LR - Hearing Before the Maryland Senate Finance Co
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Position: FAV

Hearing Before the Maryland Senate Finance Committee on Commercial Financing - Small Business Truth in Lending Act

Testimony of Don Cutwright, Senior Loan Officer, Baltimore Community Lending (BCL)

February 14, 2024

Chairperson Beidle, Ranking Member Kramer, and distinguished Members of the Committee, thank you for the opportunity to appear before you today. My name is Don Cutwright, and I am a Senior Loan Officer at Baltimore Community Lending (BCL). BCL is a Community Development Financial Institution (CDFI) located in Baltimore City with a dedicated mission to support the revitalization and strengthening of targeted neighborhoods through innovative and flexible financial resources. BCL's Small Business division provides loans, technical support, and training to startup and emerging small businesses located in Baltimore City, Baltimore, Howard, Harford, Carroll, and Anne Arundel County that do not have the collateral or face other barriers to qualifying for traditional loans.

I am testifying today because BCL frequently refinances high cost, non-transparent financing products obtained by our small business borrowers. Most of these small businesses are unaware of the actual APR for these products and they come to us for support because they are experiencing a strain on their cash flow as a direct result of this high-cost debt. You will hear from one of our amazing small business owner clients today who was able to refinance a high-cost merchant cash advance to stay afloat and rebuild her business finances. I am here today because we need to ensure that finance providers are disclosing the true cost of their products and setting Maryland business owners up for success. This would make it easier for lenders like

Baltimore Community Lending to meet our mission by connecting with borrowers at the time when they are ready to grow, rather than when they are at risk of shutting their doors. I urge you to stand with Maryland business owners by supporting this bill as introduced.

Weaver Testimony on SB0509, the Commercial Financ

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Position: FAV

Honorable Delegates, thank you for the opportunity to testify on this important issue.

I am a Maryland native and resident of Takoma Park, MD. I founded and was CEO until recently of Opportunity Fund, which is the largest non-profit provider of micro and small business loans nationwide.

During my time at Opportunity Fund following the Great Recession we saw an increasing number of small businesses coming to us desperately trying to refinance merchant cash advances they had taken out without understanding how expensive they actually were, because they had never been given an interest rate or an APR. They were unable to afford the daily payments and afraid of losing their businesses. We decided to find out what was going on. We analyzed 150 of the financing contracts they had with merchant cash advance providers. By looking at the financing contracts and making estimates of their business' future payments based on their historical revenues, we were able to calculate the actual Annual Percentage Rates, or APRs, on these small business credit products.

We found that the average APR on these 150 transactions was 94%. The average APR the MCAs charged Black business owners was higher, at 128%. The highest APR we found was an astonishing 358%! It was easy to compute the APRs. We had enough data to pretty accurately calculate how much income the business owners had available to pay debt service after paying all their other bills. We found their monthly payments on these loans were on average nearly double what the business owners could afford—at 178%! Hispanic business owners were made to pay over 400% of the actual income they had available. These loans are often not sustainable, and they are putting people out of business.

When these finance companies tell you it is impossible for them to calculate an estimated APR at the time the loan is made, it is not true. They are choosing the amount they advance to a customer based on that customer's historic revenues—either by looking at their bank statements or their credit and debit card sales. They know exactly what percentage return they are expecting from that customer. The business owner deserves to know as well!

SB 0509 - MBA - FAV - GR 24.pdf
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SB 509 - Commercial Financing - Small Business Truth in Lending Act
Committee: Senate Finance Committee
Date: February 14, 2024
Position: Favorable

The Maryland Bankers Association (MBA) **SUPPORTS** SB 509. This legislation establishes a regulatory framework for businesses engaged in commercial financing transactions. This new framework would appropriately fall under the regulatory and enforcement authority of the Office of Financial Regulation (OFR).

While OFR currently has the power to investigate financial transactions to determine any violations, SB 509 would positively impact Maryland small businesses by implementing consistent standards and transparency requirements for commercial lenders to ensure equity and accountability in lending.

Maryland banks are proud to work with thousands of Maryland businesses to offer extensive responsible commercial financing products and services and strongly support transparency for all small business financing.

This bill is a smart step forward in protecting Maryland small businesses and accordingly, MBA urges a **FAVORABLE** report on SB 509.

The Maryland Bankers Association (MBA) represents FDIC-insured community, regional, and national banks, employing more than 26,000 Marylanders and holding more than $209 billion in deposits in over 1,200 branches across our State. The Maryland banking industry serves customers across the State and provides an array of financial services including residential mortgage lending, business banking, estates and trust services, consumer banking, and more.

Everett K. Sands Testimony SB0509-HB574.pdf
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Position: FAV

lendistry

February 13, 2024

Honorable members of the committee, thank you for your time and attention. My name is Everett K. Sands, and at my lending institution, Lendistry, we can calculate APR faster than Gunner Henderson can turn a double play, faster than you can eat a Berger cookie, faster than you can sign your name. For a responsible lender that has their customer's best interest in mind, it's that easy. Lendistry has provided financing with transparent APR disclosures for hundreds of Maryland businesses, 69% of which were minority-owned. We do it dozens of times per day nationwide. It is likely the least complicated thing we do when processing a loan application.

For the record, any lender who tells you calculating APR with the proper disclosures isn't feasible most likely makes their money from charging astronomical hidden fees. Yes, this bill could put predatory lenders out of business, and that is the best possible outcome for Maryland's small business owners. When small business owners in Maryland are empowered with clear information about their financing options, they have the opportunity to choose the best product for their needs. Every entrepreneur deserves access to responsible, affordable capital that will help their business thrive, not force them out of business. Access to this information will not hurt Maryland small business owners because Lendistry and its fellow Community Development Financial Institutions (CDFIs) will be here to support them.

Lendistry was founded to show small business owners that fast and flexible business loans could be done responsibly. I have more than 20 years of experience in lending at community banks, and at one of the largest national banks. As founder and CEO of Lendistry, I have focused on innovating and executing alternatives to traditional financing to support the underserved small businesses that frequently fall through the gaps, particularly those owned by minorities, women, veterans, and people in rural areas. My team and I have made it our mission to disrupt the predatory lending industry, and the transparency provided through the Commercial Financing - Small Business Truth in Lending Act will go a long way toward supporting that mission.

To date, our grant and loan programs have provided over 630,000 small businesses with nearly $10 billion in capital. More than 60% of Lendistry's outstanding principal loan balance is with minority and women-owned borrowers, more than 70% is with underserved small businesses, and 60% is with low- or moderate-income borrowers. Lendistry was the #8 PPP lender in the country in 2021, ranked above large banks like Wells Fargo. We have served more than 12,000 Maryland small businesses. All this is to assure you that, while my team and I never claim to have found the final solution, we have made significant progress in reaching the communities that need capital and lack experience with the application process. We also have significant insight into the financial hurdles they face that drive them to see predatory lenders as their only option if they want to sustain and grow their businesses.

Nearly ten million new businesses were formed in 2020 and 2021, according to the U.S. Census Bureau.[1] The nearly 4.4 million new businesses formed in 2020 was more than 50 percent higher than the average annual number of new businesses formed between 2010 and 2019.[2] In fact, 2020's new business formation figure was a record, but it stood for just one year before it was far surpassed by the 5.4 million new businesses formed in 2021.[3]

Furthermore, a raft of data reveals how significant a role minority and women entrepreneurs have played in the recent new business formation activity[4][5][6], building on their already-strong pre-pandemic entrepreneurial representation.[7]

According to the Intuit QuickBooks Small Business Index's Annual Report, access to financing is harder to obtain for new businesses and those owned by women or underrepresented racial groups. Small businesses owned by underrepresented racial groups are twice as likely to say "getting funding" is their #1 challenge. 72% of men who own small businesses say they can get funding over the next 12 months but among women, this drops to 64%[8]. In my experience, continued access to nonbank fintech credit is key for small businesses, particularly those who tend to need smaller dollar loans.

The capital access landscape many small businesses have traversed before and since the pandemic resembles a desert, where the lifeblood of responsibly-priced capital is scarce. Worse, it is a desert that is made almost impossibly steep by the prevalence of predatory lenders that have filled a void left by two decades of bank consolidation. The small businesses that tend to be most affected by these arduous conditions are those owned by minorities, women, and veterans; those located in rural areas; and those which, regardless of their

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1 "New Startups Break Record in 2021: Unpacking the Numbers," Daniel Newman and Kenan Fikri for Economic Innovation Group, January 19, 2022. https://eig.org/news/new-start-ups-break-record-in-2021-unpacking-thenumbers

2 "Entrepreneurs Started Businesses in Record Numbers During the Pandemic," Brett Grossfeld for Salesforce.com's The 360 Blog, June 29, 2021. https://www.salesforce.com/blog/small-business-pandemicentrepreneurs/

3 D. Newman and K. Fikri

4 "Black Business Owners Are Up 38% from Pre-Covid Levels," Michael Sasso, *Bloomberg*, September 15, 2021. https://www.bloomberg.com/news/articles/2021-09-15/black-business-owners-are-up-38-in-u-s-from-pre-covidlevels?sref=2gRlZMND

5 "Black-owned businesses took a pandemic hit, but they're doing better than ever now – largely because of Black women," Jason Lalljee, *Insider*, February 7, 2022. https://www.businessinsider.com/black-women-businesses-fuelincrease-pandemic-hit-entrepreneurship-covid-2022-2

6 "Black women are the fastest growing group of entrepreneurs. But the job isn't easy," Elana Dure, J.P. Morgan Chase, October 21, 2021. https://www.chase.com/personal/investments/learning-and-insights/article/blackwomen-are-the-fastest-growing-group-of-entrepreneurs-but-the-job-isnt

7 "Black Entrepreneurship Represents Highest Rate in U.S.," Bryan Lipiner, Global Enterpreneurship Monitor, August 13, 2020. https://entrepreneurship.babson.edu/gem-data-black-entrepreneurship-us/

8 Intuit QuickBooks Small Business Index Annual Report 2023, October 6, 2023, https://quickbooks.intuit.com/r/small-business-data/index-annual-report-2023/?cid=pr_TOF_QBB_press-release_US_EN_SMBIndex_AR

ownership demographics, have capital requirements that are simply too small to be profitably served by traditional banks, whose median asset size ballooned by more than 500% between 2000 and 2019.[9]

While traditional banks are very effective in deploying very large amounts of capital, their operational incentive is to do so through as few separate underwritings as are prudent from a risk management perspective, resulting in a very large average loan size. This logic also bears out in Federal Reserve survey data regarding the businesses that traditional banks tend to establish relationships with. Minority-owned businesses—which are disproportionately small businesses—are much less likely than other businesses to have banking relationships.[10]

It is urgent that policymakers hold lenders accountable for providing capital to these businesses with integrity. The predatory claim that it is too difficult or expensive to break down APR calculation clearly is simply false. If it were, Lendistry and its fellow responsible lenders would not be able to provide this detail today.

Everett K. Sands
CEO

[9] Most banks simply are too large to efficiently make small loans. Twenty years of bank consolidation has cut the number of FDIC-chartered banks in the U.S. by 45%. According to FDIC data, there were 8,315 FDIC-insured banks in 2000, compared to 4,519 in 2019, with just 32 new FDIC-insured bank charters issued since 2010. As a result, the median asset size of remaining banks has grown by more than 500%, from $751 million in 2000 to $3.9 billion in 2019.

[10] Federal Reserve Banks, 2019 Small Business Credit Survey and 2020 Report on Employer Firms. Fewer than 1 in 4 Black owned businesses with employees and fewer than 1 in 3 Latinx-owned businesses with employees had received funding from a bank in the prior five years, compared with nearly half of white-owned firms with employees. Moreover, just 1 in 10 Back-owned sole proprietorships or independent contractors – which comprise a disproportionate share of all Black-owned businesses – had a recent borrowing relationship with a bank, compared with 1 in 4 white-owned non-employer businesses.

Everett Sands oral testimony SB0509-HB574.pdf
Uploaded by: Everett Sands
Position: FAV

February 14, 2024

Senator Beidle, Senator Klausmeier and honorable members of the committee, thank you for your time and attention. My name is Everett K. Sands, and at my lending institution, Lendistry, we can calculate APR faster than Gunner Henderson can turn a double play, and faster than you can sign your name. We are a nationwide lender who has taken over 12,000 applications in Maryland. For a responsible lender that has their customer's best interest in mind, it's that easy. Lendistry has provided financing with transparent APR disclosures for hundreds of Maryland businesses, 69% of which were minority-owned. It is likely the least complicated thing we do when processing a loan application.

For the record, any lender who tells you calculating APR with the proper disclosures isn't feasible probably makes their money from charging astronomical hidden fees. Yes, this bill could put predatory lenders out of business or cause them to charge more responsible fees, and that is the best possible outcome for Maryland.. When small business owners in Maryland are empowered with clear information about their financing options, they have the opportunity to choose the best product for their needs. Every entrepreneur deserves access to responsible, affordable capital that will help their business thrive, not force them out of business.

My team and I have made it our mission to disrupt the predatory lending industry, and the transparency provided through the Commercial Financing - Small Business Truth in Lending Act will go a long way toward supporting that mission.

Thank you for your time.

767 S. Alameda Street, Ste. 340, Los Angeles, CA 90021 | 888.594.7270 | lendistry.com

2019 Federal Reserve Report Uncertain Terms What S

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Position: FAV

Board of Governors of the Federal Reserve System

Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites

December 2019

Barbara J. Lipman
Manager, Policy Analysis Unit, Division of Consumer & Community Affairs
Federal Reserve Board

Ann Marie Wiersch
Senior Policy Analyst, Community Development
Federal Reserve Bank of Cleveland

Special thanks to Scott Colgate and PJ Tabit from the Federal Reserve Board for their considerable assistance with the technical aspects of the website review, including the assessment of visitor tracking tools.

The authors wish to thank the following colleagues for their thoughtful comments, managerial support, and guidance: Angelyque Campbell and Alejandra Lopez-Fernandini from the Federal Reserve Board and Lisa Nelson from the Federal Reserve Bank of Cleveland. The authors also appreciate research assistance provided by Lucas Misera and Logan Herman, former interns at the Federal Reserve Bank of Cleveland. Finally, thanks are due to Madelyn Marchessault, Susan Stawick, Pamela Wilson, and Anita Bennett from the Federal Reserve Board for the valuable assistance they provided to this publication.

Contents

Executive Summary

This report discusses findings of a study conducted by the Federal Reserve Board and the Federal Reserve Bank of Cleveland to assess the information presented to prospective borrowers on small business online lender websites. The Federal Reserve has an ongoing interest in small businesses and their access to the credit they need to succeed and grow. Without adequate credit, they may underperform, slowing economic growth and employment. As the small business credit market evolves, prompting discussion about borrower protections, the experiences of small business owners are an important consideration.

Nonbank online lenders are becoming more mainstream alternative providers of financing to small businesses. These nonbank lenders offer small-dollar credit products including cash advances, lines of credit, and various types of loans, typically under $100,000. Borrowers can apply in minutes and receive funds in days or even hours, expedience made possible with data-driven technologies. The industry's growing reach has the potential to expand access to credit for small firms, but also raises concerns about product costs and features, and the manner in which these are disclosed to prospective borrowers.

This study considers the information that is important to prospective borrowers and the availability of such information on lender websites for the purposes of understanding and comparing product costs and features. The study includes a systematic analysis of the content on online lender websites, such as, where and how credit products' costs and other details are disclosed, how much product information is made available before website visitors are asked to supply the owner's personal or business information, and the extent to which visitors are tracked.

Key Findings of the Study

- Online lenders varied significantly in the amount of information provided, especially on costs. Lenders that offer term loan products were likely to show costs as an annual rate, while others convey costs using terminology that may be unfamiliar to prospective borrowers. Still others, particularly those that offer merchant cash advances, provide no information at all.
- Among lenders that provide cost details, their websites varied in the presentation of information. Lenders commonly present lowest-available rates. Ranges or average rates, if shown, are most often found in footnotes, fine print, or frequently asked questions (FAQs).
- On a number of the websites examined for this study, prospective borrowers must provide the lender with personal and business information in order to obtain details about products' costs and terms. Lenders' policies permit any user-provided data to be used by the lender and other third parties to contact business owners, often leading to bothersome sales calls.
- Online lenders make frequent use of trackers to monitor visitors on their websites. So, even when visitors do not share identifying information with the lender, embedded trackers may collect this information, as well as data on how visitors navigate the lender's website and other sites they visit.

Several implications arise from these findings, and addressing these issues is all the more important as online lending becomes more mainstream. For one, the lack of standardization in product descriptions across lenders' websites was identified in previous focus group research to be a source of confusion for small business owners. Focus group participants reported challenges understanding product terms and making product comparisons, suggesting that standardized disclosures could support more informed borrowing decisions. Moreover, in cases where lenders do not provide up-front pricing details, businesses incur a "cost" when sharing their information to request a quote or start an application. In addition to exposing their business to a potentially burdensome number of phone calls and a flurry of marketing content, some lenders may run credit checks early in the process, even if the business owner is just shopping rates. Furthermore, businesses could be subjecting their data to use by lenders and other third parties.

Finally, the data collected from trackers may be matched with data from external sources to develop profiles of small businesses that shop for credit online. Small business advocates have voiced concerns that data collected surreptitiously through trackers may be matched with data from third-party sources to identify individual business owners. It is unclear whether these data are used to underwrite and price offers of credit.

Overview of Small Business Online Lending

Online lenders are nonbank credit providers that serve small business borrowers using data-driven processes and technology. These lenders are increasingly becoming mainstream providers of financing to small businesses.[1] According to the Federal Reserve's Small Business Credit Survey (SBCS), an annual survey of small businesses, credit seekers are increasingly turning to online lenders. Over the past three years, the share of applicants that reported they applied at an online lender increased from 19 percent in 2016 to 24 percent in 2017, and to 32 percent in 2018.[2]

Customers of online lenders apply, are processed, underwritten, receive funds, and are serviced largely—though not entirely—online. While the structure and features of the credit products vary significantly, they generally fall into one of two categories:

- **Loans and lines of credit:** Some loans are term loans with fixed rates, multi-year terms, and fixed monthly payments. Other products have a less traditional structure, with fixed fees or total repayment amounts, and requiring weekly or daily payments. Equivalent annual percentage rates (APRs) typically range from 10 percent to 80 percent, and funds are often repaid in six to 18 months.
- **Merchant cash advances (MCAs):** MCAs entail the sale of future receivables for a set dollar amount, repaid with a set percentage of the business's daily sales receipts. For example, $50,000 in capital is provided in exchange for $65,000 in future receipts, repaid with automatic draws of 10 percent of daily credit card sales. Depending on the speed of repayment, equivalent APRs may exceed 80 percent or even rise to triple digits. MCAs are generally repaid in three to 18 months.

Lenders themselves vary in their business models, as some lend their own funds while others connect borrowers with investors. Note that for purposes of this report, lenders utilizing any of these business models and offering these types of products are referred to as "online lenders." Though some online lenders specialize in specific types of financial products, it is clear from Federal Reserve focus group studies that small business owners view these companies collectively as lenders, and their various products as loans. Payments processors are also active in lending, as they offer loans to the merchants that process payments through their online platforms, but for this analysis are considered separately.

Lenders assert that they are broadening access to credit, reaching borrowers underserved by traditional lenders. SBCS data suggest that smaller, newer, and minority-owned firms are more likely

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1 Because online lenders have no requirements to report lending volumes, there are no reliable figures on industry growth; however, top small business lenders that publish statistics have indicated steady increases in lending.

2 The Small Business Credit Survey is an annual survey of employer and non-employer small firms administered by the 12 Federal Reserve Banks; see https://www.newyorkfed.org/smallbusiness/small-business-credit-survey-2018.

to apply to online lenders.[3] In addition, the data suggest medium- and high-credit-risk applicants have had greater success obtaining credit at online lenders than at traditional banks (approval rates of 76 percent versus 34 percent at large banks and 47 percent at small banks).[4]

Applicants that chose to seek financing at online lenders reported the most important factors in their choices were the speed at which they expected lenders to approve and/or fund their application, and their perceptions that they had a better chance of being approved at an online lender.

While more applicants are successfully funded at online lenders, the SBCS indicates satisfaction levels with online lenders are far lower than with traditional lenders (net satisfaction of 33 percent at online lenders versus 73 percent at small banks and 55 percent at large banks).[5] In 2018, 63 percent of online lender applicants reported challenges working with their lender, with more than half saying they experienced high interest rates and almost a third reporting concerns with unfavorable repayment terms.

Also, it is important to note that the Truth in Lending Act (TILA) rules that apply to consumer loan and credit products generally do not apply to business credit, so in practice, lenders have more flexibility in their disclosures of product costs and features.[6] And indeed, as discussed in the next section, qualitative studies suggest that small business owners struggle to understand the wide range of products offered by online lenders and the unfamiliar terminology that some lenders use in their product descriptions.

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[3] Ann Marie Wiersch, Barbara J. Lipman, and Brett Barkley, *Click, Submit: New Insights on Online Lender Applicants from the Small Business Credit Survey,* (Federal Reserve Bank of Cleveland special report, October 2016), https://www.clevelandfed.org/newsroom-and-events/publications/special-reports/sr-20161012-click-submit.aspx. As of this writing, an updated version of this report is forthcoming. See also, Mark E. Schweitzer and Brett Barkley, "Is 'Fintech' Good for Small Business Borrowers? Impacts on Firm Growth and Customer Satisfaction," Working Paper 17-01 (Federal Reserve Bank of Cleveland, February 2017), https://www.clevelandfed.org/newsroom-and-events/publications/working-papers/2017-working-papers/wp-1701-is-fintech-good-for-small-business-borrowers.aspx.

[4] Federal Reserve System, 2019 *Report on Employer Firms: Small Business Credit Survey,* https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/sbcs-employer-firms-report.pdf. Approval rate is the share of firms approved for at least some credit.

[5] In the SBCS, net satisfaction is the share of firms satisfied minus the share of firms dissatisfied.

[6] The Truth in Lending Act is implemented through Regulation Z. Regulation Z does impose certain substantive protections applicable to credit card holders, including where the card is issued for business use. Alternative small business lenders, however, do not typically issue credit cards.

About the Study

This study builds on prior work, including two rounds of focus group studies conducted by the Federal Reserve (see box 1) and quantitative findings from the SBCS.[7] The participants in these focus group studies—more than 80 small business owners—completed a "virtual shopping" exercise and compared mock products based on real online product offerings. These studies found that small business owners struggle to understand many of the products offered by online lenders and the unfamiliar terminology that some lenders use in their product descriptions.[8]

Box 1. Background on Focus Groups Studies

- Online focus groups with more than 80 business owners
- Two rounds of focus groups: 2014–2015 and 2017
- Participants were the business owner or financial decisionmaker
- Participants' small businesses:
  - Less than $2 million in revenue, fewer than 20 employees
  - In business at least two years
  - Included a variety of industries from across the United States
  - Had applied for credit in the prior 12 months (2017 focus group only)
- Topics:
  - Process for seeking short-term credit
  - Impressions of websites when virtually "shopping"
  - Evaluations of mock credit products and recommendations
- Key findings:
  - Participants found the websites appealing, but many noted information they sought was not readily accessible
  - They strongly disliked that information they considered important appeared in fine print or footnotes
  - Terminology used to describe the products was unfamiliar to some
  - They reported that aspects of the product descriptions were confusing or lacking sufficient detail
  - They found it challenging to identify interest rates or estimate costs
  - They made (sometimes mistaken) assumptions about the products based on past experiences with traditional bank loans

This present study considers the information that is important to prospective borrowers and the availability of such information on lender websites for the purposes of understanding and comparing

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[7] See Barbara J. Lipman and Ann Marie Wiersch, *Alternative Lending Through the Eyes of "Mom & Pop" Small Business Owners: Findings from Online Focus Groups* (Cleveland, OH: Federal Reserve Bank of Cleveland, 2015), https://www.clevelandfed.org/newsroom-and-events/publications/special-reports/sr-20150825-alternative-lending-through-the-eyes-of-mom-and-pop-small-business-owners.aspx; and Barbara J. Lipman and Ann Marie Wiersch, *Browsing to Borrow: "Mom & Pop" Small Business Perspectives on Online Lenders* (Washington: Federal Reserve Board, 2018), https://www.federalreserve.gov/publications/files/2018-small-business-lending.pdf.

