators and articles, organized under money, marketing and management – with then sub-topical areas, all available in ways that support various learning styles.

**Question 5: And what can Congress do to be helpful in facilitating such an effort?**

Congress can support more efforts such as the Small Business Broadband and Emerging Information Technology Enhancement Act which would leverage the SBA’s existing resources to train small business owners on how best to integrate broadband internet and other emerging technologies into their businesses.

The impact of COVID 19 was felt all around the world. This created challenges for our businesses that included reduction of demand, employee health concerns resulting in temporary closure and business owners finding it harder to catch up to the now digital world that the pandemic created. Another critical component that will continue to be felt are talent shortages for small businesses as staff capacity hinders their ability to function.



**Question & Answer Responses by Jon Gaines**  
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To this end, we have ramped up WWBIC's program trainings to focus around human resource capabilities and capacities - how to retain and attract talent, marketing strategies, and how to live in a digital world. Supply chain issues continue to disrupt small businesses and their ability to offer products and services to pre-pandemic levels. These items are being monitored by WWBIC and continually being reviewed to ensure we remain diligent to provide programming for both of these components. The future is unknown with what long-term implications will reverberate across the economy.

WWBIC's diversity in ensuring availability and access to a myriad of programming offerings to provide exemplary customer service to assure needs are being met. Unfortunately, due to the pandemic, uncertainty continues to rattle the small business community which creates a level of stress on how best to plan. To this end, it is difficult to know what the trends will be - one thing is for certain, WWBIC remains the front line for economic development and meeting small business owners where they are at - irrespective of the state of the economy.

The two most common barriers to success for our low-income clients are lack of basic financial acumen and lack of a formal business plan, and we offer extensive programming around these topics. Along with lending, business training, access to networks and business technical assistance WWBIC will continue to provide the financial capability to our consumers with this funding. WWBIC was an early adopter of the personal financial capability training now widely promoted by financial institutions and other organizations. Financial capability also benefits our micro borrowers, who generally have their personal and business finances intertwined.

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Outreach to Start-Up Entrepreneurs

Nevada is home to more than 280,000 small businesses, which make up over 99% of all businesses in the state. And over the past few years, Nevada has seen a spike in startups.

According to the Economic Development Authority of Western Nevada, in the Reno-Sparks area alone, nearly 100 startups were created since the beginning of 2020. Startups are an integral part of Nevada's economy and the United States. As a strong advocate for entrepreneurship, I want to see this surge continue and want to ensure entrepreneurs of color have the proper access to capital and resources in order to grow their businesses.

**Question 6: Mr. Gaines, what specific actions have the Certified Development Company (CDC) or Women's Business Initiative Corporation (WWBIC) taken to ensure aspiring entrepreneurs of color are aware of the resources that your centers provide to startups?**

WWBIC is a leader and innovator in entrepreneur business training. WWBIC offers trainings to promote financial acumen and in starting, sustaining, and growing a business for entrepreneurs at various levels. Information and registration are listed on website and sessions are offered in English and Spanish.



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Entrepreneurship training topics include financial management, technology, operations, marketing, and other aspects of successful operation. Trainings are offered throughout the state through WWBIC's network of five regional offices offering a hybrid approach to ensure access to all. Solid business planning, personal money management, strong management skills, and access to markets are vital for both individual and business success.

**Pre & Post Business Technical Assistance**

WWBIC's extremely pro-active model for providing technical assistance to loan clients mitigates the risk of lending to unbankable borrowers. Prior to receiving a loan, clients receive one-on-one counseling, which can include evaluating or creating a business plan and understanding financial and operational constraints. SBA microlenders also receive accounting, human resource management, and information on research in their industry. WWBIC provides pre-loan technical assistance through group training sessions as well as one-on-one consultations.

A WWBIC "Small Business Consultant" staff member is assigned to each loan client immediately upon loan closure and begins providing post-loan technical assistance that continues during the life of the loan, up to ten years. Clients also have access to WWBIC's Initiate Portal to access online technical assistance 24/7. WWBIC offers credit counseling and credit repair to help individuals qualify for a small business loan. In addition, the small business consultants leverage the local community expertise of more than 400 volunteers in professional fields (including banking, law, and accounting) who work one-on-one as coaches and mentors to WWBIC clients. To best help the borrower better market their business and be successful, WWBIC can even work with a client who is having financial and/or repayment difficulty.

**Business Lending**

WWBIC's access to capital initiatives provide a continuum of options to best meet business borrower needs, ranging from \$1,000 to \$350,000. WWBIC's programs include very small loans through a collaboration with Kiva, microloans up to \$50,000, lines of credit, and larger loans up to \$350,000 – many of which have an SBA Community Advantage guarantee. There is also a piloted a nano-grant program and small equity investments for defined businesses. In addition to managing its own portfolio, WWBIC also supports a small number of other entities with the underwriting and management of their microloan activities.

Both WWBIC's business and micro loans can be used for starting or expanding a business, purchase of or repair of machinery or equipment, furniture and fixtures, inventory, supplies and working capital. The targeted and typical profile of a WWBIC microloan client is low or moderate income, has experienced personal financial setbacks, credit history issues, is financially insecure, may be working a low-wage job with no opportunity for advancement, and is at a point in life where starting a business may be the best of few options. These smaller, riskier loans are often under-secured and require a high level of business technical assistance in order to be sustainable.



**Question & Answer Responses by Jon Gaines**  
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WWBIC offers lines of credit to more established clients to supplement their term loans to address cash flow management needs. The two most common barriers for our low-income clients are lack of basic financial acumen and lack of a formal business plan. We have extensive programming around these topics. Approximately half of our pre-loan clients need individual counseling or one-on-one business and technical assistance to become loan ready. A personal relationship encourages timely repayments to us and other creditors.

The rate for both Micro and Business loans ranges from 8-10% (with some special limited funds at 2%.) Fees range from \$500 for micro loans to \$1,500 for business loans; SBA Community Advantage loans require up to a 2.5% packaging fee for a \$350,000 loan. Flexibility features include collateralization requirements, smaller down payments & lower equity contributions than banks require. WWBIC underwrites on projected business cash flows & debt service coverage (not simply collateral & credit score) character, & ability to repay the debt. WWBIC lends to low credit scorers in special circumstances like medical debt or divorce, & to those at least 18 months past bankruptcy discharge if low score or bankruptcy was not due to credit abuse. More than 50% of WWBIC loans finance startups in higher-risk sectors (restaurants, retail, jewelry stores, building trades & childcare.)

**Financial Capability**

WWBIC was an early adopter of the personal financial capability training now widely promoted by banks and other organizations. WWBIC was named a "Legacy Award" recipient in the 2014 Governor's Financial Literacy Awards. WWBIC offers a multi-part Make Your Money Talk classroom education series covering personal finances. Graduates who income-qualify can open a matched savings account to save for one or more of select assets: first-time home purchase, starting or expanding a business, vehicle expenses, debt repayment, or returning to school for post-secondary education. One-on-one financial educational counseling helps clients create and maintain personal budgets. Through the WWBIC-led Wisconsin Saves public awareness campaign, participants save money that might otherwise go to check cashing firms and payday lenders.

Thank you for your time and your continued service to our communities!

Sincerely,

**Jon Gaines, MBA | Vice President, Business Services and Finance**  
**WWBIC**

A Leading Innovative Statewide Economic Development Organization  
 Statewide Headquarters/Milwaukee Office  
 1533 N. RiverCenter Drive | Milwaukee, Wisconsin | 53212  
 Direct: 414-395-4531 | General Info: 414-263-5450  
[jgaines@wwbic.com](mailto:jgaines@wwbic.com) [www.wwbic.com](http://www.wwbic.com)

*Questions for Mr. Schwellenbach*

*Question from:*

*Senator Cantwell*

*The CHIPS and Science Act supercharges America's investment in innovation. It also promises new resources and policies to allow historically Black colleges and universities and other minority-serving institutions to participate equitably and genuinely in this research funding, and in the entrepreneurship and economic opportunity it can create.*

*I believe that this innovation economy can be strengthened by inclusivity and greater diversity.*

*The SBA can participate in the support of this objective through its lending and capital programs including those we are discussing here today. Even the smallest loans can be the seed funding for a new idea or for a new company to contribute to the innovation supply chain.*

*Innovative ideas can come from anywhere, anybody. And with CHIPS and Science, we envision technology hubs to be inclusive at all levels of contribution, including early-stage businesses that have something to offer but may not be able to get conventional loans.*

**QUESTION 1:**

*Can you to share your views on how the SBA can focus its resource and capital programs to bring more minority individuals and businesses into the innovation economy?*

**POGO has not reviewed the SBA's role in expanding opportunities for individuals from minority communities and businesses owned by them in the innovation economy, but there are some best practices that the agency should embrace.**

**Engaging these communities early on is important when agencies are considering launching new programs or changing existing ones. In a variety of contexts, advocates, experts, and government officials have told me that early stakeholder outreach is highly likely to shape program design since communities may have insights that federal officials are not aware of.**

**SBA outreach should be proactive and as inclusive as possible. As the Partnership for Public Service's Loren DeJonge Schulman and Accenture Federal Services' Kathy Conrad have written, "It may be that the people the agency needs to hear from most are the least likely to participate in a customer survey or listening session, perhaps because of issues such as past discrimination that makes them less likely to trust government. Special efforts may be needed to get them involved."**

Such stakeholder outreach should not just be a box-checking exercise and the SBA should not be reflexively adverse to approaches that significantly diverge from business as usual. The agency should strive to be creative and flexible. If there are genuine structural challenges to change, such as statutory or budgetary barriers, the agency should be fully transparent in explaining them to stakeholders. Full transparency regarding barriers can lay the groundwork for broader changes in partnership with Congress and stakeholders. The SBA should also be open to program changes after program rollout if shortcomings are identified.

