

Strictly Business: An FTC Forum on Small Business Financing  
May 8, 2019  
Transcript

SPEAKER 1: -- In the Bureau of Consumer Protection at the Federal Trade Commission. Welcome to all of you, and thank you for coming to our forum on small business financing. Before we get started with today's program, I have a few administrative announcements that I'm going to run through. First, please silence any mobile phones. I'd appreciate it if you don't use your phone. But if you have to, please be cognizant of others in the audience.

And also be aware that if you leave Constitution Center this morning, you will have to go back through security. So particularly for our panellists, be mindful of that because it does often take a couple of minutes to get back through. Restrooms are in the hallway right behind me. And I think everyone received a lanyard today when you came in. We reuse these here. So when you're done, please hand them to one of our staff or drop them in a box that we'll have on the way out.

If an emergency occurs that requires an evacuation of the building, an alarm will sound. Everyone should leave the building through the 7th Street exit, which many of you came in. After leaving the building, you'll turn left, cross 7th Street, and then cross E to the FTC's emergency gathering area, where we'll have a sign. You should remain in that area until you receive further instruction. If an emergency occurs that requires you to just leave the conference center but stay in the building, please listen for announcements over the PA system.

Please be advised that the event today is being photographed, being webcast, and recorded. By participating in today's event you are agreeing that your image and anything you say could be posted indefinitely at [FTC.gov](http://FTC.gov) or on one of our publicly-available websites. So that's it for the administrative announcements. So we can start our great program this morning. And now I am very pleased to introduce FTC Commissioner Chopra.

[APPLAUSE]

ROHIT CHOPRA: Good morning, everyone. So I want to thank you all for joining the Federal Trade Commission's Forum on Small Business Financing. Today we're going to examine the regulatory landscape and concerning practices that entrepreneurs and small businesses face. We're joined by a wide range of experts, as well as officials from the Federal Reserve and the Small Business Administration. I want to thank the FTC team that put this whole forum together - Malini Mithal, Sandy Brown, Evan Zullow, Stephanie Rosenthal, Sarah Kerman, and June Chang, and also all of the event planning web team, press office, honors, paralegals, and all of you for being here today.

But before we begin, I wanted to share some broader concerns about the state of entrepreneurship and small business in America, their lack of freedom in negotiating contracts, and the FTC's long role in policing unfair contracts. I'll leave you with several questions that we're going to need to answer as part of this inquiry.

So being an entrepreneur and starting a new business is tough, but it is also what makes an economy thrive. The hard work, independence, and creativity of entrepreneurs and new small businesses helped us grow, innovate, and create wealth in communities across the country. But today, large firms increasingly dominate more sectors of the economy. Not only can these firms use their market power to block entrepreneurs from challenging them, they can also use their power to influence government to protect their incumbency, often, ironically, in the name of promoting small business.

It's getting harder and harder for entrepreneurs to launch new businesses. Since the 1980s, new business formation began its long steady decline. And a decade ago, births of new firms started to be eclipsed by death of firms. According to Census Bureau data analysed by the Kaufmann Foundation and the Brookings Institution, the number of new companies as a share of all businesses has declined by 44% from 1978 to 2012. The stairway to success for entrepreneurs and new businesses are as steep. For minority and women-owned businesses, that climb can be even steeper.

One of the most powerful weapons wielded by firms over new businesses is the "take it or leave it" contract. Entrepreneurs and new small businesses cannot negotiate the terms in these contracts, and the terms usually transfer rights and power to the dominant firm on the other side. To be clear, a fair and thriving economy and society rests on contracts. Contracts are ways that we put promises on paper. When it comes to commerce, arm's-length dealing codified through contracts is a prerequisite for prosperity. But when a market structure requires small businesses to be dependent on a small set of dominant firms, or firms that don't engage in scrupulous business practices, these incumbents can impose contract terms that cement dominance, extract rents, and make it harder for new businesses to emerge and thrive.

For example, entrepreneurs who develop mobile applications face a slew of onerous contract terms imposed by app stores. Sometimes these contracts allow platforms to hike their fees at any time, and impose regulations that limit how businesses communicate with their customers, depriving these developers of the autonomy they need to run their business. Many small businesses are similarly dependent on dominant online marketplaces, which might impose contractual terms that ban merchants from selling their goods elsewhere at a lower price. Small farmers and poultry growers must agree to terms imposed on them by large agribusinesses that restrict their ability to contest their payments when their food is weighed. It's not just tech, retail, or agriculture. The loss of small business freedom when it comes to contracts is no longer the exception, it's increasingly becoming the norm.

In other contexts, a market structure allows firms, regardless of their dominance, to exploit their position through other means, sometimes by deceiving customers. The Federal Trade Commission Act prohibits unfair or deceptive acts or practices, as well as unfair methods of competition. And the FTC has a long tradition of prohibiting unfair contract terms and requiring fair ones, recently, the FTC began to enforce a ban on non-disparagement clauses in contracts that forbid purchasers from posting truthful reviews online about a product or service. There was consensus that these terms harmed consumers in competition, particularly when contracts gave no, quote, "meaningful opportunity" to negotiate.

