Testimony of

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On Behalf of

First Security Bank, Arkansas Bankers Association & American Bankers Association

Before the

Senate Committee on Small Business & Entrepreneurship

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Chair Ernst, Ranking Member Markey, and members of the Committee, thank you for the opportunity to offer testimony for today's Hearing: "Hearing from Lenders: Managing Risk for the Long-Term in the 7(a) Loan Program." My name is Itzel Sims, and I am Director of Small Business Administration (SBA) Lending for First Security Bank, a community bank located in Searcy, Arkansas.

Small businesses are the backbone of the American economy. The Small Business Administration's 7(a) Program helps small businesses that might not otherwise have access to capital obtain loans, so that they can grow and create jobs. Now in my 26th year making loans to small businesses, I am proud of the work that my colleagues at First Security and I do to assist businesses across Arkansas with 7(a) and other small business loans. I am very pleased to present this testimony on behalf of First Security and the American Bankers Association (ABA).[1]

My work with SBA lending has spanned four institutions, giving me a broad perspective regarding the challenges and opportunities presented by the 7(a) Program. I began my career at Arkansas Capital Corporation, an Arkansas nonprofit, nonbank lender that specializes in government guaranteed lending. In 2015, Regions Bank approached me to become an SBA specialist for its Arkansas market, where I was a top producer of SBA loans. In 2019, I pursued an opening as SBA Regional Manager for Simmons Bank, a midsize bank located in Pine Bluff, Arkansas. In that role, I managed the origination and closing process across six states.

In 2021, I joined First Security, a privately-held community bank that has among the most complete and diverse product offerings of any Arkansas-based financial services holding company. With $1.5 billion in total capital, $8.13 billion in assets, and 1,000 employees covering locations throughout Arkansas, First Security offers solutions for the financial needs of small businesses, as well as individuals and the public sector. In my four years with First Security, I have created a new SBA lending platform for SBA 7(a), SBA Express, and SBA 504 loans. During this time, First Security has been ranked as a top-10 SBA lender in the State of Arkansas.

I am a strong proponent of SBA's loan programs because, in each of the positions I have held, I have helped small business loan applicants that had strong business plans, drive, and determination – but who could not meet underwriting requirements for commercial loans due to

[1] The American Bankers Association is the voice of the nation's $24.2 trillion banking industry, which is composed of small, regional and large banks that together employ approximately 2.1 million people, safeguard $19.1 trillion in deposits and extend $12.6 trillion in loans.

risk, seasonality of the business, or lack of collateral. And by applying prudent underwriting, I and other SBA lenders have helped the SBA achieve its goal of a "zero subsidy rate" for its 7(a) Program in 10 out of 16 years between Fiscal Year 2007 and 2022 – i.e., the Program generated sufficient revenue through fee collections and recoveries of collateral on defaulted loans to not require an appropriation from Congress.[2]

Today's hearing comes at an opportune time. Two years ago, SBA lifted the moratorium on the number of nonbank lenders that could participate in the 7(a) Program while simultaneously loosening underwriting standards for these loans. Available data indicate that the Program has experienced increased defaults since those changes went into effect, particularly in loans originated by nonbank lenders. As SBA considers reforms, this Committee can play an important role in strengthening the Program so that *all* lenders make 7(a) loans in a safe and sound manner to help small businesses gain access to needed capital to grow their business.

