Testimony of Parris Sanz
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Before the House Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit

"Examining the Opportunities and Challenges with Financial Technology ("FinTech"): The Development of Online Marketplace Lending"

July 12, 2016

Chairman Neugebauer, Ranking Member Clay, and Members of the Subcommittee:

I am honored to appear before the Subcommittee today on behalf of CAN Capital and the Electronic Transactions Association ("ETA") to discuss the critical role online lending can play in expanding access to credit to our nation's small business owners.

About CAN Capital

Founded in 1998 by a woman small business owner who sought to solve the problem of small business access to capital, CAN Capital is the longest tenured and largest alternative small business finance company. CAN Capital currently employs approximately 450 employees and has provided access to over $6 billion of capital to our small business customers in more than 175,000 separate transactions. The Company provides access to as much as $250,000 per business location, although most customers seek $100,000 or less, and the average transaction size is approximately $45,000. The Company has served small businesses in hundreds of different industries, including healthcare, food retail, automotive, construction, spas and beauty, and business equipment and services, among others. For over 18 years, CAN Capital has served the Main Street businesses that account for half of the private sector workforce and two out of every three new jobs created in the last two decades.[1]

About ETA

ETA is the leading trade association for the payments industry, representing over 500 companies that offer electronic transaction processing products and services, including financial institutions, transaction processors, payments networks, and others. ETA members make commerce possible by processing more than $6 trillion in purchases in the U.S. and deploying payments innovations to merchants and consumers. ETA also has members that are engaged in online lending for commercial enterprises, primarily small businesses, either directly or in partnership with other lenders.

[1] Joint Small Business Credit Survey Report, 2014, Federal Reserve Banks of New York, Atlanta, Cleveland and Philadelphia (released February 2015) at 4 ("Joint Small Business Credit Survey"); Karen Gordon Mills, Brayden McCarthy, The State of Small Business Lending: Credit Access During the Recovery and How Technology May Change the Game, Harvard Business School Working Paper 15-004 (July 22, 2014) at 24 ("State of Small Business Lending").

Problems with Small Business Access to Credit

Access to capital is the lifeblood of small businesses and a major determinant of their success or failure. Unlike larger businesses, small businesses do not typically have access to the capital markets and are heavily dependent upon bank financing.[2] Even when bank lending to small businesses was at its apex, from 2005 through 2007, more than 50% of small and midsized businesses reported difficulties obtaining sufficient credit.[3] Thereafter, the financial crisis virtually shut down almost all bank lending to small businesses. More than eight years later, challenges still exist for many small businesses to obtain the credit they need from traditional small business loans. According to a 2014 Federal Reserve survey "a majority of small firms (under $1 million in annual revenues) and startups (under 5 years in business) were unable to secure any credit in the prior year".[4] That is a huge gap in credit availability that leaves many small businesses struggling, with significant adverse implications for the economy as a whole.

The problem is especially acute for small businesses seeking smaller loan amounts. Loans of $100,000 or less account for 90% of small business loans.[5] According to the same 2014 Fed survey mentioned above, more than half of the small businesses surveyed that applied for credit in 2014 were seeking loans of $100,000 or less.[6] Among small business applicants with less than $1 million in annual revenues, more than half of them received less than 50% of the amount for which they applied.[7] This lack of access to smaller loans adversely affects the ability of small businesses to pursue growth opportunities or hire new employees.

Traditional lenders have been unable to effectively address the needs of small businesses because of high customer acquisition and underwriting costs, outmoded and cumbersome underwriting methods and overhead costs associated with their brick and mortar branches. As the Department of Treasury noted in its recent request for information ("RFI") on online and marketplace lending, traditional small business lenders have "high search, transaction and underwriting costs … relative to potential revenue - it costs about the same to underwrite a $5 million dollar loan as a $200,000 loan - and many small business owners report they are unable to access the credit needed to grow their business".[8] Because of the disproportionately high costs of originating small business loans, it can be uneconomical for many banks and other financial institutions to make loans to many small businesses in amounts less than $150,000, $250,000 or even $1 million dollars. As a result, such institutions have not largely focused on the small business lending market and the percentage of bank loans made to small businesses has dropped to record low levels. In 1995, small business loans accounted for 50% of all bank loans. By 2012, this number had declined to 30%.[9] Foreseeably, the continuing consolidation in the banking industry may result in even less traditional bank lending to small businesses.

