March 27, 2023

State of Illinois
House Financial Institutions and Licensing Committee
Capitol Building - Room 122B
Springfield, IL 62701

RE: Support for HB 3064 *Small Business Truth in Lending Act,* Subject Matter Hearing

Dear Chairperson Croke, Vice Chairperson Avelar, Republican Spokesperson Ugaste, and Members of the Illinois Financial Institutions and Licensing Committee:

The Responsible Business Lending Coalition (RBLC) writes in strong support of HB 3064*,* the *Small Business Truth in Lending Act,* as introduced by Representative Hoan Huynh. The bill aims to bring transparency to the small business lending marketplace through standardized disclosures, particularly disclosure of the annual percentage rate (APR.) When small business owners are empowered with clear information about their financing options, they have the agency to choose the best product for their needs.

The undersigned organizations represent members of the RBLC, a leading cross-sector voice on small business financial protection. The coalition includes nonprofit and for-profit fintechs, community development financial institutions (CDFIs), investors, and small business advocates whom all share a commitment to innovation in small business lending as well as serious concerns about the rise of irresponsible small business lending.

As introduced, HB 3064 offers clear and easy-to-compare disclosures that are paramount as entrepreneurs and small businesses evaluate financing. It would bring sunshine to the commercial financing marketplace by requiring all financing providers to disclose APR or estimated APR for all small business loan products. APR is the only established metric that enables informed comparisons of the cost of capital over time and between products of different dollar amounts and term lengths. APR is the time-tested rate that people know and expect because it is the legally required standard for mortgages, auto loans, credit cards, student loans, and personal loans, including short-term loans.

When small businesses currently shop for financing, they are not able to make similar comparisons between financing providers. Without standardization of APR or estimated APR disclosure requirements across lenders, small businesses are more likely to choose higher-cost products. For instance, a research study found that when asked to compare a sample short-term loan product with a 9%“simple interest” rate to a credit card with a 21.9% interest rate, most participants in the study incorrectly guessed the short-term loan to be less expensive. Research indicates that small businesses can pay APRs of 94%, and as high as 350%, without these high rates being properly disclosed. This is why including both APR and other financing products in the legislation will better protect small businesses. What’s more, a Federal Reserve study demonstrated that Black and Hispanic-owned businesses are more likely to use “high-cost” and “non-transparent” financing, referring specifically to merchant cash advances as well as factoring products.

Additionally, calculating APR is not burdensome for providers or the marketplace. The consumer financing marketplace remains a vibrant, healthy, and competitive marketplace over fifty years after implementation of the consumer Truth-in-Lending Act and APR disclosure. Unlike a loan that accrues interest over time, a small business must pay a factor rate and a repayment amount that are determined upfront by revenue-based financing providers. Providers can easily calculate APR using common spreadsheet software. Many commercial financing providers across the country already disclose APR. The State of California's law has been in effect since December 9, 2022, and the State of New York's Commercial Financing Disclosure law takes effect on August 1st, 2023.

This bill will not limit access to capital because it does not explicitly prohibit products or providers in the marketplace. It simply requires financing companies to tell their small business customers the APR, or estimated APR, they will be charged. Private-sector and nonprofit lenders in the RBLC, as well as in the consumer financing marketplace, already disclose their rates and terms without the practice impeding their operations. If high-cost lenders lose business once they begin to transparently disclose their pricing, it will be because small businesses are saving money by identifying lower-cost financing options.

In the below appendices, we have included a document that dispels some of the common myths regarding transparent disclosure requirements along with several informational slides on the need for standardized discloses and APR.

We ask you to support HB 3064 and urge you to do what is necessary to get this critical small business protection legislation through the Illinois Financial Institutions and Licensing Committee and signed into law as soon as possible. We are happy to serve as a resource as you move forward.

Sincerely,

The Responsible Business Lending Coalition

RESPONSIBLE BUSINESS LENDING COALITION

Claims and Facts in Support of Small Business Truth in Lending

The following explores claims that question the necessity of APR in disclosure regulations by explaining current misconceptions and providing clarifications with the latest research.

