November 15, 2017

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

Re: Small Business Administration's Request for Information Aimed at Reducing Regulatory Burden, Docket No. SBA-2017-0005

The Milken Institute (the Institute) is a nonprofit, nonpartisan think tank determined to increase global prosperity by advancing collaborative solutions that widen access to capital, create jobs, and improve health. The Institute appreciates the opportunity to provide comments to the U.S. Small Business Administration's (SBA) request for information on reducing regulatory burden.[1] Given the SBA's mission to maintain and strengthen the vibrancy and dynamism of the small business economy, the Institute applauds efforts led by SBA Administrator Linda McMahon to initiate a review of current SBA regulations to determine overall effectiveness and relevancy in today's economy.

Beginning in Fall 2016, the Milken Institute joined with the SBA on a two-year pilot program called the Partnership for Lending in Underserved Markets (PLUM). The program focuses on developing actionable solutions to address long-standing structural problems that inhibit minority-owned small businesses from accessing capital and growing their operations.

Baltimore, Maryland and Los Angeles, California were selected as the pilot cities and the Institute has held numerous convening's with local stakeholders in both cities to uncover challenges minority small business owners face in efforts to obtain capital (debt and/or equity). From this engagement, the Institute has formed local and national action groups to develop actionable solutions to address the myriad of challenges facing minority-owned small businesses, particularly in underserved localities. Earlier this year, the Institute published a white paper summarizing the challenges and opportunities that surfaced in discussions with stakeholders.[2]

The Small Business Economy

Small businesses are the backbone of the American economy. There are almost 30 million businesses in the United States that are classified by the U.S. Small Business Administration (SBA) as "small businesses." These small businesses, nearly three-quarters of which are sole proprietorships,[3] employ more than 56 million Americans. In fact, nearly half of all employees in the private sector work at small

[1] Available at: https://www.federalregister.gov/documents/2017/08/15/2017-17176/reducing-unnecessary-regulatory-burden
[2] Carolyn Karo and Jackson Mueller, Partnership for Lending in Underserved Markets: Phase I Summary: Developing Action-Oriented Solutions to the Financing Challenges Facing Minority-Owned Small Businesses, Milken Institute, September 2017. Available at: http://assets1b.milkeninstitute.org/assets/Publication/Viewpoint/PDF/092617-PLUM-Phase-I-Summary.pdf
[3] https://www.sba.gov/blogs/sole-proprietorship-popular-business-structure-right-you

businesses. As the Bureau of Labor Statistics has found, small businesses accounted for 62 percent of net new jobs created between 1993 and 2006.[4]

Many of the nation's small business owners face challenges unique to their geography, race, and ethnicity. For example, the share of entrepreneurs and sole proprietors in rural America has been declining for the last two decades.[5] And entrepreneurs located in underserved populations, particularly African-American and Hispanic business owners, continue to remain dramatically underrepresented in the small business community relative to their population size. In 2012, Hispanics owned 5.6 percent of all small businesses in the U.S. and yet made up nearly 17 percent of the population. Even worse, African-American's owned 2.1 percent of all small businesses yet represented 13 percent of the population. Rural- and minority-owned small businesses play an important role in driving job creation, raising wages, and elevating standards of living in their respective communities. Business ownership is also a critical pathway for minorities to close the racial wealth gap.

Given the economic role small businesses play in the United States and how vital local, state, and federal efforts are to supporting the vitality of this formidable sector of the economy, the Institute commends the SBA on opening up this important discussion to the public for comment.

Based on extensive engagement with local stakeholders in both Baltimore and Los Angeles, coupled with data-driven research and analysis covering the challenges and opportunities small businesses face in obtaining capital, the Institute has provided the following recommendations to help the SBA more effectively achieve its core goals. Not all of the recommendations pertain to reducing unnecessary regulation, but enhancing current SBA regulation as well.

The recommendations are:

- *Expand and make permanent the Alternative Size Standards to provide for greater certainty and to account for loan size when determining whether a small business qualifies for a program.*
- *Make permanent the Community Advantage 7(a) Loan Program and refine specific protocols*
- *Refine requirements for gaining access to SBA secondary loan markets that may prevent lenders from helping small businesses adjust their finances during a credit downturn.*
- *Streamline the process for establishing a Small Business Investment Company (SBIC) and develop guidance on SBIC investment in minority-owned firms and/or underserved areas.*
- *Relax requirements for minimum SBIC capitalization thresholds to encourage smaller investment.*
- *Review Barriers for SBIC Investments in CDFIs*
- *Remove barriers to making SBA lending data and partner firm data publicly available*
- *Increase the number of nonbank licenses with specific LMI focus*

Expand and make permanent the Alternative Size Standards to account for loan size when determining whether a small business qualifies for a program.

The North American Industry Classification System (NAICS)—which contains industry-specific size standards the SBA utilizes to determine program eligibility—now tops more than 1,000 industry

[4] https://www.sba.gov/sites/default/files/Whats-New-w-Small-Business-2017.pdf
[5] https://www.sba.gov/sites/default/files/advocacy/Retreat-Rural-Entrepreneur.pdf

classifications across 18 different sub-industry activities.[6] The size standards matter because certain government programs, including SBA loan programs and contracting opportunities, are available only to business that fit within the size standards.[7] The financial services industry also utilizes these definitions when making a determination as to the products a small business may qualify for.