The SBA should collect and utilize data to identify equity challenges, such as disparities in who is receiving loans and who is being denied loans. The discrimination that minorities face can result in a loan denial. As my colleague, POGO Senior Policy Analyst Sean Moulton, has written, there is a lack of demographic data "collected for businesses receiving assistance awards such as grants, federal loans, or direct payments. Without this data, federal agencies cannot reliably say how equitably they are distributing assistance to companies."

Improving access to SBA loans is just part of the challenge. The agency should take a broad approach, such as considering whether to make loan repayments less onerous for businesses that have been structurally locked out of accessing private capital. According to a 2016 Stanford Institute for Economic Policy Research paper on minority-owned startups' access to capital, there is evidence suggesting that "access to formal debt channels remains limited for minorities."

It is important that these efforts are properly resourced by SBA and receive the organizational attention by high-level officials that they deserve.

Question from:

Senator Inhofe

Capital Access for Rural Communities

*Mr. Schwellenbach, as a former small business owner, I know firsthand the work required to build a company from the ground up. Entrepreneurs in rural parts of Oklahoma often struggle with finding access to capital and will use SBA programs like the 7(a) loan program to help.*

*During the pandemic, the SBA's Paycheck Protection Program had insufficient guardrails that led to over a \$100 billion dollars' worth of fraud.*

QUESTION 1:

*Mr. Schwellenbach, how can the SBA ensure that programs meant to provide capital access to rural communities won't experience high rates of fraud?*

**POGO has conducted over two years of investigative work focused on fraud and potential fraud in the Paycheck Protection Program. A key lesson from that work is that the SBA should not rely on loan applicants' self-certification of eligibility. It is important that lenders and lender service providers participating in SBA programs conduct adequate due diligence, such as complying with Know Your Customer (KYC) rules. When lenders and their service providers follow these rules and adequately vet loan applicants, it is less likely that funds will be fraudulently diverted to ineligible entities, as made clear by a December 2022 report from the House Select Subcommittee on the Coronavirus Crisis. The SBA also needs the capacity to conduct adequate oversight of those participating lenders and service providers, a shortcoming that the SBA's Office of Inspector General identified in October 2022 as one of the agency's top management challenges.**



**Senate Committee on Small Business and Entrepreneurship Hearing  
December 14, 2022  
Follow-Up Questions for the Record**

Question from:

Senator Cantwell

The CHIPS and Science Act supercharges America's investment in innovation. It also promises new resources and policies to allow historically Black colleges and universities and other minority-serving institutions to participate equitably and genuinely in this research funding, and in the entrepreneurship and economic opportunity it can create.

I believe that this innovation economy can be strengthened by inclusivity and greater diversity. The SBA can participate in the support of this objective through its lending and capital programs including those we are discussing here today. Even the smallest loans can be the seed funding for a new idea or for a new company to contribute to the innovation supply chain.

Innovative ideas can come from anywhere, anybody. And with CHIPS and Science, we envision technology hubs to be inclusive at all levels of contribution, including early-stage businesses that have something to offer but may not be able to get conventional loans.

**QUESTION 1:**

Can you share your views on how the SBA can focus its resource and capital programs to bring more minority individuals and businesses into the innovation economy?

Thank you for the question, Senator. I agree with you that innovative ideas can come from anywhere and anybody and SBA can be part of the ecosystem that supports innovation.

One positive step has been the development of The Interagency Community Investment Committee (ICIC), which is focused on operations and execution of federal programs that facilitate the flow of capital and the provision of financial resources into underserved communities, including Communities of Color. ICIC is composed of Treasury, SBA, Commerce, HUD and USDA. I would ask that your office follow the progress of the ICIC to guarantee that the goal of facilitating the flow of resources to underserved communities is met.

There is no question that SBA has a critical role in ensuring capital flows to underestimated communities. To date, this includes the development of the SBA Community Advantage program in 2011, and subsequent revisions of the program. In April of 2022, the program underwent its latest revisions, and we applaud SBA for the recent changes. However, SBA can continue to do more. This includes:

1. SBA supporting Congressional action to make Community Advantage a permanent program
2. As an interim measure, SBA extending the pilot program until September 30, 2034, to encourage greater lender participation
3. Increasing the maximum SBA guarantee on CA loans to 90 percent - recognizing that lenders are intentionally targeting underserved businesses
4. Reduce the CA program minimum SBSS Score from 140 to 130
5. Expand the definition of a "small business concern in an underserved market" for purposes of the CA program to include a business owned by one of more socially and economically disadvantaged individuals, and also any woman-owned business
6. Ensure that adequate training is provided to CA lenders, especially those new to SBA lending
7. Ensure SBA staff, including district office staff and other SBA resource partners, receive training and are familiar with the CA program, its mission and goals, and what is expected of CA lenders in order to safeguard the programmatic integrity of CA
8. Make grants available (SBA grants) to CA lenders to support the delivery of business assistance and support services provided to business borrowers. These support services are a crucial component of the CA program and critical to the success of CA borrowers and their ability to manage risk and effectively address the needs of underserved community businesses
9. Allow 100% financing for all types of use of proceeds without **requiring** an owner equity injection
10. Eliminate the credit elsewhere test for CA lenders or at a minimum ease the burden associated with satisfying the test since CA lenders are intentionally targeting businesses that are not bankable for a variety of reasons. Requiring a business owner to produce a bank turn down letter is not only burdensome - it can also be interpreted as disrespectful, by the client
11. Implement a streamlined, limited documentation closings for seasoned CA lenders making CA Loans of \$150,000 or less [similar to what SBA allows in SBA 7(a) Express]; including -
  - a. No life insurance required for CA loans of \$150,000 or less
  - b. Simplified verification of use of proceeds and equity injection

Questions from:

Senator Rosen

Expanding SBA Loan Eligibility

The pandemic was devastating for our nation's small businesses, especially in my home state of Nevada. While thankfully the outlook is better now than in 2020 or 2021, I have heard from many of my constituent small business owners that without additional access to capital for their businesses, some could still end up shutting their doors for good.

That is why I've made it a priority to ensure that ALL small businesses in Nevada and nationwide can access SBA loans. Last month, I introduced the Fair Access for Cannabis Small Business Act, which would ensure that legally operating cannabis small businesses have access to loans and programs provided by the Small Business Administration (SBA).

And earlier this Congress I introduced with Senator Ernst the Small Business Child Care Investment Act, which would allow non-profit child care providers that are small businesses to participate in all SBA loan programs.

**QUESTION 1:**

Mr. Villarreal, how might opening up SBA program eligibility to more businesses help small business owners in underserved communities, particularly those operating minority-owned businesses?

Thank you for the question, Senator. To clarify, your question is referring to opening up eligibility for more small businesses or to more new lenders? I will address both.

In regard to small businesses, almost all for-profit businesses are eligible for SBA loans. There are certain categories of small businesses which are not eligible, such as those of a prurient nature. The SBA has recently revised the rules on returning citizens and we are in support of that expansion. What the SBA can continue to make improvements on is "expanding the credit box" for small businesses. As the leading SBA Community Advantage in the country, we are able to assist a number of underserved businesses because we are allowed to lend to those businesses with a lower SBSS score (than traditional 7a lenders). That score could be further lowered. We, and many other mission lenders, have demonstrated via non-SBA lending products that taking greater "risk" does not result in substantial losses.

As to "opening up" the SBA to new lenders, particularly non-traditional lenders, we have some concerns. As you are aware, the SBA recently proposed lifting the moratorium on licensing new Small Business Lending Companies (SBLCs). While we share the SBA's commitment to bridging the gaps that for too long has prevented aspiring entrepreneurs and small businesses from accessing the financing they need to launch and sustain their enterprises, particularly businesses in underestimated and underbanked markets, we have concerns with the SBA's proposal and specifically questions about how the SBA's proposal would increase SBA-backed lending to the underestimated communities and entrepreneurs that The Agency is looking to serve - those "struggling to obtain financing on non-predatory terms." As the rule is currently proposed, there are no requirements on the new lenders to deploy a percentage of their loans to underserved communities.

If the Agency is looking to provide greater access to underserved communities, particularly communities of color, then they should be clear and explicit to any new "non-traditional" lenders that they are required to serve these targeted communities and build in accountability measures. Without proper guardrails and requirements, Congressional leaders

should be very wary of allowing new for-profit lenders access into the government program which was initially developed to support underserved small businesses.

**QUESTION 2:**

How might this enhance the impact of the Certified Development Center (CDC) and the Women Business Initiative Corporation?

As part of the SBA's proposal to "open up" the SBLC licenses, the Agency is recommending a new type of SBLC, called mission-SBLCs. These would be current Community Advantage lenders (like CDC Small Business Finance and the Women's Business Initiative Corporation) to become SBLCs. While we are supportive of this recommendation, the Agency needs to provide greater clarity as to how they will regulate mission-SBLCs. The proposed rule is still too vague for Community Advantage (CA) lenders to fully commit from transitioning as CA lenders to mission-SBLCs. While there is the utmost confidence and trust in the current leadership at SBA, there are concerns that as administrations and leadership at SBA change, the rules for mission-SBLCs could change, creating an inconsistent program for the lenders.

We are also supportive of your bill introduced with Senator Ernst, the Small Business Child Care Investment Act. We have developed a team that has a deeper understanding of home child-care providers and how they operate. We would welcome the addition of non-profit childcare providers and facilities being eligible for SBA lending.

We would also encourage the SBA to lower the SBSS score for Community Advantage lenders from 140 to 130. Lowering the score would make the SBA 7(a) program more available to underserved small business owners, who have not had the opportunity to build a strong credit score (which is one of the primary drivers of the SBSS score).

Expanding Online Resources for Small Business Owners

As a result of the pandemic, small businesses have relied more and more on online tools, ranging from teleworking to e-commerce. It is important that the federal government meets small business owners where they are, including via expansion of digital interactions between small businesses, SBA's resource partners, and other independent entities to SBA.