Small business Truth in Lending is supported by leading fintech and bank for-profit lenders, nonprofit CDFIs, civil rights groups, and small business groups. However, it may face opposition as well, such as from finance companies that charge relatively higher APRs and do not disclose them.

Claims critical of Truth in Lending were considered extensively in California and New York. After consideration, the legislatures of both states passed strong Truth in Lending Bills by wide, bipartisan margins (132-9 in the New York Assembly and 72-3 in the California Assembly). The following are common claims and facts about small business Truth in Lending:

Claim: Factor rates and/or the total cost in dollars is sufficient for Merchant Cash Advance products for business owners to understand the cost of the financing.

Fact: As shown in examples A to E, simply giving factor rates, total cost in dollars, monthly factor rates, and simple interest rates does not allow a business owner to compare potential financing options. Factor rates and total cost in dollars, according to the Federal Reserve are often misleading to entrepreneurs as they do not factor in fees. Further, alternative financing options may use completely different terminology. APR allows products to be compared across term lengths and includes fees in its calculation to reflect the true price of the financing.

Claim: Disclosure of the APR is not needed in small business financing

Fact: APR is the only metric that enables comparison of the price of financing of different types, amounts, and term lengths. In response to the rise of high-rate small business financing, the need for transparent disclosure in APR in small business financing has been raised by:

1. Multiple research studies published by the Federal Reserve[1]
2. National Consumer Law Center[2]
3. Bloomberg News editorial board ("Protect Small Businesses from Predatory Lending… The best solution would be for Congress to pass a truth-in-lending law for small business, along the lines of the rules that already exist for consumer loans.")[3]
4. Federal Reserve Governor Lael Brainard[4]
5. Federal Reserve Board of Governors Community Advisory Council[5]
6. The Conference of State Bank Supervisors' Fintech Industry Advisory Panel
7. 110+ industry and nonprofit signatories and endorsers of the Responsible Business Lending Coalition's *Small Business Borrowers Bill of Rights*[6]
8. A dozen member companies of the Innovative Lending Platform Association[7]
9. Bipartisan Policy Center[8]
10. Former Democratic and Republican SBA Administrators Karen Mills[9] and Chris Pilkerton
11. US Treasury officials[10]
12. Numerous news articles (e.g. McClatchy, "Even Finance Whizzes Say It's Impossible to Compare Online Small Business Loan Options." June 2018)[11]

Why is APR so critical? The CFPB website explains that: "The APR, or annual percentage rate, is the standard way to compare how much loans cost. It lets you compare the cost of loan products on an 'apples-to-apples' basis."[12] It can be especially useful for comparing different types of financing products. The CFPB encourages credit seekers to compare short-term payday loans to longer-term installment loans or credit cards by focusing on APRs.[13]

Claim: The CFPB and Federal Reserve have published studies stating that APR is misleading, ineffective, or not used by consumers.

Fact: While the quotes do reference arguments made by the Board and CFPB, the way the quotes are used leaves out important context. One of these CFPB studies concerned an instance in which the Board was eliminating a proposed additional APR for credit cards. Another study concerned home mortgage lending. In this instance, the CFPB gave prominence to the interest rate, but retained the APR in another location. Unlike in small business financing, the interest rate and APR are generally very close in mortgage lending—within 0.03% on bankrate.com today. But small business owners are often shown no interest rate or APR at all. According to a report issued by Opportunity Fund, the average alternative small business loan carried an APR of 94%, with some loans carrying APRs upwards of 350%.[14]

Claim: Revenue-based financing companies, also known as "merchant cash advances (MCAs)" can't calculate APR.

Fact: Some MCA companies already disclose APR. Others advertise their high annualized yields to their investors, but don't disclose these annualized percentage rates to their small business customers. Additionally, APR can easily be calculated using common spreadsheet software. All revenue-based financing companies are required to disclose APR in California and beginning on August 1, 2023 in New York. Our small businesses deserve the same transparency.

