



Policy Recommendations for a Small Business Truth in Lending Act

A consensus has formed. The rise of irresponsible small business lending has led to widespread recognition of the need for small business “truth in lending” standards. The federal Truth in Lending Act, which requires transparent disclosures in consumer finance, does not apply to small businesses. In this regulatory gap, research finds financing companies charging some small businesses average APRs of 94%, ranging as high as 350%, without these rates ever being disclosed to the borrower.¹

Federal Reserve research has established that small businesses disclosures used today often leave business owners unable to make informed comparisons about the price of financing.² This has real consequences for small businesses—research found the *average* monthly payments charged to be almost double what these small businesses could afford to pay.³

Transparent price disclosure is the basis of free markets. Without it, market competition on price does not occur effectively. Today, small businesses are inhibited in making informed choices and may overpay for credit, impacting their ability to grow and hire and leading some to struggle and close.

Hope for responsible innovation brought leading fintech innovators and nonprofit organizations together in 2015 to form the Responsible Business Lending Coalition and launch the *Small Business Borrowers’ Bill of Rights*.⁴ This became the first cross-sector consensus on responsible business lending standards, and calls for transparent disclosure of price and terms. It has been signed by over 90 fintech companies, nonprofit organizations, small business groups, lenders, advocates, think tanks, and more.⁵

The Responsible Business Lending Coalition offers the following policy recommendations for a Small Business Truth in Lending Act, to enable small businesses to make fully informed decisions, and thrive.

Disclosures Should Include These 7 Elements:

1. *Financing amount*

- Include “Disbursement Amount,” accounting for fees or charges withheld at disbursement.

2. *APR or “Estimated APR”*

- 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. This is why APR has become the long-standing price metric that people are familiar with, vetted over 50 years of the Truth in Lending Act.

¹ <https://www.opportunityfund.org/media/blog/unaffordable-and-unsustainable-new-opportunity-fund-report>

See also: http://www.woodstockinst.org/wp-content/uploads/2016/07/Woodstock_Analysis_of_Online_SB_Loan_Terms.pdf

² <https://www.federalreserve.gov/newsevents/pressreleases/other20180628a.htm>; and

<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>

³ <https://www.opportunityfund.org/media/blog/unaffordable-and-unsustainable-new-opportunity-fund-report>

⁴ The mission of the RBLC is to drive responsible practice in the small business lending sector. RBLC’s members are Accion and Opportunity Fund, the two largest nonprofit CDFI small business lenders; Funding Circle and Lending Club, two leading FinTech innovators in marketplace lending; Community Investing Management, an investor in responsible FinTech small business lending; Small Business Majority, a nonprofit trade association and advocate for small businesses; and the Aspen Institute, a nonpartisan policy studies organization and the facilitator of the coalition.

⁵ <http://www.borrowersbillofrights.org/>

- “Estimated APR” should be used when providing variable-term financing such as merchant cash advances. Borrowers need an Estimated APR to make informed comparisons when shopping for financing. A variable term provider can simply calculate Estimated APR using the term length they have assumed in underwriting.
3. *Payment Amount and Frequency*
 - Include the “Total Monthly Payment Amount” if payment frequency is other than monthly. This is to enable apples-to-apples comparison between products offered with daily, weekly, bi-weekly, and monthly payments.
 - Understanding the impact of financing on cashflow is critical for small businesses. If payments are a variable amount, such as “X% of monthly sales through XYZ payment processing platform,” provide not only this description of the method used to calculate payment amounts, but also the “Estimated Total Monthly Payment Amount” in dollars. This is to enable informed comparison with financing that may simply quote “\$947 per month.”
 4. *Term, or Estimated Term in the case of variable term financing*
 5. *All Upfront and Scheduled Charges listed with dollar amounts*
 6. *Prepayment Charges*
 - A description of any financing amount due when financing is paid in full, if paid early.
 - This method of disclosure is important to address hidden prepayment penalties, by which a small business may be required to pay a fixed financing charge, such as \$20,000, regardless of whether the financing is repaid on time or early. Providers should not characterize these transactions as having “no prepayment penalty” or offering “prepayment discounts.”
 7. *Collateral requirements, if any*

Manner of Disclosure:

These seven disclosure elements should be presented in writing, at the stage when the financing is offered (such as in an initial term sheet, as well as at closing), in a manner that conforms with the “4 Cs of Transparency:” Clear, Conspicuous, Complete, and Comparable across the range of financing options that may be considered.

