

Small Business Access to Capital Coalition

September 3, 2019

The Honorable John Kennedy
Chair, Subcommittee on Financial Services
& General Government Appropriations
U.S. Senate
Washington, D.C. 20510

The Honorable Christopher Coons
Ranking Member, Subcommittee on Financial
Services & General Government Appropriations
U.S. Senate
Washington, D.C. 20510

The Honorable Mike Quigley
Chair, Subcommittee on Financial Services &
General Government Appropriations
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Tom Graves
Ranking Member, Subcommittee on Financial
Services & General Government Appropriations
U.S. House of Representatives
Washington, D.C. 20515

Re: Stop the Unauthorized Tax on Small Business

Dear Chairmen Kennedy and Quigley and Ranking Members Coons and Graves,

The undersigned members of the Small Business Access to Capital Coalition are writing to ask for your assistance in avoiding an October 1 shutdown of the Small Business Administration's flagship 7(a) business loan program. The continued availability of this important source of small business financing is at risk due to a questionable federal credit subsidy rate estimate contained in the President's Fiscal Year 2020 Budget.

Last year approximately 60,000 small companies across the country were able to open or expand their businesses and hire or retain their employees because of a 7(a) loan from one of almost 2,000 lenders who provide these loans when credit is not otherwise available. If the Office of Management and Budget does not issue a correction before September 30, the fees collected from borrowers and lenders to support this program will not be sufficient to cover OMB's inflated cost estimate and the program will shut down unless Congress fills the funding gap with appropriated funds or increased fees.

As you know, in the Federal Credit Reform Act of 1990 Congress assigned to OMB the responsibility for making annual estimates of the net present value of expected future government outlays and receipts for federal credit programs like SBA 7(a) loans. The statute permits OMB to coordinate with agencies in this process and directs OMB to consult with the Congressional Budget Office. These OMB estimates then determine the level of funding, from program fees or appropriated funds, that must be available to support new loan originations each fiscal year. The statute also requires OMB to re-estimate these subsidy costs yearly for each annual cohort of outstanding loans, providing an ongoing reconciliation of the original estimates to actual loan performance.

In recent years, OMB and SBA have failed to carry out their roles in the subsidy estimation process in the objective manner envisioned by FCRA. Consequently, we believe Congress should act to ensure the continued effectiveness of this program that is so crucial to the small business sector.

The following facts illustrate the degree and persistence of these troubling practices by OMB and SBA. All this information is taken from federal budget documents, formal agency reports, or agency testimony provided to Congress:

- Significant downward 7(a) re-estimates have occurred in every year since 2010
- During that period, 7(a) re-estimates have totaled more than \$3 billion
- Last year's cumulative downward re-estimates were \$757 million for the 7(a) program and \$1.492 billion for all SBA credit programs
- The subsidy model inexplicably weighs all 26 years of performance data equally
- The subsidy model does not reflect 7(a) program improvements that reduce risk
- The subsidy model does not accurately reflect the impact of lender credit policies
- The subsidy model uses a recovery rate of 37%; the actual 5-year average rate is 50%
- 7(a) loss rates have been trending down since 2010 and are at historic lows
- 7(a) portfolio performance has never been better, yet OMB estimates that loans made in FY 2020 will cost more than loans made in FY 2010 when default rates were more than 6 times higher than in 2018 and the unemployment rate was over 8%, more than double the current rate

The flawed subsidy calculations prepared by OMB and SBA in recent years have unnecessarily driven up the cost of 7(a) loans, forcing borrowers to pay higher fees and lenders to raise interest rates to cover lender fees. The current annual loss rate on 7(a) loans is less than 1% while statutory fees on these loans can be as high as 3.75%. These up-front payments come directly out of the pockets of small business borrowers, to whom every dollar is precious and needed to support business growth.

The ongoing practice of overcharging SBA borrowers and later returning the surplus amount to a Miscellaneous Receipts account at Treasury is quite simply a stealth tax on small business. The magnitude of this diversion of funds is staggering, and these amounts are lost in the shuffle and not available for future use inside the SBA loan program. For example, the \$3 billion in overcharges admitted by OMB so far since 2010 would be sufficient to cover the additional 33 basis point subsidy amount they claim is needed for next year and pay for a \$30 billion 7(a) program for the next thirty years.

We would like to work with Congress over time to develop a permanent solution to stop this stealth small business tax by increasing transparency and accountability in the subsidy estimation process. As Chair and Ranking Member of the Appropriations Subcommittee with jurisdiction over OMB and SBA, you will be crucial to that reform effort.

In the short term, though, we ask for your assistance in avoiding the looming shutdown of the 7(a) program at the end of September. The most direct solution would be for OMB to review its work and correct the ill-considered subsidy rate estimate included in the original budget submission to Congress. Ample justification exists for a correction and requiring OMB to "sharpen the pencil" is consistent with FCRA's directive to use the most accurate historical performance data and develop the best possible estimates.

In the absence of a correction to the subsidy rate estimate, a modest appropriation would be required in lieu of raising fees yet again on small business borrowers at a time when even the current fee levels are higher than the actual cost of the program. The 7(a) program has operated at a zero subsidy rate without congressional appropriation for many years and anticipates continuing to do so in the context of a fair and accurate subsidy rate. Under the circumstances explained above, however, we believe Congress should avoid shifting the burden of an erroneous subsidy rate estimate onto the backs of small borrowers.

We stand ready to provide any additional information that might be helpful to you on this matter and we look forward to working together in the interests of our small businesses.

Sincerely,

U.S. Chamber of Commerce
International Franchise Association (IFA)
Asian American Hotel Owners Association (AAHOA)
National Association for the Self Employed (NASE)
National Association of Manufacturers (NAM)
National Small Business Association (NSBA)
Small Business & Entrepreneurship Council
American Bankers Association (ABA)
Consumer Bankers Association (CBA)
Independent Community Bankers of America (ICBA)
National Association of Government Guaranteed Lenders (NAGGL)

cc:

The Honorable Marco Rubio
U.S. Senate
Chair, Committee on Small Business &
Entrepreneurship
Washington, D.C. 20510

The Honorable Ben Cardin
U.S. Senate
Ranking Member, Committee on Small Business
& Entrepreneurship
Washington, D.C. 20510

The Honorable Nydia Velazquez
U.S. House of Representatives
Chair, Small Business Committee
Washington, D.C. 20515

The Honorable Steve Chabot
U.S. House of Representatives
Ranking Member, Small Business Committee
Washington, D.C. 20515