



## **SMALL BUSINESS ADMINISTRATION**

### **13 CFR Parts 109, 115, 120, and 123**

**RIN 3245-AI03**

### **Criminal Justice Reviews for the SBA Business Loan Programs, Disaster Loan Programs, and Surety Bond Guaranty Program**

**AGENCY:** U.S. Small Business Administration.

**ACTION:** Final rule.

**SUMMARY:** On September 15, 2023 the U.S. Small Business Administration (SBA or Agency) published a notice of proposed rulemaking (“NPRM” or “proposed rule”) to amend regulations governing SBA’s business loan programs (7(a) Loan Program, 504 Loan Program, Microloan Program, Intermediary Lending Pilot Program (ILP), Surety Bond Guarantee Program, and the Disaster Loan Program (except for the COVID-19 Economic Injury Disaster Loan (EIDL) Program) for criminal background reviews. The proposed rule introduced amendments to improve equitable access based on criminal background review of applicants seeking to participate in one or more of these programs. This final rule implements proposed regulatory changes and addresses comments SBA received.

**DATES:** This final rule is effective [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**FOR FURTHER INFORMATION CONTACT:** Alejandro C. Contreras, Acting Director, Office of Financial Assistance, Small Business Administration, at (202) 205-6436 or [alejandro.contreras@sba.gov](mailto:alejandro.contreras@sba.gov).

### **SUPPLEMENTARY INFORMATION:**

I. Background Information

The mission of SBA is to “aid, counsel, assist and protect” the interests of small business concerns to “preserve free competitive enterprise” and “maintain and strengthen the overall economy of our nation.” 15 U.S.C. 631(a). SBA accomplishes this mission, in part, through Capital Access programs that bridge the financing gap in the private market and help businesses of all sizes to recover from disasters. Further, 15 U.S.C. 636(a)(1)(B) states that the Administrator may verify the criminal background of the applicant, which grants SBA the flexibility to determine whether and how to consider criminal history in the context of issuing loan guarantees, so long as the loans are of sound value. Congress provided SBA with authority to promulgate rules to carry out these provisions. See 15 U.S.C. 634(b)(6).

SBA has comprehensively reviewed its capital programs’ current policies on individuals with criminal history records to ensure that the policies promote SBA’s statutory mandates that recognize the importance of small business development in general as well as the responsibility to increase opportunities for certain groups that may not historically have had equitable opportunities for small business ownership. See 15 U.S.C. 631(a), 636(a)(1)(B), 636(b)(1)(A), 636(l), 636(m), 694(b), and 695. It is SBA’s position that this final rule supports these Federal statutory mandates. The final rule also supports and reflects changing conditions in how State and local governments and the private sector have broadened access to business capital for qualified people with certain criminal history records and Federal laws and policies, including bipartisan legislation, such as the Second Chance Act of 2008 and the First Step Act of 2018, that have reduced barriers to successful reentry in order to reduce the risk of future criminal justice system involvement. This final rule helps facilitate employment opportunities for individuals with criminal history records and is supported by data and empirical research demonstrating the public safety and economic benefits of doing so.

Based on its review of SBA capital programs' current policies on individuals with criminal history records, SBA recognizes the need to update regulations to reduce barriers to participation in these programs for equitable support for qualified small business owners with certain criminal history records and issued a proposed rule for public comment. As the SBA expands access to capital to more qualified entrepreneurs, it continues to implement additional reforms to mitigate the risk of fraud in its traditional capital programs, including front-end detection protocols conducted by SBA. These safeguards are in addition to ones set and implemented by lenders and local, State, and Federal laws. Currently, the ILP Intermediary Program considers as ineligible businesses with an Associate (as defined by 13 CFR 109.20) that is incarcerated, on parole or probation, or that has been indicted but not convicted for a felony or a crime of moral turpitude; for the Surety Bond Guaranty Program, SBA considers an applicant ineligible if any of the Principals (as defined by 13 CFR 115.10) are under indictment but not convicted, previously convicted of a felony or have received civil judgment regarding business transactions; for the 7(a) and 504 business loan programs, SBA considers an applicant ineligible if the business has an Associate who is incarcerated, on probation, on parole, or is under indictment for a felony or any crime involving or relating to financial misconduct or a false statement, and for Microloans, in addition to an Associate who is incarcerated, an Associate who is on probation or parole for an offense involving fraud or dishonesty; and for the Disaster Loan Program in 13 CFR 123.101(i) (adopted by reference in 13 CFR 123.201 and 123.301) and 123.502(c), SBA considers ineligible any principal owners of the damaged property that are currently incarcerated, or on probation or parole following conviction for a serious criminal offense, with additional specific restrictions for Immediate Disaster Assistance Program (IDAP) loans, that include presently being under indictment, on parole or probation; charged with, arrested for, convicted, placed on pretrial diversion, and/or placed on any form of probation (including

adjudication withheld pending probation) for any criminal offense other than a minor motor vehicle violation (including offenses which have been dismissed, discharged, or not prosecuted).