How Disclosure Standards Should Apply:

Transparency requirements should apply to the range of “small business financing” options small businesses consider. Specifically, it should enable small business owners to make informed comparisons between prices of loans, lines of credit or other open-ended products, merchant cash advances, asset-based financing, financing structured as a lease, and receivables financing. A level playing field helps the financing industry, is necessary for small businesses themselves, and creates healthy price competition.

These transparency standards should apply when financing offers are presented by brokers as well.

In considering financing provided through nonbanks that facilitate financing on behalf of banks, we recommend legislation utilize the entire definition of “provider” in the CA small business truth in lending act passed in 2018, SB 1235:

“‘Provider’ means a person who extends a specific offer of commercial financing to a recipient. ‘Provider’ also includes a nondepository institution which enters into a written agreement with a depository institution to

arrange for the extension of commercial financing by the depository institution to a recipient via an online lending platform administered by the nondepository institution. The fact that a provider extends a specific offer of commercial financing or lending on behalf of a depository institution shall not be construed to mean that the provider engaged in lending or originated that loan or financing.”⁶

While defining “small business” may be quite difficult and complicated, defining “small business financing” can be considerably easier. For example, small business financing could be defined as financing of the types described above, for a stated commercial purpose, in amounts below \$1 million.

Create Transparency Regarding “Double Dipping”:

A practice called “double dipping” involves financing providers effectively double-charging small businesses when renewing their financing. When “double dipping,” a provider offering an existing customer new financing requires that customer to pay down their outstanding financing—but does not refund the financing charge the borrower already paid for the financing being replaced. In this way, the borrower is charged twice for amount that was outstanding. The borrower is “double dipped.”⁷

If a financing offer requires paying off or paying down an existing financing transaction from the same provider, this should be reflected in the APR or Estimated APR disclosed. Specifically, the dollar amount of any existing financing that is required to be paid down, either with loan proceeds or otherwise, should be subtracted from the “disbursement amount” provided to the borrower that is used to calculate APR or Estimated APR. For example, if a financing offer of \$50,000 requires the borrower to pay down an open account by \$20,000 and pay an origination fee of \$5,000, the APR or Estimated APR calculation should be based on a “disbursement amount” of \$25,000.

Prohibit abusive “Confessions of Judgement”:

A “confession of judgement” clause causes the borrower to agree in advance to lose any dispute. News coverage documents widespread abuse, destroying businesses. It is already illegal in some states.⁸

Enforcement:

Appropriate bodies to conduct enforcement may include the FTC, CFPB, state financial regulators, or state attorneys general. These activities may fall within existing UDAP or UDAAP powers.

Suitable legal protection should extend to providers disclosing an “estimated APR” and “estimated total monthly payment amount” in good faith and reasonable accuracy. It is not possible for a provider to ensure that estimates will be perfectly accurate.

However, the appropriate agencies should consider whether a provider’s estimates systematically underestimate cost. For example, providers could be required to report to the chosen regulator the Estimated APR disclosed to the borrower, and the actual APR at time of payoff. If actual APRs are generally below the Estimated APR to a notable degree, this could indicate that correction is needed.

