Center for Responsible Lending

May 15, 2020

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The Honorable Jovita Carranza
Administrator
U.S. Small Business Administration
409 3rd St SW
Washington, DC 20416

Re: Interim Final Rule, Docket No. SBA-2020-0015
RIN 3245-AH34

Dear Administrator Carranza:

The Center for Responsible Lending[1] submits this comment on the Interim Final Rule governing the Paycheck Protection Program (PPP), and identifies changes necessary to ensure that the program equitably serves smaller firms, non-employer firms, and businesses owned by people of color.

The PPP was created to sustain small business jobs during the ongoing public health and economic crisis. The effect of the crisis on small businesses has been profound—over half (51.4%) of small businesses said the crisis has had a large negative effect on their businesses and 74% of small businesses said they have had a decrease in operating revenues. Temporary closings have impacted 41.4% of small businesses, and 11.5% of small businesses said they had missed a loan payment since the beginning of the crisis. These impacts were far worse for some hardest hit sectors, including education, food service and accommodations and recreation.[2] To help address these hardships, 74.9% of small businesses with employees have requested financial assistance from the PPP and 38.1% have received assistance.[3] According to the Small Business Administration (SBA), as of May 12, 2020, the program has dispersed 4.3 million loans totaling nearly $534 billion.[4]

In this comment, we describe the most significant inequities, and suggest changes to address them. This comment focuses on two key challenges with the PPP to date:

- **The Paycheck Protection Program continues to be disadvantageous to smaller businesses, and businesses without employees.** PPP loans can be forgiven if the business is able to use the funds for eligible expenses within eight weeks of receiving the loan. This requirement makes it challenging, particularly for very small businesses, to ensure loans are forgiven rather than converted into long-term debt. The PPP fee structure also heavily incentivizes loans to larger firms that can garner higher fees. By distributing PPP funds through existing eligible SBA approved lenders, banks, and credit unions, the program ensures that disadvantaged businesses, including those owned by people of color are likely to face barriers in accessing critical PPP loans. Long delays in the distribution of funding and the prioritization of larger firms mean that small businesses and businesses owned by people of color had to wait to receive critical PPP loans to retain their employees and stabilize their businesses.

- **Small businesses owned by people economically and socially marginalized were hardest hit by the structural limitations built into the PPP.** Businesses owned by people of color are likely to have fewer employees and less revenue than white-owned businesses. As a result, they were less likely to qualify for larger loans that would yield the higher fees that would make them a priority for lenders at the outset of the program. Small businesses owned by people of color are even more likely to have no employees, putting them at an even greater disadvantage to larger businesses that could garner higher fees. Further, the program out-right excludes criminal legal system-involved business owners, including people who have been charged, but not tried or convicted of a crime.

The comment concludes with recommendations to the Small Business Administration to improve the program so that small businesses owned by socially and economically marginalized individuals are adequately served going forward.

The Paycheck Protection Program continues to be disadvantageous to smaller businesses, including the self-employed.

1. **The loan forgiveness requirements present substantial challenges to small businesses whose survival depends on PPP loan forgiveness rather than conversion to long-term debt.**

   The PPP documentation requirements necessary to ensure that loans are forgiven rather than converted to long-term debt are far more difficult for businesses too small to have a lawyer, accountant, or other compliance staff. Further challenges are created by the requirement that eligible expenses be spent during the covered period eight weeks after the origination of the PPP loan.[5] This requirement may pose serious challenges for businesses that were forced to scale back or close their doors entirely and are now trying to preserve resources for use when COVID19 is under control.

2. **The PPP fee structure heavily discourages small loans to smaller businesses and, in particular, non-employer firms.** The first round of PPP funding was distributed quickly, with banks prioritizing larger businesses and businesses with existing financial relationships, putting businesses owned by socially and economically marginalized individuals at a disadvantage. PPP loans are capped at 2.5 times the monthly payroll plus other non-payroll eligible expenses, and there is a limit on the salary amount used to calculate the payroll component of the PPP loans. Lenders earn an origination fee equal to 5% of the loan balance for loans under $350,000, 3% for loans between $350,000 and $2,000,000, and 1% for loans above $2,000,000. For a loan of $40,000, a lender would make just $2,000 – creating a powerful incentive to make larger loans to larger firms. Under this formula, the $10 million loan given to Shake Shack and later returned, would have garnered $100,000 in fees.[6] This fee structure put very small businesses and non-employer businesses and at a distinct disadvantage.