Claim: California and New York regulators haven't finalized their regulations because the topic is complicated.

Fact: In June 2022, the California Department of Financial Protection and Innovation (DFPI) released the final rule implementing Senate Bill 1235 - the first state bill extending Truth In Lending Act protections to small business financing. The CA final rule, which requires APR disclosure on any financing to a California-based small business, took effect on December 9th, 2022. DFPI refuted the idea that APR disclosure is too complicated to adopt, saying "While the DFPI recognizes that APR is more difficult to calculate mathematically than ACC, calculating an APR based upon estimated payments is not a complicated task for individuals with minimal training and can be accomplished in widely available spreadsheet programs."

In February 2023, the New York Department of Financial Services (DFS) released the final rule implementing the Small Business Truth in Lending Act (SB5470B) which was signed into law in 2021. The final rule will take effect on August 1, 2023.

Claim: Studies show that small business owners do not understand APRs.

Fact: Four successive Federal Reserve studies have demonstrated that small businesses are currently misled towards higher-cost financing by disclosures that lack APR, and that APR would be among the most helpful disclosure elements to small business owners.[15]

Claim: Use of estimates in small business truth in lending disclosures will open commercial financing providers to a wave of litigation.

Fact: Estimates are anticipated and acceptable. Senator Proxmire, sponsor of the federal Truth in Lending Act, explained on the floor of the Senate in 1967 that in cases when an exact APR cannot be calculated, the Truth in Lending Act "makes it abundantly clear that lenders need only state an approximate annual rate and would not be held to absolute accuracy down to the last decimal point."[16]

Claim: The bill's disclosures related to the practice of double-charging borrowers while refinancing their loans is unnecessary, as this practice, called "double dipping," is not a problem.

Fact: Double dipping is described as an irresponsible practice, even among small business financing providers. See, for example, "Beware: Double Dipping!" by financing company Next.[17]

Claim: The regulatory burden of standardized disclosures will cause providers to stop offering financing. Affected providers will not be able to continue operating or offering certain products. The net result will be reduced access to capital for small businesses.

Fact: Private-sector and nonprofit providers in the RBLC are already disclosing APR and other metrics required by the legislation, voluntarily, and it is not impeding their ability to continue operating.

Consumer financing providers have had to comply with Truth-in-Lending regulations for decades and the marketplace remains vibrant and diverse. From these examples, we know that the costs of compliance are not overly burdensome for providers. The only reason that a provider would stop operating is as a natural consequence of market competition; some high-cost providers could lose customers after transparently disclosing their pricing and terms.

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

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

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

Federal Reserve Bank of Atlanta, "Small Business Credit Survey: Report on Minority-Owned Firms," Dec 2019. https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/20191211-ced-minority-owned-firms-report.pdf This study notes that "Minority-owned firms more frequently applied for potentially higher-cost and less-transparent credit products."

[2] See letter in Appendix B: 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

[3] https://www.bloomberg.com/amp/opinion/articles/2018-11-28/confessions-of-judgment-small-business-and-predatory-lending

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

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

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

[7] https://innovativelending.org/

[8] https://bipartisanpolicy.org/wp-content/uploads/2018/07/Main-Street-Matters-Ideas-for-Improving-Small-Business-Financing.pdf

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

[10] 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,

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

[12] www.consumerfinance.gov/consumer-tools/credit-cards/answers/key-terms/

[13] www.consumerfinance.gov/ask-cfpb/my-payday-lender-said-my-loan-would-cost-15-percent-but-my-loan-documents-say-the-an nual-percentage-rate-apr-is-almost-400-percent-what-is-an-apr-on-a-payday-loan-and-how-should-i-use-it-en-1625/

[14] https://aofund.org/app/uploads/2021/03/Unaffordable-and-Unsustainable-The-New-Business-Lending-on-Main-Street_Opportuni ty-Fund-Research-Report_May-2016.pdf