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[2] Small businesses receive 95% of their financing from banks. 2011 Economic Report of the President, Council of Economic Advisors, The White House.
[3] Experian Information Solutions, Quarterly Business Credit Review for Q3 2013, December 10, 2013, citing NFIB Small Business Optimism Survey, Moody's Analytics, 2013.
[4] Joint Small Business Credit Survey at 4.
[5] Office of Advocacy, Small Business Lending in the United States 2013, Victoria Williams, U.S. Small Business Administration, 2014.
[6] Joint Small Business Credit Survey at 4.
[7] Ibid at 14.
[8] 80 FedReg. 42866, 42867 (July 20, 2015), citing The Future of Finance, Goldman Sachs Equity Research, March 3, 2015.
[9] Karen Gordon Mills, Brayden McCarthy, The State of Small Business Lending: Credit Access During the Recovery and How Technology May Change the Game, Harvard Business School Working Paper 15-004 (July 22, 2014) at 24 ("State of Small Business Lending").

Even where a bank's minimum loan amount may be consistent with the needs of a small business, the prospective borrower would still have to contend with a potentially cumbersome underwriting process that frequently focuses more upon the creditworthiness and collateral of the business owner than factors associated with the performance of the business.

In addition, small business owners want to focus on running their businesses, not searching for funds. On average, a small business owner may spend 30 hours or more applying for credit from a traditional small business loan program and wait weeks or longer for the underwriting process to run its course and the funds to be disbursed, assuming the loan request is approved.[10] By and large, small business owners do not have the luxury of devoting this kind of time to a search for funds, especially where their own low personal credit scores or absence of sufficient collateral may make the search futile. For small business owners with the fortitude to work through the traditional lending process, the odds of receiving all the capital needed for their business still are not guaranteed.[11]

Online Lenders Role in Expanding Access to Credit to Undeserved Small Businesses

Fortunately for small businesses, new and innovative technology platforms are expanding access to credit and offering attractive alternatives to traditional loans.[12] Online lending platforms, like CAN Capital and other ETA members, provide small businesses with access to smaller loans (typically less than $250,000) and shorter terms[13] that are often better suited to their day to day operating needs or short-term use cases. Online lending platforms also allow small businesses to apply for credit online, from any geographic location, in a fraction of the time it takes to apply for credit from a traditional loan program.[14] Using sophisticated, data-driven algorithms to screen the creditworthiness of potential small business borrowers, our industry is able to reach funding decisions quickly and efficiently, and provide access to capital to approved borrowers expeditiously and in some cases within 24 hours. [15] Taking advantage of these technology platforms has allowed small businesses to focus more of their time and effort on growing their businesses, hiring workers and positively impacting the economy.[16]

Our industry's approach to evaluating risk differs materially from the traditional underwriting process. Instead of focusing on the performance and prospects of potential small business borrowers, traditional loan programs tend to focus on the personal credit histories of the business owners. They require extensive documentation and frequently require specific and/or personal collateral. Their underwriting approach tends to work only for small businesses with an

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[10] Small Business Credit Survey, Spring 2014, Federal Reserve Bank of New York ("Small Business Credit Survey"). Of the small businesses surveyed, 40% applied for credit in 2013. Among those that applied for credit, they spent, on average, 33 hours applying, submitting 3 applications to 2.7 financial institutions and more than 51% of them were seeking $100,000 or less.

[11] Small Business Credit Survey at 13. Out of the 40% of small businesses surveyed that applied for credit in 2013, only 39% received all or most of the capital that their businesses required.

[12] In 2014, almost 20 percent of small business applicants sought credit from an online lender. 80 FedReg 42867.

[13] 80 FedReg. 42867.

[14] Joint Small Business Credit Survey at 4,6 (reporting that survey respondents spent an average of 24 hours researching and completing credit applications).

[15] In the case of CAN Capital's platform, business owners can complete a pre-qualification application online or over the phone and receive a no-obligation quote within 10 minutes. The approval rate among businesses that submit a pre-qualification application is approximately 50%. For most customers whose complete applications have been approved, funds are sent the same day as approval or the next day.

[16] A study conducted by the Analysis Group in 2014 estimated that the first $1 billion in loans made by one of the largest online marketplace small business lenders generated $3.42 billion in economic impact through industry, supply chain and job creation gains and that 22,000 jobs were created as a result of small business owners having capital to grow their businesses.[cite]

extensive history of profitability, owners with good personal credit histories, and businesses that do not have an urgent need for capital.