Although the original intent of these restrictions was to protect the performance of SBA's capital programs against a presumed higher likelihood of default, data and research refute the concerns that may have animated SBA's initial rationale. Importantly, SBA reviewed the relevant research and found no evidence of a negative impact on repayment for qualified individuals with criminal history records in any American business loan program. This lack of data demonstrates that continuing to rely on this restriction for that purpose would contradict the available evidence and although the restrictions may have been originally put in place with the goal of protecting program performance, the lack of data suggests continuing to rely on this restriction would reflect an outdated, inaccurate regulatory barrier against individuals with criminal history records. Specifically, research demonstrates that employment increases success during reentry, decreases the risk of recidivism, and strengthens both public safety and economic opportunity. Research also demonstrates that entrepreneurship provides an important and distinct avenue for economic stability given persistent stigma from employers who may decline to hire people with criminal history records. Notably, SBA found several studies showing the difficulty of obtaining employment for formerly incarcerated people (see for example, *Investigating Prisoner Reentry: The Impact of Conviction Status on the Employment Prospects of Young Men*;<sup>1</sup> from the Department of Justice's National Institute of Justice Grant) and a positive link between employment and successful reentry, including preventing recidivism (see for example, *Local Labor Markets and*

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<sup>1</sup> *Investigating Prisoner Reentry: The Impact of Conviction Status on the Employment Prospects of Young Men. Investigating Prisoner Reentry National Institute of Justice Grant, Final Report., October 2009.*

*Criminal Recidivism*<sup>2</sup> in the Journal of Public Economics). Moreover, because individuals with criminal history records may face barriers in obtaining employment, entrepreneurship can be a productive option, and SBA found several studies showing the potential for entrepreneurship among individuals with criminal records (see for example *From Prison to Entrepreneurship*<sup>3</sup> in the American Academy of Political and Social Science).

After conducting its review of SBA capital programs' current policies on people with certain criminal history records, SBA posted a proposed rule for public comment. Given the lack of data suggesting program performance issues and the breadth of research indicating the benefits, SBA is removing unnecessary restrictions that limit access to capital for qualified people with certain criminal history records. Furthermore, the proposed rule sought to provide employment opportunities for qualified people with certain criminal history records because expanding access to entrepreneurship strengthens individual and community economic opportunity and growth while also strengthening public safety by facilitating successful reentry and thereby reducing the risk of future criminal justice system involvement.

The Agency received 19 comments on all aspects of the revisions in the proposed rule and on any related issues affecting the 7(a) Loan, 504 Loan, Microloan, ILP, Surety Bond Guarantee Program, and Disaster Loan Programs. (88 FR 63534) There were 17 comments received from separate individuals or entities as follows: three Community Development Companies (CDCs), one trade association, one government entity, seven advocacy non-profit groups, six individuals, and the *Federal Register* posting itself which

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<sup>2</sup> *Local Labor Markets and Criminal Recidivism*, ScienceDirect, Journal of Public Economics, Volume 147, March 2017, Pages 16-29

<sup>3</sup> *From Prison to Entrepreneurship: Can Entrepreneurship be a Reentry Strategy for Justice-Impacted Individuals?*, <https://doi.org/10.1177/00027162221115378>, Sage Journals, Volume 701, Issue 1, September 14, 2022.

tallies as a comment. There was one invalid comment received which was not posted to regulations.gov. The comments received are tallied by each proposal in the section-by-section analysis below. SBA has reviewed and considered those comments and is now issuing a final rule to implement those changes. Throughout this final rule, “currently incarcerated” means “a person who is currently serving a sentence of imprisonment imposed upon an adjudication of guilt.”

Pursuant to its statutory authority to promulgate rules to carry out its mandate, and after considering public comments, SBA is revising several regulatory provisions. See 15 U.S.C. 634(b)(6). SBA is updating the 7(a), 504, Microloan, ILP, Surety Bond Guarantee Program, and Disaster Loan Program regulations requiring criminal background reviews. Specifically, SBA is revising 13 CFR 109.400(b)(15) on “Eligible Small Business Concerns”; 13 CFR 115.13(a)(2)(i) on “Eligibility of Principal”; 13 CFR 120.110(n) on “What businesses are ineligible for SBA business loans?”; 13 CFR 120.707(a) on “What conditions apply to loans by Intermediaries to Microloan borrowers?”; 13 CFR 123.101(i) on “When am I not eligible for a home disaster loan?”; 13 CFR 123.502(c) on “Under what circumstances is your business ineligible to be considered for a Military Reservist Economic Injury Disaster Loan?”; and 13 CFR 123.702(c)(1) and (2) on “Character requirements.”

SBA is revising 13 CFR 109.400(b)(15) for ILP loans to small businesses to remove the restrictions on Associates of an applicant who are on probation or parole; 13 CFR 115.13(a)(2)(i) for surety bond applicants to remove restrictions on a Principal bidding for a contract (as defined in 13 CFR 115.10) who has been previously convicted of a felony or received civil judgment regarding business transactions; 13 CFR 120.110(n) for 7(a) and 504 loans to remove restrictions on businesses with an Associate who is on probation or on parole; 13 CFR 120.707(a) for Microloans to remove restrictions on businesses with an Associate who is currently on probation or parole for

an offense involving fraud or dishonesty; and 13 CFR 123.101(i) for physical and economic injury and 13 CFR 123.502(c) for military reservist economic injury disaster loans to remove restrictions regarding principal owners of damaged property who are on probation or parole following conviction for a serious criminal offense.

Further, regarding IDAP loans, in 13 CFR 123.702(c)(1) and (2), SBA will remove restrictions for businesses with an Associate who is presently on parole or probation; that has ever been charged with, arrested for, convicted, placed on pretrial diversion, and/or placed on any form of probation (including adjudication withheld pending probation) for any criminal offense other than a minor motor vehicle violation (including offenses which have been dismissed, discharged, or not prosecuted).

