September 2, 2022

Congressman Sean Casten
2440 Rayburn HOB
Washington, DC 20515

Dear Congressman Casten:

We write this letter to urge you to co-sponsor H.R. 6054 (Velázquez). This bill would give small businesses "Truth-In-Lending" rights like those consumers have when borrowing money. Currently, when a small business applies for a loan, a lender is not required to disclose the loan's Annual Percentage Rate (APR). Consequently, small businesses are getting loans without knowing the cost, or worse, being misled into believing that a predatory loan is actually affordable.

*Predatory Lenders Hide Usurious Interest Rates.*

There is a lack of data on small business lending in the United States. Banks report a limited amount of information to regulators on their small business lending as part of the Community Reinvestment Act (CRA), but financial institutions not covered by the CRA, including online "fintech" lenders, are not required to report data to regulators. Section 1071 of the Dodd-Frank Act ("Section 1071") is intended to fix that by establishing a data-reporting regime for small business lending similar to what has existed for nearly 50 years in the case of mortgage lending pursuant to the Home Mortgage Disclosure Act. The Section 1071 rules proposed by the Consumer Financial Protection Bureau would require lenders to report data on pricing, including interest rate, total origination charges, broker fees, initial annual charges, additional cost for merchant cash advances or other sales-based financing, and prepayment penalties.

In the meantime, to get a better grasp on what was happening in the small business loan market, Woodstock examined 13 small business loan contracts in 2016.[1] We published our findings in a

[1] A lender provided the documents for analysis. No personally identifiable information or names of the borrowers were shared. This is not a random or statistically significant sample. It is only a snapshot.

fact sheet. This chart reflects our central findings, which shows small businesses paying very high rates that were never disclosed to them:

| Lender | Amount Disbursed[1] | Total of Payments | Interest and Fees Paid | Effective Interest Rate | Daily Payment | Loan Term in Days |
|---|---|---|---|---|---|---|
| OnDeck(1) | $17,550 | $24,661 | $7,111 | 75.2% | $97.86 | 352 |
| BizFunds | $20,000 | $27,210 | $7,210 | 43.9% | $71.24 | 530 |
| Can Capital[2] | $18,584 | $24,290 | $5,706 | 48.1% | $79.45 | 428 |
| Can Capital[3] | $18,584 | $24,289 | $5,705 | 36.0% | $59.59 | 572 |
| Can Capital[4] | $18,584 | $24,290 | $5,705 | 60.1% | $99.32 | 341 |
| Capital Alliance | $7,465 | $10,875 | $3,410 | 323.9% | $164.77 | 92 |
| CBSG | $185,241 | $261,071 | $75,830 | 240.7% | $2,373.37 | 110 |
| DirectCapital | $34,800 | $39,554 | $4,755 | 26.3% | $152.13 | 362 |
| Direct Merchants | $14,160 | $19,050 | $4,890 | 116.5% | $135.00 | 198 |
| EBF | $38,830 | $56,000 | $17,170 | 206.4% | $560.00 | 138 |
| Fora Financial | $67,200 | $96,600 | $29,400 | 94.5% | $449.30 | 298 |
| InAdvance | $7,295 | $11,600 | $4,305 | 367.7% | $159.00 | 101 |
| Mantis Funding | $7,304 | $12,320 | $5,021 | 347.5% | $140.00 | 122 |
| Merchant Funding | $23,866 | $37,475 | $13,609 | 346.4% | $499.00 | 106 |
| OnDeck (2) | $57,000 | $75,812 | $18,812 | 41.5% | $200.56 | 378 |

As you can see from the above chart, interest rates vary wildly – from a low of 26.3% to a high of 367.7%![2] Before Illinois adopted a 36% rate cap, the average APR on a payday loan was 297%.[3] Four of the loans in the chart were more expensive than the average payday loan in Illinois. If triple-digit interest rates are allowed, at a minimum, borrowers – whether individual consumers or small businesses – should know what they're getting into.