That is why, I introduced the One Stop Shop for Small Business Licensing Act. This bipartisan legislation requires the Small Business Administration (SBA) to create a centralized web portal for local, state, and federal licensing and business permit information and materials for small businesses. This portal would make it easier for aspiring small business owners to access the proper tools to start and register their business, taking one major hurdle out of the way from accessing the capital needed for ensuring their business thrives.

Mr. Villarreal, I have heard from small businesses about the need for more digital tools and counseling through the SBA and its private entities.

**QUESTION 3:**

Is either the Certified Development Center or Women Business Initiative Corporation considering making investments to increase online access for small business owners to business counseling?

CDC Small Business Finance has a robust Technical Assistance (TA) program, with six business advisors providing over 10,000 hours of TA per year. Historically our TA was in-person, very bespoke, with 1:1 counseling. When the pandemic hit, we quickly had to pivot and provide TA via digital platforms. This included daily webinars (bi-lingual) to walk small businesses through the PPP application process. After the PPP program ended, these webinars continued, walking PPP recipients through the forgiveness process.

We are now applying what we learned during the pandemic to increase online access to TA. This includes providing digital resources such as LivePlan (business planning tool), Be Boss Online, which assists with digital marketing. We are also exploring partnerships with organizations that have on-line platforms for TA. For example, we recently entered into an agreement with Macy's, to be their preferred lender to their diverse suppliers. We will deploy \$200 million in capital over the next five years to their diverse suppliers. To better serve these small businesses, which are located across the country, we will need to work with an on-line platform to deliver quality and relevant TA.

**QUESTION 4:**

And, are there similar plans to provide small business startups more online tools to help them navigate often confusing compliance requirements?

CDC Small Business Finance has developed an expertise in lending to start-ups. In fact, over 50% of our Community Advantage lending in 2002 was to start-ups and for all Community Advantage lenders, 42% of lending went to start-ups (as defined by SBA). This compares to just 15% for standard (primarily banks) lenders.

To be successful in lending to start-ups requires an investment in TA, as this is the differentiator that results in our loss rate to startups being the same, or even better, than to established businesses. As noted above, we have the tools identified and we will continue to explore additional on-line resources.

**QUESTION 5:**

And what can Congress do to be helpful in facilitating such an effort?

Eliminate the 50/50 rule on SBA Microloan TA. This was presented by Mr. Gaines in the hearing. Further, allow the SBA microloan TA grant to be used for TA on other SBA programs, such as the Community Advantage, 7(a) and SBA 504.

Congress could allocate TA dollars specifically for Community Advantage lenders. Community Advantage lenders provide TA to their borrowers yet are not compensated for this service. We are also required to provide reserves greater than traditional 7a lender (3% on the amount that is sold in the secondary market). Therefore, Community Advantage lenders are asked to serve the "non-bankable," provide greater service (TA), with the

requirement of increased costs to be in the program. Congress should make the program permanent, provide resources to the lenders, and also to SBA for oversight.

In addition, Senator Cardin's legislation (the *Community Advantage Loan Program Permanency Act of 2022*) seeks to expand the reach of CA lending by seeking to formalize the Community Advantage Network Partners. Among other benefits, the CA Network Partners model would provide an on-ramp for mission lenders considering entering the CA program. These mission lenders are touchstones in the local community and have established trust within the community. This local network creates a pathway for small business owners and entrepreneurs to establish a local relationship with a local lender, and, where the business owner may receive technical assistance or simple reassurances as they go through the application process. The small business owners receive financing structured on the historical cash flow available to service the debt while the company grows. The legislation will also allow SBA 7(a) lenders to refinance CA loans after the small business owner has demonstrated key indicators like the need for additional capital and a track record of timely payments.

#### Outreach to Start-Up Entrepreneurs

Nevada is home to more than 280,000 small businesses, which make up over 99% of all businesses in the state. And over the past few years, Nevada has seen a spike in startups.

According to the Economic Development Authority of Western Nevada, in the Reno-Sparks area alone, nearly 100 startups were created since the beginning of 2020. Startups are an integral part of Nevada's economy and the United States. As a strong advocate for entrepreneurship, I want to see this surge continue and want to ensure entrepreneurs of color have the proper access to capital and resources in order to grow their businesses.

#### **QUESTION 6:**

Mr. Villarreal, what specific actions have the Certified Development Company (CDC) or Women's Business Initiative Corporation (WWBIC) taken to ensure aspiring entrepreneurs of color are aware of the resources that your centers provide to startups?

We work through SBA partners, such as Women Business Centers, Small Business Development Centers (SBDCs) and SCORE. We also participate in the SBA's Lender Match program. This is an on-line referral program on the SBA's website. We receive approximately 100 referrals a week from this site and applaud SBA for continuously improving the site.

In Nevada, CDC Small Business Finance has funded 34 loans for just over \$3 million. More than half have been to start-ups.

It is clear that Community Advantage lenders are doing a better job of financing "pre-revenue" or "pure start-ups. The SBA only recently started to monitor lending to pure start-ups as part of their weekly lending reports - and one thing that is clear is that CA lenders are making loans to these businesses at a MUCH higher rate than conventional 7a lenders. This is not at all surprising and I might even argue that traditional 7(a) lenders should be working with CA lenders regarding pure startups - as these are businesses that need assistance AND financing, and CA lenders can provide both.

**Senate Committee on Small Business and Entrepreneurship Hearing**  
**December 14, 2022**  
**Follow-Up Questions for the Record**

Questions for Ms. Murphy

Question from:

Senator Cantwell

The CHIPS and Science Act supercharges America's investment in innovation. It also promises new resources and policies to allow historically Black colleges and universities and other minority-serving institutions to participate equitably and genuinely in this research funding, and in the entrepreneurship and economic opportunity it can create.

I believe that this innovation economy can be strengthened by inclusivity and greater diversity. The SBA can participate in the support of this objective through its lending and capital programs including those we are discussing here today. Even the smallest loans can be the seed funding for a new idea or for a new company to contribute to the innovation supply chain.

Innovative ideas can come from anywhere, anybody. And with CHIPS and Science, we envision technology hubs to be inclusive at all levels of contribution, including early-stage businesses that have something to offer but may not be able to get conventional loans.

**QUESTION 1:**

Can you to share your views on how the SBA can focus its resource and capital programs to bring more minority individuals and businesses into the innovation economy?

I have seen firsthand the impact of investing in early-stage small businesses, as well as the types of small businesses you describe that are part of the innovation economy. While SBA does not provide data on the types of businesses by industry, there is valuable data provided by the Agency regarding the extent to which the 7(a) portfolio currently reaches early-stage and minority-owned businesses. Here is what we know when it comes to how the 7(a) loan program performed in FY22:

- 55% of all 7(a) loans in dollars were made to new businesses, with 33% of those loans going to small businesses that have been operational for 2 years or less or where the capital is going to open the business, which we describe as a new-start; and 22% of those loans going to small businesses that have a change of ownership, which are generally considered new-start businesses on the whole. In terms of units of loans delivered, 49% of all 7(a) loans in FY22 went to these small businesses (operational for 2 years or less, new-start businesses, or change of ownership).
- One-third of all 7(a) loans in dollars are made to minority populations, and about 30% of all 7(a) units are made to minority populations—and these numbers have been steadily on the rise.

- 25% of 7(a) borrowers amounting to \$6.5 billion in small business loans did not identify their race or ethnicity, so the actual percentage of loans to minorities is likely higher than the statistics indicate, knowing that disclosure of any demographic is entirely voluntary and must be completed by the borrower, and that anecdotally, we know it is most likely underserved markets and minority borrowers who are most reticent to check a box disclosing their race or ethnicity.
- African Americans are the fastest growing demographic in the program, with nearly \$1 billion in loans last year alone—nearly a 60% increase since FY17. And so far this year, loans to African Americans are up 52% in units and 72% in dollars compared to last year.
- Hispanics totaled \$1.85 billion—more than a 27% increase since FY17. And so far this year, loans to Hispanics are up 91% in units and 98% in dollars compared to last year.

Knowing anecdotally and from experience that new-start businesses and borrowers from underserved markets most often seek smaller dollar loans, here is what the program achieved in small dollar loans in FY22:

- Roughly 50% of all loans were \$150,000 or smaller, and
- More than two-thirds of all loans were \$350,000 or smaller.
- It also appears SBA is now defining small dollar loans as \$500,000 or below considering the SBA announcement of small dollar fee waivers in FY23 for loans \$500,000 or below, the percentage of small dollar loans in the 7(a) loan program is even larger than reported. Likely three out of every four loans made are \$500,000 or below, but SBA does not publicly provide that breakdown.

All this data is taken directly from SBA's own publicly published data.

We also cannot forget to look at the Community Advantage Pilot Program when we are assessing what SBA does in the minority lending space for the types of borrowers you describe. The Community Advantage Pilot Program has existed since 2011, and allows mission-focused lending participants to make 7(a) loans up to \$350,000, a maximum loan cap that was just raised this past May by recent SBA changes. This pilot program continues to be extended by SBA while Congress continues to work through legislation to make it statutorily permanent. In the meantime, the Community Advantage program has not wasted any time—hundreds of loans made to minority borrowers are made each year, and these loans have a profound impact.

Rather than celebrate what the 7(a) loan program does achieve for minority borrowers and lean in to better support Community Advantage, SBA claims that the 7(a) loan program is failing at small dollar loans and criticized Community Advantage as “unviable” in their recently Proposed Rules released in the fall. As a lender, this is discouraging and hard to follow.

SBA's Affiliation Proposed Rule would loosen or remove the 7(a) program's requirements for how lenders underwrite loans. The SBLC Proposed Rule would lift the existing forty-year moratorium on the number of non-federally regulated institutions (called Small Business Lending Companies or SBLCs) that can make loans under the 7(a) program and permits SBA to add an unlimited number of SBLCs to the existing 14 licenses.