SBA has determined that reducing barriers to these programs for otherwise qualified applicants where one or more of their associates has the criminal justice system involvement described above is necessary to ensure equity and expand economic opportunities. These changes will further the goals of SBA's statutory mandates. SBA believes that modernizing the character requirements regarding consideration of the criminal history records of SBA loan applicants and Associates of business loan applicants is timely and appropriate to reflect changes in the public and private sector that have reduced unnecessary barriers to access to capital and successful reentry. Doing so also promotes equitable consideration for applicants who are ineligible for Federal assistance in SBA's programs due to prior convictions that have been adjudicated and terms of incarceration that have been served. These changes create the opportunity for formerly incarcerated individuals to participate in SBA's loan and surety bond programs and engage in entrepreneurial endeavors that research shows statistically decrease recidivism based on employment and continued engagement within their communities,

thereby strengthening public safety.<sup>4</sup> These changes will enable SBA programs to provide capital in the form of Surety Bonds, 7(a), 504, Microloan, ILP, and Disaster loans to more qualified small businesses and disaster survivors, which will strengthen our economy. SBA did not remove or change 13 CFR 120.110(q) regarding ineligibility due to prior default and loss to the Federal Government. Finally, SBA will continue the practices it recently implemented to access certain public data to perform fraud checks prior to approval of any 7(a), 504, or Disaster loans.

## II. Comments That Apply To Every Section

SBA received comments requesting modifications for each section of the proposed rule. As the same modifications were repeated for each section, they are addressed in this overview rather than in the section-by-section analysis. Each of the requested modifications or requests and the reason for accepting or not accepting the modification or request is provided below:

- (1) SBA should consider retaining the ability to conduct criminal background checks of program applicants and allow additional time to review the information contained therein for the expanded categories of individuals. SBA considered but did not accept the modification proposed by these comments. As SBA noted in the preamble of the final rule Lenders, CDCs, and Microlender Intermediaries may continue background checks if it is in their lending policies to do so. The final rule makes clear that, as the SBA expands access to capital to more qualified entrepreneurs, SBA continues to implement additional reforms to mitigate the risk of fraud in its traditional capital programs, including front-end detection protocols conducted by SBA,

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<sup>4</sup> Providing Another Chance: Resetting Recidivism Risk in Criminal Background Checks | RAND Bushway, Shawn D., Brian G. Vegetabile, Nidhi Kalra, Lee Remi, and Greg Baumann, Providing Another Chance: Resetting Recidivism Risk in Criminal Background Checks. Santa Monica, CA: RAND Corporation, 2022.

and these additional SBA front-end safeguards are in addition to ones set and implemented by lenders and local, State, and Federal laws.

(2) SBA should consider expanding access to capital to small business owners with criminal convictions only if ten years or more have elapsed since the last conviction. SBA considered but did not accept the modification suggested by these comments because (a) the comment did not provide any empirical support as to why a ten-year period (as opposed to another period of time) would strengthen either public safety or economic opportunity; (b) the comment did not provide any empirical support as to why other fact-specific and individualized indicia of rehabilitation and success during reentry in a shorter timespan after conviction should not be given more weight by SBA and the lender than an arbitrary number of years after conviction; (c) SBA determined that a categorical ten-year bar would undermine SBA's ability, through this rulemaking, to honor and incorporate the statutory mandates of 15 U.S.C. 631 that recognize the importance of small business development in general as well as the responsibility to increase opportunities for certain groups that may not historically have had equitable opportunities for small business ownership; and (d) small business applicants commented, and SBA agrees, that this ten-year categorical bar would be overburdensome for compliance. Requiring an additional waiting period for loan eligibility delays access to capital.

(3) SBA should provide additional guidance to lenders, beyond the proposed rule, on how exclusions for criminal convictions may cause a broad disparate impact for persons of color. SBA considered but did not accept this request because the research and analysis proposed by the commenter goes beyond the scope of SBA's authority in this regulatory rulemaking. This final rule is

limited to improving equitable access based on criminal background review of applicants seeking to participate in one or more of the programs addressed by this rule.

- (4) SBA should develop and issue guidance on this final rule in order to provide clarity to lenders to ensure that they implement its provisions with fidelity.

Although enforcement goes beyond the scope of this regulatory rulemaking, SBA will provide future guidance on compliance in Standard Operating Procedures and training by specific programs.

- (5) The SBA should work with lenders to reassess their underwriting standards to mirror changes to proposed rule. SBA does not accept this request because SBA does not have authority to mandate changes to lenders' safeguards and standards, and lenders are not obligated to adopt the changes SBA proposed. Lenders' authority to set and implement safeguards and standards is independent, which SBA recognizes and respects.

### III. Section-by-Section Analysis

#### *Section 109.400(b)(15) Eligible Small Business Concerns.*

The current § 109.400(b)(15) for the ILP Program states that ineligible businesses are those with an Associate who is currently incarcerated, on probation, on parole, or has been indicted but not convicted of a felony or crime of moral turpitude. SBA is revising this regulation to remove those barriers while maintaining the prohibition against only those businesses with an Associate who is currently incarcerated or who is indicted but not convicted of a felony or crime of moral turpitude. SBA considered removing the prohibitions related to Associates under indictment in the NPRM. However, upon reconsideration based on its evaluation of public and interagency comments, SBA has decided to retain the existing language related to indictments. This revision is therefore narrowly tailored to reduce barriers to access for qualified formerly incarcerated small

business owners who may be eligible to receive a loan through the ILP Program from an existing Intermediary with remaining funds to lend. The proposed rule received a total of 17 public comments of which nine or 53 percent were in support, 5 or 29 percent were in support with modifications and 3 or 18 percent were neutral and did not comment this on proposed rule specifically. The summary overview explains why the modifications were not incorporated into the final rule. SBA is finalizing the rule as proposed while retaining current prohibitions against businesses with an Associate indicted for certain crimes.

