RESPONSIBLE BUSINESS LENDING COALITION

Statement Submitted by

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The Responsible Business Lending Coalition

to the
U.S. House Committee on Financial Services
for the April 27, 2022, hearing entitled
"Consumers First: Semi-Annual Report of the Consumer Financial Protection Bureau"

Chairwoman Waters and Ranking Member McHenry, the Responsible Business Lending Coalition (RBLC)[1] appreciates the opportunity to submit this statement to encourage the Consumer Financial Protection Bureau's (CFPB) to implement Section 1071 of the Dodd-Frank Act in a timely manner and to encourage the committee to support efforts to protect small business owners from deceptive and predatory financing practices by passing the Small Business Lending Disclosure Act.

As the foremost cross-sector voice advocating for small business financial protection, the RBLC's leadership includes nonprofit and for-profit fintech lenders, community development financial institutions (CDFIs), investors, and small business advocates. Members of the RBLC share a commitment to innovation in small business lending as well as serious concerns about the rise of irresponsible small business lending.

In 2015, the RBLC created the Small Business Borrowers' Bill of Rights, the first cross-sector consensus on the rights that small business owners deserve and the standards of practice that financing providers should abide by to uphold those rights. Over one hundred small business lenders, brokers, lead generators, and advocacy organizations have endorsed these standards.

The RBLC views section 1071 as pro-innovation regulation that could encourage the development of more inclusive and higher-quality small business financing offerings simply by creating transparency into how the market is working today. The transparency created by section 1071 also has the potential to spur innovation by encouraging adoption of the products and practices that the data reveals are effective in serving underserved market segments. This long-needed data collection will also increase equity in the commercial financing marketplace by enabling regulators

[1]Members of the RBLC include Accion Opportunity Fund, Community Investment Management, Funding Circle, LendingClub, Opportunity Finance Network, Small Business Majority, and the Aspen Institute.

to identify violations of the Equal Credit Opportunity Act (ECOA) or revealing unmet credit needs that financing providers could help address.

We concur with a statement made by Director Chopra in his opening remarks that ”laws work best when they are easy to understand, easy to follow, and easy to enforce” which is why the RBLC advocates for federal legislation that would require commercial finance providers to disclose clear and comprehensive pricing information, using the same metrics, so small business owners and entrepreneurs can make apples-to-apples comparisons when seeking financings.

To that end, we urge the committee to pass the Small Business Lending Disclosure Act (H.R. 6054) as introduced by Congresswoman Nydia Velazquez as well as the Small Business Fair Debt Collection Protection Act sponsored by Congressman Al Lawson. Both bills seek to extend critical and straightforward protections to small business owners seeking financing.

The Small Business Fair Debt Collection Protection Act would extend the Fair Debt Collection Practices Act (FDCPA) to our country's hard-working entrepreneurs and small businesses. Unlike consumer borrowers who are covered by FDCPA, small business borrowers are not protected from the threat of harassment or the predatory practice of some debt collectors. Extending FDCPA protections to entrepreneurs as proposed by the Small Business Fair Debt Collection Protection Act is especially important to women and minority small business owners who are especially vulnerable to predatory debt collection practices.

The Small Business Lending Disclosure Act would bring much needed transparency to small business credit markets. Small businesses owners are not protected by the Truth in Lending Act which requires the transparent disclosure of annual percentage rates (APR) in consumer lending. Transparent price disclosure is the basis for free and efficient markets and the lack of price transparency in small business financing is undermining market price competition, stymying innovation, and misleading small business into paying high rates. For many small businesses, choosing an unaffordable credit product unknowingly could be the difference between survival and failure.

Without standardization of disclosure requirements across lenders, small businesses are more likely to choose higher-cost products. Research indicates that small businesses can pay APRs of 94%, and as high as 350%, without these high rates being properly and clearly disclosed. 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.

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.

The RBLC has endorsed the Small Business Lending Disclosure Act, as have a growing list of organizations across the country including the Accompany Capital, African American Alliance of CDFI CEOs, the California Association for Micro-Enterprise Opportunity (CAMEO), the Colorado Black Chamber of Commerce, Latino Economic Development Center (LEDC), Lendistry, Main Street Alliance, the National Alliance of Community, Economic Development Associations (NACEDA), the National Association for Latino Community Asset Builders (NALCAB), National Urban League, New York State, CDFI Coalition, UpState NY Black Chamber of Commerce, United States Hispanic Chamber of Commerce, and the Woodstock Institute.