[8] It is important to note that focus groups are designed to gather insights, not to measure incidence. Findings are not necessarily reflective of a wider population of small businesses.

product costs and features. The study includes a systematic analysis of the content on online lender websites, including:

- where and how credit products' interest rates, fees, repayment and prepayment terms, and other features are disclosed;
- how much product information is made available before website visitors are asked to supply the owner's personal or business information; and
- the extent to which data on visitors are collected, either passively through trackers or actively through inquiry forms.

This work was inspired by two previous efforts, one by the Federal Trade Commission (FTC) and the other from the Financial Conduct Authority, the United Kingdom's consumer protection agency.[9] Both studies examined how information was displayed on the websites of consumer online lenders, identifying the number of clicks needed to obtain certain product information and the font displaying that information. The FTC study also looked at the extent to which site visitors are tracked. These two studies focused on consumer lenders, while the study presented in this report focuses on small business credit providers.

Among the caveats to note, the scope of this study includes only the content and features of select lender websites. Therefore, the findings should not be considered representative of all websites in the industry. Importantly, the websites covered in the study largely overlap, but differ somewhat from those that the participants chose to view in the focus group studies. Note that the study does not explore what information lenders communicate directly to individual small business owners that seek credit. Finally, the study does not address provisions of formal offers of credit or loan agreements, and makes no attempt to assess whether the product terms described on lenders' websites match the terms in actual loan agreements.

Methodology

The authors considered several factors in developing the list of 10 online lending companies included in the study. The list was compiled so as to include established lenders that report significant small business credit activity. In addition, the authors considered which lenders small business owners would encounter when conducting internet searches for small business lenders. To this end, the authors consulted numerous lists of the industry's largest lenders and conducted multiple keyword searches, identifying those lenders that appeared earliest in the search results. Finally, the authors attempted to ensure that a cross-section of lenders—based on business models and products offered—were included. Note that the list is not representative of the composition of the industry, which is highly fragmented and includes a significant number of small lenders, MCA providers, and broker websites.

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[9] This study builds on earlier work by the Federal Trade Commission, "A Survey of 15 Marketplace Lenders' Online Presence," June 2016, https://www.ftc.gov/system/files/documents/public_events/944193/a_survey_of_15_marketplace_lenders_online_presence.pdf and the U.K. Financial Conduct Authority, Payday Lending Market Investigation, "Review of the Websites of Payday Lenders and Lead Generators," appendix 6.4, February 2015, https://assets.publishing.service.gov.uk/media/54ebb75940f0b670f4000026/Appendices_glossary.pdf.

Separate from the 10 online lenders, the study reviewed the websites of two payments processors that extend loans to their merchant customers. These companies were considered separately because offers of credit products are made to existing customers, based on information that the company already has. Many of the considerations in the study, therefore, do not apply. Finally, for comparison purposes only, the authors identified five commercial banks that offer online applications for small business loans, and reviewed the presentation of product information on those websites.

The study itself involved a systematic review of the content on lenders' websites, ways in which their products are described, and the processes through which lenders collect information from prospective small business borrowers. The authors reviewed 15 different aspects of the content, documenting in standard forms the language used and where and how the information is displayed. The specific variables reviewed are described in the following section. In addition, the study utilized a Chrome browser extension to identify and quantify the number and types of third-party trackers employed by the websites.

As noted earlier, this study is intended to capture the information that prospective borrowers encounter when researching and comparing credit products. Therefore, throughout the report, the content described is not associated with the names of specific lenders.[10] Although the information shown is publicly available, company names have been anonymized as this analysis is intended to describe typical practices in the marketplace rather than to single out practices of individual companies.

Considerations for the Study

To ascertain which aspects of product descriptions should be considered in the study, the authors consulted various sources.

Focus group studies: The participants in the two rounds of focus groups (outlined in box 1) described the information they were looking for when they completed a virtual shopping exercise. Participants identified the following details as being important to them as they searched for information on online lenders and the funding products these lenders offer:

- application process and information required by the lender for the application
- approval requirements/qualifications
- interest rates, fees, and other charges
- repayment terms (frequency, length of term, method of repayment)
- maximum available loan amounts

[10] Online lenders considered in this study include BFS Capital, CAN Capital, Credibly, Fundation, Funding Circle, Kabbage, Lending Club, National Funding, OnDeck, and Rapid Finance. Payments processors include PayPal Working Capital and Square Capital. Commercial banks include Bank of America, Live Oak Bank, TD Bank, US Bank, and Wells Fargo. The order in which the companies are listed here does not correspond to the identifiers used in subsequent sections of this report.

- time to approve application and speed of funding
- trust cues (customer reviews, Better Business Bureau ratings, etc.)

Truth in Lending Act: While, as noted earlier, TILA rules generally do not apply to business credit, the requirements provide a frame of reference for disclosure of credit products. Additionally, because the business owners using online lenders tend to be smaller "mom & pops," they are very consumer-like in their approach to financing.[11] Most have limited financial expertise and, more often than not, do not have a dedicated chief financial officer on staff.

Although not intended for small business credit, TILA provides useful guidelines for the advertising of consumer credit products, including what's shown on websites. The requirements ensure the costs of various credit products are comparable since financing charges must be shown as an APR. The guidelines also help to ensure important details—like repayment terms and fees—are described clearly, so consumers are not misled by statements in advertising.

FTC dot.com guidance: The website analysis considers not only what is presented, but how it's presented. The FTC's dot.com guidance says disclosures should[12]

- be truthful; not misleading or unfair,
- use understandable language,
- be readily noticeable to consumers and not require scrolling,
- use the same font size as other text,
- be located near advertising claims they qualify, and
- not relegate necessary information to "terms of use."

Taking the focus group findings, the TILA rules, and the FTC guidance into account, the authors developed a framework for a systematic review of the description and display of 15 items (see box 2).

[11] See Small Business Credit Survey, *2019 Report on Employer Firms,* Data Appendix, Employer Firms by Revenue, https://www.fedsmallbusiness.org/survey.

[12] Federal Trade Commission, *.com Disclosures: How to Make Effective Disclosures in Digital Advertising* (March 2013), https://www.ftc.gov/sites/default/files/attachments/press-releases/ftc-staff-revises-online-advertising-disclosure-guidelines/130312dotcomdisclosures.pdf.

Box 2. Elements Included in Systematic Website Review

- Lenders' appeal to prospective customers
  - Main marketing pitch
  - Trust cues, such as customer reviews, Better Business Bureau ratings, etc.
- Application process
  - Approval requirements and borrower qualifications
  - Information required to initiate an application
  - Application form and identification of product
  - Impact of an inquiry on credit score
  - Speed of approval and funding
- Products, rates, fees, and features
  - Level of detail in product descriptions
  - Terminology used to describe interest rates and additional costs and fees
  - Repayment terms
  - Prepayment savings or penalties
  - Maximum loan amounts

This review tracked language used on websites, the level of detail provided, and the position and appearance of text for key information.

Themes and Observations from Online Lender Website Analysis

Online Lenders Seek to Engender Trust

While online lenders have grown and become more mainstream, the industry is still relatively new and faces challenges in attracting customers. One contributor to those challenges is the unfavorable views of the industry held by some prospective borrowers.

During the focus group studies, small business participants were asked for their initial impressions of "online lenders." Some participants had positive perceptions. They thought of these lenders as being faster, more efficient, and more willing to work with small business borrowers. Some thought that, since they have less overhead, online lenders would be more affordable. However, a larger share of participants had negative impressions, associating online lenders with high costs and interest rates. Some of their responses indicated a lack of trust in online lenders, while others mentioned unwanted calls, mail, and email.

Online lenders have positioned themselves as trusted alternative providers of small business credit, advertising their faster, more convenient processes and their product options for firms with low credit scores. The content on the lenders' websites reflects their awareness of borrowers' perceptions of the industry. Indeed, focus group participants reported having more positive impressions of online lenders after visiting some of the lender websites during the virtual shopping exercise.

The headings, taglines, and other prominent text on lenders' websites convey their focus on speed and simplicity ("Get a quote in minutes," "minimal paperwork"), while also highlighting their flexibility and willingness to work with small businesses with less-than-perfect credit ("High approvals," "All credit scores are considered").

Some focus group participants were impressed with sites that offer comparison charts, but a review of these charts suggests many lack specific content. Lenders give themselves check marks for fast funding, easy process, and flexible approval criteria, shown side-by-side with unfavorable marks (Xs or blanks) they attribute to nonspecific competitors ("banks" or "other lenders"). In most cases, these charts simply reiterate companies' sales propositions, while relaying minimal details about product features or costs that would be useful to a prospective borrower who is comparison-shopping.

This analysis finds that online lenders seek to engender the trust of businesses visiting their websites. This was most evident in the display of badges and logos of various business intermediaries—such as the Better Business Bureau, Trust Pilot, and similar organizations. Mentions of their companies in the media also were often featured on the pages, as well as ratings and endorsements from outside organizations. Five of the 10 lenders also referenced a relationship with an FDIC-insured bank. This strategy does appear to reassure some visitors:

"I'm not sure why I trust them, but I do. Maybe because they state they are BBB accredited."

"I appreciated how they address concerns about their credibility up front with their BBB and TrustPilot rating."

While reviews, ratings, and testimonials were valued by some focus group participants, a scan of online lenders' reviews and ratings revealed very little specific information about products; however, these are the details that are important to borrowers, based on responses from focus group participants. Most reviews were positive, but limited to customers' early interactions with their lenders. The majority either commented on positive experiences with sales representatives, simple applications, or quick turnaround; they offered little insight on the products themselves or experiences with the lenders after receipt of funding.

Inquiries Lead to Collection of Prospective Borrowers' Data

All of the online lenders' websites prominently feature links and buttons prompting visitors to "apply now" or "get a quote." These links connect visitors to pages on the websites with online forms to input their personal and business information. These forms typically serve as an initial inquiry with a lender, either requesting pricing information or initiating an online application. They collect contact information from prospective borrowers, and in many cases, financial details—including annual revenues, credit scores, and account balances. In at least one case, the lender requests that the applicant grant access to the business's Quickbooks account to expedite the application process.

Table 1. Select details on application processes from online lender websites

Online lender	Common application form for all products	Initial inquiry impact on credit score*	Consent to use of contact information
Company A	Not applicable, only one product offered	Soft pull: "won't affect your credit score"	By clicking "continue" on lenders "get a quote" form, user gives consent
Company B	Common application; fine print on application form notes user is not applying for a specific product	Soft pull: "will not impact your personal credit score"	By clicking "continue" on application form, user gives consent
Company C	Common application; all "get quote" links for all products lead to same form, same URL	Soft pull: "no credit impact to get a quote"	By clicking "continue" on "get my quote" form, user gives consent

Company D	Not applicable, only one product offered via online application	Credit check: FAQs specify that credit report is pulled for business owner	By clicking “get started” on application form, user consents to privacy policy (includes permission to contact)
Company E	Common application; all “apply now” links lead to same form/URL, regardless of page or product	Soft pull: “no impact on credit score”	Website’s terms of use specifies that user expressly consents to be contacted
Company F	Common application; “get started” links on all product pages lead to same form/URL	Soft pull: prequalification “does not negatively impact your credit score”	Prequalification form includes authorization to contact
Company G	Not applicable, only one product offered	Soft pull: “won’t impact your credit score”	Website’s terms of use specifies that user expressly consents to be contacted
Company H	Common application; all “apply now” links lead to same form/URL, regardless of page or product	Not specified; terms and conditions authorizes company and affiliates to request credit report	By clicking “get started” on application form, user consents to terms and conditions (includes permission to contact)
Company I	Common application for two products, though application link appears only in the menu and not with product descriptions	Not specified; privacy policy specifies that the company may obtain credit reports	Website’s privacy policy specifies that users consent to be contacted
Company J	Common application for two types of loans and MCAs; “apply now” links on both product pages lead to same form/URL	Credit check; “personal credit check is part of the approval process”	User must check box indicating agreement with privacy policy; permission to contact also described in a footnote on application form

Note: Although all information shown is publicly available, company names have been anonymized, as this analysis is intended to describe typical practices in the marketplace rather than to single out practices of individual companies.

* A “soft pull,” also known as a soft inquiry, is a credit check performed by a lender to pre-qualify a prospective borrower. Unlike hard credit inquiries, soft pulls do not appear on customers’ credit reports and do not affect their credit scores.

Source: Authors’ analysis of company websites, as of August, 2019.

A majority of the companies utilize a common application, that is, a single form for all products. For example, the “apply now” link shown with a lender’s business loan description, and the “apply now” link shown with their MCA description both lead to the same URL and application form. In such a case, a prospective borrower may complete an application seeking a business loan. The concern is that this may be a potential source of confusion for borrowers who think they may be applying for one product, but are offered another product with different terms than what they were seeking.

Once a user completes a lender’s application or inquiry form, the lender begins steps to verify the creditworthiness of the user and to establish terms of any credit offer that may be extended.

Several companies advertise that their initial credit check will not affect the user's credit score, often specifying that only a "soft pull" is done upon receipt of the application or inquiry. Other companies state, typically in Terms of Use or FAQ pages, that a credit check is part of the application process, without reference to a soft pull.

Lack of Information Prompts Solicitation

Lenders vary significantly in the level of upfront information they provided to prospective borrowers. On some sites, product descriptions feature little or no information about the actual products, but instead focus on the ease of applying and qualifying for funding, the speed at which applications are approved, and the array of uses for loan proceeds. Details that were important to focus group participants—rates, fees, and repayment information—were absent from several of the websites. In some cases, details like loan terms were found on Terms and Conditions pages or in FAQs. Note that the lack of detail described here is typical of lenders that cater to higher-risk borrowers and those that offer MCAs.

As noted earlier, on the websites of several online lenders included in this study, visitors must enter their personal and business information in order to obtain information about the lenders' products. Some focus group participants that encountered such sites during the virtual shopping exercise were frustrated by the lack of information:

> "All these sites are a lot of clicking around and not getting very far without providing information I'm not ready to provide. I don't want to be solicited for the rest of my life just because I was looking for some information."
>
> "I hoped to see rates, terms and what I qualified for. [The site] wouldn't provide any information without an email or contact info."
>
> "I couldn't get info unless I signed in. I wanted to know how much interest, and if I paid back quickly, was there lower interest."

Several participants cited concerns about lenders' requests for information about their businesses in online forms and the prospect of receiving solicitations as a result of providing this information. Indeed, the lenders themselves are somewhat transparent about their intent to use the information collected to make contact with the business. As shown in table 1, all of the companies include some provision for users to grant permission to the lenders and lenders' affiliates to contact them using any information the lender collects. On some sites, the consent is described explicitly on the application form; on others, consent is implicitly given, as described in the sites' privacy policy or terms of use pages. The consent provisions cover purposes that include communications regarding applications and loans, but also marketing and sales of additional products.

More than three-quarters of the focus group participants reported receiving some type of contact from online lenders in the past, either in the form of email, mail, phone calls, or offers. These contacts, particularly the phone calls, were bothersome to the participants:

> "I get these calls and emails almost every day. The worst part is they almost never take 'no' for an answer."
>
> "I received 20+ calls a week after I secured a loan with [an online lender]."
>
> "I get calls twice a week and emails all the time. You just want to shut it off and not be bothered by it."

Online Lender Websites Vary in Cost Information Provided

Some sites provide more details about the features of their financing products than others.[13] However, even on websites with more information, specific details about repayment, fees, and other items important to focus group participants were sometimes missing or not readily displayed. For example, one lender featured in prominent bold print the "as low as" rate for a loan product, but in a footnote, disclosed a far higher average rate for the product. A few lenders relied on footnotes to convey key details about products, especially costs (see table 2).

[13] This analysis covers companies' business loans, merchant cash advances, and lines of credit. Certain specialized products offered by some lenders, such as equipment leases and industry-specific loans, are not included.

Table 2. Select details from online lender websites

Online lender	Location of cost information	Product cost description*	Additional fees
Company A	On home page in box, details in footnotes	**Business loans:** rates described as a **Total Annualized Rate**; fixed rates ranging from 5.99% to 29.99%	Origination fee: 1.99% to 8.99% of loan amount
Company B	On home page in plain text, details on product pages in feature text and in footnotes	**Term loans:** costs shown as **simple interest** starting at 9% for short-term loans and Annual Interest Rate **(AIR)** starting at 9.99% for long-term loans (both rates exclude fees). **Lines of credit (LOCs):** costs shown as Annual Percentage Rate **(APR)** (starting at 13.99%, weighted average is 32.6%)	Origination fee: up to 4% of loan amount; monthly maintenance fees on LOC
Company C	Not provided	**Loans and lines of credit: no rates** or product costs are described **MCAs: factor rates** usually between 1.14 and 1.48	No information
Company D	On Rates and Terms page in feature text, details in footnotes	**Loans:** costs are described as a monthly fee determined by the **fee rate**, which ranges from 1.5% to 10%	Third-party partners may charge up to an additional 1.5% per month
Company E	Not provided	**Loans and MCAs: No rates** or product costs are described on the website	3% origination fee (loans), $395 admin fee (MCAs)
Company F	On product page in plain text	**Working capital loans and MCAs: factor rates** as low as 1.15 **Business expansion loans:** interest rates starting at 9.99% (not an APR)	Set-up or underwriting fee: 2.5% of loan total; Admin fee up to $50/month
Company G	On home page in feature text, details in tables on Rates and Fees page	**Loans:** costs shown as **fixed annual interest rate**, ranging from 4.99% to 26.99%	Origination fee: 0.99% to 6.99%; late payment fee: 5% of missed payment
Company H	Not provided	**Loans and MCAs: No rates** or product costs are described on the site	No information
Company I	Not provided	**Loans and MCAs: No rates** or product costs are described on the site	No information
Company J	Not provided	**Loans and MCAs: No rates** or product costs are described on the site	No information

Note: Although all information shown is publicly available, company names have been anonymized, as this analysis is intended to describe typical practices in the marketplace rather than to single out practices of individual companies.

* A factor rate is a rate used to calculate a borrowing fee, often expressed as a percentage of the borrowed amount and typically shown in decimal form.

Source: Authors' analysis of company websites, as of August, 2019.

The placement of product cost information on lenders' websites varies from lender to lender. In some cases, cost information—typically the lowest-available rate—is conspicuously displayed in an upfront manner that would be highly visible to a user visiting the website. A few lenders prominently advertise their costs in "feature" text, that is, in font that is larger than other text on the page, often in bold or in an accent color. Lenders also may display the information as part of graphic features like tables and boxes. By contrast, other lenders provide cost information in a way that is less visible to users of the websites—for example, in plain text or in footnotes at the bottom of a page.

Focus group participants had mixed reactions to footnotes. Many were frustrated by fine print, and said they thought lenders were trying to conceal information. Conversely, other participants appreciated the additional information provided in the footnotes, after being unable to successfully locate such details on some of the websites they encountered during their shopping exercise.

> "Any company hiding things in fine print and buried in paperwork should not be trusted."
>
> "Fine print [has] what I want to see. They're being more upfront and aboveboard about the reality of their loans."

In some cases, footnotes and fine print contain information on fees that companies typically charge for their products, aside from interest charges. These fees are most often for product origination, but others include administrative fees, account maintenance fees on credit lines, or fees charged by partners. Fees may be disclosed as a range of rates, flat monthly or one-time charges, or charges "up to" a set percentage. Some lenders do not describe any fees on their websites.

The website analysis found significant variation in the terminology used to explain products' costs. As shown in table 2, two lenders provide costs in the form of an annual rate that excludes fees; a third describes costs in APR terms for only one product, their line of credit. Several lenders describe costs for at least one of their products using nontraditional terminology, such as a "factor rate," "fee rate," or "simple interest." Four lenders provide no rates or costs for any of their products. For traditional term loans, product descriptions tend to be somewhat detailed, while descriptions for MCAs include little or no information about the actual costs and repayment terms.

The variation in the product cost descriptions was confusing to focus group participants. They found it challenging to determine products' actual costs and to compare products when descriptions used unfamiliar or varying terminology.

"It is difficult [to compare when] they are using different models and different terminology."

▪ ▪ ▪ ▪

"They don't like to use the word 'interest,' and they dress it up in other ways to conceal the real cost of the loan."

▪ ▪ ▪ ▪

"I don't know what a 'factor rate' is."

▪ ▪ ▪ ▪

"Full disclosure, like on credit cards or mortgages… is what is necessary. They need to state the actual APR."

Participants noted that the varying product descriptions provided no common basis for cost comparisons, and several suggested that APR would be helpful for that purpose. In fact, determining the equivalent APR on some products may be challenging, given the non-standard terminology and structure of products offered by online lenders. Table 3 presents APR-equivalents for a common scenario in which $50,000 is repaid in six months according to the terms and rates promoted on the lenders' sites.

Table 3. Estimated APRs for select online products

Rate advertised on website	Product details	Estimated APR equivalent
1.15 factor rate	• Total repayment amount $59,000 • Fees: 2.5% set-up fee; $50/month administrative fee • Term: none (assume repaid in six months) • Daily payments (assume steady payments five days/week)	Approximately 70% APR
4% fee rate	• Total repayment amount $56,500 • Fee rate: 4% (months 1–2), 1.25% (months 3–6) • Fees: none • Monthly payments • Term: six-month term	Approximately 45% APR
9% simple interest	• Total repayment amount $54,500 • Fees: 3% origination fee • Weekly payments • Term: six-month term	Approximately 46% APR

Source: Authors' calculations, based on product descriptions on company websites.

The non-standard terminology also proved challenging for focus group participants trying to compare online offerings with traditional credit products. For example, when asked to compare a sample short-term loan product with a 9 percent "simple interest" rate to a credit card with a 21.9 percent interest rate, most participants incorrectly guessed the short-term loan to be less expensive.[14] For another sample product—a $50,000 MCA with a factor rate of 1.2 and total repayment of $60,000—focus group participants were asked for their guesses of an interest rate, if the funds were repaid in one year. Interestingly, although all participants were presented with exactly the same information about the product, they responded with a wide range of estimates, from 10 percent to over 50 percent.[15]

Payment Arrangements Are a Source of Confusion

All companies described the frequency of required payments for their products, ranging from daily to monthly payments. Fixed payments were most common for term loans. Payments on MCAs are typically variable, as the payment amount usually fluctuates with sales volume. A few companies provided no information on the payment structure for one or more products offered.