For additional information, please contact us at info@responsiblebusinesslending.org

⁶ https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180SB1235

⁷ An educational advertisement video by a merchant cash advance provider illustrating double dipping can be found here: <https://www.youtube.com/watch?v=k62kCK5tZwo>

⁸ <https://www.bloomberg.com/graphics/2018-confessions-of-judgment/>



Summary of Publications on the Need for Small Business Truth in Lending

For consideration of the policy recommendations above, we offer the following list of statements and whitepapers by regulators, policymakers, and others, recognizing the need for transparency standards:⁹

- *Federal Reserve Governor Brainard*: “Some have raised concerns about the high APRs associated with some online alternative lending products. Others have raised concerns about the risk that some small business borrowers may have difficulty fully understanding the terms of the various loan products or the risk of becoming trapped in layered debt that poses risks to the survival of their businesses.”¹⁰
- *Federal Reserve Bank of Philadelphia President Harker*: “I hear these stories constantly, about a small business in particular getting into a situation where they didn’t quite know what they signed up for, and then they walk into their community bank and say, ‘I’ve got to get out of this deal, it’s killing me.’ And so, there are good actors and bad actors... That is the role of the regulators, not just at the federal level.”¹¹
- *Federal Reserve Bank of New York President Dudley*: “There are individuals who try to take advantage of owners of new businesses by providing them with poor advice or overcharging them for credit... It would be helpful to have consistent standards and transparency requirements for organizations that lend to small businesses. Such standards and requirements exist for lending to households, and I believe the same justification exists to extend these requirements to small businesses.”¹²
- *US Treasury Department 2016*: “Small Business Borrowers Will Likely Require Enhanced Safeguards.”¹³
- *Federal Reserve Research 2018*: Federal Reserve researchers studied the need for disclosures, and themselves use APR to describe costs, including for merchant cash advances: “Depending on the speed of repayment, equivalent annual percentage rates (APRs) can exceed 80% or even rise to triple digits.”
 - “...Several [business owners] perceived that lenders were attempting to ‘hide’ or ‘conceal’ true costs by excluding basic information about their products from their sites or by using terminology which they were less familiar (for example, ‘simple interest’ or ‘factor rate’ versus APR).”
 - The research spoke to the concern that it is not possible to calculate a precise APR or payment amount for products with a variable term. When small business owners were asked about estimation in key disclosures, “Nearly all said this level of detail, even if estimated or presented as a range, should be available to potential borrowers before they apply and turn their businesses’ financial data over to the lenders.”¹⁴
- *Federal Reserve Research 2015*: Researchers presented small business owners with a series of typical online business loan disclosures. They asked the small business owners if they found anything confusing, or if any additional information was needed. Typical 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

⁹ These are provided as an illustration of the broad recognition of this need, not as characterization of RBLC’s views.

¹⁰ <https://www.federalreserve.gov/newsevents/speech/brainard20150930a.pdf>

¹¹ <https://youtu.be/6q6RWVsAaCY?t=1h34m45s>

¹² <https://www.newyorkfed.org/newsevents/speeches/2015/dud150508.html>

¹³ <https://www.treasury.gov/connect/blog/Pages/Opportunities-and-Challenges-in-Online-Marketplace-Lending.aspx>;

¹⁴ <https://www.federalreserve.gov/newsevents/pressreleases/other20180628a.htm>

know. Answers included 28%, 5%, 9.8%, and topped out a “a whopping 30%.” The actual rate was 60%. None realized it was that high.¹⁵

- *New York Department of Financial Services*: In the Online Lending Report 2018, the Department writes: “There also is not a uniform practice among respondents to disclose in a clear, simple and transparent manner the full price of a loan, including all fees, charges and other costs to their borrower either as included in the applicable annual percentage rate of the loan or in addition to the APR.”¹⁶
- *California Department of Business Oversight*: A 2015 survey requested and published small business finance pricing in APRs, and notes *median* APRs ranging from 15.5% to 51.8%.¹⁷
- *California Senate Bill 1235*: The bipartisan bill, passed 72-3 in the Assembly in September 2018, requires disclosure of “The total cost of the financing expressed as an annualized rate.”¹⁸
- *The Bipartisan Policy Center*: The 2018 main street finance whitepaper calls for disclosure standards, including APR. “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.”¹⁹
- *Shining a Light*: Whitepaper by a former US Treasury official calls for transparency rules with APR.²⁰
- *Harvard Business School*: “The State of Small Business Lending” whitepaper by former head of the SBA calls for disclosure standards. “The best model disclosures will incorporate APRs, as well as a host of other metrics.”²¹