How does this relate to your focus on minority borrowers looking to finance new-starts? These Proposed Rules could harm borrowers, especially those most vulnerable and least served. Whenever we start stripping a program's prudent lending guidelines away, it opens the door to erode program performance and increases a program's overall risk profile. This in turn leads to higher losses which would need to be supported by higher fees eventually. Making the cost of access to capital for borrowers higher is not helping underserved markets. Further, bringing in non-federally regulated entities that are not properly regulated and have no framework to ensure against fraud or predatory practices in the way we have all come to expect from the financial services sector will not only damage the 7(a) loan program's integrity and performance, but it will do real harm to the borrowers you mention in your question. Without any limitations, guardrails, or regulatory framework, we should not rush to bring FinTech into SBA's loan programs at the same time that Congress has identified that FinTech was responsible for tens of billions of dollars in fraud in the Paycheck Protection Program. These ideas need to be better thought out with reasonable guardrails, and shouldn't be proposed at the same time that SBA is stripping the program of all prudent lender standards. I'm worried personally for the future of SBA lending.

So how can SBA focus its loan programs on bringing more minority borrowers into the innovation economy?

First, do no harm—withdraw the Proposed Rules as drafted. Next, SBA needs to better support the Community Advantage program by extending the pilot program's sunset date and allowing recent programmatic changes to take affect that could help bolster further success.

Finally, we need to discuss common sense improvements, not wide-sweeping removal of all prudent guardrails like SBA is attempting. These could include ideas such as targeted goals for small dollar loans for each 7(a) lender and codifying in statute fee waivers for small dollar loans. Improved reporting and data collection of lending to underserved markets is also a critical piece of how we better our reach. When we have an accurate picture of what kind of lending we do, we can work towards improvement based on facts.

Question from:

Senator Inhofe

Capital Access for Franchises

Ms. Murphy, one of the most successful staffing companies in the U.S. is headquartered right in the heart of my home state in Oklahoma City. And it's a franchise – Express Employment Professionals started in 1983 and grew to be a multi-billion-dollar company with over 800 locations worldwide. Approximately 10 percent of SBA 7(a) loans go to franchises, which support hundreds of thousands of jobs – many in my home state of Oklahoma. The proposed changes to the 7(a) program will change credit scoring and underwriting rules that could jeopardize the program for businesses like these.

**QUESTION 1:**

Ms. Murphy, how would the proposed SBA regulations impact the integrity of the 7(a) loan program, and consequently franchises who access capital through the program?

The Affiliation Proposed Rule would loosen or remove the 7(a) program's requirements for how lenders underwrite loans. The SBLC Proposed Rule would lift the existing forty-year moratorium on the number of non-federally regulated institutions (called Small Business Lending Companies or SBLCs) that can make loans under the 7(a) program and permits SBA to add an unlimited number of SBLCs to the existing 14 licenses. SBA also creates a new type of SBLC called "Mission-Based SBLCs" that are meant to have mission requirements, but which are not specified. In other words, the Affiliation Rule proposes removal of the prudent lending standards I have spent my career relying upon, and the SBLC Rule proposes to bring unregulated entities, such as FinTech, into a program that has now been stripped down of its prudent guardrails.

Let me say upfront: all lenders understand the value of automation and simplification, particularly for underserved borrowers. We are not anti-FinTech, and we are not averse to simplifying SBA processes where they can be simplified. What I am profoundly opposed to are imprudent proposals that could harm underserved markets and damage the 7(a) loan program's integrity from both a reputation and performance perspective. I believe these proposals as drafted do just that.

The concerns are numerous. First, the proposals as drafted fail to demonstrate how they will aid mission lending. The additional SBLCs, like the existing fourteen licenses, would not have any mission requirements and do not seem to be meant to serve underserved borrowers in any way. The Mission-Based SBLCs, while presumably meant to focus on mission lending, do not have any defined set of mission-lending requirements, leaving it up to the SBA political appointees to establish program parameters on a lender-by-lender basis.

As a lender, I am deeply troubled that SBA does not have the oversight capacity to serve as primary regulator for additional SBLCs. Given the office's current responsibilities, especially as

SBA continues to untangle from a post-PPP world, OCRM is operating at its maximum capacity in my opinion. As a lender, I see firsthand the ways in which OCRM lacks the resources and has limited staff. SBA states they currently have the capacity to take on three additional SBLCs without a mission focus—my front row seat would tell me otherwise.

SBA did not propose a slow and steady test run of bringing FinTech into the 7(a) loan program. The preamble of the proposed rule states that they will bring in three new SBLCs, which are not mission lenders, right now. However, the actual proposed rule allows an unlimited number of SBLCs into the program whenever SBA sees fit.

As a federally regulated lender, I am worried and surprised that SBA did not propose to require new SBLCs mirror any federal regulatory and compliance requirements imposed on depository institutions that are supervised by a federal banking agency or the National Credit Union Administration (NCUA). Imprudent lending behavior could lead to risk to both borrowers and the performance of SBA's 7(a) portfolio. If SBA is opening the program in an unlimited fashion to entities that have no federal regulator and plans to serve as primary regulator, we need to understand the basic premise that SBA does not have federal regulator-like standards to apply to these new non-federally regulated entities. In other words, they are not set up to act like a primary regulator in the way the federal regulators are equipped, and the proposed rule does not attempt to remedy this gap. If the goal is to help underserved markets, this regulatory gap should raise concerns, as it is the most basic notion that a prudent regulatory framework protects borrowers.

I am also troubled by the clear direction that SBA is taking the 7(a) loan program—instead of bringing FinTech into the existing program with guardrails, the agency appears to be modifying the program for FinTech, removing guardrails to make 7(a) lending fit into a low-touch model that FinTech currently utilizes.

If a lender is directed simply to follow procedures it would use for its similarly sized non-SBA-guaranteed loans, the likely result is that federally regulated lenders will continue to operate based on the requirements imposed on them by their primary federal regulator while non-federally regulated lenders will have no such limitations. Borrowers, especially in underserved markets, would be harmed by this.

Finally, I am deeply disturbed that SBA is welcoming FinTech into the program in an unlimited fashion with a loosening of rules just as Congress is releasing explosive reports announcing that FinTech was at the center of tens of billions of dollars in fraud in the Paycheck Protection Program because of the lack of prudent behavior and internal guardrails from those entities. While investigations into potential criminal behavior by FinTech companies in one federal government program at SBA are still underway, the Agency should not invite FinTech entities into another federal government program before better understanding the role these non-federally regulated entities played in this large-scale fraud.

Specifically regarding your concern about franchises, SBA is proposing in its Affiliation Proposed Rule to loosen standards lenders need to consider when examining if a borrower is affiliated with a larger business (key to the franchise relationship you mentioned). In this

loosening of affiliation standards, the end result could be that SBA's *small* business loans could be going to large businesses that should not be getting these types of loans. Further, SBA has also proposed that they will no longer be providing a guiding framework to determine eligibility for franchise lending, called the SBA Franchise Directory. This is a process that works very well right now and a large portion of SBA 7(a) loans go to franchisees currently, in part because of the success of the existing system. By SBA proposing to do away with this directory, there will be a complete lack of consistency in how lenders evaluate franchisees, lenders will be left to guess at basic eligibility criteria meeting SBA's assessments, and ultimately, less lending to franchisees will be the likely result. This is the opposite result we should want.

As a lender, I'm deeply troubled by the direction SBA is taking the loan programs and look forward to your assistance in remedying these issues.

*Improving Access to Capital in Underserved Communities: The Community Advantage Program, Microloans, and other SBA Initiatives*

December 14, 2022

**Senator Hickenlooper Statement for the Record**

Affordable access to capital is the lifeblood of small businesses. The SBA and its partners have diligently worked together, primarily through its flagship 7(a) program, to expand access to loans for entrepreneurs who cannot otherwise secure affordable capital.

Unfortunately, as the country has emerged from the pandemic, the rate of small businesses applying for financing has fallen sharply – from 43% in 2019 to 34% in 2021. Of those businesses that did apply, only 31% received all the funding they sought in 2021, compared to 51% in 2019. These issues are compounded by significant gaps in lending, especially for micro-businesses and those in underserved areas, which makes today's hearing especially timely.

Many entrepreneurs, especially women, minorities, and those living in rural areas, still struggle to access affordable capital from traditional lending institutions. According to data from the 2018 State of Small Business Credit Survey, only 64% of Black- and 65% of Hispanic- owned firms were approved for financing compared to 80% for White-owned firms. Both policymakers and the private sector must work together to ensure creditworthy individuals are not overlooked by financial services providers.

Financial technology firms (fintechs) and other non-bank lenders have demonstrated a capacity to help expand the pool of those looking to serve small businesses and fill gaps in access by deploying innovative strategies to support borrowers and serve traditionally underbanked communities. Fintech firms provided a lifeline to underbanked Paycheck Protection Program (PPP) borrowers by serving new customers. A New York Federal Reserve study from May 2021 found that, while disbursing only a small share of total PPP loan amounts, fintechs provided important support to minority business owners. Approximately 1 in 4 Black-owned companies applied to fintech lenders, more than twice the rate of other firms.

I'm aware of recent reports that certain fintech PPP loan providers engaged in fraudulent activity and facilitated fraud in the program. However, there is no reason to believe that bad behavior by a select group of fintechs is representative of the entire industry. Fintech lenders should engage in all the compliance measures required of traditional banks such as know your customer rules, anti-money laundering rules, and seek to engage in transparent underwriting processes.

Moving forward, we must employ the lessons learned during PPP to modernize the 7(a) program while ensuring sufficient oversight and compliance mechanisms are enforced. That's why Senator Tim Scott and I have introduced the Expanding Access to Affordable Credit for Small Businesses Act, which would lift the SBA's moratorium on allowing additional non-banks to serve as Small Business Lending Companies (SBLCs) and allow qualifying non-banks to provide access to the 7(a) program as guaranteed lenders.

