Re: TREAS-DO-2015-0007
Marketplace Lending RFI

September 27, 2015

To: U.S. Department of Treasury

The following comments are submitted by Opportunity Fund in response to the Request for Information on Expanding Access to Credit through Online Marketplace Lending.

Introduction

Thank you to the Treasury for the opportunity to provide input on this important issue. Because we lend only to small businesses, our comments focus specifically on small business credit. Opportunity Fund is a Community Development Financial Institution that has been lending to underserved small business owners since 1994 and is currently the largest non-profit microlender in California. Since the economic downturn and recovery we have seen significant changes to small business owners' ability to access appropriate capital. Since the recession banks simply are not lending to most small businesses, especially those needing a loan of $100,000 or less. At the same time, innovations in lending have opened new avenues to commercial borrowers in the form of online and alternative business finance.

While the growth of alternative small business finance is bringing needed capital to many American small businesses, it is occurring within a regulatory vacuum, which has, not surprisingly, led to a range of concerning lending practices that are harming many small businesses and the communities they serve and employ. In the following comments we will discuss troubling practices we have seen and the need for consumer protections for small business owners. We will also describe what we believe is a role for banks to responsibly support this growing industry as well as a promising partnership with a marketplace lender.

Harms to Consumers and Small Businesses

As a lender, Opportunity Fund has an intimate view into the finances of the small businesses who seek capital from us. As such, we have direct experience with the harmful practices employed by some alternative business lenders and recently have seen a dramatic uptick in the number of entrepreneurs attempting to refinance out of harmful existing business debt. Over the past three years we have worked with several hundred business owners who have at least one (and up to four) short term and high cost cash advances. These small businesses represent typical Main Street enterprises such as restaurants, dry cleaners, and hair salons. Almost all were viable healthy businesses that do not have any indication of needing to resort to harmful business debt. Among these are many businesses that could be considered historically underserved– minority-owned, woman-owned and low-income businesses.

Like sub-prime consumers during the mortgage frenzy that preceded the financial crisis, many small business owners who were without access to financing for a long time now find themselves highly sought after by multiple lenders. Investors excited about the alternative lending space, and hungry for yield, are pushing online/alternative lenders to show the highest growth rates, rather than focusing as they should on credit quality and sustainability. As a result, many of these finance companies seem not to care who they lend to or how much they lend. Unfortunately, the terms of the financing provided, especially within the sub-prime segment are often detrimental to a business's profitability – and even to its survival. On a consistent basis, we are seeing too much capital provided over too short a repayment period, often at a high cost (APRs of 50-150%). Even lenders who are serving a prime or near prime segment are not adjusting their rates downwards to sufficiently account for the lower risk. With both balance sheet and marketplace lenders, the needs of the investors seem to come before those of the business being financed.

The typical cash-advance is one month's worth of gross sales that is repaid over a period of 3-6 months with a cost of funds around 33% ($0.33 for every $1.00). The business becomes unable to service the debt payments, which triggers a cascade of negative consequences such as dozens of Non-Sufficient Funds fees that cost hundreds of dollars, and the propensity to take out another cash-advance as an attempt to reverse the negative cash-flow. Small businesses that have taken out cash-advances have come to Opportunity Fund to seek assistance in getting out of their debt. But sometimes even a mission-based lender such as Opportunity Fund (with a subsidized cost of funds, lower interest rates and longer loan terms) is unable to help refinance the debt, and ultimately the business is forced to shut down. The following is a real-life example of how one business shut its doors after being getting caught in a debt-stacking trap:

By the time the owners of a Southern California bakery, immigrants from Taiwan, contacted Opportunity Fund hoping to refinance its existing debt, the owners were making daily payments of more than $600 to four different high-cost, short-term lenders. The payments ate up more than 25 percent of their daily revenue. For a food business such as a bakery, with profit margins typically around ten percent, that level of indebtedness is simply not sustainable in the long term. Unfortunately, Opportunity Fund was unable to refinance the high-cost debt — even with a much longer loan term. The bakery eventually shut down, putting its 13 employees out of work. In cases such as these — and we're aware of scores of similar examples — each shuttered business represents not just the damaged dreams and credit of the individual owners, but lost jobs, vacant storefronts, and the loss of local goods and services as well.

In terms of resources and sophistication, very small businesses more closely resemble a consumer than a major commercial enterprise. As such, we believe that small business owners looking for relatively small amounts of financing (under $100,000-$250,000) should be afforded the same protections as consumers. Many lenders and brokers utilize deceptive marketing tactics that hide the true cost of their debt and its impact on the cash-flow of the small business. These include the outright misinformation of the cost of the loan, repayment terms and conditions, and hidden fees including broker fees. Furthermore, alternative lenders and brokers regularly market their debt as regular installment term loans when in reality the debt is structured as a purchase of future receivables. Borrowers are never informed of the difference. Some lenders with questionable practices circumvent state regulation by using bank charters in states with lax regulation or by classifying the loans as “advances” to avoid being considered lenders at all. In addition, some lenders deliberately engage in destructive behavior such as the refusal to communicate promptly when contacted by the borrower and the reluctance to allow a borrower to pay off the debt before the end of the term. Such abuses resemble the behavior exhibited by consumer payday lenders.