*<u>Some Loan Contracts Are Confusing and/or Deceptive as to APR.</u>*

The Truth in Lending Act (TILA) enables borrowers to do an apples-to-apples comparison of loans. Without TILA, borrowers are given a confusing hodge-podge of disclosures. In some cases, the disclosures are arguably deceptive. For the sake of comparison, here is a sample of the well-known TILA disclosure box:

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[2] Calculations for this chart assume that (1) payments are made every weekday, with no consideration of holidays, unless loan documents establish a different schedule; (2) interest accrues on the outstanding balance daily; (3) fees are deducted from the amount disbursed to the borrower; (4) if a fixed payment amount is specified as an estimate of the percentage of receipts, the fixed amount was used as the payment; (5) if no fixed amount is specified for payment based on a percentage of Visa and MC receipts (Can Capital), then the estimate is based on three different levels of income. Consult the fact sheet to see the chart's footnotes and additional information.

[3] Ill. Dept. of Fin. and Professional Regulation, *Illinois Trends Report* (11/23/21).

**TRUTH-IN-LENDING DISCLOSURE STATEMENT**
(THIS IS NEITHER A CONTRACT NOR A COMMITMENT TO LEND)

| | | | |
|---|---|---|---|
| Applicants: | MICKEY MOUSE | Prepared By: | The McCue Mortgage Company |
| Property Address: | 1 MICKEY MOUSE BLVD<br>MIDDLETOWN, CT 06457 | | PO BOX 1000, One Liberty Square<br>NEW BRITAIN, CT 06050 |
| Application No: | | Date Prepared: | 02/12/2013 Ph: 800-382-0017 |

| ANNUAL PERCENTAGE RATE<br>The cost of your credit as a yearly rate | FINANCE CHARGE<br>The dollar amount the credit will cost you | AMOUNT FINANCED<br>The amount of credit provided to you or on your behalf | TOTAL OF PAYMENTS<br>The amount you will have paid after making all payments as scheduled |
|---|---|---|---|
| * 4.075 % | $ * 132,349.98 | $ * 188,276.71 | $ * 320,626.69 |

Below are actual examples of loan disclosures under the current system. In the first example, the lender provides no rate information of any kind. The APR on this loan, according to our analysis, is 41.5%, which is relatively affordable compared to some of the other loans we looked at.