In its November 7th rulemaking, the SBA announced plans to implement our bill by removing the SBLC lending cap. We applaud the SBA's decision to do so, and look forward to a rigorous notice and comment period on how best the SBA should proceed.

Over the past four decades the SBA has successfully managed 14 SBLCs, and supervised the sale of their licenses. As the SBA looks to implement regulations to expand the program, it must ensure that it has the resources to maintain sufficient oversight of every SBLC. Similarly, introducing flexibility for traditional SBLCs and new Mission-based SBLCs is critical to serving underbanked communities. However, under no circumstances can the SBLC program become a haven for financial services providers to engage in regulatory arbitrage. All 7(a) loan providers must be held to the same fundamental safety standards to preserve the long-term health of the 7(a) program.

Using technology and innovation, fintech firms have created new products, have offered more choice, and reduced costs for small firms looking for capital. That's why I support efforts to strengthen and modernize the SBA with programs such as the SBLC program. We must continue to develop, implement, and preserve innovative ways to support traditionally underserved small business owners.



**National Association of Development Companies (NADCO) Statement for the Record**

*“Improving Access to Capital in Underserved Communities: The Community Advantage Program, Microloans and other SBA Initiatives”*

Senate Committee on Small Business and Entrepreneurship  
December 14, 2022

The National Association of Development Companies (NADCO) represents the Certified Development Company (CDC) industry whose economic development mission is realized through delivery of the Small Business Administration’s (SBA’s) 504 Loan Program, Community Advantage Loan Program (CA), Microloan Program, and a host of other federal, state, and local programs. In particular, CDCs comprise over 40 percent of CA lenders delivering nearly 60 percent of CA dollars.

With this context in mind, NADCO offers the following comments on recent congressional action related to the Community Advantage Loan Program, as well as proposed rules released by the SBA that would impact underserved borrowers by 1) streamlining lending criteria and affiliation principles for SBA’s business loan programs, and 2) lifting the moratorium on Small Business Lending Companies (SBLCs) and creating a new category of SBLC geared toward mission lending (Mission-Based SBLC).

**Community Advantage Loan Program**

SBA established the Community Advantage Loan Program in 2011 as a pilot housed within the 7(a) Loan Program, which is delivered by non-profit, mission-lenders with parameters intended to reach underserved borrowers who were not only left behind by conventional lending options, but were still not being served by SBA programs. Since its inception, the CA program has undergone a number of programmatic changes. Most recently, in April 2022, SBA announced changes to the CA program intended to speed loan processing, delivery of capital of underserved communities, and encourage greater lender participation. Specific reforms included –

1. Extending the pilot program for two years (to September 30, 2024)
2. Removing the temporary moratorium on new CA lender participation applications
3. Granting delegated authority to all experienced CA lenders
4. Modifying lending criteria to simplify and streamline underwriting and approval of CA applications, including authorizing the use of business credit scoring models
5. Modifying regulations to provide equitable access under SBA programs and economic opportunities to justice-involved individuals
6. Increasing the maximum CA loan size from \$250,000 to \$350,000
7. Revising fee methodology and maximum interim rate to encourage greater lender participation in the CA Loan Program
8. Revising collateral requirements to increase the speed for capital being delivered to small businesses while decreasing overall costs to the CA lender and borrower

9. Allowing revolving lines of credit to better meet the evolving capital needs of small businesses
10. Revising the requirements for hazard insurance
11. Simplifying affiliation principles

NADCO supported these changes in written comment to the Agency, but expressed the need for a longer extension of the program. NADCO has long advocated for the CA Loan Program to be made permanent either through congressional action or through SBA's long-term extension of the program to create certainty around program availability and encourage increased lender participation. NADCO also supports additional reforms to increase participation and better meet the capital needs of underserved communities by expanding the definition of underserved communities, addressing lender capitalization constraints, establishing performance metrics, and incorporating parameters for success around business and technical assistance.

#### **Chairman Cardin Community Advantage Loan Program Bill**

Chairman Cardin has a long track record of focusing on the gaps in financing available for underserved communities and crafting legislation to fill those gaps and reach underserved borrowers in an equitable manner. Most recently, Chairman Cardin – along with Representative Judy Chu – introduced the *Community Advantage Loan Program Permanency Act of 2022* on November 15, 2022.

NADCO supports this legislation and the impactful changes it makes to the CA program to bolster lending to underserved communities. Namely, the bill makes Community Advantage permanent, which creates certainty for lenders and borrowers alike. The bill also makes the following changes:

- Expands the definition of underserved to better reach these communities
- Appropriately balances risk with capitalization concerns by reformulating contributions to the Loan Loss Reserve for CA loans
- Further addresses capitalization concerns of non-profit lenders by increasing the guarantee for CA loans
- Focuses needed attention on developing performance metrics for CA lenders, as well as business and technical assistance metrics for both lenders and borrowers
- Incorporates valuable training for CA lenders and collaboration between lenders and SBA
- Requires extensive reporting to Congress to be made publicly available that will better capture the impact of the program and areas for improvement

#### **Affiliation and Lending Criteria Proposed Rule**

SBA released a proposed rule titled, "Affiliation and Lending Criteria for the SBA Business Loan Programs," on October 26, 2022. The proposed rule streamlines SBA's current lending criteria from nine metrics to three, incorporates the use of credit scoring in the underwriting process, and simplifies affiliation principles to ease understanding and compliance by lenders and borrowers. To provide further detail outlining our support for these proposed rule changes (with noted caveats), NADCO offers the following commentary:

1. NADCO supported SBA's recent streamlining of lending requirements for the CA program and supports extending the simplification and modernization of its lending requirements to the 504 Loan Program, while also embracing new technology to allow generally acceptable commercial credit analysis processes and procedures, including loan scoring models, to streamline underwriting. However, we also strongly encourage SBA to continue its focus on prudent lending standards while balancing program access with portfolio performance and program integrity.
2. For 504 Loan Program purposes, NADCO specifically supports SBA removing the requirement to consider character and reputation because as SBA stated in the proposed rule, "the lending industry commonly uses the terms character and credit history interchangeably." Credit history is a more objective, empirical measure than the amorphous concepts of "character" and "reputation." SBA's proposed change would focus more appropriately on current conditions more indicative of creditworthiness rather than minor infractions in an applicant's past.
3. There are a few caveats to NADCO's support for the proposed changes to lending criteria. First is the concern that SBA may implement a minimum credit score for all loans – we recommend SBA make clear in SOP guidance that CDCs are able to use mitigating factors when a credit score is impaired for explainable reasons. NADCO also recommends that SBA retain the consideration of "experience and depth of management" in its lending criteria, as this is particularly important for start-up or new businesses – while management strength can be implied by the financial performance of existing businesses, it should be a separate consideration for start-up or new businesses where underwriting is based in part on management skills and projections.

SBA's proposed rule also seeks to streamline SBA's affiliation criteria for all of its business loan programs, including 504 and 7(a). SBA proposes to specifically remove the principle of control of one entity over another as a separate basis for finding affiliation because the concept of control has proven particularly burdensome for applicants and lenders to understand and implement. NADCO supported SBA's streamlining and modernizing affiliation principles in the Community Advantage Loan Program in April 2022 and advocated for SBA to extend those changes to the 504 Loan Program as part of our long-term goal of program simplification. Additionally, the current level of complexity has led to inconsistent interpretation and implementation by all parties in the loan approval process. SBA's proposal would create a "bright line" test that CDCs and small businesses can easily understand and implement.

With respect to the individual revisions to affiliation principles –

1. NADCO supports SBA's proposed revisions to affiliation based on ownership
2. NADCO supports SBA's proposed revisions to affiliation based on stock options, convertible securities, and agreements to merge
3. NADCO supports SBA's proposed elimination of affiliation based on management. NADCO also supports SBA's statement that "it [SBA] should not interfere in a business owner's right to enter into a service agreement with a management company." To the extent that SBA requires review and approval of management agreements for loan program requirements (i.e., passive business

activity), NADCO expects SBA will continue its current guidance established in existing Standard Operating Procedures (SOP).

4. NADCO supports SBA's proposed elimination of affiliation based on identity of interest. NADCO agrees with SBA that the existing requirement is "inherently unfair and impractical" when a close relative is not a principal of the Applicant business.
5. NADCO supports SBA's proposed elimination of affiliation based on franchise and license agreement; however, NADCO does not support elimination of the SBA Franchise Directory and SBA's approval of compliance with loan program requirements (i.e., business model eligibility). The current franchise review and approval process for business model eligibility has evolved over time and is working well for CDCs, third party lenders, and small business applicants. Keeping SBA involvement in the approval of business model eligibility will assure consistency and avoid second guessing through SBA's oversight activities. NADCO recommends that SBA continue reviewing franchise and license agreements for compliance with loan program requirements and publishing that data on the Franchise Directory to provide transparent assurance to CDCs, third party lenders, and small business applicants.

#### **Small Business Lending Company (SBLC) Proposed Rule**

SBA released a proposed rule titled, "Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization," on November 7, 2022. This proposed rule lifts the moratorium on new Small Business Lending Companies (SBLCs), which will allow new for-profit SBLCs into the program. SBA will also create a new type of non-profit Mission-Based SBLC, which SBA purports will help bridge financing gaps, particularly in underserved communities. Based on current oversight capacity, SBA anticipates it has the ability to approve three new SBLCs in total (regular for profit SBLC and Mission-Based SBLC).

As drafted, NADCO strongly opposes this proposed rule – we do not believe it will improve access to capital for underserved communities, nor do we believe this route is the best avenue to create permanency for mission-lenders within the 7(a) Loan Program. We foresee significant adverse impact of the rule on Community Advantage and its current lending community, which will harm the very borrowers we are seeking to serve. Finally, we do not believe it prudent for SBA to open the doors to financial technology institutions to deliver government guaranteed programs during a time in which Congress is investigating their actions during delivery of SBA emergency COVID relief programs.

