

Proposed Rules

Federal Register

Vol. 87, No. 206

Wednesday, October 26, 2022

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

SMALL BUSINESS ADMINISTRATION

13 CFR Parts 120 and 121

RIN 3245-AH87

Affiliation and Lending Criteria for the SBA Business Loan Programs

AGENCY: U.S. Small Business Administration.

ACTION: Proposed rule.

SUMMARY: The U.S. Small Business Administration (SBA or Agency) is proposing to amend various regulations governing SBA's 7(a) Loan Program and 504 Loan Program, including use of proceeds for partial changes of ownership, lending criteria, loan conditions, reconsiderations, and affiliation standards, to expand access to capital to small businesses and drive economic recovery. The proposed amendments to affiliation standards will also apply to the Microloan Program, Intermediary Lending Pilot Program, Surety Bond Guarantee Program, and the Disaster Loan programs (except for the COVID Economic Injury Disaster Loan (EIDL) Disaster Loan Program).

DATES: SBA must receive comments on this proposed rule on or before December 27, 2022.

ADDRESSES: You may submit comments, identified by RIN 3245-AH87, through the Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.

SBA will post all comments on <http://www.regulations.gov>. If you wish to submit confidential business information (CBI) as defined in the User Notice at <http://www.regulations.gov>, please submit the information via email to Dianna.Seaborn@sba.gov. Highlight the information that you consider to be CBI and explain why you believe SBA should hold this information as confidential. SBA will review the information and make the final determination whether it will publish the information.

FOR FURTHER INFORMATION CONTACT: Dianna Seaborn, Director, Office of

Financial Assistance, Office of Capital Access, Small Business Administration, at (202) 205-3645 or Dianna.Seaborn@sba.gov.

SUPPLEMENTARY INFORMATION:

I. Background Information

The mission of SBA is to "aid, counsel, assist and protect the interests of small business concerns in order to preserve free competitive enterprise and to maintain and strengthen the overall economy of our nation." 15 U.S.C. 631(a). SBA accomplishes this mission, in part, through Capital Access programs that bridge the financing gap in the private market and help businesses of all sizes to recover from disasters. 15 U.S.C. 636(a) and (b). SBA has determined that changing conditions in the American economy, technological developments, and a constantly evolving small business community necessitate the need to revise regulations to improve program efficiency and the customer experience for the 7(a) and 504 Loan Programs. Additionally, SBA has determined that revisions for similar purposes to SBA regulations on affiliation determinations should also apply to the Microloan Program, the Intermediary Lending Pilot Program (ILP Program), the Surety Bond Guarantee Program (SBG Program), and the Business Disaster Loan Programs, which consist of Physical Disaster Business Loans, Economic Injury Disaster Loans, and Military Reservist Economic Injury Disaster Loans (but do not include COVID EIDL Disaster Loans).

SBA is proposing to streamline and modernize the 7(a) Loan Program and 504 Loan Program regulations setting forth use of proceeds regarding partial changes of ownership, lending criteria, hazard insurance requirements, and reconsiderations. Specifically, SBA is revising 13 CFR 120.130 on "Restrictions on uses of proceeds"; 13 CFR 120.150 on "What are SBA's lending criteria?"; 13 CFR 120.160 on "Loan conditions"; 13 CFR 120.193 on "Reconsideration after denial"; 13 CFR 120.202 on "Restrictions on loans for changes of ownership".

Historically, SBA has permitted loan proceeds for use only in three situations involving a change of 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). 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. SBA proposes to revise restrictions on Borrowers using 7(a) loan proceeds to effect partial changes of ownership to assist small businesses and expand pathways to ownership.

SBA believes that streamlining and modernizing regulations on lending criteria and loan conditions for its 7(a) Loan Program and 504 Loan Program can better position the Agency 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. Further, these proposed changes will enable SBA to provide capital in the form of 7(a) and 504 loans to more small businesses.

SBA also proposes to revise the process for reconsideration after denial of a loan application or loan modification request in its 7(a) Loan Program and 504 Loan Program to provide the Director, Office of Financial Assistance, with the authority to delegate decision making to designees. The proposed revision would also provide that the Administrator, solely within her discretion, may review these matters and make the final agency decision on reconsideration. Such discretionary authority of the

Administrator would not create additional rights of appeal on the part of an applicant not otherwise specified in SBA regulations.

Further, SBA proposes to simplify 13 CFR 121.301, which sets forth the principles for determining affiliation in the 7(a) Loan Program, 504 Loan Program, Microloan Program, ILP Program, SBG Program, and Business Disaster Loan Programs (except for the COVID EIDL Disaster Loan Program). Specifically, SBA proposes to remove the provisions on affiliation arising from management and control, franchise or license agreements, and identity of interest, and SBA proposes to streamline affiliation determinations based on ownership. This proposed rule would redefine affiliation for all these programs, thereby simplifying affiliation determinations.

The Agency requests comments on all aspects of regulatory revisions in this proposed rule and on any related issues affecting the 7(a) Loan, 504 Loan, Microloan, ILP, SBG, and Business Disaster Loan Programs.

II. Section-by-Section Analysis

Section 120.130—Restrictions on Uses of Proceeds

Current § 120.130, paragraph (g), refers to a restriction in § 120.202 regarding restrictions on Borrowers from using loan proceeds to purchase a portion of a business or another owner's interest in a business. SBA proposes to revise § 120.202, as described below, to allow use of 7(a) loan proceeds to fund partial changes of ownership. SBA is proposing to make this change to assist small businesses and provide a path to ownership for employees. Therefore, SBA is proposing to revise § 120.130(g) to remove the reference to § 120.202.

Section 120.150—What are SBA's lending criteria?

Current § 120.150 states that SBA's lending criteria for 7(a) and 504 loans requires that the applicant (including the Operating Company) must be creditworthy; loans must be so sound as to reasonably assure repayment; and SBA will consider nine specific factors in its lending criteria. The factors consist of: (a) Character, reputation, and credit history of the applicant (and the Operating Company, if applicable), its Associates, and guarantors; (b) Experience and depth of management; (c) Strength of the business; (d) Past earnings, projected cash flow, and future prospects; (e) Ability to repay the loan with earnings from the business; (f) Sufficient invested equity to operate on a sound financial basis; (g) Potential for

long-term success; (h) Nature and value of collateral (although inadequate collateral will not be the sole reason for denial of a loan request); and (i) The effect any affiliates (as defined in part 121 of this chapter) may have on the ultimate repayment ability of the applicant. SBA proposes to revise this regulation as discussed below.

In revising § 120.150, SBA would retain the requirement that the applicant (including an Operating Company) must be creditworthy and that loans must be so sound as to reasonably assure repayment, consistent with section 7(a)(6) of the Small Business Act.

SBA is proposing to incorporate into the regulation a new requirement that Lenders and Certified Development Companies (CDCs) must use appropriate and prudent generally acceptable commercial credit analysis processes and procedures consistent with those used for their similarly-sized, non-SBA guaranteed commercial loans. In using such appropriate and prudent processes and procedures, Lenders and CDCs would be required to underwrite SBA loans in the same manner in which the Lenders and CDCs underwrite their similarly-sized, non-SBA-guaranteed commercial loans where they bear all risk of loss in the case of loan default. SBA is aware that some SBA Supervised Lenders (as defined in 13 CFR 120.10) and some CDCs do not make non-SBA guaranteed commercial loans, and therefore do not have comparable processes and procedures for non-SBA guaranteed commercial loans. Therefore, the proposed language regarding non-SBA guaranteed commercial loans would not apply to such SBA Supervised Lenders and CDCs. For these SBA Supervised Lenders and CDCs, SBA has and would continue to require that they submit their credit policies, including credit scoring models, for review by SBA during the participant application process and/or during lender oversight processes in accordance with Loan Program Requirements as defined in 13 CFR 120.10.