*Section 115.13(a)(2)(i) Eligibility of Principal.*

The current § 115.13(a)(2)(i) for the Surety Bond program states that ineligible businesses are those with a Principal who is under indictment but is not convicted, or has been previously convicted of a felony, or a final civil judgment has been entered stating that such Person has committed a breach of trust or has violated a law or regulation protecting the integrity of business transactions or business relationships. Through this final rule, SBA is removing those barriers while maintaining the prohibition against only those businesses with a Principal who is currently incarcerated or who is under indictment for a felony. SBA considered removing the prohibitions related to Principals under indictment in the NPRM. However, upon reconsideration based on its evaluation of public and interagency comments, SBA has decided to retain the existing language related to indictments. This revision is narrowly tailored to reduce barriers to access for qualified small business owners with certain criminal history records to compete for Federal and other contract opportunities by obtaining guarantees for surety bid and final payment and/or performance bonds. The proposed rule change received a total of 17 public comments of which 9 or 53 percent were in support, 5 or 29 percent supported with modification and 3 or 18 percent were neutral or did not comment on the proposed rule. The summary overview explains why the modifications were not incorporated into

the final rule. SBA is finalizing the rule as proposed while retaining current prohibitions against businesses with an Associate indicted for certain crimes.

*Section 120.110(n) What businesses are ineligible for SBA business loans?*

The current § 120.110(n) for the 7(a), 504, and Microloan programs states that ineligible businesses are those with an Associate who is currently incarcerated, on probation, on parole, or is under indictment but not convicted for a felony or any crime involving or relating to financial misconduct or a false statement. Through this final rule, SBA is revising this regulation to address the challenges people on probation or on parole have accessing capital while maintaining the prohibition against businesses with an Associate who is currently incarcerated or who is under indictment for a felony or any crime involving or relating to financial misconduct or a false statement. SBA considered removing the prohibitions related to Associates under indictment in the NPRM. However, upon reconsideration based on its evaluation of public and interagency comments, SBA has decided to retain the existing language related to indictments. This revision is narrowly tailored to reduce barriers to access for qualified small business owners with certain criminal history records. Under 15 U.S.C. 636(a)(1)(B), the SBA may verify an applicant's criminal history background, but it does not require such verification, nor does it prohibit loans for people with criminal history records. Lenders, CDCs, and Microloan Intermediaries make risk-based lending decisions. SBA's final rule revision does not impact a Lender's, a CDC's or a Microloan Intermediary's ability to conduct a criminal history background check, in accordance with their own policies, provided they do so in a manner that complies with the Equal Credit Opportunity Act and other relevant laws and does not result in an unjustified discriminatory effect on a protected class group. Lenders can continue to deny loans, for example, where criminal history, when considered along with other information, presents an unacceptable credit risk. The proposed rule received a total of 17 public comments, of which 12 or 71

percent were in support, and 5 or 29 percent support with modifications. No commenters opposed. The summary overview explains why the modifications were not incorporated into the final rule SBA is finalizing the rule as proposed.

*Section 120.707(a) What conditions apply to loans by Intermediaries to Microloan borrowers?*

SBA proposed to revise § 120.707(a) to increase access to capital to businesses with an Associate who is on probation or parole for an offense involving fraud or dishonesty while maintaining the prohibition against a business with an Associate who is incarcerated. For public safety reasons, however, SBA will retain the prohibition against making a loan to a childcare business, where an Associate is on probation or parole for an offense against children. This change will closely align with the revised requirements for all business loan programs regarding the determination that an applicant with a Principal or Associate that is currently incarcerated is ineligible for assistance and support the flexibility and access to capital for qualified business owners with criminal history records. The proposed rule received a total of 17 public comments, of which 9 or 53 percent were in support, 5 or 29 percent were in support with modifications, 3 or 18 percent were neutral/did not comment and none were opposed. The summary overview explains why the modifications were not incorporated into the final rule. SBA is finalizing the rule as proposed.

*Section 123.101(i) When am I not eligible for a home disaster loan?*

The current § 123.101(i) for the Disaster Loan Program states that SBA considers ineligible any principal owners of the damaged property that are presently incarcerated, or on probation or parole following conviction for a serious criminal offense. In this final rule, SBA revises § 123.101(i) to state that the applicant is ineligible to receive a disaster loan when any principal owner of a home that sustained damage is currently incarcerated. The eligibility requirements in § 123.101 are cross referenced in §§ 123.201 and 123.301;

therefore, this final rule change will also apply to business property loans as well as economic injury loans. Notwithstanding SBA's final rule change, in accordance with statutory provisions that bar loans to those with certain convictions, SBA will maintain its existing prohibition where such prohibition is required by law. This final rule will align the requirements for all SBA loan programs regarding currently incarcerated applicants and support the flexibility and access to capital for qualified disaster survivors with criminal history records. The proposed rule received a total of 17 public comments, of which 9 or 53 percent were in support, 5 or 29 percent were in support with modifications, and 3 or 18 percent were neutral/did not comment. The summary overview explains why the modifications were not incorporated into the final rule. SBA is finalizing the rule as proposed.

*Section 123.502(c) Under what circumstances is your business ineligible to be considered for a Military Reservist Economic Injury Disaster Loan?*

The current § 123.502(c) for the Disaster Loan Program states that SBA considers ineligible any principal owners of the damaged property who are presently incarcerated, or on probation or parole following conviction for a serious criminal offense. In this final rule, SBA revises § 123.502(c) to state that for Military Reservist Economic Injury Disaster loans (MREIDL), the applicant is ineligible to receive a disaster loan when an Associate of a business that sustained damage is currently incarcerated. Notwithstanding SBA's final rule changes for disaster loans, in accordance with statutory provisions that bar loans to those with certain convictions, SBA will continue to consider as ineligible applicants whose eligibility is prohibited by law. This final rule change will align the requirements proposed for all SBA loan programs regarding individuals currently incarcerated and support the flexibility and access to capital for qualified small business owners with criminal history records. The proposed rule received a total of 17 public comments, of which 9 or 53 percent were in support, 5 or 29 percent were in support with

modifications, 3 or 18 percent were neutral/did not comment and none were opposed.