As shown in table 4, companies provide limited details on the impact of prepayment. A few note that by prepaying, the customer incurs savings on interest (as they would with a traditional loan). Other companies advertise that some borrowers may qualify for prepayment discounts on their remaining financing charges. Still others provided no details regarding charges or savings associated with early repayment.

Table 4. Select details on product repayment from online lender websites

Online lender	Payment amount and frequency	Term length (loans only)	Prepayment
Company A	Fixed monthly payments	1–5 years	Interest savings
Company B	Fixed daily or weekly payments	3–36 months	"Potential interest reductions"
Company C	**Loans:** fixed daily, weekly, or monthly payments **MCA:** variable daily or weekly payments based on sales volume **LOC:** daily or weekly payment (fixed vs. variable not specified)	3–60 months	Not specified

[14] See Lipman and Wiersch, *Browsing to Borrow*, 18 (sample Product B). According to the product description, Product B has a 3 percent origination fee and requires weekly payments.

[15] See Lipman and Wiersch, *Browsing to Borrow*, 18 (sample Product C). Note that although interest owed on this product is 20 percent of the principal value, the effective rate, assuming daily payments and steady sales, would be on the order of 40 percent.

Company D	Monthly payments in set amounts established at loan origination	6–18 months	Savings on monthly fees implied
Company E	**Loans:** fixed daily payments **MCA:** variable daily payments based on sales volume	6–18 months	Discount available on loans repaid within 90 days of origination
Company F	**Loans:** fixed daily or weekly payments **MCA:** variable daily payments based on sales volume	6–24 months	Not specified
Company G	Fixed monthly payments	6 months to 5 years	Interest savings
Company H	**Loans:** daily or weekly payments (fixed vs. variable not specified) **MCA:** variable daily payments based on percentage of sales	4–24 months	Discount available on loans repaid within 100 days of origination
Company I	**Loans:** biweekly payments (fixed vs. variable not specified) **LOC:** fixed monthly payments	Up to 4 years	Interest savings
Company J	**Loans:** fixed daily or weekly payments **MCA:** variable daily payments based on percentage of sales	Up to 18 months	Not specified

Note: Although all information shown is publicly available, company names have been anonymized, as this analysis is intended to describe typical practices in the marketplace rather than to single out practices of individual companies. MCA is a merchant cash advance and LOC is a line of credit.

Source: Authors' analysis of company websites, as of August, 2019.

Early repayment on products with fixed payback amounts was particularly confusing for focus group participants. Using the same sample MCA described above—an advance of $50,000 with a repayment amount of $60,000 paid back with a small percentage of daily credit card sales—participants were asked the impact of higher-than-expected sales on the repayment of the advance. While most participants correctly noted that repayment would occur more quickly, their expectations regarding the effect on their interest rate were varied:

> "I would definitely plan to [pay] the loan back much sooner and have a lesser repayment amount."
>
> "The stronger [your] sales the faster you could pay off the loan which would in effect lower the interest rate."

Importantly, some participants, accustomed to traditional consumer products, expected that their interest or financing charges would be reduced by repaying quickly. In fact, faster repayment would increase the effective interest rate and would not reduce the $60,000 amount owed.

Comparing Online Lender Websites to those of Banks and Payments Processors

To provide a frame of reference for the findings from the analysis of online lenders' websites, the authors conducted similar systematic reviews of two other groups of lenders: (1) payments processors that provide small business credit, and (2) commercial banks that offer their own small business credit products online.

Payments processors: This study looked at the two major payments processors that offer credit to their small business customers. Though these companies are among the largest online lenders, they are excluded from the set of online lenders analyzed in this study for several reasons. First, these companies lend exclusively to their existing customers by making customized offers to their merchants based on the data they already collect on sales processed through the platforms (sales data as well as inflows and outflows to and from the merchants' accounts). Therefore, key elements of the website analysis undertaken for this study are not relevant, as the companies already have their customers' data. Furthermore, these lenders communicate product information to their customers through the credit offers themselves; therefore, the content on the websites serves a less critical role in informing the prospective borrower.

That said, issues around the comparability of products are relevant for the payments processors, as would-be borrowers may have a need to compare offers of credit from these companies to products available at other online lenders, or to other options such as credit cards.

The payments processors, like many other online lenders, use non-standard cost structure and product terminology. In some ways, their products are hybrids of MCAs and loans. Like an MCA, the products feature a fixed repayment amount, and further, the credit is repaid through swipes of daily sales receipts, so payment amounts vary with sales volume. However, like a term loan, these lenders require loans to be fully repaid in a set number of months, regardless of sales activity. The lenders may require periodic supplemental payments if sales are slow.

Focus group participants were shown a sample product like that offered by one of the payments processors. For the sample loan, the borrower chooses a "repayment percentage," that is, the portion of their daily sales devoted to repayment, and borrowing costs are set accordingly.[16] The terminology and the corresponding change in cost were confusing to many focus group participants. Some appeared to equate the repayment percentage with an interest rate.

[16] Lipman and Wiersch, *Browsing to Borrow*, 16 (Product A).

> "It doesn't make sense that if the fee is 30%, the [repayment] amount is lower."
>
> "What are the monthly installments?"
>
> "The interest rates are not published so you have to calculate yourself."
>
> "I feel like they are trying to hide the true cost of the loan. Just tell me the % interest."
>
> "I'm not interested in paying that high of fees. The minute I saw 30% I was turned off."

Commercial Banks: Again for comparison purposes, this study considered the manner in which credit products' costs and features are communicated on bank websites. For a suitable comparison, the five banks identified for the study offer small business credit and an online application process. Their online products are loans and lines of credit, generally unsecured, and typically up to $100,000.[17]

In their advertising, these banks placed far less emphasis than online lenders on easy credit, and as a general rule, the minimum qualifications described were more stringent. In addition, the banks downplayed their speed of funding and processing times. The two banks that do reference funding times specify a week to 10 days.

As with online lenders, the analysis finds considerable variation across the bank sites in the level of detail provided. Three of the five banks provided cost information for their credit products; two provided none. Among the three that did give more thorough product information, the products tended to be traditional term loans with fixed monthly payments, and were described using familiar terminology. Costs were described using an annual interest rate, such as prime plus a fixed percent. Similar to online lenders, the banks featured their "as low as" rates, and some cost details were conveyed in footnotes and FAQs.

[17] Websites were reviewed in August, 2019. One institution offers secured loans and lines of credit only, and one offers unsecured loans up to $250,000.

Tracking Website Visitors

As stated in the introduction, a goal of this study was determining the extent to which online lender website visitors are tracked. In addition to the collection of customer data through the use of forms, described earlier, lenders have robust tools for tracking and identifying customers. Some of these are generally imperceptible to customers, though a few of the small business focus group participants expressed concerns about their privacy during the virtual shopping exercise and in their prior experiences:

> "I was wondering if my IP address was being tracked because I was getting solicitations through my email while researching."
>
> "I just feel violated because I never applied for any loans. It's a scary feeling wondering how these people get your information."

Companies use "trackers" to collect data on prospective customers. When installed on a lender's website, trackers collect identifying information about website visitors and attempt to match them to known businesses or owners, using data from a variety of sources including Facebook, Amazon, Twitter, LinkedIn, and other common web platforms.[18] The profiles may contain information like company name, address, and internet activity, as well as more sensitive data including financial information and owner demographics. So, even when visitors do not share identifying information with the lender, embedded trackers may collect this information, as well as data on how visitors navigate the lender's website and other sites they visit. Such details can then be shared with data aggregators to build a more complete profile.

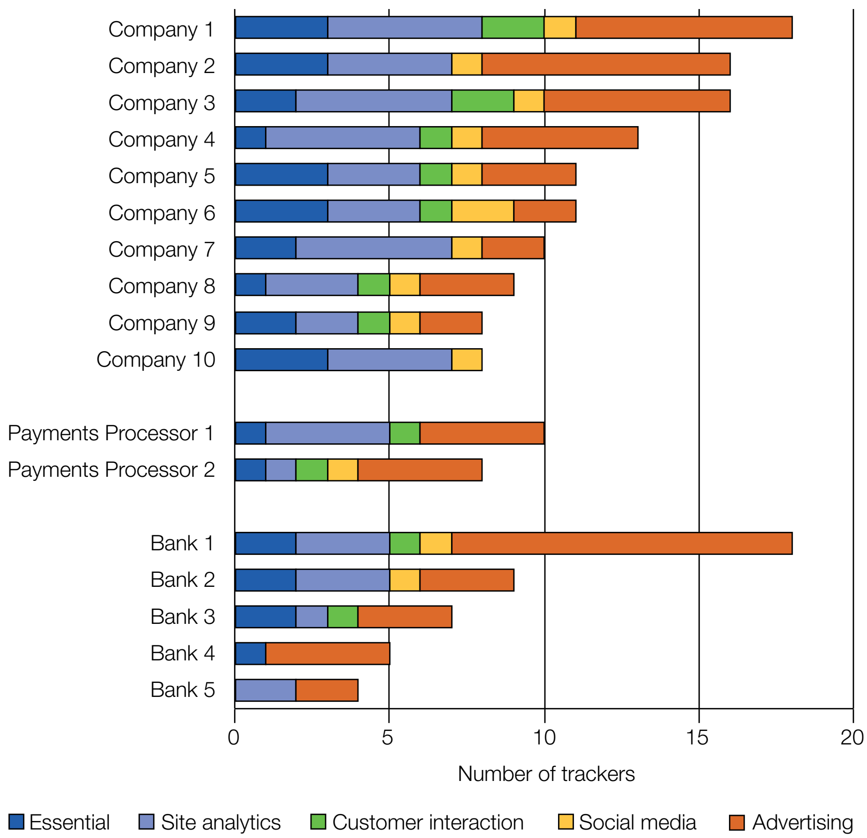
The analysis of trackers on lender websites utilized Ghostery, an open source browser extension, to measure the extent to which visitors are tracked on websites using embedded trackers. The Ghostery tool analyzes every network request (e.g., clicks) generated on a specific web page and then matches the outgoing URL patterns against a database of known trackers to determine which trackers are present on the website (see figure 1).[19] The analysis finds that third-party trackers are commonly used by both online lenders and banks, though the online lenders were more likely than

[18] See, for example, Wolfie Christl, *Corporate Surveillance in Everyday Life: How Companies Collect, Combine, Analyze, Trade, and Use Personal Data on Billions* (Vienna: Cracked Labs, June 2017), https://monoskop.org/images/b/ba/Cracked_Labs_Corporate_Surveillance_in_Everyday_Life_2017.pdf. See also, Katharine Kemp, "Getting Data Right," Center for Financial Inclusion at Accion (blog), September 27, 2018, https://www.centerforfinancialinclusion.org/getting-data-right.

[19] The analysis does not include websites' use of so-called "zero day trackers," which are designed to be undetectable.

the banks included in this study to have trackers in greater numbers. Each of the 10 online lender websites used at least eight trackers, and most used several in each category.

Figure 1. Use of trackers on select online lender and bank websites.



Note: Key identifies bars in order from left to right. Company names have been anonymized; the order in which they are listed here does not correspond with the order in tables 1, 2, and 4, or with the order in footnote 10.

Essential includes tag managers, privacy notices, and technologies that are critical to the functionality of a website.
Site analytics collects and analyzes data related to site usage and performance.
Customer interaction includes chat, email messaging, customer support, and other interaction tools.
Social media integrates features related to social media sites.
Advertising provides advertising or advertising-related services such as data collection, behavioral analysis, or retargeting.

Source: Federal Reserve Board analysis, as of September, 2019

Lenders use trackers much the way other companies do—to collect as much information as possible about each visitor in order to customize visitors' experiences and reach them through targeted advertising. However, privacy experts as well as small business advocates have suggested that data collected through trackers may be used along with the other alternative data (such as cash flow, invoicing, and shipping information) that online lenders employ in their algorithms to underwrite and price offers of credit.[20]

[20] See Christl, *Corporate Surveillance in Everyday Life*, 53. Also see FinRegLab, *The Use of Cash-Flow Data in Underwriting Credit* (September 2019), https://finreglab.org/wp-content/uploads/2019/09/FinRegLab-Small-Business-Spotlight-Report.pdf.

Implications and Policy Questions

As discussed earlier in the analysis of product descriptions on companies' websites, the online lenders varied significantly in the amount of information provided, especially on costs. Lenders that offer term loan products were likely to show costs as an annual rate, while others use nontraditional terminology to convey costs. Still others, particularly those that offer MCAs, provide no information at all. That said, virtually all the sites focus on the ease of applying and qualifying for funding, the speed at which applications are approved, and the array of uses for loan proceeds.

The study also found that, in many cases, prospective borrowers must furnish information about themselves and their businesses in order to obtain details about product costs and terms. This information, as well as other data collected on website visitors through the use of trackers, may be used to build profiles of small businesses.

These practices, coupled with relatively low satisfaction rates shown in the SBCS, raise concerns that some borrowers may be opting for credit products that are not well-suited for their businesses—even in some cases, putting their businesses at risk.[21]

Merits of Standardized Disclosures

The debate about small business borrower protections and product disclosures has accelerated recently with California enacting truth in lending legislation applicable to small business online lenders—an action being considered by other states.[22] At the national level, legislators, regulators, and policy advisory groups continue discussions about whether and how to address concerns in small business lending.[23]

Also, some in the online lending industry itself continue their efforts to promote standardization of disclosures. In 2016, several lenders in coordination with a nonprofit organization, launched the SMART Box disclosure initiative, aimed at developing a format for voluntary disclosures in loan documents that would present total cost of the loan, APR, and other repayment terms. The effort

[21] Record of Meeting, Community Advisory Council and the Board of Governors (October 5, 2018), 7, https://www.federalreserve.gov/aboutthefed/files/cac-20181005.pdf: "The Council notes a growing trend among small business owners getting into trouble with expensive online small business loans, such as merchant cash advances (MCA). Oftentimes, the pricing and structure of these loans [are] deliberately obscured, and small business owners take on debt burdens and fees that they are not able to sustain."

[22] California SB-1235, "Commercial Financing Disclosures," was signed into law on September 30, 2018. As of this writing, it has not yet been implemented as the California Department of Business Oversight is adopting regulations. The New York and New Jersey legislatures are considering similar bills.

[23] See, for example, U.S. House of Representatives, Committee on Small Business, "Financing through Fintech: Online Lending's Role in Improving Small Business Capital Access," hearing held October 26, 2017, https://www.govinfo.gov/content/pkg/CHRG-115hhrg27255/html/CHRG-115hhrg27255.htm. See also, the Bipartisan Policy Commission report *Main Street Matters: Ideas for Improving Small Business Financing* (August 2018), https://bipartisanpolicy.org/report/main-street-matters-ideas-for-improving-small-business-financing/.

is voluntary and, as of this writing, an updated version of the SMART Box is being considered.[24] It is the case, though, that the required inclusion of APR for products is a point of contention in the industry.

Some lenders argue APR should not apply to small business products with variable payments and no fixed term, such as MCAs. However, small business advocates suggest that APR is important for cost comparisons with other products, including consumer products like credit cards and home equity lines of credit that are often used to finance small businesses. Furthermore, APR is a familiar metric. Prospective borrowers generally are aware from their experiences with consumer products what constitutes a high APR.

It seems apparent that clearer descriptions of products and, in particular, their costs would position small business owners to make better borrowing decisions. That said, research suggests that borrowing decisions are not always driven by costs. For example, while among the focus group participants, “best price” was the most commonly mentioned top factor in their choice of lender, “quick and easy loan application process,” “a lender I know and trust,” and “likelihood application will be approved” were primary considerations for others. Similarly, the SBCS finds that several factors—including the likelihood of approval and speed of the decision and funding—are more important than cost for online lender applicants in their choice of a financing source. Therefore, clearer information—in the form of standardized disclosures—will not necessarily alter the decisions of some small business borrowers about whether and where to obtain financing.

Even so, the clear disclosure of product costs and terms could help many of these business owners make informed decisions about the amounts they borrow, cash flow management, early repayment, and repeat borrowing. Focus group participants reacted favorably to a sample disclosure box with total cost of capital, the term, payment frequency, APR, average payment amount, and basic information about prepayment.[25] Their comments indicated that such information, presented clearly and in a standard format, would be very useful for product comparisons. A majority of participants commented that APR was among its most helpful details. The repayment amount, frequency of payments, and prepayment penalties were also cited as important.

When small business borrowers receive disclosures may be nearly as important as *what* is disclosed. Nearly all focus group participants said they would want clear upfront information to help them make borrowing decisions, stating they would want the level of detail that is provided in the disclosure as early as possible in the process. Many remarked that presenting the product rate and terms at loan closing is too late, as they have already invested time in the application process, shared their financial data with the lender, and may have already committed the expected loan proceeds.

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[24] Two of the lenders included in the website analysis are SMART Box adopters and both present sample SMART Boxes on their websites, showing rates that are nearly the lowest offered by these lenders. According to their websites, one lender provides the SMART Box at the time credit is offered; the other includes it with the loan agreement. For more information on the SMART Box Model Disclosure Initiative, visit http://innovativelending.org/smart-box/.

[25] Lipman and Wiersch, *Browsing to Borrow*, 22.

To this end, much as technology has introduced efficiencies and increased the speed of lending, technology-based solutions may be leveraged to inform borrowers early in the process. For example, one focus group participant suggested lenders make interactive tools available on their websites that would enable small business owners to input their information (e.g., credit scores, monthly sales, years in business) to see—upfront—the average interest rates and terms for a business like theirs.

In sum, greater transparency and early disclosure would enable business owners to determine which lenders offer products with rates and terms they would find acceptable, and would encourage prospective borrowers to explore additional financing options and make informed comparisons.

Privacy Concerns and Business Owners' Data

This study considers the level of information about products and their costs that small business owners can access without providing the lender with information about themselves or their businesses. Indeed, there is a "cost" to the business incurred by sharing their information to request a quote or start an application. In addition to exposing their business to a potentially burdensome number of phone calls and a flurry of marketing content, some lenders run credit checks early in the process, even if the business owner is just shopping rates. A few of the focus group participants voiced concerns about this practice and the potential impact on their credit scores. Furthermore, while many of the participants in the most recent focus group study appeared resigned to the potential for data breaches with any financial services provider, some were particularly concerned about the security of their information with online lenders. As a practical matter, providing personal and business information to numerous lenders simply for the purpose of comparison shopping is certainly not ideal from the standpoint of preserving a prospective borrower's privacy. Such concerns may limit a prospective borrower's willingness to explore all their options.

The analysis in this report on the use of website trackers by small business lenders only scratches the surface on issues regarding privacy and use of data collected. Though the use of trackers is widespread in many industries, there are unique issues associated with the use of data by lenders. Little is known about online lenders' underwriting algorithms and the data they employ. Small business advocates have voiced concerns that data collected surreptitiously through trackers may be matched with data from third-party sources to identify individual business owners. It is unclear whether these data are used to underwrite and price offers of credit.[26] However, this potential use of alternative data raises questions about how such practices could amplify—or perhaps mitigate—concerns about fair lending.

Questions for Future Research and Analysis

The lack of data on small business lending remains a critical issue that hampers the ability of lenders and policymakers to make informed decisions about lending and policy. Nonbank lending is a particular blind spot, as comprehensive data for the online lending industry are not available.[27]

[26] See Christl, *Corporate Surveillance in Everyday Life*, 53.

[27] Section 1071 of the Dodd Frank Act amended the Equal Credit Opportunity Act to require that lenders gather information on credit applications made by small businesses, and women- or minority-owned businesses. As of this writing, this requirement has not yet been implemented by the Consumer Financial Protection Bureau.

Policymakers would benefit greatly from data on outcomes for small business credit applicants and borrowers to strengthen understanding of the impact of being denied credit, and how firms fare after securing credit—either from traditional or alternative lenders. Such insight would benefit organizations that serve small businesses and the business owners themselves, as they make borrowing decisions.

For online lenders, specifically, greater insight is needed on the information disclosed to prospective borrowers throughout the entire application process, that is, beyond the shopping phase. As small business applicants receive actual offers of credit from online lenders, are they given clear information that is sufficient to support decisionmaking? Furthermore, are the credit agreements, presented to business owners at closing, explicit about costs and terms? Do borrowers have a clear understanding of their obligations and any possible penalties?

With public attention now focusing on the potential benefits of standardized disclosures, it is worth further exploring the impact on borrowers of more transparent, comparable, and complete information. Could greater transparency improve borrowers' satisfaction levels and their trust in online lenders? And ultimately, how would better information help owners make the borrowing decisions that best help their small businesses thrive and grow?

Board of Governors of the Federal Reserve System

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CLICKING FOR CREDIT:

EXPERIENCES OF ONLINE LENDER APPLICANTS FROM THE SMALL BUSINESS CREDIT SURVEY

Ann Marie Wiersch, *Federal Reserve Bank of Cleveland*
Barbara J. Lipman, *Board of Governors of the Federal Reserve System*
Kim Wilson, *Board of Governors of the Federal Reserve System*
Lucas Misera, *Federal Reserve Bank of Cleveland*

A publication of the Federal Reserve Bank of Cleveland, August 2022

https://doi.org/10.26509/frbc-cd-20220816

About this report

The Federal Reserve has an interest in the availability of financing for small businesses. These firms play an important role in local economies as employers and as providers of goods and services. Small businesses' ability to borrow, and to do so affordably, is essential to their financial health and future growth prospects.

The Federal Reserve has been monitoring developments in the online small business lending industry since the industry's emergence after the 2008 financial crisis. While the funding provided by the online lending industry is small compared to the entirety of financing extended to small businesses, online lenders have become an important part of the credit landscape, particularly for very small firms. Moreover, the industry is of interest to the Federal Reserve because online lenders may have expanded access to credit for some borrowers, spurring cooperative relationships with—and competitive responses from—traditional banks.

This analysis draws on a subset of the data from the 2021 Small Business Credit Survey (SBCS) conducted in September through November 2021 using the weighted dataset for nearly 11,000 employer firms—those small businesses with at least one employee other than the owner(s). Of employer firms in the 2021 SBCS, 34 percent applied for financing in the prior 12 months—down from 43 percent and 37 percent in 2019 and 2020, respectively.

For more details on the figures included in this report, including sample sizes and supplemental data, please see the Appendix.

The authors appreciate the thoughtful comments, managerial support, and guidance from the following colleagues: Mark Schweitzer, Lisa Nelson, and Merissa Piazza from the Federal Reserve Bank of Cleveland, and Dan Gorin and Angelyque Campbell from the Federal Reserve Board. Valuable assistance with this publication also was provided by Heather Ann and Ellen Seguin of the Federal Reserve Bank of Cleveland.

Overview

Nonbank online lenders serve as an important source of capital for small businesses. Online lenders, also referred to as fintech lenders, provide a variety of credit products, such as short- and fixed-term loans, lines of credit, and merchant cash advances. They use data-driven processes and technology for underwriting, pricing, servicing, and delivering funds to borrowers. The number of small businesses seeking credit online steadily grew in the years leading up to the COVID-19 pandemic.