More than a generation ago, the FTC found that many consumers had no ability to bargain around consumer credit contracts, and that this imbalance was resulting in significant harm to consumers. Based in part on those findings, the FTC developed the Holder Rule, which requires lenders to add a notice to contracts preserving borrowers' legal rights, even if the creditor sold the loan to Wall Street or another lender. The rule has reshaped consumer credit markets, and has been described as one of the most important consumer protections the commission has ever taken.

And even more relevant to today's discussion is the FTC's Credit Practices Rule, developed 35 years ago, which bans a host of one-sided contract terms that require consumers and customers to waive their rights or assign their wages to lenders. For example, the rule bans confessions of judgment, where a borrower must agree to waive any defences if they are sued. In issuing the rule, the commission found that terms like these were the product of an unequal bargain where consumers could not protect their interests.

But the Credit Practices Rule Applies only to consumer contracts. And today we are seeing some small business financing products, particularly those offered online, that include some of the same terms that the FTC barred creditors from imposing on consumers. These terms have led to a flood of questionable legal actions through which creditors seize small business owners' assets.

The FTC is the sole federal regulator and enforcer in the non-bank small business financing marketplace, so we are accountable for cleaning up this market. We will need to determine whether certain contract terms and business practices constitute a violation of the law. And I believe all of us should approach this inquiry with several questions in mind.

First, what are the best sources and methods to assemble qualitative and quantitative data on contract terms and business practices in the market? What can we learn from reforms in other jurisdictions around the world when it comes to unfair contract terms for small businesses and entrepreneurs, such as those recently pursued by the Australian Competition and Consumer Commission?

Second, which contract terms and business practices are likely to be unlawful under the FTC Act, and which practices may be discriminatory under the Equal Credit Opportunity Act? Third, if there are unlawful practices that may be widespread or prevalent across the market, should the agency seek to deter this misconduct by activating civil penalties through section 5(m)(1)(B) or through a rulemaking? Fourth, how should the agency support efforts by state legislatures and regulators that are seeking to promote a competitive dynamic climate for entrepreneurs and new businesses seeking financing?

I hope that these questions can be tackled today during the three panels we will hear from, as well as over the course of the next several months. Today will include an overview of the marketplace for small business financing. It will also discuss potentially problematic products and other risks.

So in conclusion, the Federal Trade Commission will need to play a pivotal role in restoring dynamism and entrepreneurship in our economy to reverse some of the alarming trends that

undermine the values our country stands for. Aggressive enforcement that promotes competition and protects consumers and honest businesses, complemented by rigorous analysis of the marketplace to eradicate unfair contract terms and business practices, is absolutely essential. Today is just the start of these discussions, and we look forward to learning more from all of you today. Thank you.

[APPLAUSE]

MALINI MITHAL: [INAUDIBLE] could please come up. We can get started.

OK, we have a lot to cover this morning, so we'll go ahead and get started. My name is Malini Mithal, and I'm with the Federal Trade Commission. And this is Thomas Kost. He's going to be my co-moderator, also at the Federal Trade Commission.

And this is Panel 1-- an Overview of the Small Business Financing Marketplace. This panel will provide an introduction to the role of small businesses in the US economy, the types of financing products available, and the benefits of these products, as well as recent trends in the financial marketplace.

So we're going to do very brief introductions because we have a lot of ground to cover. So immediately-- I'm not going to get the right and left right. So immediately over here is Claire, Claire Kramer Mills. She's the assistant vice president of the Federal Reserve Bank of New York. Then we have Sam Taussig. Did I pronounce your last name correctly? OK. He's the head of global policy at Kabbage. Next to him, we have Lew, Lew Goodwin, banking services lead at Square Capital. Then Gwendy Brown, the vice president of research and policy with Opportunity Fund. And finally, we have Scott Talbott, the senior vice president of government affairs at the Electronic Transactions Association.

So to kick off our panel, I'm going to start with what's a very basic question. But can you all talk about what the importance of credit and financing is for small businesses. I'm going to start with you, Claire.

CLAIRE KRAMER MILLS: Sure. And I'll just preface any remarks with the following disclaimer-- the views I express are my own, and do not necessarily represent those of the Federal Reserve Bank of New York or the Federal Reserve System. With that said, so small businesses-- and I think just to level-set, we're talking about, here, both non-employer firms, solo proprietorships, as well as firms that have employees on payroll. They need funds to fuel day-to-day operations, and they also need funds for expansion and growth. And you know, for the last couple of years, the Federal Reserve has had surveyed, regularly, small businesses. And when we asked about financial challenges that they've experienced in the last 12 months, they regularly tell us that they have challenges funding operating expenses. So I think a big concern is this daily flow and management of cash.

MALINI MITHAL: Sam.

SAM TAUSSIG: Thank you. And good morning, everybody. And thanks for showing up to visit with us before 9 AM. I also do have to preface some comments. I do represent the views of Kabbage, but I will try to distinguish when I am representing my own personal views. My regulatory attorneys would like me to remind you that I'm not a lawyer, and that any loans I refer to today are actually made by Celtic Bank within the Kabbage program, member FDIC.

Now, with that being said, our business at Kabbage is serving the small business credit needs. And our customers are typically five to seven employees, truly mainstream American small businesses, that are looking for project-based financing, often referred to as working capital. And about 27% of them don't receive the funds they need to grow. And the average small business, according to our research, only has about 27 days of cash flow on hand. So if you, as a small business owner, need to seize an opportunity to expand your revenue, or a one-off event, such as your freezer in your ice cream store breaks, it's very difficult to access that capital quickly to get back to business or to grow your business. And that's where non-bank fintech platforms like Kabbage have stepped in to facilitate that access to credit.