3. **Access to PPP funding is heavily dependent on prior banking relationships.** To receive a PPP loan, applicants must apply at an eligible SBA approved lender, a bank, or a credit union. By requiring applicants to go through a lender, rather than directly applying to the PPP program, the program ensured that those businesses with existing credit relationships were more likely to access PPP funds at the outset of the program and in future rounds of funding.

According to the 2019 Small Business Credit Survey, in the previous five years, 46% of white-owned businesses with employees accessed credit from a bank, and 6% accessed credit from a credit union. During that same time, just 23% of Black-owned employer firms accessed credit from a bank, and 8% from a credit union and 32% of Latino-owned employer firms accessed credit from a bank and 4% from a credit union.[7] These disparities put them at a distinct disadvantage when accessing PPP funds through banks.

4. **Non-employer firms were unable to apply during the first week of the program. This delay may have caused irreparable harm to smaller businesses with no employees, which had to wait to receive PPP funds.** Non-employer businesses were forced to sit on the sidelines for days, while billions of dollars went to large and well-connected businesses. PPP rules prevented non-employer firms, such as the self-employed, from applying for loans until April 10, 2020, one week after the program opened to other businesses.[8] As of April 13, 2020, almost $250 billion of the initial $350 billion had already been allocated.[9] The first round of PPP funding was depleted entirely by April 16, 2020.

5. **While second-round funding remains available and loan sizes have declined since the outset of the program, suggesting some improvement in efforts to reach smaller businesses, the negative impact on business' long-term prospects may be difficult to reverse.** At the end of the first round of funding on April 16, 2020, the average loan size was $206,000. Second round funding averaged $72,296 as of May 12, 2020.[10] Smaller businesses that were pushed to the end of the line by larger and more connected businesses at the outset of the program, however, were forced to go weeks without critical support to keep their employees on payroll and their businesses afloat. While funding is still available in round two, the lost opportunity for prompt relief may have compounded financial hardship for many businesses and may increase the amount of assistance required to get them back on their feet.

Businesses of color were more likely than White-owned businesses to be disadvantaged by the structural limitations built into the PPP program.

1. **Businesses owned by people of color are likely to have fewer employees and less revenue, meaning they were less likely to garner higher fees that would make them attractive borrowers at the outset of the program.** Businesses headed by people of color are less likely to have employees, have fewer employees when they do, have less revenue, and have a smaller share of revenue compared to white-owned businesses. White-owned businesses are twice as likely to be employers and hire 50% more employees than businesses owned by people of color.[11]

2. **Businesses owned by people of color are even more likely to have no employees, putting them at a disadvantage to larger businesses that could garner higher fees.** Two third (63%) of non-employers rely on their businesses as their primary source of income, and 20% of non-employers started their businesses because they lacked other options.[12] Non-employer businesses are far more likely to be owned by people of color. Nearly 95% of Black-owned firms were non-employers, and 91% of Latino-owned firms were non-employers. In comparison, 78% of white firms are non-employer businesses.[13] Of all small businesses, businesses without employees were the most likely to face challenges accessing PPP funds in the initial round.[14] Along with other very small businesses with few employees, the PPP fee structure continues to

ensure that these businesses may face challenges finding lenders willing to make small, but critical loans.

3. **Pre-existing disparities in access to capital have posed further disadvantages for business owners of color, both by making it less likely that they would have the commercial lending relationships necessary to access the PPP program and by discouraging many from applying. These challenges may have played a role in lenders' application processing decisions.** A recent study by the National Community Reinvestment Coalition found steep reductions in SBA 7(A) lending to Black businesses between 2008 and 2016. That same study also found that Black and Hispanic testers when applying for loans were required to produce more documentation to support their loan application and received less information about fees, and less friendly service when visiting a small business lender.[15]

4. **The SBA failed to issue guidance to lenders about prioritizing borrowers in underserved and rural markets.** A report by the SBA Inspector General did not find any evidence that the SBA issued guidance to lenders to ensure that they prioritized underserved markets, including rural, minority, and women-owned businesses.[16]

5. **The SBA failed to require demographic data to determine if lenders prioritized underserved markets and businesses.** The SBA Inspector General noted that the SBA did not include the "optional standard demographic information for principals" on its PPP loan application form. As a result of this failure to collect data, the SBA Inspector General found that it was unlikely that the SBA would be able to determine whether funds reached underserved markets.[17]

6. **The program out-right excludes people based on many forms of criminal legal system involvement, including people who have been charged, but not tried or convicted of a crime. Given the myriad of barriers some system-involved individuals already face to employment,** self-employment is a major source of income and opportunity, strengthening family incomes.[18] This program, however, excludes business owners with past felony convictions, penalizing those who have already served their sentences and have returned to their communities for a fresh start. Additionally, employees of these business owners also suffer from this restriction to access of the PPP program, given that system-involved individuals are not eligible. Racial disparities in all aspects of the criminal legal system are well-documented, and there is some evidence that this provision in the PPP has already negatively impacted business owners of color, their employees, and their communities.[19]

Had PPP been designed to serve businesses owned by socially and economically marginalized individuals, businesses of color would be better positioned to participate in the recovery.