Following the onset of the pandemic, supply of and demand for online credit changed in several ways. Online lender approvals declined in response to rising delinquencies and weak investor interest. On the demand side, fewer firms applied for credit due to economic uncertainty and the availability of government relief funding—notably, the Paycheck Protection Program (PPP). However, a number of fintech lenders did originate PPP loans, and they did so to not only existing customers but to many new ones. In fact, more than two thirds of businesses that applied for PPP loans at online lenders had no prior relationship with their lender.[1] While many fintech lenders focused on PPP lending and restricted their approvals for non-PPP financing, most of these lenders continued to offer their usual credit products to some extent. The analysis presented here focuses on applications for financing other than pandemic-related financial assistance.

This report builds on previous publications to further examine the characteristics, financing experiences, and credit outcomes for three subsets of small business credit applicant firms: those that applied to only online lenders, those that applied to only banks, and those that applied to both online lenders and banks.[2]

1 Federal Reserve Banks. 2021. *Small Business Credit Survey 2021 Report on Employer Firms*. February 3. https://www.fedsmallbusiness.org/survey/2021/report-on-employer-firms.

2 Wiersch, Ann Marie, Barbara J. Lipman, and Scott Lieberman. 2019. *Click, Submit 2.0: An Update on Online Lender Applicants from the Small Business Credit Survey*. Federal Reserve Bank of Cleveland. December 19. https://www.clevelandfed.org/newsroom-and-events/publications/special-reports/sr-20191216-click-submit-2.aspx; Lipman, Barbara J., and Ann Marie Wiersch. 2019. *Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites*. Board of Governors of the Federal Reserve System. December. https://www.federalreserve.gov/publications/what-small-business-borrowers-find-when-browsing-online-lender-websites.htm.

Key findings

SMALLER, NEWER, BLACK-OWNED, AND HISPANIC-OWNED FIRMS ARE MORE LIKELY TO APPLY TO ONLINE LENDERS.

Consistent with prior years' survey findings, firms that apply to online lenders are more likely to be newer and have fewer employees, lower revenues, and weaker credit scores. Higher shares of Black- and Hispanic-owned firms apply to online lenders compared to white- and Asian-owned firms.

APPROVAL RATES AT ONLINE LENDERS—WHICH PAST SURVEYS SHOW WERE AN IMPORTANT FACTOR IN APPLICANTS' CHOICE OF LENDER—HAVE DECLINED.

Prior to the pandemic, online lenders approved higher shares of applicants than banks did. However, the latest SBCS findings indicate that online lenders were less likely than large and small banks to fully approve applicants for all of the financing they sought.

ONLINE LENDER APPLICANTS WERE LESS SATISFIED WITH THEIR EXPERIENCES THAN WERE BANK APPLICANTS.

Overall satisfaction rates remain lower for online lender applicants than for large and small bank applicants. Among applicant firms that were at least partially approved, 76 percent of small bank applicant firms reported satisfaction with their lenders, compared to only 39 percent of online lender applicants.

ONLINE LENDER APPLICANT FIRMS OFTEN REPORTED CHALLENGES WITH HIGH INTEREST RATES AND UNFAVORABLE REPAYMENT TERMS.

Overall, approved applicants cited fewer challenges with their lender experiences than did applicants that were denied. The only exception was at online lenders, where approved applicants were more likely than denied applicants to cite challenges with high interest rates and unfavorable repayment terms. This finding suggests that online lender applicants may have been offered pricing and terms that differed from what they expected.

While small businesses most often applied for financing at banks, nearly one quarter applied at online lenders.

Credit sources applied to[3]

% of loan, line of credit, and cash advance applicants

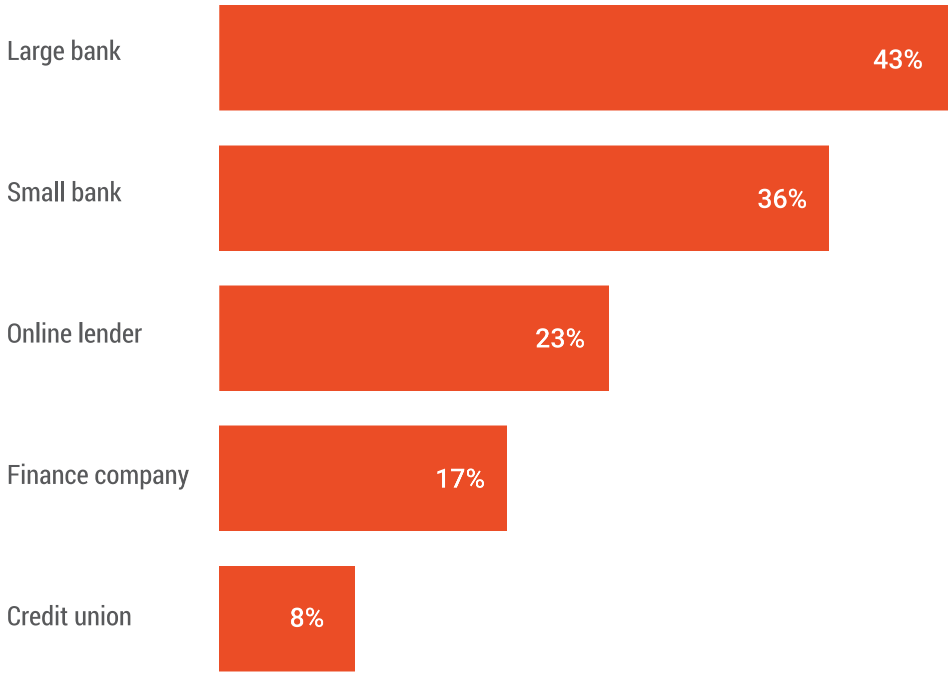


Chart notes: Respondents could select multiple sources. Community Development Financial Institutions (CDFIs) and other lenders not shown. See the *Small Business Credit Survey 2022 Report on Employer Firms* for more details.

3 Federal Reserve Banks. 2022. *Small Business Credit Survey 2022 Report on Employer Firms*. February 22. https://www.fedsmallbusiness.org/survey/2022/report-on-employer-firms.

Overall, the SBCS finds that among employer firms, 34 percent applied for financing in the prior 12 months.[3] This report focuses on applicant firms and the three types of lenders at which small businesses most commonly sought financing: large banks, small banks, and online lenders.

As shown in the chart, small businesses most often turned to banks for financing. While the use of online lenders has declined somewhat (to 23 percent, down from 33 percent of applicants prior to the pandemic), the 2021 SBCS finds that nearly one quarter of applicants applied at an online lender in the prior 12 months.

SMALL BUSINESS CREDIT SURVEY LENDER DEFINITIONS

Large bank	Large banks are defined as those with at least $10B in total deposits.
Small bank	Small banks are those with less than $10B in total deposits.
Online lender	Online lenders/fintech companies are nonbanks that operate online. Examples provided to respondents vary by question but include OnDeck, Kabbage, CAN Capital, PayPal, and Square.
Finance company	Finance companies are nonbanks that provide loans, leases, and other financial services. Examples include mortgage companies, auto finance companies, investment funds, and insurance companies.
Credit union	Credit unions are nonprofit cooperatives where members can borrow money at competitive rates from pooled deposits.

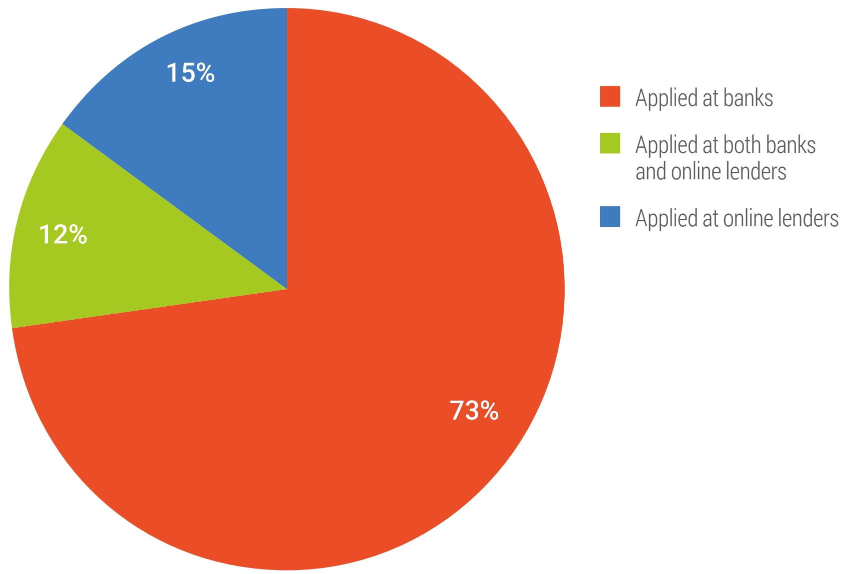
Focusing on applicants that sought financing at banks or online lenders, 73 percent applied at banks but not online lenders, 15 percent applied at online lenders but not banks, and 12 percent applied at both banks and online lenders.

FOR SELECT CHARTS, APPLICANTS ARE DIVIDED INTO THREE CATEGORIES:

Applied at banks	Firms that applied for loans, lines of credit, or cash advances at large or small banks but not at online lenders
Applied at both banks and online lenders	Firms that applied at a bank (large or small) and an online lender
Applied at online lenders	Firms that applied for loans, lines of credit, or cash advances at online lenders but not at large or small banks

Share of applicants that sought financing at banks, online lenders, or both

% of loan, line of credit, and cash advance applicants at banks and online lenders



Small businesses, in aggregate, apply for many types of financing, including loans, credit cards, trade credit, and leases. And, as shown on the prior page, they turn to several bank and nonbank sources.

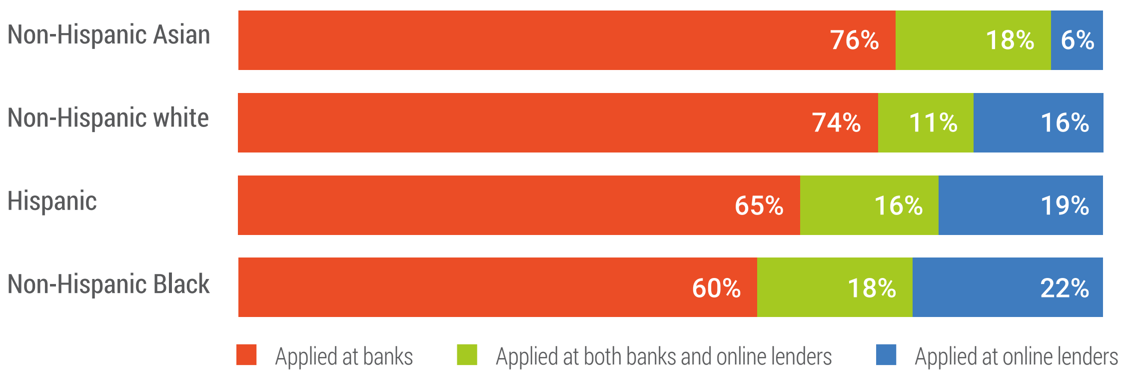
The SBCS gathers more detailed information on applicants' experiences with a subset of products: loans, lines of credit, and merchant cash advances. For purposes of this report, the analysis focuses on firms that sought only these products. Further, to simplify the analysis, the report relays the experiences of only those firms that applied at banks or online lenders. As such, firms that applied at only finance companies, credit unions, CDFIs, and other lenders are excluded from this analysis. However, the appendix of the *Small Business Credit Survey 2022 Report on Employer Firms* presents findings on those applicants' experiences.

Chart notes: This figure and those that follow exclude employer firm applicants that sought loans, lines of credit, or cash advances at finance companies, credit unions, CDFIs, or other lenders (e.g., farm credit institutions, friends/family, private investors), unless they also applied at a bank or an online lender. The excluded applicants account for approximately 15 percent of loan, line of credit, and cash advance applicants in the 2021 SBCS; therefore, percentages in this figure do not correspond to those in the figure on page 4, which represents the share of all loan, line of credit, and cash advance applicants.

Black- and Hispanic-owned firms and smaller-revenue firms were more likely than their white-owned and larger-revenue counterparts to apply for financing at online lenders.

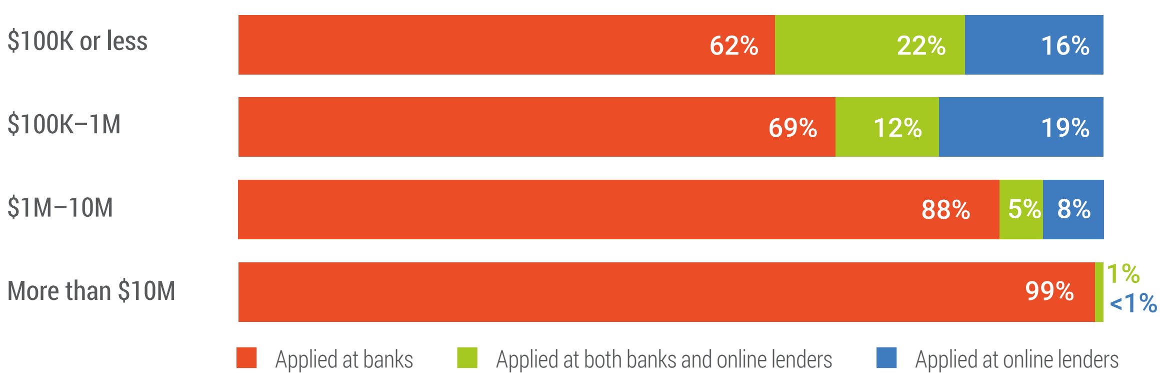
Application rate at source type by race/ethnicity of owner(s), prior 12 months

% of loan, line of credit, and cash advance applicants at banks and online lenders



Application rate at source type by firm revenue size, prior 12 months

% of loan, line of credit, and cash advance applicants at banks and online lenders



Black- and Hispanic-owned firms were more likely than white- and Asian-owned firms to apply at online lenders in the prior 12 months. These findings are consistent with findings from recent survey years. Also, Black- and Hispanic-owned firms were more likely than other firms to cite credit availability as a financial challenge. These firms may have been inclined to turn to online lenders, which—as past SBCS findings indicate—are perceived to offer applicants a greater chance of approval.[4]

Additionally, firms with annual revenues of $1M or less were more likely than larger-revenue firms to apply at online lenders. The smallest-revenue firms—those with revenues of $100K or less—were most likely to apply at online lenders. Compared to larger-revenue firms, smaller-revenue firms and their smaller-dollar credit needs may be better aligned with the offerings of online lenders, which typically extend unsecured credit in amounts up to $100,000.

Chart notes: Percentages shown may not sum to 100 because of rounding. "Prior 12 months" refers to the 12 months leading up the the time respondents answered the survey in September–November 2021.

4 See SBCS reports for survey years 2017–2019 for findings on factors that influenced applicants' choice of lender. https://www.fedsmallbusiness.org/survey.

High-credit-risk firms—those with low credit scores—and newer firms were more likely than low-credit-risk and more established firms to apply at online lenders.

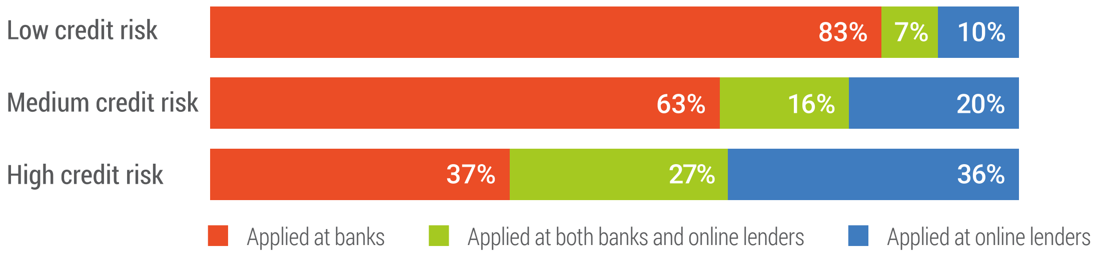
High-credit-risk firms—that is, firms with weaker credit scores—were much more likely than low-credit-risk firms to apply at online lenders. Similarly, newer firms—those in business five years or fewer—were more likely than established firms to apply at online lenders.

Firm age and credit risk are closely related. Newer firms tend to be considered riskier, while more established firms are more likely to have stronger credit scores. In fact, two thirds of high-credit-risk firms in the SBCS sample have been in business for five years or less.[5]

While their approval rates declined after the onset of the pandemic, historically, online lenders have been more likely than banks to approve higher-credit-risk businesses.[6] By emphasizing cash flow over credit scores and by incorporating alternative data into their underwriting models, online lenders may approve applicants for unsecured credit, even if the applicants have limited credit histories and few assets. Because of their risk profiles, these applicants are less likely to be approved at banks.

Application rate at source type by credit risk, prior 12 months

% of loan, line of credit, and cash advance applicants at banks and online lenders



Application rate at source type by firm age, prior 12 months

% of loan, line of credit, and cash advance applicants at banks and online lenders

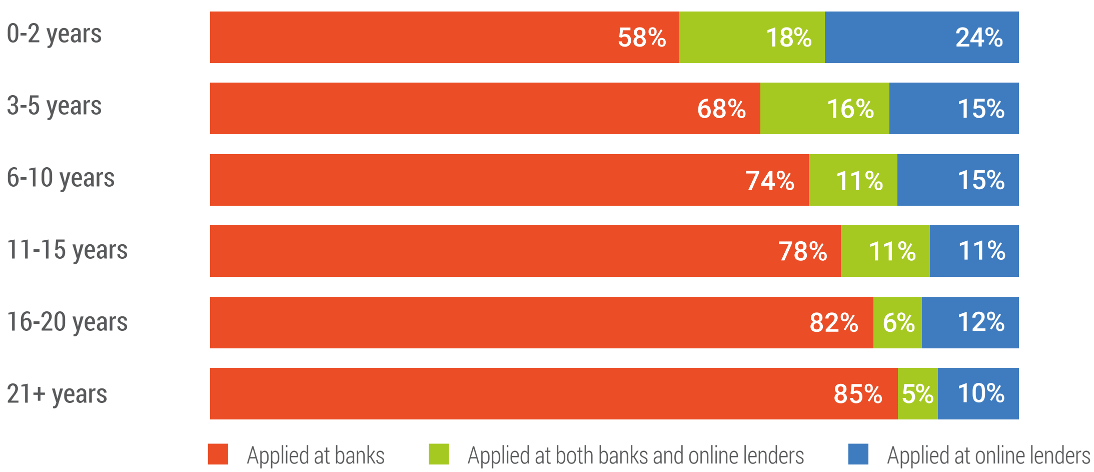


Chart notes: Percentages may not sum to 100 because of rounding. "Prior 12 months" refers to the 12 months leading up the the time respondents answered the survey in September–November 2021.

5 See the Appendix of the *Small Business Credit Survey 2022 Report on Employer Firms*. https://www.fedsmallbusiness.org/survey/2021/report-on-employer-firms.

6 Federal Reserve Banks. 2020. *Small Business Credit Survey 2020 Report on Employer Firms*. April 7. https://www.fedsmallbusiness.org/survey/2022/report-on-employer-firms.

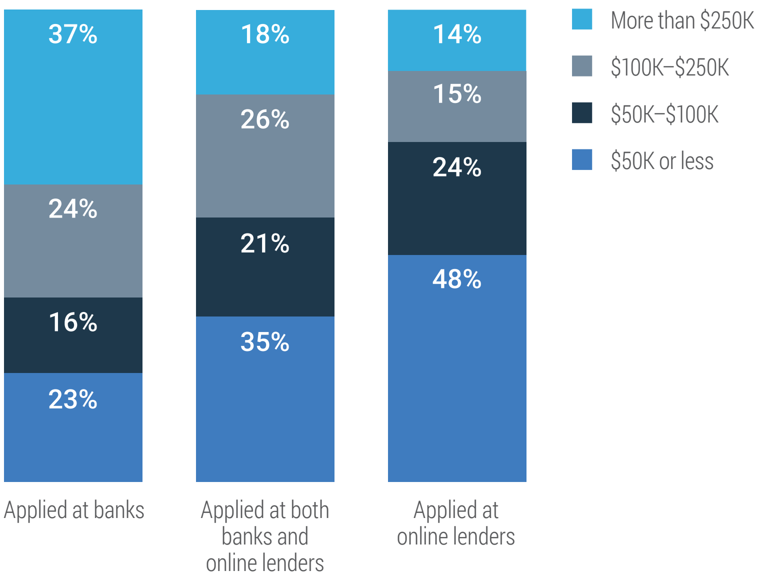
Compared to applicants at banks, firms that applied at online lenders sought smaller amounts of financing and more often sought financing to meet operating expenses.

Compared to bank applicants, online lender applicants sought smaller amounts of financing and were more likely to apply because they needed funds to meet their operating expenses. Online lenders' unsecured credit products are generally available in smaller amounts than traditional products offered by bank lenders.

Additionally, businesses in need of working capital funds may be more inclined to apply at online lenders because they typically offer faster turnaround on applications and because their working capital products may be used for any business purpose.

Total amount of financing sought

% of applicants, by category



Reasons for applying for financing

% of applicants, by category

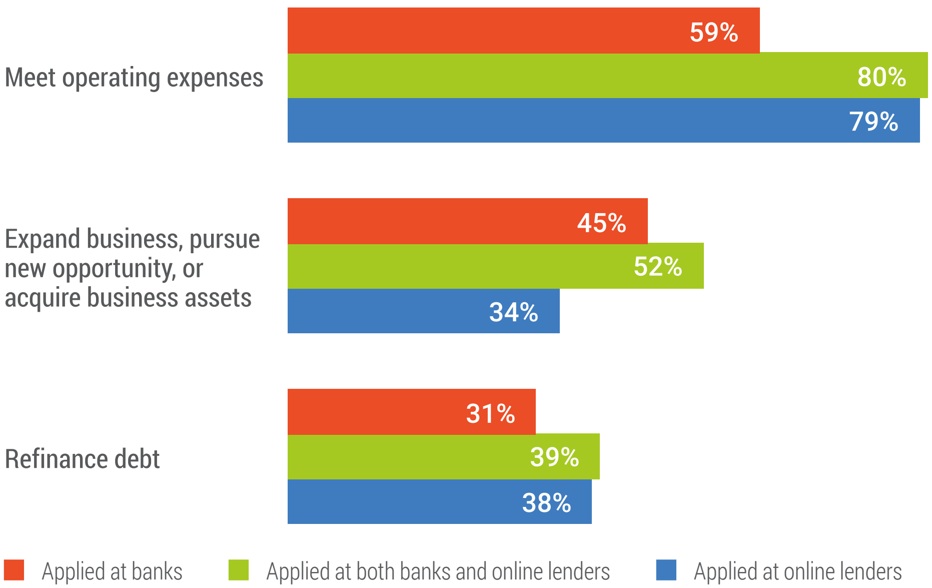
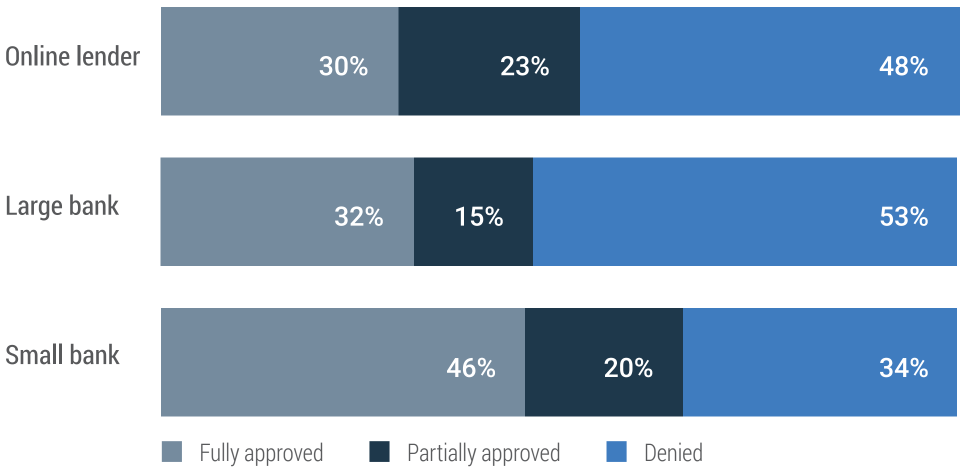


Chart notes: Total amount sought in the 12 months prior to the survey. Percentages shown in first chart may not sum to 100 because of rounding. Financing reasons shown are the top three responses; respondents could select multiple reasons. Prior to the pandemic, firms most often sought financing for business expansion.

