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December 17, 2018

Submitted Electronically to <http://www.regulations.gov>

The Honorable Linda McMahon
Administrator
United States Small Business Administration
409 Third Street Southwest
Washington, DC 20416

Re: Express Loan Programs; Affiliation Standards (RIN 3245-AG74)

Dear Administrator McMahon:

The Independent Community Bankers of America (ICBA)¹ appreciates the opportunity to comment on the proposed rule issued by the Small Business Administration (SBA) that would amend several regulations governing its business loan programs. Community banks are vital to small business lending across the country and originate and hold a significant majority of all U.S. small business loans. The viability of community banks is often directly linked to the success of their small business customers.

Thousands of community banks participate in the SBA's guaranteed lending programs to provide needed capital to small businesses nationwide. The long-term success of the SBA lending programs is important to the community banking sector and their small business customers. Due to recent loan growth, both Congress and the SBA have examined the notion of additional oversight of the SBA's flagship 7(a) lending program. ICBA is committed to working to ensure proper oversight of 7(a) and other SBA loan programs.

ICBA does not believe the SBA's proposed regulation cited above is necessary for the administration of its loan programs. Our letter identifies several components of the proposed rule which warrant further attention and revision. Community bank concerns include:

¹ The Independent Bankers of America® creates and promotes an environment where community banks flourish. With more than 52,000 locations nationwide, community banks constitute 99 percent of all banks, employ more than 760,000 Americans and are the only physical banking presence in one in five U.S. counties. Holding more than \$4.9 trillion in assets, \$3.9 trillion in deposits, and \$3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.

- Altering the affiliation principles applicable to SBA’s financial assistance programs.
- Reintroducing a personal resources test.
- Limiting allowable fees for the 7(a) Loan Program.

Proposed Affiliation Principles

ICBA is concerned the proposed affiliation standard could cause many Main Street small businesses and agricultural enterprises to be deemed ineligible for SBA loans which provide much needed access to capital. Additionally, under the proposed rule there may be numerous unintended consequences for small businesses, particularly the thousands of small businesses that work with larger businesses. The risk of increased unemployment and underemployment in many towns and localities attributable to the new affiliation standard should not be ignored. Contractors and subcontractors will be particularly at risk of being deemed an affiliated company under the proposed regulations. Consider the examples described below.

- A subcontractor that installs flooring or provides other home renovation services, for example, would suddenly be deemed an affiliate of a larger business simply based on SBA’s proposed 85% of business test (i.e. the business receives 85 percent of its income from a single provider over a three-year period).
- A cleaning company that primarily provides services to a Fortune 500 company’s local office building in a local community could suddenly be labeled an affiliate of the large company.
- Farmers selling corn to a single ethanol producer in their marketplace or dairy farmers selling milk to their dairy cooperative could also fall victim to SBA’s 85 percent test, as would a broad swath of American farmers and ranchers.

The types of businesses that would be potentially impacted are virtually unlimited, and the harm done by SBA’s proposal would be far reaching. ICBA strongly recommends removal of the 85 percent of income component of SBA’s proposed regulation.

ICBA is also concerned that SBA could deem a small business an affiliate even though no single factor is enough to constitute affiliation. While the proposed rule does provide a few clarifying examples, the provision causes confusion and fear that an affiliation determination may be made despite the small company not violating any specific provision in the regulation.

This objectionable provision appears to be a ‘catch-all’ designed by SBA to arbitrarily disqualify otherwise fully qualified small businesses. This component of SBA’s regulation should also be removed.

ICBA also has serious concerns about the impact of the proposed regulation on the agricultural industry, particularly but not limited to poultry producers. If the proposed rule is implemented as written, it is likely that SBA 7(a) loans to small poultry farmers will cease altogether.

SBA appears to assume that small family farmer poultry producers are not true family farmers but controlled affiliates of large corporate integrators. This is an unfounded characterization.

SBA's assumption is driven in large part by the false notion that business management practices stipulated in contracts with integrators remove the ability of producers to independently operate their farms. SBA also contends that independent family poultry farms are affiliates when there is only a single integrator available to purchase their poultry.

We strongly disagree with these contentions. Poultry farmers assume the daily risks of raising poultry with the prospects of significant losses should their farming enterprises be unsuccessful. These producers assume enormous management risks including obtaining financing for the purchase of real estate and construction of poultry facilities; supervising the farm's daily operations including the hiring, management and payment of employees; purchasing necessary equipment or other resources; and handling bookkeeping and taxes. These producers receive a 1099 form, indicating they do not receive wages or salaries from the integrator, but are indeed independent operators.

Integrators may insist on certain management practices involving the feeding and care of the birds being raised. This is because the integrator desires a uniform product of consistent quality. The integrator has developed methodologies that over time have proven to be efficient and cost effective while producing a uniform product desired by consumers and thus easily marketable through retail outlets. These management practices are not for the purpose of "controlling" the family farmer, but rather are designed to maximize the efficiencies and profits of both the integrator and farmers. Achieving profitable operations allows the poultry farmers to repay guaranteed loans from lenders with a low default risk to the SBA.

SBA's interpretation that a limited number of integrators indicates that the farm or small business owner is affiliated with a larger entity is incorrect. Many markets contain only a single integrator. The farmer or small business owner should not be held responsible for the overall business structure or marketplace of an entire state or economic area which is outside of the farmers' control.