The following items do not encapsulate the totality of NADCO's concerns, but provide further context for NADCO's strong objection to the proposed rule:

1. Lifting the moratorium and adding non-mission SBLCs does not improve access to mission lending for underserved communities since the proposed rule does not impose any mission-based requirements on non-Mission-Based SBLCs, which is contrary to SBA's stated goal. Furthermore, the rule leaves programmatic details (i.e., geography, maximum loan size, target markets, etc.) to be approved by SBA

personnel on a lender-by-lender basis, thus creating separate guidelines for each lender and places added responsibilities on an already overburdened agency to devise, approve, and monitor individualized lender compliance.

2. The proposed rule is absent specificity and transparency around Mission-Based Small Business Lending Companies (SBLCs) and the transition of existing CA lenders to this new category. SBA proposes to “allow CA Lenders an opportunity to apply to permanently participate in the 7(a) Loan Program as a Mission-Based SBLC while continuing to meet the needs of underserved communities.” However, the proposed rule provides no details on this “application” process and no assurance that all existing CA lenders will be granted the new Mission-Based SBLC designation. Depending on how implemented, transitioning existing CA lenders could be costly and time-consuming to lenders and inhibit their ability to serve borrowers. The rule also contains no details on an application process for new Mission-Based SBLCs not coming from the CA loan program. Further, SBA removed the temporary moratorium on new CA lenders in April 2022 to encourage greater lender participation in the CA program, but the proposed rule states that SBA “has capacity to authorize three new SBLC Licenses” and “SBA anticipates approving three SBLCs, including Mission-Based SBLCs, in the full first year after this proposed rule becomes effective.” This would restrict adding new mission lenders when no such restriction exists in the CA Loan Program today.
3. The proposed rule is silent on capital requirements for Mission-Based SBLCs, which could impede existing CA lenders from transitioning to a Mission-Based SBLC designation and deter new lenders from applying. For context, the current SBLC capital requirement is \$5 million, or 10 percent of the aggregate of its share of all outstanding loans, whichever is greater.
4. Per the proposed rule, Mission-Based SBLCs would be subject to the same oversight requirements as non-Mission-Based SBLCs, with an initial \$10,000 safety and soundness review and a total biennial cost of these risk-based reviews that is currently \$50,000 to \$150,000 per institution. As mission-based non-profit lenders, CA lenders pay oversight fees commensurate with the size of their CA loan portfolios and associated risk; whereas traditional SBLCs are for-profit lenders not subject to SBA’s mission lending mandates, have significantly larger portfolios, and can make loans up to \$5 million. This proposal raises concerns about creating another cost pain point for mission-based lenders and forcing smaller CA lenders to exit the program, which is counterproductive to the goal of increasing lending to underserved communities.
5. Lifting the moratorium could have significant impact on program integrity. For example, as proposed, both regular and Mission-Based SBLCs would operate within the SBA 7(a) Loan Program. Because there is no limit to the number of SBLCs SBA could potentially add to participate in 7(a) lending, borrowers in underserved communities may experience disruptions in their ability to access capital through the 7(a) program if for-profit SBLCs lend at a rate to which the authorization cap is reached and the program is shut down, which would require an act of Congress to

address. Additionally, unfettered access to the 7(a) Loan Program by for-profit SBLCs may result in subsidy costs to the program necessitating not only the elimination of fee waivers for small dollar and veteran borrowers, but higher fees for all borrowers. Borrowers will suffer any unintended consequences of lifting the moratorium on SBLCs.

6. Finally, SBA's April 2022 reforms to the CA Loan Program included lifting the moratorium on new lenders and extending the program until September 30, 2024. Lenders considering CA program participation must balance the cost of investing in a new program with the uncertainty of the program ever becoming permanent. As SBA stated in the proposed rule when discussing new SBLC lenders, "newly established SBLCs take up to five years to reach the current lending activity sustained by established SBLC license holders." In contrast, SBA's reforms to the CA Loan Program have only been in place since April 2022. Rather than being "an unviable alternative" for increasing volume in underserved lending, CA simply needs time to realize the impact of recent changes. Additionally, had SBA paired its program reforms with a longer extension of the pilot, lenders would have more certainty to justify the investment in a program to deliver much-needed capital to underserved communities.

We appreciate the ability to offer NADCO's perspective on the Community Advantage Loan Program, including Chairman Cardin's bill, and the SBA's proposed rules. We welcome further dialogue to advance our shared goal of creating parity in access to capital to underserved communities.

Sincerely,



Rhonda Pointon  
President & CEO  
National Association of Development Companies (NADCO)



December 12, 2022

Dianna Seaborn, Director  
Office of Financial Assistance  
U.S. Small Business Administration  
409 Third Street SW  
Washington, DC 20416

RE: RIN 3245-AH87  
Document ID: SBA-2022-0012-001  
Affiliation and Lending Criteria for the SBA Business Loan Programs

Dear Ms. Seaborn:

The National Association of Development Companies (NADCO), on behalf of the Certified Development Company (CDC) industry, submits these comments in response to the U.S. Small Business Administration's (SBA's) Proposed Rule titled "Affiliation and Lending Criteria for the SBA Business Loan Programs (RIN 3245-AH87)."

**Background**

NADCO provides comments specific to CDCs and their involvement in SBA programs as mission-based lenders focused on promoting economic development through job creation. CDCs are non-profit lenders approved by SBA to participate in specific agency loan programs, including the 504 Loan Program, the Community Advantage (CA) Pilot Program, and the Microloan Program. The Agency is the primary regulator and conducts rigorous oversight of CDCs, including – but not limited to – a biennial review of each CDC's risk rating, historical performance measures (e.g. default rate, purchase rate and loss rate), and portfolio compliance; quarterly Loan and Lender Monitoring System (L/LMS) analysis of the outstanding balance of each CDC's portfolio; specific reviews and biennial reapproval for CDCs who have Accredited Lenders Program (ALP) or Premier Certified Lenders Program (PCLP) status; an extensive Annual Report to SBA covering every aspect of CDC activity from operations of the CDC to loan portfolio metrics; and more.

CDCs are by design economic developers, which is a primary reason that in addition to the myriad of other federal, state, and local programs they offer, they all have in common delivery of the SBA's 504 Loan Program. The 504 program is SBA's only program for which economic development in the form of job creation or meeting public policy or community development goals are requirements for eligibility, which differentiates it from other SBA capital access programs for which credit elsewhere (including consideration of personal resources) is a statutory determinant for eligibility. Additionally, the 504 Loan Program is focused on economic development through the purchase of commercial real estate and capital equipment, in essence, fixed assets.

The Community Advantage Loan Program is also delivered by non-profit entities, which includes nearly 50 CDCs, many who have delivered the program since its inception in 2011. This program is also mission-driven with 60% of loans made in underserved communities, encapsulating rural, HUBZone, low-to-moderate income, and new businesses. Many of the changes SBA proposes in this rule were introduced

for the Community Advantage Loan Program on April 29, 2022 (87 FR 25398), which NADCO supported in comments submitted to the Agency on May 24, 2022. At that time, NADCO encouraged SBA to extend many of these reforms to the 504 Loan Program.

NADCO's comments below are reflective of the manner in which CDCs operate within the SBA ecosystem, the unique parameters of the programs they deliver, and are consistent with comments made to the Agency previously. **NADCO has long advocated for simplification and streamlining of SBA's 504 Loan Program and Community Advantage Loan Program to promote speed, consistency, and certainty for small business access to capital.**

Given this background, NADCO offers the following –

**Section 120.130—Restrictions on Uses of Proceeds**

Current § 120.202 restricts Borrowers from using 7(a) loan proceeds to purchase a portion of a business or a portion of another owner's interest. SBA proposes to revise this section to allow Borrowers to use 7(a) loan proceeds to fund partial changes of ownership in addition to full changes of ownership.

*NADCO supports SBA's desire to assist small businesses and provide a path to ownership for employees. While no such regulatory restriction on partial change of ownership projects exists in § 120.884 for SBA's 504 Loan Program, SBA has historically used Standard Operating Procedure (SOP) guidance to allow full change of ownership projects in 504. SBA has not historically allowed 504 to fund partial change of ownership projects. NADCO recommends that SBA change its guidance to allow the 504 Loan Program to finance full or partial change of ownership projects provided those projects are supported by underlying fixed assets.*

**Section 120.150—What are SBA's lending criteria?**

Current § 120.150 states that SBA's lending criteria for 7(a) and 504 loans requires that the applicant (including the Operating Company) must be creditworthy; loans must be so sound as to reasonably assure repayment; and SBA will consider nine specific factors in its lending criteria. The factors consist of: (a) Character, reputation, and credit history of the applicant (and the Operating Company, if applicable), its Associates, and guarantors; (b) Experience and depth of management; (c) Strength of the business; (d) Past earnings, projected cash flow, and future prospects; (e) Ability to repay the loan with earnings from the business; (f) Sufficient invested equity to operate on a sound financial basis; (g) Potential for long-term success; (h) Nature and value of collateral (although inadequate collateral will not be the sole reason for denial of a loan request); and (i) The effect any affiliates (as defined in part 121 of this chapter) may have on the ultimate repayment ability of the applicant.

SBA proposes to revise this regulation by retaining the requirement that the applicant (including an Operating Company) must be creditworthy and that loans must be so sound as to reasonably assure repayment and streamlining the nine specific factors in its lending criteria to three specific criteria when approving loans: (a) The credit score or credit history of the applicant (and the Operating Company, if applicable), its Associates and any guarantors; (b) The earnings or cashflow of the applicant; or (c) where applicable, any equity or collateral of the applicant.