Contrary to prepandemic survey results, in 2021, online lenders were *least* likely to fully approve applicants for loans, lines of credit, and cash advances compared to large and small banks.

Loan, line of credit, and cash advance applicant approvals at source

% of applicants, by source



Online lenders and large banks approved, partially or fully, about half of loan, line of credit, and cash advance applicants in the prior year. Small banks approved a higher share of their applicants for at least some funding (66 percent).

These findings diverge from prepandemic survey results, which show that online lender applicants consistently reported higher approval rates than applicants at small and large banks. The 2019 SBCS found that 80 percent of online lender applicants in the prior year were at least partially approved; that share is 27 percentage points higher than the share of online lender applicants at least partially approved in 2021.[7] The economic effects of the pandemic may have contributed to this trend, as lenders' liquidity constraints and lower repayment rates on outstanding balances led to credit tightening among online lenders.[8]

While it is the case that higher-credit-risk applicants more often seek financing at online lenders, the decline in approval rates for these applicants has been even more significant than one might expect given past rates of approval. In 2019, 77 percent of medium- and high-credit-risk applicants were at least partially approved at an online lender; in 2021, just 44 percent of medium- and high-credit-risk applicants were at least partially approved.

Chart notes: Percentages may not sum to 100 because of rounding.

7 Federal Reserve Banks. 2020. *Small Business Credit Survey 2020 Report on Employer Firms.* April 7. https://www.fedsmallbusiness.org/survey/2020/report-on-employer-firms.

8 Ben-David, Itzhak, Mark J. Johnson, and René M. Stulz. 2021. *Why Did Small Business Fintech Lending Dry Up During March 2020?* NBER Working Paper No. 29205. September. https://www.nber.org/system/files/working_papers/w29205/w29205.pdf.
Anand,Tanvi and Sachin Goel. 2021. "The Seesaw Journey of Alternative Lenders during the COVID-19 Pandemic." ABFJournal. January 27. https://www.abfjournal.com/articles/the-seesaw-journey-of-alternative-lenders-during-the-covid-19-pandemic/.

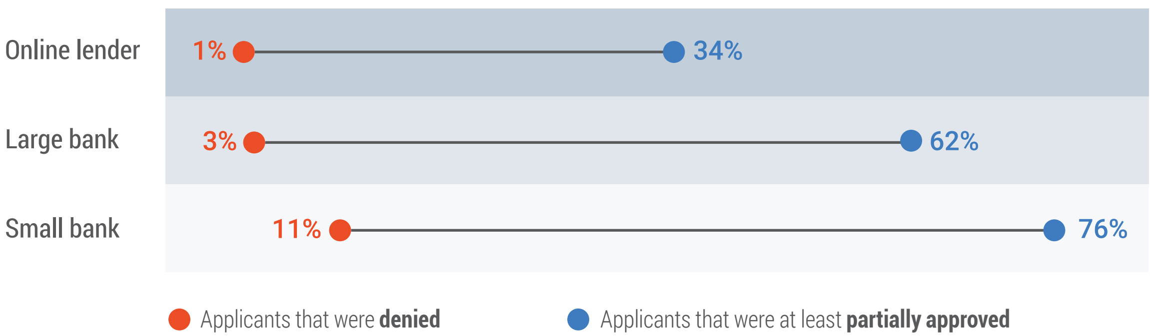
Overall satisfaction rates at all sources were much higher among applicant firms that were at least partially approved than among applicants that were denied funding. Generally, though, online lender applicants were least satisfied.

Not surprisingly, firms that were at least partially approved for a loan, line of credit, or cash advance were consistently more satisfied with their experiences with the lender at which they sought financing than were firms that were denied outright, among bank and online lender applicants alike. These findings indicate that approval status may influence satisfaction with lenders.

It should be noted that although they were not offered financing, denied applicants did rate their satisfaction with their experiences applying at their lenders. Beyond the outcomes of their applications, their ratings may reflect communications with their lenders, support received during the process, or other aspects of their application experiences. As for approved applicants, some may have included their borrowing experiences as part of their satisfaction ratings. It is also the case that some approved applicants may not have been satisfied with, and may not have accepted, the financing offered.

Satisfaction with lenders, by approval

% of loan, line of credit, and cash advance applicants at source



Among applicant firms, those that applied at online lenders were least satisfied, overall.

Only **34%** **of online lender applicants** that were approved for at least some financing were satisfied with their lender, while the same was true for just **1%** **of denied applicants.**

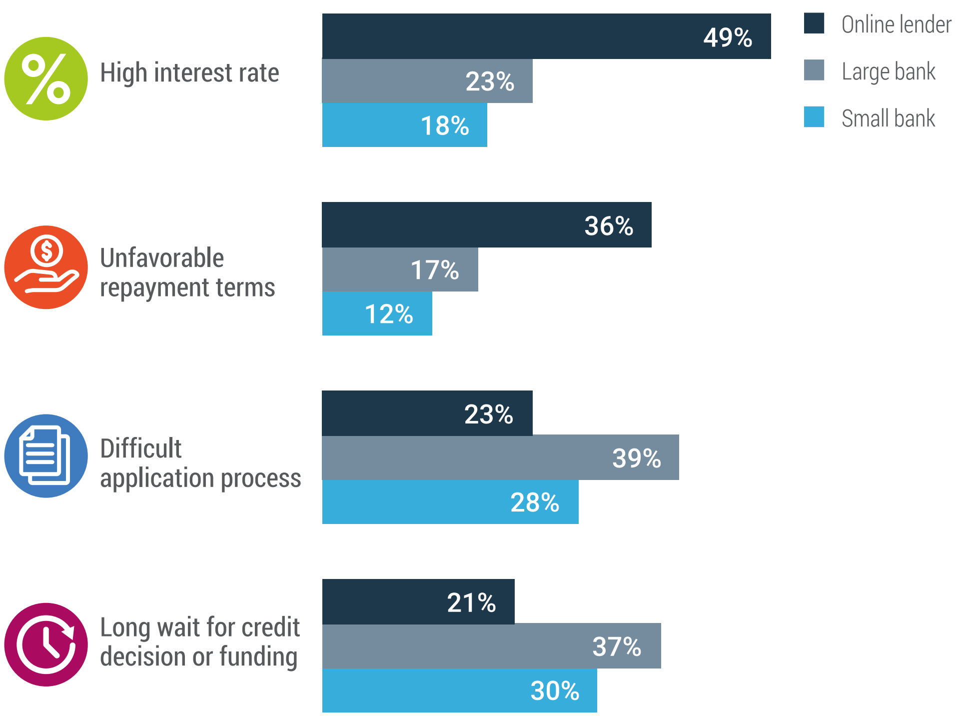
Small bank applicants that were at least partially approved reported the highest satisfaction rates; **76%** **of approved applicants** were satisfied with their lender, while **11%** **of denied applicants** were satisfied.

Chart notes: Shares shown are the shares of applicants that were satisfied with their lender experiences.

In terms of *specific challenges*, online lender applicants more often noted high interest rates and unfavorable repayment terms, while bank applicants typically cited challenges with the application process and long wait times.

Challenges with lenders

% of loan, line of credit, and cash advance applicants at source



Online lender applicants' top challenges were related to the terms of the products offered by their lenders—specifically, high interest rates and unfavorable repayment terms. Conversely, bank applicants' primary challenges were a difficult application process and long wait for a credit decision or funding. Historically, online lender applicants have consistently reported high interest rates and unfavorable terms as their top challenges, and they have been less likely than bank applicants to report challenges with the application process and wait times.

Credit risk is not a strong factor in the challenges applicants experienced. In fact, online lender applicants with strong credit scores were more likely to cite challenges with high interest rates than were bank applicants with weak credit scores.[9]

These findings suggest that online lender applicants—even low-credit-risk applicants—may pay higher interest rates with less favorable repayment terms in exchange for an easier, faster application and funding process. Online lender applicants' experiences reflect the value proposition presented in online lenders' marketing language, which emphasizes streamlined applications and fast funding, often within 24 hours. Additionally, past survey findings indicate that applicants prioritize speed as the highest-ranked factor in their decision to apply to an online lender.[10]

Chart notes: Top challenges shown. Respondents could select multiple challenges.

9 See the Appendix of the *Small Business Credit Survey 2022 Report on Employer Firms*. https://www.fedsmallbusiness.org/survey/2022/report-on-employer-firms.

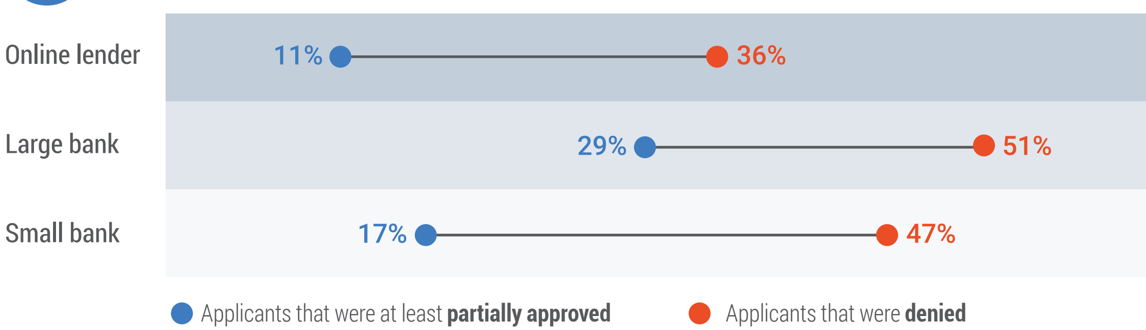
10 Federal Reserve Banks. 2020. *Small Business Credit Survey 2020 Report on Employer Firms*. April 7. https://www.fedsmallbusiness.org/survey/2020/report-on-employer-firms.

Compared to applicants that were denied financing, approved applicants—regardless of the type of lender they applied to—reported fewer challenges with the application process and wait time for a decision or funding.

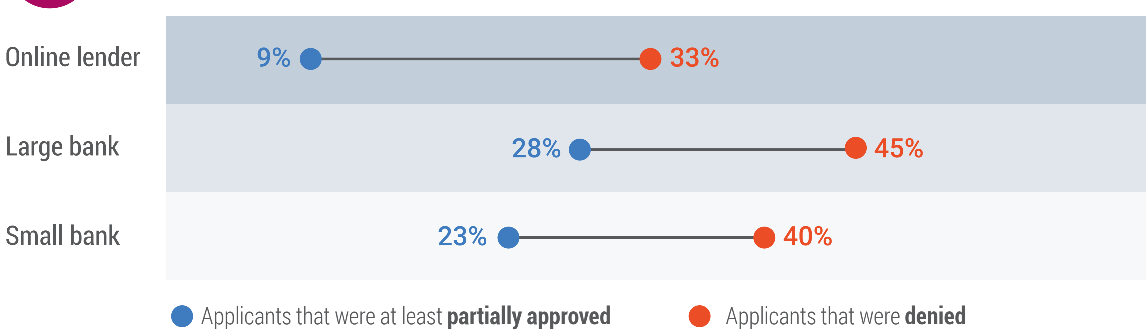
Challenges with lenders, by source and approval

% of loan, line of credit, and cash advance applicants at source that were denied/approved

Difficult application process



Long wait for credit decision or funding

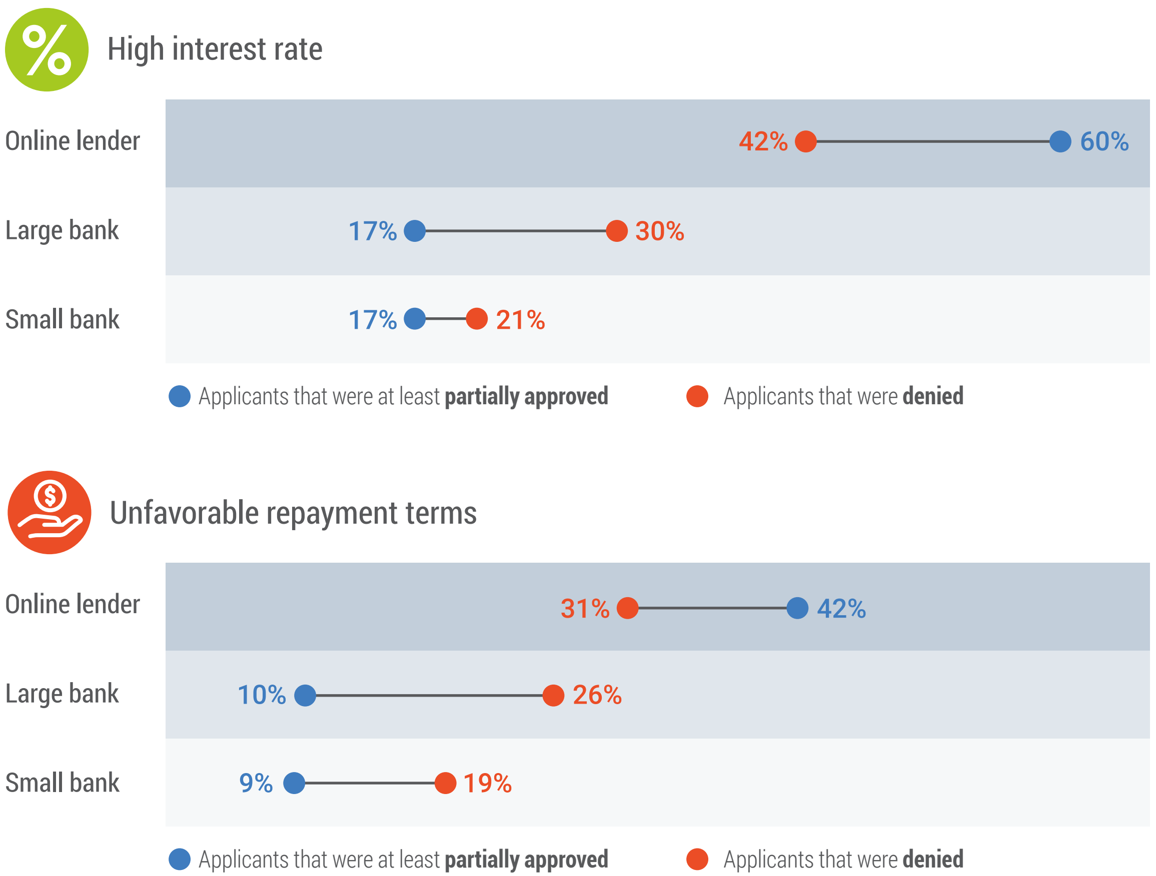


Consistent with the overall satisfaction ratings that reflect greater dissatisfaction among firms that were denied financing (page 10), denied applicants were more likely than approved applicants to report challenges with a difficult application process and a long wait for a decision or funding.

Unlike the pattern observed with bank applicants, online lender applicants that were approved were *more* likely than denied applicants to cite challenges with interest rates and repayment terms.

Challenges with lenders, by source and approval

% of loan, line of credit, and cash advance applicants at source that were denied/approved



Online lender applicants that were approved for financing were more likely than those that were denied financing to cite high interest rates and unfavorable repayment terms as challenges with their lender.[11] This finding suggests that online lender applicants may be offered products or terms that differ from the products or terms for which they believed they had applied.

11 In 2019, it was also true that approved online lender applicants reported more interest rate challenges than denied online lender applicants, while similar shares of approved and denied applicants reported challenges with repayment terms. The question about lender challenges was not asked in the 2020 SBCS.

Policy implications

This report highlights the experiences of small businesses that sought financing from banks and online lenders. After the onset of the pandemic, approval rates declined across all lenders, but online lenders' approval rates declined the most. This has implications for smaller-revenue, newer, and minority-owned firms which, according to the SBCS, disproportionately sought financing at online lenders.

Moreover, the SBCS has consistently found that small businesses are less satisfied with their experiences at online lenders in comparison to their experiences at large and small banks. Online lender applicants are more likely to cite challenges with high interest rates and unfavorable repayment terms. Importantly, **approved** online lender applicants are more likely to report these challenges than online lender applicants that are denied financing. This suggests that **small businesses may not fully understand the cost and terms of some online financing products until after they are approved or funded**. Online lender applicants, then, may carry a higher risk of taking out financing with costs and terms that they may not fully understand at the time of the application or that the business may be unable to afford. This potential lack of understanding of pricing and terms is especially notable given that, as indicated above, certain segments of small businesses apply at online lenders more often than others.

Issues with prospective borrowers' understanding of online lender product costs and terms are longstanding. Prior to the pandemic, the Federal Reserve Board and the Federal Reserve Bank of Cleveland conducted qualitative studies with 86 prospective or actual small business credit applicants.[12] In a simulated credit-shopping exercise, participants viewed online lender websites and sample credit products and were asked about their understanding of the products' costs and features.

Many participants reported that they found it challenging to locate the details they had been looking for on product terms, interest rates, overall cost of the credit, and repayment arrangements on the lenders' websites. Cost descriptions expressed in terms such as "repayment percentage options," "simple interest," and "factor rate" were confusing to some participants who conflated these with the annual percentage rate (APR). In fact, some participants were initially impressed with the advertised rates, but became frustrated when calculating and comparing total product costs. Finally, participants tended to make (sometimes mistaken) assumptions that paying more quickly would result in savings, likely based on their past experiences with traditional bank loans.

12 See Lipman, Barbara J., and Ann Marie Wiersch. 2018. *Browsing to Borrow: "Mom & Pop" Small Business Perspectives on Online Lenders.* Board of Governors of the Federal Reserve System. June. https://www.federalreserve.gov/publications/small-business-perspectives-on-online-lenders.htm and Lipman, Barbara J., and Ann Marie Wiersch. 2015. *Alternative Lending through the Eyes of "Mom-and-Pop" Small-Business Owners: Findings from Online Focus Groups*. Federal Reserve Bank of Cleveland. August. https://www.clevelandfed.org/en/newsroom-and-events/publications/special-reports/sr-20150825-alternative-lending-through-the-eyes-of-mom-and-pop-small-business-owners.aspx.

Policy implications (continued)

Nearly all focus group participants noted that clear disclosure of product costs and terms would be helpful, particularly early in the application process, rather than at closing, when businesses may have already committed the anticipated funds. Focus group participants indicated that even estimated costs, provided as ranges or averages based on a typical customer of the lender, would be useful.

A separate study examining select online lender websites found significant differences in the information that lenders presented to prospective borrowers.[13] The study corroborated the focus group participants' observations, finding variation across websites with respect to the type of information, level of detail, and terminology used in descriptions of product costs and terms. Unlike consumer credit, credit extended for a business or commercial purpose is not covered by the disclosure requirements of the federal Truth in Lending Act. As a result, online small business lenders have more flexibility in how they describe product costs and features.

The need for consistent disclosures for small business credit products is a topic of discussion among small business advocates, online lenders, and government policymakers alike. A number of states, including New York and California, have enacted small business lending disclosure laws.[14] As these laws take effect and as other state legislatures consider actions, future studies could help to shed light on whether standardized disclosures would be beneficial.

The issues raised here are important, considering that the overall share of small firms applying to online lenders may increase as credit markets evolve. One source of demand may be the new relationships that fintech lenders established with PPP borrowers. Also, expiring COVID-19 relief programs, coupled with a decline in approval rates at banks, could lead more small businesses to turn to online credit as a financing option.

13 Lipman, Barbara J., and Ann Marie Wiersch. 2019. *Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites*. Board of Governors of the Federal Reserve System. December. https://www.federalreserve.gov/publications/what-small-business-borrowers-find-when-browsing-online-lender-websites.htm.

14 As of this writing, four states have passed legislation requiring small business financing disclosures: California SB-1235 (2018), New York SB 5470 (2020), Utah SB 183 (2022), and Virginia House Bill 1027 (2022). Other states, including North Carolina, New Jersey, and Missouri, have proposed legislation on small business lending disclosures.

SBCS methodology

The SBCS is a national survey, conducted since 2016, that gathers information from small businesses on credit needs and financing and provides their perspectives on borrowing experiences—including outcomes, satisfaction, and challenges with both bank and nonbank lenders.

The SBCS uses a convenience sample of establishments. A diverse set of organizations that serve the small business community invite small businesses to participate in the survey by email. The Federal Reserve Banks also directly contact prior SBCS participants.

The sample for the SBCS is not selected randomly; thus, the SBCS may be subject to biases not present with surveys that do sample firms randomly. To control for potential biases, the sample data are weighted so the weighted distribution of firms in the SBCS matches the distribution of the small-firm (1 to 499 employees) population in the United States by number of employees, age, industry, geographic location (census division and urban or rural location), gender of owner(s), and race or ethnicity of owner(s).

RBLC APR Fact Sheet.pdf
Uploaded by: Mary Childs
Position: FAV

RESPONSIBLE BUSINESS LENDING COALITION

ANNUAL PERCENTAGE RATE (APR)

A CRITICAL COMPONENT OF SMALL BUSINESS FINANCING TRANSPARENCY

Small business owners have come to expect standard information to understand the cost of financing, including Annual Percentage Rate (APR), since this information has been required for consumer products like credit cards and home loans for more than 50 years. But because small business financing products aren't covered by the federal Truth in Lending Act, finance providers can legally mislead business owners to take on debt with hidden fees and APRs as high as 350%, without ever disclosing these rates to the borrower.[1] Business owners are being trapped in cycles of harmful debt that devastate their finances, and in many cases, force them to close their doors.

APR HELPS BUSINESS OWNERS COMPARE PRODUCTS

APR is the only pricing metric that enables business owners to accurately compare various finance products, regardless of the amount, term length, payment period, or combination of interest and fees. Research from the Federal Reserve suggests that in the absence of required disclosures, business owners confuse commonly used terms such as "simple interest" and "factor rate" with an APR and mistakenly select costlier products based on this information.[2]

The examples below from the Federal Reserve report illustrate the range of terms and rates promoted on alternative finance providers' websites. While the finance companies in the study did not disclose APR, the report authors calculated the estimated APR for these examples—showcasing just how misleading these lenders/products can be.[3]

Federal Reserve Report: Illustration of Terms for $50,000 Repaid in 6 Months

Rate advertised on website	Product details	Estimated APR
1.15 Factor Rate	• Total repayment amount $59,000 • Fees: 2.5% set-up fee; $50/month administrative fee • Term: none (assume repaid in six months) • Daily payments (assume steady payments five days/week)	70% APR *(not disclosed)*
4% fee rate	• Total repayment amount $56,500 • Fee rate: 4% (months 1–2), 1.25% (months 3–6) • Fees: none • Monthly payments • Term: 6 months	45% APR *(not disclosed)*
9% simple interest	• Total repayment amount $54,500 • Fees: 3% origination fee • Weekly payments • Term: 6 months	46% APR *(not disclosed)*

APR CAN BE CALCULATED FOR *ANY* FINANCING PRODUCT

APR can be calculated for a range of financing products regardless of their structure, fees, or term length. That's why companies offering a range of innovative consumer financing products have been disclosing APR or estimated APR for decades as required under the federal Truth in Lending Act. Many commercial financing providers across the country, including members of the Responsible Business Lending Coalition and signatories of the Small Business Borrowers' Bill of Rights, already disclose APR for various types of small business financing.