Press Coverage of Irresponsible Business Lending and the Need for Transparency

Many articles have covered the rise of predatory business lending. A few we highlight include:

- Bloomberg Opinion, “Protect Small Businesses from Predatory Lending.” November, 2018.²²
- McClatchy, “Their bakery faced a cash crisis. The solution nearly cost them the business.” June 2018.²³
- The Hill, “California passes historic truth in small-business lending law — Congress should take note.” October 5, 2018.²⁴
- Forbes, “Why Online Small Business Loans Are Being Compared to Subprime Mortgages.” Dec 2015.²⁵
- Bloomberg News, “Wall Street Finds New Subprime with 125% Business Loans,” May 2014.²⁶

¹⁵ <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>

¹⁶ https://www.dfs.ny.gov/reportpub/online_lending_survey_rpt_07112018.pdf

¹⁷ http://www.dbo.ca.gov/Press/press_releases/2016/Survey%20Response%20Summary%20Report%2004-08-16.pdf

¹⁸ https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=201720180SB1235

¹⁹ <https://bipartisanpolicy.org/wp-content/uploads/2018/07/Main-Street-Matters-Ideas-for-Improving-Small-Business-Financing.pdf>

²⁰ https://www.progressivepolicy.org/wp-content/uploads/2017/11/PPI_SmallBizCredit_2017.pdf

²¹ http://www.hbs.edu/faculty/Publication%20Files/17-042_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf

²² <https://www.bloomberg.com/amp/opinion/articles/2018-11-28/confessions-of-judgment-small-business-and-predatory-lending>

²³ <https://www.mcclatchydc.com/news/nation-world/national/article212524749.html>

²⁴ <https://thehill.com/blogs/congress-blog/politics/410049-california-passes-historic-truth-in-small-business-lending-law>

²⁵ <https://www.forbes.com/sites/laurashin/2015/12/10/why-online-small-business-loans-are-being-compared-to-subprime-mortgages/#2ef5d6999288>

²⁶ https://www.stltoday.com/business/local/wall-street-finds-new-subprime-with-brokers-pitching-percent-loans/article_430dedc9-bfc1-56e1-ad07-8ed8706cfce2.html

Additional articles include:

- Bloomberg Businessweek, "Sign Here to Lose Everything: Part 2." November 27th 2018.²⁷
- Bloomberg Businessweek, "Sign Here to Lose Everything: Part 1." November 20th 2018.²⁸
- ValuePenguin, "California Looks to Change Small Business Lending Practices." October 2, 2018.²⁹
- Capitol Weekly, "Truth-in-lending law needed now." September 29, 2018.³⁰
- American Banker, "California Gov. Brown should sign new bill to protect small businesses." September 25, 2018.³¹
- Silicon Valley Business Journal, "Why I slipped on a suit to make small-business lending better." September 13, 2018.³²
- CALmatters, "My turn: Protect small businesses from predatory lending." September 13, 2018.³³
- American Banker, "Small-Business Borrowers on Verge of Consumer-Style Protections in Calif." September 5, 2018.³⁴
- Bloomberg BNA, "Calif. Small-Business Loan Disclosure Bill Gains Steam." August 28, 2018.³⁵
- Nerdwallet, "It's the 'Wild West Out There'" October 13th, 2016.³⁶
- Huffington Post, "The Promise and Perils of Online Lending." May 11th, 2016.³⁷
- Bankrate, "4 ways to protect personal loan borrowers." May 10th, 2016.³⁸
- MarketWatch, "Treasury Department calls for more oversight of online lending industry." May 10th, 2016.³⁹
- Governing, "Illinois May Target Predatory Lending to Small Businesses." April 18th, 2016.⁴⁰
- Forbes, "How A 4,058% APR Inspired Small Business Lender Able's New Products." April 11th, 2016.⁴¹
- Inc., "How Alternative Lenders Are Cleaning Up Their Image." April 8th, 2016.⁴²
- PublicCEO, "How to Address Predatory Small Business Lending in Your Community." December 17th, 2015.⁴³
- PaymentsSource, "ISO Lending Needs Regulation to Balance Risks and Rewards." Dec 15th, 2018.⁴⁴