SBA believes that allowing Lenders and CDCs to use appropriate and prudent commercially acceptable credit analysis processes and procedures consistent with those used for their similarly-sized, non-SBA guaranteed commercial loans will encourage Lenders and CDCs to participate in the 7(a) loan program because of alignment between their processes for guaranteed and non-guaranteed loans. This will allow CDCs to align with the credit processes and procedures of the 504 Loan Program's Third Party Lenders. SBA also believes this may encourage

Lenders and CDCs to make smaller loans by reducing the underwriting burden, including time and costs.

SBA also proposes adding language to § 120.150 to permit Lenders, CDCs, and SBA to use a business credit scoring model. Lenders and CDCs may use SBA's Small Business Scoring Service (SBSS) credit scoring model. Lenders and CDCs may also use other credit scoring models; however, when doing so, Lenders and CDCs must be able to validate the credit scoring model and must document with appropriate statistical methodologies that their credit analysis procedures are predictive of loan performance, and they must provide that documentation to SBA upon request and during oversight reviews. Credit scoring models could incorporate, for example, the earnings and cashflow of an applicant, equity, or collateral, in which case those factors would not necessarily be separately considered by a Lender or CDC unless otherwise specified by Loan Program Requirements (*e.g.*, where SBA requires an equity injection for certain project financing). SBA would continue to require new SBA Supervised Lender applicants and CDCs to submit their credit policies in accordance with Loan Program Requirements; as part of this process, SBA would require that these policies include any credit scoring models that the applicant intends to use for SBA lending at the time of application. SBA may use a business credit scoring model for non-delegated loan processing. SBA believes that allowing Lenders and CDCs to use credit scoring models for credit underwriting will result in more lenders making more smaller loans because the costs for making the small loans will decrease. SBA anticipates that credit scoring models will primarily be used for small loans. SBA anticipates that the higher an applicant's requested loan amount is, the more likely it will be that a Lender or CDC will conduct more traditional underwriting in accordance with their credit analysis processes and procedures consistent with those used for their similarly-sized, non-SBA guaranteed commercial loans.

The use of credit scoring models will not replace the requirement for Lenders and CDCs to comply with other Loan Program Requirements, such as, ensuring the project meets program eligibility requirements, adequate controls on disbursements are in place, providing accurate descriptions of uses of proceeds, and documenting that credit is not available elsewhere.

Modernizing SBA's lending criteria may result in the leveraging of technology by Lenders, including credit

scoring, to assess a loan's risk more quickly without compromising the credit quality of the overall 7(a) and 504 portfolios and possibly reducing fraud. A Congressional Research Service report reviewing the use of data by marketplace lenders indicates that accuracy of credit assessments may improve by using data and advanced statistical modeling, leading to fewer delinquencies and write-offs.¹ Additionally, using data in credit models could also allow Lenders, CDCs, and SBA to make credit assessments on applicants with little or no traditional credit history. According to a U.S. Department of the Treasury Report, industry proponents state that the use of data and modeling techniques for underwriting is a promising source of innovation that benefits small businesses.² Use of data may allow reduction in the cost of acquiring customers, automation of the origination of loans and the collection of loan documentation, and reduction in fraud.³

SBA proposes to revise this section to state that, as part of considering whether the applicant (including an Operating Company) is creditworthy and the loan is so sound as to reasonably assure repayment, SBA, Lenders, and CDCs may consider (as applicable) three specific criteria when approving loans: (a) The credit score or credit history of the applicant (and the Operating Company, if applicable), its Associates and any guarantors; (b) The earnings or cashflow of the applicant; or (c) Where applicable, any equity or collateral of the applicant. SBA believes consideration of these factors may be necessary to determine whether a small business is creditworthy and there is reasonable assurance of repayment.

Under the proposed rule, SBA, Lenders, and CDCs may consider the credit score or credit history of the applicant (including any Operating Company, if applicable), any Associates of the applicant, and any individuals or entities that will guarantee the loan. SBA is removing the requirement to consider character and reputation. The lending industry commonly uses the terms character and credit history interchangeably. The term credit history has a clearer meaning in the context of loan underwriting and credit review.

¹ Congressional Research Service, "Marketplace Lending: Fintech in Consumer and Small-Business Lending," September 4, 2018, Summary page and page 8 at <https://crsreports.congress.gov/product/pdf/R/R44614>.

² U.S. Department of the Treasury, "Opportunities and Challenges in Online Marketplace Lending," May 10, 2016, page 19 at https://home.treasury.gov/system/files/231/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf.

³ Ibid.

Reputation is difficult to define and apply as a component of loan underwriting and credit review. SBA, Lenders, and CDCs may also consider an applicant's earnings and cashflow (based on historical financial information or projections, depending on whether the applicant is an existing business or a startup) as part of the analysis to ensure that the applicant is creditworthy, and the loan is so sound as to reasonably assure repayment. SBA notes that some businesses, such as startups or new businesses, may not yet have historical data regarding earnings and cashflow, and as such, use of realistic projections would be reasonable and prudent. Where applicable, SBA, Lenders, and CDCs may also consider any equity or collateral of the applicant. In continuing with SBA's current policy, however, inadequate collateral would not be the sole reason for denial of a loan application, as some businesses may not have sufficient collateral available. There may also be circumstances where equity must be considered, such as where SBA requires an equity injection for certain project financing, e.g., for start-up businesses and certain changes of ownership.

SBA's proposed rule streamlines SBA's lending criteria by reducing the number of factors that are required to be applied in determining creditworthiness and reasonable assurance of repayment and allows for flexibility. Reducing the required factors does not prevent Lenders, CDCs, or SBA from considering other appropriate factors, particularly if the Lender's or CDC's generally acceptable commercial credit analysis processes and procedures for their similarly-sized, non-SBA-guaranteed commercial loans require review of additional factors. SBA will continue to provide further guidance regarding creditworthiness and reasonable assurance of repayment in Loan Program Requirements.

Section 120.160—Loan Conditions

Current § 120.160(c) states that for 7(a) and 504 loans SBA requires hazard insurance on all collateral and does not distinguish this requirement by loan size. SBA has determined that the hazard insurance requirement can be burdensome for the smallest businesses borrowing the smallest amount of money. SBA proposes to modify the requirement for hazard insurance for all 7(a) and 504 loans \$150,000 and under to create flexibility for SBA Lenders. SBA proposes revising this regulation to state that SBA requires hazard insurance for loans greater than \$150,000. SBA will include guidance in the Loan

Program Requirements for loans of \$150,000 or under, that SBA Lenders must follow the hazard insurance policies and procedures they have established and implemented for their similarly-sized, non-SBA-guaranteed commercial loans. SBA Lenders must continue ensuring that borrowers obtain flood insurance per § 120.170 when required under the Flood Disaster Protection Act of 1973 (Sec. 205(b) of Pub. L. 93-234; 87 Stat. 983 (42 U.S.C. 4000 *et seq.*)).

Section 120.193—Reconsideration After Denial

Under current § 120.193, the process for reconsideration after denial of a loan application or loan modification request in the 7(a) and 504 Loan Programs states that final reconsideration is made by the Director of the Office of Financial Assistance. To facilitate fair and expeditious reconsiderations, SBA proposes revising this regulation to state that the Director of the Office of Financial Assistance or the Director's designee(s) may make the final decision on reconsideration. For purposes of 7(a) loan applications, the Director's designee would include the Chief, 7(a) Loan Policy. For purposes of 504 loans, the Director's designee would include the Chief, 504 Loan Policy. From time to time, SBA may change the designee(s) and would do so in accordance with published Delegations of Authority. Further, SBA proposes also revising this regulation to provide the Administrator with the authority, solely within the Administrator's discretion, to review a reconsideration request and make the final Agency decision. Finally, the proposed regulation would state that the Administrator's discretionary authority does not create any additional appeal rights for the applicant that are not otherwise specified in regulation.

