



December 23, 2022

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

Re: Affiliation and Lending Criteria for the SBA Business Loan Programs (RIN 3245-AH87)

Thank you for the opportunity to comment on the proposed rule regarding affiliation and eligible uses of proceeds for an SBA loan.

On October 26, 2022 Volume 87, No. 206 of the Federal Register contained a Notice of Proposed Rulemaking on *Affiliation and Lending Criteria for the SBA Business Loan Programs* (87 FR 64724). The purpose of the proposed Rule is to streamline and modernize regulations on lending criteria and loan conditions for the 7(a) and 504 loan programs to better help meet the needs of America's small businesses, create jobs, assist with recovery from the COVID-19 pandemic, and grow the economy.

The African American Alliance of CDFI CEOs (the Alliance) is pleased to provide the following comments in response to the Proposed Rulemaking, 87 FR 64724. The Alliance is a membership-driven intermediary organization that aims to: build the capacity of member organizations; build bridges to economic stability, well-being, and wealth for Black individuals, families, and communities; and build power in Black communities by challenging and influencing financial sectors to operate more equitably. Since launching in 2018, the Alliance has established a network of 70 CEOs of Black-led Community Development Financial Institutions (CDFIs), which includes loan funds, credit unions, and venture capital funds. Alliance members reach historically underserved communities in all 50 states by providing financial services in the small business, affordable housing, and commercial real estate development sectors.

#### **Authorizing 7(a) Loan Proceeds to Effect Partial Changes of Ownership**

Currently 7(a) loan proceeds *may only be used to fund the purchase of an entire business or an owner's entire ownership interest*. 7(a) loan proceeds may not be used to purchase *a portion of a business or a portion of another owner's interest*.<sup>1</sup> Specifically, SBA has historically allowed loan proceeds for use only in three (3) situations involving a change in ownership:

1. A **complete change of ownership** where the debt was used to finance a change of ownership of a business concern with new owner(s) who previously held no interest in the small business concern acquiring 100 percent of the outstanding equity ownership in the small business from the selling owner(s), and the seller(s) completely divest from all ownership interest and management activities for the small business concern; or

2. A **Partner Buyout**, where the small business concern uses the loan to affect a change of ownership between existing owners and the owners which remain after the sale is complete held an ownership interest prior to the sale, and the selling owner(s) completely divest from all ownership interest and management activities for the small business concern; and
3. Where an **Employee Stock Ownership Plan or equivalent trust (ESOP)** purchases a controlling interest (51% or more) in the employer small business from the current owner(s).<sup>1</sup>

Among the changes proposed by SBA is to remove the reference to Section 120.202 in Section 120.130(g) and revising Section 120.202 to read:

*Notwithstanding §120.130(a), a Borrower may use 7(a) loan proceeds to purchase a portion or the entirety of an owner's interest in a business, or a partial or full purchase of a business itself.*

The Alliance believes the proposed change will help close the gap in financing for those businesses that wish to undergo a partial change of ownership (e.g., those situations where there is no buyer for a complete change of ownership; or a small business owner wishes to bring in additional owners for a certain amount of time to learn the key aspects of the business before turning it over). The Alliance also believes that the proposed change will provide employees a path to ownership that they would otherwise be blocked from pursuing due to their inability to secure private financing to purchase a partial ownership stake in the business. This allows for employee ownership of a business without the additional upfront and ongoing costs incurred by a small business in the formation and operation of an Employer Stock Ownership Plan (“ESOP”) trust.

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### **Size Standards and Affiliation Principles Applicable to FA programs**

In light of numerous requests from participating lenders and the public, SBA has proposed to remove the principle of control of one entity over another as a separate basis for finding affiliation, as this has been proven time and again to be unduly burdensome for applicants to implement. The proposed revision also brings the affiliation principles/criteria of all of its business loan programs into alignment (including 504, 7(a), and Community Advantage). This means that affiliation will no longer be established by:

- Management agreements;
- Identity of interest between close relatives; and
- Franchise, license, and similar agreements.