The summary overview explains why the modifications were not incorporated into the final rule. SBA is finalizing the rule as proposed.

*Section 123.702(c)(1) and (2) What are the eligibility requirements for any IDAP Loan?*

The current § 123.702(c)(1) and (2) for IDAP loans state that SBA considers ineligible any applicant business that has an Associate that who is presently under indictment but not convicted, on parole or probation; charged with, arrested for, convicted, placed on pretrial diversion, and/or placed on any form of probation (including adjudication withheld pending probation) for any criminal offense other than a minor motor vehicle violation (including offenses which have been dismissed, discharged, or not prosecuted). In the final rule, SBA revises § 123.702(c)(1) and (2) to state that the applicant is ineligible to receive an IDAP loan when any principal owner of a home or business that sustained damage is currently incarcerated. SBA will continue to consider as ineligible applicants who are presently under indictment or whose eligibility is prohibited by law. SBA considered removing the prohibitions related to applicants under indictment in the NPRM. However, upon reconsideration based on its evaluation of public and interagency comments, SBA has decided to retain the existing language related to indictments.

*Policy Discussion*

In addition to applicants in all programs certifying to having no owners or Associates that are currently incarcerated, SBA will access certain external and widely acceptable and reliable databases to verify eligibility regarding incarceration and criminal history status. While the implementation of the final rule will expand access and thereby increase loan volume, SBA believes that these changes do not compromise the credit quality and performance of the loan portfolios. For example, the Microloan and Surety

Bond Guaranty programs have permitted loans to businesses with individuals on parole or probation at no negative impact to overall program performance.

As published in June 2021, The RAND Research Brief<sup>5</sup> estimated that over 200,000 small businesses were affected or disqualified from participating in the Paycheck Protection Program (PPP) due to SBA's rules regarding current indictments and incarceration, and prior criminal convictions and criminal justice system involvement. Predictably, the survival rate of legitimate small businesses that did not receive assistance during the pandemic is lower than those that did receive support. There are several key distinctions between the PPP program and the SBA loan and surety programs at issue here. For example, PPP loans were forgivable while loans in the other SBA loan programs are not, and SBA has developed and implemented additional front-end detection protocols to strengthen program integrity since PPP. This RAND study is useful to highlight the number of otherwise qualified applicants who were ineligible to apply but required SBA assistance in order to survive.

Due to significant barriers to employment for individuals with criminal history records, self-employment and entrepreneurship are often vital avenues to successful reentry and employment. In fact, 28 percent of individuals with criminal history records are self-employed.<sup>6</sup> SBA's general and targeted loan programs should be a resource that provides options that support economic success and growth for individuals and communities, from basic self-employment to becoming employers within communities, and that support successful reentry outcomes, thereby strengthening public safety. Research is clear that reducing barriers to employment reduces recidivism and supports

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<sup>5</sup>The Prevalence of Criminal Records Among Small Business Owners | RAND *How Many Business Owners, Businesses, and Employees Are Affected by PPP Restrictions?*

<sup>6</sup> <https://onlinelibrary.wiley.com/doi/10.1002/pam.22438>. *Criminal Justice Involvement, Self-employment, and Barriers in Recent Public Policy. Journal of Policy Analysis and Management*, 42(1),11-4

successful reentry, leading to better outcomes for individuals and communities<sup>7</sup>--all of which underscore the necessity for SBA to revisit and update these regulations to remove barriers to small-business employment and business ownership.

Under the final rule, for each program, SBA, Lenders, CDCs, Microloan Intermediaries, Sureties, and ILP Intermediaries, must consider the applicant business ineligible based on criminal history record when there is an Associate or Principal who is currently incarcerated or, depending on the program, under indictment.

SBA's final rule also streamlines SBA's lending criteria by reducing the number of factors that are required to be applied in determining eligibility based on criminal history records of small business owners. Lenders, CDCs, and Microloan Intermediaries make risk-based lending decisions as part of their existing and continuing protocols. Some lenders include conducting criminal history background checks and others do not. SBA's final rule revision does not impact a Lender's, CDC's or Microloan Intermediary's authority or ability to continue to do so, in accordance with their own policies, provided that they do so in a manner that complies with the Equal Credit Opportunity Act and other relevant laws. This proposed rule received a total of 17 public comments, of which 9 or 53 percent were in support, 5 or 29 percent were in support with modifications, 3 or 18 percent were neutral or did not comment on this section and none were opposed. The summary overview explains why the modifications were not incorporated into the final rule. SBA is finalizing the rule as proposed.

#### **IV. Severability**

One comment recommended that SBA include in this rule an express provision addressing the effect of a judicial declaration of invalidity as to any section or portion of this rule or to parts 109, 115, 120 and 123. The question of severability addresses whether a judicial finding of a provision's invalidity should extend to other provisions or

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<sup>7</sup> Providing Another Chance: Resetting Recidivism Risk in Criminal Background Checks | RAND

applications or whether it should be limited to the invalid provision or application, leaving in effect the remainder of the rule.

Like the entirety of parts 109, 115, 120 and 123, this rule seeks to implement, to the maximum extent possible, the stated congressional purposes of the Small Business Act and the Small Business Investment Act— *i.e.*, “to...aid, counsel, assist, and protect, insofar as is possible, the interests of the small-business concerns in order to preserve free competitive enterprise” and “to foster economic development and to create or preserve job opportunities in both urban and rural areas by providing long-term financing for small business concerns.” *See* 15 U.S.C. 631 and 695.