Section 120.202—Restrictions on Loans for Changes of Ownership

Current § 120.202 restricts Borrowers from using 7(a) loan proceeds to purchase a portion of a business or a portion of another owner's interest. SBA proposes to revise this section to allow Borrowers to use 7(a) loan proceeds to fund partial changes of ownership in addition to full changes of ownership. The proposed revision will allow a Borrower to purchase a portion of the business or a portion of an owner's interest in a business, or to purchase the entire business or an owner's entire interest. A Borrower could also purchase the partial or entire interests of multiple owners. This revision will allow Borrowers to use 7(a) loan proceeds to fund partial changes of

ownership and will help provide employees a path to ownership.

SBA has determined there is a need to assist small businesses to carry out partial changes of ownership. For example, the mass retirement of Baby Boomers is creating a glut of businesses that must either undergo a change of ownership or close. SBA currently authorizes complete changes of ownership; however, a gap in financing exists for those businesses that wish to undergo a partial change of ownership, such as when the owner is unable to find a buyer for a complete change of ownership, and when employees are unable to find private financing to capitalize a partial change of ownership. Partial changes of ownership allow the seller to remain in place as a part owner and employee, providing guidance and experience to ensure the success of the business. Partial changes of ownership also allow businesses to attract new owners or partners to expand, transfer interests in family businesses to family members, and facilitate continuity for both the business and employees.

ESOPs provide employees with a path to partial or complete ownership in the business, which aligns the interests of the owner-employees with the interest of the business. Further, ESOPs provide participants with tax benefits and the opportunity for retirement benefits. SBA currently facilitates employee ownership through ESOPs by providing 7(a) loan guarantees to ESOPs to purchase a controlling interest in the employer small business and by providing 7(a) loan guarantees to an eligible employer small business for the sole purpose of making a loan to an ESOP that results in the ESOP trust owning at least 51 percent of the employer small business. This proposed rule will not change SBA's current rules on ESOP lending. However, SBA has determined that the costs for ESOP formation and remaining in compliance with all applicable Internal Revenue Service, U.S. Department of the Treasury, and Department of Labor regulations are prohibitive barriers to entry and participation for most small businesses. As described below in the Regulatory Impact Analysis, from Fiscal Years 2018 through 2021, SBA approved a total of only 17 7(a) loans to assist an ESOP in acquiring 51% or more of a business, indicating that current policies are not accomplishing the Agency's intended goal of increasing employee ownership of businesses.

Accordingly, SBA proposes to remove its prohibition on partial buyouts in the 7(a) Loan Program to fill the gap in financing and to provide a path to ownership for employees.

Section 121.301—What size standards and affiliation principles are applicable to financial assistance programs?

Section 121.301 states the size standards and affiliation principles that are applicable to SBA's financial assistance programs. Paragraph (f) details how affiliation principles are applied for the 7(a) Loan Program, the 504 Loan Program, the Microloan Program, the ILP Program, the Business Disaster Loan Programs (except for the COVID EIDL Disaster Loan Program),⁴ and the SBG Program. This paragraph currently has seven sub-paragraphs, each of which details a separate affiliation principle that must be applied to the applicant and other entities to determine whether the entities are affiliated. The determination of affiliation is necessary to ensure that an applicant is "small" for purposes of eligibility for SBA financial assistance and to ensure that the applicant (including affiliates) does not exceed the maximum guaranty amount available. The seven sub-paragraphs consider: (1) affiliation based on ownership, including the principal of control of one entity over another; (2) affiliation arising under stock options, convertible securities, and agreements to merge, including the principal of control of one entity over another; (3) affiliation based on management, including the principal of control of one entity over another; (4) affiliation based on identity of interest between close relatives; (5) affiliation based on franchise and license agreements, including the principal of control of one entity over another; (6) determining the concern's size; and (7) exceptions to affiliation.

Participating lenders and the public have requested simplification of the affiliation rules for SBA's financial assistance programs, and recent Congressional actions have streamlined the affiliation rules for certain circumstances. For example, certain temporary COVID-19 pandemic relief programs enacted by Congress streamlined SBA's financial assistance affiliation requirements to speed relief to small businesses in hard-hit industries. The CARES Act created the Paycheck Protection Program (PPP), which is a temporary 7(a) Loan Program, and for that program, Congress waived affiliation requirements for businesses operating under North American Industry Classification System (NAICS) Code 72 (Accommodations and Food Services), for small businesses operating under a franchise agreement listed on

⁴ The affiliation principles for the COVID EIDL Disaster Loan Program are contained in paragraph (g) of § 121.301.

SBA's Franchise Directory, and for small businesses that were financed by a Small Business Investment Company (SBIC). Similarly, the American Rescue Plan Act (ARPA), Public Law 117-2, enacted on March 11, 2021, created the Restaurant Revitalization Fund (RRF), a program to assist hard-hit eligible restaurants and other food-related businesses that experienced pandemic-related revenue loss, and for that program, Congress provided a streamlined definition of an "affiliated business" in section 5003(a)(2). In SBA's interim final rule on "Disaster Loan Program Changes" (86FR50214, September 8, 2021), SBA adopted the simplified RRF definition of "affiliated business" for the temporary COVID EIDL program so that those applicants could more easily identify affiliates and complete the loan application process, with the expectation that this simplification would expedite the flow of funds to applicants that still needed relief from the COVID-19 pandemic.

Drawing on the successful experience of affiliation streamlining under the temporary pandemic relief programs and mindful of lender and public comments requesting affiliation streamlining for the permanent financial assistance programs, SBA is proposing to streamline the financial assistance affiliation requirements as set forth in this proposed rule.

Accordingly, SBA proposes to revise the § 121.301 affiliation provisions to simplify the program requirements, streamline the application process for SBA's programs, and facilitate the review of such applications. SBA proposes to specifically remove the principle of control of one entity over another as a separate basis for finding affiliation because the concept of control has proven particularly burdensome for applicants and lenders to understand and implement. For example, determining whether an entity has control over another has at times required in-depth analyses of franchise and license agreements and management agreements and delayed application processing. SBA believes that affiliation based on ownership also captures much of the control component, and control as a separate basis for finding affiliation is not necessary.

SBA is revising § 121.301 to add an introductory paragraph at the beginning to include the Small Business Act definition of a small business concern as one which is independently owned and operated, and which is not dominant in its field of operation. SBA interprets this statutory definition to require, in certain circumstances, the inclusion of other

entities (“Affiliates”) owned by the applicant or an owner of the applicant in determining the size of the applicant.

SBA is revising § 121.301(f)(1), “Ownership,” to remove the principle of control of one entity over another when determining affiliation. SBA is proposing to expand upon the definition of “ownership” under paragraph (f)(1) to clarify the thresholds of ownership at which SBA considers an Applicant to be affiliated with an individual or another business. The Small Business Act defines a small business concern as one which is independently owned and operated and which is not dominant in its field of operation. Accordingly, SBA will also clarify that certain instances of affiliation by ownership will only arise if the Applicant and another business operate in the same 3-digit NAICS subsector to restrict affiliates to businesses in the same field. Paragraph (f)(1)(i) will state that businesses in which the Applicant is a majority owner are affiliates of the Applicant. Paragraph (f)(1)(ii) describes affiliation with businesses that own a majority of the Applicant as well as businesses in the same 3-digit NAICS subsector that are majority-owned by the Applicant’s owner. Paragraph (f)(1)(iii) describes affiliation with another business when the Applicant and the other business are both majority-owned by the same individual and operate in the same 3-digit NAICS subsector. Paragraph (f)(1)(iv) describes a 20 percent threshold of ownership for affiliation with the Applicant when the Applicant does not have a majority owner if a 20% owner also operates in the same 3-digit NAICS subsector as the Applicant. Paragraph (f)(1)(v) will state that if the Applicant does not have a majority owner and an individual owns 20 percent or more of the Applicant, businesses that are majority-owned by that owner and operate in the same 3-digit NAICS subsector will be affiliates of the Applicant. Paragraph (f)(1)(vi) will state that ownership interests of spouses and minor children will be combined when determining ownership interest (as interests may be held in trust by parents for minors). Finally, paragraph (f)(1)(vii) will state that SBA will analyze the pro rata beneficial ownership of entities to determine affiliation and provide an example of the combined interest of an individual and an entity that is wholly-owned by the same individual. SBA believes this proposed regulatory language provides increased detail and clarity for lenders to apply, and also eliminates the confusion and frustration of determining affiliation by control.