Companies like CAN Capital deploy data-driven algorithms to quickly assess the risk of extending capital to small businesses with the same robustness as traditional lenders. Underwriting decisions are made based on factors including the financial performance and prospects of the small business itself and look beyond the business owner's FICO score (i.e., the criterion on which many banks seem to rely in determining eligibility for a small business loan). Unlike many traditional bank loans, none of the small business financial products we provide require personal collateral (such as a personal residence or automobile); only a pledge of business assets. Accordingly, CAN Capital and other industry peers have built risk and underwriting models based on firmographic variables, including sales and revenue data, cash flow history, and time in business, to approve small businesses whose owners may have personal FICO scores below 650 (arguably the most underserved segment of the small business population). As a result, our platform allows us to safely provide access to capital for many small business applicants that most banks might decline.

While one might think the ease and speed of our industry's underwriting process coupled with our willingness to cater to underserved small businesses would have a negative effect on loan performance, the data tells a different story. Since 2008, for example, CAN Capital's average net write-off rate has been less than 7%. During that time, which includes the most recent financial crisis, we provided small businesses with access to nearly $5 billion in funding. In contrast, small business lending from traditional bank loan programs essentially froze during the same time period, thereby underscoring the resiliency of our business model. [17]

Online Small Business Lending Models

Online lenders are a diverse, nimble and innovative group. The many different models for online lending platforms are the products of the creativity and resourcefulness made possible by the use of financial technology to expand access to credit for small businesses, improve the borrower experience, and bring technology-based efficiencies to the market. As policymakers evaluate the various business models in the online small business lending industry, we hope they appreciate that the broad range and diverse nature of various credit products available to small businesses may not fit neatly into the market segmentation categories used in traditional lending.

Lending models vary based on the nature of the borrower – consumer or business – and the mechanisms used to fund the loans, whether through retail investor participation, private market investor participation, balance sheets, bank partners, and/or hybrid combinations. For example, U.S. peer-to-peer lending – which we would define primarily as the matching of retail investors (although institutional investors may play a large role) with individual borrowers through the SEC registration of a security -- developed within the consumer lending space. To date, this model is predominantly deployed on the consumer side and not for small business/commercial loans.

[17] Access to capital has been critical to small businesses, which were hit harder during the 2008 financial crisis and have been slower to recover. State of Small Business Lending at 3.

Some online lending platforms may finance their loans using a combination of private marketplaces, securitization and balance sheet financing. Balance sheet platforms retain the loans they make (or that are purchased from an original bank) on their own book. These bank partnerships can involve a sharing of the credit risk, or the balance sheet platform may assume the entire credit risk. As a result, the success and incentives of the balance sheet platform are fully aligned with the success of the small business borrower. CAN Capital applies a balance sheet model and we retain all loans that we make or purchase from our bank partners.

Other online lending platforms are “matching” platforms, which enable consumers or small businesses to access a variety of lenders based on their specific needs and that transfer the potential borrower’s data to the lenders in an application package. It is important to note that pure “matching” platforms do not lend directly.

It is worth noting that the business models of companies in the industry are also evolving rapidly and in some cases, the business models are converging. For example, pure peer-to-peer platforms may soon begin retaining assets on their balance sheets to diversify their revenue streams (supplementing the origination and servicing fees they currently earn with net interest income) and their sources of financing (e.g., asset-backed warehouse lines of credit).[18]

In short, the business models of some current industry participants already show signs of converging, as do the means by which they finance their businesses (i.e., through private investment, balance sheet financing, bank partners, and securitization) and the loans to which they provide access. The industry will continue to evolve rapidly, as current participants and new ones continue to develop and use data-driven models and technology to reduce acquisition and servicing costs, drive scale, and expand access to capital to small businesses and consumers with new products and services.

In light of this varied and rapidly evolving (possibly converging) industry, we believe it would be premature for policymakers to make sharp distinctions among small business lenders or based on market segments associated with traditional lending. Instead, we suggest that policymakers continue to monitor and study developments in the industry, recognizing the difference between consumer and commercial lenders, and promote further innovation. New technologies and capital products continue to emerge and competition within and between business models is at an early stage. Prematurely regulating the industry based on frameworks designed for traditional lending, as some have suggested, risks stifling innovation and competition and curtailing access to capital for millions of small businesses.

Important Distinction Between Consumer and Small Business Lending

CAN Capital and ETA suggest that as policymakers evaluate the industry, they consider the important and well established distinctions between small business and consumer loan programs and resist calls to regulate these products similarly. Business loans involve risks that are materially different and substantially greater than consumer loans. For example, small businesses have high failure rates and are heterogeneous in nature. Detailed business or financial

[18] 3 is a magic number in the Marketplace Lending Ecosystem, Glenn Goldman, CEO, Credibly, August 17, 2015. https://orchardplatform.com/blog/3-is-a-magic-number-in-the-marketplace-lending-ecosystem/

information is frequently lacking and, even where available, it can be difficult, time-consuming and costly to obtain, verify and interpret. These characteristics make small business lending more risky and unpredictable compared to consumer loan products that are more standardized and generic in nature.[19]

Lending programs for small businesses play a vastly different role in the economy than consumer lending products, which to date have been used primarily for debt consolidation or consumer purchases (e.g. a house or car). Small businesses seek capital for sophisticated use-cases: to hire new employees; to buy new equipment and inventory; to upgrade facilities and expand; and to market themselves. They also seek capital to manage unexpected expenses and slow sales periods.[20] All small businesses utilize funds to generate a return on investment. The businesses use-case is considerably different and more nuanced than generic consumer lending products such as home or automobile loans.