1. **There is some evidence that the structural barriers at the outset of the program and carried over to the second round resulted in either no access or delayed access to critical PPP funding.** In a survey conducted by Goldman Sachs of more than 1,700 small business owners, Black-owned firms were less likely to apply for and less likely to be approved for PPP during the first round of funding. While 91% of all firms in the survey applied for funding, just 79% of Black-owned firms applied. Just 40% of black-owned firms were approved for funding, while 52% of total firms were approved. Black-owned firms were more likely to indicate that their finances had been hurt and that they had less than one month's cash reserves on hand.[20] Even these

disparities in application and approval are likely understated. The study was based on a convenience sample of firms participating in the Goldman Sachs *10,000 Small Businesses Program*, suggesting these firms may have advantages and connections not readily available to most small businesses.

2. **Delay in application submissions for self-employed postponed relief that may have exacerbated financial hardship for some firms, causing them to incur fines or late fees, or other compounding financial difficulties.** Ensuring these firms were fully supported at the outside of the crisis should have been a top priority. Among non-employers, those firms with no employees besides the owner, 71% have plans to expand, and one in four (24%) plan to hire employees in the next 12 months.[21] Barring them from funds at the outset of the program may have imposed additional long-term challenges to economic growth, future hiring, and entrepreneurship opportunities for some firms. These harms should be taken into account in assessing the extent of necessary further relief.

Recommendations: The SBA must improve the program so that funding gets to the businesses that were excluded from the PPP.

1. **Collect information on race, ethnicity, gender, and veteran status of principal owners of each applicant and each approved loan.** The PPP application should be modified to include these optional questions. Any subsequent required documentation including the forgiveness application should also include these questions. All collected data should be made publicly available just as the data reporting produced for other SBA lending programs. Data should also be released disaggregated by congressional district.

2. **Issue guidance to lenders about prioritizing borrowers in socially and economically underserved markets, including rural, minority, and women-owned businesses.**

3. **Reserve $10 billion of PPP small business loan funding for loans by community development financial institutions (CDFIs) and minority-depository institutions (MDIs) (not to include bank-affiliated CDFIs), of which $5 billion is reserved for loans of up to $75,000.**

4. **Revise loan forgiveness requirements to ensure small businesses qualify for forgiveness rather than have their loans converted to long-term debt, by permitting, businesses of up to ten employees to spend up to 50% of forgivable loan proceeds on eligible expenses other than payroll.**

5. **Remove ineligibility for individuals not convicted of any crime, or for prior convictions.**

6. **Remove ineligibility for all businesses owned by nonresidents with ITIN numbers.**

Conclusion

The Paycheck Protection Program continues to be disadvantageous to smaller businesses, businesses owned by people of color, and businesses without employees. Small businesses owned by people of color were hardest hit by the structural limitations built into the PPP. The PPP must be improved to ensure funding gets to the businesses that were excluded from PPP. Additionally, the SBA must improve the transparency of the program to ensure that it prioritizes businesses owned by people of color, woman-owned businesses and businesses in rural areas, as Congress intended.

Thank you for your consideration.

Yours truly,

Center for Responsible Lending

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[1] The Center for Responsible Lending (CRL) is a non-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL's views on small business lending are informed by its affiliation with Self-Help, one of the nation's largest nonprofit community development financial institutions. Self-Help has provided over $7 billion in financing to 70,000 homebuyers, small businesses, and nonprofits, and serves more than 80,000 mostly low-income families through 60 retail credit union branches and offices in North Carolina, California, Chicago, Florida and South Carolina, serving 154,000 members.

[2] "Small Business Pulse Survey - April 26 to May 2," May 14, 2020. https://portal.census.gov/pulse/data/#data. The survey target population was all nonfarm, single nonfarm, single-location employer businesses with between 1-499 employees and receipts of $1,000 or more in the 50 states, District of Columbia, and Puerto Rico. Some industries were excluded, a complete list is provided in the survey methodology available at https://portal.census.gov/pulse/data/#methodology

[3] Small Business Pulse Survey, 2020.