This rule includes numerous enhancements to the ILP Program, the Surety Bond Guaranty Program the Business Loan Programs, and the Disaster Loan Programs. The individual sections added or modified in this rule, and those which remain in parts 109, 115, 120 and 123 from prior rulemakings, shall operate independently in service of the stated congressional purposes and the objectives set forth above for this rule.

Accordingly, in the event that any portion or application of the rule is declared invalid or unenforceable as applied to any person or circumstance, SBA intends for the provision to be construed so as to continue to give the maximum effect to the provision permitted by law, including as applied to persons not similarly situated or to dissimilar circumstances, unless such holding is that the provision of these paragraph is invalid and unenforceable in all circumstances. Further, SBA intends that the various other provisions and applications of parts 109, 115, 120 and 123, including those added or modified in this rule, be severable from the unlawful portion, unless such declaration of invalidity renders another section or provision meaningless or deprives that other section or provision of its functionality though only in such circumstances. Moreover, such collateral invalidity is intended only to the extent required by logic or loss of functionality.

As an illustration, if a court were to find unlawful this rule's revisions to the criminal background provisions in the Business Loan Programs (§ 120.110), such finding would have no effect upon this rule's revisions to the criminal background provisions in the Intermediary Lending Pilot (§ 109.400), the Surety Bond Guarantee (§ 115.3) and the Disaster Loan (§§ 123.101, 123.502 and 123.702) Programs, or various other provisions which in no way are dependent upon the criminal background provisions. To further this illustration, if a court were to find unlawful this rule's revisions to the criminal background provisions in the Business Loan Programs (§ 120.110), such finding would have no effect upon any of the other provisions and applications of parts 109, 115, 120 and 123 (e.g., Eligible uses of proceeds as set forth in 13 CFR 120.120). The foregoing are merely examples and do not express an intent that any other provision be considered non-severable. SBA reiterates that where any provision of this part is declared invalid, any collateral invalidity is intended to the least extent necessary, in order to advance program objectives to the maximum extent possible. Such provisions would help mitigate uncertainty that may result from future court decisions if a lawsuit occurs.

**Compliance with Executive Orders 12866, 12988, 13132, and 13563, the Congressional Review Act (5 U.S.C. §§ 801-808), the Paperwork Reduction Act (44 U.S.C., Ch. 35), and the Regulatory Flexibility Act (5 U.S.C.**

**§§ 601-612)**

Executive Order 12866

The Office of Management and Budget has determined that this rule is a "significant regulatory action" under Executive Order 12866, as amended by Executive Order 14094. SBA included in the proposed rule and presents in the final rule a Regulatory Impact Analysis for the public's information in the next section. Each section begins with a core question.

A. Regulatory Objective of the Proposal

Is there a need for this regulatory action?

In accordance with statutory mandates of 15 U.S.C. 631(a), 636(a)(1)(B), 636(b)(1)(A), 636(l), 636(m), 694(b), and 695 , the Agency believes it needs to reduce regulatory restrictions for applicants with Associates or Principals based on criminal histories for the SBA Disaster, 7(a), 504, Microloan, ILP and Surety Bond Guaranty programs by reducing the requirement for criminal history records consideration to only applicants with a Principal or Associate currently incarcerated or, depending on the program, under indictment, in the manner proposed above. Many formerly incarcerated persons experience significant barriers in accessing employment and capital and credit often necessary to start a business. The revisions in SBA's final rule will remove barriers to access capital and employment for qualified applicants. SBA will reduce the administrative burden on applicants as well as the need for fingerprints by providing a single succinct directive that SBA determines any applicant with a Principal or Associate that is currently incarcerated or, depending on the program, under indictment, to be ineligible with no further requirements for disclosure of prior criminal history records.

#### B. Benefits and Costs of the Rule

What are the potential benefits and costs of this regulatory action?

SBA does not anticipate significant additional costs or impact on the subsidy to operate the 7(a), 504, Microloan, ILP, Surety Bond Guaranty and Disaster Loan Programs under these proposed regulations because all loans submitted must always meet Loan Program Requirements. In general, the final rule benefits otherwise qualified entrepreneurs who would not otherwise be eligible to apply for these programs due to outdated restrictions that were not evidence-informed, and therefore it strengthens our economy and our public safety.

SBA does not receive information from lenders on how many applicants they decline for 7(a), 504, and Microloans. SBA has received substantial feedback and

research from stakeholders that its current rules have presented broad barriers to otherwise qualified individuals with criminal history records that seek financing to start, run, or expand small businesses. This final rule aligns with the statutory mandates in 15 U.S.C. 631 and supports the inference that reducing or removing barriers will result in additional applications from those otherwise qualified small business owners with criminal history records who may have been deterred from applying due to the current prohibitions related to criminal history records.

In the 7(a) and 504 programs, for formerly incarcerated individuals and people not on parole or probation, out of more than 50,000 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. SBA's Disaster Loan Program has declined 93 individuals for criminal history record background checks between 2018 and 2022, with an additional 1,026 files withdrawn by applicants prior to review during the same period. Microloan Intermediaries do not submit loans to SBA for approval, so SBA does not have data for criminal history records of Microloan applicants. SBA's final rule provides clarity for borrowers who might have otherwise withdrawn their application based on eligibility concerns. Finally, Lenders, CDCs, and Microloan Intermediaries make risk-based lending decisions. The statistics above do not account for any checks conducted by lenders or any resultant applications being withdrawn. Some lenders include conducting criminal history background checks and others do not. SBA's proposed revision does not impact a lender's ability to continue to do so, in accordance with their own policies, provided that they do so in a manner that complies with the Equal Credit Opportunity Act and other relevant laws.

### C. Alternatives

What alternatives have been considered?