In January 2016, the SBA finalized rules to adjust monetary based size standards for inflation. As the SBA noted in its press release,[8] the Administration "also adjusted its program specific monetary size standards with the exception of the new alternative size standard based on tangible net worth and net income that applies to SBA's 7(a) and 504 loan programs. The new alternative standard was established under the Jobs Act and will remain in effect until the SBA establishes a permanent alternative size standard for these programs." At this time, however, the SBA has yet to indicate whether the alternative standard will be made permanent. To provide certainty to small businesses and industry stakeholders engaged in utilizing the above-mentioned SBA programs to provide small businesses with capital, we recommend the SBA make permanent the adjusted size standards.

Make permanent the Community Advantage 7(a) Loan Program and refine specific protocals

The Community Advantage pilot program was launched back in February 2011 and designed to support eligible lending institutions in providing capital to underserved markets. Lending institutions eligible to participate in the SBA's Community Advantage pilot program are SBA-authorized Certified Development Companies, SBA-authorized Microloan Intermediaries, and non-federally regulated Community Development Financial Institutions.

The program, however, remains a pilot with the SBA required to reauthorize the program every so often. The pilot was originally scheduled to expire in March 2017, but was extended until March 2020. At this time, there has been no assurances made from the SBA that the pilot program will be extended further. Eligible financial institutions currently involved in the program face considerable uncertainty that may affect the level of interest and participation in the program. Even so, the program is proving far more effective in meeting the needs of minority-owned borrowers with nearly 20 percent of funds flowing to African-American small businesses, in particular.[9] Given the fact that the eligible institutions are often on the front lines in serving the small business needs of their communities and the fact that this pilot program provides for additional avenues to serve small business needs, particularly those in underserved communities, the Institute would recommend the SBA make permanent the Community Advantage program.

Nonetheless, there are areas for improvement in the Community Advantage (7a) loan program. Lenders that wish to get access to the 7a program must go through a certification program. Even if a lender is already designated as a Community Development Financial Institutions (CDFI) by the U.S. Commerce

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[6] Robert Jay Dilger, Small Business Size Standards: A Historical Analysis of Contemporary Issues, U.S. Congressional Research Service, July 21, 2017. Available at: https://fas.org/sgp/crs/misc/R40860.pdf

[7] SBA Programs utilizing the standard NAICS definitions include, but are not limited to: Microloan Program, 7(a) Business Loan Guarantee program, Certified Development Company (504) loans, Small Business Investment Companies (SBIC), Surety Bond Guaranty Programs, Small Business Innovation Research (SBIR), Small Business Technology Transfer (STTR)

[8] SBA Finalizes Rule to Adjust Monetary Based Size Standards For Inflation, SBA, January 28, 2016. Available at: https://www.sba.gov/about-sba/sba-newsroom/press-releases-media-advisories/sba-finalizes-rule-adjust-monetary-based-size-standards-inflation

[9] Mentioned during an SBA-MI PLUM Baltimore Lender Working Group meeting on November 18, 2016

Department that CDFI would be required to be 7a certified as well, effectively increasing the cost and barriers to utilization of the 7a program. The Institute encourages the SBA to look for vetted community lender/investors in other Agencies that could be given exempted access to 7a programs

Refine requirements for gaining access to SBA secondary loan markets that may prevent lenders from helping small businesses adjust their finances during a credit downturn.

For a lender, being able to sell the guaranteed portion of an SBA loan on a secondary market increases that lenders liquidity and ability to issue more loans. The secondary market for many lenders has been a critical resource for expanding their capacity. To encourage a robust secondary market, the SBA has implemented a strict set of terms and conditions. In particular, the guidelines on nonperforming loans require lenders to treat borrowers in specific ways. In the aftermath of the 2008 crisis, a number of lenders reported that even though as a lender they were willing to refinance struggling small businesses, the rules and regulations governing SBA loan programs and secondary markets prevented such activity. Effectively, SBA-approved lenders were limited in their ability to help small businesses restructure non-performing loans during a credit downturn.

Streamline the process for establishing a Small Business Investment Company (SBIC) and develop guidance on SBIC investment in minority-owned firms and/or underserved areas.

Small business investment companies (SBICs) play an effective role in small business expansion. By facilitating the investment of capital into qualifying small businesses, the resources of the SBA are demonstrably amplified by SBICs. While raising the cap on private funds that a single SBIC can manage requires Congressional approval, other changes can be made to the program to increase its effectiveness.

For instance, the application process can be cumbersome for applicants seeking to become an SBIC, requiring a two-phased process that requires a significant time commitment. The application process can take as long as 10 weeks, if not more, while the licensing process can take at least six months. The process does not include the applicant having to raise sufficient private capital within 18 months before moving on to the second phase of the process (licensing process).[10]

Efforts to reduce the length of time it takes for an applicant to receive an SBIC license without compromising the level of scrutiny applied by the SBA throughout the application process could lead to more interest in forming SBICs and additional private capital generated to support small businesses. The Institute recommends that in the Administration's analysis of its regulations, the SBA should also seek to examine where certain pain points are in the application process and undertake efforts to reduce the amount of time the entire process takes.