²⁷ <https://www.bloomberg.com/graphics/2018-confessions-of-judgment-millionaire-marshall/>

²⁸ <https://www.bloomberg.com/graphics/2018-confessions-of-judgment/>

²⁹ <https://www.valuepenguin.com/2018/10/california-looking-change-small-business-lending>

³⁰ <http://capitolweekly.net/truthin-lending-law-needed/>

³¹ <https://www.americanbanker.com/opinion/california-gov-brown-should-sign-new-bill-to-protect-small-businesses>

³² <https://www.bizjournals.com/sanjose/news/2018/09/13/california-small-businesslending-measure-sb-1235.html>

³³ <https://calmatters.org/articles/commentary/my-turn-protect-small-businesses-from-predatory-lending/>

³⁴ <https://www.americanbanker.com/news/small-business-borrowers-on-verge-ofconsumer-style-protections-in-calif>

³⁵ <https://www.bna.com/calif-smallbusiness-loan-n73014482092/>

³⁶ <https://www.nerdwallet.com/blog/small-business-special-report-mca>

³⁷ http://www.huffingtonpost.com/john-arensmeier/the-promise-and-perils-of_b_7260518.html

³⁸ <http://www.bankrate.com/financing/personal-loans/4-ways-to-protect-personal-loan-borrowers>

³⁹ <http://www.marketwatch.com/story/treasury-department-calls-for-more-oversight-of-onlinelending-industry-2016-05-10>

⁴⁰ <http://www.governing.com/topics/finance/gov-illinois-predatory-small-business-loans.html>

⁴¹ <https://www.forbes.com/sites/laurashin/2016/04/11/how-a-4058-apr-inspired-small-business-lenderables-new-products/#122cea56681f>

⁴² <http://www.inc.com/jeremy-quittner/marketplace-lenders-create-association-to-promote-fairness-inlending.html>

⁴³ <http://www.publicceo.com/2015/12/how-to-address-predatory-small-business-lending-in-yourcommunity>

⁴⁴ <https://www.paymentsource.com/opinion/iso-lending-needs-regulation-to-balance-risks-and-rewards>