And we'll get much more into the needs of small businesses as we go through this panel. But again, thank you for joining us this morning.

MALINI MITHAL: Lew.

LEWIS GOODWIN: Thank you. And I'm here with Square and Square Capital. And the disclaimers are the same. So look, as you all know, I mean, small businesses are the lifeblood of the US economy. 48% of the total population is employed by small business. And so it's just a huge factor here. And their access to capital is such a critical need. And in Square, we deal with a lot of small and microbusinesses. And the challenges to capital, I think, are even tougher, because their access to capital is usually your friends and family. And friends and family, that's a tough bank to go back to time after time.

And so in our research, we found that 70% of the small businesses that go out and try to get financing are not able to get what they want or need. So it's certainly an acute problem that we look forward to talking to on this panel.

GWENDY BROWN: Good morning. I'm Gwendy Brown, with Opportunity Fund. And I'd like to speak to, in addition to the role that small businesses play in providing jobs for many Americans, the role that small businesses play in providing income for those small business owners. Particularly for low-income minority and women business owners, access to capital is a tremendous problem in our country. And access to quality responsible financing is essential in order to really make ends meet and provide for their families through their small business enterprise. So therefore having access to capital is really why we're all here today.

SCOTT TALBOT: Thanks. Good morning. Scott Talbot, I don't have any disclosures. I am a lawyer. But I appreciate this opportunity. I think-- real quickly, I think it's important to recognize that, excitingly, the market has changed. And we're sitting here because there is a host of new products available that fintech has helped deliver and created new opportunities for financing for small businesses, whether it's through the companies up here, merchant cash advances, I know

we'll talk about later, which have been around for a little while. But these products are exciting, and the marketplace has created them to help serve customers, which is fantastic.

And it's especially important for all the reasons already mentioned. But when you look at what the companies, small businesses, do with this capital, the economic output is fantastic. We did a survey of large ETA members, and we found that, out of \$10 billion lent over a two-year period, it generated almost 400,000 jobs and \$12.6 billion in wages in local economies. So there is a multiplier effect here of delivering capital to small businesses who are going to put it to work and help our economy.

MALINI MITHAL: Great, thank you. OK, so something that was coming up in our answers is a little bit about the profile of a small business. I think, Sam, you mentioning that many of your companies that you deal with have five to seven employees. I know Gwendy was talking about women and minority-owned businesses. So let's talk a little bit more about the profile, anything you want to add to that. And I'll start with you, Sam.

SAM TAUSSIG: Sure. Thank you. Yes, so the Kabbage customer base is interesting, because we offer a line of credit between \$2,000 and \$250,000, that the borrower is able to select exactly how much they want to access. And that capital is accessed on the basis of a term loan. That term loan is 6, 12, or 18 months. So within the \$2,000 to \$250,000 range, you can imagine that we have a couple of different stratifications of business types. But overall, they are about five to seven employees that are operating in every sort of NAICS code or retail sector and SIC code that you could possibly imagine.

You know, on average, they're looking for return on investment capital. At the higher end of the scale, we have customers that are accessing that \$250,000 line. Those are much more mature businesses. You're looking at closer to the \$1 million revenue line, though typically not over. You're looking at 11 to 12-plus employees, typically concentrated in high-input or high-investment industries such as custom manufacturing, particularly in the Midwest.

I will say, though, that within our profile, it's very interesting to look at the distribution. The Kabbage program operates in all 50 states, and as I said, across all retail and other industry segments. But we have an incredibly diverse portfolio of small business owners. Because the application is entirely protected-class blind, we don't really know the race or sex of the borrower. We know they're not a terrorist or violating other AML/KYC/KYB issues, but those customers come to us in sort of a selection bias, because they don't need to present documents or sit before a banker. And by the nature of that kind of anonymous program, we've developed a really, really diverse profile across the country.

MALINI MITHAL: OK, thank you. Claire, I think you have some things to say on this.

CLAIRE KRAMER MILLS: Sure. So just to kind of level-set, and just speak broadly about the small business population, roughly 80% or so of small businesses are sole proprietorships. Of those firms that have employees on payroll, 55% of them, give or take, have 1 to 4 employees. So by and large, small businesses are in fact small. And by and large, their credit and their financing needs are small. And this is not to underestimate the gazelles and the fast-growth

companies that we want to make sure are financed, but just to give you a sense of where the market is. We've found in our research that typically most small businesses with employees need roughly \$100,000 or less in financing. Roughly 2/3 need \$250,000 or less.

And I think, to speak to some points that have already been raised, that's increasingly a tough market for traditional banks to serve, for a variety of reasons. I mean, we'll touch on that later. But there certainly has been-- if you marry sort of need and where the borrower is at this point, there's certainly opportunities-- and very wide ones-- for innovations in the marketplace.

MALINI MITHAL: OK, great. And I don't know if anyone has anything to add about the role of minority and women-owned businesses. I think, Gwendy, that's something you were bringing up.

