

November 14, 2023

Dianna Seaborn, Director
Office of Financial Assistance
U.S. Small Business Administration
409 3rd Street SW
Washington, DC 20416

RE: *RIN 3245-AI03, 2023-19183, Criminal Justice Reviews for the U.S. Small Business Administration's Business Loan Programs and Surety Bond Guaranty Program,*

Dear Director Seaborn:

The undersigned organizations appreciate the opportunity to comment on the Small Business Association's ("SBA's") proposed rule on Criminal Justice Reviews for the SBA Business Loan Programs and Surety Bond Guaranty Program. We support the actions taken by the SBA to revise its program regulations to remove restrictions based on a loan applicant's criminal history, and we commend the explanation for this action in the commentary.

In this letter we highlight some of the welcome changes and provide additional support for them. In addition, we recommend one additional regulatory change that would apply to all the affected business and disaster loan programs. We also urge the SBA to encourage intermediary lenders more explicitly and directly to conform their policies to those now adopted by the SBA.

As the SBA notes in its introduction to the proposed rule, the Small Business Act's provision giving the SBA authority to inquire into a loan applicant's criminal background is permissive, and it gives the SBA significant latitude regarding "whether and how to consider criminal history in the context of issuing loan guarantees."¹ Based on existing empirical research, the SBA has now concluded that there is no sound reason to continue to make such inquiries. The SBA explains that while the original intent of its criminal history restrictions was likely to protect the performance of SBA's capital programs against a presumed higher likelihood of default, there appears to be "no evidence of a negative impact on repayment for qualified individuals with criminal history records in any American business loan program."² Accordingly, the SBA believes that continuing to rely on these criminal history restrictions "would contradict the available evidence" and "reflect an outdated, inaccurate structural bias against individuals with criminal history records."³ The Consumer Financial Protection Bureau has reached a similar conclusion.⁴

¹ 88 Fed. Reg. 63534. The Act provides that "the Administrator may verify the applicant's criminal background, or lack thereof, through the best available means . . ." 15 U.S.C. 636(a)(1)(B). The SBA is proposing to revise the 7(a), 504, Microloan, ILP, SBG and Disaster Loan Program regulations requiring criminal background reviews.

² 88 Fed. Reg. at 63535.

³ *Id.*

⁴ See Consumer Financial Protection Bureau (CFPB), *Justice-Involved Individuals and the Consumer Financial Marketplace* 34 (Jan. 2022) ("There is limited evidence to suggest that criminal history decreases creditworthiness."), https://files.consumerfinance.gov/f/documents/cfpb_jic_report_2022-01.pdf. This 2022 CFPB report points out that "[t]he approach largely adopted by government programs contrasts with that of private lenders," and that "financial institutions generally do not screen small business credit applicants on the basis of criminal history." *Id.* See additional discussion at notes 26-28, *infra*.

We therefore commend the SBA’s decision to revise its program regulations to remove consideration of most criminal records in recognition that it is sound economic and social policy to reduce barriers for small business entrepreneurs with criminal history records. Given the lack of evidence that would correlate criminal history with creditworthiness that the SBA recognizes, the disqualification requirements tied to involvement in the criminal law system reflected in the current provisions are arbitrary and needlessly harmful. We welcome this important step in the dismantling of the SBA’s structure of criminal record-based discrimination, a dismantling that began in the early weeks of the pandemic with bipartisan support.⁵ We note that other federal agencies have taken similar positions in connection with housing and employment.⁶

We also commend the SBA’s important complementary action to omit from application forms inquiries about business owners’ criminal history, just as we supported its decision last spring to remove “character” as a regulatory loan criterion, and to revise its Standard Operating Procedures to omit the requirement that applicants with a felony conviction submit to an FBI background check and undergo a “character determination” by the SBA.⁷ It seems likely that the unexpected prospect of referral to the FBI has discouraged many justice-impacted business owners from completing the application process, and the statistics cited by the SBA in its proposed rule appear to evidence this.⁸

The proposed changes in the rules will be particularly beneficial for communities of color that have been adversely affected by the rules as they are currently written.⁹ Due to systemic racism embedded in the criminal law system, the population subject to arrest and prosecution is disproportionately Black and Hispanic; as a result, the population with a criminal history is also disproportionately Black and

⁵ See Lankford, Portman, Cardin, Booker Introduce Bipartisan Bill to Ensure PPP Access for Small Business Owners Who Earned Second Chance (June 4, 2020), <https://www.lankford.senate.gov/news/press-releases/lankford-portman-cardin-booker-introduce-bipartisan-bill-to-ensure-ppp-access-for-small-business-owners-who-earned-second-chance/>.