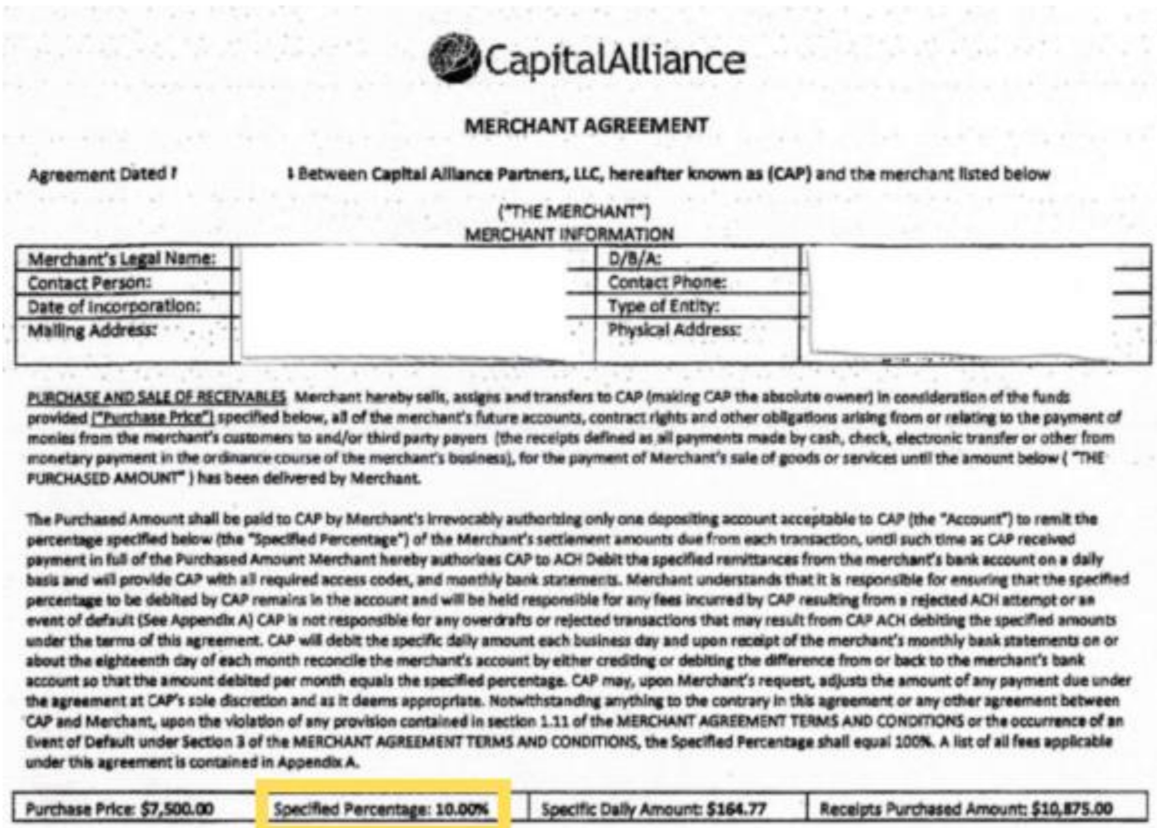
OnDeck

| YOUR LOAN DETAILS | |
|---|---|
| Amount | $57,000.00 |
| Term (months) | 18 |
| Loan Origination Fee | $0.00 |
| Disbursement Amount | $57,000.00 |
| **YOUR PAYBACK DETAILS** | |
| Total Payback | $75,811.68<br>Total payback of $75,811.68 with $57,000.00 in principal and $18,811.68 of interest |
| Cents on the Dollar | $1.33 |
| Daily Payment | $200.56 |
| Number of Daily Payments | 378 |

The Disbursement Amount above is what will appear in your bank account as your loan proceeds, after the Origination Fee is assessed. The Loan Origination Fee is assessed up front and covers the costs of collecting and processing your application.

In addition to the lack of an interest rate or APR disclosure, this loan includes the confusing term "Cents on the Dollar." What this term means is that the borrower pays $1.33 for every dollar borrowed. Disclosure of an APR would almost certainly make more sense to a borrower, and at a minimum the APR would be crucial information for a small business owner to know to compare the prices of different financing options.

Our second example is worse because it is arguably deceptive:


CapitalAlliance

MERCHANT AGREEMENT

Agreement Dated ! ! Between Capital Alliance Partners, LLC, hereafter known as (CAP) and the merchant listed below

("THE MERCHANT")

MERCHANT INFORMATION

| | | | |
|---|---|---|---|
| Merchant's Legal Name: | | D/B/A: | |
| Contact Person: | | Contact Phone: | |
| Date of Incorporation: | | Type of Entity: | |
| Mailing Address: | | Physical Address: | |

PURCHASE AND SALE OF RECEIVABLES Merchant hereby sells, assigns and transfers to CAP (making CAP the absolute owner) in consideration of the funds provided ("Purchase Price") specified below, all of the merchant's future accounts, contract rights and other obligations arising from or relating to the payment of monies from the merchant's customers to and/or third party payers (the receipts defined as all payments made by cash, check, electronic transfer or other from monetary payment in the ordinance course of the merchant's business), for the payment of Merchant's sale of goods or services until the amount below ( "THE PURCHASED AMOUNT" ) has been delivered by Merchant.

The Purchased Amount shall be paid to CAP by Merchant's irrevocably authorizing only one depositing account acceptable to CAP (the "Account") to remit the percentage specified below (the "Specified Percentage") of the Merchant's settlement amounts due from each transaction, until such time as CAP received payment in full of the Purchased Amount Merchant hereby authorizes CAP to ACH Debit the specified remittances from the merchant's bank account on a daily basis and will provide CAP with all required access codes, and monthly bank statements. Merchant understands that it is responsible for ensuring that the specified percentage to be debited by CAP remains in the account and will be held responsible for any fees incurred by CAP resulting from a rejected ACH attempt or an event of default (See Appendix A) CAP is not responsible for any overdrafts or rejected transactions that may result from CAP ACH debiting the specified amounts under the terms of this agreement. CAP will debit the specific daily amount each business day and upon receipt of the merchant's monthly bank statements on or about the eighteenth day of each month reconcile the merchant's account by either crediting or debiting the difference from or back to the merchant's bank account so that the amount debited per month equals the specified percentage. CAP may, upon Merchant's request, adjusts the amount of any payment due under the agreement at CAP's sole discretion and as it deems appropriate. Notwithstanding anything to the contrary in this agreement or any other agreement between CAP and Merchant, upon the violation of any provision contained in section 1.11 of the MERCHANT AGREEMENT TERMS AND CONDITIONS or the occurrence of an Event of Default under Section 3 of the MERCHANT AGREEMENT TERMS AND CONDITIONS, the Specified Percentage shall equal 100%. A list of all fees applicable under this agreement is contained in Appendix A.