[15] See note i

[16] Senator Proxmire, William, "Congressional Record - Senate," Jan 1967. https://web.archive.org/web/20120415005111/http://www.llsdc.org/attachments/wysiwyg/544/TILA-LH-CR-1967-01-31.pdf

[17] See, e.g. https://next-financing.com/double-dipping/, and, https://www.breakoutfinance.com/double-dipping-explained/

March 2023

RESPONSIBLE BUSINESS LENDING COALITION

APR: An Essential Figure for Small Business Finance

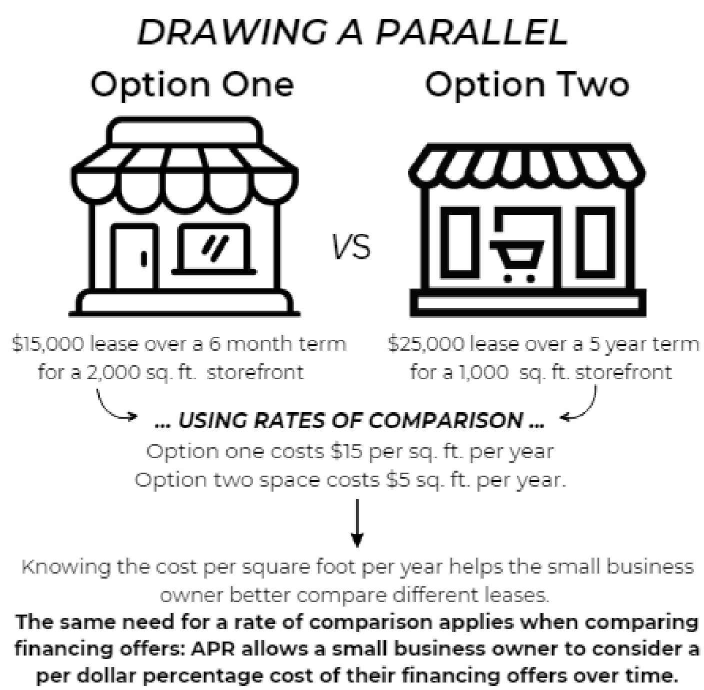
The Illinois *Small Business Truth in Lending Act* requires nonbank, commercial finance providers to disclose the terms, conditions, and fees- including the annual percentage rate (APR)- associated with their products. This information, especially the APR, equips small business owners with the knowledge they need to make the best choice for their business's future. The purpose of this literature is to demonstrate why and how APR is essential information to allow small business owners to make informed decisions when considering financing products.

APR: THE CRITICAL NUMBER

Annual Percentage Rate (APR) has been the national standard for an apples-to-apples price comparison between consumer financing products since the passage of the federal Truth in Lending Act in 1968. The same standard is needed in commercial lending as APR allows small business owners to shop for financing to best understand the **true price of the financing** and to **compare offers**.

APR is the only pricing metric that enables true comparison between products. Regardless of the amount, term length, payment period, or combination of interest and fees, APR allows a clear comparison of cost over a common unit of time: the year. The APR formula is indifferent to when and how the recipient is charged, it simply calculates the total cost of the financing (interest, fees, etc.) over the life of the financing as an annualized percentage. Thus, the APR provides small business owners with a valid rate of comparison across various financing products.

To draw a comparison, take for example a small business owner considering two different leases:
Option 1: a $15,000 commercial lease over a 6-month term for a 2,000 sq. ft. storefront and
Option 2: a $25,000 commercial lease over a 5-year term for a 1,000 sq. ft. storefront.
These two options have differing costs, terms, and square footage. Is the $15,000 larger storefront a better deal than the $25,000 storefront?