GWENDY BROWN: I think I'd just like to speak to more informal businesses, traditionally sole proprietors or very small employers. What we often see is that they've really mingled their personal and business finances. They've started with personal credit cards, possibly with home equity. And as they build their business, they begin trying to access business products. But ultimately, until they get quite formalized, their business and personal finances are intertwined. And they really see consumer and business credit as both options for them to consider to grow their business. So they're not kind of completely separate. And in the same way, many lenders and financing companies are looking at their personal credit as well as perhaps their business credit as well.

MALINI MITHAL: Claire, did you have--

CLAIRE KRAMER MILLS: In our survey, in the Fed survey, we find that 50% of small businesses are using exclusively their personal scores to secure financing for their business. Another roughly 30% are using both personal and business scores. Certainly when they go to traditional providers, personal guarantees are pretty standard for term loans. They're also using, at roughly equal levels, personal assets and business assets to secure financing for their business.

MALINI MITHAL: And can anyone speak to kind of the sophistication of the small business owners that are seeking financing?

LEWIS GOODWIN: I'll take a go at it. First of all, I mean, as far as sophistication goes, I think people that are in small business and these sole proprietors really understand their dilemma. They really understand their cash flow from hour to hour, much less week to month. And so I think it's very important for them to understand how they can solve some of their liquidity and cash flow issues. And that is so important when you are trying to make it day to day.

It is also important that when you get financing, that it isn't some sort of an arrangement that would take all of your earnings, kind of a bullet type of a situation where you have to pay back everything at a certain point. Square's business makes it so that the payment is generally always under 15% of what the inflows would be. And square takes payments on its loans on the business's daily receipts. So as they sell, they would pay back their loan. And I think it's very important that you can help these small businesses to see what is available to them for financing.

SAM TAUSSIG: So I think we're dancing around an interesting point that I just want to make really clear. There is a very important difference between consumer credit and commercial credit. And we spend a lot of time educating policymakers on this difference because of how the laws and the regulations are actually applied.

But if you really look at what a small business customer is trying to do, in the real world, certainly for the Kabbage customers, they're trying to buy equipment, purchase inventory, boost marketing. All of these things are in search of a return on investment. And that's very important to understand. Small business owners-- sole proprietors, one to two employees, five to seven employees, 100, 1,000 employees, they're looking to invest and grow their business or recover from an event. And that is a return on the investment, and that's a return on the capital. Whereas compared to the consumer credit, typically-- not always, but typically-- is used for consolidating previous debt or purchasing depreciating assets that don't necessarily return that return on capital.

And so when we look at the sophistication of small businesses, we do look at necessarily how they're using their credit and what they want to use credit for. We at Kabbage are leveraging the cash flow underwriting data, similar to what my colleague at Square was just referring to, to underwrite the business. And so our seven-minute application process that leverages the underlying existing business data, such as bank account data, credit card receivables data, accounting inventory, shipping inventory, et cetera, is looking at the fundamental underlying transactions of that business to make sure that if the Kabbage program were to inject additional capital into the business for whatever that business wants to do to grow, they can sustain and service that debt. And that's very important to understand.

GWENDY BROWN: I'd like to just add, as far as sophistication, that what we find is that our business owners are sophisticated when it comes to their specific business. If they're a florist, they know flowers in and out, as well as their suppliers, and on and on through the industries. What they're not experts at is the landscape of small business finance, which where we're talking about today. And I think it is important to acknowledge that regardless of their level of sophistication, even if they have MBAs, we've had many people come to us really unable to fully understand the terms of different financing options presented to them. So sophistication as a business owner does not necessarily equate to sophistication in terms of being able to assess financing options available.

CLAIRE KRAMER MILLS: Just one quick thing that I would add there in reference to the points that have just been made, we ask a series of questions that ask borrowers about why they chose particular financing options and particular lenders. And I would just say, broadly, I agree with you, Gwendy. I think the nuances of different financing vehicles may just not be terrain that an early-stage entrepreneur has faced before. And so those are those are really challenging circumstances for them. What they do understand, though, I think, is a broad appreciation of trade-offs that they're making, that I may be-- I'm going to pay in cost for a speedy decision. And there's a trade-off there, right? I want the funds tomorrow, and I'm willing to pay maybe a higher APR for that, or other associated fees and costs. So I do think, generally, they get the broad contours. But I think the devil is sometimes in the details.



SAM TAUSSIG: And it's reflected amongst the customer base. So a third of our customers in the Kabbage portfolio could go to a bank and receive a funding option, but they choose not to because they don't want to wait seven-plus business days. Another third of our customers have been rejected from a bank, on average, two to three times, and come to us for that value of cash flow underwriting because we can look at a more holistic, more detailed scope of what their business activities are. And the other third sit somewhere in the middle, of, they probably could go to a bank, they might be denied by one, but could shop around to another. But again, that time to funding and how long it's going to take to fill out the paperwork and deal with a loan officer is just not worth it to them if they need to capitalize on a very important, very quick business opportunity.

SCOTT TALBOT: Yeah, just to follow up, in our surveys, we found that almost 90% of them have college degrees. And they are excited about the number of options that are available to them now. Especially when you go back five, 10 years, they didn't have them. And we find that the level of education and understanding of finance of the options is increasing. And what they are good at, though, is taking-- understanding their business. I agree with Gwendy. And then the ROI that whatever that financing option is will help them provide. So whether it's flowers for Mother's Day, whether it's beer for St. Patrick's Day, whether it's ice cream for the summer, they get that, if they have x dollars, they are going to generate y returns. And that is an inherent decision that helps them figure out, yes, I need funding, and this is how I'm going to help get it-- within the options, this is how I'm going to move forward with it.