The RBLC looks forward to working with the committee and with the CFPB to promote policies that support and protect small business owners. We have included two documents with additional information on the importance of transparency in small business financing and particularly the importance and practicality of APR as a metric. We are honored to serve as a resource to you and your staff if you have questions or would like additional information.

SUPPORT: Small Business Lending Disclosure Act (H.R. 6054)

Small businesses are not protected by the Truth in Lending Act, which requires transparent disclosure of annual percentage rates (APR) in consumer lending. In the absence of transparency standards, some financing companies are charging small businesses effective APRs averaging 94%, and as high as 350%, without disclosing those APRs to small business borrowers.[1] Federal Reserve research finds that small businesses are often misled by disclosures quoting “rates” that are not APRs and would prefer an APR disclosure for all of their financing options.[2]

Transparent price disclosure is the basis for **free and efficient markets**. Today, the lack of price transparency in small business financing is undermining market price competition, stymying innovation, and misleading small business into paying high rates. **For small businesses already on the brink of closure amid the pandemic, choosing an unaffordable credit product unknowingly could be the difference between survival and failure.**

To ensure that all small businesses receive the transparency they need to make informed decisions, **Congresswoman Nydia Velázquez** (D-NY-7) introduced the *Small Business Lending Disclosure Act* (H.R. 6054). This legislation requires financing providers to disclose clear and comprehensive pricing information to small business borrowers. H.R. 6054 cosponsors as of 2/28/22 include Chairwoman Waters, Rep. Perlmutter, Rep. Meeks, Rep. Cleaver, Rep. Beatty, Rep. Maloney, and Rep. Lynch.

Small Business Lending Disclosure Act: Gives small businesses the transparency they deserve by requiring all commercial financing providers to disclose key terms to prospective borrowers, for amounts up to $2.5 million

- *Annual percentage rate (APR)*, or estimated APR for merchant cash advances and other alternative products
- *Total cost* of the financing in dollars, including any/all unavoidable fees
- *Financing amount*, and the disbursement amount after fees are deducted
- *Term* or estimated term of repayment
- *Payment amount and frequency* (daily, weekly, monthly, etc.), and the average monthly payment amount to enable comparison
- *Renewal costs* for financing that is ‘renewed’ or refinanced with new fees assessed
- *Clear description of prepayment cost*, addressing hidden prepayment charges

Which loan is cheaper?

Federal Reserve researchers asked small businesses this question, which businesses commonly face today.[3]

Loan 1		Loan 2	
9% Simple Interest Rate	***or***	21.9% APR	**?**

Answer: Loan 2. The Fed found that “most participants incorrectly guessed the 9% simple interest short-term loan to be less expensive.”[3] In fact, it had an APR of approximately 46%.[4]

1 Opportunity Fund, “Unaffordable and Unsustainable: The New Business Lending on Main Street,” 2016: https://www.opportunityfund.org/wp-content/uploads/2019/09/Unaffordable-and-Unsustainable-The-New-Business-Lending-on-Main-Street_Opportunity-Fund-Research-Report_May-2016.pdf
2 Federal Reserve Board, “Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites,” 2019: https://www.federalreserve.gov/publications/files/what-small-business-borrowers-find-when-browsing-online-lender-websites.pdf
3 Ibid.
4 Ibid.

APR is the Cornerstone of Transparent Small Business Financing Disclosures

By providing small businesses with APR disclosure when they seek financing, the Act would bring transparency and price competition to the market, saving businesses an estimated $4.7 billion annually.[1]

1. **Federal Reserve studies confirm the need for APR disclosure.**

   Federal Reserve research finds that small business owners consider APR among the "most helpful details" in an ideal disclosure.[2] Small businesses want to see APR because it is the only familiar, trusted, and universal price metric enabling apples-to-apples comparison.

2. **APR enables comparison of borrowing cost over a common unit of time.**

   A price of $10,000 to rent an apartment for a month is not the same as $10,000 to rent for a year. The same is true in financing, which is the rent of money over a period of time. APR uses a common unit of time, the year, to enable price comparison.

   When selecting an auto mechanic, drivers can compare different mechanics' hourly rates--even if considering less than an hour of work. Drivers may choose to pay a higher hourly rate for a mechanic that is more convenient or skilled. Knowing the hourly rate first enables them to make an informed choice.

3. **APR helps entrepreneurs compare offers with different term lengths, even those shorter than one year.**

   While some shorter-term cash advance are typically 6-18 months in term for a single use, financing companies encourage small businesses to 'renew' many times, extending longer than one year.

