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National Association of Federally-Insured Credit Unions

January 6, 2023

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

RE: SBLC Moratorium Rescission and Removal of the Requirement for a Loan Authorization (RIN 3245-AH92)

Dear Ms. Seaborn:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the Notice of Proposed Rulemaking (NPR) issued by the Small Business Administration (SBA) regarding the proposal to lift the moratorium on licensing new Small Business Lending Companies (SBLCs), add a new type of entity called a Mission-Based SBLC, and remove the requirement for a Loan Authorization (SBLC Proposed Rule). NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 133 million consumers with personal and small business financial service products. NAFCU and its member credit unions appreciate the opportunity to provide input on this NPR and urge the SBA to safeguard the 7(a) Loan Program by rescinding or pausing this rulemaking until its impacts in relation to financial technology companies (fintechs) and the proposed changes in the Affiliation and Lending Criteria proposed rule (Affiliation Rule)[1] are better understood. NAFCU is deeply troubled by the risks that would be introduced to the 7(a) Loan and Microloan Program if unregulated, fraud-prone fintechs were given access. Additionally, although NAFCU supports efforts to increase access to lending in underserved communities, it is concerned that the Mission-Based SBLC program, as currently proposed, lacks the specificity and program requirements necessary to achieve that goal.

General Comments

As a champion of financial inclusion, NAFCU has been at the forefront of efforts to increase access to personal and small business financial services for underserved communities. Credit union commercial lending eclipsed 2021's record year of lending with a total of $12.8 billion in business loans originated in the third quarter of 2022. Credit unions have grown their overall business lending portfolio by more than 20% this year, which is nearly identical to the growth rate over

[1] 87 FR 64724.

the past five years.[2] At the same time, NAFCU has worked tirelessly to ensure that non-depository financial institutions such as fintechs operate on a level playing field with credit unions to protect consumers and small businesses by instituting appropriate financial safeguards and compliance processes. Although NAFCU appreciates the spirit in which the SBLC Rule was proposed, there are serious shortcomings in this rule that call into question its efficacy and safety.

On October 26, 2022, shortly before the SBA issued the SBLC Proposed Rule, the SBA published the Affiliation Proposed Rule which would loosen affiliation standards, lending criteria, and loan conditions in the SBA's 7(a) Loan Program and 504 Loan Program. The simultaneous loosening of lending requirements and opening 7(a) lending to underregulated, fraud-prone fintechs would represent a major shift in SBA lending, the impacts of which may be significant, and which have not been properly examined.

As a general matter, NAFCU supports the recommendations made in the joint letter led by the National Association of Government Guaranteed Lenders (NAGGL) to Senator Cardin, Senator Paul, Representative Velázquez, and Representative Luetkemeyer. NAFCU also reasserts by reference the comments submitted in its comment letter to the SBA on the Affiliation Proposed Rule on December 27, 2022. NAFCU again urges the SBA to delay issuance of a final rule for either proposal until it has adequately considered the impacts of each rule upon the other, and the combined impact of both.

Risky Fintech Lending

Fintechs embody a rapidly growing segment of the financial services market, but just as with any emerging tool or service, they present a wide variety of opportunities and risks. To remain competitive and relevant in today's financial marketplace, many credit unions are already investing and partnering or considering whether to invest or partner with fintech companies. At the same time, credit unions must grapple with the reality that fintechs, as nonbanks, have structural advantages; in essence, often benefiting from reduced regulatory burden that corresponds with a lack of federal safety and soundness standards. A recent report from the U.S. Department of the Treasury discussed the dangers this dynamic can present, saying, "some new entrant non-bank firms may pose risks by engaging in harmful regulatory arbitrage, conducting activities in a manner that inappropriately sidesteps safety and soundness and consumer protection law requirements applicable to an insured depository institutions (IDI)."[3] The growth of fintech market share and the adoption of fintech products and services by consumers and small businesses has been explosive. In 2019, 64 percent of consumers worldwide had used one or more fintech platforms, up from 33 percent in 2017. In terms of lending, nearly half of all personal loans in the U.S. are originated by fintechs, up from 22 percent in 2015, as estimated by

[2] NCUA Q3 2022 Call Report.