To address this gap and to promote responsible business lending, Opportunity Fund worked in collaboration with other small business lending leaders to create the Small Business Borrower’s Bill of Rights, available in full at www.responsiblebusinesslending.org. These rights were written to address the most common abuses we have seen. The Small Business Borrower’s Bill of Rights outlines key rights that all small business borrowers deserve and represents the first consensus regarding responsible small business lending practices. The six rights are as follows:

1. The Right to Transparent Pricing and Terms

You have a right to see the cost and terms of any financing you are offered in writing and in a form that is clear, complete, and easy to compare with other options, so that you can make the best decision for your business.

What this means for lenders and brokers:

- Transparent Rate – Disclose an annualized interest rate or APR. Opportunity Fund believes that APR should eventually become the standard for all business lenders.
- No Hidden Fees – Disclose all upfront and scheduled charges.
- Plain-English Terms – Describe all key terms in an easy-to-understand manner, including the loan amount, payment amount and frequency, collateral requirements, and the cost of prepayment.
- Clear Comparison – Present all of these pricing and other key terms clearly and prominently, in writing, to the borrower when the loan offer is summarized for the borrower and whenever a term sheet, offer summary, or equivalent is provided.

2. The Right to Non-Abusive Products

You have a right to loan products that will not trap you in expensive cycles of re-borrowing. Lenders’ profitability should come from your success, not from your failure to repay the loan according to its original terms.

What this means for lenders:

- No Debt Traps – If the borrower is unable to repay an existing loan, extend new credit only if due diligence indicates that the borrower’s situation has changed, enabling them to repay the new loan.
- No “Double Dipping” – When refinancing or modifying a loan, do not add new fees or fixed charges on existing principal.

- No Hidden Penalties – Charge interest only on the time period that the loan remains outstanding. If the borrower pays off a loan early, do not charge interest or periodic costs associated with the remaining period of the loan, unless such costs have been clearly disclosed, prior to making the loan and specifically disclosed at the time of payoff, as a prepayment penalty or fee.
- Pressure Free – Allow borrowers a reasonable time to consider their loan options free from pressure or artificial timelines.
- Prompt Prepayment Assistance – If a borrower seeks to prepay a loan, provide any information required for prepayment within two days of the borrower's request.

3. The Right to Responsible Underwriting

You have a right to work with lenders who will set you up for success, not failure. High loss rates should not be accepted by lenders simply as a cost of business to be passed on to you in the form of high rates or fees.

What this means for lenders:

- Believe in the Borrower – Offer financing only with high confidence that the borrower can repay its entire debt burden without defaulting or re-borrowing.
- Alignment of Interests – Lenders who receive repayment directly from the borrower’s gross sales must also verify, through documents, data from third parties, and/or due diligence, that the borrower can repay all indebtedness and remain profitable, or that it has a credible path to profitability. Lenders must not rely on an ability to be paid, regardless of the borrower’s profitability, to make loans that the borrower cannot afford.
- Right-sized Financing – Size loans to meet the borrower’s need, rather than to maximize the lender’s or broker’s revenue. Seek to offer the borrower the size of loan that they need, rather than offering the maximum amount they qualify for.
- Responsible Credit Reporting – Report loan repayment information to major credit bureaus and consult the borrower’s credit data when underwriting a loan. Such reporting enables other lenders to responsibly underwrite the borrower and helps the borrower build a credit profile that may facilitate access to more affordable loans in the future. Lenders must inform the borrower and any guarantors if they intend to report loan repayment performance to guarantors’ credit bureaus only in certain circumstances, such as after a default.

4. The Right to Fair Treatment from Brokers

You have a right to transparency, honesty, and impartiality in all of your interactions with brokers.

What this means for brokers:

- Transparent Loan Options – Disclose all loan options for which the borrower qualifies through the broker’s services, emphasizing the lowest APR option, and disclose all lenders to which the broker sends loan applications on the borrower’s behalf.

- Transparent Broker Fees – Disclose all compensation paid to the broker, and all charges that will be paid directly or indirectly by the borrower, whether paid up front or financed in the loan.
- Transparent Results – Post clearly and prominently on the broker's website the anonymous and aggregated results of borrowers who obtain financing through the brokers' services, in terms of APR and financing product.
- Empower Borrowers to Make Informed Financing Decisions – Educate the borrower on each loan option and ensure that the borrower reasonably understands the cost and terms as well as the pros and cons of financing decisions before they sign a loan document. Brokers should use tools that help the potential borrower comparison shop, including APRs and loan calculators.
- Disclosure of Conflicts of Interest – Disclose any conflicts of interest, the broker's fee structure, and any financial incentives they have, including whether the broker receives higher fees for brokering certain loans. Brokers who are paid higher fees with certain lenders, loan types, or terms other than the size of the loan, may not state they are acting in the best interest of the potential borrower.
- No Fees for Failure – No fees can be charged to the potential borrower if the broker is unable to find them a loan and if the borrower does not accept a loan secured through the broker's services.

5. The Right to Inclusive Credit Access

You have a right to fair and equal treatment when seeking a loan.

What this means for lenders and brokers:

- Non-Discrimination – Respect the letter and intent of fair lending laws, including the Equal Credit Opportunity Act. Do not discriminate against small business owners on the basis of race, color, religion, national origin, sex, marital status, age, sexual orientation or identity, or any other protected class. Lesbian, Gay, Bisexual and Transgender (LGBT) small business owners deserve the same protection when seeking or obtaining credit.

6. The Right to Fair Collection Practices

If you are unable to repay a loan, you have a right to be treated fairly and respectfully throughout the collections process. Collections on defaulted loans should not be used by lenders a primary source of repayment.

What this means for lenders:

- Fair Treatment – Abide by the spirit of the Fair Debt Collection Practices Act and provide borrowers similar protections as described in that Act.
- Responsible Oversight – Diligently vet and oversee the collections practices of third-party collectors and debt buyers. Do not work with collectors or debt buyers who fail to treat borrowers fairly.

- Accurate Information – Transmit accurate, current, and complete information about the loan to third-party collectors and debt buyers.

As a voluntary effort, all small business lenders and brokers are encouraged to abide by these principles and become signatories. We hope this represents a key step in moving towards greater accountability and transparency in alternative small business finance, and we urge policymakers to consider these principles as well as other best practices such as standardized disclosure formats

Role for Banks and Traditional Financial Institutions

Although the rise in online marketplace lenders is seen as separate from mainstream financial institutions, banks have played and can play an important role in facilitating responsible online business lending in several ways. First, because many online lenders utilize a "rent a charter" model of partnering with a bank to facilitate nationwide lending, banks (and their regulators) could use this role to promote responsible lending. For example, banks should disclose the pricing of any business loans they facilitate for an online lender with the same transparency as loans they make directly. Banks and their regulators should also more closely examine insufficient funds (NSF) fees associated with these products.

Second, alternative lenders access billions of dollars of loan capital from mainstream financial institutions. This relationship between alternative lenders and traditional financial institution represents a risk and an opportunity to help small businesses. Currently, both alternative lenders and financial institutions are enjoying lucrative fees and yields because of regulatory gaps. The use of loan capital from traditional financial institutions to put hundreds of thousands of Main Street small businesses into harmful debt is a systemic risk. Financial institutions should require their alternative lender clients to practice responsible lending by adopting standards.

Third, even though bank approval rates remain very low, the vast majority of business owners still consider a bank to be their first stop in securing financing. Therefore, it is essential to remove barriers that banks currently face to referring loan candidates to other responsible lenders. Currently the only method for a non-bank lender (including CDFIs) to obtain bank referrals post-denial is by becoming an "approved vendor," which is a multi-million dollar investment. Regulators should consider giving CRA credit to banks that are successful at assisting small business applicants from underserved markets in accessing appropriate capital, including through referral relationships—especially automated referral relationships.

Partnerships between Online Marketplace Lenders and CDFIs

In addition to the multi-sector collaboration on the Borrower's Bill of Rights described above, Opportunity Fund has also launched a partnership with a responsible online marketplace lender, Lending Club, to reach more underserved businesses online. The initial pilot for this collaboration will provide $10 million in loans over a period of five months to 400 small businesses in underserved areas of California-businesses that would typically be unable to get a loan from traditional lenders. Borrowers will apply for a loan through Lending Club, and after Lending Club collects the initial application and performs its automated screening, Opportunity Fund will review the applicants. Opportunity Fund will fund qualifying applicants that otherwise would have been turned down and then service the loans, offering business advice and support to help these businesses succeed. When coupled with the expertise of mission-based lenders, marketplace lending has tremendous potential to provide responsible capital to underserved market segments. Therefore, continued support for programs such as the Community Development Financial Institution (CDFI) Fund is critical to support innovative partnerships and ongoing investment in underserved markets.

Conclusion

Done responsibly, the dramatic growth of online and alternative business lending can benefit business owners with timely access to appropriate capital. However, widespread irresponsible lending practices threaten the viability of small businesses across the country. Drawing on best practices such as the Small Business Borrower's Bill of Rights, Opportunity Fund encourages alternative lenders, banks, brokers, advocates and policy makers to work together to educate business owners, facilitate responsible lending and eliminate harmful practices.

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