SBA is also incorporating into the regulation a new requirement that Lenders and Certified Development Companies (CDCs) must 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. The rule also adds language to § 120.150 to permit Lenders, CDCs, and SBA to use a

business credit scoring model to streamline loan underwriting. Lenders and CDCs may use SBA's Small Business Scoring Service (SBSS) credit scoring model. Lenders and CDCs may also use other credit scoring models; however, when doing so, Lenders and CDCs must be able to validate the credit scoring model and must document with appropriate statistical methodologies that their credit analysis procedures are predictive of loan performance, and they must provide that documentation to SBA upon request and during oversight reviews.

*NADCO supported SBA's recent streamlining of lending requirements for the Community Advantage (CA) Loan Program [implemented in April 2022 via Federal Register Notice Vol. 87, No. 63 and via Federal Register Notice Vol. 87, No. 83], as these changes expanded access to the CA program's delivery of critical capital through small loans to underserved communities. CDCs have participated in the Community Advantage Loan Program since its inception in 2011. Historically, approximately 40-50 CDCs have delivered the program as part of our mission-based lending ethos, representing over 40% of total CA lenders and over 60% of CA lending dollars.*

*NADCO supports SBA's desire to extend the simplification and modernization of its lending requirements to the 504 Loan Program, while also embracing new technology to allow generally acceptable commercial credit analysis processes and procedures, including loan scoring models, to streamline underwriting. NADCO strongly encourages SBA to continue its focus on prudent lending standards while balancing program access with portfolio performance and program integrity.*

*For 504 Loan Program purposes, NADCO specifically supports SBA removing the requirement to consider character and reputation because as SBA stated in the proposed rule, "the lending industry commonly uses the terms character and credit history interchangeably." Credit history is a more objective, empirical measure than the amorphous concepts of "character" and "reputation." SBA's proposed change would focus more appropriately on current conditions more indicative of creditworthiness rather than minor infractions in an applicant's past.*

*NADCO is concerned that SBA may use this change to implement a minimum credit score for all loans and recommends that SBA make clear in SOP guidance that CDCs are able to use mitigating factors when a credit score is impaired for explainable reasons. NADCO recommends that SBA retain the consideration of "experience and depth of management" in its lending criteria, as this is particularly important for start-up or new businesses – NADCO acknowledges that management strength can be implied by the financial performance of existing businesses, but it should be a separate consideration for start-up or new businesses where underwriting is based in part on management skills and projections.*

**Section 120.160—Loan Conditions**

Current § 120.160(c) states that for 7(a) and 504 loans, SBA requires hazard insurance on all collateral and does not distinguish this requirement by loan size. In the proposed rule, SBA is modifying the requirement for hazard insurance for all 7(a) and 504 loans \$150,000 and under to create flexibility for SBA Lenders to mirror their hazard insurance requirements for their similarly sized non-SBA loans. SBA proposes revising this regulation to state that SBA requires hazard insurance for loans greater than \$150,000.

*NADCO supported SBA making this change in the Community Advantage Loan Program for small loans to underserved communities. As NADCO has long advocated for SBA to simply and*

*streamline the 504 Loan Program, we support this change for 504 loans, as it allows for CDC flexibility to meet the needs of the small business Applicant more cost-effectively. To the extent that the CDC believes that hazard insurance is necessary for small loans secured by real estate, the proposed rule still allows that flexibility.*

*NADCO has advocated for SBA to grant similar flexibility for life insurance for the 504 Loan Program and recommends that SBA not automatically require life insurance for single owner businesses, allowing the CDC and Applicant to make the case that life insurance is not necessary, even for sole proprietorships and single member LLCs. In situations where life insurance is deemed necessary for these entities, if SBA's collateral gap calculation is less than a minimum threshold (i.e., \$50,000), NADCO advocates for SBA to simply waive the requirement for life insurance altogether as this cost can be onerous for small business owners while providing minimal risk to SBA.*

**Section 120.193—Reconsideration After Denial**

Under current regulation § 120.193, the Director of the Office of Financial Assistance (OFA) makes all reconsideration decisions. To facilitate fair and expeditious reconsiderations, SBA is proposing to grant the OFA Director the ability to delegate decision making to designees – for 7(a) loan applications, the Director's designee would include the Chief, 7(a) Loan Policy; for 504 loans, the Director's designee would include the Chief, 504 Loan Policy. From time to time, SBA may change the designee(s) and would do so in accordance with published Delegations of Authority.

*NADCO supports this proposed change.*

**Section 120.202—Restrictions on Loans for Changes of Ownership**

Current § 120.202 restricts Borrowers from using 7(a) loan proceeds to purchase a portion of a business or a portion of another owner's interest. SBA proposes to revise this section to allow Borrowers to use 7(a) loan proceeds to fund partial changes of ownership in addition to full changes of ownership.

*This proposed change is contemplated in conjunction with SBA's proposed change to § 120.130 as outlined above. As stated above, NADCO supports SBA's desire to assist small businesses and provide a path to ownership for employees. While no such regulatory restriction exists in SBA's 504 Loan Program, SBA has historically used Standard Operating Procedure (SOP) guidance to restrict partial change of ownership projects in 504. NADCO recommends that SBA change its SOP guidance to allow the 504 Loan Program to finance full or partial change of ownership projects provided those projects are supported by underlying fixed assets.*

**Section 121.301—What size standards and affiliation principles are applicable to financial assistance programs?**

SBA's proposed rule seeks to streamline SBA's affiliation criteria under § 121.301 for all of its business loan programs, including 504 and 7(a). SBA proposes to specifically remove the principle of control of one entity over another as a separate basis for finding affiliation because the concept of control has proven particularly burdensome for applicants and lenders to understand and implement.

*NADCO supported SBA's streamlining and modernizing affiliation principles in the Community Advantage Loan Program in April 2022 and advocated for SBA to extend those changes to the 504 Loan Program as part of our long-term goal of program simplification.*

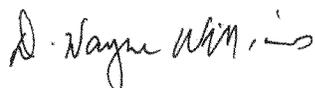
To use SBA's words, existing affiliation rules are "particularly burdensome for applicants and lenders to understand and implement." Additionally, the complexity has led to inconsistent interpretation and implementation by all parties in the loan approval process. SBA's proposal would create a "bright line" test that CDCs and small businesses can easily understand and implement.

With respect to the individual revisions to § 121.301 –

1. NADCO supports SBA's proposed revisions to affiliation based on ownership in § 121.301(f)(1).
2. NADCO supports SBA's proposed revisions to affiliation based on stock options, convertible securities, and agreements to merge in § 121.301(f)(2).
3. NADCO supports SBA's proposed elimination of affiliation based on management in § 121.301(f)(3). NADCO also supports SBA's statement that "it [SBA] should not interfere in a business owner's right to enter into a service agreement with a management company." To the extent that SBA requires review and approval of management agreements for loan program requirements (i.e., passive business activity), NADCO expects SBA will continue its current guidance established in existing Standard Operating Procedures (SOP).
4. NADCO supports SBA's proposed elimination of affiliation based on identity of interest in § 121.301(f)(4). NADCO agrees with SBA that the existing requirement is "inherently unfair and impractical" when a close relative is not a principal of the Applicant business.
5. NADCO supports SBA's proposed elimination of affiliation based on franchise and license agreement in § 121.301(f)(5); however, NADCO does not support elimination of the SBA Franchise Directory and SBA's approval of compliance with loan program requirements (i.e., business model eligibility). The current franchise review and approval process for business model eligibility has evolved over time and is working well for CDCs, Third Party Lenders, and small business Applicants. Keeping SBA involvement in the approval of business model eligibility will assure consistency and avoid second guessing through SBA's oversight activities, including Payment Integrity Information Act of 2019 (PIIA) audits and CDC reviews. NADCO recommends that SBA continue reviewing all franchise and license agreements for compliance with Loan Program Requirements and publishing that data on the Franchise Directory to provide transparent assurance to CDCs, Third Party Lenders, and small business Applicants.

NADCO appreciates the opportunity to provide these comments and welcomes additional collaboration with SBA to create additional efficiencies in the 504 Loan Program.

Sincerely,



Wayne Williams  
Executive Vice President  
Regulatory Affairs & Training



Mission Lenders Working Group  
*Building Success in Underserved Communities*

Testimony for the Record  
Submitted to the  
Senate Small Business and Entrepreneurship Committee

For the hearing:  
“Improving Access to Capital in Underserved Communities: The Community Advantage  
Program, Microloans, and other SBA Initiatives”

Wednesday, December 14, 2022

Submitted by Alison Feighan on behalf of the Mission Lenders Working Group

Chairman Cardin and Ranking Member Paul, on behalf of the Mission Lenders Working Group (MLWG), I write to thank you for convening a hearing focused on improving access to capital in underserved communities and for the opportunity to reflect on how the SBA’s Community Advantage (CA) pilot program has increased SBA-backed lending to underserved businesses and markets. We were very pleased that CA lender CDC Small Business Finance was invited to testify before the committee alongside representatives from the traditional 7(a) program, and the microloan program.

The Mission Lenders Working Group (MLWG) is a network of SBA 7(a) Community Advantage (CA) lenders that was organized in 2015 as a way for CA lenders to share best practices, offer peer-to-peer training and support, and collaborate on education and advocacy to keep policymakers updated on the pilot’s impact. MLWG members act as agents of change in their communities by intentionally making capital accessible to support and sustain underserved and underbanked small businesses. MLWG membership represents the diversity of the mission lending industry – including some of the largest CA lenders in terms of volume as well as smaller lenders, rural-focused lenders, and lenders targeting underserved urban centers, but all are seasoned lenders and all are intentionally mission-driven and committed to financing, supporting and sustaining underbanked businesses.

Together, the MLWG members are responsible for more than half of all CA lending in terms of loan count and volume to date. Based on the experience of the MLWG members, we are sharing comments for the committee’s hearing record on:

- SBA’s Community Advantage Pilot Loan Program,
- Chairman Cardin’s legislation to codify the CA program within the Small Business Act, and
- SBA’s proposed rule released on November 7, 2022, that would negatively impact underserved small business owners and entrepreneurs by lifting the moratorium on Small Business Lending Companies (SBLCs) as well as creating a new category of SBLC known as Mission-Based SBLC, with no accountability to underserved markets.