THOMAS KOST: One interesting trend that we might want to talk about more-- and it's been mentioned here-- is that banks are offering fewer loans to small businesses than they have in the past, especially smaller-dollar loans. Claire, would you mind providing some detail on this trend.

CLAIRE KRAMER MILLS: Yeah, so regulated institutions are required to submit data on their outstanding balances. So we look at reports from the FFIEC. And when you look at outstanding loan balances-- and our proxy for this, it's not perfect, it is loans under \$1 million are taken as proxies. I know, everyone is smiling because we know that \$1 million is a high bound-- are taken as proxies for small business loans. And loans in excess of a million are taken as loans to large businesses.

And when you look at sort of-- I wish I had a visual, but if you can just bear with me and kind of look at this, these are the big loans and these are the small loans, small loans have basically remained relatively flat. They are not yet back quite to pre-crisis levels. On the face of it, it's quite a stark graph when you look at it. The one thing that I would say is that tells us about the supply, the outstanding stock of loans. It doesn't necessarily tell us the story of, is that stock meeting the demand of the borrowers or potential borrowers. And I think, there, our survey research does lend some insights. We find, I think-- we're all doing our own surveys here on this panel, but I think we all probably would agree that we do perceive, and our respondents are telling us that there are salient gaps.

So roughly 50% of firms that we survey tell us that they have a funding shortfall of some sort or another. That is more stark when you look at women-owned businesses, black or African-

American-owned businesses, and Latino businesses, most stark, I should say, for black and African-American-owned firms.

THOMAS KOST: And Gwendy, do you have any additional thoughts on the role that the banks are playing or should be playing?

GWENDY BROWN: We've done some analysis that suggests that the gap could be as large as \$87 billion. So really looking at small business, we're talking about a really meaningful and sizable gap. I mean, I think, ultimately, Claire spoke well to it about kind of the lines. And ultimately what has happened is that larger loans are more profitable and smaller loans are hard to do, and hard to do well. And so ultimately I think there is a role for technology in making sure that the cash that small businesses need can get into their bank accounts more quickly. And so I think the balance is really making sure that banks are playing a role in providing capital and providing capital to responsible players, and in really utilizing their networks and their branches to ensure that all of those businesses that are going to them are accessing quality capital, whether it be through them or through trusted partners.

SCOTT TALBOT: Yeah, just to add onto that, I think if you go back 10, 20 years, our parents' or grandparents' days, the old days, bringing all your materials into a loan officer, having that be reviewed, waiting a long time to get a result, and maybe it was positive or negative, and then you had to get a check for disbursement of the funds. That took a long time.

Fast-forward to where we are now. With the new products that are tailored to the cash flow, we see smaller loans. Average loan size can be \$30,000 to \$50,000, somewhere in there, with a decision made, as Sam said earlier, in minutes, based on electronically-submitted data. That is exciting opportunities. And banks, for them traditionally, the cost of underwriting a loan, whether it was \$5.00 or a million dollars, was the same. They had to go through that same process. So they tend to favor, as Gwendy pointed out, the larger loans.

In this new environment, however, we see that traditional banks are partnering with online small business lenders to help white-label their products so that they can serve that customer that walks into their branch that fits that small business profile that traditionally might not have been their ideal target customer. But now, through these partnerships, the banks are able to help provide that capital. And that's an exciting development, another one in the space that I think is worthwhile, worth noting.

LEWIS GOODWIN: And for Square, again, our customers run the gamut, but many of them are very small. Our average loan size is between \$6,000 and \$7,000. And that is just not economically feasible for a bank to go out there and do it, to Scott's point that it takes a lot to underwrite either a small loan or a large loan. And so what we do is we look at the underlying Square data, the cash flow that they are running through their business and through Square. And we're able to actually offer them, even without them asking for it or applying, we're offering them some credit that's in line with what their current cash flows, in a real-time basis, look like. And so it is quick and immediate, and you get the payment the next day, like Sam talked about.

SCOTT TALBOT: I'm sure we'll talk about later, but the repayment options have also modernized. In the old days, you had to make a payment on the first of the month. Your PNI was due. That was it. Now you see new payment options, as well as terms that are shorter or longer, with various structures based mostly on cash flow. If the small business does well, has a lot of receipts that day, then their repayment is the same percent as if they had a terrible day, versus that fixed repayment term which could loom large over small business, especially if they had a rough month or if they were seasonal. If you only did ice cream sales in summer, you had a tough time getting through the winter and fall months. But now with these new repayment options, these new products, we're able to serve that market better.

THOMAS KOST: So at a high level, it sounds like we've been talking about the fundamental shift that's happened from banks to online lenders providing capital to small businesses. I think, Claire, it might be helpful if you could kind of quantify the shift over the last few years, and talk about if there has been an increase in small business use of online credit products, what that looks like.