Finance providers have access to all the information they need to calculate the APR or estimated APR for business financing products. **In fact, many of the same financing providers that claim they can't disclose APRs to their small business borrowers already disclose annualized yields (essentially the same metric) to their financing investors.** Small business owners deserve the same transparency.

SMALL BUSINESS OWNERS NEED AND EXPECT TRANSPARENCY, INCLUDING APR DISCLOSURE, TO COMPARE FINANCE PRODUCTS

Research from the Federal Reserve demonstrates that business owners want clearly stated price disclosures to better compare financing options—including interest rates expressed as APR.[4]

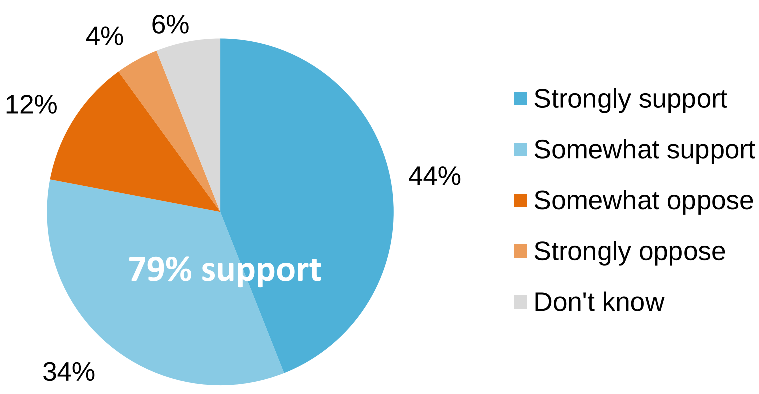
"They don't like to use the word 'interest,' and they dress it up in other ways to conceal the real cost of the loan."

"Full disclosure, like on credit cards or mortgages… is what is necessary. They need to state the actual APR."

- Business owner quotes from the Federal Reserve's online focus group research

Scientific opinion polling commissioned by Small Business Majority reveals that nearly 8 in 10 small business owners support legislation that would require disclosure of APR and other key terms.[5]

Would you support or oppose a law to require certain disclosures for small business loan products, including Annual Percentage Rate (APR), total cost of capital, and all fees and prepayment penalties, in a uniform standard?



Endnotes

1. Accion Opportunity Fund. Unaffordable and Unsustainable: The New Business Lending. 2016 https://aofund.org/news/unaffordable-and-unsustainable-new-business-lending/

2. Federal Reserve Bank of Cleveland, "Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites," December 2019 https://www.clevelandfed.org/publications/cd-reports/2019/sr-20191219-uncertain-terms

3. Ibid.

4. Board of Governors of the Federal Reserve System, "Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites," December 2019. https://www.federalreserve.gov/publications/files/what-small-business-borrowers-find-when-browsing-online-lender-websites.pdf

5. Small Business Majority. "State Opinion Polls: Small business owners say government doesn't understand their concerns, need help with healthcare costs and other challenges." Poll conducted by Chesapeake Beach Consulting for August 13, 2019. https://smallbusinessmajority.org/our-research/entrepreneurship-freelance-economy/small-business-owners-say-government-doesn-t-understand-their-concerns-need-help-healthcare-costs-and-other-challenges

Small Business Majority Small Business Survey 8 in

Uploaded by: Mary Childs

Position: FAV

SMALL BUSINESS OWNERS SAY GOVERNMENT DOESN'T UNDERSTAND THEIR CONCERNS, NEED HELP WITH HEALTHCARE COSTS AND OTHER CHALLENGES

Publisher: Small Business Majority
Date: Tuesday, August 13, 2019

Policymakers at all levels, from town councils to the halls of Capitol Hill, emphasize the challenges of small businesses as a key talking point during political debates. But new opinion polling in four states—Illinois, Missouri, Virginia and Wisconsin—reveals small businesses feel their government officials don't actually understand their challenges, and they support a wide array of policies to address their needs, some of which might come as a surprise to their elected officials.

Key Findings

- **Small businesses feel their government officials don't understand their needs:** Only 12% of respondents feel their state and federal government officials understand the needs and challenges of small businesses like theirs "a lot." The top three reasons why they feel government officials don't understand small businesses are: they are too influenced by special interests (41%), they primarily care about larger businesses (33%) and they don't take time to listen to or understand the views of business owners like them (15%).

Here are some reasons that others have given as to why government officials don't understand small business needs and challenges. Of these, please indicate which is the top reason why they don't understand your needs.

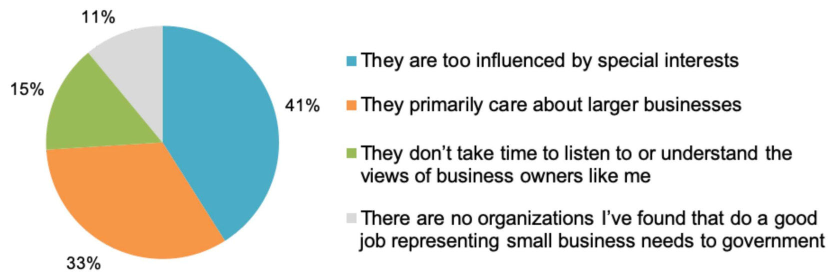
FILTER BY STATE

- Any -

OUR RESEARCH

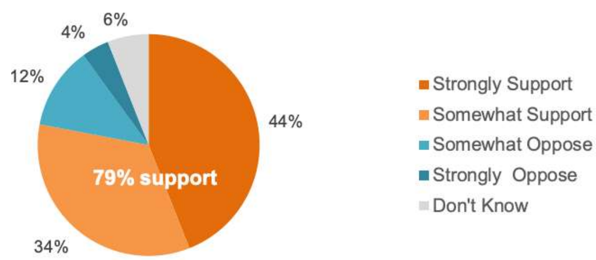
Access to Capital
Fair Competition
Entrepreneurship & Independent Economy
Healthcare
Workforce
Digital Transformation
Retirement Security
Taxes, Budget & Economy
Infrastructure
Technology
Government Accountability
Immigration
Clean Energy Economy

Outdoor Economy



- **Small businesses identify the biggest barriers to maintaining or growing their businesses:** The top two barriers are taxes and healthcare costs (56% and 47% respectively), followed by licensing and regulations (36%), access to capital (22%), a lack of qualified workers (22%), a lack of access to business support services (21%) and infrastructure (18%).
- **Small business owners agree on a multitude of policy solutions to address their healthcare costs:** This includes increasing existing federal subsidies that help make healthcare more affordable to provide financial assistance for people who make under 400% of the federal poverty level (less than $100,400 for a family of four) (71%), requiring all individuals to maintain a basic level of health insurance (65%), allowing individuals to buy in to Medicare or Medicaid at no net cost to the government (78%) and creating a reinsurance program to create more stability in the market (77%). Additionally, 60% support banning short-term insurance and association health plans, which do not have to cover all essential health benefits and can exclude those with pre-existing conditions.
- **A majority of small business owners believes access to capital is a problem for small businesses and support solutions to predatory lending practices:** Currently, there is no law or standard governing how the rates or fees for commercial lending products for small businesses are disclosed to borrowers. Nearly 8 in 10 (79%) support a law to require certain disclosures for small business loan products, including APR, total cost of capital and all fees and prepayment penalties, in a uniform standard.

Would you support or oppose a law to require certain disclosures for small business loan products, including Annual Percentage Rate (APR), total cost of capital, and all fees and prepayment penalties, in a uniform standard?



- **Only 1 in 3 respondents (35%) say the Tax Cuts and Jobs Act of 2017 has had a positive impact on their business.** A combined 55% say the new tax law has had no effect or a negative effect on their business.

- **Entrepreneurs support policies implementing retirement saving and paid family and medical leave programs:** Sixty-three percent support state efforts to enact retirement programs that automatically enroll employees of businesses without their own retirement plans into a state-administered retirement saving program. Similarly, 67% feel it is important to establish state programs to guarantee access to paid family and medical leave, funded by modest employee and employer contributions.

- **Small business owners are politically diverse:** 45% of respondents identify as Republican or Republican-leaning independents, 37% are Democrat or Democrat-leaning independents and 18% are pure independent or other.

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Press Releases

- Scientific Opinion Poll: Small Business Owners Say Government Doesn't Understand Their Concerns, Need Help With Healthcare Costs and Other Challenges
- Scientific Opinion Poll: Mo. Small Business Owners Say Government Doesn't Understand Their Concerns, Need Help With Healthcare Costs and Other Challenges
- Scientific Opinion Poll: Va. Small Business Owners Say Government Doesn't Understand Their Concerns, Need Help With Healthcare Costs and Other Challenges
- Scientific Opinion Poll: Wisc. Small Business Owners Say Government Doesn't Understand Their Concerns, Need Help With Healthcare Costs and Other Challenges
- Scientific Opinion Poll: Ill. Small Business Owners Say Government Doesn't Understand Their Concerns, Need Help With Healthcare Costs and Other Challenges

Category:
Tax policy, Healthcare, Medicaid, Access to capital, Workforce, Retirement security, Family Medical Leave, Government accountability, Entrepreneurship

State(s): National, IL, MO, VA, WI

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Uniform Law Commission Request for RBLC to Provide
Uploaded by: Mary Childs
Position: FAV

Dear ULC Study Committee on Commercial Financing Disclosure,

The Responsible Business Lending Coalition ("RBLC") appreciates your invitation to provide input regarding the consideration of a model or uniform law for small business financing disclosure. We commend Professor Sepinuck on the thoughtful memo provided for the Study Committee's October 24th meeting and hope here to provide additional information for the Study Committee's consideration.

The RBLC is the leading cross-sector voice on small business financial protection. The RBLC includes for-profit financing companies, nonprofit and for-profit CDFIs, financing investors, and small business advocates who share a commitment to expanding access to responsible and innovative capital options that will help small businesses thrive.[1]

In the following letter, we offer several points for your consideration:

In 2015, the RBLC raised the need for small business financing disclosure to national awareness by launching the *Small Business Borrower's Bill of Rights* initiative. The *Small Business Borrower's Bill of Rights* is the first cross-sector consensus on responsible lending standards in small business financing.[2] It begins with a transparent disclosure framework, detailed in Right #1, The Right to Transparent Pricing and Terms, which has contributed to a nationwide wave of lawmaking around small business price disclosure. The Coalition's position is that any commercial finance disclosure law must align with Right #1 of the Small Business Borrowers' Bill of Rights to offer comprehensive protections and support a healthy business financing

[1] Members of the Responsible Business Lending Coalition include Accion Opportunity Fund, the Aspen Institute, BlueVine, Camino Financial, Community Investment Management, LendingClub, Opportunity Finance Network, the National Association for Latino Community Asset Builders, the National Community Reinvestment Coalition, and Small Business Majority. For more information, visit www.borrowersbillofrights.org.

[2] Over 80 small business lenders, brokers, and advocacy organizations have endorsed the *Small Business Borrower's Bill of Rights*. See http://www.borrowersbillofrights.org/signatories.html. We welcome additional endorsers who seek to uphold responsible practices in small business financing. To join, please visit http://www.borrowersbillofrights.org/join-us.html

market. We urge the Committee to reference these Rights in considering any model or uniform commercial finance disclosure law.[3]

In 2018, inspired by the *Small Business Borrower's Bill of Rights*, the RBLC led advocacy efforts supporting the passage of the first small business truth in lending law in the nation, California's SB 1235.[4] In 2020, the RBLC supported the passage of the second small business truth in lending law in the nation, New York S5470b. We consider NY S5470b to be the model law for small business financing disclosure because it aligns most comprehensively with the Small Business Borrowers' Bill of Rights. It incorporates many lessons learned after California's SB 1235 and reflects two years of negotiations that took place among industry, nonprofit, and small business advocacy stakeholders who came to the table after California's law passed.[5]

These campaigns for small business financing disclosure were borne out changes in the small business financing market. For many years, the primary financing challenge facing small business owners was one of exclusion—a lack of access to capital for many businesses. Over the last two decades, that problem has been joined by another: the rise of irresponsible small business financing.

Today, small business seeking financing often find themselves between a rock and a hard place. On the one hand, many businesses continue to struggle to access capital.[6] On the other hand, businesses are now inundated with offers of fast, easy cash. Unfortunately, these newer types of financing are often characterized by high and uncompetitive rates, a lack of transparency about those high rates, and a lack of underwriting of the businesses' ability to repay.[7]

For example, research by the CDFI Accion Opportunity Fund evaluated the terms of financing secured by business owners who had approached Accion Opportunity Fund to refinance products that were harming their cash flow. Their analysis found that that among these products, the effective APRs averaged 94% and exceeded 350% in some cases. Further, the average payment amount for these products represented 178% of the small businesses borrower's net income.[8] In

[3] Detailed practice standards for the Small Business Borrowers' Bill of Rights are available at http://www.borrowersbillofrights.org/bill-of-rights.html
[4] This year, RBLC organized the passage of California SB 33, which passed unanimously to strengthen this disclosure framework by making permanent the required disclosure of an annualized rate, and explicitly naming APR and Estimated APR in statutory text.
[5] Ultimately, California and New York's small business disclosure regulations are substantially similar, though New York's include several important elements omitted in California. Many of the important details of the truth in lending framework that appear in regulation in California exist in both statute and regulation in New York.
[6] For example, less than half of nonemployer firms reported their funding needs being met in 2019 research by the Federal Reserve Bank of New York. Federal Reserve Bank of New York, "Small Business Credit Survey: Report on Nonemployer Firms," 2019, pg 10. https://www.newyorkfed.org/smallbusiness/small-business-credit-survey-2018.
[7] See e.g. Woodstock Institute, "Analysis of Small Business Loan Terms," July 2016. Woodstock Institute. https://woodstockinst.org/wp-content/uploads/2016/07/Woodstock_Analysis_of_Online_SB_Loan_Terms.pdf.
[8] Opportunity Fund, "Unaffordable and Unsustainable: The New Business Lending on Main Street." May 2016. Unaffordable-and-Unsustainable-The-New-Business-Lending-on-Main-Street_Opportunity-Fund-Research-Report_May-2016.pdf (aofund.org)

other words, the *average* financing contract was pushing the small business into unprofitability, charging double what the business could afford to pay.

Although some small businesses may be able to bounce back from using high-cost, short-term financing in an emergency, the business models of high-cost financing companies are often designed to encourage borrowers to use short-time financing on an ongoing basis that resembles a payday loan debt cycle.[9] For example, the CEO and founder of a one short-term financing company celebrated on stage at an industry conference that "customers take 20 loans over four to five years, four to five loans every year."[10] An analysis by reporters at McClatchy nearly a decade ago found more than 700 personal and business bankruptcies associated with major merchant cash advance companies.[11]

Concerns like these led RBLC to partner with hundreds of organizations nationwide to pass the state small business truth in lending laws referenced above and to introduce a federal small business financing disclosure bill that has earned support from nearly 90 diverse organizations including fintech companies, banks, chambers of commerce, racial justice organizations, small business technical assistance providers, CDFIs, and more.[12]

These legislative advancements reflect the efforts of for-profit and non-profit financing innovators to create a level playing field of transparent price disclosure where competition and innovation can thrive. Price competition cannot take place without transparent price disclosure. Today, in states that do not require transparent disclosure of APR or Estimated APR, small business owners lack important information they need to compare financing prices. Financing companies may compete on the speed and ease of accessing their financing, but in some market segments competition on the price of that financing is hindered. In fact, in some sense competition is taking place on how well the financing company is able to obscure their prices.

1) APR is the keystone of transparent pricing. Without it, disclosure bills are counterproductive.

The lack of transparency in small business financing today *is* the lack of APR. APR is the only pricing metric that enables business owners to accurately compare various finance products, regardless of the amount, term length, payment period, or combination of interest and fees. This is why APR has become familiar as the keystone of transparent price disclosure in consumer financing since the Truth in Lending Act was passed in 1968. Entrepreneurs often rely on personal finance products to fund their businesses, such as credit cards and home equity lines of

[9] deBanked, "Boiler Rooms Are Not Brands, Kabbage CEO Says," April 2018. https://debanked.com/2018/04/boiler-rooms-are-not-brands-kabbage-ceo-says

[10] Zachary Miller, "Behind Amex's use of Kabbage as 'the heartbeat' of its strategy to help SMBs with cash flow," Tearsheet, Sept 2022. https://tearsheet.co/podcasts/behind-amexs-use-of-kabbage-as-the-heartbeat-of-its-strategy-to-help-smbs-with-cash-flow

[11] Their bakery faced a cash crisis. The solution nearly cost them the business. | McClatchy Washington Bureau (mcclatchydc.com). https://www.mcclatchydc.com/news/nation-world/national/article212524749.html#cardLink=row1_card1

[12] Small Business Financing Disclosure Act of 2023 Earns Strong Cross-Industry Support. http://www.borrowersbillofrights.org/strong-cross-industry-support.html

credit, especially when they're just starting out. They may not realize that business finance products don’t come with the same protections, even if they are used for the same purpose.

APR is not the only metric that is useful to small business owners.[13] For example, the finance charge, sometimes referred to casually as the total dollar cost, is also extremely helpful. It is required alongside APR in the small business truth in lending laws of California and New York. But dollar cost alone, without APR, does not enable applicants to compare the costs of financing options with financing amount or different expected term lengths. Because dollar cost alone does not consider how much time the borrower is able to use the financing for a given cost they must pay, it can mislead small businesses towards shorter-term financing that they pay more to use, in dollar terms, over equivalent periods of time. Additionally, dollar cost is generally disclosed today already, making legislation requiring it unnecessary.

The problem of relying on dollar cost without APR was described especially well by MFTransparency, which proposed transparency standards in the international microfinance industry:

> “Using Total Cost of Credit is like looking at the price of an apartment, but not taking into account how long you will be able to stay! But APR is like looking at a standardized cost per year for that same apartment:
> · $1,000 per day = $365,000 per year
> · $1,000 per month = $12,000 per year”[14]

Federal Reserve researchers have conducted five studies documenting what has become clear to many working in small business financing today: small businesses are being misled by the lack of transparent disclosure in the absence of transparent disclosure of APR or Estimated APR.[15]

In 2015, the Federal Reserve researchers published perhaps the first comprehensive government study specifically of online small business financing disclosures. The Federal Reserve

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[13] For example, the financing charge, sometimes referred to as the total dollar cost, is also helpful.

[14] MicroFinance Transparency, “Total Cost of Credit vs. APR,” 2010. http://www.mfransparency.org/total-cost-of-credit-vs-apr

[15] 1) Federal Reserve Bank of Cleveland, “Clicking for Credit: Experiences of Online Lender Applicants from the Small Business Credit Survey,” August 2022. https://www.clevelandfed.org/publications/cd-reports/2022/sr-20220816-clicking-for-credit-experiences-of-online-lender-applicants-from-sbcs
2) Board of Governors of the Federal Reserve System, “Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites,” December 2019. https://www.federalreserve.gov/publications/files/what-small-business-borrowers-find-when-browsing-online-lender-websites.pdf
3) Board of Governors of the Federal Reserve System, “Searching for Small Business Credit Online,” Consumer and Community Context, Nov 2019, Vol 1, No 2, https://www.federalreserve.gov/publications/files/consumer-community-context-201911.pdf
4) Federal Reserve Board of Governors, “Browsing to Borrow: ‘Mom & Pop” Small Business Perspectives on Online Lenders,” June 2018. https://www.federalreserve.gov/publications/files/2018-small-business-lending.pdf
5) Federal Reserve Bank of Cleveland, “Alternative Lending through the eyes of ‘Mom & Pop’ Small-Business Owners,” August 2015. https://www.clevelandfed.org/newsroom-and-events/publications/special-reports/sr-20150825-alternative-lending-through-the-eyes-of-mom-and-pop-small-business-owners.aspx

researchers found that, "Using information typically provided on online alternative lenders' websites, small businesses find it difficult to compare credit products… Virtually all the focus group participants said they want clearly stated product features and costs and an easier way to compare product offerings. Among their suggestions were interest rates expressed as APRs, straightforward explanation of all fees, and required statements about payment policies, including late fees and prepayment penalties."[16]

Interestingly, the research found that small business owners often did not recognize the extent to which disclosures that lacked APR or Estimated APR were insufficient or misleading. When presenting standard disclosures such without APR or Estimated APR, the Federal Reserve researchers asked the small business owners if anything seemed confusing or if any additional information was needed. Replies included "No, it's pretty straightforward," and "I can't think of anything more I would like to see, really." However, when asked what rate they would pay, the small business owners did not know, and often appeared not to realize that they did not know. Answers included 28%, 5%, 9.8%, and the highest guess was a "a whopping 30%." The actual effective APR was 60%. None realized the price was that high.[17]

A study conducted by Federal Reserve researchers in 2019 suggests that in the absence of APR or Estimated APR, business owners often misinterpret the "novel pricing metrics" used today by high-price financing companies, and mistakenly select costlier products as a result.[18] Below is an excerpt from that study, demonstrating how misleading pricing metrics are being used today to misguide small business owners into higher-priced financing.

In the table below, the Federal Reserve researchers present three different financing offers of $50,000, using the disclosure metrics of their respective financing companies.[19] As the table illustrates, in the left column, the Federal Reserve researchers highlight that some high-priced financing companies quote "novel" rates on their website such as a "1.15 factor rate", "4% fee rate", and "9% simple interest rate." These financing companies do not disclose that these rates correspond to approximate Estimated APRs of 70%, 45%, and 46% respectively.

[16] *Id,* Page 3
[17] *Id.*
[18] Federal Reserve, Dec 2019. (Page 18) https://www.federalreserve.gov/publications/files/what-small-business-borrowers-find-when-browsing-online-lender-websites.pdf
[19] *Id.*

Table 3. Estimated APRs for select online products

Rate advertised on website	Product details	Estimated APR equivalent
1.15 factor rate	• Total repayment amount $59,000 • Fees: 2.5% set-up fee; $50/month administrative fee • Term: none (assume repaid in six months) • Daily payments (assume steady payments five days/week)	Approximately 70% APR
4% fee rate	• Total repayment amount $56,500 • Fee rate: 4% (months 1–2), 1.25% (months 3–6) • Fees: none • Monthly payments • Term: six-month term	Approximately 45% APR
9% simple interest	• Total repayment amount $54,500 • Fees: 3% origination fee • Weekly payments • Term: six-month term	Approximately 46% APR

Source: Authors' calculations, based on product descriptions on company websites.