[3] Treasury, "Assessing the Impact of New Entrant Non-bank Firms on Competition in Consumer Finance Markets" (November, 2022) *available at* https://home.treasury.gov/system/files/136/Assessing-the-Impact-of-New-Entrant-Nonbank-Firms.pdf

the Consumer Bankers Association.[4] By the end of 2016, nonbank lenders had a market share of 59% in small business lending.[5]

There is no question that there is a need for increased small business lending in the United States. In the wake of the 2008 Financial Crisis "business investment in the United States fell by more than 11% from June 2008 to December 2010."[6] Bank lending to medium and small sized businesses rebounded over the following six years, but never fully recovered, particularly with the "four largest US banks, which reduced their combined annual lending volume by 44%."[7] The intervening years have not mitigated this reduction in credit access, in fact, "research reveals that almost 80% of small business loans were rejected by big banks in 2019."[8] The extent of the absence of big bank small business lending was made clear during the COVID-19 pandemic as the SBA worked to roll out the Paycheck Protection Program (PPP). While many big banks would not offer PPP loans in underserved areas, credit unions stepped in, with "719 credit unions with assets less than $1 billion ma[king] $3.1 billion in PPP loans [in 2020 and] 859 credit unions of all sizes ma[king] loans totaling $5.6 billion in 2021."[9] In recognition of this issue, the SBA issued the Affiliation Proposed Rule and the SBLC Proposed Rule, to "encourage and facilitate more lenders to make more small dollar loans"[10] and "increase lending activity in identified capital market gaps, resulting in the expansion of business opportunities and the creation of more jobs in underserved communities."[11]

While it is important that the financial services industry find ways to reach underserved borrowers, it is essential to balance greater access with borrower protections. The economics of smaller dollar business lending are challenging — it is expensive to find borrowers, and to make and service loans relative to the amount of interest one generates on a small, often unsecured loan. This dynamic is present in small dollar financial transactions in consumer lending markets just as in small business lending markets. Fintechs have stepped into this market with the inherent advantage of non-depository lenders — a lack of comprehensive regulation and supervision. This allows them to streamline processes and increase efficiencies by assessing creditworthiness with business credit scoring models and leveraging AI and big data analytics to

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[4] Consumer Bankers Association, "Bank and Consumer Groups Petition CFPB for Oversight of Fintech Lenders" (September, 2022) *available at* https://www.consumerbankers.com/cba-media-center/media-releases/bank-and-consumer-groups-petition-cfpb-oversight-fintech-lenders.
[5] Gopal and Schnabl, "The Rise of Finance Companies and FinTech Lenders in Small Business Lending" (August, 2021) *available at* https://www.fdic.gov/analysis/cfr/bank-research-conference/annual-20th/papers/gopal-paper.pdf.
[6] Id.
[7] Id.
[8] Forbes, "How Fintech Lending Trends Benefit Small Businesses" (November, 2021) *available at* https://www.forbes.com/sites/forbesbusinesscouncil/2021/11/05/how-fintech-lending-trends-benefit-small-businesses/.
[9] Credit Union Times, "Where Do PPP Loans Fit In The Credit Union Balance Sheet?" (August, 2021) *available at* https://creditunions.com/features/where-do-ppp-loans-fit-in-the-credit-union-balance-sheet/.
[10] 87 FR 64724.
[11] 87 FR 66963.

speed up loan approval processes. This faster, less costly approach to lending may appear to be an unadulterated good, and that may be true of certain aspects of these innovations; however, there are good reasons behind many of the regulations governing traditional financial institutions and every new approach to lending has trade-offs.

Fintechs and their service providers often tout the ease-of-use, lack of bias against early-stage or startup businesses, and speed of their lending products. One article discussing a fintech lender notes that "businesses can apply in minutes to get a credit line of between $1,000 to $150,000. They are able to do this by automatically obtaining business data and verifying a business' bank account, which can avoid the need for a manual review."[12] A digital lending platform provider admits that "financial technology lenders typically have higher loan approval rates than banks because they have less stringent requirements for small business loans."[13] Credit unions understand this dynamic, with 89 percent of NAFCU respondents reporting that they do not believe their credit union is operating on a level playing field with nonbank small business loan originators.[14] The common threads in promoting these businesses are their looser lending requirements and reliance on automation. Recent history has shown how dangerous that combination can be.