SBA considered the impact of maintaining the current rules that deem as ineligible businesses with Principals or Associates currently incarcerated, on parole or probation or convicted of certain financial and other crimes. This would result in continuing barriers for small businesses owned by individuals with criminal history records. Instead, SBA's final rule balances that concern against the risk to SBA of making guarantees and loans to businesses whose Principals or Associates lack the ability to manage and execute day-to-day business operations due to their current incarceration. SBA's final rule also supports disaster survivors during recovery with increased equal access to capital.

### **Congressional Review Act**

The Office of Management and Budget's (OMB) Office of Information and Regulatory Affairs has determined that this rule is not a major rule under Subtitle E of the Small Business Regulatory Enforcement Fairness Act of 1996 (also known as the Congressional Review Act), 5 U.S.C. 804(2). The annual effect on the economy is less than \$100 million.

### Executive Order 12988

This action meets applicable standards set forth in sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. The action does not have preemptive effect or retroactive effect.

### Executive Order 13132

This final rule does not have federalism implications as defined in Executive Order 13132. It will not have substantial direct effects on the States, on the relationship between the National Government and the States, or on the distribution of power and

responsibilities among the various levels of government, as specified in the Executive order. As such it does not warrant the preparation of a Federalism Assessment.

Executive Order 13563

A description of the need for this regulatory action and benefits and costs associated with this action, including possible distributional impacts that relate to Executive Order 13563, are included above in the Regulatory Impact Analysis under Executive Order 12866.

Paperwork Reduction Act, 44 U.S.C. Ch. 35

SBA has determined that this final rule would require that the following forms be revised: SBA Form 1919, "Borrower Information Form," SBA Form 1244, "Application for Section 504 Loans," SBA Form 5, "Disaster Business Loan Application," SBA Form 5C, "Disaster Home/Sole Proprietor Loan Application," and SBA Form 994, "Application for Surety Bond Guarantee Assistance".

SBA Form 1919 is approved under OMB Control number 3245-0348. SBA Form 1244 is approved under OMB Control number 3245-0071. SBA Form 5 is approved under OMB Control number 3245-0017 and SBA Form 5C is approved under OMB Control number 3245-0018. SBA Form 994 is approved under OMB Control number 3245-0007.

SBA will revise SBA Form 1919, and SBA Form 1244 to conform to the eligibility change at 13 CFR 120.110(n). When small businesses apply for 7(a) or 504 loans, the estimated hour burden for applicants and lenders will decrease because the criminal history analysis and collection of data will no longer be required.

SBA will revise SBA Form 5 and 5C to conform to the eligibility change at 13 CFR 123.101(i). When disaster survivors apply for disaster loans, the estimated hour burden for applicants will decrease because the criminal history record analysis and collection of data will be reduced.

SBA will revise SBA Form 994 to conform to the eligibility change at 13 CFR 115.13(a)(2)(i). When small businesses apply for surety bond guarantees, the estimated hour burden for applicants will decrease because the criminal history record analysis and collection of data will no longer be required.

Regulatory Flexibility Act, 5 U.S.C. 601- 612

When an agency issues a rulemaking, the Regulatory Flexibility Act (RFA), 5 U.S.C. 601-612, requires the agency to “prepare and make available for public comment an initial regulatory analysis” which will “describe the impact of the proposed rule on small entities.” Although the rulemaking may potentially impact a small percentage of loans reviewed by 7(a) Lenders, CDCs, Microloan Intermediaries, ILP Intermediaries, the 44 Sureties that participate in the Surety Bond Guaranty Program, and SBA regarding the disaster loans, SBA does not believe the impact will be significant because this rule streamlines regulatory burdens. However, there may be impacts due to increased loans for businesses with Principals or Associates that have a criminal history record but are not currently incarcerated or under indictment.

SBA reviews approximately 586 Character determination requests annually and declines 3 or 4 percent, or 17 to 23 requests, due to the nature of the offense or incomplete judicial records. The revisions to § 120.110(n) will eliminate the need for 100 percent of these character determination reviews. SBA Form 1919, “SBA 7a Borrower Information Form,” is the application form for the 7(a) Loan Program. SBA Form 1244, “Application for Section 504 Loans,” is the application form for the 504 Loan Program. Each application includes 3 questions that Associates of the applicant must answer regarding their criminal history records. Under the final rule revisions, SBA will eliminate the three current questions and replace them with one new question regarding incarceration or being under indictment. SBA estimates that all applicants for the 7(a) Loan Program and 504 Loan Program will save 5 minutes completing the applications

due to these revisions. Intermediaries for the Microloan Program use their own applications for Microloan borrowers, but it is reasonable to assume similar time savings. The 7(a) Loan Program, 504 Loan Program, and Microloan Program make approximately 68,677 loans per year. Saving 5 minutes for each application will result in total time savings of 5,723 hours annually.

## **List of Subjects**

### **13 CFR Part 109**

Community development, Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

### **13 CFR Part 115**

Claims, Reporting and recordkeeping requirements, Small businesses, Surety bonds

### **13 CFR Part 120**

Community development, Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

### **13 CFR Part 123**

Disaster assistance, Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

For the reasons stated in the preamble, SBA amends 13 CFR parts 109, 115, 120 and 123 as follows:

## **PART 109—INTERMEDIARY LENDING PILOT PROGRAM**

1. The authority citation for 13 CFR part 109 continues to read as follows:

**Authority:** 15 U.S.C. 634(b)(6), (b)(7), and 636(l).

2. Add § 109.15 to read as follows:

### **§ 109.15 Severability.**

Any provision of this part held to be invalid or unenforceable as applied to any person, entity, or circumstance shall be construed so as to continue to give the maximum effect to such provision as permitted by law, including as applied to persons or entities not similarly situated or to dissimilar circumstances, unless such holding is that the provision of this part is invalid and unenforceable in all circumstances, in which event the provision shall be severable from the remainder of this part and shall not affect the remainder thereof.