   One provider states: "Approximately 90% of our Merchant Cash Advance clients participate in the program more than once. In fact, the average customer renews about ten times!"[3]

   Another explains: "Once your Merchant Cash Advance or Business Loan payback is 50% complete, you'll be eligible to renew with us for additional funding. Over 70% of our merchants take advantage of this option, many of them renewing for a third or fourth time… Our goal is to make a lasting connection…"[4]

4. **APR can easily be calculated for alternative, sales-based products. State laws in New York and California require APR disclosure for all commercial financing, and some providers proactively disclosed APR to customers prior to the passage of these laws.**

   APR is calculated and disclosed today by many small business financing providers, including some providers of merchant cash advances. APR is already disclosed by the signatories of the Small Business Borrowers' Bill of Rights, users of the SMART Box, and others. Soon, all nonbank small business financing providers operating in New York and California will begin including APR in all small business credit contracts as these laws take effect. New York and California's commercial financing laws establish APR as the de facto standard for small business price comparison nationwide. [4]

5. **Opposition to state disclosure bills centered around opposition to APR disclosure.**

   Opponents to the New York and California bills consisted of some alternative financing companies that charged high APRs and did not want to disclose them to small businesses. Supporters of the bills included responsible fintech/private-sector financing companies, CDFIs, small business organizations, and civil rights groups.

1 Responsible Business Lending Coalition, "Responsible Business Lending Coalition Commends Small Business Lending Disclosure Act, of 2021," 2021: http://www.borrowersbillofrights.org/rblcendorsessblendingandbrokerdisclosureact.html

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

3 Financing company website

4 Financing company website

UNDISCLOSED APRS AS HIGH AS 350%

Small business demand for capital increased during the pandemic, while loan offerings declined. Now, alternative financing companies promising fast cash seek to fill this void, with prices that are not clearly disclosed to borrowers.

Some **unregulated financing companies charge hidden APRs of up to 350%** but tell businesses their "rates" are in the single digits.

BIPOC BUSINESSES DISPROPORTIONATELY IMPACTED BY DECEPTIVE LENDING

The 2021 Small Business Credit Survey found that:

- Business owners of color are worse off financially due to the pandemic, and
- Credit availability is Black entrepreneurs' top concern.

Moreover, **Black and Hispanic business owners are twice as likely** to apply to high-cost and less transparent financing companies.

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SMALL BUSINESSES NEED RESPONSIBLE CAPITAL TO REBUILD FROM THE COVID-19 CRISIS. A LACK OF TRANSPARENCY PUTS THEIR FUTURES AT RISK.

NOW MORE THAN EVER, SMALL BUSINESSES NEED LENDING TRANSPARENCY TO AVOID UNSUSTAINABLE DEBT AS THEY REBUILD FROM COVID-19.

The federal government has regulated ***consumer*** financing disclosures for over 50 years. In that time, business financing has grown exponentially, without any disclosure requirements. **It is time for a Small Business Truth in Lending Act.**

Passed in 1968, the Truth in Lending Act requires lenders to disclose key pricing and term information to consumers, enabling them to compare options and make informed credit decisions.

A Small Business Truth in Lending Act would give business owners the same level of transparency from commercial financing providers.

FINANCING TRANSPARENCY COULD SAVE SMALL BUSINESSES *BILLIONS OF DOLLARS* PER YEAR IN EXCESS FINANCING CHARGES.

ONE MILLION SMALL BUSINESSES

Using data from the Federal Reserve's Small Business Credit Survey and U.S. Census Bureau, we estimate that each year, nearly one million price-sensitive small businesses will select lower-cost financing if presented with clear, comparable cost disclosures. Disclosures must include APR so that businesses can compare offers with different term lengths.

SAVING OVER $4.7 BILLION PER YEAR

Small businesses will save an estimated $4.7 billion annually with the ability to switch to lower-cost loan products. These savings could fund median-wage-rate jobs for over 115,000 unemployed workers.

ADDITIONAL BENEFITS

Businesses will not only save on finance charges, but also avoid secondary costs of unaffordable debt.

Time is money: Entrepreneurs often seek to refinance out of unaffordable debt, spending an average of 26 hours searching and applying for credit. By understanding the cost of financing upfront, entrepreneurs can avoid the need to refinance.

Missed payments can increase the cost of credit for years to come: Unaffordable products lead to missed payments and charge offs. Transparency can help businesses avoid credit score damage that increases the cost of future borrowing.

Preserving future business revenue: Unaffordable debt can force businesses to close prematurely. Business owners risk losing billions of dollars in future revenue without access to clear disclosures.

Contact: info@borrowersbillofrights.org