⁶ See HUD Office of General Counsel, Guidance on Application of Fair Housing Act Standards to the Use of Criminal Records by Providers of Housing and Real Estate-Related Transactions, https://www.hud.gov/sites/documents/HUD_OGCGUIDAPPFHASTANDCR.PDF; EEOC, Enforcement Guidance on the Consideration of Arrest and Conviction Records in Employment Decisions under Title VII of the Civil Rights Act, <https://www.eeoc.gov/laws/guidance/enforcement-guidance-consideration-arrest-and-conviction-records-employment-decisions>; see also Relman Colfax News, *Landmark \$1,187,500 Settlement Reached in Fair Housing Case Challenging Criminal Record Ban* (Nov. 4, 2019), <https://www.reلمانlaw.com/news-206>.

⁷ See Standard Operating Procedure (SOP) 50-10, Lender and Development Company Loan Programs (effective August 1, 2023), <https://www.sba.gov/document/sop-50-10-lender-development-company-loan-programs>.

⁸ The deterrent effect of the existing rules seems evident from the statistics cited by the SBA in its discussion of the proposed rule:

[O]ut of more than 50,000 thousand loans made annually, SBA lenders have submitted to SBA for review approximately 586 Character determination requests containing information on criminal history records involving felonies. SBA declines on average only 17–23 of the requests per year due to the nature of the offense or incomplete judicial records.

88 Fed. Reg. at 63538. Unless the SBA approved close to 100% of the loan applications referred for character determinations under the process in effect prior to August 2023, which seems to us unlikely, the most logical reading of these statistics is that a substantial percentage of justice-impacted owners withdrew from the process at the point they were required to provide fingerprints for a referral to the FBI, the prelude to a character determination under SOP 50 10 6 (Oct. 1, 2020). If the questions about criminal history on the application form were not enough to deter justice-impacted business owners, the prospect of an FBI investigation probably was.

⁹ See, e.g., Zachary Best and Stephen Hayes, *The SBA Should Change Its Rules on Criminal History*, The Reg. Rev. (Apr. 4, 2022), <https://www.theregreview.org/2022/04/04/best-hayes-sba-should-change-its-rules-on-criminal-history/2>; The Pub. Int. L. Ctr., *Increasing Employment Opportunities For Pennsylvanians With Criminal Histories* (updated June 29, 2020), <https://pubintlaw.org/cases-and-projects/civil-rights-organizations-sue-the-small-business-administration-for-excluding-business-owners-with-criminal-records-from-covid-19-relief/>.

Hispanic.¹⁰ Because these justice-impacted individuals have historically faced structural barriers to employment,¹¹ many turn to entrepreneurship as a means of providing for themselves and their families.¹² As a result, individuals of color are likely to be disproportionately impacted by the criminal record restrictions of the rules in their current state.

An additional consequence of limiting access to justice-impacted individuals pursuing entrepreneurship is that it further inhibits their ability to build wealth.¹³ Black and Hispanic households affected by incarceration face greater barriers to economic mobility than their white counterparts, as demonstrated by the disparity in their ability to receive loans.¹⁴ This challenge was illuminated during the pandemic when Congress passed the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act, which was meant to provide support to small-business owners.¹⁵ Fortunately, many of the restrictions that led to that outcome were lifted,¹⁶ but this history demonstrates the importance of ensuring that there are not unnecessary restrictions barring justice-impacted individuals from accessing capital and ultimately building wealth for themselves and their communities.