3. Amend § 109.400 by revising paragraph (b)(15) to read as follows:

**§ 109.400 Eligible Small Business Concerns.**

\* \* \* \* \*

(b) \* \* \*

(15) Businesses with an Associate who is currently incarcerated, serving a sentence of imprisonment imposed upon adjudication of guilty, or is under indictment for a felony or a crime of moral turpitude;

\* \* \* \* \*

**PART 115—SURETY BOND GUARANTEE**

4. The authority citation for 13 CFR part 115 continues to read as follows:

**Authority:** 5 U.S.C. app 3; 15 U.S.C. 636i, 687b, 687c, 694a, and 694b note.

5. Add § 115.3 to read as follows:

**§ 115.3 Severability.**

Any provision of this part held to be invalid or unenforceable as applied to any person, entity, or circumstance shall be construed so as to continue to give the maximum effect to such provision as permitted by law, including as applied to persons or entities not similarly situated or to dissimilar circumstances, unless such holding is that the provision of this part is invalid and unenforceable in all circumstances, in which event the

provision shall be severable from the remainder of this part and shall not affect the remainder thereof.

6. Amend § 115.13 by revising paragraph (a)(2)(i) to read as follows:

**§ 115.13 Eligibility of Principal.**

(a) \* \* \*

(2) \* \* \*

(i) The Person is currently incarcerated, serving a sentence of imprisonment imposed upon adjudication of guilty, or under indictment for a felony; or

\* \* \* \* \*

**PART 120—BUSINESS LOANS**

7. The authority citation for 13 CFR part 120 continues to read as follows:

**Authority:** 15 U.S.C. 634(b)(6), (b)(7), (b)(14), (h), and note, 636(a), (h) and (m), 650, 687(f), 696(3) and (7), and 697(a) and (e); sec. 521, Pub. L. 114-113, 129 Stat. 2242; sec. 328(a), Pub. L. 116-260, 134 Stat. 1182.

8. Add § 120.4 to read as follows:

**§ 120.4 Severability.**

Any provision of this part held to be invalid or unenforceable as applied to any person, entity, or circumstance shall be construed so as to continue to give the maximum effect to such provision as permitted by law, including as applied to persons or entities not similarly situated or to dissimilar circumstances, unless such holding is that the provision of this part is invalid and unenforceable in all circumstances, in which event the provision shall be severable from the remainder of this part and shall not affect the remainder thereof.

9. Amend § 120.110 by revising paragraph (n) to read as follows:

**§ 120.110 What businesses are ineligible for SBA business loans?**

\* \* \* \* \*

(n) Businesses with an Associate who is currently incarcerated, serving a sentence of imprisonment imposed upon adjudication of guilty, or is under indictment for a felony or any crime involving or relating to financial misconduct or a false statement;

\* \* \* \* \*

10. Amend § 120.707 by revising paragraph (a) to read as follows:

**§ 120.707 What conditions apply to loans by Intermediaries to Microloan borrowers?**

(a) *General.* Except as otherwise provided in this paragraph (a), an Intermediary may only make Microloans to small businesses eligible to receive financial assistance under this part. A borrower may also use Microloan proceeds to establish a nonprofit childcare business. An Intermediary may not make Microloans to businesses with an Associate who is currently incarcerated, serving a sentence of imprisonment imposed upon adjudication of guilty, or to childcare businesses with an Associate who is currently on probation or parole for an offense against children. Proceeds from Microloans may be used only for working capital and acquisition of materials, supplies, furniture, fixtures, and equipment. SBA does not review Microloans for creditworthiness.

\* \* \* \* \*

**PART 123—DISASTER LOAN PROGRAM**

11. The authority citation for 13 CFR part 123 continues to read as follows:

**Authority:** 15 U.S.C. 632, 634(b)(6), 636(b), 636(d), 657n, and 9009.

12. Add § 123.22 to read as follows:

**§ 123.22 Severability.**

Any provision of this part held to be invalid or unenforceable as applied to any person, entity, or circumstance shall be construed so as to continue to give the maximum effect to such provision as permitted by law, including as applied to persons or entities not similarly situated or to dissimilar circumstances, unless such holding is that the

provision of this part is invalid and unenforceable in all circumstances, in which event the provision shall be severable from the remainder of this part and shall not affect the remainder thereof.

13. Amend § 123.101 by revising paragraph (i) to read as follows:

**§ 123.101 When am I not eligible for a home disaster loan?**

\* \* \* \* \*

(i) You or other principal owners of the damaged property are currently incarcerated, serving a sentence of imprisonment imposed upon adjudication of guilty;

\* \* \* \* \*

14. Amend § 123.502 by revising paragraph (c) to read as follows:

**§ 123.502 Under what circumstances is your business ineligible to be considered for a Military Reservist Economic Injury Disaster Loan?**

\* \* \* \* \*

(c) Any of your business' principal owners is currently incarcerated, serving a sentence of imprisonment imposed upon adjudication of guilty;

\* \* \* \* \*

15. Amend § 123.702 by:

- a. Revising paragraph (c)(1);
- b. Removing paragraph (c)(2); and
- c. Redesignating paragraphs (c)(3) through (5) as paragraphs (c)(2) through (4).

The revision read as follows:

**§ 123.702 What are the eligibility requirements for an IDAP loan?**

\* \* \* \* \*

(c) \* \* \*

(1) is currently incarcerated, serving a sentence of imprisonment imposed upon adjudication of guilty, or is presently under indictment;

\* \* \* \* \*

**Isabella Casillas Guzman,**

*Administrator.*

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