On December 1, 2022, the Select Subcommittee on the Coronavirus Crisis released a staff report detailing the poor performance of many fintechs in administering the nation's largest pandemic relief program, the Paycheck Protection Program (PPP).[15] The report found, among other things, that the rate of fraud among fintech PPP loans was disproportionately high, that fintechs were aware of the fraud but did not have the capabilities to detect and respond to this fraud, that billions of taxpayer dollars were lost to fraud, and that fintechs prioritized high-dollar loans to the exclusion of smaller sized loans.

Key to much of this fraud, and much of the appeal of fintech participation in PPP, was fintech lenders' outsized reliance on automated processes to underwrite and originate loans. One fintech lender claimed that it "simplif[ied] the application processes for lending programs by using high-quality, proprietary lending software and fraud detection tools."[16] When this lender found that the software was detecting too much fraud, it simply stopped using the program. The Subcommittee noted that this action "increased the number of applicants receiving loans (which,

[12] Forbes, "How Fintech Lending Trends Benefit Small Businesses" (November, 2021).
[13] Biz2X, "How Large is the Small Business Lending Market in 2022?" (March, 2022) *available at* https://www.biz2x.com/how-large-is-the-small-business-lending-market-in-2022/.
[14] NAFCU Report on Credit Unions, 2022.
[15] Select Subcommittee on the Coronavirus Crisis, "'We are not the fraud police' How fintechs facilitated fraud in the paycheck protection program" (December 1, 2022) *available at* https://coronavirus.house.gov/sites/democrats.coronavirus.house.gov/files/2022.12.01%20How%20Fintechs%20Facilitated%20Fraud%20in%20the%20Paycheck%20Protection%20Program.pdf.
[16] Id.

by extension, would increase Blueacorn's profits)."[17] Fintechs would also prioritize and give less scrutiny to higher value loans, again increasing profits while increasing fraud risk to the program.

Even when human reviewers were involved in manual oversight of these automated systems, fintechs failed to take action against suspected fraud. "The Subcommittee found that reviewers frequently saw applications with signs of fraud, despite those applications having already cleared Blueacorn's automated systems. The supervisor [stated] that reviewers told Blueacorn's management that they saw fraud that the automated checks did not detect, but that Blueacorn management took no action: "They told us to keep pushing everything through."[18] These findings paint a picture of fintech lenders so focused on profit and so detached from regulatory concerns that they readily facilitated millions of suspicious loans and allowed large-scale fraud to occur in the nation's largest pandemic relief program.

This, of course, raises major questions about the potential for fraud if fintechs were issued SBLC licenses and allowed access to the 7(a) and microloan programs. But from a macro perspective, it evinces an ethos among fintechs that is profit-driven and apathetic to borrower protection. Fintechs often advertise their commitment to serving the underserved and providing financial services in the places and to the people and businesses that big banks will not. While they may offer loans in more places to more entities, it is not altruism that motivates them, it is their understanding that through less restrictive lending criteria and fewer borrower protections, they can offer loans at a profit where other financial institutions cannot. If the economics of small business lending no longer worked sufficiently in their favor, fintechs would vacate the market of small business lending in underserved communities as quickly as they entered it. Conversely credit unions, which are not-for-profit, member-owned financial institutions, operate solely to promote the financial well-being of their members and their communities. Profits made by credit unions are returned back to members in the form of reduced fees, higher savings rates, higher dividends, and lower loan rates. As depository institutions, credit unions would be ineligible to participate in the SBLC program, however credit union service organizations (CUSOs) would be eligible and share the same community-minded focus that distinguishes credit unions in the financial services market.