| | | | |
|---|---|---|---|
| Purchase Price: $7,500.00 | Specified Percentage: 10.00% | Specific Daily Amount: $164.77 | Receipts Purchased Amount: $10,875.00 |

This loan is arguably deceptive because it has a disclosure box like a TILA disclosure box and a "specified percentage," which could easily be mistaken for an interest rate or APR. An APR of 10% would be considered by many, even by Woodstock, to be an affordable loan. The reality is that the interest rate on this loan is 323.9%. The "specific percentage" is the percentage of revenue from each sale that is to be paid to the lender. Thus, what appears to be an affordable loan is in fact a predatory loan that can be ruinous to a small business that is operating close to the margins.

It is well documented that small business financing companies today commonly quote prices in novel ways that have the effect of preventing price comparison and misguiding small businesses towards higher-cost financing. For example, Federal Reserve researchers conducted a study of small business owners' interpretations of pricing metrics commonly quoted today.[4] The research found that "the non-standard terminology also proved challenging for focus group participants trying to compare online offerings with traditional credit products. For example, when asked to compare a sample short-term loan product with a 9 percent 'simple interest' rate to a credit card with a 21.9 percent interest rate, most participants incorrectly guessed the short-term loan to be less expensive." The actual APR of this 9% simple interest rate product was 46%, according to the Federal Reserve researchers. Indeed, the ability of these "non-standard pricing metrics" to misguide small business towards higher-cost financing may be exactly why higher-cost financing companies utilize these metrics.

*This is a Racial Justice Issue.*

Racial disparities in access to traditional small business credit compared to "potentially higher-cost, less-transparent credit products" make small business Truth in Lending a racial justice issue.[5] Woodstock published five reports in 2017-2019 regarding small business lending by banks.[6] The reports examine the extent to which there are racial/ethnic and/or economic disparities in banks' small business lending. Woodstock found disparities in all the regions examined. For example, in the Chicago region, businesses in low-income census tracts constituted an average of 6.6 percent of all businesses in the region between 2012 and 2014, but they received only 3.5 percent of CRA-reported bank loans under $100,000. Similarly, in the Chicago region, businesses in predominantly minority census tracts constituted an average of 15.1 percent of businesses, but they received only 8.2 percent of CRA-reported loans under $100,000.

The general rule in all regions was that there was an inverse correlation between the racial/ethnic and economic composition of a census tract and the number of small business loans made to businesses in those tracts. This inverse correlation is well illustrated by the following graph.[7] Lending goes down as the percent minority population goes up.