Because SBA is revising its regulation generally by removing the principle of control of one entity over another as a separate basis for finding affiliation, the proposed rule would also revise § 121.301(f)(2), “Stock options, convertible securities, and agreements to merge,” paragraphs (f)(2)(i) and (iv). Where paragraph (f)(2)(i) currently states that SBA considers stock options, convertible securities, and agreements to merge (including agreements in principle) to have a present effect on the power to control a concern, the revised paragraph (f)(2)(i) would state that these items will have a present effect on ownership of the entity. SBA proposes to revise paragraph (f)(2)(iv) by deleting the first sentence where SBA currently states SBA will consider whether an individual, concern or other entity that controls one or more other concerns cannot use options, convertible securities, or agreements to appear to terminate such control before actually doing so. The proposed rule would remove the first sentence of paragraph (f)(2)(iv) because it is superfluous; the remaining sentence of the paragraph clearly states that SBA will not give present effect to the ability of an entity to divest in the future to avoid a finding of ownership.

SBA proposes to remove paragraph (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. SBA believes it should not interfere in a business owner’s right to enter into a service agreement with a management company. The business owner’s decision to hire a management company is a decision best left to the business.

The proposed rule would also remove paragraph (f)(4), affiliation based on identity of interest, because SBA believes it is inherently unfair and impractical to require close relatives to provide multiple years’ worth of financial statements for review by a lender and by SBA when the close relative is not a principal of the applicant business. For example, the current rule requires a sole proprietor who is requesting an SBA direct or guaranteed loan to provide their sibling’s business’s financial statements for review when the sibling is in the same or similar industry in the same geographic area. SBA believes this requirement imposes a chilling effect on applicants that may elect to use alternative predatory lending when relatives will not disclose their business financial statements for transactions in which they have no ownership interest. However, as stated above, SBA will still

combine the ownership interests of spouses and minor children when determining affiliation by ownership.

SBA proposes to remove paragraph (f)(5), affiliation based on franchise and license agreements. Because SBA is removing the principal of control of one entity over another from its affiliation consideration, this paragraph is no longer needed. Upon the effective date of this rule, SBA would no longer publish the SBA Franchise Directory. SBA Lenders retain the responsibility for ensuring that the applicant meets all Loan Program Requirements. SBA will continue to collect a franchise identifier number on each loan for the purpose of completing mandatory reporting requirements to Congress and for responding to congressional inquiries. Upon entering a loan into SBA’s electronic transmission system (E-TRAN), SBA Lenders will, for a franchise that is already listed in E-TRAN, pick the franchise from a list, for example a dropdown menu, or, for franchises that are not yet listed in E-TRAN, the SBA Lender will request a franchise identifier number, which SBA will provide without regard to whether the franchise meets SBA eligibility rules. SBA will use a franchise identifier number rather than allowing the SBA Lender to type in the name of the franchise so that SBA can ensure an exact match to the appropriate franchise.

SBA Lenders will still be expected to examine Franchised businesses for affiliation based on ownership. For example, when lending to a Franchised business, the SBA Lender should determine who owns the applicant business and any businesses the applicant owns in accordance with these regulations. However, neither the SBA Lender nor SBA will review the applicant Franchised business for affiliation with other entities beyond ownership; the applicant business will not be considered affiliated with the Franchisor or other Franchised businesses except by ownership.

SBA Lenders will also be expected to ensure the applicant meets Loan Program Requirements, including but not limited to eligibility and SBA’s lien priority. Some of these determinations may require a limited examination of the Franchise Agreement (or similar agreement) to determine whether there are any restrictions that would violate Loan Program Requirements (*e.g.*, discriminatory hiring practices, restrictions on security interests or lien priority for the Franchisor, etc.). For example, regardless of restrictions on security interests for Franchisor’s collateral present in Franchise

Agreements, SBA Lenders must ensure that the SBA Lender obtains, for the 7(a) loan program, a first lien, and for the 504 loan program, a second lien, on any property, equipment, inventory, etc. purchased with loan proceeds.

Compliance With Executive Orders 12866, 12988, 13132, and 13563, the Paperwork Reduction Act (44 U.S.C., Ch. 35), the Congressional Review Act (5 U.S.C. 801–808), and the Regulatory Flexibility Act (5 U.S.C. 601–612)

Executive Order 12866

The Office of Management and Budget has determined that this rulemaking is a “significant regulatory action” under Executive Order 12866. SBA has drafted a Regulatory Impact Analysis for the public’s information in the next section. Each section begins with a core question.

A. Regulatory Objective of the Proposal

Is there a need for this regulatory action?

The Agency believes it needs to streamline and reduce regulatory burdens to facilitate robust participation in the business loan programs that assist small and underserved U.S. businesses and the disaster loan programs that assist businesses of all sizes with recovery from disasters.

Regarding modernization of lending criteria, as a result of the emergency lending programs mandated to address economic impacts of the pandemic, SBA significantly leveraged the use of technology in loan delivery to capture efficiencies that can be applied across programs to increase access and lower costs for both participating lenders and the public. SBA also understands that lenders are currently leveraging data analytics tools and machine learning modelling in their conventional lending criteria models, particularly for small dollar loans, and that by modernizing SBA’s lending criteria to match lending practices already being implemented by its participating lenders, SBA will encourage more lender participation in its programs. For these reasons, among others, SBA is proposing the changes to SBA’s lending criteria rules at 13 CFR 120.150.

By dispensing with the requirement for hazard insurance for all 7(a) and 504 loans \$150,000 or less, SBA will eliminate a burdensome regulatory requirement for small loans while providing SBA Lenders with the flexibility use their own policies for similarly-sized non-SBA guaranteed loans regarding hazard insurance on these loans.

By permitting the Director, Office of Financial Assistance, to delegate reconsideration requests to a designee, SBA will facilitate fair and expeditious review of reconsideration requests and provide finality to applicants that are in the process of making important financial decisions.

SBA is revising its affiliation regulations in response to continuing requests by SBA’s participating lenders and the public. SBA believes that revising its affiliation regulations will result in expansion of credit to those who cannot obtain credit elsewhere and increased understanding of and compliance with program rules while decreasing time spent reviewing an applicant for eligibility.

There is also a need for SBA to address financing for changes of ownership. Orderly transitions of business ownership are beneficial both to the small business and its employees. Employees acquiring partial ownership interest in small businesses assists with transitions of ownership, especially when there is more than one current owner and one of the current owners intends to sell their equity stake in the small business to one or more employees who may not have an equity ownership interest at that time. The small business benefits by remaining in operation when it might otherwise be forced to close, and the employees benefit by having a path to ownership in a small business that remains in operation. Partial changes of ownership among existing owners of a small business permit such businesses to attract new employees as partial owners (e.g., allowing a dental group to attract a new dentist to the practice and providing the new dentist with partial ownership in the small business). Financing for changes of ownership also permit family members to purchase partial ownership in a family-run small business to ensure continuation of the small business after the retirement or death of an owner. However, SBA does not fully meet the financing needs of small businesses regarding partial changes of ownership due to current restrictions, necessitating this proposed rule.