The 7(a) Community Advantage (CA) pilot was launched by the SBA in 2011 to expand access to SBA-backed loans for underserved small businesses. Initially, CA loans were capped at \$250,000 but on May 31, 2022, the SBA increased the maximum CA loan size to \$350,000. There are approximately 110 CA non-profit lenders consisting of SBA-Authorized Certified Development Companies (CDCs), SBA-Authorized Microloan Intermediaries, and Community Development Financial Institutions (CDFIs).

When the CA pilot was launched, the SBA recognized the unique capacity of nontraditional lenders – particularly CDCs, CDFIs, and SBA Microloan Intermediaries— to finance and grow businesses that traditional 7(a) lenders could not and in many cases should not lend to. The SBA acknowledged that in order to increase lending in underserved markets using SBA’s flagship 7(a) loan guarantee - they needed to enlist the expertise of non-traditional lenders that had experience and a presence in the markets that conventional banks and traditional 7a lenders could not reach. The CA program aims to help these underserved and underbanked small businesses climb the ladder of economic opportunity, contributing to business growth and economic development in emerging markets.

CA lenders are required to deliver at least 60% of their CA loans to businesses in an “underserved market,” currently defined by SBA as Empowerment Zones and Enterprise Communities, HUBZones, Low-to-Moderate Income communities (LMI), Opportunity Zones, rural areas, startups, and veteran-owned businesses.

While not required, CA lenders often provide support or technical assistance to a borrower or prospective borrower and this approach to lending is one of the factors that allows mission lenders to manage the risk involved in lending to businesses deemed ‘unbankable’ by conventional lenders (including start-ups.) As mission-oriented organizations, CA lenders consistently exceed the 60% requirement.

The CA model works and is powerful for reaching underserved and underbanked small businesses and entrepreneurs. CA lenders know their communities and it is within their mission to serve small businesses. The CA program benefits economically and socially disadvantaged businesses that need access to patient capital that is structured as affordable for the businesses to grow.

Since the CA pilot launched in 2011, the SBA has approved a total of \$1,050,734,400 in CA loans to 7,673 businesses with an average loan size of \$139,000. Traditional 7(a) and Community Advantage lending declined during the pandemic as lenders shifted their focus to processing PPP loans. In addition, many States rolled out their own affordable capital programs and provided free business support services to small businesses. In FY 2020, SBA lending started to pick up with CA lenders continuing to target a significant portion of their lending to underserved markets. In FY 2022, 717 CA loans were approved for an average loan size of \$158,995, representing an increase in CA loan approval of 21 percent.

What the SBA has not done is to define or specify what success looks like in terms of acceptable or unacceptable risks. Under the program, mission-based CA lenders were asked to serve the hardest-to-reach markets. While there is an expectation of higher losses, that has never been publicly defined and presented to the CA lenders. A conversation with SBA and agreeing upon the success of the program would assist in further defining the program for new lenders and likely increase participation.

The MLWG is committed to working with the SBA to increase SBA-backed lending to underserved markets and increase the efficiency of SBA lending while at the same time making sure every small business owner seeking an SBA loan is able to access the product(s) and/or service(s) they need. We understand the

importance of a business having access to credit - but it's critically important that loans are "right-sized, priced" and structured to meet the needs of a business.

#### **The Community Advantage Loan Program Permanency Act of 2022**

The CA program has been operating as a pilot for more than ten years and based on the success of the pilot the MLWG is urging Congress to codify the program and grant it full status as a mission-driven loan program within the flagship 7(a) program.

We appreciate Chairman Cardin's leadership and support for the codification of CA and the MLWG is pleased to endorse the *Community Advantage Loan Program Permanency Act of 2022* (S.5102) introduced by the Senator last month. In addition to elevating CA from a pilot program, the Chairman's bill incorporates important lessons learned over the pilot period and the bill seeks to improve and strengthen the program to more effectively serve businesses.

The bill expands the definition of "underserved community" to include businesses owned by socially and economically disadvantaged individuals, businesses owned by women, and rural businesses, which is an essential step in achieving parity for small business owners that are underbanked and underestimated.

This critical legislation recognizes the need to institutionalize mission-driven lending as part of the SBA's mission to "aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns" by identifying markets that have historically been underserved and requiring CA lenders to make at least 70% of the loans to identified markets. This is up from the 60% target threshold in the CA pilot.

We appreciate that The CA program should serve as the SBA's primary vehicle for delivering loans of up to \$350,000 to economically and socially disadvantaged business owners who lack banking relationships. This legislation will help small business owners to navigate and continue to rebuild from the Covid-19 economic crisis.

The legislation seeks to expand the reach of CA lending by seeking to formalize the CA Network Partners. Among other benefits, the CA Network Partners model would provide an on-ramp for mission lenders considering entering the CA program. These mission lenders are touchstones in the local community and have established trust within the community. This local network creates a pathway for small business owners and entrepreneurs to establish a local relationship with a local lender, and, where the business owner may receive technical assistance or simple reassurances as they go through the application process. The small business owners receive financing structured on the historical cash flow available to service the debt while the company grows. The legislation will also allow SBA 7(a) lenders to refinance CA loans after the small business owner has demonstrated key indicators like the need for additional capital and a track record of timely payments.

#### **The Continuum of Capital**

Network Partners referrals ➡ CA Lender: TA if needed, financing ➡ SBA 7(a) lenders refinances CA loans ➡ CA lender is reimbursed and had the capital to assist new underserved businesses

During the hearing, there was some discussion about the fate of a business that applied for a 7(a) loan but is turned down for one reason or another, often based on a determination of their inability to repay. This is where CA lenders can step in, possibly with business assistance or with the ability to accept collateral or manage the risk that a conventional lender could not. CA lenders assist these businesses to secure the right-

sized financing to build their financial resumes and get them 'bankable' over time. This is where our work begins and places a small business on the 'continuum of capital.'

The CA program has operated as a "pilot program" for the last ten years, despite its proven success and sustainability in reducing credit disparities. Since 2011, the CA program has received several short-term extensions, leaving lenders without assurance of the program's long-term outlook and its capacity to serve the most overlooked small businesses. The CA program is currently set to expire at the end of FY 2024.

The multiple extensions of the program over different administrations, along with changing operating rules, have made it problematic for new mission lenders to commit to the program. No large for-profit financial institution would tolerate such programmatic changes, yet mission lenders are expected to continue to reach the hardest to serve and adapt to the changing rules, which are more restrictive than to other 7(a) lenders. This legislation creates a pathway for emerging mission lenders to invest in a long-term CA program.

The CA program, which has a ten-year established, successful track record in supplying capital to underbanked businesses, should be among the core strategies for wealth-building and economic development in underserved communities. CA program permanency would allow mission lenders to grow their CA lending portfolios, invest in the necessary staff and systems, and continue using SBA loan guarantee authority to finance small businesses that traditional 7(a) lenders and other financial institutions do not serve. The MLWG urges the SBA Administrator to publicly endorse Senator Cardin's legislation.

#### **SBA's proposed rule on Small Business Lending Companies**

We appreciate the opportunity to share our thoughts, questions, and concerns regarding the SBA's proposal to list the moratorium on Small Business Lending Companies and create a tier of non-profit Mission SBLCs with criteria that differ from those in place for traditional SBLCs.

While we appreciate and share SBA's commitment to addressing the needs of businesses and entrepreneurs in underserved markets, the MLWG is concerned that the proposed rule as drafted will not actually promote mission lending.

We question the need for having two types of SBLCs and specifically question why the SBA would certify three new for-profit SBLCs without requiring the new entities to abide by any of the mission objectives that would be assigned to the non-profit SBLCs.

The MLWG was also troubled by a statement in the Federal Register notice regarding the limitations of the CA program: "SBA considered leaving the regulations unchanged and relying upon the CA Pilot Loan Program to address the needs of access to capital in underserved markets; however, the low historic loan volume and lack of any CA loan activity in some rural and underserved geographic areas makes this an unviable alternative."

This statement implies that mission lenders are failing at loan production volume even as that was never an explicit requirement. The CA program was not intended to be a volume-producing program but a program to fill the small dollar loan gaps within the 7(a) program to underserved markets. We urge the SBA to lean into the CA program. The CA model does work and is powerful for reaching underserved and underbanked small businesses and entrepreneurs. The June 2018 Industrial Economics Incorporated Report states "Overall, the evaluation finds that the CA Program is serving an important function for its target market.

The financing and technical assistance provided by mission-oriented CA lenders is reaching the program's target market of small businesses in emerging markets at a critical stage for these businesses..."<sup>1</sup>

The MLWG will be submitting a comment letter to the SBA on the proposed rule and we are committed to working with the SBA to strengthen the CA program in a way that will also serve to advance the SBA's equity plan and ensure more lending to underserved businesses and markets.

**Closing**

As a network of committed CA lenders, members of the MLWG see themselves as stewards of the mission and goals of the CA pilot, and as such we are committed to working with this Committee and with the SBA to intentionally and responsibly advance the stated goals of the CA pilot - to increase access to credit for small businesses in an underserved area and expand points of access to the SBA 7(a) loan program by allowing non-traditional, mission-oriented lenders to participate.

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<sup>1</sup> Industrial Economics Incorporated, "Evaluating Technical Assistance and Economic Opportunity Outcomes of the Community Advantage Pilot Program," June 2018. [https://www.sba.gov/sites/default/files/2020-11/Community\\_Advantage\\_Final\\_Evaluation\\_Report\\_-\\_June\\_21\\_2018.pdf](https://www.sba.gov/sites/default/files/2020-11/Community_Advantage_Final_Evaluation_Report_-_June_21_2018.pdf)