CLAIRE KRAMER MILLS: Yeah, sure. So I can speak to maybe two things that we're seeing in our data. And just by way of background, so the Federal Reserve banks, in partnership with roughly 300 organizations across the country, field an annual survey of small businesses. And what that enables us to do, we've essentially created an intelligence network that provides us insight into a deep dive into financing needs and experiences on the part of borrowers. And so what we're seeing from that is that, first, there's definitely, as you suggest-- and I think we're all sitting here for a reason-- there has been a growing interest and awareness of online providers of financing.

So we've looked at this over the last couple of years, and in our most recent data from 2018, roughly 32% of applicants did file an application at an online lender. Now, that doesn't tell you that they ultimately ended up deciding to take the financing from that provider, but that has trended upward over the last couple of surveys. That said, when you look at the marketplace, and you look at where borrowers or potential borrowers most frequently apply for financing, banks large and small-- and particularly large-- are really still very critical players. Which I think-- Scott, you highlighted the growing partnerships between traditional and new players. And I think that that's really an important point to make, that this isn't necessarily one or the other. They're both providing in tandem. And we're seeing some interesting partnerships, I think, across the board.

MALINI MITHAL: OK, and I think we've all been kind of touching upon this in some of our answers, but let's talk a little bit about the benefits of online financing products. Why do small businesses typically seek these out? And I think that is something that's coming out. But let's just kind of add to the discussion about what are other benefits we're seeing.

SAM TAUSSIG: Sure. Predominantly, it's the direct-to-business owner experience, the opportunity in the cash flow underwriting context at many fintech platforms, to leverage the data that you're already creating through purchases, transaction, inventory logging in your business, to quickly and easily apply for credit options. It's really easy to use.

And then on the product side-- so that's the application experience side, which is very important-- but on the product side, as Scott alluded to, there are many, many more flexible, more dynamic short-term capital options that allow the business to tailor the credit product to this specific project that they're trying to build or achieve in their business.

And that's important. So if you think about how credit used to be applied for and doled out from a bank, you'd go to a bank, you'd wait a long time, as we described, and you would be given essentially a lump sum. And so you, as a small business owner, you may have a debt capacity of, let's say, \$55,000. You really only need \$12,000 for this very specific project. You go to the bank, the bank says, look, you've been banking with us for a long time. We have some fixed costs and some marginal costs. We really need you to take \$20,000. I know you only need \$12,000, \$12,500, but this is what we have for you, you can take it or leave it.

And that leaves the small business in a very precarious place. You don't want to have them carry more debt than they need to. And that's why these more dynamic products that allow the customer to vary the time for which the product the debt is out and take exactly what they need, when they need it, is really important and really a huge benefit to the business. And much like Square, our average draw from the line of loans to initiate a term loan, is between \$6,000 and \$7,000. And so you're looking at small businesses that are making these very specific investments in themselves and their businesses to achieve that return on investment.

But it is important to understand that online small business financing is only one part of the entire credit ecosystem. I don't compete with community banks or SBA programs that are offering million dollar or \$800,000 loans that allow that small business to buy their competitor or open a new warehouse. We work together with those programs for the small businesses' kind of credit suite, as opposed to directly trying to compete with them. And specific to the business, the yields bear out the benefit. I mean, we did a study with ETA that shows that for every dollar that Kabbage deploys, it generates about \$3.79 in gross economic output, on average, across American communities. So that's real money that's being invested in the business and reinvested into their communities.

LEWIS GOODWIN: Yeah, and I'll second that, what you're saying, Sam. The borrowers may-- we will give them a slider. So they may be eligible for up to \$20,000 but they can slide it down and see, well, I maybe only need \$10,000. So they can slide it down, see the terms, see the repayment, and it helps them size their deal easily for that specific project. And so I think it's important to be able to always be out there to your customers. And in our case at Square, we are offering them-- if they are eligible, we are offering them, and then they can see it, in what we call their dashboard, on a monthly basis. And they don't have to try to go out there and apply for that until they need it.

And so that offer changes as their business changes, both positive and negative. But it is there. And they can go and access it when they need to. And that's allowed us to, over the last 3 and 1/2 years, give out 700,000 loans for a total of \$4.5 billion. And so we also don't think we compete with community banks or large banks, because we fill a void that just has not been available to these small and microbusinesses.

THOMAS KOST: I think, at this point, it makes a sense to maybe do a deep dive into the particular business financing products that your organizations offer and those that are available in the marketplace, and talk a little bit about their specs. I will say that we'll reserve any discussion of MCAs, just out of deference to the next panel, which is doing a case study on them.

GWENDY BROWN: If I could just speak quickly to kind of the benefits of fintech, we are a non-profit microlender and have partnered with several fintechs in order to really ensure that customers that they can't serve can get access to quality financing. And so we're very, very supportive. That said, we also have seen a number of concerning practices, which I know future panels will talk about, but want to make sure that those are at least brought up here as well since this is an overview.

One key one is lack of transparency around terms and pricing. It's a real issue. We found, in a study we did, that the average APR business owners found when they came to us seeking to refinance-- I'm sorry, the APR that they had when they came to refinance was 94%. They were not aware of this fact. And second, we also see some other concerning practices. We see, in many cases, something called double dipping, where business owners are being charged twice for the same capital or stacking multiple products on top of each other.

So I think that, for all of the benefits that this technology can bring, at the same time, it's very important to acknowledge that, in many cases, business owners are taking on more debt than they can afford it, at quite high rates.