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<sup>1</sup> Except for where an ESOP purchases a controlling interest (51% or more) in the employer small business from the current owner(s), SBA's current regulations do not permit 7(a) loan proceeds to be used for partial changes of ownership.



Specifically, SBA is revising **Section 121.301(f)(1), “Ownership,”** to simplify affiliation based on ownership. Namely, SBA details how it intends to determine affiliation by ownership –

1. When the Applicant owns more than 50 percent of another business, the Applicant and the other business are affiliated.
2. When a business owns more than 50 percent of an Applicant, the business that owns the Applicant is affiliated with the Applicant. Additionally, if the business entity owner that owns more than 50 percent of the Applicant also owns more than 50 percent of another business that operates in the same 3- digit NAICS subsector as the Applicant, they are all affiliated.
3. When an individual owns more than 50 percent of the Applicant and the individual also owns more than 50 percent of another business entity that operates in the same 3-digit NAICS subsector as the Applicant, the Applicant and the individual owner’s other business entity are affiliated.
4. When the Applicant does not have an owner that owns more than 50 percent of the Applicant, if an owner of 20 percent or more of the Applicant is a business that operates in the same 3- digit NAICS subsector as the Applicant, the Applicant and the owner are affiliated.
5. When the Applicant does not have an owner that owns more than 50 percent of the Applicant, if an owner of 20 percent or more of the Applicant also owns more than 50 percent of another business entity that operates in the same 3-digit NAICS subsector as the Applicant, the Applicant and the owner’s other business entity are affiliated.
6. Ownership interests of spouses and minor children must be combined when determining amount of ownership interest.
7. When determining the percentage of ownership that an individual owns in a business, SBA considers the pro rata beneficial ownership of entities.

The Alliance supports these changes, noting that there is a chance that removing industries outside of the operating company’s NAICS will distort the analysis.

SBA is also revising **Section 121.301(f)(2), “Stock options, convertible securities, and agreements to merge”** to remove references that such items will have present effect based on the “power to control a concern” and substituting that that such items will have present effect “on ownership of the entity.” The Alliance supports this change and appreciates the fact that SBA is retaining for SBA lenders and CDCs the concept that stock options, etc. have “present effect” when determining affiliation based on ownership.

SBA also proposes to remove **Section 121.301(f)(3), affiliation based on management,** because SBA is revising its regulation generally by removing the principal of control of one entity over another from consideration of affiliation. The Alliance supports this recommendation as it believes SBA should not interfere in a business owner’s right to enter into a service agreement with a management company.



The Alliance also supports the proposed rule to remove **Section 121.301(f)(4), affiliation based on identity of interest**. It does not appear fair to require close relatives to provide SBA with voluminous financial statements spanning several years when that close relative is not even a principal of the applicant business. The requirement appears to be an overreach that hinders small businesses from getting access to affordable capital.

Finally, the Alliance supports the SBA proposal to remove **Section 121.301(f)(5), affiliation based on franchise and license agreements**. However, the Alliance cautions that a business model eligibility standard for SBA is prudent. The proposed rule removes the principal of control of one entity over another from its affiliation consideration, which the Alliance applauds. However, the Alliance is concerned about the 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 SBA's lending partners. 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 reviews. The Alliance 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 its lending partners and small business Applicants.

The Alliance believes that streamlining and modernizing regulations on use of loan proceeds and principles for determining affiliation for its 7(a) Loan Program and 504 Loan Program can better position SBA and participating lenders to meet the needs of America's small businesses, create jobs, assist with recovery from the COVID-19 pandemic, and grow the economy, fueling American entrepreneurship, particularly in communities of color served by Alliance members. The Alliance looks forward to continuing its partnership with SBA to find equitable solutions to narrowing the racial wealth gap in America.

Sincerely,

A handwritten signature in black ink, appearing to read "Lenwood V. Long Sr.", written in a cursive style.

Lenwood V. Long Sr.  
President and CEO  
African American Alliance of CDFI CEOs