



March 28, 2013

SBA Proposes Changes to 504 and 7(a) Loan Programs

SUMMARY

- The Small Business Administration (SBA) is proposing a number of changes intended to reduce regulatory restrictions associated with its 504 Loan Program and 7(a) Loan Program.
- The proposal would:
 - Eliminate the personal resources test required for both the 504 and 7(a) Programs.
 - Eliminate the 9-month provision of the 504 Program that permits financing of expenses toward a project only if they were incurred “within nine months prior to receipt by SBA of a complete loan application, unless the time limit is extended or waived by SBA for good cause.”
 - Make changes to the 504 Program regarding Certified Development Company (CDC) affiliations.
 - Eliminate the requirement that a CDC have membership.
 - Revise the 504 Program regulation to emphasize the authority and the responsibilities of the CDC Board of Directors, including a requirement that the Board have between 11 and 25 voting directors.
 - Revise the 504 Program in regard to reporting by CDCs, including by adding a new requirement that CDCs provide an annual compensation report covering all current and former officers and directors receiving compensation, and current and former employees and independent contractors with compensation of more than \$100,000 during the covered period.
- SBA is accepting comments until April 26, 2013; please send your comments to CUNA by April 19.

BACKGROUND

SBA proposes to strip away regulatory restrictions that detract from the 504 Loan Program’s core job creation mission as well as the 7(a) Loan Program’s positive job creation impact on the American economy. The 504 Loan Program and 7(a) Loan Program are SBA’s two primary business loan programs authorized under the Small Business Act. Executive Order 13563 provides that “[t]o facilitate the periodic review of existing significant regulations, agencies shall consider how best to promote retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned.” SBA has reviewed its regulations with regard to the loan programs and is proposing a number of amendments and revisions to accomplish this goal.

CUNA Question: Do you support this effort? Do you feel the proposed approach will achieve this goal?

The primary purpose of the 504 Program is to provide long-term fixed asset financing to small businesses for the purchase or improvement of land, buildings, and major equipment purchases, in an effort to facilitate the creation of jobs and local economic development. Certified Development Companies (CDCs) are non-profit corporations certified and regulated by the SBA to package, process, close, and service 504 Loans. 504 Loans are issued through a partnership with CDCs and private sector, third party lenders.

The primary purpose of the 7(a) Program is to help eligible small businesses obtain credit when they cannot obtain “credit elsewhere.” This program provides financing for general business purposes through SBA’s guaranty of a loan made by an approved lender, of which there are currently 4,500.

CUNA Question: Does your credit union participate in SBA lending? If so, please provide details on volume, loan amount, etc.

SUMMARY OF PROPOSED CHANGES

Personal Resources Test (§ 120.102) (Applies to 504 and 7(a) Programs)

An applicant is ineligible for financing under the SBA's business loan programs if it can obtain credit elsewhere. Under the current personal resources test for the 7(a) and 504 Programs, an assessment is required of the liquid assets of each owner of 20% or more of the applicant company to determine the overall dollar value of personal resources that do not have to be injected into the business.

SBA has become concerned, that even borrowers whose principals have significant personal resources may be unable to obtain long-term fixed asset financing from private sources at reasonable rates. The agency is now questioning whether the existence of personal resources directly correlates to the ability to obtain commercial credit on reasonable terms and is, therefore, rethinking the appropriateness of using personal resources as an indirect means of determining whether credit is available from private sources.

SBA believes that the core business loan program missions, including the core job creation mission of the 504 Program and the small business credit support mission of the 7(a) Program, would best be served by focusing on the statutory requirement regarding the availability of credit on reasonable terms without attempting to document and enforce precise determinations regarding the appropriateness of personal resource contributions. The agency is therefore proposing to eliminate the personal resources test from the regulations for both loan programs.

CUNA Question: Do you agree with SBA's rationale for removing the personal resources test? Do you support removal of the test?

"9-Month Rule" (§120.882) (Applies to 504 Program)

The current 504 Program regulation permits financing of expenses toward a project only if they were incurred "within nine months prior to receipt by SBA of a complete loan application, unless the time limit is extended or waived by SBA for good cause." SBA proposes to eliminate this 9-month limitation and permit financings of expenses toward a project regardless of when they were incurred.