SCOTT TALBOT: Can I just add on, to the benefits, Thomas, I think one thing that is important to note is these new products have developed new tools for underwriting as well as the ability to look at other or alternative sources of data that, in the past, had not necessarily been considered by traditional borrowers, not just the speed to do it, but the ability to see deeper into the small business by using FedEx receipts, for example, to track their inventory and their sales. These new data sources give the lender the ability to see deeper into the small business, and therefore have a better evaluation of their creditworthiness, which decreases the risk of default and increases the risk of payment. I think that's an important benefit. Because ultimately it's going to end up increasing the amount of credit. If previously you didn't have this data, now you have it, you can better understand the borrower. And that will increase the amount of money that's available.

Real quickly-- I won't get into it too much, but just on Gwendy's point about APR-- I think APR is an important tool, but you have to understand the limitations to APR. It's an annualized metric which works well in the traditional loan senses that we're all used to, a 30-year fixed, maybe a seven-year car loan. But it's an annualized metric, so it has its weaknesses when you look at the short-term nature of these loans. There is a mathematical inverse relationship between the length of loan and the APR. So if I borrow for Mother's Day flowers, and repay it the next day, on an annualized basis, that's going to be very high APR. If I were to hold that money for a longer term, the APR would come down over time. So it's important to understand the weaknesses or the way APR is structured when you talk about APR.

Given all that we've talked about in the small businesses understanding of their business, and their business needs, and their cash flow needs, there's another metric out there that we think makes sense-- and we've surveyed this, and the results are positive-- and that is total cost of capital. If you're a small business and you say, I need to have this much money for Mother's Day to sell flowers on Mother's Day, I know I'm going to make x dollars, and you tell me I'm going to borrow \$10,000 and pay \$2,000 in interest, I'm less focused on what the APR, how that product fits into that mathematical formula, and more interested on that \$12,000 is going to generate me \$20,000 in flower sales.

So total cost of capital is one metric that is useful in this context, and deals with some of the challenges that APR presents. And it's also, given the way small businesses think about their financing needs, right on point for what they are looking at when evaluating financing options. So I don't want to get into the whole APR thing, but I thought that was interesting to point out.

CLAIRE KRAMER MILLS: One final point that I just want to make, to zoom out a bit, we had an earlier discussion about the demographics of business ownership. And I think it's really important, in the context of sort of new credit decisioning, to point out that there's been a big discussion about decline in entrepreneurship, not as many startups and so forth. But when we look at who is starting businesses at the highest rate, I think it's really important to consider that one in four new businesses is owned by a Latino. Black women entrepreneurs are the fastest growing component of small business starts.

And when you think about traditional underwriting, and there are requirements of term loans, you need two years of tax receipts, minimum, you need collateral, you need a variety of other assets. And when we're talking about populations that may not have historically had that depth of assets, this new decisioning, I think, offers real opportunity as we look at the changing demographics of entrepreneurship. So I think there is promise as well as some of the storm clouds that folks have alluded to.

SAM TAUSSIG: And that's a depth of both personal and commercial assets. And there--

CLAIRE KRAMER MILLS: Because there's an alignment with what industry is businesses are concentrating in.

SAM TAUSSIG: Right. And there has been a move, with many fintechs, to move away from looking at and leveraging personal or consumer credit qualities or scores because of the potential racial bias or other projected class bias that's encoded into those consumer credit scores. But also just the relevance to the business-- we find, more often than not that a commercial consumer credit score is not correlative to our small businesses' success rate. Because they're leveraging their consumer credit so much to start their business, they have actually have real sweat equity in it then.

LEWIS GOODWIN: Yeah, and I'll back that up. Because again, we do not even go to FICO scores. We don't consider those. Because in many cases we believe that, as you're starting a small business, you've really put pressure on your personal finances, and you probably ruin them to some extent if you're going to get credit. And so what we look at is truly your business in real

time, what it creates, and what it generates. And that's how we will offer a loan product. And we don't take collateral, we don't take personal guarantees, we're going on the sweat equity you talk about that you're putting into that business. And this is their livelihood. And this is how we judge and make our credit decisions.

SAM TAUSSIG: Likewise, ironically, the Kabbage co-founders totally tanked their personal credit to start Kabbage.

[CHUCKLING]

THOMAS KOST: Thanks. I think, now that we've talked a lot about underwriting, maybe it makes sense to talk about product terms a little bit more. And I'll just go down the panel, especially with our lender panelists, and ask if you can describe the products that your companies offer, focusing on things like costs, and term, and repayment, whether you require collateral or personal guarantees. I know we've touched on some of this. But it might make sense to have that discussion all at once. Sam, I'll start with you.

SAM TAUSSIG: Sure. So the Kabbage product, as I've somewhat described before, is fairly simple. Again, it's a line of loans, which seems complicated, but it's a line of credit that the customer qualifies for. And we work with that business over time to adjust. So a small business can qualify for up to \$250,000. But for illustrative purposes, let's say this flower shop-- because flowers are really expensive-- this flower shop qualifies for \$100,000 in credit. That offer is live, and they can come back at any time and look at the offer. The offer will adjust over time, and grow with that business. And so their line of credit qualification may grow to \$110,000. We typically like not to decrease that for small blips. But over a period of time, if that small business is showing decline, we will downgrade that line of credit to, let's just say, \$90,000.