Historically, SBA has permitted loan proceeds for use only in three situations involving a change of ownership: (1) A complete change of ownership; (2) a Partner Buyout; and (3) where an ESOP purchases a controlling interest (51% or more) in the employer small business from the current owner(s). Outside of loans to ESOPs, SBA’s current regulations do not permit 7(a) loan proceeds to be used for partial changes of ownership.

Over the past 4 completed fiscal years (FY 2018 through FY 2021), SBA approved 31,940 7(a) loans where loan proceeds were used to affect a change of ownership. ESOP loans (loans to assist an ESOP trust in acquiring 51 percent or more of the equity ownership in the small business concern) accounted for only 17 of the 31,940 loans used for a change of ownership in the four years between FY 2018 and FY 2021, or fewer than five loans per year, and therefore ESOP loans have not made the anticipated impact in transitioning small businesses to employee ownership as originally intended by the Agency. For these reasons, SBA intends to lift the prohibition on partial changes of ownership.

Current SBA policy only permits the selling owner(s) to remain as an owner or as an Associate or Key Employee of the small business in cases where the SBA guaranteed loan is made to the ESOP. SBA also permits 7(a) loans to an eligible employer small business for the sole purpose of making a loan (often referred as a back-to-back loan) to an ESOP that results in the ESOP owning at least 51 percent of the employer small business concern. However, the costs associated with the creation of an ESOP and ongoing compliance with associated regulations may be cost-prohibitive for small businesses.

The organizational costs for unleveraged ESOPs start at \$80,000 with additional annual compliance reporting obligations.⁵ In a leveraged ESOP transaction, the initial costs increase by 25 percent or more.⁶ SBA believes these costs to be prohibitive for many small businesses that qualify for SBA assistance. Consequently, SBA intends for the proposed rule change to allow for partial changes of ownership for employee ownership without the additional upfront and ongoing costs incurred by the small business in the formation and operation of an ESOP trust.

The proposed changes will reduce regulatory burdens, modernize program delivery through the use of data analytics tools and machine learning modelling, reduce the number of hours spent processing an application to deliver a loan for both SBA and lenders and increase access to capital.

⁵ <https://www.nceo.org/articles/too-small-for-esop> “How Small is Too Small for an ESOP?” by the National Center for Employee Ownership, updated July 29, 2022.

⁶ *Ibid.*

B. Benefits and Costs of the Rule

What are the potential benefits and costs of this regulatory action?

SBA does not anticipate significant additional costs or impact on the subsidy to operate the 7(a), 504, Microloan, ILP, SBG and Business Disaster Loan Programs under these proposed regulations.

SBA anticipates a minor impact to the subsidy as a result of approximately 800 new loans per year in 7(a) loan activity for loans involving a partial change of ownership. Over the past 4 completed fiscal years (FY 2018 through FY 2021), SBA processed a total of 206,415 7(a) loans, of which 31,940 loans (approximately 15.5%) included loan proceeds used to affect a change of ownership. ESOP loans (loans to assist an ESOP trust in acquiring 51 percent or more of the equity ownership in the small business concern) accounted for only 17 loans in the four years between FY 2018 and FY 2021, or fewer than five loans per year, and therefore ESOP loans have not made the anticipated impact in transitioning small businesses to employee ownership as originally intended by the Agency.

In revising SBA's lending criteria at 13 CFR 120.150, SBA anticipates that modernizing SBA's lending criteria to include credit scoring will not compromise the credit quality of the overall 7(a) and 504 portfolios. When using a credit scoring model other than SBA's SBSS model, Lenders and CDCs must be able to validate the credit scoring model and must document that their credit analysis procedures are predictive of loan performance; therefore, no reduction in credit quality is anticipated as a result of using credit scoring models. Streamlining the number of criteria lenders consider when approving loans, and for regulated lenders, using the same commercial credit analysis processes and procedures consistent with those used for their similarly-sized, non-SBA guaranteed commercial loans will not negatively impact the credit quality of the 7(a) and 504 Loan Program portfolios and will provide a time saving ranging from zero to several hours per loan depending on the size and complexity of the loan. SBA anticipates that modernizing SBA's lending criteria and allowing Lenders and CDCs to use their own processes and procedures will result in an increase in the number of participating lenders and loans in both programs, which would mean increased access to capital for small businesses.

The primary goal driving the revisions to 13 CFR 120.150 is to encourage and

facilitate more lenders to make more small dollar loans. SBA believes these streamlined rules will result in increased lender participation, particularly for community banks, credit unions and other mission-based lenders that generally serve more rural communities and underserved populations with smaller dollar loans. Currently, a substantial portion of SBA's portfolio is made by a small number of lenders: the top 25 lenders that participate in the 7(a) Loan Program make 40 percent of total loans (based on outstanding balance), and the top 2 lenders make 12 percent of the loans (based on outstanding balance). Meanwhile, the number of participating 7(a) Lenders has steadily decreased each year from FY 2010 with 2,034 Lenders to FY 2019 with 1,632 Lenders.

With more community-based lenders making small loans, borrowers that would not otherwise be able to obtain credit elsewhere will benefit by having access to credit being extended at non-predatory interest rates, fees, and terms. For example, Loan Program Requirements set the maximum variable interest rate that may be charged on a 7(a) Loan of \$50,000 or less at 6.5 percentage points over the base rate (e.g., prime rate). Since March 16, 2020, the prime rate is currently 5.5 percent, which equates to a maximum interest rate of 12 percent for a 7(a) Loan up to \$50,000 (loans above \$50,000 have lower maximum interest rates) and a maturity of up to 10 years. This is in comparison to a large online lender offering small business loans with annual percentage rates up to 98.4 percent with a maximum maturity of 36 months.⁷ A loan for \$50,000 made through the 7(a) Loan Program at 12 percent over 10 years results in a monthly payment of \$717, whereas a loan made by an online lender, at for example, 28 percent interest over 3 years results in a monthly payment more than three times higher at \$2,068. The smaller monthly payments accessible through the 7(a) Loan Program represent a significant increase in monthly capital available for other expenses.

By revising 13 CFR 120.160 to state that SBA requires hazard insurance only for loans greater than \$150,000, SBA anticipates a de minimis impact on annual subsidy calculation for the 7(a) 504 Loan Programs. The primary benefit to removing the requirement for hazard insurance on these small loans is to increase the speed with which lenders

can disburse loan proceeds after loan approval. Hazard insurance is only impactful when it is protecting collateral. Currently, SBA does not require collateral for loans \$25,000 or less, so these loans are not impacted by the proposed revision to hazard insurance requirements. Further, Lenders will continue to require hazard insurance for loans of \$150,000 and under when tangible assets such as real estate or equipment are financed with the loan in accordance with their non-SBA guaranteed policies and federal regulators. As such, although lenders will continue to require hazard insurance in accordance with their similarly-sized non-SBA guaranteed policies, they will experience a time savings by no longer providing SBA with documentation of proof of hazard insurance as part of SBA's loan origination and monitoring requirements. Further, even with hazard insurance in place, the lender and/or SBA's recovery on assets in this dollar range is minimal after the costs of liquidation and litigation are considered. In the 7(a) Loan Program, SBA is not listed as a loss payee on hazard insurance policies, so SBA does not have data regarding hazard insurance collections. However, from October 1, 2020, through December 31, 2021, the 504 Loan Program reported 270 instances of collection on a hazard insurance policy, 30 of which were for loans \$150,000 or less. This is an average of 2 collections per month for loans \$150,000 or less in a portfolio of approximately 56,000 total outstanding loans and 5,962 loans of \$150,000 or less. Although SBA does not collect hazard insurance payment data in the 7(a) Loan Program, it is reasonable to assume the 7(a) Loan Program experiences approximately the same hazard insurance collection rates. As of December 31, 2021, the 7(a) Loan Program had approximately 100,000 outstanding loans of \$150,000 or less, which approximates to 400 instances where a 7(a) lender would receive a hazard insurance collection, representing a minimal impact in the 7(a) Loan Program. The benefit to SBA for requiring hazard insurance at this amount is minimal, while lenders will save time and be able to disburse loan proceeds more quickly after loan approval by using their own procedures and not having to provide additional documentation evidencing insurance to SBA.