In practice, exceptions to the 9-month rule have been granted regularly because, generally speaking, the date the expense was incurred is a poor indicator as to whether the expense was directly attributable to the applicant's 504 project. For example, because of the weak economy, many businesses' expansion plans have been delayed or placed on hold. Now, in the post-recession recovery period, many small business owners are preparing to resume their plans only to discover that expenditures already made, or the method of financing those expenditures, results in those costs not being eligible for 504 financing.

In the last five years, SBA has declined about 19% of rule exception requests, while approving approximately 81% of such requests. This data confirms the agency's belief that determining whether an expense has been incurred by an applicant for a 504 project requires a fact specific analysis which appropriate agency personnel need to make regardless of when the expense was incurred. As it relates to loan processing, the agency will continue to review any expense that was incurred prior to the date of application to ensure that it is "directly attributable" to the project. Based on SBA's experience in the application of the 9-month rule and having, for the most part, approved requests from applicants that SBA make an exception to this policy, SBA proposes eliminating the 9-month restriction.

CUNA Question: Do you support removal of the 9-month rule? Do you foresee any unintended consequences—positive or negative—of such removal?

CDC Affiliation (§ 120.820) *(Applies to 504 Program)*

SBA proposes the following changes to its regulation that sets forth requirements regarding CDC affiliations:

- In paragraph (a), CDC would need to be independent and not be affiliated with any person except as permitted in this section.
- In paragraph (b), CDCs could be affiliated with nonprofit economic development entities or state and local government political subdivisions.
- In paragraph (c), a CDC could continue to be affiliated with a 7(a) Lender if: (1) the affiliation was in effect as of the effective date of this regulation; and (2) the lender is either a state development company approved by SBA as of November 2003, or a credit union. This proposed change would permit the continuation of existing relationships between CDCs and 7(a) Lenders that are credit unions or state development companies, but does not permit the creation of such relationships going forward.
- In paragraph (d), consistent with current policy, a CDC would be prohibited from affiliating with or investing in or financing another CDC.

CUNA Question: Do you support these proposed changes? Is your credit union currently (or formerly) “affiliated” with a CDC?

CDC Membership (§ 120.822) *(Applies to 504 Program)*

Currently, this section requires CDCs to have at least 25 members or stockholders, and also sets forth membership group requirements. SBA proposes to eliminate the requirement that a CDC have membership. Now that CDCs currently have authority to loan in a statewide (or multistate) area, the local membership board does not have the same impact as when CDCs represented a smaller service area. Maintaining both membership and a Board of Directors places an unnecessary burden on CDCs. Lessening this burden may encourage more entities to become CDCs, resulting in an expansion of the program and loans to small businesses. A CDC may continue to have membership but it is no longer an SBA requirement. Instead, SBA is emphasizing the responsibilities and duties of the CDC Board of Directors in the following section.

CUNA Question: Do you agree with the SBA’s rationale for proposing to remove the membership requirement? Do you support such removal? Is this change likely to impact your credit union in any way?

CDC Board of Directors (§ 120.823) *(Applies to 504 Program)*

In paragraph (a), SBA proposes to revise the regulations to emphasize the authority and the responsibilities of the CDC Board of Directors. The proposed regulation provides that the initial board may be created as permitted by state law. It also outlines proposed requirements for the directors’ backgrounds and areas of expertise. SBA proposes adding a requirement that the Board size shall be not less than 11 voting directors and not more than 25.

CUNA Question: Do you support requiring a CDC Board of 11 - 15 Directors?

The Agency lists several proposed areas of expertise that it believes are essential to the successful operation of the CDC Board. SBA proposes to require that a CDC have, at a minimum, one director that is a representative from the economic, community or workforce development field and two directors that are representatives from the commercial lending field. This proposed change is intended to expand the pool of potential directors and to encourage more diversity and expertise on the Board. Retired individuals may represent the fields from which they retired, as the Agency recognizes the value of their knowledge and experience.

CUNA Question: Do you support the proposed expertise requirement?