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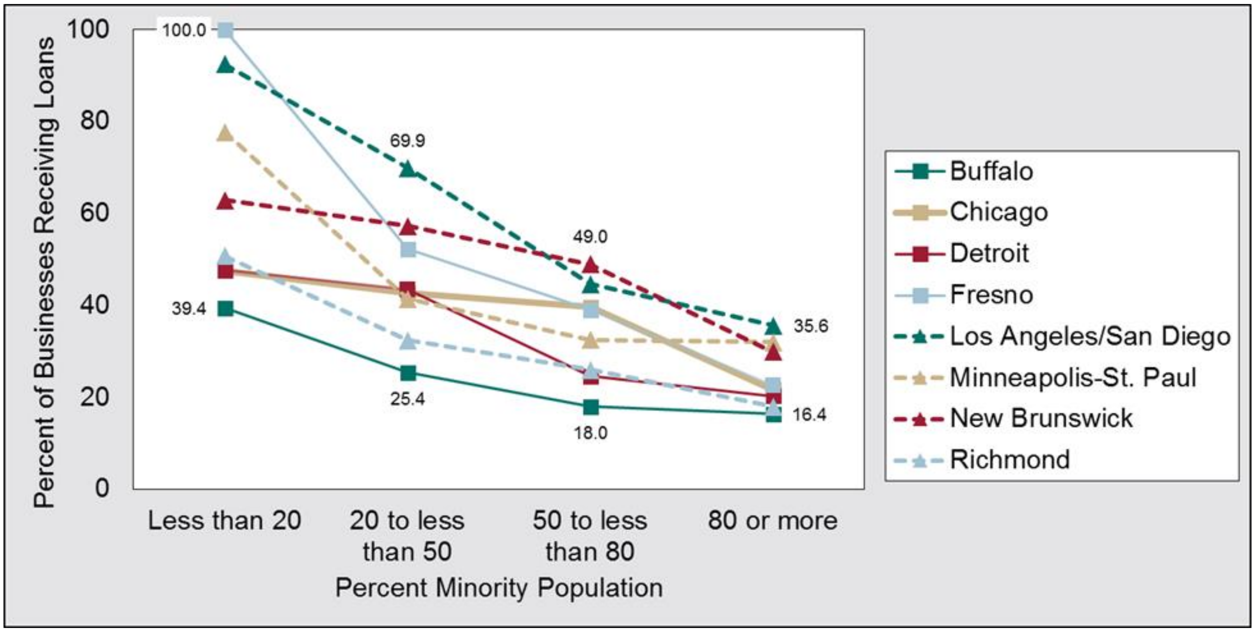
[4] Board of Governors of the Fed. Reserve System, *Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites* (Dec. 2019).

[5] Federal Reserve Bank of Atlanta, *Small Business Credit Survey: Report on Minority-Owned Firms*, (Dec 2019).

[6] Spencer Cowan, Woodstock Institute, *Patterns of Disparity: Small Business Lending in the Chicago and Los Angeles-San Diego Regions* (Jan. 2017). Woodstock Institute, *Patterns of Disparity: Small Business Lending in the Buffalo and New Brunswick Regions* (April 2017). Woodstock Institute, *Patterns of Disparity: Small Business Lending in the Detroit and Richmond Regions* (Aug. 2017). Spencer Cowan, Woodstock Institute, *Patterns of Disparity: Small Business Lending in Fresno and Minneapolis-St. Paul Regions* (Nov. 2017). Lauren Nolan and Brent Adams, Woodstock Institute, *Patterns of Disparity: Small Business Lending in Illinois* (Aug. 2019).

[7] Data source: *See* Spencer Cowan, Woodstock Inst., *Patterns of Disparity: Small Business Lending in Fresno and Minneapolis-St. Paul Regions*, at 32 (Nov. 2017) (citing various sources).




Woodstock's working hypothesis is that these disparities cause a disproportionately high number of small businesses of color to pursue loans from non-bank, "fintech" lenders. Correspondingly, we believe predatory fintech lenders are targeting small businesses of color in the same way that payday lenders target neighborhoods of color.[8] When the Section 1071 rules are finally implemented, we will have the data to test this hypothesis. Requiring fintech lenders to disclose APRs will assist small businesses of color who are, we believe, at disproportionately high risk of receiving predatory small business loans.

*Disclosure Promotes Competition.*

APR disclosure permits a prospective borrower to shop for the best price. Market price competition is impossible if prices are not disclosed in a way that enables customers to comparison shop. APR is simply the representation of the all-in cost of financing relative to the amount of financing provided, over a common unit of time. Thus, APR is the only price metric that enables comparison between products of different financing amounts, term lengths, types, and composition of fees and interest charges. Empowering small businesses to make these comparisons would promote competition, and basic economic theory is that competition leads to lower prices.

