NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

November 10, 2017

Ms. Holly Turner
Regulatory Reform Officer
U.S. Small Business Administration
409 3rd Street, SW
Washington, DC 20416

Re: Docket Number SBA 2017-0005

Dear Ms. Turner:

The National Association of Government Guaranteed Lenders (NAGGL) appreciates the opportunity to provide comments on behalf of its members regarding the appropriateness of existing regulations related to the the U.S. Small Business Administration (SBA) 7(a) loan program. In this regard, we note that in the Request for Information (RFI), SBA specifically requested that commenters identify those regulations that they believe impose unnecessary burdens or costs that exceed their benefits, eliminate jobs or inhibit job creation, or are ineffective or outdated.

While we appreciate the goals of the Executive Orders cited in the RFI, we believe that the regulations governing the 7(a) program are significantly different from the regulations governing many other federal programs in that they do not proscribe mandatory conduct for entire industries or entire communities. Rather, SBA's regulations provide the parameters under which SBA will provide a specific federal benefit, i.e., a government loan guaranty, with the 7(a) regulations applying only to lenders seeking the SBA loan guaranty on a loan and to the individual small businesses applying for an SBA-guaranteed loan. Given this fundamental difference, we believe that making substantial cuts to existing program regulations may not be appropriate.

In this regard, we would note that SBA recently undertook its own clean-up effort related to the regulations governing its lending and surety bond programs (13 CFR parts 115 and 120). The Final Rule, most of which took effect on September 20, 2017, removed regulatory provisions that had become obsolete and rearranged and restructured additional provisions to provide greater clarity. NAGGL appreciates the effort that went into crafting those

regulatory amendments and recognizes that this effort was intended, in part, to meet the spirit of the Executive Orders related to federal regulations.

As a trade association that represents a significant number of 7(a) lenders and other entities that participate in various ways in providing 7(a) loans, we believe that appropriate program oversight is essential to assuring the continuing success and integrity of the 7(a) program. Therefore, one of our primary concerns is that 7(a) program regulations are detailed enough to allow loan applicants, lenders, and others involved in 7(a) lending to fully understand the requirements being imposed by SBA, and to assure that SBA can enforce these program requirements when necessary. Therefore, we would oppose any reduction in regulations that would be contrary to those goals.

We have noted, however, several provisions in current regulations that we believe could be eliminated or amended without harming the integrity of the 7(a) program. NAGGL's recommendations regarding possible amendments are provided as an attachment to this letter.

Thank you again for providing this opportunity to make the views of NAGGL's members known to SBA.

Sincerely,

Anthony R. Wilkinson
President and Chief Executive Officer

cc: William Manger, Associate Administrator for Capital Access
Christopher Pilkerton, General Counsel

NAGGL Suggestions for Amendments to 13 CFR 120

1. **Suggested Amendment [13 CFR 120.10. Definitions.]:** Amend the definition of "*Associate of a Small Business*" to exclude "*key employee*".

   Current Regulation: 13 CFR 120.10 Definitions – Associate of a small business.
   An Associate of a small business is: (i) An officer, director, owner of more than 20 percent of the equity, or key employee of the small business; (ii) Any entity in which one or more individuals referred to in paragraphs (2)(i) of this definition owns or controls at least 20 percent; and (iii) Any individual or entity in control of or controlled by the small business (except a Small Business Investment Company ("SBIC") licensed by SBA).

   [SBA defines the term key employee as "*any Person hired by a business to manage its day-to-day operations, including, for example, the hiring and firing of employees, and the expenditure of money*". (SOP 50 57 2, Chapter 2, *Definitions*.)]