Figure 1: Table from 2019 Federal Reserve Study Illustrating APR Calculations for Commercial Finance Products

The Federal Reserve Researchers found that, without APR, "participants noted that the varying product descriptions provided no common basis for cost comparisons, and several suggested that APR would be helpful for that purpose. In fact, determining the equivalent APR on some products may be challenging [for small business owners], given the non-standard terminology and structure of products offered by online lenders."[20] Moreover, the researchers found that small businesses were misled, perhaps strategically. "When asked to compare a sample short-term loan product with a 9 percent 'simple interest' rate to a credit card with a 21.9 percent interest rate, most participants incorrectly guessed the short-term loan to be less expensive."[21]

These are among the reasons why the need for APR transparency in small business financing has been raised by:

- The Bloomberg News editorial board ("Protect Small Businesses from Predatory Lending")[22]

[20] *Id.*
[21] *Id.*
[22] https://www.bloomberg.com/opinion/articles/2018-11-28/confessions-of-judgment-small-business-and-predatory-lending

- The Bipartisan Policy Center[23]
- The Conference of State Bank Supervisors' Fintech Industry Advisory Panel
- Former Democratic SBA Administrator Karen Mills[24] and Former Republican SBA Administrator Christopher Pilkerton
- US Treasury officials[25]
- Federal Reserve Governor Lael Brainard[26]
- Federal Reserve Board of Governors Community Advisory Council[27]
- 80+ industry and nonprofit signatories and endorsers of the Responsible Business Lending Coalition's *Small Business Borrowers Bill of Rights*[28]
- A dozen member companies of the Innovative Lending Platform Association[29]
- The National Consumer Law Center[30]
- Center for Responsible Lending ("These things have the same functional problems as payday loans, except they're worse. There's very manipulative pricing.")[31]
- The New York Department of Financial Services[32]
- Numerous news articles, (e.g. McClatchy, "Even Finance Whizzes Say It's Impossible to Compare Online Small Business Loan Options." June 2018)[33]

Unfortunately, after the passage of small business truth in lending laws in California and New York, several states have passed disclosure laws without APR. In our view, these bills generally do not meaningfully advance transparency. Instead, these bills have generally served as a way for high-priced financing companies to muddy the water about the need for transparent disclosure of APR. These bills generally require disclosure of information that is already disclosed universally by finance providers, such as the financing amount.

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[23] https://bipartisanpolicy.org/wp-content/uploads/2018/07/Main-Street-Matters-Ideas-for-Improving-Small-Business-Financing.pdf (they write specifically about the challenges small business owners face comparing the price of sales-based financing to other options: "There can also be confusion around some forms of small business credit, called merchant cash advances. These products are not classified as loans and, as such, are not expressed in terms of an APR, making it challenging to compare with other types of credit products. ")

[24] http://www.hbs.edu/faculty/Publication%20Files/17-042_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf

[25] https://www.treasury.gov/connect/blog/Pages/Opportunities-and-Challenges-in-Online-Marketplace-Lending.aspx, https://www.progressivepolicy.org/wp-content/uploads/2017/11/PPI_SmallBizCredit_2017.pdf,

[26] Board of Governors of the Federal Reserve System, "Remarks by Lael Brainard: Community Banks, Small Business Credit, and Online Lending," 2015. www.federalreserve.gov/newsevents/speech/brainard20150930a.pdf

[27] See page 7, https://www.federalreserve.gov/aboutthefed/files/cac-20181005.pdf

[28] http://www.borrowersbillofrights.org/signatories.html

[29] https://innovativelending.org/

[30] See NCLC's letter in Appendix B of the RBLC's comment letter: http://www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/sb_1235_support_coalition_and_rblc_comment_-_small_business_disclosures_file_no_pro_01-18.pdf

[31] Their bakery faced a cash crisis. The solution nearly cost them the business. | McClatchy Washington Bureau (mcclatchydc.com) https://www.mcclatchydc.com/news/nation-world/national/article212524749.html

[32] https://www.dfs.ny.gov/docs/reportpub/online_lending_survey_rpt_07112018.pdf

[33] https://www.mcclatchydc.com/news/nation-world/national/article212491199.html

In short, any small business disclosure bill that omits APR and Estimated APR will not address the lack of price transparency small businesses face in the financing market today. It would instead rubber-stamp that lack of price transparency.

Disclosure bills that include APR have been supported by small business groups, responsible for-profit lenders, civil rights groups, CDFIs, and small business themselves.[34] Disclosure bills without APR have been opposed by all of these groups, and generally supported only by high-price financing companies that do not disclose APR. Naturally, companies that currently mislead business owners to secure high-cost products have a vested interest in preventing these business owners from understanding the true price of their financing, since this could cause them to lose business to lower-cost providers.

2) APR or Estimated APR can be calculated for all types of financing, including merchant cash advances and factoring

The disclosure laws of California and New York demonstrate that APR or Estimated APR can be disclosed for all types of financing, including merchant cash advance, factoring, open and closed end credit, asset-based lending, and so on. While merchant cash advance has been the most controversial (and in our view, perhaps the most in need of improved transparency), some merchant cash advance companies disclosed Estimated APRs prior to the passage of these laws.[35] Other merchant cash advance companies have vociferously opposed disclosing the high APRs they charge, with reasons shifting as quickly as they are discredited.

Financing companies are not in the business of disbursing capital with no expectation of when it will be repaid, and at what return. They enter into financing transactions with an expected annualized yield in mind—sometimes described as an internal rate of return ("IRR"). APR is this same metric from the perspective of the customer, and in fact it can be computed using the IRR formula. Merchant cash advance companies generally set the terms they offer in their underwriting to achieve their targeted annualized yield or IRR. The cash advance company's fee size and split rate is adjusted to achieve the target yield, given the expected rate of repayment. Further, merchant cash advance companies sometimes advertise these targeted annualized yields to investors who provide the financing capital, in documents as legally scrutinized as securities

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[34] With respect to support of small business themselves, a poll of small business owners commissioned by Small Business Majority found that 79% of small business owners would Strongly Support or Somewhat Support "a law to require certain disclosures for small business loan products, including Annual Percentage Rate (APR), total cost of capital, and all fees and prepayment penalties, in a uniform standard." Small Business Majority. "State Opinion Polls: Small business owners say government doesn't understand their concerns, need help with healthcare costs and other challenges." Poll conducted by Chesapeake Beach Consulting for August 13, 2019. https://smallbusinessmajority.org/our-research/entrepreneurship-freelance-economy/small-business-owners-say-government-doesn-t-understand-their-concerns-need-help-healthcare-costs-and-other-challenges

[35] See, e.g. some historical members of the ILPA's "SMART Box" initiative and some signatories of the Small Business Borrower's Bill of Rights

solicitations.[36] Surely, the small business borrowers paying those prices deserve the same transparency.

Computing the Estimated APRs for these products can be simple for finance professionals once clear guidelines are established. An Estimated APR on a merchant cash advance can be computed in a matter of seconds in Microsoft excel.[37] For merchant cash financing companies unable to automate Estimate APR calculations themselves, and whose staff lack excel and finance skills, a leading merchant cash advance company sells software to "efficiently" automate these Estimated APR computations.[38]

Professor Sepinuck's memo notes that there has been litigation regarding California's small business truth in lending framework. A trade association of merchant cash advance companies has sued California, arguing that the requirement to transparent disclose the Estimated APRs they propose to charge small business owners is a violation of the financing company's free speech rights. Professor Sepinuck's memo raises that this trade association's argument that because Estimated APR is computed based on assumptions, it thus "would arguably not require purely factual speech, and thus might violate protections for freedom of speech."

We believe it is obvious that an estimate can be disclosed factually. For example, it may be a fact that the "Estimated APR" of a specific transaction is 150%, given that it is clearly labeled as an "Estimate" and calculated according to stated assumptions. Financing companies run their financing operations based on these same assumptions. Financing companies quote their expected yields to investors based on these same assumptions. Does an expected yield to earned by a financing company and investors become a free speech concern only once the small business who will be paying that yield finds out about it?

Open-end credit products and factoring financing require different assumption guidelines than merchant cash advance financing to produce standardized Estimated APRs. Nonetheless, computing these Estimated APRs is straightforward once those guidelines are established and clearly stated.

At times, high-cost financing providers have argued that APR is confusing to small business owners because they may not know the underlying algebra to compute it. A Federal Reserve official, speaking personally, refuted that argument succinctly: "When I'm in the grocery store, I don't need to know how scientists measure how many calories are in a carton of yogurt to know

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[36] See e.g. CAN Capital's advertisement to investors of 48% annualized yields, and expected term lengths disclosed in months, to two decimal places. https://dailyfunder.com/CANCapital-DBRS-securitization.pdf

[37] See, for example, instructional formulas provided here: http://www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/rblc__notice_of_fourth_modifications_to_proposed_regulations_under_division_9.5_of_the_california_financial_code_pro_01_18.pdf

[38] Will Tumulty, CEO of Rapid Finance, described their calculator as giving Industry "the tools they need to help ensure that they can continue to efficiently and compliantly meet the financing needs of their customers." Businesswire, Rapid Finance Announces Availability of API Service to Support State-Level Business Lending Disclosure Requirements (Dec. 9, 2022, 7:01 AM), https://tinyurl.com/4suct43f.

that 300 calories is more than 200 calories." This sort of clear comparison is what a successful disclosure law enables.

3) A successful disclosure bill would cover all commonly used small business financing products

Professor Sepinuck's memo succinctly sets out the objectives of a small business disclosure framework: "to enhance competition and lead to more informed decision making." For these goals to be accomplished, the framework must enable comparison between the range of financing options that small business consider. RBLC has opposed bills that exempt merchant cash advance, and bills that target only merchant cash advance.

Small businesses rarely seek out a specific product structure. Most often, they simply need capital, and explore whatever options are available to them. In many cases, the business owner may not understand the differences between products, such as whether their merchant cash advance is a loan or not.[39] If a disclosure framework requires APR of some products, but not others, it will prevent effective comparison, disadvantage more-transparent forms of financing, and advantage financing that may charge higher and prices with less transparency. Ultimately, small businesses will pay the price.

The Responsible Business Lending Coalition looks forward to continuing to provide feedback to the Study Committee, and, if warranted, the Drafting Committee on Commercial Finance Disclosure. It is our hope that the results of these efforts align with the principles of the Small Business Borrowers' Bill of Rights. For any commercial finance disclosure law to meet the goals of enhancing competition and supporting informed decision making, it must include APR disclosure for all forms of financing products. We thank you for your consideration.

Sincerely,

The Responsible Business Lending Coalition (members listed below):

Accion Opportunity Fund
Aspen Institute
BlueVine
Camino Financial
Community Investment Management
LendingClub
Opportunity Finance Network
National Association for Latino Community Asset Builders
National Community Reinvestment Coalition
Small Business Majority

[39] See, e.g. Their bakery faced a cash crisis. The solution nearly cost them the business. | McClatchy Washington Bureau (mcclatchydc.com)
https://www.mcclatchydc.com/news/nation-world/national/article212524749.html#cardLink=row1_card1

Appendix A – Several sample disclosure forms intended to comply with California and New York small business truth in lending frameworks

Below are example disclosures forms from California for closed end loans, open end lines of credit, and sales-based financing (i.e. merchant cash advance) respectively. Please note that these are specific examples, and so financing offers with other terms (e.g. different payment periods or prepayment structures) would appear slightly differently.

OFFER SUMMARY
Fixed Term Loan (Closed-End Transaction)

Funding Provided	$[Amount]	This is how much funding [Lender] will provide. Due to deductions or payments to others, the total funds that will be provided to you directly is $[Disbursed Amount]. For more information on what amounts will be deducted, please review the attached document "Itemization of Amount Financed".
Annual Percentage Rate (APR)	[APR]%	APR is the cost of your financing expressed as a yearly rate. APR includes the amount and timing of the funding you receive, interest and fees you pay and the payments you make. Your APR is not an interest rate. Your interest rate is [Interest Rate]%. Your APR may be higher than your interest rate because APR incorporates interest costs and other finance charges.
Finance Charge	$[Finance Charge]	This is the dollar cost of your financing.
Total Payment Amount	$[Total Repayment Amount]	This is the total dollar amount of payments you will make during the term of the contract.
Payment	$[Monthly Payment] / month	This is the dollar amount you will be required to pay to [Lender] per month.
Term	[Term] years	
Prepayment	If you pay off the financing early, you will not need to pay any portion of the finance charge other than unpaid interest accrued (if applicable).	
	If you pay off the financing early you will not pay additional fees	

RESPONSIBLE BUSINESS LENDING COALITION

OFFER SUMMARY

Line of Credit

The calculations below are based on an initial draw of your full Approved Credit Limit of $75,000 and assume that you will pay off the draw entirely according to the agreed payment schedule, that you miss no payments, and that you do not redraw on this line. Actual costs may differ substantially.		
Funding Provided	**$73,125.00 (approved credit limit minus $1,875.00 draw fee)**	This is the maximum amount of funding [Lender] may provide.
Annual Percentage Rate (APR)	**81.25%**	APR is the cost of your financing expressed as a yearly rate. APR includes the amount and timing of the funding you receive, interest and fees you pay and the payments you make. APR is not an interest rate. Your interest rate is 1.36% per week. Your APR may be higher than your interest rate because APR incorporates interest costs and other finance charges.
Estimated Finance Charge	**$16,418**	This is the dollar cost of our financing based upon the assumptions described at the top of this disclosure.
Estimated Total Payments	**$89,543.48**	This is the total dollar amount of payments you will make during the term of the contract based upon the assumptions described at the top of this disclosure.
Average Monthly Cost	**$14,974**	Although this financing does not have monthly payments, this is our calculation of your average monthly cost for comparison purposes.
Estimated Payment	Date of payment (02/22/2023): $3,443.98 Date of payment (03/01/2023): $3,443.98 Date of payment (03/08/2023): $3,443.98 Date of payment (03/15/2023): $3,443.98 Date of payment (03/22/2023): $3,443.98 Date of payment (03/29/2023): $3,443.98 Date of payment (04/05/2023): $3,443.98 Date of payment (04/12/2023): $3,443.98 Date of payment (04/19/2023): $3,443.98 Date of payment (04/26/2023): $3,443.98 Date of payment (05/03/2023): $3,443.98 Date of payment (05/10/2023): $3,443.98 Date of payment (05/17/2023): $3,443.98 Date of payment (05/24/2023): $3,443.98 Date of payment (05/31/2023): $3,443.98 Date of payment (06/07/2023): $3,443.98 Date of payment (06/14/2023): $3,443.98 Date of payment (06/21/2023): $3,443.98 Date of payment (06/28/2023): $3,443.98 Date of payment (07/05/2023): $3,443.98 Date of payment (07/12/2023): $3,443.98 Date of payment (07/19/2023): $3,443.97 Date of payment (07/26/2023): $3,443.97 Date of payment (08/02/2023): $3,443.98 Date of payment (08/09/2023): $3,443.98 Date of payment (08/16/2023): $3,443.97 The above payment schedule assumes the minimum required payments are made.	
Draw Period	**Life of the Line of Credit**	This is the time period for which you will be able to make draws. Additional draws may be requested up to the maximum amount of the line of credit, in accordance with the requirements of your Financing Agreement.
Term	**182 days**	

Prepayment	If you pay off the financing early, you will not need to pay any portion of the finance charge other than unpaid interest accrued (if applicable). If you pay off the financing early, you will not pay additional fees.
Collateral Requirements	As defined in Section 1.3 of your Financing Agreement.
Avoidable Fees and Charges	Late Interest Fee (the product of the unpaid principal balance of the Draw and 0.3% per day), the Failed Payment Fee (with respect to any ACH debit payment that is dishonored by Client's bank, the greater of (i) 5% of missed payment amount; or (ii) $35), and the Wire Fee ($15 per processed wire).

Applicable law requires this information to be provided to you to help you make an informed decision. By signing below, you are confirming that you received this information.

Recipient Signature: ______________________

Date: 02/15/2023

RESPONSIBLE BUSINESS
LENDING COALITION

OFFER SUMMARY – PAYMENT RIGHTS SALE DISCLOSURE AGREEMENT

Funding Provided	$ 7,500	This is how much funding Bitty Advance 2, LLC will provide. Due to deductions or payments to others, the total funds that will be provided to you directly is $ 6,806. For more information of what amounts will be deducted, please review the attached document "Itemization of Amount Financed." The amount paid directly to you may change based on required pay-off/pay downs to third-parties, which amounts have not yet been confirmed at the time of this disclosure.
Estimated Annual PercentageRate (APR)	177.74%	APR is the estimated cost of your financing expressed as a yearly rate. APR incorporates the amount and timing of the funding you receive, fees you pay and the payments you make. This calculation assumes your estimated average monthly income through sales of goods and services will be $ 14,453. Since your actual income may vary from our estimate, your effective APR may also vary. APR is not an interest rate. The cost of this financing is based upon fees charged by Bitty Advance 2, LLC rather than interest that accrues over time.
Finance Charge	$ 5,139	This is the dollar cost of your financing.
Estimated Total Payment Amount	$ 11,945	This is the total dollar amount of payments we estimate you will make under the contract.
Estimated Monthly Cost	$ 2,284	Although this financing does not have monthly payments, this is our calculation of your estimated average monthly cost for comparison purposes.
Estimated Payment	$ 102 / Day	
Payment Terms	The contact provides for Daily periodic payments. The specified percentage of 35% will be delivered to the buyer Daily. The initial estimated Daily debit amount is intended to represent the Specified percentage of your future receipts. You or the buyer may request a reconciliation to the estimated debit amount to more closely reflect your actual future receipts times the specified percentage. Refer to "Changes to the Estimated Debit Amount" on page 3 in the Payments Rights Purchase and Sale Agreement.	
Estimated Term	115 days	This is the estimated term of how long it will take to collect amounts due to the buyer.
Prepayment	If you pay off the financing faster than required, you still must pay all or a portion of the finance charge, up to $ 5,139 based upon our estimates.	
	If you pay off the financing faster than required, you will not be required to pay additional fees.	

Applicable law requires this information to be provided to you to help you make an informed decision. By signing below, you are confirming that you received this information.

[redacted] [redacted]

Recipient's Signature Date

MDDCCUA Final - 2023 - SB509 .pdf
Uploaded by: Rory Murray
Position: FAV

MD|DC
Credit Union Association

February 12, 2024

Chairman Pam Beidle
3 East
Miller Senate Office Building
Annapolis, Maryland 21401

Chairman Beidle, Vice-Chair Klausmeier, and Members of the Committee,

The MD|DC Credit Union Association, on behalf of the 70+ Credit Unions and their 1.9 million members that we represent in the State of Maryland, appreciates the opportunity to testify on this legislation. Credit Unions are member-owned, not-for-profit financial cooperatives that prioritize the financial well-being of their members. **We support this bill.**

This proposed legislation seeks to introduce a structured regulatory framework overseen by the Office of the Commissioner of Financial Regulation (OCFR), ensuring consumer protection and necessary oversight in commercial lending practices. Senate Bill 509 represents a significant stride towards safeguarding Maryland's small businesses by instituting uniform standards and transparency mandates for commercial lenders. These provisions are essential to fostering fairness, equity, and accountability in the lending landscape, thereby promoting a safe and level playing field for all businesses seeking financial support.

The MD|DC Credit Union Association wholeheartedly supports the bill and urges a favorable report on SB 509.

Thank you for your attention to this matter, and please do not hesitate to reach out if you require any further information or assistance.

Sincerely,

John Bratsakis
President/CEO
MD|DC Credit Union Association

Fiserv Testimony on SB509 - FWA.pdf
Uploaded by: Chris DiPietro
Position: FWA

Senate Bill 509: Commercial Financing – Small Business Truth in Lending Act

Favorable With Amendment

February 14, 2024

Chair Beidle and distinguished members of the Senate Finance Committee, my name is Chris DiPietro and I come before you on behalf of my client Fiserv.

Fiserv is a global payment processor, which means we work directly with businesses of all sizes and enable them to accept electronic payments such as credit or debit cards. We also manufacture a point-of-sale terminal called Clover. Through Clover we offer merchants a suite of services including a product called Clover Capital. The legislation before you seeks to regulate such commercial financing offerings.

As you are all aware SB509 is modeled from existing law in the state of New York. In our review we identified a technical oversight regarding annual reports that are required to be submitted to the Commissioner. The bill as drafted requires ALL sales-based providers to submit annual reports to the Commissioner, when the intent of the language is for only those who elect the "opt-in" method to do so.

Thus, we respectfully offer the following technical amendment for your consideration:

<u>Amendment to Senate Bill 509</u>

(Third Reading File Bill)

On page 8, in line 32 after "**YEAR**," strike the word "**A**" and insert "**AN OPT-IN**".

The justification for this change comes in (2)(III) starting on page 9, line 14. The "hook" of the provision requiring annual review of rates is that opt-in providers found to have too large of a variance have to move from opt-in to historical. It does not make sense to have historical applicable in (D).

With the above amendments, Fiserv supports the legislation and urges a favorable report.

Thank you.

NPFA Leave-Behind on MD CFDL.pdf
Uploaded by: Chris DiPietro
Position: FWA

NPFA
National Premium Finance Association

Insurance Premium Financing is a Maryland state-regulated product and should be exempt from proposed commercial financial transactions disclosure legislation

<u>What is Insurance Premium Financing?</u>

- A process for small businesses to acquire necessary insurance coverage without having to make a large, upfront lump sum payment, including when insurance companies do not offer installment payments.
- Small businesses use premium financing for a variety of reasons; including, inability to pay for adequate coverage in a lump sum, smoothing out cash flow, preserving working capital for other business objectives, and preserving other credit options.
- Insurance agents and brokers assist their business customers to arrange premium financing by soliciting loan quotations from one or more premium finance lenders, often through a speedy automated process online.

<u>How May Proposed Commercial Financial Disclosure Legislation Affect Premium Financing?</u>

- Commercial financial disclosure legislation was introduced in January 2024 as Maryland Senate Bill 509 with a companion House Bill 574. These measures propose to curb perceived commercial lending abuses in Maryland by requiring additional financial disclosures when making loans to small businesses and seeking to regulate the unregulated lenders in the State.
- Commercial loans of $2,500,000 and less are subject to the law's requirements unless an exemption applies. The types of loans captured by the legislation included open-end and closed-end credit facilities, factoring transactions, sales based financings, and other types of commercial financings. Commercial financings regulated under the bills include any form of financing, the proceeds of which the loan recipient does not intend to use primarily for personal, family or household purposes.
- The bills, among other things, require certain interest rate calculations, establish numerous disclosure requirements that apply to each type of financing, and oblige potential borrowers to sign each applicable disclosure before a lender or provider can continue the commercial finance process.
- Without express exemption from such legislation, insurance premium finance loans likely fall within the scope of its application.

<u>Why is Insurance Premium Financing Different than other Lending Covered by Legislation?</u>

- Insurance premium finance lending is already highly regulated in the State of Maryland.
- Premium finance lenders are required by law to register with the Maryland Insurance Commissioner through the Maryland Insurance Administration (the "MIA").
- Registration includes but is not limited to the following: evidence of financial solvency and information about the lender's officers, directors, and owners; a list of finance charges, initial service fee, service charges, and any other fees and charges to be applied plus method of interest rate calculation; a copy of all proposed rate charts, schedules, and/or manuals; and an original copy of the proposed premium finance agreement to be used.

- Premium finance loan agreements are strictly governed by Maryland Insurance Code, Title 23, including requisite loan term and fee disclosures, interest rate calculations and maximums, and mandatory prepayment statements.
- Nearly every disclosure contemplated under proposed commercial finance transaction legislation has already been required for insurance premium finance loans under existing Maryland law.