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When analyzing the data, Option 2 costs $15 per sq. ft. per year, versus Option 1, the smaller space, which costs $5 sq. ft. per year. *Knowing the cost per square foot per year helps the small business owner better compare the offers.*

Similar to considering the cost per square foot per year, the ***APR allows a small business owner to consider a per dollar percentage cost of their financing offers over time***. One financing option that includes large fees, low interest, and a long term can be compared with another option that has no fees, a higher interest rate, and a shorter term. In both cases, the borrower has a cost of funds, but without knowing APR they are unable to compare the respective costs. **APR allows small business owners to compare the value of a product, factoring in all fees, across other products with varying term lengths and different amounts.** Other rates do not provide this information to consumers. In fact, the Federal Reserve found that disclosure of alternative rates without APR is misleading to small business owners.[i]

KEY TERMS

- *Annual Percentage Rate (APR):* The APR, as the all-in annualized price of the financing, is the best metric to help borrowers effectively evaluate and compare the price of financing products and therefore must be disclosed. In the case of a merchant cash advance (MCA) a lender would disclose an "estimated APR."
- *Purchase Price*: The amount of funding that the borrower receives. This may, or may not, be inclusive of fees.
- *Purchased Percentage*: The percentage of the businesses' revenues that will be required to be used to repay the financing.
- *Purchase Amount*: The amount that the borrower will be required to repay.
- *Specified Daily Amount*: The daily payment amount that is required.
- *Factor Rate*: The number that is multiplied by the financing amount to determine the total amount to be paid by the recipient (ex. $100 financed at 1.25-factor rate = $125 to be repaid).
- *Total Monthly Payments*: The total monthly payment is the best metric to help a borrower evaluate affordability and therefore must be disclosed. If payment frequency is not monthly, a lender must calculate the estimated monthly payment and disclose the frequency and amounts of each payment (e.g., $xx each weekday) and in the case of an MCA, a lender must disclose how payments are calculated and with what frequency payments are due (e.g., X % of every dollar in sales to be deducted daily until $xx is repaid).
- *Term:* The term of the financing must be disclosed – either in months or years – and if the term is not fixed then the lender must disclose the "estimated term."
- *Total Cost:* The total cost of the financing must be disclosed and broken down, so a borrower can understand what expenses and/or fees are included in the total cost (e.g., Interest Expense = $xx, Origination Fee = $xx).

- *Prepayment Cost/Savings*: To assess the cost of financing, a borrower must be able to account for any cost or savings associated with prepayment. Therefore, a lender must disclose if there is a cost (or a benefit) to the borrower associated with prepayment (e.g., Prepayment Cost/Savings = Up to $xx)

APR IN ACTION

The following provides 5 examples to demonstrate the importance of APR when weighing product offers. These examples use the same language and level of detail in disclosures that an entrepreneur might actually see.

Example 1: Comparing very similar products with different payments

Consider the following products and the type of information that a borrower would typically receive. With this information, which option is of better value?

OPTION ONE: **Merchant Cash Advance**

- Purchase Price: $21,500
- Purchased Percentage: 15%
- Purchase Amount: $31,175
- Specified Daily Amount: $174

OPTION TWO: **Merchant Cash Advance**

- Purchase Price: $24,500
- Purchased Percentage: 22%
- Purchase Amount: $37,175
- Specified Daily Amount: $102

Discussion: Looking at these two MCA products, it is difficult to determine which product has better value. However, if APR was disclosed, the following would be clear:

- Option One has a 161% estimated APR and
- Option Two has a 90% estimated APR.

  Knowing the estimated APR would allow a small business owner to understand Option Two has the best value.

Example 2: Comparing products using "factor rates"

Consider the following products and the type of information that a borrower would typically receive. With this information, which option is of better value?