The reality is that several sectors of American agriculture have experienced various degrees of consolidation and vertical integration in recent decades, and this trend will likely continue through no fault of independent family farmers or small business owners. Yet, SBA's proposal would penalize these farmers and small business owners for industry structure or marketplace realities they are completely unable to influence to any measurable degree.

Furthermore, SBA's suggestion that the agency itself will make the affiliation determinations provides little comfort to lenders. Under the proposed rule, SBA may deem nearly all poultry loans ineligible due to the affiliation paradigm.

Additionally, while SBA offers to provide further information on the determination process in the final rule, interested parties, such as ICBA or individual community banks, will have no opportunity to meaningfully comment on how such a process is designed. Consequently, ICBA believes SBA's proposed affiliation provisions should be removed from the proposed rule.

Personal Resources Test (PRT)

ICBA also has several concerns with the proposal to reintroduce the personal resources test. SBA proposes that when an owner of 20 percent or more of a business has liquid assets in excess of stated thresholds, the owner is required to inject cash to reduce the amount of the SBA loan that would otherwise be requested. While this proposal may seem logical and was previously utilized by SBA, we find many bankers in disagreement with it.

When used in the past, the personal resources test effectively removed any buffer the borrower had for unforeseen personal, business or family expenses. The proposal ignores the need for borrowers to have cash on hand for a variety of unplanned expenses or income shortfalls (e.g., cost of living expenses associated with child care, education, illness or injury, or reduction of income due to economic downturn). Lenders report that on many occasions the result was ruinous to the financial condition of borrowers. The provision would eliminate potential borrowers from the program and may be difficult to incorporate into current loan underwriting. We again note that the default rates on SBA loans are very low. Seeking additional requirements of SBA borrowers to further "reduce risks" is simply unnecessary and creates financial risk for the very borrowers that SBA is supposedly trying to assist.

Further, the additional requirements for cash injections will cause the terms of many loans to be unworkable for borrowers who are trying to use the SBA programs because they do not qualify for conventional credit. Many borrowers cannot obtain similar terms on conventional credit with regard to loan structure (amortization, reliance on projections rather than actual revenues and expenses, and the nature and type of collateral that is deemed acceptable).

The proposal will likely result in fewer qualified business loan opportunities and make remaining loan opportunities riskier, leading to higher default rates for SBA loans. Potential investors will shun promising business opportunities because they will have to invest more of their personal assets for the completion of the loan.

Additionally, the SBA's proposal lacks clarity in the definitions of liquid assets and other measures. Will lenders be able to determine which assets may be considered liquid? How much liquidity will a borrower be allowed to retain in case of emergency? Lenders also find the

formula for determining the amount of the cash injection confusing. Greater clarity through specific examples would have been helpful.

The personal resources test was tried previously and found to be a hindrance to sound lending. If SBA reimposes the test, ICBA believes it should be more flexible and its application more limited than proposed. For example, the test:

- Should not apply to smaller loans (i.e., under \$1 million) or to start-up companies which need to preserve cash in the early stages to achieve sustainability;
- Should apply only to majority owners (those owning at least 51 percent of the company); and
- Should apply only to the 7(a) program and not the 504 program as the latter is intended to spur job creation and economic development.

What's more, SBA should not 'second-guess' lender decisions regarding the use of a personal resources test for loan applications. Again, ICBA advises against reinstating the test and believes implementing this provision will harm SBA's portfolio quality.

Fee Limitation

The proposed rule provides that lenders may collect a fee from an SBA loan applicant that is no more than \$2,500 for a loan of up to \$350,000 and no more than \$5,000 for a loan over \$350,000. ICBA is concerned that the proposed revisions to the SBA 7(a) program fee structure may significantly limit loans below \$350,000. Many community banks rely on agents and other third parties who help facilitate the SBA lending process. This provision may unintentionally result in a decline in small dollar lending to the small businesses that are often most in need of financing.

ICBA believes this proposal will hurt community banks that rely on packagers because those providing referrals will have a reduced financial incentive to offer services, especially for small dollar SBA loans which many community banks provide. We note that USDA does not have loan size distinctions for their allowable program fees.

The size of a loan typically is unrelated to the time and complexity associated with underwriting and application processing. For example, the cost to put together a \$25,000 loan is not significantly less than for a \$3 million loan with similar terms. Complexity, not loan size, determines the time required for loan processing.

The proposal could unintentionally lead to a decline in smaller loan applications; cause loan packagers and services to stop utilizing SBA loan programs; and reduce the use of SBA loan programs by community banks, thereby undermining the original rationale for establishing SBA loan programs.

For these reasons, ICBA strongly recommends that the rule be amended to: 1) define what is an acceptable packaging service; 2) not require fees to be documented in terms of processing which would only create additional paperwork burden; 3) allow lenders to charge a fee of up to \$5,000 fee regardless of loan size; and 4) index the fee to a workable inflation index.

Conclusion

ICBA appreciates the opportunity to comment on SBA's proposed rule. As outlined above, we believe the proposed rule would have detrimental impact and negative unintended consequences on many small businesses, family farmers, and the many community banks who serve these borrowers. Again, we urge SBA to remove the proposed affiliation standard, withdraw or amend the proposed personal resource test, and adjust the fee structure as suggested by ICBA.

If you have any questions or would like additional information, please do not hesitate to contact our staff by email at Steve.Keen@ICBA.org.

Sincerely,

/s/

Rebeca Romero Rainey
President & CEO

cc: Office of Financial Assistance, Office of Capital Access, SBA