   Rationale for Suggested Change:
   Per SOPs 50 10 5(I) and 50 57 2, associates of a small business loan applicant must provide additional personal documentation and lenders must consider specific factors related to such individuals when making decisions regarding loan approval and certain liquidation activies. For example, if a small business that applies for a 7(a) loan has an associate who is not of good character, has caused a prior loss to the government, or has a delinquent federal debt, the requested loan generally will be found not to be eligible. Also, when deciding the creditworthiness of a small business applicant, a lender is required, among other things, to evaluate the credit history of associates of the business. In addition, under the recently published SOP 50 10 5(J) which is scheduled to take effect on January 1, 2018, a lender will be required to address whether some or all of the requested loan is available from non-federal sources "including the liquidity of owners, spouses, guarantors, Associates, and the Applicant".

   NAGGL believes that it is inappropriate for employees of an applicant business to be held to the same standard as owners, officers and directors of the applicant business since employees, even those that meet the definition of key employees, do not hold the same status as owners, officers or directors. In this regard, typically, key employees do *not* contribute to the capitalization of their employer firm and, generally they are *not* in a position either to benefit finanancially in the same way that an owner would if the

business is successful, or to suffer a loss like that which an owner would in the event the business fails.

It should be noted, however, that if SBA were to make the proposed change, it would not be prohibited from, when appropriate, requiring additional documentation from key employees or from considering such status when taking various actions. But, if the suggested change were adopted, the regualtions would better distinguish between the status of those individuals who are directly involved in the business structure, i.e., owners, officers and directors, and those who are only employees of the business.

Benefit of Amending Regulation as Suggested: By implementing the proposed change, SBA would clarify and have the ability to better target its requirements regarding key employees. In addition, if adopted, the proposed change would reduce the regulatory burden imposed on small business loan applicants and recipients, including reducing the paperwork required to be completed by loan applicants, thus potentially increasing access to SBA loan guaranties by small businesses.

2. **Suggested Amendment: [13 CFR 120.10 Definition – Loan Program Requirements]** Amend the definition of "*Loan Program Requirements*" to exclude "*forms*" and "*loan authorizations*" and to revise "*notices*" to include only "policy notices" which, like SOPs are approved by the SBA Administrator.

Current Regulation: 13 CFR 120.10 Definitions – Loan Program Requirements:
Loan program requirements are requirements imposed upon Lenders or CDCs by statute, SBA regulations, any agreement the Lender or CDC has executed with SBA, SBA SOPs, official SBA notices and forms applicable to the 7(a) and 504 loan programs, and loan authorizations, as such requirements are issued and revised by SBA from time to time.

Rationale for Suggested Change: Per 13 CFR 120.1400, by making a 7(a) loan, a lender automatically agrees to "the terms, conditions and remedies in [SBA's] Loan Program Requirements, as promulgated or issued from time to time…". A lender's failure to comply with all Loan Program Requirements may result in it being subjected to an enforcement action that can impact the lender's participation in the 7(a) program, or even remove it from such participation, and can also cause SBA to deny liability under an individual loan guaranty.

NAGGL believes that the current definition of Loan Program Requirements is overly broad in that it includes guidance documents that are issued by SBA on an ad hoc basis, without either input from, or prior notice to, lenders. Under the current definition, lenders are obligated to comply with guidance included in documents that are not published for public comment, forms (sometimes called "templates") that are issued without clearance by the Office of Management and Budget, procedural and information notices that are issued without the clearance or signature of the SBA Administrator, etc. By requiring lender to adhere to shifting program requirements, SBA is imposing an unnecessary burden on lenders to keep abreast of informal changes that SBA may not even publicize.

NAGGL believes that any guidance which mandates lender compliance should, if not contained in regulations, at a minimum, be issued as a formal SOP or by an Information Notice which enjoys the same level of review and approval as an SOP.

Benefit of Amending Regulations as Suggested: By implementing the proposed change, SBA would be providing much clearer guidelines for program participation, thus reducing the possibility that a lender might inadvertently jeopardize its status as a program participant, or put the SBA guaranty on an individual loan at risk. This change would be expected to lessen the possibility that a lender might need to pursue relief via litigation, thus reducing the time and expense involved with such actions. Finally, by implementing this change, SBA would better meet the requirements of the *Administrative Procedures Act*, by keeping the public better informed about SBA's procedures and rules.