OPTION ONE: **Merchant Cash Advance**

- Stated Purchase Price: $50,000
- Factor Rate: 1.15
- Total Payback Amount: $57,500
- Fees: 2.5% set-up fee; $50/month administrative fee
- Daily payment: 20% of sales or a minimum of $328

OPTION TWO: **Merchant Cash Advance**

- Purchase Price: $50,000
- Factor Rate: 1.30
- Total Payback Amount: $65,000
- Fees: None
- Specified Daily Amount: $178

Discussion: The "factor rate" of Option One[1] is lower than Option Two. This can be deceiving to borrowers as the "factor rate" is often misunderstood to be equivalent to APR. However, if the estimated APR was disclosed, borrowers would see:

[1] *Option One is an example used in a 2019 Federal Reserve Study.* [i]

- ➢ Option One with its fees and faster repayment period has a higher estimated APR at 72%
- ➢ Option Two has an estimated APR of 55%

This example shows how *estimated APR* allows the entrepreneur to make apples-to-apples comparisons on the relative cost of capital in spite of a range of fees, varied payment amounts, large prepayment penalties, etc.

Example 3: Comparing products using simple interest and different payment frequencies

Consider the following products and the type of information that a borrower would typically receive. With this information, which option is of better value?

OPTION ONE: **Short-Term Loan**

- Loan Amount: $50,000
- Total Repayment Amount: $54,000
- Term: 6-month term
- Fees: None
- Monthly Payments
- "Simple interest": 8%

OPTION TWO: **Short-Term Loan**

- Loan Amount: $50,000
- Total Repayment Amount: $54,000
- Term: 6-month term
- Fees: 3% origination fee
- Weekly payments
- "Simple interest: 8%

Discussion: Based on the so-called "Simple Interest" disclosure, a small business owner might think that these two financing options have the same price- 8%. However, while it is not disclosed,

- ➢ **Option 1** has an APR of 27%, and
- ➢ **Option 2** has an APR of 42%.[2] The higher APR of Option 2 reflects two differences. First, Option 2 has a $1,500 origination fee (.03*50K) that is not included in the "Simple Interest," but ***is*** included in the APR. This fee is accounted for in the APR but not in the simple interest.

  Second, Option 2 requires payments to be made more frequently--*weekly* instead of *monthly*. Because the borrower has to pay back the money more quickly, they'll have less of the borrowed money to use. (For example, three weeks after the loan is disbursed a borrower of Option 1 will have made no payments and still have $50,000 of borrowed money on hand to use. But a borrower of Option 2 will have returned to the lender three weekly payments' worth of that money, $6,231.

  The higher APR of Option 2 reflects that the borrower will have less borrowed money to use over time, given the finance charge they're required to pay.

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[2] *Option two is an example used in a 2019 Federal Reserve Study.*[i]

Example 4: Comparing different products over the same period

Consider the following products and the type of information that a borrower would typically receive. With this information, which option is of better value?

OPTION ONE: **Merchant Cash Advance**

- Purchase Price: $21,500
- Purchased Percentage: 15%
- Purchase Amount: $31,175
- Specified Daily Amount: $174

OPTION TWO: **Short-Term Loan**

- Loan Amount: $21,500
- Term: 6 Months
- Financed Origination Fee: 5%
- Monthly Payment: $4,627

Discussion: It would be very difficult for a small business to compare the cost of these two financing options, without improved disclosures. With transparent disclosures, an apples-to-apples comparison would show that:

- Option One has a 161% estimated APR and
- Option Two has an APR of 115%.

Option Two is of greater value in this scenario, despite its high APR.

Example 5: Comparing different products with the same initial cash in hand at closing

Consider the following products and the type of information that a borrower would typically receive. With this information, which option is of better value?

OPTION ONE: **Invoice Factoring**

- Invoice Amount: $32,000
- Invoice Factor Advance Amount: $21,500
- Total Amount Paid Back: $29,120
- Monthly Factor Rate: 3%
- Invoice Due: 90 days

OPTION TWO: **Short Term Loan**

- Loan Amount: $21,500
- Term: 3 Months
- Interest Rate: 11%
- Financed Origination Fee: 2%
- Monthly Payment: $7,298

Discussion: These options both allow for the same initial cash in hand at closing, however, knowing which product is of greater value is not easily understood given the information offered for each type of product. The APR creates a rate of comparison between product types, allowing an entrepreneur to understand that Option Two is of greater value with an APR at 23% rather than Option One's APR at 54%.