Separate from the application process, in developing analyses on the local small business markets in Baltimore and Los Angeles, the Institute found it difficult to measure SBIC investment in minority-owned small businesses or geographic areas. The difficulty stems from the fact that the SBA has yet to issue guidance on the collection and reporting of such information. The Institute would recommend that the

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[10] Cindy Barnes, Small Business Investment Companies: Characteristics and Investment Performance of Single and Multiple Licensees, GAO-16-107, January 2016. Available at: http://www.gao.gov/assets/680/674813.pdf

SBA publish proposed guidance on how the Administration seeks to collect such information in order to inform interested stakeholders on how much capital is flowing to underserved small businesses.

In order to ascertain how effective the SBA's SBIC program is in meeting the capital needs of small businesses in underserved areas, the SBA should not make it optional for SBICs to report their data, but require it.

Remove barriers to making SBA lending data and partner firm data publicly available
Separate from SBIC data deficiencies, SBA data from its other lending programs is also needed to determine overall effectiveness of each program, where investment is flowing and who is receiving what types of funding.

In FY 2016, the SBA approved more than 70,000 loans, totaling nearly $29 billion, through the 7(a) and 504 loan programs. The data the SBA collects from financial institutions, in particular, is made public only upon request. Expediting the public availability of this data would provide significant benefits not only for determining key gaps and inefficiencies in SBA programs, but also for assessing credit risks and opportunities in targeted areas that can help lenders reach potential clients.

Relax requirements for minimum SBIC capitalization thresholds to encourage smaller investment.
Applicants to become an SBIC are required to raise a minimum of $5 million in private capital, however most SBICs raise significantly larger amounts of private capital. For instance, in FY 2014, debenture SBICs raised an average of nearly $50 million in private capital.[11]

SBICs are constrained by the larger scale and parameters set by their limited partners and the SBA. The typical SBIC fund, in order to maintain profitability and provide a return, is looking at deals greater than $1 million. According to 2012 U.S. Census Data, 62 percent of small business nationwide have 5 or less employees, 68 percent and 67 percent, respectively, for Black-owned and Hispanic-Owned small businesses. SBIC's simply cannot address the credit demand of small businesses seeking $100,000-$1 million in financing, which is relevant for the majority of small businesses.

As such, the Institute would encourage the SBA to relax the minimum capital thresholds required to become an SBIC in order to foster smaller-scale SBICs that can make deals below $1 million. Relaxing of capital thresholds could entice certain investors to make inroads into smaller revenue generating businesses, providing an additional avenue of capital to smaller businesses in underserved markets.

Review Barriers for SBIC Investments in Community Development Financial Institutions (CDFIs)
The Institute would recommend the SBA review §107.720 as it relates to the eligibility of small businesses for SBIC financing. According to the SBA, "relenders" or "reinvestors" are not permitted to receive SBIC financing. As a result, SBICs cannot make investments into CDFIs focused on Low and Middle Income (LMI) census tracks, as relenders or reinvestors as defined under the subsection.

[11] Small Business Investment Companies: Investment Option for Banks, OCC Community Affairs Department, September 2015. Available at: https://www.occ.treas.gov/topics/community-affairs/publications/insights/insights-sbic.pdf

Conversely, under current law, federally insured banks and federal savings associations may invest up to 5 percent of their capital and surplus in SBIC, and there are industry calls to raise that allowable amount to 15 percent.

CDFIs are a critical resource for deploying capital into LMI tracks, and having the capacity and capability to serve the community is a critical need. The Institute believes that by allowing SBICs to invest in CDFIs, as long as investments are prudently made, not only is the capacity of the CDFI enhanced, but the SBIC is able to meet the credit demands of small businesses in underserved areas in particular. In testing this hypothesis, the Institute would support the SBA undertaking a pilot or, at the very least, provide written assessment of the potential benefits in allowing SBICs to provide financing to relenders and reinvestors that are specifically targeting LMI.

Increase the number of nonbank licenses with specific LMI focus

Since the early 1980s, the SBA has limited the number of non-bank licenses for the 7(a) loan program at 14. That limitation has remained unchanged for nearly 40 years. While thousands of banks can participate in the 7(a) loan program, the SBA has kept limits on non-bank participation, despite the influx of non-bank financial services providers to the small business lending market.

For all the talk of the need for a level-playing field, current SBA policy puts non-banks at a substantial competitive disadvantage. The Institute recommends the SBA review its policies related to non-bank licensing and lift the ceiling that currently prevents non-bank lenders from leveraging the 7(a) program to make further inroads into supporting small businesses in underserved markets.

The Milken Institute appreciates the opportunity to comment on the Small Business Administration's request for information on reducing regulatory burden. Please let us know if we can provide any additional information, and we would be honored to have the opportunity to continue this discussion in person.

Regards,

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