- Forbes, “Why Online Small Business Loans Are Being Compared To Subprime Mortgages.” December 10th, 2015.⁴⁵
- New York Times, “Lawmakers Ask for Information About Online Lenders.” November 12th, 2015.⁴⁶
- Bloomberg, “How Two Guys Lost God and Found \$40 Million.” October 6th, 2015.⁴⁷
- Forbes, “Disclosure Needed: A Guide to Alternative Lending Regulatory Issues As Treasury Comment Period Ends.” September 29th, 2015.⁴⁸
- Aspen Journal of Ideas, “Why We Need a Small Business Borrower’s Bill of Rights.” August 2015.⁴⁹
- Forbes, “Talking Alternative Finance With MultiFunding’s Ami Kassari: 'It's The Wild, Wild West Out There'.” August 7th, 2015.⁵⁰
- Forbes, “Lenders Voluntarily Create A Bill Of Rights To Protect Small Businesses From Lending Abuses.” August 6th, 2015.⁵¹
- Locavesting, “Can a Borrowers’ Bill of Rights Tame the Wild West of Online Lending?” Aug 6th, 2015.⁵²
- Inc., “How Short-Term Lenders Keep You on the Hook.” August 12th, 2014.⁵³
- Inc, “A New Group of Alternative Lenders: Investment Lenders.” July 23rd, 2014.⁵⁴
- Bloomberg, “How Much is Too Much to Pay for a Small Business Loan.” May 16th, 2014.⁵⁵
- Wall Street Journal, “Ami Kassari: Know the True Costs of Short-Term Online Loans.” May 14th, 2014.⁵⁶
- Inc., “Beware of Sharks: New Rules of Fast Cash.” May 2014.⁵⁷
- Bloomberg, “Forget the Algorithms. Get Me a Loan Broker!” April 4th, 2014.⁵⁸
- Bloomberg, “Brokers Get Big Commissions for Selling Entrepreneurs Costly Loans.” March 31st, 2014.⁵⁹
- CNN, “Stacking: Merchant Cash Advance Funders Jeopardize Main Street.” February 17th, 2014.⁶⁰
- Wall Street Journal, “Alternative Lenders Peddle Pricey Commercial Loans.” January 7th, 2014.⁶¹
- Buynance, “Stacking: Merchant Cash Advance Funders Jeopardize Main Street.” February 3rd, 2014.⁶²

⁴⁵ <https://www.forbes.com/sites/laurashin/2015/12/10/why-online-small-business-loans-are-being-compared-to-subprime-mortgages>

⁴⁶ https://www.nytimes.com/2015/11/13/business/lawmakers-ask-for-information-about-onlinelenders.html?_r=0

⁴⁷ <https://www.bloomberg.com/news/features/2015-10-06/how-two-guys-lost-god-and-found-40-million>

⁴⁸ <https://www.forbes.com/sites/amyfeldman/2015/09/29/alternativelending-regulation-a-guide-to-the-issues-as-treasurys-comment-period-draws-to-a-close>

⁴⁹ <http://aspen.us/journal/editions/julyaugust-2015/why-we-need-small-business-borrower%E2%80%99sbill-rights>

⁵⁰ <https://www.forbes.com/sites/amyfeldman/2015/08/07/talking-alternativefinance-with-multifundings-ami-kassar-its-the-wild-wild-west-out-there>

⁵¹ <https://www.forbes.com/sites/nickclements/2015/08/06/lenders-voluntarilycreate-a-bill-of-rights-to-protect-small-businesses-from-lending-abuses>

⁵² <http://www.locavesting.com/raising-capital/can-a-borrowers-bill-of-rights-tame-the-wild-west-ofonline-lending>

⁵³ <http://www.inc.com/amikassar/the-cash-advance-and-short-term-loan-hook-how-providers-keep-you-coming-back-for.html>

⁵⁴ <http://www.inc.com/ami-kassar/a-new-group-of-alternative-lenders-investment-lenders.html>

⁵⁵ <https://www.bloomberg.com/news/articles/2014-05-16/how-much-is-too-much-to-pay-for-a-smallbusiness-loan>

⁵⁶ <https://www.wsj.com/articles/SB10001424052702304547704579561962818707096>

⁵⁷ <http://www.inc.com/magazine/201405/alix-stuart/alternative-lending-easy-expensive.html>

⁵⁸ <https://www.bloomberg.com/news/articles/2014-04-03/alternative-lenders-still-rely-on-loan-brokers>

⁵⁹ <https://www.bloomberg.com/news/articles/2014-03-31/brokers-get-big-commissions-for-sellingentrepreneurs-costly-loans>

⁶⁰ <http://ireport.cnn.com/docs/DOC-1086596>

⁶¹ <https://www.wsj.com/articles/SB10001424052702304477704579256123272658660>

⁶² <http://archive.is/KI90X>