As long as a fintech culture geared toward quick, easy profit persists, the incentives for fintechs will always run counter to safe and responsible lending. The end result will be risks to the 7(a) and microloan programs and the financial ecosystem as a whole. Individual borrowers could be put at risk, with borrowers that are not creditworthy taking on loans that they are unable to repay. The 7(a) Lending Program itself would face increased risk from fraud, credit losses, and reputational risk. This would have widespread implications for the larger financial markets and is a serious risk to the future of small businesses.

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[17] Ibid.
[18] Ibid.

Lack of Capacity

The SBLC Proposed Rule would give supervisory responsibility over any new SBLC to the SBA's Office of Credit Risk Management (OCRM). NAFCU is concerned that OCRM lacks the staff, funding, and supervisory experience to properly oversee the new SBLC licensees, particularly if they are fintech lenders.

Fintechs, as nondepository financial institutions, traditionally have not been allowed access to SBA loan programs. The urgency of the COVID-19 pandemic and the need to quickly issue PPP loans prompted the SBA to allow fintechs into the program. As previously discussed, this resulted in widespread fraud and testimony at a recent Senate Small Business Committee hearing noted that "it appears that the government did not do enough to ensure that all nontraditional lenders participating in the PPP had sufficient anti-fraud controls either in-house or through their service providers."[19] There is no reason to believe, absent additional guardrails, that fintech lenders would change their negligent behavior if again allowed into SBA Loan Programs, nor is there evidence that the SBA has made sufficient changes to ensure that they have the capacity to supervise these lenders. Moreover, the SBA simply lacks experience supervising fintechs and fintechs lack experience being supervised.

Traditional financial institutions, such as credit unions, that engage in lending through the SBA loan programs are bound to the loan programs' requirements, just as fintechs would be. Importantly however, traditional financial institutions are also subject to the regulations and supervision of their prudential regulator. This includes 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. The SBA however, does not supervise their lenders for compliance with these crucial regulations, which means that any fintech with an SBLC license would have no supervisory incentive to comply with them.

The SBA might be capable of reviewing and monitoring loan practices and performance of fintech SBLC loans, but it is not equipped to ensure parity with its other lenders. Currently, the SBA lists seven SBA authorized fintech lenders on its website.[20] All of these lenders are listed as a result of participation in PPP lending, a relatively short lending program that resulted in significant failures of supervision. The rule notes that the SBA anticipates that it will require one new Risk Management Analyst full-time equivalent employee for every seven new SBLC Licenses issued.[21] Current SBA lenders have indicated that the OCRM is operating at its maximum capacity, given

[19] American Banker, "Lawmakers caution SBA on admitting fintech lenders to 7(a) program" (December, 2022) *available at* https://www.americanbanker.com/news/lawmakers-caution-sba-on-admitting-fintech-lenders-to-7a-program.
[20] SBA, "SBA Authorized Fintech Lenders" (May, 2020) *available at* https://www.sba.gov/sites/default/files/2020-05/FinTech_Lenders_.pdf.
[21] 87 FR 66963.

its existing responsibilities, low staffing, and limited resources. The reason that a moratorium was placed on new SBLCs in 1981 was "because the Agency did not have adequate resources to effectively service and supervise additional SBLCs."[22] The SBA, by allowing lenders with a bad track record and who are relatively unfamiliar to the SBA, to be supervised by an office already at capacity that lacks experience dealing with unregulated entities, risks a repeat of the PPP fiasco and the demise of new SBLCs.

Beyond concerns regarding current SBA capacity, the limited and variable funding of the SBA has the potential to exacerbate the problem. In past years, funding for the 7(a) loan program has been exhausted before new appropriations are provided, suspending or delaying the SBA's ability to fund additional loans.[23] The addition of a possibly unlimited number of new SBLC lenders would result in the further allocation of these limited funds, potentially away from some of the very borrowers to whom the SBA is trying to expand access. If the new recipients of these funds were subject to the sort of rampant fraud seen in the PPP, it would sap available funding, create negative publicity, and potentially impact further Congressional appropriations.