Revising 13 CFR 120.193 will allow the Director of the Office of Financial Assistance to delegate to a designee the authority to make final decisions on

⁷ U.S. Department of the Treasury, "Opportunities and Challenges in Online Marketplace Lending," May 10, 2016, page 10.

reconsideration after denial of a loan application or loan modification request in the 7(a) and 504 Loan Programs. SBA does not anticipate any additional costs or impact on the subsidy to operate the 7(a) and 504 Loan Programs under this proposed regulation. Additionally, the number of loans impacted by this change is very low in comparison to the number of loans processed in both loan programs. On average, the 7(a) Loan Program accounts for 10 to 12 requests per year, and the 504 Loan Program accounts for 28 to 41 requests per year. For comparison, in fiscal year 2021, the 7(a) Loan Program approved 51,856 loans, and the 504 Loan Program approved 9,676 loans. Lenders, CDCs, and applicants will benefit in a faster turn time for decision-making.

SBA does not anticipate significant additional costs or impact on the subsidy to operate the 7(a), 504, Microloan, ILP, SBG and Business Disaster Loan Programs under the proposed regulations at 13 CFR 121.301 regarding affiliation. Complex affiliation rules limit accessibility to SBA's business loan programs, with an outsized impact on underserved borrowers who may struggle to access traditional capital or other resources such as attorneys and CPAs. SBA anticipates that providing clear and streamlined regulatory guidance for its affiliation rules will result in an increase in the number of participating lenders and loans and will encourage more borrowers to apply. SBA anticipates that participating lenders will spend less time screening applicants for eligibility under SBA Size Standards because lenders and applicants will readily be able to determine which entities they are affiliated with, and lenders will have fewer documents to examine.

C. Alternatives

What alternatives have been considered?

SBA considered eliminating even more regulatory burdens and determined the proposed rules strike the right balance in responsibly streamlining regulations without substantially increasing the risk of waste, fraud, or abuse of the programs or otherwise threatening the integrity of the business loan programs or taxpayer dollars. Regarding affiliation, SBA has implemented several variations of its affiliation rules as discussed above, and SBA has determined the simplest affiliation rules were the least burdensome.

SBA also considered limiting partial changes of ownership to employees of

the business; however, the Agency believes this may restrict small businesses in need of additional expertise from providing a percentage of ownership as an incentive to recruit and retain new highly skilled employees. For example, an existing dental practice may recruit a new dentist by offering the dentist an equity ownership in the business as a hiring incentive. For this reason, SBA determined that partial changes of ownership should not be exclusive to existing employees of the business.

Executive Order 12988

This action meets applicable standards set forth in sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. The action does not have preemptive effect or retroactive effect.

Executive Order 13132

This proposed rule does not have federalism implications as defined in Executive Order 13132. It will not have substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government, as specified in the Executive Order. As such it does not warrant the preparation of a Federalism Assessment.

Executive Order 13563

A description of the need for this regulatory action and benefits and costs associated with this action, including possible distributional impacts that relate to Executive Order 13563, are included above in the Regulatory Impact Analysis under Executive Order 12866.

Paperwork Reduction Act, 44 U.S.C. Ch. 35

SBA has determined that this proposed rule would require that the following forms be revised: SBA Form 1919, "Borrower Information Form," SBA Form 1920, "Lender's Application for Loan Guaranty for all 7(a) Loan Programs," SBA Form 1244, "Application for Section 504 Loans," SBA Form 5—Disaster Business Loan Application, and SBA Form 5C—Disaster Home/Sole Proprietor Loan Application.

SBA Forms 1919 and 1920 are approved under OMB Control number 3245–0348. SBA Form 1244 is approved under OMB Control number 3245–0071. SBA Form 5 is approved under OMB Control number 3245–0017 and SBA Form 5C is approved under OMB Control number 3245–0018.

SBA will revise SBA Form 1919, SBA Form 1920, and SBA Form 1244 to conform to the lending criteria changes at 13 CFR 120.150. When lenders choose to use a credit scoring model in accordance with 13 CFR 120.150, the estimated hour burden for lenders will decrease when the credit score incorporates consideration of certain lending criteria (e.g., the earnings and cashflow of an applicant), in which case those factors would not necessarily be separately considered by a lender unless otherwise specified by Loan Program Requirements. However, SBA expects that Lenders and CDCs will make more smaller loans due to the ability to use credit scoring models, which increase the estimated burden hours due to the increase in loans. This reporting requirement will be included in the OMB-approved collections for the affected forms. The other revisions to 120.150 (i.e., requirement that Lenders and CDCs use appropriate and prudent generally acceptable commercial credit analysis processes and procedures consistent with those used for their similarly-sized, non-SBA guaranteed commercial loans, and criteria that may be considered in lending criteria), will have a de minimis impact on the estimated hour burden because regulated lenders must comply with more rigorous lending criteria requirements from their federal regulators, and SBA-Supervised Lenders and CDCs must continue to comply with the credit policies submitted to OCRM.

SBA will revise SBA Form 1920 to conform to revisions at 13 CFR 120.130 and 13 CFR 120.202 to permit partial changes of ownership.

SBA will revise SBA Form 1919, SBA Form 1920, SBA Form 1244, and SBA Form 5 to conform to the affiliation rule changes at 13 CFR 121.301, which will reduce the estimated hour burden for applicants and lenders because SBA anticipates fewer entities will fall under the definition of "affiliate."

Congressional Review Act, 5 U.S.C. Ch. 8

Subtitle E of the Small Business Regulatory Enforcement Fairness Act of 1996, also known as the Congressional Review Act or CRA, generally provides that before a rule may take effect, the agency promulgating the rule must submit a rule report, which includes a copy of the rule, to each House of the Congress and to the Comptroller General of the United States. SBA will submit a report containing this rulemaking and other required information to the U.S. Senate, the U.S. House of Representatives, and the Comptroller General of the United States. A major

rule under the CRA cannot take effect until 60 days after it is published in the **Federal Register**. The Office of Information and Regulatory Affairs has determined that this rulemaking is not a “major rule” as defined by 5 U.S.C. 804(2). Therefore, this rulemaking is not subject to the 60-day restriction.

Regulatory Flexibility Act, 5 U.S.C. 601–612

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act (RFA), 5 U.S.C. 601–612, requires the agency to “prepare and make available for public comment an initial regulatory analysis” which will “describe the impact of the proposed rule on small entities.” Although the rulemaking will impact all of the approximately 2,897 7(a) Lenders, all of the approximately 216 CDCs, all of the approximately 150 Microloan Intermediaries, all of the approximately 35 ILP Intermediaries, and all of the approximately 44 Sureties that participate in the SBG Program, SBA does not believe the impact will be significant because this proposal modifies and streamlines existing regulations and procedures. However, as described below, there may be impacts due to increased 7(a) loans for partial changes of ownership.

SBA approved a total of 206,419 7(a) loans for the four-year period between FY 2018 and the end of FY 2021 (not including PPP loans), of which there were 31,940 loans that included proceeds used for a change of ownership (an average of just under 7,985 loans per year, or 15.5 percent of 7(a) loans approved each year).