Given these differences, it would be inappropriate and ineffective to regulate consumer and small business lending in a similar fashion. We also strongly believe that doing so could dramatically impact sponsors of small business lending programs and adversely impact small businesses access to much needed capital.

It is important to note that there is extensive legislative history making a distinction between consumer and commercial lending platforms from a regulatory perspective. For instance, the federal Truth in Lending Act (TILA) of 1968 has generally applied solely to extensions of credit made primarily for personal, family, or household use purposes. And although TILA has been amended numerous times since its enactment in 1968, legislators have never amended the law such that it would apply to extensions of commercial credit. As a subset of commercial lending, non-credit card, small business loans have never been subject to TILA's regulatory regime or compliance requirements. To now alter, for the first time, the regulatory landscape to include regulation of small business lending would represent a fairly significant change to the regulatory framework currently adopted by Congress as it relates to the historic distinction between consumer and commercial credit, as exemplified by the distinctions made in the federal financial regulatory laws, such as TILA.

We commend Chairman Neugebauer, Ranking Member Clay and other Members of this Committee for a recent letter that pushed back against mistaken efforts to conflate consumer and small business lending, especially absent careful analysis of how this might impact the flow of capital to small businesses.[21] The letter correctly highlighted how such policy actions would unnecessarily restrict the availability of capital to small business owners, who have already suffered contractions in traditional bank lending since the financial crisis.[22]

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[19] Difference between Business Loan & Consumer Loan, Leigh Anthony, Demand Media, 2016. http://smallbusiness.chron.com/difference-between-business-loan-consumer-loan-3710.html

[20] Small business owners are turning to online lenders for loan products that better fit their financing needs, including small loans to cover unexpected cash flow needs. See Scott Shane, Why Small Businesses are Turning to Online Lenders, Entrepreneur (Apr. 15, 2015); https://www.entrepreneur.com/article/245075

[21] U.S. House of Representatives Financial Services Committee Letter to Treasury Secretary, May 3, 2016. ("HRFC Letter to Treasury") http://www.aba.com/Advocacy/Grassroots/WINNDocs/HFSC-sub-chairs-letter-to-TSY-Lew-on-regulation-of-online-small-business-lenders.pdf

[22] Ibid.

Department of Treasury Recommendations Related to Small Business Lending

In May of this year, the Department of Treasury released a white paper on online lending entitled: “Opportunities and Challenges in Online Marketplace Lending.” The paper thoughtfully laid out the significant benefits of online lending platforms to consumers and small businesses. It also made some good recommendations, including potentially facilitating greater interagency coordination to facilitate FinTech innovation, expanding access to credit by creating greater access to government-held data, and promoting access to credit through helping to foster partnerships between online lenders and financial institutions, including Community Development Financial Institutions (CDFIs).

One recommendation in the Department’s white paper, however, warrants additional discussion and consideration. The recommendation calls on Congress to consider crafting legislation that would regulate small business loans under $100,000 in a similar manner as consumer loans. The Director of the Consumer Financial Protection Bureau, Richard Cordray, also signaled his preference to regulate lending to small businesses and consumers similarly.[23] If implemented, this hastily drawn recommendation – which runs counter to the wishes of many Members of this Committee[24] – would impact a massive 90% of all small business loans.[25]

For the reasons outlined above, we believe such a policy initiative fails to recognize the important and significant distinctions between consumer and small business lending, would result in stifling innovation and competition, and would significantly roll back the expanded access to credit small business owners enjoy through online lending platforms. The U.S. is home to millions of businesses that require commercial financial products well below $100,000 to sustain and grow their business. The use of funds, commercial or consumer, should dictate the applicable lending regulations, not the dollar amount of the loan.