An important part of SBA’s mission is to “strengthen the overall economy of our nation.”¹⁷ The proposed changes would accomplish this goal by rectifying the potential detrimental impact that previous restrictions have had not only on “small business owners with past criminal records” but on “the economies of the communities they serve.”¹⁸ The SBA’s criminal history restrictions have likely contributed to the racial inequalities in our economy.¹⁹ In addition, given that criminal recidivism is

¹⁰ See, e.g., NAACP, Criminal Justice Fact Sheet, <https://naacp.org/resources/criminal-justice-fact-sheet> (last visited Oct. 3, 2023).

¹¹ Hannah Grabenstein, *Incarcerated people face barriers to reenter post prison. How one initiative aims to help*, PBS (May 19, 2022), <https://www.pbs.org/newshour/nation/incarcerated-people-face-barriers-to-reentry-post-prison-how-one-initiative-aims-to-help>.

¹² CFPB, *Justice-Involved Individuals*, *supra* note 4 at 35 (“individuals returning from incarceration are 50 percent more likely to become entrepreneurs than people who have never been incarcerated”).

¹³ “Households affected by incarceration have fewer chances for long-term wealth building.”

Christian E. Weller, Akua Amaning, & Rebecca Vallas, *America’s Broken Criminal Legal System Contributes to Wealth Inequality*, Ctr. for Am. Progress (Dec. 13, 2022), <https://www.americanprogress.org/article/americas-broken-criminal-legal-system-contributes-to-wealth-inequality/>.

¹⁴ *Id.*

¹⁵ Because of the criminal record-based restrictions that initially applied to loans under the CARES Act, researchers have estimated that 212,655 small businesses were ineligible for relief by virtue of a recent felony conviction. See Shawn D. Bushway *et al.*, *Small Businesses, Criminal Histories, and the Paycheck Protection Program* (Santa Monica, CA: RAND Corporation, 2021), available at https://www.rand.org/pubs/research_reports/RRA1295-1.html. The authors of this study estimate that just under 4% of all small business owners have a criminal history, and about 1.5% have a felony record. See also Keith Finlay, Michael Mueller-Smith, & Brittany Street, *Criminal Disqualifications in the Paycheck Protection Program*, U.S. Census Bureau (June 2020), <https://www.census.gov/content/dam/Census/library/working-papers/2020/econ/cjars-ppp-adeq-working-paper-20200622.pdf>.

¹⁶ CCRC Staff, *Applying for an SBA loan with a criminal record in 2021*, Collateral Consequences Resource Ctr. (Mar. 8, 2021), <https://ccresourcecenter.org/2021/03/08/applying-for-an-sba-loan-with-a-criminal-record-2/>; see also CCRC Staff, *SBA throws in the towel and Congress extends the PPP deadline*, Collateral Consequences Resource Ctr. (July 7, 2020), <https://ccresourcecenter.org/2020/07/07/sba-throws-in-the-towel-and-congress-extends-the-ppp-deadline/>.

¹⁷ U.S. Small Bus. Admin., <https://www.sba.gov/about-sba/organization>.

¹⁸ The Pub. Int. L. Ctr., *supra* note 9.

¹⁹ David Schluskel, *Federal policies block loans to small business owners with a record*, Collateral Consequences Resource Ctr. (Aug. 2, 2021), <https://ccresourcecenter.org/2021/08/02/federal-policies-block-support-for-small-business-owners-with-a-record/>.

estimated to reduce the annual GDP by \$65 billion dollars,²⁰ the SBA’s restrictions have likely diminished the strength of our nation’s economy.²¹ As the SBA noted, “entrepreneurship provid[es] an important and distinct avenue for economic stability” for justice-impacted individuals given the “persistent stigma from employers who may decline to hire people with criminal history records.”²² Justice-impacted individuals who are employed recidivate at a lower rate than those who do not obtain employment.²³ Therefore, reducing barriers to successful entrepreneurship is aligned with the SBA’s mission of strengthening the economy.

In sum, we commend the SBA’s proposal to remove unnecessary regulatory and procedural restrictions that have effectively limited access to capital for justice-impacted business owners and the communities they serve. We believe that these changes will provide much needed opportunities for these entrepreneurs to provide for themselves and their families, to the betterment of the communities they live in and serve.