Paragraph (c) outlines the proposed minimum requirements for Board meetings and explicitly establishes the Board's responsibilities for the actions of the CDC, its staff, and any committees established by the Board of Directors. To ensure effective operation and oversight of the CDC by the Board, and to encourage maximum involvement by each Director, the Agency proposes requiring that a quorum of not less than 50% of the Board be present to conduct all business. Non-voting directors will not be included for the purposes of establishing a quorum. SBA is aware that some CDCs were requiring that a quorum be present only to begin a meeting; this practice would not comply with the proposed rule. In subparagraph (c)(3), SBA proposes that meetings may be held in any manner permitted by state law, recognizing that there are methods for meeting other than being physically present. Paragraph (c)(4) proposes to maximize diversity on the Board by limiting representation by commercial lenders to less than 50% of the Board of Directors. Paragraph (c)(5) proposes to limit the ability of an outside entity (including affiliates of that entity) to control the Board by restricting the entity's representation on the CDC Board to one member.

In paragraph (d), SBA proposes to require that the Board be responsible for ensuring that the structure and operation of the CDC, as set forth in the Bylaws, comply with SBA's Loan Program Requirements. In subparagraphs (d)(1) and (2), SBA proposes to require that the Board be responsible for setting the mission and hiring, firing, supervising and evaluating the CDC manager. To emphasize the fiscal responsibility of the Board as it relates to salaries, subparagraph (d)(3) explicitly outlines the duties of the Board to set salaries for the CDC manager and to review all other salaries to provide greater transparency and accountability.

As provided in current § 120.825, a CDC must invest in its Area of Operations. Subparagraph (d)(10) proposes to require that the Board approve all investments of over \$2,500 and that the CDC manager approve investments of \$2,500 or less in order to ensure that the investments constitute appropriate economic development activity and that such investments do not compromise the adequacy of the reserves.

The Agency proposes to require in subparagraph (d)(11) that the Board establish a policy in the Bylaws of the CDC prohibiting an actual or apparent conflict of interest, and enforce such policy. The agency would expect that the policy would provide, among other things, that no director may participate in deliberations on a loan if the director is employed by or is otherwise associated with the Third Party Lender. SBA proposes to add subparagraph (d)(14) requiring the CDC's Board of Directors to establish commercially reasonable loan approval policies, procedures, and standards. The CDC's credit approval process and delegations of authority, if any, must be set forth in the Bylaws. In addition, the loan must be credit-approved before the application is submitted to SBA. SBA is proposing to allow Boards to delegate authority to the Loan Committee to provide credit approval of: (1) loans of less than \$1 million, and (2) loans of \$1 million to \$2 million subject to ratification by the Board or the Executive Committee prior to debenture closing.

In paragraph (e), SBA proposes to add the requirement that the Board must maintain directors' and officers' liability and errors and omissions insurance to protect the CDC. The Agency requires at least \$5,500,000 for each occurrence and \$5,500,000 in the aggregate per year, as well as a deductible of not more than \$50,000 for both directors' and officers' liability insurance and errors and omissions insurance. These coverage amounts correspond to the maximum loan amount.

CUNA Question: Any other comments regarding the proposed changes to the CDC Board requirements?

Reports a CDC Must Submit (§ 120.830) (Applies to 504 Program)

SBA proposes the following revisions to its regulation regarding reporting by CDCs in order to improve transparency and accountability:

- In paragraph (a), copies of federal tax returns would need to be submitted in the annual report to assist the SBA in reducing risk by reviewing the financial condition of the CDC and compensation of CDC employees.
- In subparagraph (a)(2), a CDC would be required to provide an annual compensation report covering all current and former officers and directors receiving compensation during the covered period, and any current and former employees and independent contractors with total compensation of more than \$100,000 during the covered period.
- In subparagraph (a)(3), the annual report would need to include an annual certification by each of the directors that he or she has read and understands the requirements in proposed § 120.823.
- In subparagraph (a)(4), a CDC would need to report on investments in economic development activities in each state in which the CDC has an outstanding 504 Loan.

CUNA Question: Do you support these proposed reporting requirements? In particular, do you foresee any issues with the compensation-reporting requirement? Are there additional reports you believe should be required of a CDC?

**Please send comments and questions to Senior Assistant
General Counsel [Luke Martone](#).
[Here](#) is the proposal in the *Federal Register*.**