3. **Suggested Amendment:** Delete all references to direct and immediate participation loans [13 CFR 120.211 – *What Limits are there on the Amounts of Direct Loans*, 13 CFR 120.210 – What fixed interest rates may a Lender charge? Sub-paragraph (b) *Direct loans*, and any other place where there are references to direct or immediate particiption loans]; and delete guidance for special purpose programs which are authorized but not funded, including: *Disabled Assistance Loan (DAL)* [13 CFR 120.310-315); *Businesses Owned by Loan Income Individuals* [13 CFR 120.320]; *Veterans Loan Program* [13 CFR 120.360-361]; *Loans to Participants in the 8(a) Program* [13 CFR 120.375-377]; *Defense Economic Transition Assistance* [13 CFR 120.380-383]. Also, amend 13 CFR 120.398 – *America's Recovery Capital (Business Stablilization) Loan Program – ARC Loan Program* to clarify that the program has sunset and that the regulations are provided only to provide guidance for loans previously made.

Rationale for Suggested Changes: Section 7(a) of the Small Business Act authorizes SBA to make loans on a direct or immediate or deferred participation basis, and also authorizes a number of special programs as noted above. Despite the existence of these authorities, however, SBA has not received appropriations to support loans made on a direct or intermediate basis, including appropriations to support the listed special programs, for approximately 20 years. NAGGL is recommending these changes because we believe that if any of the special programs receive funding, or if SBA were to receive funding for direct or immediate participation loans, the Agency would need to promulgate new regulations specifying the conditions under which such lending could occur.

We would also note that the suggested change is consistent with the way that SBA is handling this issue in SOP 50 10 5(J) that is scheduled to take effect on January 1, 2018. In this new version of the SOP, SBA has, for the first time, eliminated detailed descriptions of "certain special purposed loan programs". Instead, the SOP only states that the programs are authorized under separate or special funding but that currently the programs are not funded and that individuals interested in any of the programs should check with SBA to see if funding is available.

Benefit of Amending Regulations as Suggested: By adopting the recommended changes, SBA would lessen the possibility that lenders or small businesses would assume that the named programs/processes remain available, and the time that such entities might spend researching their availability.

4. **Suggested Amendment [13 CFR 120.212 What limits are there on loan maturities?]:** Amend to clarify when a construction period may be added to the maximum maturity allowed for a loan.

Current Regulation: 13 CFR 120.212 What limits are there on loan maturities?
The term of a loan shall be:
(a) The shortest appropriate term, depending upon the Borrower's ability to repay;
(b) Ten years or less, unless it finances or refinances real estate or equipment with a useful life exceeding ten years; and
(c) A maximum of 25 years, including extensions. (A portion of a loan used to acquire or improve real property may have a term of 25 years plus an additional period needed to complete the construction or improvements.)

Rationale for Suggested Change: There is confusion regarding the maximum term that applies to a loan where the use of proceeds involves "tenant/leasehold improvements", and also regarding whether loans made for such purpose qualify for an addition to the maximum available maturity to cover the period needed to complete the work.

In SOP 50 10 5(J) which will take effect on January 1, 2018, SBA states that the maximum term for this loan purpose is 10 years unless there is "significant construction/build-out". The term "significant construction/build-out" is not currently defined in the SOP, but SBA has indicated that it will provide this definition. SBA also has indicated verbally that allowing the maximum maturity to be extended to cover the construction period appears reasonable. However, the current regulatory language appears to allow an additional period to be added to the maximum term only for loans with maximum terms of 25 years.

Therefore, NAGGL recommends that the regulation be amended to clarify when a construction period may be added to the maximum maturity allowed for a loan for tenant/leasehold improvements, even if the maximum maturity is limited to 10 years.