We also question the evidence the Department used to support this recommendation. For instance, in supporting the $100,000 threshold, the white paper cited a Federal Reserve Bank Small Business Credit Survey (SBCS) to question online small business borrowers’ satisfaction with their experience. However, the SBCS survey specifically notes that it’s methodology “is not a random sample of small employer firms, and therefore suffers from a greater set of biases than surveys that contact firms randomly,” that “caution should be taken when interpreting the results” and that “the data are not a statistical representation of small businesses.”[26] We would also highlight that the figure cited by Treasury from the SBCS survey in fact demonstrates that more customers were satisfied with their online experience than those dissatisfied.[27]

Similarly, the Treasury white paper states that “***strong evidence*** indicates that small business loans under $100,000 share common characteristics with consumer loans yet do not

[23] You can see Director Cordray’s testimony here; (@1:03:31): https://www.youtube.com/watch?time_continue=3814&v=imfCKtAzLxA
[24] HFSC Letter to Treasury
[25] Office of Advocacy, Small Business Lending in the United States 2013, Victoria Williams, U.S. Small Business Administration, 2014.
[26] The Federal Reserve Banks et. al “The Joint Small Business Credit Survey 2015” at Page 23. https://www.clevelandfed.org/community-development/small-business/about-the-joint-small-business-credit-survey/2015-joint-small-business-credit-survey.aspx
[27] The “score” is not a percentage — instead “the satisfaction score is the share of satisfied with lender minus the share dissatisfied,” which yields a differential of 15 (not a percentage).

enjoy the same consumer protections" (emphasis added). [28] However, the paper never cites or specifies the "strong evidence" it used to support its recommendation.

Contrary to the Department's supporting evidence, a recent survey of 592 small businesses conducted by Edelman Intelligence on behalf of ETA found that 99% of online small business borrowers were satisfied with their online lending experience (40% somewhat satisfied; 59% very satisfied). The study found that 91% of online borrowers were likely to take out another loan through an online lending platform.[29]

Relationships With Traditional Lending Institutions and Insured Depository Institutions

Many technology-based online lending platforms are also partnering with traditional banks and institutions, which may fund the loans. Although CAN Capital provides loans and other forms of capital directly to small businesses, it also has a relationship with WebBank, a Utah-chartered industrial bank, member FDIC (the "Bank"), under which CAN Capital provides small businesses with access to certain business loans offered by the Bank. As a service provider to the Bank, CAN Capital assists the Bank to identify potential borrowers, receive and process applications, and arrange for loan closings. The Bank underwrites, originates and funds loans sourced through CAN Capital. CAN Capital is the servicer of small business loans made by the Bank. The Bank may hold the loans or offer to sell them to CAN Capital. If CAN Capital elects to purchase loans from the Bank, it holds them on its balance sheet.[30]

In our experience, bank partnerships of this nature enhance and expand regulatory supervision of online lending platforms and create significant benefits to borrowers and investors. Although non-bank lenders such as CAN Capital are licensed in certain states and subject to supervision and examination by state financial services regulators such as the California Department of Business Oversight, non-banks that partner with a bank become subject to a significant amount of additional regulation and supervision, both by federal banking agencies that oversee the bank and by the bank itself (a complete list of applicable federal and State laws and regulations for online commercial lending is in Appendix B of this testimony). For example, under the Bank Service Company Act, the federal regulator of a bank has the authority to examine a service provider of a bank, such as a non-bank platform that performs services for a bank. In addition, as a matter of their own responsible business practices and to satisfy the expectations of banking regulators with respect to risks associated with third party vendors, banks that partner with online lenders can be expected to operate a robust vendor management program that provides regular and comprehensive oversight of the bank partner's activities on behalf of the bank, including compliance with applicable laws. This oversight frequently includes third party audits by independent consultants that often retain former bank examiners to assist in their review of the non-bank's Compliance Management System and other practices. As a result, online lending platforms that partner with banks voluntarily submit to ongoing regulatory scrutiny at both the federal and state level. Policymakers should understand

[28] "Opportunities and Challenges in Online Marketplace Lending", U.S. Department of the Treasury, 2016. https://www.treasury.gov/connect/blog/Documents/Opportunities%20and%20Challenges%20in%20Online%20Marketplace%20Lending%20vRevised.pdf
[29] See Appendix A.
[30] Such loans may become collateral in the securitization transaction mentioned above.

how these arrangements between online lending platforms and banks ensure compliance with law and safe and sound banking practices and make additional supervision or regulation unnecessary.

Moreover, we note the significant benefits to borrowers and investors derived from partnerships between online lending platrforms and banks. Given the patchwork of lending laws among the states, banks are able to offer loan products on a more uniform basis than non-bank lenders, enabling the provision of credit to a broader spectrum of qualified small business borrowers of varying degrees of credit quality in all states. Banks that partner with non-bank platforms are able to provide credit to otherwise underserved borrowers and increase competition for loans to small businesses generally, which as noted above, is vitally important to support business lending. Borrowers also benefit from the fact that their lender is subject to comprehensive regulation and supervision by a federal banking agency as well as the bank's chartering agency, which may be a state or federal banking agency. Investors who purchase loans originated by banks through a partnership with a non-bank platform likewise benefit from the enhanced regulatory scrutiny applied to the origination of the loans they purchase. Although the recent *Madden v. Midland* Funding case has introduced some uncertainty to the secondary market given the case's errant analysis of federal preemption and failure to apply the longstanding common law "valid when made" doctrine, we believe that thoughtful investors recognize the enhanced value of loans that are originated through a collaboration of a bank and an innovative non-bank platform such as CAN Capital given the focus that both the bank and the non-bank platform place on satisfying regulatory requirements for safe and sound banking practices, including prudent underwriting, as well as compliance with applicable laws.

Federal Policymakers Should Facilitate Positive Innovation in Lending

ETA and CAN Capital encourage federal policymakers to facilitate positive innovation in lending, and proposes the following options for achieving this goal:

- Federal policymakers should encourage online lending platforms to participate in federal programs, such as the loan guarantee programs of the Small Business Administration,

- The government should encourage traditional lending institutions to refer small business customers whose loan applications they have declined to online small business lending platforms. To this point, policymakers should consider the potential benefits in encouraging banks to participate in and help grow online lending to small businesses. Due to their underwriting requirements and higher overhead expenses, it is often not profitable for traditional lending institutions to extend small amount, short term loans to small businesses. Rather than turn customers seeking loans that do not meet their underwriting criteria away altogether, traditional banks could refer them to online lenders. Where the small business customer is able to secure a loan based on such a referral or joint-origination effort, the bank is able to maintain a good relationship with the customer as well as promote access to necessary capital from an alternative source.

- Federal policymakers should encourage industry self-regulatory efforts and determine whether, in light of such efforts, any increased government regulation of online small business lending is necessary. Groups like ETA, the Innovative Lending Platform Association, and the Marketplace Lending Association are working to develop industry standards for loan disclosures and borrower rights which, if supported by industry participants and government actors, may obviate the need for additional regulations.

- Federal policymakers should support initiatives that create a harmonized and rationalized policy framework that foster competition. For example, state law harmonization efforts or the creation of a federal licensing regime could permit more uniform application of policy and potentially provide customers with a single point of contact. This approach could prevent application of an inefficient and duplicative patchwork of state and federal laws that increasingly drive friction in a modern, internet-based economy, and fail to accomplish regulatory objectives.

Conclusion

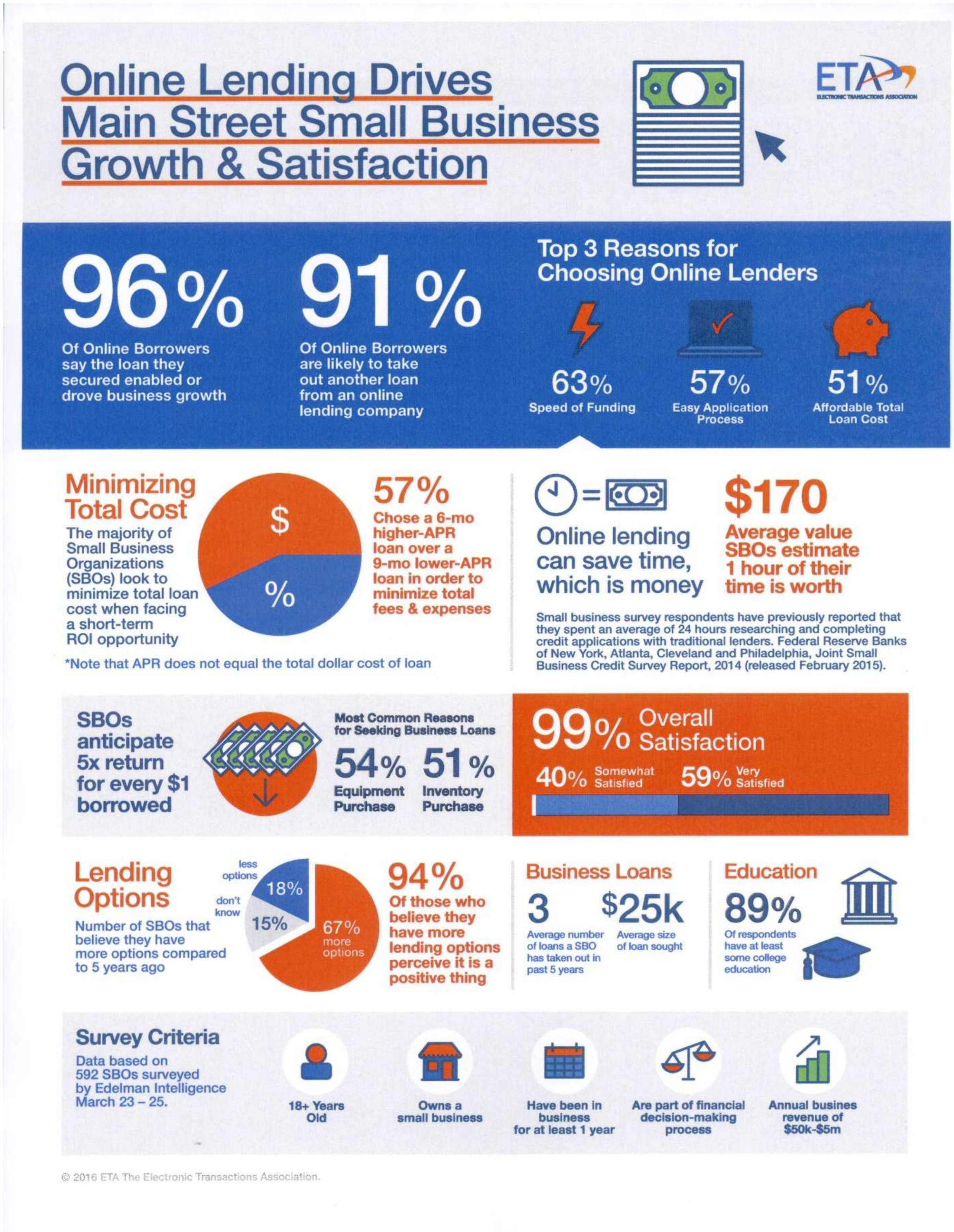
CAN Capital thanks the Subcommittee for the opportunity to provide its input on expanding access to capital through online small business lending and alternative finance platforms.

For various reasons stated above, traditional small business loan programs are not able to adequately serve the capital needs of our nation's small businesses. This is especially true when small businesses need $100,000 or less, which accounts for 90% of small business loans.[31] Companies like CAN Capital and other ETA member companies have been able to address this unmet need by developing data-driven risk and underwriting models and user-friendly technology platforms to quickly and effectively provide small businesses with access to the capital they need to grow their businesses and, in turn, help propel the U.S. economy. Since 1998, CAN Capital has provided historically underserved small businesses with access to over $6 billion in the form of innovative financial products that address their needs for smaller amounts of capital with flexible payment options.

Policymakers should recognize the existing framework of federal and state laws that apply to online small business lending and be sensitive to the risk that additional regulation of non-bank platforms will stifle innovation and competition and rollback the expanded access to capital that small businesses enjoy through platforms like CAN Capital. Accordingly, we suggest that policymakers continue to monitor and learn about the industry and promote further innovation as well as increasing collaboration between traditional bank lenders and non-bank platforms like CAN Capital that can help all participants better address the capital needs of their small business customers.

[31] Office of Advocacy, Small Business Lending in the United States 2013, Victoria Williams, U.S. Small Business Administration, 2014.

Appendix A



Online Lending Drives Main Street Small Business Growth & Satisfaction
ETA
ELECTRONIC TRANSACTIONS ASSOCIATION
96%
Of Online Borrowers say the loan they secured enabled or drove business growth
91%
Of Online Borrowers are likely to take out another loan from an online lending company
Top 3 Reasons for Choosing Online Lenders
63% Speed of Funding
57% Easy Application Process
51% Affordable Total Loan Cost
Minimizing Total Cost
The majority of Small Business Organizations (SBOs) look to minimize total loan cost when facing a short-term ROI opportunity
$
%
57%
Chose a 6-mo higher-APR loan over a 9-mo lower-APR loan in order to minimize total fees & expenses
*Note that APR does not equal the total dollar cost of loan
Online lending can save time, which is money
$170
Average value SBOs estimate 1 hour of their time is worth
Small business survey respondents have previously reported that they spent an average of 24 hours researching and completing credit applications with traditional lenders. Federal Reserve Banks of New York, Atlanta, Cleveland and Philadelphia, Joint Small Business Credit Survey Report, 2014 (released February 2015).
SBOs anticipate 5x return for every $1 borrowed
Most Common Reasons for Seeking Business Loans
54% Equipment Purchase
51% Inventory Purchase
99% Overall Satisfaction
40% Somewhat Satisfied
59% Very Satisfied
Lending Options
Number of SBOs that believe they have more options compared to 5 years ago
less options 18%
don't know 15%
67% more options
94%
Of those who believe they have more lending options perceive it is a positive thing
Business Loans
3
Average number of loans a SBO has taken out in past 5 years
$25k
Average size of loan sought
Education
89%
Of respondents have at least some college education
Survey Criteria
Data based on 592 SBOs surveyed by Edelman Intelligence March 23 – 25.
18+ Years Old
Owns a small business
Have been in business for at least 1 year
Are part of financial decision-making process
Annual busines revenue of $50k-$5m
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Appendix B
The Electronic Transactions Association
Federal and State Laws and Regulations for Online Commercial Lending

Online small business lending platforms are transforming the small business lending market by making it more cost efficient and convenient for small businesses to access the capital they need to acquire equipment, hire employees, and grow. These online small business lending platforms use advanced analytics and technology platforms to lend to small businesses.

Although online small business lending has received considerable attention in recent years as a beneficial and "new" technology, the business model, at a basic level, involves many of the same steps as traditional commercial lending – the marketing, underwriting, closing, servicing, securitization (in some cases), and collection of loans.

In this regard, contrary to frequent references to the "Wild West," commercial online lending is subject to various federal and state laws and regulations. Depending on circumstances, such as the nature of the product, the lending model, and the states in which the loans are offered, these laws may include requirements related to fair lending, licensing, interest rates, credit reporting, and debt collection, among other requirements.[32]

For more information, please contact Scott Talbott, Senior Vice President, Government Relations, the Electronic Transactions Association at stalbott@electran.org.

The following chart outlines federal and state laws relevant to commercial online small business lending.

Law[33]	**Summary**
Section 5 of the Federal Trade Commission Act	Prohibits unfair or deceptive business acts or practices (UDAP).
Equal Credit Opportunity Act (Regulation B)	Prohibits creditors from discriminating against applicants on basis of race, color, religion, national origin, sex or marital status, or age, or the fact that all or part of the applicant's income derives from any public assistance program or the fact that the applicant has in good faith exercised any right under the federal Consumer Credit Protection Act or any applicable state law. Requires creditors to provide notice of the reasons for any adverse action taken on a credit application or existing credit account.

[32] Many lending platforms partner with banks and other regulated entities which fund loans. As a result, online small business lenders are often obligated to comply with the commercial lending regulatory requirements and policies and procedures of such banks.

[33] Application of these laws may vary depending on circumstances, such as the nature of the product, the lending model, and the states in which the loans are offered.

Law[33]	Summary
Fair Credit Reporting Act (Regulation V)	Requires a permissible purpose to obtain a consumer credit report, and requires persons to report information to credit bureaus accurately; imposes disclosure requirements on creditors who take adverse action on credit applications based on information contained in credit reports; requires creditors to develop and implement an identity theft prevention program.
Bank Secrecy Act as amended by the Patriot Act	Requires covered financial institutions to implement anti-money-laundering procedures and customer verification programs.
Economic Sanctions	Requires compliance with economic and trade sanctions against targeted countries, entities, and individuals.
Electronic Signatures in Global and National Commerce Act	Authorizes legally valid and enforceable agreements utilizing electronic records and signatures and requires businesses that want to use electronic records or signatures in consumer transactions to obtain the consumer’s affirmative consent to receive information electronically.
Investment Advisers Act of 1940	Requires investment advisers to meet recordkeeping, custodial, reporting, and other regulatory responsibilities.
Securities Act of 1933 (Public Offerings and Private Offerings)	Public Offerings: Online lenders engaged in the public offering of securities are required to register the securities offerings with the Securities and Exchange Commission, unless the securities or offerings are exempt from the registration requirements of the Securities Act of 1933. Private Offerings: Online lenders may engage in private offerings of their securities, including offerings made in reliance on the safe harbors in Regulation D.
Securities Exchange Act of 1934 Risk Retention Rule	Securitizers or sponsors of asset-backed securitizations (ABS), including securitizers that are depository institutions, are generally required to retain an economic interest equal to at least 5 percent of the credit risk of the assets collateralizing the ABS issuance.
State Lending Laws	Some states have licensing requirements applicable to brokers, lenders, servicers, collectors and investors of commercial loans and leases, including equipment leases and loans, mezzanine loans, mortgage loans, and unsecured loans.

Law[33]	Summary
State UDAP Laws	Most states have “mini-FTC acts” that prohibit unfair or deceptive business acts or practices.
State Usury Laws	Govern the amount of interest that can be charged on a loan.
State Debt Collection Laws	Some states have debt collection laws applicable to commercial finance transactions.
Uniform Commercial Code	Comprehensive set of laws governing commercial transactions.