We would add one further comment directed at the SBA’s decision to continue imposing categorical ineligibility on business owners who are incarcerated. We understand that this remaining criminal history restriction is based on an assumption that a confined person will likely “lack the ability to manage and execute day-to-day business operations,”²⁴ and therefore be unable to satisfy the statutory requirement that loans be “of such sound value or so secured as reasonably to assure repayment.”²⁵ While this assumption may have some validity in the case of sole proprietors who are incarcerated, the collateral consequence that the SBA proposes to retain applies to any 20% owner of a business. Thus, a business owned and operated by several individuals could be disqualified based on one owner’s imprisonment, even if the other owners were fully able “to manage and execute day-to-day business operations.” For example, we can imagine a situation where a family-owned business could be effectively managed by four family members who were not incarcerated, even if the fifth family member owner was. Accordingly, we question whether it makes sense, in terms of the statutory concern for “sound value,” to retain this consequence as a categorical basis for ineligibility. To disqualify an entire business because of the circumstances of one of its several owners appears unnecessary and punitive.

Therefore, we propose that the SBA consider loosening this categorical exclusion to allow case-by-case decisions when some owners who are not in prison are fully capable of managing the business and securing the value of the loan, even though one owner may be serving a prison sentence. If the disqualifying circumstances of one owner can disqualify the entire business without regard to practicalities, this consequence appears rooted in unwarranted assumptions about an individual’s “just deserts” as opposed a concern for the “sound value” of the loan.

²⁰ Eunice Hernandez, *The negative effects on the economy caused by mass incarceration*, N. Tex. Daily (Feb. 24, 2020), [https://www.ntdaily.com/the-negative-effects-on-the-economy-caused-by-mass-incarceration/#:~:text=It%20is%20estimated%20that%20criminal,of%20crime%20that%20was%20committed; Christopher Zoukis, *The Cost of Recidivism: Victims, the Economy, and American Prisons*, \(Feb. 10, 2014\), <https://federalcriminaldefenseattorney.com/cost-recidivism-victims-economy-american-prisons/>.](https://www.ntdaily.com/the-negative-effects-on-the-economy-caused-by-mass-incarceration/#:~:text=It%20is%20estimated%20that%20criminal,of%20crime%20that%20was%20committed;Christopher Zoukis, The Cost of Recidivism: Victims, the Economy, and American Prisons, (Feb. 10, 2014), https://federalcriminaldefenseattorney.com/cost-recidivism-victims-economy-american-prisons/)

²¹ Zoukis, *supra* note 20.

²² 88 Fed. Reg. at 63535.

²³ Lucius Couloute and Daniel Kopf, *Out of Prison & Out of Work: Unemployment among formerly incarcerated people*, Prison Policy Initiative (July 2018), <https://www.prisonpolicy.org/reports/outofwork.html>.

²⁴ 88 Fed. Reg. at 63538.

²⁵ 15 U.S.C. § 636(a)(6).

While we recognize that the proposed rules revisions are a significant change, we urge the government to go further and to encourage private lenders to follow suit. We believe that the SBA's regulations can set the standard for private lenders, noting that "some financial institutions look to SBA's rules in forming their own internal policies on lending to business applicants with criminal histories."²⁶ Accordingly, we urge the SBA to do more to explicitly and directly encourage intermediary lenders not to discriminate against those with criminal records. The commentary to the proposed regulation states that the SBA does not intend to affect a lender's ability to conduct criminal history background checks according to their own policies, as long as a policy complies with the Equal Credit Opportunity Act and other applicable laws.²⁷ However, we think that the SBA would do better to encourage lenders to revisit their own practices regarding the use of criminal history in light of SBA's finding that "there is no evidence of a negative impact on repayment for qualified individuals with criminal history records in any American business loan program."²⁸ That is, we believe that the SBA should encourage lending institutions to limit disqualification based on criminal history to cases where an applicant is unable to provide assurances of sound value because they are incarcerated.

