December 5, 2023

The Honorable Roger Williams (R-TX)
Chairman
House Small Business Committee
2361 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Nydia M. Velázquez (D-NY)
Ranking Member
House Small Business Committee
2361 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Marc Molinaro (R-NY)
Chairman
Subcommittee on Innovation, Entrepreneurship, and Workforce Development
2361 Rayburn House Office Building
Washington, DC 20515

The Honorable Morgan McGarvey (D-KY)
Ranking Member
Subcommittee on Innovation, Entrepreneurship, and Workforce Development
2361 Rayburn House Office Building
Washington, DC 20515

Dear Chairmen Williams and Molinaro and Ranking Members Velázquez and McGarvey,

On behalf of the millions of American entrepreneurs who work every day to launch and build the new businesses that drive economic growth, job creation, and opportunity, we write today to express our strong support for the Small Business Administration's final rule "Affiliation and Lending Criteria for the SBA Business Loan Programs" (the "Affiliation Rule"), which was published in the Federal Register on April 10, 2023 and which took effect on May 11, 2023. The final rule is "aimed at closing gaps in capital access for America's small business owners…particularly those owned by individuals in underserved communities who are highly entrepreneurial, [yet] still face longstanding barriers in accessing capital needed to start or grow their businesses."

Starting a new business requires money. In the initial days of a startup, capital needs may be limited to the bare essentials – money to purchase supplies, computers, and other office equipment. But as new businesses begin to grow, capital needs multiply. Entrepreneurs need money to pay bills, move out of the garage or dining room into office space, and, hopefully, begin paying initial employees. Most importantly, entrepreneurs need capital to further develop their product or service idea, research the marketplace, and develop and implement a strategy for identifying and targeting customers. Because such costs typically arrive long before the first dollar of revenue, capital and credit are the lifeblood of any new business.

The mission of the Small Business Administration (SBA) is "to maintain and strengthen the nation's economy by enabling the establishment and viability of small businesses and by assisting in the economic recovery of communities after disasters."

In pursuit of its mission, the SBA administers several programs to support new and small businesses, including loan guaranty programs to enhance small business access to capital; programs to increase small business federal contracting opportunities; direct loans for businesses, homeowners, and renters to assist their recovery from natural disasters; and access to entrepreneurial education to assist with business formation and expansion.

The 7(a) loan program is SBA's primary program for providing financial assistance to small businesses. The program's purpose is to provide financial help for those seeking to start a new business, or to acquire, operate, or expand an existing business, that are unable to secure conventional financing. The program makes capital available up to $5 million through bank and non-bank lending institutions, and loans can be used for working capital, debt refinancing, or the purchasing of equipment, fixtures, furniture, and supplies. In fiscal year 2021, nearly 52,000 7(a) loans totaling more than $36.5 billion were provided to American small businesses, including $11 billion to minority-owned businesses, $5 billion to women-owned businesses, and $1.2 billion to veteran-owned businesses. Similarly, the SBA's 504 loan program provides long-term, fixed-rate financing up to $5.5 million for major fixed asset purchases by small businesses. The SBA's guarantee of these loans encourages lenders to provide financing to new and small businesses that may not meet traditional loan criteria, making it a valuable lifeline for many entrepreneurs.

To be eligible to participate in the 7(a) or 504 loan programs, applicants must qualify as a small business concern under SBA regulations. The SBA defines a business concern as an agricultural cooperative or for-profit business entity with a place of business located in the United States, and which operates primarily within the United States, or which makes a significant contribution to the U.S. economy through the payment of taxes or use of American products, materials, or labor.

The SBA generally determines that a business is small by comparing the business' revenues or number of employees against a size standard assigned to a six-digit North American Industrial Classification System (NAICS) code. The Office of Management and Budget creates and is responsible for maintaining and revising these codes. In making its determination, the SBA adds the revenues and employees of each of the applicant's current affiliates. Prior to May 11, 2023, the SBA determined that businesses and other entities "are affiliated with each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. It does not matter whether the control is exercised, so long as the power to control exists. Affiliation may also be found where one party exercises control indirectly through a third party."

The SBA's "control"-based methodology for determining affiliation has been highly problematic for new and small businesses for many years. The conceptual, theoretical, and even hypothetical nature of control, "the power to control," and especially the unexercised power to control, is complex and required in-depth analysis of an applicant's contractual relationships. Indeed, determining control often required subjective judgements that led to inconsistent conclusions. This complexity and lack of clarity often created confusion, uncertainty, and anxiety for new and small businesses interested in SBA-backed loans or government contracting opportunities. Indeed, many new and small businesses who might have been eligible for SBA assistance have simply chosen not to apply.

This dilemma has been particularly acute for venture-backed startups whose venture investors also invest in other companies, often leading to erroneous and nonsensical affiliation determinations. Such circumstances reached emergency conditions during the early months of the Covid pandemic, when the control-focused methodology of affiliation determination threatened to prevent many startups from accessing badly needed loans from the Paycheck Protection Program (PPP).

With these difficulties in mind, the new and small business community welcomes the SBA's amended methodology for determining affiliation. Under the terms of the new rule, the principal of "control" of one entity over another will no longer be the basis for establishing affiliation. Additionally, affiliation will no longer be determined by way of management or management agreements; identity of interest between close relatives; or franchises, licenses, or other similar agreements.

Instead, the new rule determines affiliation according to *ownership*, as follows:

- When any business owns more than 50 percent of the applicant, or the applicant owns more than 50 percent of another business, the two are affiliated;

- When any owner – whether a business or an individual – of an applicant owns more than 50 percent of the applicant and owns more than 50 percent of another business in the same 3-digit NAICS subsector, the applicant, the owner, and all such businesses in the same 3-digit NAICS subsector are affiliated;

- When no owner owns more than 50 percent of an applicant, any 20 percent or more owner – whether a business or an individual – of the applicant that is a business in the same 3-digit NAICS subsector, or that owns more than 50 percent of a business in the same 3-digit NAICS subsector, in such cases the applicant, all such owners in the same 3-digit NAICS subsector, and all such businesses owned by such owners in the same 3-digit NAICS subsector, are affiliated;

- For purposes of determining the percentage of business ownership, the ownership interests of spouses and minor children will henceforth be combined; and,

- Stock options, convertible securities, and agreements to merge will be given present effect, unless they are incapable of fulfillment.

The SBA's new ownership-based methodology – along with the measurement thresholds of "more than 50 percent" and "more than 20 percent" – is much more clear and precise than the vague and subjective, and, therefore, often confusing "control"-based methodology.

The clarity provided by the new rule's ownership-based methodology will promote several important and positive objectives, including:

- Far greater certainty and, therefore, confidence among new and small business applicants;

- Greater participation in SBA assistance programs by eligible new and small businesses based on that greater clarity and confidence;

- More eligible new and small businesses getting access to the capital they need to survive, grow, and create American jobs; and,

- Better compliance with both the letter and spirit of the SBA's affiliation guidelines and regulations.

Given these significant advantages, we express our strong support for the SBA's May 11, 2023 final rule regarding the determination of business affiliation.

We thank each of you for your continued leadership on behalf of America's new and small businesses, and with regard to this important issue.

Sincerely,

Angel Capital Association
Carta
Center for American Entrepreneurship
Economic Innovation Group
Engine
Financial Technology Association
International Business Innovation Association (InBIA)
National Venture Capital Association
Right to Start
Small Business & Entrepreneurship Council
Technology Councils of North America (TECNA)