[4] See "Paycheck Protection Program (PPP) Report Approvals through 12 PM EST 4/16/2020." Small Business Association: 4/16/2020, "Paycheck Protection Program (PPP) Report: Second Round Approvals from 4/27/2020 through 05/01/2020." Small Business Administration, 2020. https://home.treasury.gov/system/files/136/PPP2-Data-05012020.pdf and "Summary of Paycheck Protection Program Round 2 Data as of 5:00 P.m. EDT, Wednesday, May 6, 2020." Small Business Administration. https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program#section-header-11.

[5] Coronavirus Aid, Relief, and Economic Security Act, Pub.L. 116–136, §1106(a)(3).

[6] "Shake Shack Will Return Its $10 Million Loan Amid Furor Over Stimulus Program - The New York Times." https://www.nytimes.com/2020/04/20/business/shake-shack-returning-loan-ppp-coronavirus.html.

[7] "Small Business Credit Survey: Report on Employer Firms," 2020. https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2020/2020-sbcs-employer-firms-report.

[8] "Small Business Paycheck Protection Program." US Department of Treasury. https://home.treasury.gov/system/files/136/PPP%20--%20Overview.pdf

[9] "Paycheck Protection Program (PPP) Report Approvals through 4/13/2020." Small Business Administration, April 13, 2020. https://www.sba.gov/sites/default/files/2020-04/PPP%20Report%20SBA%204.14.20%20%20-%20%20Read-Only.pdf.

[10] See "Paycheck Protection Program (PPP) Report Approvals through 12 PM EST 4/16/2020." Small Business Association: 4/16/2020, "Paycheck Protection Program (PPP) Report: Second Round Approvals from 4/27/2020 through 05/01/2020." Small Business Administration, 2020. https://home.treasury.gov/system/files/136/PPP2-Data-05012020.pdf and "Summary of Paycheck Protection Program Round 2 Data as of 5:00 P.m. EDT, Wednesday, May 6, 2020." Small Business Administration. https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program#section-header-11.

[11] McManus, Michael. "Minority Business Ownership: Data from the 2012 Survey of Business Owners." US Small Business Administration, September 14, 2016. https://cdn.advocacy.sba.gov/wp-content/uploads/2016/09/07141514/Minority-Owned-Businesses-in-the-US.pdf.

[12] "Small Business Credit Survey: Report on Nonemployer Firms." Washington, DC: Board of Governors of the Federal Reserve System, 2019. https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/sbcs-nonemployer-firms-report-19.pdf.

[13] McManus, 2016.

[14] The availability of Pandemic Unemployment Assistance does not solve the problem of lack of access to the PPP program, for many small businesses. While the PUA gives states the option to offer expanded unemployment assistance to self-employed business owners, it should not be considered a substitute for the critical lifeline provided to businesses through the PPP program, which replaces considerably more lost income.

[15] "Disinvestment, Discouragement and Inequity in Small Business Lending." National Community Reinvestment Coalition, 2019. https://ncrc.org/wp-content/uploads/2019/09/NCRC-Small-Business-Research-FINAL.pdf.

[16] "Flash Report Small Business Administration's Implementation of the Paycheck Protection Program Requirements." Washington, DC: SBA Inspector General, May 8, 2020. https://www.sba.gov/sites/default/files/2020-05/SBA_OIG_Report_20-14_508.pdf.

[17] SBA Inspector General, 2020.

[18] The program excludes businesses for which "An owner of 20 percent or more of the equity of the applicant is incarcerated, on probation, on parole; presently subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction; or has been convicted of a felony within the last five years; has been convicted of a felony within the last five years." SBA Business Loan Program Temporary Changes; Paycheck Protection Program, Interim Final Rule, 85 FR 20811, https://www.federalregister.gov/documents/2020/04/15/2020-07672/business-loan-program-temporary-changes-paycheck-protection-program

[19] Brooks, Khristopher. "A Criminal Past Means No Paycheck Protection Program Loan." *CBS News*, April 21, 2020. https://www.cbsnews.com/news/paycheck-protection-program-loans-small-business-owners-criminal-convictions-excluded-coronavirus/.

[20] "Survey: US Small Business Owners Need More Funding and Immediate Legislative Action." Goldman Sachs, 2020. https://www.goldmansachs.com/citizenship/10000-small-businesses/US/infographic-small-business-relief/.

[21] "Small Business Credit Survey: Report on Nonemployer Firms." Washington, DC: Board of Governors of the Federal Reserve System, 2019. https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/sbcs-nonemployer-firms-report-19.pdf.