To illustrate, a Google search of "affordable used car financing" gives you these results:

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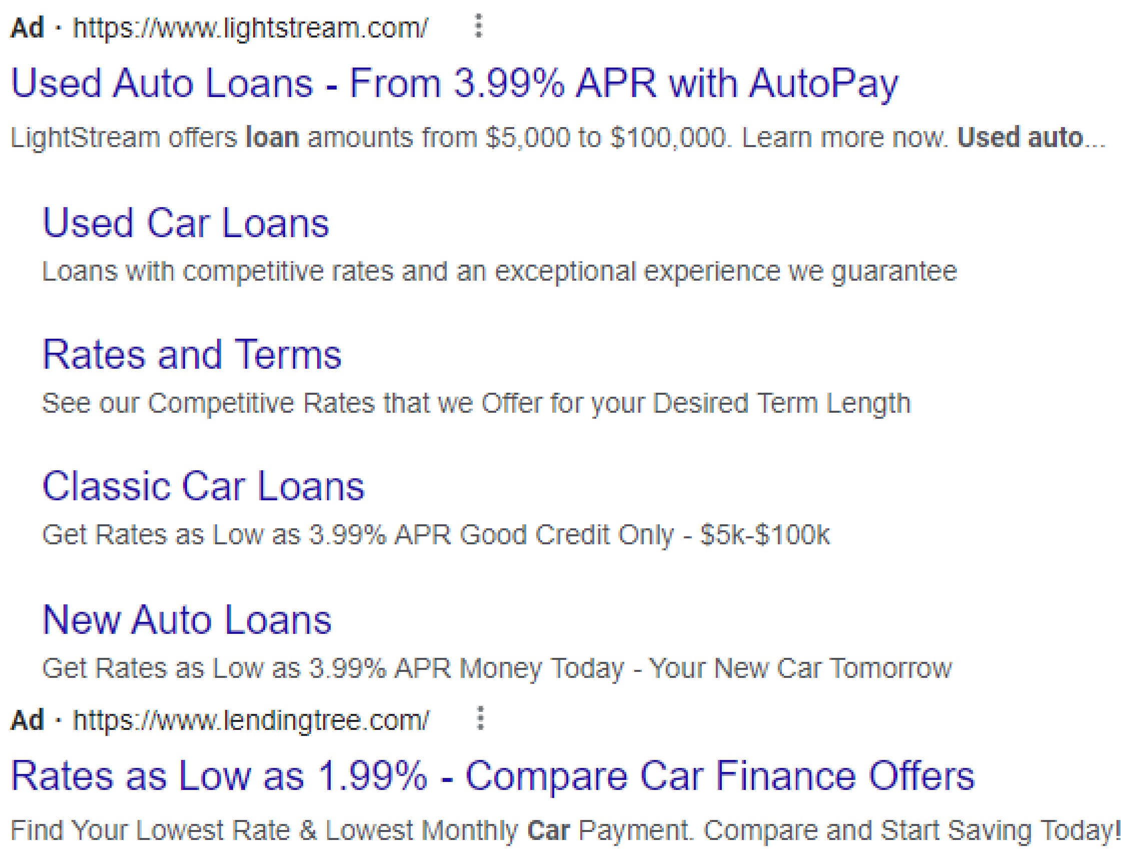
[8] *See* Stephanie Zimmerman, *Chicago Sun-Times*, "High-interest loans in Chicago target Black neighborhoods," (Nov. 26, 2021).




In a market where APR disclosures are required, many lenders use their APR as a selling point. If auto lenders could keep their APRs secret, some lenders would "dress up" their loans to make them appear affordable when in fact the borrower is paying a predatory interest rate.

*Conclusion*

Simple fairness and equity support giving small businesses the same TILA rights that individual consumers have. California and New York have both enacted laws to do this. Even in the case of open-ended loans and merchant cash advances, it can be straightforward to calculate APR, and empower small businesses to make informed business decisions when obtaining financing.[9] We hope you will co-sponsor H.R. 6054. As always, we are available to speak to your or your staff about any questions or concerns.

[9] In the bill, for open-end credit, "the finance charge shall be computed assuming the maximum amount of credit available to the recipient, in each case, is drawn and repaid at the minimum rate."

Very truly yours,

Brent E. Adams
SVP of Policy & Communication