SBA estimates the burden for completing SBA Form 1919, “SBA 7a Borrower Information Form”, including time for reviewing instructions, gathering data needed, and completing and reviewing the form, is 15 minutes per response. SBA will not need to change SBA Form 1919 as a result of the proposed rule for partial changes of ownership because the applicant simply writes in the dollar amount of the loan request and the purpose of the loan. SBA anticipates the proposed rule allowing partial changes of ownership will increase the number of 7(a) loans by 800 loans per year, with each of the loans representing a unique small business applicant. SBA Form 1919 will not need to be revised due to the proposed rule for SBLCs because Applicants use SBA Form 1919 regardless of whether their lender is an SBLC or some other type of 7(a) Lender.

The estimated burden for completing the SBA Form 1919, including time for reviewing instructions, gathering data needed, and completing and reviewing

the form remains unchanged at 15 minutes per response. SBA anticipates the proposed rules will result in an increase to loan volume by a potential 1,225 loans per year⁸ representing 1,225 unique small business Applicants.

An applicant completing the SBA Form 1919 will spend approximately fifteen minutes per response in completing the form, at a cost of \$23.55 per loan application. This estimate represents a total time burden cost of \$28,849 for the 1,225 total anticipated additional unique small business Applicants for loans for partial changes of ownership and new loans from SBLCs, including Mission-Based SBLCs. This small business Applicant burden estimate was derived from using the median hourly rate for General and Operations Managers from the May 2021 National Occupational Employment and Wage Estimates for the United States of \$47.10 per hour,⁹ and increasing this rate by an additional 100 percent (an additional \$47.10) to allow for the hourly costs for overhead and benefits, bringing the total hourly cost to complete SBA Form 1919 per applicant to \$94.20 per hour (Base) multiplied by fifteen minutes per response. The proposed rules will not change the time costs of completing the revised SBA Form 1919 as the proposed rule changes will not require the Applicant small business to provide any additional responses in completing SBA Form 1919 other than those already required.

In revising 13 CFR 120.130 and 120.202 to permit partial change of ownership, SBA will update the SBA Form 1920, “Lender’s Application for Loan Guaranty for all 7(a) Loan Programs”, in Section “O”, to add a question for the Lender to indicate that the change of ownership is a partial change of ownership. The current estimated burden for the 7(a) Lender in completing SBA Form 1920, including time for reviewing instructions, gathering data needed, and completing and reviewing the form is 25 minutes per response. Section “O” of SBA Form 1920 is required to be completed in cases involving a change of ownership using the loan proceeds. SBA Form 1920 currently requires the Lender to check an “N/A” box if the loan does not finance a change of ownership and answer an additional six “Yes” or “No” questions about the circumstances for the change of ownership. It is

⁸ The 1,225 additional loans represents 800 additional loans due to the proposed rule for partial changes of ownership and 425 new loans from the three new anticipated SBLC applicants.

⁹ Data available at the U.S. Bureau of Labor Statistics website at https://www.bls.gov/oes/current/oes_nat.htm#11-0000.

anticipated the additional language will be similar in length to the existing questions of approximately 30 words per question, which should add approximately 10 seconds per application to read and respond to the question by checking the yes or no box,¹⁰ which represents a cost increase to lenders of approximately 11 cents per application.¹¹

13 CFR 120.150, “What are SBA’s lending criteria?”

Based on industry feedback, SBA estimates Lenders and CDCs will save anywhere from zero to 2 hours per loan under the proposed revision of 13 CFR 120.150 to require that Lenders and CDCs must use appropriate and prudent generally acceptable commercial credit analysis processes and procedures consistent with those used for their similarly-sized, non-SBA guaranteed commercial loans. The range in time saving is due to the size and complexity of the loan and federally regulated lenders continuing to underwrite loans in accordance with their own procedures. Based on the average of the most recent 3 fiscal years, each year the 7(a) Loan Program approves 48,687 loans and the 504 Loan Program approves 7,631 loans, for a total of 56,318 loans approved per year. The mean hourly wage of a loan officer is \$36.99 according to the May 2020 U.S. Bureau of Labor Statistics. SBA estimates a cost saving ranging from \$0 to \$2,083,215 per year for Lenders and CDCs, calculated by multiplying 56,318 (total loans approved per year) by \$36.99 (mean hourly wage of a loan officer). This revision will have no direct impact on Applicants and possibly an indirect impact due to faster processing times that could lead to faster loan approval.

SBA anticipates the proposal to allow Lenders and CDCs to use a credit scoring model will increase the number of small loans approved while generally decreasing the length of time required to process a loan. Not all lenders will use credit scoring, and those that do will limit credit scoring to small loans. SBA estimates lenders will save from 2 to 4 hours per loan when they elect to use a credit scoring model.

¹⁰ The average silent reading rate for adults in English is 238 words per minute, based on an analysis of 190 studies with 18,573 participants by Brysbaert, Marc (April 12, 2019) How many words do we read per minute? A review and meta-analysis of reading rate, page 2, at <https://psyarxiv.com/xynwg/>.

¹¹ Based on the mean hourly wage of \$38.74 per hour for Loan Officers as of May 2021 U.S. Bureau of Labor Statistics at https://www.bls.gov/oes/current/oes_nat.htm#13-0000.

13 CFR 120.160, “Loan Conditions”

SBA estimates Lenders and CDCs will save anywhere from 0.25 to 6 hours per loan over the life of the loan under the proposed revision of 13 CFR 120.160 to eliminate the requirement for hazard insurance on loans \$150,000 or less. The range in time saving is due to whether lenders require hazard insurance on similarly-sized non SBA guaranteed loans in accordance with their own procedures. Lenders that do not require hazard insurance may save up to 6 hours over the life of the loan when including the time required to monitor whether the policy remains in place each year. Lenders that continue requiring insurance will experience a time savings by no longer documenting proof of insurance for SBA.

13 CFR 120.193, “Reconsideration After Denial”

The Director of the Office of Financial Assistance processes an average of 10 to 12 reconsideration requests for the 7(a) Loan Program and 28 to 41 reconsideration requests for the 504 Loan Program each year. Revising this rule will have a minimal impact on the overall portfolio; however, to the individual applicants that are impacted by reconsideration requests, a faster decision will allow the applicants to quickly move forward with financing with a positive decision or pursue other financing options with a negative decision.

Section 121.301, “What size standards and affiliation principles are applicable to financial assistance programs?”

The revisions to 13 CFR 121.301 will impact all of the approximately 1,738 7(a) Lenders and 186 CDCs that make an SBA loan annually (based on FY 2021 data), all of the approximately 150 Microloan Intermediaries, all of the approximately 44 Sureties that participate in the SBG Program, and all of the applicants for each of these programs and SBA’s Disaster programs. SBA’s proposal to streamline its affiliation rules will increase the overall number of loans made while simultaneously reducing the time required to process each loan.

List of Subjects*13 CFR Part 120*

Community development, Loan programs—business, Reporting and recordkeeping requirements, Small businesses.

13 CFR Part 121

Loan programs—business, Reporting and recordkeeping requirements, Small businesses.

For the reasons stated in the preamble, SBA proposes to amend 13 CFR parts 120 and 121 as follows:

PART 120—BUSINESS LOANS

■ 1. The authority citation for 13 CFR part 120 continues to read as follows:

Authority: 15 U.S.C. 634(b)(6), (b)(7), (b)(14), (h), and note, 636(a), (h) and (m), and note, 636m, 650, 657t, and note, 657u, and note, 687(f), 696(3), and (7), and note, and 697, 697a and e, and note; Public Law 116–260, 134 Stat. 1182.

■ 2. Amend § 120.130 by revising paragraph (g) to read as follows:

§ 120.130 Restrictions on uses of proceeds.

* * * * *

(g) Any use restricted by §§ 120.201 and 120.884 (specific to 7(a) loans and 504 loans respectively).

■ 3. Revise § 120.150 to read as follows:

§ 120.150 What are SBA’s lending criteria?