In conclusion, we commend the SBA for taking this long overdue action to support justice-impacted entrepreneurs who are already dealing with countless barriers to successful reintegration into society. Many current restrictions applicable to individuals with a criminal history, including some imposed by the federal government, continue to unfairly punish them long after their sentence has been fully served. Without these revisions, the existing provisions present yet another deterrent to one of the most promising means of employment for many justice-impacted individuals. Revising these requirements will facilitate a promising path forward for them, and positively benefit our economy and society.

Thank you for considering these comments. We can be reached at staff@ccresourcecenter.org with any questions.

²⁶ Best & Hayes, *supra* note 9.

²⁷ 88 Fed. Reg. at 63536.

²⁸ *Id.* at 63535. This would appear particularly appropriate in light of a recent CFPB finding from its supervision program on various types of loans, but particularly small business loans, that "the discovery of criminal records prompted enhanced or second-level underwriting review." See CFPB, *Supervisory Highlights* 17 (Issue 30, Summer 2023), https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights_issue-30_2023-07.pdf. This CFPB report noted that there were "variations amongst the policies and procedures as to how the lender identified criminal records and which violations or charges triggered further review or denial," and that "without clear guidelines and well-defined standards designed to meet legitimate business needs, lenders risked violating ECOA and Regulation B by applying these underwriting restrictions in a manner that could discriminate on a prohibited basis." *Id.* This variation is particularly noteworthy in light of a CFPB statement from a report the previous year: "Outside of government programs, financial institutions generally do not screen small business credit applicants on the basis of criminal history, basing their underwriting decisions on creditworthiness, as determined by credit history and ability to repay." CFPB, *Justice-Involved Individuals*, *supra* note 4 at 34. The fact that financial institutions generally do not screen small business loan applicants based on criminal history is strong evidence that such screens are not necessary to advance legitimate business needs. Those institutions that do engage in these practices should seriously reconsider them in light of their likely unwarranted adverse impacts.

Respectfully submitted,

Collateral Consequences Resource Center
National Community Reinvestment Coalition
Washington Lawyers Committee for Civil Rights and Urban Affairs

Center for Employment Opportunities (CEO)
Center for Law and Social Policy (CLASP)
Church of Scientology National Affairs Office
Church World Service
Coalition on Human Needs
Criminon New Life DC
CURE (Citizens United for Rehabilitation of Errants)
Drug Policy Alliance
Georgia Justice Project
Jewish Council for Public Affairs
Justice & Accountability Center of Louisiana
Justice Impact Alliance
JustLeadershipUSA
JustUS Coordinating Council
Legal Action Center (LAC)
Main Street Alliance
Maui Economic Opportunity
National Association of Criminal Defense Lawyers
National Employment Law Project
NETWORK Lobby for Catholic Social Justice
Prosperity Now
Public Interest Law Center
Reentry Working Group
Safer Foundation
Small Business Majority
Voices of Hope, Inc.

727 Management LLC
A & O Medical Billing, LLC
Affinity Consulting Group NEFL
Affordable Homeownership Foundation Inc.
African American Alliance of CDFI CEOs
Alliance 85
CAMEO-California Association for Micro Enterprise Opportunity
Concept Creative Group, LLC
Delaware Community Reinvestment Action Council
The DM Firm
Fair Finance Watch
Fair Housing Center for Rights & Research

Freedom Equity Inc.
Georgia Advancing Communities Together, Inc.
Housing Education and Economic Development
Ignite! Alabama
Leviticus Alternative Fund, Inc.
Local First Arizona
Morris Builders LLC
MS Communities United for Prosperity (MCUP)
National Association of American Veterans, Inc.
Pacific Community Ventures
PathStone Enterprise Center, Inc.
Proud Ground
Quantum Power Skills
Qwalifize LLC
Rise Economy (formerly California Reinvestment Coalition)
River City Housing
Southern Dallas Progress Community Development Corporation
Southwest Georgia United
Spiritus Christi Prison Outreach Inc.
Neighborhood Home Solutions
TCH Development, Inc
The Advisory
The Center for Micro-Entrepreneurial Training
The Food Trust
The Southeastern Group
Tilt Investments
True Value Global Corporation
Welfare Reform Liaison Project, Inc.