The American Bankers Association and I support SBA's efforts to expand access to credit for small businesses. We offer the following recommendations to maintain the financial stability of the 7(a) Program while removing barriers to efficient and effective loan-making:

- SBA should reinstate the nine-factor lending criteria for underwriting 7(a) loans that had been in place prior to 2023.
- SBA should focus on increasing the number of regulated banks that participate in the 7(a) Program instead of seeking new nonbank entrants to the Program. SBA should not grant any new small business lending company (SBLC) licenses unless and until the agency demonstrates there is a small business lending "desert," the new SBLC is the institution best able to serve that specific geographic or socioeconomic gap, and SBA has the resources to oversee the new SBLC.
- SBA should reinstate the Loan Authorization, which was required prior to 2023, as a required document for 7(a) loans.
- SBA should reinstate the requirement, in place until January 2024, that 7(a) small business borrowers provide a 10% equity injection when the borrower is a startup (fewer than two years of business operations) or when the borrower is purchasing an existing business.
- SBA should reinstate the franchise directory, a valuable resource that assisted 7(a) lenders with determining the eligibility of a franchisee for a 7(a) loan before it was discontinued in 2023.
- Congress should repeal section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act to ensure small businesses have access to the capital they need to thrive.

I. Promoting Safe and Sound Lending in the 7(a) Program

As mentioned above, in 2023, SBA lifted the moratorium on the number of nonbanks – called "small business lending companies" (SBLCs) – that can participate in the 7(a) Program. Participation in the 7(a) Program had long been capped at 14 non-depositories, which are supervised federally by only the SBA. Since 2023, however, SBA has granted licenses to six new

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[2] Cong. Research Svc., Small Business Administration 7(a) Loan Guaranty Program 14 (Jun. 30, 2022), https://crsreports.congress.gov/product/pdf/R/R41146/135 (table 3).

SBLCs to participate in the 7(a) Program,[3] despite stating in 2022 that the agency had the resources to supervise only three new nonbank entrants to the Program.[4]

At the same time that SBA lifted the moratorium, the agency also loosened underwriting standards for 7(a) loans. Specifically, SBA replaced its nine-factor underwriting test with a requirement that lenders use the same underwriting that the lender uses for its "similarly-sized, non-SBA guaranteed commercial loans" or use a "business credit scoring model."[5] One month later, SBA through a Procedural Notice imposed stronger underwriting criteria for 7(a) loans greater than $500,000 – i.e., criteria that are similar, but not identical, to the nine-factor test that SBA had removed – but maintained the looser criteria for loans of $500,000 or below.[6]

The addition of six non-federally supervised SBLCs joining the 7(a) Program, coupled with the looser underwriting standard, has contributed to rising default rates. Data compiled by Lumos Technologies, a financial technology firm that advises SBA lenders, show that 7(a) loans originated by nonbank lenders in 2023 had a default rate of 8.1% in 2024 – more than double the default rate of 7(a) loans originated by banks in 2023. (See Appendix A, attached.) These data are deeply concerning and strongly suggest that SBA should return to the more robust nine-factor lending criteria for underwriting 7(a) loans that had been in place prior to 2023.

Moreover, as SBA seeks to expand lending to small businesses, the agency should focus on increasing the number of regulated banks that participate in the 7(a) Program instead of seeking new nonbank entrants to the Program. Recent research published by the FDIC indicates that community banks face regulatory hurdles that discourage them from utilizing SBA loan programs. According to the 2024 FDIC Small Business Lending Survey, roughly half of surveyed banks with less than $10 billion in assets said they had difficulty obtaining expertise and personnel to enter or expand participation in SBA lending programs.[7] Furthermore, 35 percent of community banks in the study said compliance with servicing guidelines limited their involvement in SBA programs, and 34 percent of surveyed community banks stated that high administrative costs limited their participation.

As a first priority, SBA should address these barriers to community banks' participation in the 7(a) Program and other SBA lending programs. SBA should not grant any new SBLC licenses

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[3] In November 2023, SBA granted small business lending company (SBLC) licenses to Arkansas Capital Corp., McKinley Alaska Growth Capital, and Funding Circle US. Funding Circle US surrendered its license in June 2024 after it was bought by iBusiness Funding. In December 2024, SBA granted SBLC licenses to A10 Capital, Cooperative Business Services, Lafayette Square, and Stonehenge Capital. Therefore, since SBA lifted the moratorium, it has extended seven licenses, one of which was surrendered, for an aggregate total of six licenses extended.

[4] Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization, 87 Fed. Reg. 66,963, 66,964 (Nov. 7, 2022), https://www.govinfo.gov/content/pkg/FR-2022-11-07/pdf/2022-23597.pdf ("Based on current oversight capacity, . . . SBA anticipates that it has the ability to license and supervise three new additional SBLCs.").

[5] Affiliation and Lending Criteria for the SBA Business Loan Program, 88 Fed. Reg. 21, 074, 21,085 (Apr. 10, 2023), https://www.govinfo.gov/content/pkg/FR-2023-04-10/pdf/2023-07173.pdf (*codified at* 13 C.F.R. § 120.150).

[6] Sm. Bus. Admin., SBA Procedural Notice, Implementation of the Final Rule on Affiliation and Lending Criteria for the SBA Business Loan Programs (88 FR 21074, Effective May 11, 2023) and Raising of the Maximum Loan Amount for 7(a) Small Loans, Control No. 5000-846607 (May 9, 2023), https://cdn.ymaws.com/www.naggl.org/resource/resmgr/policynotices_2023/Notice_5000-846607_Implement.pdf.

[7] Fed. Deposit Ins. Corp., 2024 Small Business Lending Survey 18-19 & fig. 2.12 (2024), https://www.fdic.gov/system/files/2024-09/small-business-lending-survey-2024-full.pdf.

unless and until the agency demonstrates there is a small business lending "desert," SBA identifies the new SBLC as the institution best able to serve that specific geographic or socioeconomic gap, and SBA demonstrates it has the resources to oversee the new SBLC. We encourage this Committee, through SBA oversight, to determine if the agency has sufficient resources to supervise the existing 20 SBLCs and to insist that SBA demonstrate its capabilities before the agency grants any more SBLC licenses.

Two other policies that would improve the safety and soundness of 7(a) lending concern the Loan Authorization and equity injections. When SBA lifted the moratorium on the number of nonbank 7(a) lenders, the agency discontinued use of a "Loan Authorization" as a required document for 7(a) loans. Before it was discontinued, the Loan Authorization reflected SBA's commitment to guarantee the loan if specified conditions are met. The loan term length, rate, amount, and allowable uses of loan proceeds will vary from one 7(a) loan to the next. The inclusion of a Loan Authorization in the loan file removed any uncertainty about the conditions applicable to the loan. This was particularly important in cases when the lender who made the loan left the financial institution or if a party to the loan seeks to make modifications to the loan after origination. SBA should reinstate the Loan Authorization as a required document for 7(a) loans.

SBA also should reinstate the requirement, in place until January 2024, that 7(a) small business borrowers provide a 10% equity injection when the borrower is a startup (fewer than two years of business operations) or when the borrower is purchasing an existing business. This requirement better ensures the start-up company has the ability to repay the loan. SBA should reinstate its requirement that start-up companies seeking a 7(a) loan provide a minimum injection of equity.

II. SBA Should Improve the Efficiency of the 7(a) Program by Reinstating the Franchise Directory

To be eligible for an SBA loan, a business must be "small." To prevent larger businesses from obtaining SBA loans, SBA has rules that govern whether a franchisor and franchisee will be considered affiliated businesses, requiring employees and revenues of the affiliated entities to be aggregated to determine whether the composite business is a small business. In 2023, SBA altered its rules to no longer consider a franchise agreement when determining whether a franchisor and franchisee are affiliated. As part of that change, SBA discontinued its franchise directory – i.e., a directory of franchises that had been reviewed by SBA and found eligible to receive SBA loans. This ended a valuable resource that assisted 7(a) lenders with determining the eligibility of a franchisee for a 7(a) loan. The onus on checking affiliated business status now rests with the lender, increasing the cost of delivering needed capital to these small businesses. SBA should continue to conduct eligibility reviews of franchisees and publish, on a regular basis, the franchise directory.