The applicant (including an Operating Company) must be creditworthy. Loans must be so sound as to reasonably assure repayment. Lenders and CDCs must use appropriate and prudent generally acceptable commercial credit analysis processes and procedures consistent with those used for their similarly-sized, non-SBA guaranteed commercial loans. Lenders, CDCs, and SBA may use a business credit scoring model. When approving direct or guaranteed loans, Lenders, CDCs, and SBA may consider (as applicable) the following criteria: credit score or credit history of the applicant (and the Operating Company, if applicable), its Associates and any guarantors; the earnings or cashflow of applicant; or where applicable any equity or collateral of the applicant.

§ 120.160 [Amended]

■ 4. Amend § 120.160(c) by adding the phrase “for loans greater than \$150,000,” after the words “SBA requires hazard insurance.”

■ 5. Amend § 120.193 by adding the words “or designee(s),” after the words “Director, Office of Financial Assistance (D/FA)” and by adding two sentences at the end of the section to read as follows:

§ 120.193 Reconsideration after denial.

* * * If the reconsideration is denied, a second and final reconsideration may be considered by the Director, Office of Financial Assistance (D/FA) or designee(s), whose decision is final. The

SBA Administrator, solely within the Administrator’s discretion, may choose to review the matter and make the final decision. Such discretionary authority of the Administrator does not create additional rights of appeal on the part of an applicant not otherwise specified in SBA regulations.

■ 6. Revise § 120.202 to read as follows:

§ 120.202 Loans for changes of ownership.

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

PART 121—SMALL BUSINESS SIZE REGULATIONS

■ 7. The authority citation for 13 CFR part 121 is revised to read as follows:

Authority: 15 U.S.C. 632, 634(b)(6), 636(a)(36), 662, 694a(9), and 9012.

■ 8. Amend § 121.301 by adding introductory text and revising paragraph (f) to read as follows:

§ 121.301 What size standards and affiliation principles are applicable to financial assistance programs?

The Small Business Act defines a small business concern as one which is independently owned and operated, and which is not dominant in its field of operation. SBA interprets this statutory definition to require, in certain circumstances, the inclusion of other entities (“Affiliates”) owned by the applicant or an owner of the applicant in determining the size of the applicant.

* * * * *

(f) Any of the circumstances described below establishes affiliation for applicants of SBA’s Business Loan, Disaster Loan, and Surety Bond Programs. For this rule, the Business Loan Programs consist of the 7(a) Loan Program (Direct and Guaranteed Loans), the Microloan Program, the Intermediary Lending Pilot Program, and the Development Company Loan Program (“504 Loan Program”). The Disaster Loan Programs consist of Physical Disaster Business Loans, Economic Injury Disaster Loans, Military Reservist Economic Injury Disaster Loans, and Immediate Disaster Assistance Program loans. The following principles apply for the Business Loan, Disaster Loan, and Surety Bond Guarantee Programs:

(1) *Ownership.* (i) When the Applicant owns more than 50 percent of another business, the Applicant and the other business are affiliated.

(ii) 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.

(iii) 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.

(iv) 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.

(v) 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.

(vi) Ownership interests of spouses and minor children must be combined when determining amount of ownership interest.

(vii) When determining the percentage of ownership that an individual owns in a business, SBA considers the pro rata beneficial ownership of entities. For example, John Smith, Jane Doe, and Jane Doe, Inc., each own an interest in the Applicant. Jane Doe owns 15 percent of the Applicant, and she also owns 100 percent of Jane Doe, Inc. Jane Doe, Inc. owns 50 percent of the Applicant. SBA considers Jane Doe to own 65 percent of the Applicant.

(2) *Stock options, convertible securities, and agreements to merge.* (i) SBA considers stock options, convertible securities, and agreements to merge (including agreements in principle) to have a present effect on the ownership of the entity. SBA treats such options, convertible securities, and agreements as though the rights granted have been exercised.

(ii) Agreements to open or continue negotiations towards the possibility of a merger or a sale of stock at some later date are not considered "agreements in principle" and are thus not given present effect.

(iii) Options, convertible securities, and agreements that are subject to

conditions precedent which are incapable of fulfillment, speculative, conjectural, or unenforceable under state or Federal law, or where the probability of the transaction (or exercise of the rights) occurring is shown to be extremely remote, are not given present effect.

(iv) SBA will not give present effect to individuals', concerns', or other entities' ability to divest all or part of their ownership interest to avoid a finding of affiliation.

(3) *Determining the concern's size.* In determining the concern's size, SBA counts the receipts, employees (see § 121.201), or the alternate size standard (if applicable) of the concern whose size is at issue and all of its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit.

(4) *Exceptions to affiliation.* For exceptions to affiliation, see § 121.103(b).

* * * * *

Isabella Casillas Guzman,
Administrator.

[FR Doc. 2022-23167 Filed 10-25-22; 8:45 am]

BILLING CODE 8026-03-P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA-2022-1303; Project Identifier MCAI-2022-01001-G]

RIN 2120-AA64

Airworthiness Directives; Alexander Schleicher GmbH & Co. Segelflugzeugbau Gliders

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: The FAA proposes to supersede Airworthiness Directive (AD) 2022-14-14, which applies to all Alexander Schleicher GmbH & Co. Segelflugzeugbau Model ASW-15 gliders. AD 2022-14-14 requires repetitively inspecting the wing root ribs for cracks, looseness, and damage and replacing any root rib with a crack, a loose rib or lift pin bushing, or any damage. Since the FAA issued AD 2022-14-14, the European Union Aviation Safety Agency (EASA) superseded its mandatory continuing airworthiness information (MCAI) to add all Model ASW-15B gliders to the applicability. This proposed AD is prompted by MCAI originated by an

aviation authority of another country to identify and correct an unsafe condition on an aviation product. This proposed AD would retain the requirements from AD 2022-14-14 of repetitively inspecting the wing root ribs for cracks, looseness, and damage and replacing any root rib with a crack, a loose rib or lift pin bushing, or any damage; and would add the Model ASW-15B gliders to the applicability. The FAA is proposing this AD to address the unsafe condition on these products.

DATES: The FAA must receive comments on this NPRM by December 12, 2022.

ADDRESSES: You may send comments, using the procedures found in 14 CFR 11.43 and 11.45, by any of the following methods:

- *Federal eRulemaking Portal:* Go to [regulations.gov](https://www.regulations.gov). Follow the instructions for submitting comments.

- *Fax:* (202) 493-2251.

- *Mail:* U.S. Department of Transportation, Docket Operations, M-30, West Building Ground Floor, Room W12-140, 1200 New Jersey Avenue SE, Washington, DC 20590.

- *Hand Delivery:* Deliver to Mail address above between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

AD Docket: You may examine the AD docket at [regulations.gov](https://www.regulations.gov) under Docket No. FAA-2022-1303; or in person at Docket Operations between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The AD docket contains this NPRM, the MCAI, any comments received, and other information. The street address for Docket Operations is listed above.

Material Incorporated by Reference:

- For service information identified in this NPRM, contact Alexander Schleicher GmbH & Co. Segelflugzeugbau, Alexander-Schleicher-Str. 1, Poppenhausen, Germany D-36163; phone: +49 (0) 06658 89-0; email: info@alexander-schleicher.de; website: [alexander-schleicher.de](https://www.alexander-schleicher.de).

- You may view this service information at the FAA, Airworthiness Products Section, Operational Safety Branch, 901 Locust, Kansas City, MO 64106. For information on the availability of this material at the FAA, call (817) 222-5110.

FOR FURTHER INFORMATION CONTACT: Jim Rutherford, Aviation Safety Engineer, General Aviation & Rotorcraft Section, International Validation Branch, FAA, 901 Locust, Room 301, Kansas City, MO 64106; phone: (816) 329-4165; email: jim.rutherford@faa.gov.

SUPPLEMENTARY INFORMATION: