



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

June 17, 2019

The Honorable Catherine Cortez Masto
United States Senate
516 Hart Senate Office Building
Washington, DC 20510

Dear Senator Cortez Masto:

Thank you for your letter of May 21, 2019, to Acting Administrator Pilkerton regarding U.S. Small Business Administration (SBA) guaranteed loans to four franchises: Complete Nutrition, Dickey's Barbeque, Experimac, and Subway. Acting Administrator Pilkerton has asked me to respond on his behalf.

As you may be aware, while SBA is an important resource for financial assistance for would-be small business owners without access to credit on reasonable terms, the Federal Trade Commission (FTC) is the key agency for the American public to obtain and report information about various business entities, including franchises. Because it appears that the concerns you raised in your letter fall within the area of responsibility of the FTC, we have referred your letter to their Bureau of Consumer Protection for further review/action. As the federal agency with responsibility for protecting consumers by stopping unfair, deceptive or fraudulent practices in the marketplace, the FTC conducts investigations, sues companies and people that violate the law, develops rules to ensure a vibrant marketplace, and educates consumers and businesses about their rights and responsibilities.

In fact, the FTC has a special responsibility when it comes to franchise systems. The FTC requires franchisors to update their Franchise Disclosure Document (FDD) each year, which includes statements to inform a prospective franchisee about historical representations (how much existing franchisees have earned in the past) or projections (how much an individual prospective franchisee is likely to earn in the future). Although franchisors may decide how they wish to disclose financial performance of the brand (provided that disclosure meets FTC requirements), the FTC prohibits a franchisor from making a financial representation that is not true or unsubstantiated.¹ Complaints regarding specific franchisors are normally handled by the FTC under federal law or through state agencies under state franchise laws. The FTC has resources available to help members of the public spot scams involving businesses, including franchise businesses. The FTC also provides a link on their website for the public to file complaints. Complaints are shared with law enforcement partners and are used to investigate fraud and eliminate unfair business practices. The FTC also releases an annual report that provides information about the number and type of complaints they receive.

SBA's engagement in franchise businesses includes its guarantees of loans that are made by its lending partners to small businesses that operate under an agreement with a franchisor (a franchisee). A relatively small percentage of SBA's guaranteed loan portfolio, fifteen percent, is made up of loans to businesses that operate under franchise agreements. Under SBA's current franchise review process, SBA reviews franchise brands only to determine if the brand is eligible for SBA financial assistance based on SBA size standards (including determining if there is affiliation between the franchisor and its franchisees) and type of business activity. SBA does not endorse or recommend franchise brands. Rather, SBA lists those brands found to

¹ For more information about the FTC's requirements for franchisors, including required disclosures by franchisors, see <https://www.ftc.gov/enforcement/rules/rulemaking-regulatory-reform-proceedings/franchise-rule>.

be eligible under size and affiliation standards on a publicly available directory so that before making an SBA loan to an applicant, SBA Lenders may rely on the directory for the franchise brand's eligibility for SBA financial assistance. However, it is important to note that those lenders are responsible for analyzing and making a determination as to the creditworthiness of the brand and of the small business Applicant (franchisee).

SBA's monitoring of ongoing franchise loans is generally limited to the performance of participating lenders through its Office of Credit Risk Management (OCRM). OCRM conducts monthly as well as a semiannual performance analysis of the loan portfolio generally, and with segmentation, including loans made to franchisees. OCRM also reviews lender performance and provides individual lender performance data to SBA Lenders through a lender portal. SBA Lenders are expected to review the portal on a regular basis, which enables the Lender to identify its loan portfolio performance down to the individual loan level. OCRM will engage SBA Lenders when identifying trends with respect to loans to borrowers operating under a franchise agreement. The Lender would be expected to take action to mitigate risk. If an SBA Lender were to determine that the performance of a franchise brand did not meet its credit parameters, the Lender would curtail lending to that franchise to minimize its risk of loss. If an SBA Lender were to become aware of any information indicating that fraud may have occurred in connection with an SBA loan, the Lender would be required to report the suspected fraud to the SBA Office of Inspector General. 13 CFR 120.197.

When a franchisee with an SBA loan experiences financial difficulty, the SBA Lender would typically work with the small business to attempt to address the issues. In addition, SBA's resource partners, such as Small Business Development Centers, SCORE, Women's Business Centers and Veterans Business Outreach Centers, are available to work with small businesses experiencing difficulties.

Below is SBA loan approval and charge-off² data for the last ten years (2019 information is year-to-date) on the four franchises identified in your letter, both nationally and for the State of Nevada. (Please note that SBA loans to Experimac did not predate 2016.)

1. Experimac (Fiscal Years 2016-2019)

Number of SBA loans approved: 77 nationally, 2 in Nevada

Number of SBA loans charged off: 23 nationally, 1 in Nevada

2. Complete Nutrition (Fiscal Years 2009-2019)

Number of SBA loans approved: 67 nationally, 2 in Nevada

Number of SBA loans charged off: 8 nationally, 0 in Nevada

3. Dickey's BBQ (Fiscal Years 2009-2019)

Number of SBA loans approved: 246 nationally, 4 in Nevada

Number of SBA loans charged off: 41 nationally, 0 in Nevada

² Generally, charge-off occurs when all reasonable efforts to achieve recovery on the loan have been exhausted or the loan balance is deemed legally uncollectible.

4. Subway (Fiscal Years 2009-2019)

Number of SBA loans approved: 1,551 nationally, 10 in Nevada

Number of SBA loans charged off: 184 nationally, 3 in Nevada

We encourage Congressional offices to reach out to the FTC to learn more about franchise issues as well as their state Bureau of Consumer Protection for relevant information on franchisors operating in their states.

We appreciate your support of SBA and the Nevada small business community. If you or your staff have any additional questions, please feel free to reach out to me directly, or through our Office of Congressional and Legislative Affairs at (202) 205-6700.

Sincerely,



Dianna L. Seaborn
Director
Office of Financial Assistance

cc: United States Senate Small Business Committee Chairman, The Honorable Marco Rubio
United States Senate Small Business Committee Ranking Member, The Honorable Ben Cardin