Because Premium Financing Is Thoroughly Regulated by the State of Maryland, Proposed Commercial Financial Disclosure Legislation Should Clearly Exempt Premium Financing

- Premium finance lenders include detailed loan disclosures as required by existing Maryland premium finance statutes in premium finance agreements, and premium finance lenders do not use loan applications.
- Premium finance lenders compete on services, interest rates, and the speed of transaction. Adding extensive disclosure and signature obligations will increase premium finance administrative costs and therefore the cost of borrowing, potentially delaying the insurance purchasing process and making insurance purchases more costly and time consuming for small businesses in the State.
- Proposed commercial finance transaction legislation in the State of Maryland should include an exemption for registered insurance premium finance lenders offering and entering into premium finance agreements as defined in Maryland Insurance Code Title 23.

NPFA SB509 FWA Testimony.pdf
Uploaded by: Chris DiPietro
Position: FWA

NPFA
National Premium Finance Association

Testimony in Support of Senate Bill 509: Commercial Financing - Small Business Truth in Lending Act

February 14th, 2024

Chair Beidle and distinguished members of the Finance Committee, it is my pleasure to come before you and offer testimony in favor, with an amendment, of **Senate Bill 509: Commercial Financing - Small Business Truth in Lending Act**. If enacted, this bill would regulate commercial financing transactions, by establishing requirements related to disclosures, calculations of annual percentage rates, terms of repayments, and other related items, including the extension of specific offers.

The National Premium Finance Association (NPFA) is the national trade organization for insurance premium finance lenders, many of which are registered with the Maryland Insurance Commissioner and transact business in the State of Maryland.

Insurance premium financing is a short-term secured loan for businesses to use specifically to pay for insurance coverage. Businesses of all sizes must obtain commercial, property, casualty, and liability insurance policies to mitigate operational risk and protect their customers. While some businesses can pay for these policies' premiums in full at the time of purchase, others either do not have sufficient funds to cover the premium or prefer to finance the premium to permit other uses of capital that would otherwise be paid to the insurance company at the inception of an insurance policy period. The financing transactions offered by insurance premium finance lenders may fall within the scope of commercial financial disclosure legislation ("CFDL"), such as this bill.

Insurance premium finance lending is highly regulated in the State of Maryland. Premium finance lenders are required by law to register with the Maryland Insurance Commissioner through the Maryland Insurance Administration (the "MIA"). Nearly every disclosure contemplated under this bill is already required for premium finance loans under existing Maryland law.

The requirements under this bill are largely redundant when applied to premium finance lenders, because of the existing oversight of MIA and laws governing insurance premium finance.

NPFA suggests the following amendment:

On page 5, line 13, after "**PROVIDER.**" Add **(10) A PREMIUM FINANCE AGREEMENT AS DEFINED IN § 23–101 OF THE INSURANCE ARTICLE**

We urge a favorable, as amended, report on Senate Bill 509.

ETA Opposition Letter - MD SB509.pdf

Uploaded by: Claire Hebert

Position: UNF

ELECTRONIC TRANSACTIONS ASSOCIATION
1300 Connecticut Avenue
Suite 475
Washington, DC 20036
202.828.2635
800.695.5509
electran.org

February 14, 2024

The Honorable Pamela Beidle
Chair, Finance Committee
Maryland Senate
3 East, Miller Senate Office Building
Annapolis, Maryland 21401

RE: Opposition to S.B. 509 – Business Truth In Lending Act

Chair Beidle, Vice Chair Klausmeier, and Distinguished Members of the Senate Finance Committee,

On behalf of the Electronic Transactions Association ("ETA"), the leading trade association representing the payments industry, I appreciate the opportunity to share our opposition and broad concerns with S.B. 509.

ETA supports disclosures that promote transparency and accountability for small business borrowers. However, as drafted, the disclosures required in S.B. 509 could be confusing for both online companies that provide financing to small business and the small business community. Moreover, ETA is concerned that the legislation's effective date will not provide regulators with the necessary time to promulgate rules required by the legislation and will not give providers of commercial financing enough time to comply.

Small businesses are the backbone of the economy and have different needs and objectives than consumers. In response, providers of commercial financing to small businesses have developed credit products specifically designed to meet those needs and objectives. ETA supports maintaining choice in small business financing, however, S.B. 509, would impose burdensome barriers for providers of commercial financing, and likely result in less options for the very businesses the legislation aims to protect. Therefore, ETA would like to work with the committee to incorporate changes to the current bill and oppose S.B. 509 as currently drafted.

<u>ETA's concerns with S.B. 509 can be summarized as follows</u>:

<u>Effective Date</u>: The current effective date and timeline for implementation of S.B. 509 would place an undue regulatory compliance burden on the industry. ETA respectfully recommends allowing for a longer regulatory comment and approval process, and a 180-day compliance period that begins after final rules are published.

<u>Requirements to Report Certain Items to the Commissioner:</u>

S.B. 509 requires a provider to disclose to the Commissioner (i) the method in which a provider is calculating the estimated annual percentage rate (APR); (ii) the estimated APR given to a recipient: (iii) requiring a provider to retroactively calculate the actual APR and provide that to the Commissioner; and (iv) any other information in a report that the Commissioner deems necessary. This is extremely overreaching and is not required by any other state that has implemented a disclosure law. There is no indication that the Commissioner wants to receive this information or even has the capability at this time to process this type of information. These requirements are overreaching and should be stricken from S.B. 509.

Annualized Percentage Rate:

- **APR as applied to Commercial Financing**: ETA is concerned that S.B. 509, by mandating an annual percentage rate or estimated annual percentage rate (collectively "APR") disclosure for commercial financing, will create significant confusion and uncertainty for Maryland small businesses trying to make informed decisions about the cost of financing products. The Truth in Lending Act ("TILA") was enacted strictly for consumer transactions, not commercial transactions and does not take into account the unique payment features of sales-based financing products, which do not have a fixed term, fixed payments, or have an absolute right to repay. The Consumer Financial Protection Bureau stated that because these types of products do not have a defined term or a periodic payment amount, it would require a funding company to assume or estimate parts of the APR formula, which only increases complexity.
- **Alternative Measurement:** ETA urges the committee to consider Total Cost of Capital ("TCC") as the method for disclosing the cost of financing products, which is what matters to small business owners.

Definitions:

- **Provider:** The definition of "provider" should exclude "1st party financing;" specifically, where the owner of the product or service is the one offering the financing opportunity.
- **Interest Accrued:** The legislation references "interest accrued," without definition. Clarifications are necessary to provide certainty of the bill's requirements and to help ensure the ability to provide accurate and meaningful disclosures.
- **Recipient:** The definition of "recipient" should be limited to businesses that are principally managed or directed from Maryland, and providers should be permitted to rely on either (1) a representation from the recipient, or (2) the business address provided by the recipient. This would parallel the approach taken by New York.
- **Total Repayment Amount:** S.B. 509 defines "total repayment amount" as the "disbursement amount plus the finance charge". This definition needs to be refined to address situations where the two amounts are not the same.

Renewal Financing:

- **Disclosure Requirements:** S.B. 509 requires disclosures for renewal financing but provides no additional guidance on calculation or disclosure, which will likely cause confusion.
- **Double Dipping:** The bill also defines the term "double dipping," which is not a formal term and fails to consider how renewal financing works in practice. Therefore, ETA suggests replacing the "double dipping" question with a statement that "part of your renewal financing will be used to pay-off your current financing with [name of provider]."

eta ELECTRONIC TRANSACTIONS ASSOCIATION

1300 Connecticut Avenue
Suite 475
Washington, DC 20036

202.828.2635
800.695.5509
electran.org

TILA Disclosure Exemption: The New York commercial financing disclosure law ("CFDL") provides that the definition of "commercial financing" *(b) does not include any transaction in which a financier provides a disclosure required by the Truth in Lending Act, 15 U.S.C. § 1601 et seq., that is compliant with such Act.* This provision should be incorporated into S.B. 509 as it prevents the unnecessary duplication of disclosures from providers who already provide TILA compliant disclosures in commercial financing transactions, and it encourages uniformity across the country, which reduces the burden of complying with the different disclosures in each state.

Open-End Financing: Section 12-1207(A)(B) requires the disclosure of the credit limit along with the amount to be drawn at the time the offer is extended. There are two issues here. Firstly, it is not always known what the initial draw will be at the time the specific offer is presented to the recipient because the recipient is only selecting a credit limit, not a credit limit plus initial draw. Secondly, it appears that the entire disclosure for an open-end product is based on the assumption that the total credit limit is being drawn. For products like a commercial credit card or line of credit, where a customer is receiving access to the card or line with an available credit limit, requiring an initial disclosure with the credit limit and initial draw is not possible. As such, we recommend removing the requirement to disclose the initial draw and only require disclosure of the overall credit limit.

* * *

Given how the uncertain inflationary economy continues to threaten the survival of many Maryland small businesses, now is not the time to pass legislation that would threaten their commercial financing options by creating burdensome and confusing barriers for small business lending providers. Therefore, ETA urges the committee to reject S.B. 509 in its current form and welcomes the opportunity to work with the sponsor and proponents to develop a legislative proposal that is clear, fair, and uniform and that all parties can support.

Thank you for the opportunity to participate in the discussion on this important issue. If you have any additional questions, you can contact me or ETA Senior Vice President, Scott Talbott at stalbott@electran.org.

Respectfully Submitted,

Brian Yates

Brian Yates
Senior Director, State Government Affairs
Electronic Transactions Association
202.677.7714 | byates@electran.org

Revenue Based Finance Coalition Letter SB 509 (2-1

Uploaded by: Katherine Fisher

Position: UNF

The Honorable Pamela Beidle, Chair
The Honorable Katherine Klausmeier, Vice Chair
Maryland Senate Finance Committee
3 East
Miller Senate Office Building
Annapolis, Maryland 21401

February 13, 2024

RE: SB 509 – Opposed Unless Amended

Dear Chair Beidle and Vice Chair Klausmeier,

The Revenue Based Finance Coalition ("RBFC") respectfully opposes SB 509 as currently drafted. RBFC members are responsible finance companies that provide needed capital to small and medium sized businesses nationwide. Our member companies offer fair and innovative financing and have filled the void created by the decline in small business lending by larger, traditional banks. Our members are committed to providing clear and accurate cost of capital disclosures to our small business customers.

SB 509 Will Prevent Small Businesses from Accessing Needed Capital

<u>Five state legislatures to date have adopted a "Total Cost of Capital" model of disclosure for commercial financing products instead of "APR" disclosures.</u>

- Connecticut, Virginia, Utah, Florida, and Georgia have all adopted "Total Cost of Capital" disclosure models for commercial financing in their states because that is an appropriate metric for commercial financing.

- For example, in Connecticut the codified disclosure legislation mandates that small businesses are given the following disclosures:

    1. The total amount of the commercial financing
    2. The disbursement amount, which is the amount paid to the recipient or on the recipient's behalf.
    3. The finance charge.
    4. The total repayment amount, which is the disbursement amount plus the finance charge.
    5. The estimated time period required for the periodic payments to equal the total repayment amount.

6. The payment amounts, either fixed or variable, and the corresponding payment schedule or description of the method used to calculate the schedule of payments.
7. A description of all other potential fees and charges not included in the finance charge, included but not limited to draw fees, late payment fees, returned payment fees, etc.
8. Any charges for early repayment and any charges not already included in the finance charge.
9. A description of any collateral requirements, if any.
10. Any compensation a provider will pay directly to a broker out of the financed amount.

- Virginia, Utah, Florida, and Georgia have also codified these same, or very similar, disclosure requirements.

- "Annualized Percentage Rate" ("APR") is not an appropriate metric for a revenue-based finance ("RBF") product because there is no maturity date or fixed term of repayment. Instead, RBF payments to the provider are tied to actual business receipts. If revenue decreases, the business can require the funder to accept smaller payments until revenue increases.

- APR is an appropriate metric for certain consumer financial products such as credit cards or mortgages that have a fixed term, compounding interest, and usually carry over year to year.

- Revenue-based financing, invoice factoring, and other types of commercial financing do not have fixed terms or compounding interest; the costs are fixed at the time of closing and are not based on the time period it takes for the business to pay its obligations.

- Therefore, calculating an APR, or estimated APR, for these commercial financing products does not give a small business owner a clear indication of how much money they will pay back to a funder. In fact, if forced to calculate and publish an APR on disclosure forms, the APR will likely be misleading and inaccurate due to the variability of daily revenue generated by a business.

SB 509 would require commercial financing providers to provide a misleading "Estimated APR" disclosure.

- An "Estimated APR" disclosure can be manipulated to make more expensive financing choices appear less costly.

- SB 509's proposed methods to calculate an "Estimated APR" will not result in a reliable and consistent APR that can be compared among other financing providers.

- Because the actual repayment amounts of a revenue-based financing transaction are based on the economic and market realities of each small business customer, an "Estimated APR" disclosure that is based on historical estimates and assumptions is of little value.

What is Revenue Based Financing?

RBFC members help meet the needs of American small business entrepreneurs by providing financing to qualified small businesses. Revenue-based financing ("RBF") is a form of flexible financing in which payments are adjusted as a percentage of business revenue. RBF allows businesses to access funds for, as an example, a seasonal inventory surge or to replace an unexpected major equipment failure.

In an RBF agreement:

- As opposed to traditional lending products, the business remits a contractually specified percentage of its future revenue. If revenue decreases, then the business has the right to correspondingly decrease its remittances.

- The RBF funder agrees up front to take the risk that the business's revenue will be generated slower than expected and the risk that the business will fail or go bankrupt.

  Example. If an RBF company purchases 10% of a business's future revenue up to a purchased amount of $10,000, the transaction would be completed whenever the business succeeded in generating $100,000 in revenue, and remitted 10% of that revenue to the RBF funder. This milestone could be achieved in a month, a year, or never.

Advantages of Revenue Based Financing

RBF has many advantages for small businesses:

- Unlike traditional consumer loans, or other loan products, there is no absolute obligation to pay. If, in the ordinary course of doing business, the business fails, then the RBF funder will have no recourse against the business.

- Funds can be provided to the business in as little as 24 hours.

- The incentives of the RBF funder and the business are aligned because the RBF funder's compensation is contingent on the business's continued success.

- Unlike most Small Business Association loans, the business owner does not need to use his or her house as collateral.

- The business owner does not enter into a partnership, nor does it give up control of the business.

Thank you for the opportunity to provide comments. We look forward to participating in discussions regarding this legislation.

Sincerely,

Mary Donohue
Executive Director

SB 509 Rapid Financial Services Written Testimony
Uploaded by: Natalie Pappas
Position: UNF

Rapid FINANCE

February 14, 2024

The Honorable Pamela Beidle
Chair, Finance Committee
Maryland Senate
3 East, Miller Senate Office Building
Annapolis, Maryland 21401

RE: Opposition to S.B. 509 – Business Truth in Lending Act

Chair Beidle, Vice Chair Klausmeier, and Distinguished Members of the Senate Finance Committee,

My name is Natalie Pappas, and I am here today on behalf of Rapid Financial Services, LLC ("Rapid Finance"). Rapid Finance was founded in 2006 and has been headquartered in Montgomery County, Maryland since its inception. To date we have provided over $2 billion in working capital to small businesses throughout the United States. We employ nearly 200 employees at our Bethesda office. I appreciate the opportunity to share our opposition and broad concerns with S.B. 509.

Rapid Finance supports disclosures that promote transparency and accountability for small business. However, as drafted, S.B. 509 could be confusing for both providers of commercial financing and small businesses. We share a common goal of increasing access to fair and responsible capital; however, this legislation fails to provide small businesses a simple disclosure to compare the cost of all types of small business finance products. Because of this, Rapid Finance asks this committee to reject S.B. 509 as currently drafted.

Rapid Finance's main concerns with S.B. 509 are as follows:

1. **Annualized Percentage Rate:** S.B. 509, requirement to disclose an annual percentage rate or estimated annual percentage rate (collectively "APR") for commercial financing, will create significant confusion and uncertainty for Maryland small businesses trying to make informed decisions about the cost of financing products. APR should be removed from S.B. 509 as it is not the proper metric to use for these types of commercial financing products.

2. **Effective Date:** The current effective date and timeline for implementation of S.B. 509 would place an undue regulatory compliance burden on the industry. Rapid Finance respectfully recommends allowing for a regulatory comment and approval process, and a 180-day compliance period after final regulations are published which is similar to timeframes provided by other states.

3. **<u>Requirements to disclose certain items to the Commissioner:</u>** S.B. 509 requires a provider to disclose to the Commissioner (i) the method in which a provider is calculating the APR; (ii) the APR given to a recipient at the time the disclosure is provided to the recipient; (iii) the actual APR for the financing, which means requiring a provider to retroactively calculate the actual APR; and (iv) any other information in a report that the Commissioner deems necessary. This is extremely overreaching and is not required by any other state that has implemented a disclosure law. It provides unnecessary burdens to providers. Furthermore, there is no indication that the Commissioner wants to receive this information or even has the capability at this time to process this type of information. These requirements are overreaching and should be stricken from S.B. 509.

4. **<u>Definitions:</u>**
    a. <u>Specific Offer</u>: The definition should be amended as follows:
        i. means a written communication to a recipient, based upon information from, or about, the recipient, of a (i) periodic payment amount, irregular payment amount, or financing amount, and (ii) any rate, price, or cost of financing (including, without limitation, any total repayment amount), in connection with a commercial financing, which offer, if accepted by a recipient, shall be binding upon a provider. *Information about the recipient* includes information about the recipient that informs the provider's quote to the recipient, such as the recipient's financial or credit information, but not the recipient's name, address, or general interest in financing.
    b. <u>Recipient:</u> The definition of "recipient" should be limited to businesses with a principal place of business in Maryland, relying on either (1) a representation from the recipient, or (2) the business address provided by the recipient.
    c. <u>Total Repayment Amount:</u> S.B. 509 defines "total repayment amount" as the "disbursement amount plus the finance charge". This definition needs to be refined to address situations where the two amounts are not the same.

5. **<u>Renewal Financing:</u>** S.B. 509 requires disclosures for renewal financing but the bill provides only confusing guidance on calculation. It also requires providers to disclose any "double dipping" as described in the legislation. First, "double dipping" is not a formal term and is not widely used throughout the industry. Second, the term, as defined, fails to consider how renewal financing works in practice. This requirement should be removed.

6. **<u>Average Monthly Cost Disclosure (for periodic payments that are not monthly):</u>** This required disclosure is problematic because (i) it is confusing to the small business as they may believe they have monthly payments instead of daily or weekly and (ii) it expresses a preference for products that ultimately may be more expensive.

7. **<u>Signature Requirement:</u>** Section 12-1211 requires the provider to obtain the recipient's signature "before a provider may allow the recipient to proceed with the commercial financing application." This is not practical and a signature should only be required "prior to consummating a commercial financing". S.B. 509 should be amended to reflect that a signature is only required prior to consummating the financing, which reflects similar signature requirements in other states.

8. **<u>Disclosure Requirements:</u>**
   a. <u>APR for Sales-Based Financing:</u> This should be disclosed as an "Estimated APR" instead of "APR" as it is an estimate.

   b. <u>Open-End Financing:</u> Section 12-1207(A)(B) requires the disclosure of the credit limit along with the amount to be drawn at the time the offer is extended. There are two issues here. Firstly, it is not always know what the initial draw will be at the time the specific offer is presented to the recipient because the recipient is only selecting a credit limit at the time and not a credit limit plus initial draw. Secondly, it appears that the entire disclosure for an open-end product is based on the assumption that the total credit limit is being drawn. Therefore, it does not make sense to include the initial draw requirement and we would request that be deleted and the entire disclosure be based on the entire credit limit.

Respectfully Submitted,

Natalie Pappas
Rapid Financial Services, LLC
Assistant General Counsel
nataliepappas@rapidfinance.com
240-514-3189

SB509_OFR_Letter of Information.pdf
Uploaded by: Amy Hennen
Position: INFO

Maryland
DEPARTMENT OF LABOR

OFFICE OF FINANCIAL REGULATION
1100 NORTH EUTAW STREET; SUITE 611
BALTIMORE, MARYLAND 21201
ANTONIO P. SALAZAR, COMMISSIONER

February 6, 2024

Senate Finance Committee
Chair: Senator Pamela Beidle
Senate Bill 509 - Commercial Financing - Small Business Truth in Lending Act

Re: Letter of Information

Senate Bill 509 creates a regulatory regime for "commercial financing" transactions – as defined by the bill. This regulatory regime establishes certain requirements surrounding these transactions, such as those related to disclosures, annual percentage rate calculations, repayment terms, extensions of special offers, and other related requirements. This new regime falls under the regulatory and enforcement authority of the Office of Financial Regulation ("OFR"). Specifically, "providers" of commercial financing (also defined by the bill) will be subject to a certain review process, which must be established by the OFR, as they will be required to notify the OFR as to which method the provider intends to use when calculating the estimated annual percentage rates for each transaction.

Further, on or before January 1 of each year, providers must report to the OFR on those estimated annual percentage rates (APRs) given to each participant, and the actual APRs of each completed transaction, along with any other information the Commissioner considers necessary. It is worth noting that some states that have adopted similar laws have chosen to require providers to report APRs given to each participant and some states have chosen not to require this.

The bill provides that the OFR shall adopt regulations substantially similar to the 52-page regulations adopted in February 2023 by the New York State Department of Financial Services regarding commercial financing (see 23 NYCRR 600). The bill also provides that violations of its mandates are subject to enforcement and civil penalties. Both of these requirements will require OFR to allocate time and resources for the drafting and implementing of new regulations, the on-going collection, monitoring, and evaluation of information, responding to anticipated complaints, and increased enforcement if appropriate. OFR does not believe it can implement the new program within existing resources. OFR submitted a fiscal note outlining the costs associated with the hiring of one (1) new examiner to handle these new program responsibilities.

Senate Bill 509 does not include a formal licensing and/or registration regime and therefore produces no new revenue for the OFR to compensate for the anticipated expenses in standing up and operating a new program. Therefore, unlike other entities regulated by OFR, entities providing commercial financing services will not contribute to the State's cost of supervision and oversight. The lack of licensing and/or registration regime makes it more difficult for the OFR: to monitor and track these business entities; assure submission of required data and/or reports; investigate and resolve any complaints received; and implement other requirements of the bill. The bill mandates no specific connection with the Nationwide Multistate Licensing System ("NMLS"), upon which the OFR relies to carry out its supervisory activities. This deficit adds further difficulties to operationalizing the requirements of this bill from a monitoring, investigatory and enforcement perspective. Thus, the OFR anticipates significant costs and technological expenditures to develop electronic systems for submitting, processing, and utilizing required data and/or reports. Additionally, OFR will need to devote resources to

OFFICE OF FINANCIAL REGULATION
1100 North Eutaw Street; Suite 611
Baltimore, Maryland 21201
Antonio P. Salazar, Commissioner

implementing the bill, responding to borrower complaints and engaging in enforcement activities related to this new authority.

This bill will likely positively impact some Maryland small businesses. The product standards and lending regime established by this bill can be expected to give small businesses the ability to utilize sales-based financing products in a transparent and affordable manner.

The commercial lenders that are subject to this bill would incur additional costs associated with preparing reports on annual percentage rates to submit to OFR.