III. Congress Should Repeal Section 1071's Small Business Lending Data Collection

We deeply appreciate this Committee's focus today on strengthening the 7(a) Program. But 7(a) loans – while an important source of financing – are only one type of loan that small businesses may receive. The broader small business lending landscape is threatened by section 1071 of the

Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). We urge this Committee and the Congress to repeal section 1071.

Section 1071 of the Dodd-Frank Act requires financial institutions to collect and report to the Consumer Financial Protection Bureau (CFPB) detailed data on each application for small business credit, including the race, sex, and ethnicity of the business owners. The goal of the data collection is to enforce fair lending laws and identify opportunities for community development. We support these goals but are concerned that section 1071 and the CFPB's implementing regulation will make it harder for banks to serve small business customers. The CFPB's final 1071 rule expanded the 13 data points required by Congress to 81 data fields for each application for credit. Banks estimate that implementing the section 1071 rule will impose average upfront costs of up to $7 million and average annual costs of up to $2 million on each bank – costs that will raise the cost of credit and decrease its availability. Even the CFPB acknowledged that banks would have to pass on these costs to their small business customers.

Congress should repeal section 1071 and ensure that small businesses have access to the capital they need to thrive.

Conclusion

We appreciate the Committee's attention to how it can work with SBA to strengthen the 7(a) Program and to facilitate small business lending more broadly. We urge SBA to impose stronger underwriting standards on 7(a) loans, not grant additional SBLC licenses without a demonstrated need and without showing that the agency can effectively supervise new entrants, and improve the efficiency of the 7(a) Program by reinstating the franchise directory. We also ask the Committee and Congress to repeal section 1071 of the Dodd-Frank Act. With these changes, the Committee can strengthen small business lending and enhance the ability of banks to make these critical loans that drive economic growth in our nation's communities.

APPENDIX A

LUMOS Small Business Lending Vintage Grid

Annual Default Rate by Lender Classification

Example: Loans Originated in 2020 by Nonbank Lenders had a 4.4% Default Rate in 2024

All Loans Credit Unions

Origination Year \ Performance Year	2017	2018	2019	2020	2021	2022	2023	2024
2017	0.7%	2.0%	2.6%	2.0%	1.2%	2.4%	2.3%	2.8%
2018		0.4%	1.4%	1.3%	1.7%	1.5%	2.1%	3.7%
2019			0.4%	0.8%	1.9%	1.5%	4.1%	3.3%
2020				0.1%	0.9%	1.5%	2.7%	2.4%
2021					0.1%	0.3%	2.3%	3.4%
2022						0.1%	1.5%	3.8%
2023							0.4%	2.1%
2024								0.2%

All Loans Bank Lenders

Origination Year \ Performance Year	2017	2018	2019	2020	2021	2022	2023	2024
2017	0.8%	2.4%	3.3%	2.3%	2.5%	2.2%	3.6%	4.4%
2018		1.1%	2.9%	2.3%	2.7%	2.4%	4.3%	5.4%
2019			1.1%	1.6%	2.4%	2.6%	4.0%	5.2%
2020				0.3%	1.0%	1.9%	3.1%	4.2%
2021					0.2%	0.9%	2.4%	3.3%
2022						0.3%	2.4%	4.5%
2023							1.0%	3.9%
2024								0.9%

All Loans Nonbank Lenders

Origination Year \ Performance Year	2017	2018	2019	2020	2021	2022	2023	2024
2017	1.6%	3.5%	6.7%	3.4%	2.5%	3.5%	5.6%	6.3%
2018		2.2%	6.4%	4.3%	3.2%	4.4%	6.4%	5.1%
2019			2.3%	2.0%	3.1%	4.9%	7.2%	7.8%
2020				0.5%	1.2%	3.6%	6.0%	4.4%
2021					0.4%	1.5%	4.9%	5.4%
2022						1.0%	5.5%	9.5%
2023							2.4%	8.1%
2024								1.4%