If the SBA is truly committed to providing credit access to small businesses in underserved areas, it must ensure that SBLCs are adequately supervised under a regulatory framework that will protect borrowers, the 7(a) and microloan programs, and the system as a whole. The SBA should apply the recommendations of Treasury regarding consumer lending to SBLC lending, which states, "as a general principle, non-bank firms and insured depository institutions (IDIs) that engage in the same activities to provide consumer financial services should be held to the same risk-based standards with respect to those activities. A lack of sufficient clarity regarding the application of existing law or supervisory standards to available credit underwriting approaches can impact the willingness of responsible lenders to use those approaches."[24]

Mission-Based SBLCs

In proposing the creation of Mission-Based SBLCs, NAFCU again applauds the SBA for their intent, if not their execution. The introduction of a category of nonprofit organization whose purpose is to fill an identified capital market gap through issuance of 7(a) loans is a logical way to address the previously discussed need for additional small business lending. Unfortunately, the rule as currently proposed seems to view the Community Advantage (CA) Pilot Program as the primary pipeline to a Mission-Based SBLC license. It is notable that the SBA has estimated the number of SBLC licenses that will be issued, while making no mention of the number of Mission-Based SBLC licenses. In lieu of discussing the number of available licenses, SBA states that it "anticipates that

[22] 87 FR 66963.
[23] CFO, "SBA 7(a) Program Runs Out of Money" (July 24, 2015) *available at* https://www.cfo.com/banking-capital-markets/2015/07/sba-7a-program-runs-money.
[24] Treasury, "Assessing the Impact of New Entrant Non-bank Firms on Competition in Consumer Finance Markets" (November, 2022) available at https://home.treasury.gov/system/files/136/Assessing-the-Impact-of-New-Entrant-Nonbank-Firms.pdf

current CA Lenders in good standing may apply and will be immediately approved as Mission-Based SBLCs, which will not increase the number of entities supervised and overseen by SBA."[25] As the CA pilot program has only been extended to September 30, 2024, this gives the appearance that the SBA simply created the Mission-Based SBLC designation to transfer CA lenders out of a program that may soon expire, to the exclusion of non-CA lenders such as community development financial institutions (CDFIs). This is more or less admitted when the rule states, "licensing new SBLCs and Mission-Based SBLCs will provide a path for successful CA Lenders to become participants in the 7(a) Loan Program long-term."[26]

Beyond the concerns regarding the pathway to a license, NAFCU has serious concerns about the unlimited discretion that the SBA affords itself to determine the level of lending necessary for a Mission-Based SBLC to fill a market gap. Specifically, the rule states that the SBA will "determine in its sole discretion a Mission-Based SBLC's minimum acceptable percentage of total loans that it must make in its identified capital market gap, maximum loan size, geographic area of operation, and capitalization."[27] Although NAFCU understands the desire for flexibility to attract lenders and strategically address market gaps, the failure to present any clear set of defined or consistent mission-lending requirements for these entities seems ripe for inconsistency and opacity.

Allowing political appointees to establish participation parameters on a lender-by-lender basis without any minimum requirements and without clearly describing how these Mission-Based SBLCs would fill market gaps is confounding and places potential applicants at a disadvantage. Furthermore, the lack of defined percentages or thresholds in the program contributes to the perception that the SBA is attempting to shape the program to fit the current CA lenders, at the expense of other, possibly more qualified lenders that might better benefit underserved communities. NAFCU supports the creation of Mission-Based SBLCs but urges the SBA to issue a clear roadmap for applicants and to set mission-lending requirements targeted to the goal of serving the underserved.

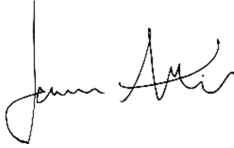
Conclusion

NAFCU appreciates the opportunity to comment on this proposed rule. NAFCU urges the SBA to rescind or pause the rulemaking process for this rule and the Affiliation rule and heed the conclusion of the Subcommittee report that stated "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

[25] Id.
[26] Id.
[27] Id.

and industry best practices."[28] If you have any questions or concerns, please do not hesitate to contact me at 703-842-2268 or jakin@nafcu.org.

Sincerely,



James Akin
Regulatory Affairs Counsel

[28] Select Subcommittee on the Coronavirus Crisis, "'We are not the fraud police' How fintechs facilitated fraud in the paycheck protection program" (December 1, 2022).