Benefit of Amending Regulation as Suggested: Adoption of the suggested amendment would assure clarity regarding the SBA requirements, and would make the regulations consistent with current SOP requirements.

5. **Suggested Amendment:** [13 CFR 120.532 – *What is a loan Moratorium?]* Delete this section in its entirety.

Current Regulation: §120.532 What is a loan Moratorium?
SBA may assume a Borrower's obligation to repay principal and interest on a loan by agreeing to make the payments to the Lender on behalf of the Borrower under terms and conditions set by SBA. This relief is called a "Moratorium." Complete information concerning this program may be obtained from local SBA offices.

Rationale for Suggested Change: To the best of our recollection, SBA does not have funding available to provide this type of relief for borrowers, and has not provided any sort of loan moratorium for many years.

Benefit of Amending Regulation as Suggested: By implementing the suggested change, SBA would eliminate the possibility for confusion by loan recipients as to the availability of this type of assistance.

6. **Suggested Amendment [13 CFR 120.540 – Liquidation and litigation plans.**]: As to 7(a) loans only, revise this section to clarify that SBA expects lenders to prepare liquidation plans for all loans but that, consistent with the Final Rule that took effect on September 20, 2017, there no longer is a requirement for SBA's prior approval of such plans, even for loans processed under a lenders CLP authority. In addition, as to 7(a) loans only, revise this section to add appointment of a receiver to the list of lender activities that require SBA's prior approval of a litigation plan.

Current Regulation: §120.540 Liquidation and litigation plans.
(a) . . .
(b) Liquidation plan. An Authorized CDC Liquidator and a Lender for a loan made under its authority as a CLP Lender must, prior to undertaking any liquidation, submit a written proposed liquidation plan to SBA and receive SBA's written approval of that plan.
(c) Litigation plan. An Authorized CDC Liquidator and a Lender must obtain SBA's prior approval of a litigation plan before proceeding with any Non-Routine Litigation, as defined in paragraph (c)(1) of this section. SBA's prior approval is not required for Routine Litigation, as defined in paragraph (c)(2) of this section.
(1) Non-Routine Litigation includes:
(i) All litigation where factual or legal issues are in dispute and require resolution through adjudication;
(ii) Any litigation where legal fees are estimated to exceed $10,000;
(iii) Any litigation involving a loan where a Lender or Authorized CDC Liquidator has an actual or potential conflict of interest with SBA; and
(iv) Any litigation involving a 7(a) or 504 loan where the Lender or CDC has made a separate loan to the same borrower which is not a 7(a) or 504 loan.
(2) Routine Litigation means uncontested litigation, such as non-adversarial matters in bankruptcy and undisputed foreclosure actions, having estimated legal fees not exceeding $10,000.
(d) . . .

Rationale for Suggested Changes: The suggested changes regarding liquidation plans would make the regulation consistent with current SOP requirements and also would

reflect the recent Final Rule change which, effective September 20, 2017, eliminated the concept of CLP lender status/loan processing. The suggested change regarding litigation plans would make the regulatory requirements consistent with current SOP requirements.

Benefit of Amending Regulation as Suggested: By implementing the suggested change, SBA would eliminate the possibility for confusion by lenders regarding which requirements apply. This would assure better compliance by lenders and reduce any time and expense that would be incurred by the Agency and the lender if a lender misinterpreted SBA's requirements and sought relief from any penalties that SBA might seek to impose because of the lender's inadvertent actions.

7. Finally, we would note that **13 CFR 120.214 – What conditions apply for variable interest rates?** – currently includes reference to the thirty-day (1-month) London Interbank Offered Rate (LIBOR) plus 3 percentage points as one of the allowed base rates for variable interest rate 7(a) loans. Because of problems identified relative to the setting of that rate, financial industry literature has raised the possibility that LIBOR may be discontinued, or that an alternate system may be substituted. NAGGL has discussed this issue with SBA, but want to take this opportunity to remind the Agency that this regulation may need to be revised depending on the fate of the LIBOR index.