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NSBA
National Small Business Association
AMERICA'S SMALL BUSINESS ADVOCATE

December 17, 2020

The Honorable Jerome Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue Northwest
Washington, DC 20551

Dear Chairman Powell:

On behalf of both Fundation Group, LLC ("Fundation") – a leading fintech and non-bank provider of affordable credit to the small business community – and the National Small Business Association ("NSBA") — the nation's oldest nonpartisan small business advocacy organization, with more than 65,000 small-business members representing every state and every industry across the country – we write to respectfully urge the Federal Reserve Board to utilize the authorities bestowed upon it by Congress under Section 13(3) of the Federal Reserve Act to create a new backstop facility that will provide critically-needed working capital and lines of credit to America's small business community. This proposed program would see the Federal Reserve Board specifically target the unique needs of small business borrowers.

The economic impact of the COVID-19 pandemic on small businesses across the country has been catastrophic and widespread. As the country – and the economy – look to the first half of 2021 to begin the long road to recovery, bolstered by an extensive deployment of vaccines, the small business community will confront a new crisis: banks and nonbank lenders ability to apply legacy underwriting models to the small business market have been significantly impaired amidst the uncertainty created by the pandemic. Without further government support, banks and non-bank lenders will likely require a prolonged period to return gradually to normal lending levels.

The sheer enormity of the future need for capital calls for a broader approach to serve a market that need not continue to rely on upsizing the Small Business Administration's ("SBA") 7(a) program, nor imposing the administrative burdens of that program on borrowers and lenders. Additionally, most SBA-sponsored lending programs are term loan products, which may not best serve the unique needs of those small businesses that emerge from the ashes of the pandemic and require more flexible working capital. A sensible and impactful program should offer small businesses with both term loans and revolving lines of credit to support them through a long-term recovery while aligning the economic interests of small business borrowers, private market lenders. Further, the federal government, over time, should incentivize banks to extend credit to those small businesses most impacted by the economic downturn.

We respectfully submit a proposal that would do just that. Under our proposed framework, the Federal Reserve Board would create a risk-sharing arrangement that incentivizes small business lenders to extend credit to the small business community using conventional bank lending programs. Banks would pay a monthly guarantee fee to the Federal Reserve Board based on the outstanding balance of credit lines and loans in exchange for a limited guarantee. Banks could offer committed lines of credit that are renewed each year with notice to the customer and a guarantee level that declines over time, eventually to zero.

This proposed framework would provide critically needed access to credit for small businesses, the support banks need to fortify their small business lending programs in the wake of the pandemic, and the limited economic assistance required from the federal government to help small businesses build back better. Small businesses would get easy access to products immediately, banks would get downside protection, and taxpayers get alignment of interests with the private market through motivating banks to make prudent lending decisions. We have provided a more detailed term sheet for this proposed program along with this letter.

While the next stimulus bill will likely extend the Paycheck Protection Program for a relatively small set of small businesses, more must be done to support the small-business community that has not only survived but is positioned to thrive –action is needed quickly and for an extended period of time through what is sure to be a long economic recovery. We hope you will strongly consider this jointly proposed framework for a Federal Reserve Board program that would facilitate small business credit access through traditional lending sources with minimal government financial exposure.

Sincerely,

Todd McCracken
President & CEO
National Small Business Association

Sam Graziano
CEO
Fundation Group, LLC

Enclosure

Cc: Senator Marco Rubio, Chairman, Senate Small Business Committee
Senator Ben Cardin, Ranking Member, Senate Small Business Committee
Representative Nydia Velazquez, Chairwoman, House Small Business Committee
Representative Steve Chabot, Ranking Member, House Small Business Committee

Private-Public Partnership Proposal for Accelerating Liquidity to the Small Business Market

Summary

The Federal Reserve will develop the Small Business Backstop Facility (the "SBBF") to provide limited guarantees to regulated banking entities ("Banking Entities") and qualified non-bank lenders ("QNBL's")[1] for lines of credit and term loans offered to eligible small businesses ("SMBs"). The program is designed to align economic interests between the government, lenders and SMBs participating and be easy to execute immediately.

Guiding Principles

- The Paycheck Protection Program sought to provide the SMB market with capital required to support employee retention and other limited specific business expenses. However, the SMB market needs immediate and ongoing liquidity support for all critical business expenditures and capital investments.

- The broad-based economic impact on the SMB market has impaired the ability for banks and other lenders to apply their legacy underwriting models and credit risk management strategies to the SMB market. Without further government support, banks and other lenders will take a prolonged period of time to return to 'normal' levels of lending.

- Effectively meeting the liquidity needs of the small business market must be constructed through a program that:
  - (a) Has an immediate impact
  - (b) Allows SMBs to manage their immediate liquidity needs as well as periodic cash flow imbalances
  - (c) Allows SMBs to use liquidity for all of its necessary business expenditures and investments
  - (d) Allows lenders to confidently deploy capital into the SMB market
  - (e) Aligns the economic interests of private market participants and U.S. taxpayers
  - (f) Has proper governance and is easy to execute and administrate

- Banking Entities and QNBL's have the:

[1] We leave it to the Federal Reserve Board's discretion as to whether or not including non-banks complicates the execution of this program. We believe this program will have a huge impact even with just regulated banking entities.

(a) Systems, technology (including online applications), and processes equipped to immediately deliver liquidity to the SMB market

(b) Liquidity and capital needed to meet the enormity of the demand for credit and liquidity

(c) Ambition and desire to meet the needs of the SMB market with an appropriate backstop from the United States Government

(d) Ability to be most effective when using their conventional lending programs rather than adhering to cumbersome SBA protocols that limit speed and efficiency.

<u>Construct of the SBBF</u>

Definitions of terms used herein:

- Borrower – an Eligible SMB that receives an Eligible Contract
- Eligible Banking Entity – a regulated banking entity that originates Eligible Contracts in this program
- Eligible Contract – a term loan or line of credit originated by an Eligible Banking Entity or Eligible QNBL that meets the standards prescribed herein
- Eligible QNBL – a qualified non-bank lender authorized to issue Eligible Contracts in this program
- Eligible SMB – a business that meets the standards prescribed herein to apply and receive an Eligible Contract
- Guarantor – an individual that has an economic ownership interest in the Eligible SMB and provides a commercial guaranty for the loan or line of credit
- Lender – an Eligible Depository or Eligible QNBL that issues an Eligible Contract

The proposed program would be constructed as follows:

Eligible Program Participants	
Eligible Banking Entities	• Banking entities in the Federal Reserve system
[Eligible QNBL's] [2]	• [Institutions that have disbursed at least [$100] million in aggregate of credit to businesses that would qualify as an Eligible SMB within the past [3] years]
Eligible SMB	The Borrower must meet the following standards:

[2] Note the concept is to focus participants to those who have substantial experience and expertise in making these types of loans

	• The business is in good standing with the secretary of state for which the business entity is registered and certifies it is engaged in a legitimate business activity • There are no outstanding unpaid tax liens against the business or any Guarantor with a federal or state taxing authority and the business has not filed for bankruptcy protection • At least [75%] of the business is owned by U.S. citizens or permanent residents [3] • The business does not currently have more 200 employees and did not have more than $10 million of annual sales in 2019 (net of cost of goods sold) • Was not 30 days or more past due on any credit obligation with the Lender in calendar year 2019 (customers making payments as agreed associated with any payment forbearance programs on or after February 15, 2020 shall not be deemed delinquent)
Terms and Conditions of Eligible Contracts	
Origination Date	• The loan or line of credit will be originated no later than [December 31, 2022]
Commitments	• Lines of credit may be renewed annually at the sole discretion of the Lender, but is not otherwise cancellable by the Lender unless there has been an Event of Default by the Borrower
Maximum Commitment or Loan Size	• [$250,000]
Maximum Term on Term Loans	• 10 years
Draws on Lines of Credit	• Lender may not require a minimum draw of more than [$100]
Origination Fee	• Lender may charge an origination fee equal to the greater [%] of the Commitment Amount/Original Principal Amount or [$]
Interest Rate[4]	• Banking Entities: The greater of WSJ Prime + [] or []% • QNBL's: The greater of WSJ Prime + [] or []% provided that the maximum rate shall step down to the maximum rate for Banking Entities if the Eligible Contract is sold to an Eligible Banking Entity

[3] Lenders will be following their standard beneficial ownership protocols per FinCen guidelines so this will not complicate the process; Further, in our opinion, the program should be targeted at independent SMBs that are owned by *individuals* not subsidiaries of larger companies
[4] Note the concept here is that banks and CDFI's have low-cost capital and non-bank lenders generally do not; You might also consider reducing the guarantee modestly for non-bank lenders.

Amortization of Outstanding Balance on Lines of Credit	• None during the Revolving Period • No less than [12] months upon termination of any Revolving Period
Payment Frequency	• No more than [twice] per month
Late Payment Fees	• Late Payment Fees: Up to [5%] of late payment after providing Borrower with a grace period of at least [5] business days
Other Fees	• None
Commercial Guarantees	• No less than [50%] of the economic ownership of the Borrower must provide a joint and several Commercial Guaranty
Use of Proceeds	• The proceeds will used exclusively for business, not household purposes
Guarantees	
Guarantee Payments to Lenders from the Federal Reserve	<u>Lines Credit</u> • [67%] of any charge-offs of any principal until the later of (a) the first anniversary of the Origination Date, or (b) if Lender elects to terminate the Line concurrent with the first anniversary date, the end of the Amortization Period • Thereafter, [33%] of any charge-offs of any principal through the later of (a) the second anniversary of the Origination Date, or (b) the end of the Amortization Period if Lender elects to terminate the Line concurrent with the second anniversary date <u>Term Loans</u> • [67%] of any charge-offs of any principal <u>Previous Forbearance or Past Due</u> • For Borrowers that were on a Lender Forbearance Program after February 15, 2020, the Eligible Contract shall not be eligible for the Guarantee Payment for any Eligible Contract that becomes 30 days or more past due within [120] days of origination • For Borrowers that were 30 days or more past due on any obligation to Lender within calendar year 2019, the Eligible Contract shall not be eligible for the Guarantee Payment for any Eligible Contract that becomes 30 days or more past due within [180] days of origination
Guarantee Fee from Lenders to the Federal Reserve	• Each Lender will pay the Fed on a monthly basis, in arrears, a Guarantee Fee equal to the Guaranty Fee Percentage multiplied by the average outstanding unpaid principal balance of performing Lines of Credit and Term Loans • The Guaranty Fee Percentage shall equal:

	○ []% in the first [12] months of each Loan or Line of Credit ○ []% thereafter
Loss of Guarantee	Lender will surrender any rights to the Guarantee on a line of credit if: • Lender fails to provide Borrower with at least [45] days' notice of the termination of any Revolving Period • Lender fails to disburse a draw within [3] business days of a requested draw
Lender Servicing and Collections Requirements	• Lender will report all positive and negative payment history on the Eligible Contract to at least 1 of the following commercial credit bureaus: Experian, Equifax, PayNet, Dun & Bradstreet, Small Business Financial Exchange[5] • Lender will conduct customer service, servicing and delinquency management activities substantially consistent with past practices for similar accounts, including an election to settle a delinquent account for an amount lower than the outstanding balance • Lender shall not pursue any legal remedies with the Borrower or any Guarantor until at least [30] days past due • Lender may rely in part on projections for future revenue as part of its underwriting for SBBF loans
[Mechanism of Obtaining Guarantee:][6]	• [Lender may draw funds from the SBBF on a monthly basis in an amount equal to satisfy any Guarantee Payments] • [The draw from the SBBF will be forgiven upon providing the Fed with a [good faith certification] and evidence of any charge-offs on an Eligible Contract]
Other	
Sales of Eligible Contracts	• Lenders may sell Eligible Contracts, but may not release servicing obligations unless Eligible Contracts are sold to another Eligible Lender • Lenders may not sell any Eligible Contracts that are past due

Why This Program Will Be Effective

This program has the essential characteristics necessary for success:

[5] It is important that other lenders can see outstanding tradelines and liabilities of other lenders

- The lending infrastructure is already in place – there is a vast group of Eligible Lenders that have websites open to apply for small business lines of credit (they do not for SBA loans) and systems designed to accommodate these products

- Capital can be delivered immediately and Banking Entities and QNBL's have the capital to do so

- This program does not rely on Congress to increase the SBA 7(a) program nor burden the delivery of capital with SBA protocols or unnecessary paperwork

- This program aligns the economic interests of the private and public sector – Lenders will be motivated to make prudent and compliant credit decisions so the program need not be overly prescriptive on SMB eligibility criteria

- This program provides SMBs with lines of credit which are the most effective credit products that allow SMBs to manage liquidity and have maximum discretion over the timing and nature of their expenditures