But with that \$100,000, a small business can draw on that line of credit as a discrete term loan for six, 12, or 18 months-- their choice-- for whatever dollar amount they want. So they literally type it in on their phone, \$6,222, and draw that for the term they want.

We work on a monthly fee structure. So we keep it as simple as possible for the customer. You pay on the last day of the month-- or you can kind of choose your own day, actually. And we tell them exactly how much you're going to pay on each day for the entirety of the six, 12, or 18-month loans. And again, as I said, the average draw is about \$6,000.

We do see repetitive borrowing in our portfolio, which is unusual for many lenders. Most lenders have a one-time and maybe, at best, a once-per-year interaction with their customers. But because our customers are drawing only what they need, when they need it, for discrete projects, we see them return, on average, about two times per year, and a couple more times throughout the life cycle of their business with Kabbage to borrow for those discrete projects.

And I'll be quick here, but last year, we put out about \$2 billion, across all 50 states. And about a quarter of that money was drawn during non-banking business hours, predominantly on the weekends. So if we talk about benefits, we're looking at our storekeepers that are-- they're the CFO, the CEO, the chief human resources officer, and they're stocking the shelves, and they

have to go apply for credit. They're doing it at their kitchen table, on the weekends, or in the evenings, or at 6:00 AM in the morning over coffee, and doing it on their tablet or whatever, and trying to save that time to go actually run their business.

LEWIS GOODWIN: Great. And Square's main product, as I've talked about a little, it's called a Flex Loan. And we actually, through machine learning and artificial intelligence, review their ongoing cash flows that they put through Square, so only the items that they process through Square, as a seller on Square. And so then they are generated and given an offer of credit. They choose up to a maximum amount. And then when they take the credit, they have, as Scott talked about, a cost of capital. And that is between 10% and 16%.

And it's important, as everyone talks about on this panel, to be very transparent and to show the cost, and to our borrowers, to see the cost upfront, no other fees, no other types of gotcha-type things along the way. They can compartmentalize and understand, OK, this is what I'm going to pay in total. So if they wanted or needed \$10,000, they would have \$10,000 and another \$1,000 fee on top of that. It's not an interest, it's a fee. And then the total amount of borrowing would be \$11,000.

And then they will pay that through a very unique way, which they will pay that through their daily sales with Square. So as they're successful and they have a good day, they will pay a hold rate on a daily basis. If they decide to take two weeks off, there is no payment that is due because they are not having receipts run through their business. Another unique thing about Square is it's an 18-month loan by contract, but it has only every-other-month minimum payments. So if you want to take time off from your business or have some need, there is only an every-other-month minimum that they have to make. And by far, the supermajority pay well in excess of their minimum through their daily sales that they have through Square.

And so our average length that they have out there is probably eight to nine months and they've repaid their loan. And as Sam talked about, the recurrence and the desire to have another loan and another relationship is very high. We don't stack loans. We don't want to have them get into a debt trap. But they're very much excited to get their new loan offers once they have paid off their first loan.

THOMAS KOST: Gwendy.

GWENDY BROWN: Sure. I can speak to microlending, so both by Opportunity Fund, as well as many other microlenders around the nation. So, many of us are called CDFIs, Community Development Financial Institutions. And the loans we offer generally are term loans. Our particular loans, we offer from \$2,500 up to \$250,000. Our longest term is five years. Our shortest term is probably nine months or 12 months. And our APRs are generally in the low teens.

One of the key distinctions, I would say, is microloan products generally are offering a longer term than some of the other providers on this panel or other providers online. And I think that's particularly important. It's great when you know exactly-- you buy your flowers and you can pay that back immediately. But we know that life happens. And many times, business owners are



particularly confident in their ability to have this next big deal really turn things around. And sometimes things don't turn out that well. And so having patient capital, making sure that you have the time you need and you have the cash flow you need to pay back is particularly important.

So one thing that, like Opportunity Fund, many microlenders do, is we actually do take a good look at cash flow, both individual and business cash flow, to make sure that someone has the true ability to repay that loan over time. It takes time, but it's very important. Because again, what we do find is that confidence-- we like the idea of people moving the dial down and borrowing less, but what we more often see is people trying to borrow more than they can afford. And we want to make sure that lenders' and borrowers' interests are aligned. And so that they're borrowing an amount that actually they can repay, even if things only go OK.

SAM TAUSSIG: The ability to repay is so fundamental, too, kind of the core concept of fintech. And you have three very different providers here. And the method of underwriting varies, but we're all getting at the same ability-to-repay analysis.

And I used to work at a CDFI. And it is a different type of underwriting. Square has an interesting type of underwriting, in that it's a closed ecosystem, it's inside of the Square transaction. Kabbage is an open ecosystem. We're looking at anything that the customer wants to authorize us to look at in an automated API connection. And that's why we do it so quickly. There's other great companies, later today, OnDeck, that serves a little bit higher credit offering than Kabbage and Funding Circle, which is looking at even larger businesses there. Everybody's using the underlying existing business information, whether it's an open ecosystem or a closed ecosystem, to get at different ways to understand ability to repay.

And I'll preview some research here. Kabbage participated in the FinRegLab research series, which is an independent organization that's evaluating the quantifiable scientific methodology behind cash flow underwriting. And they're currently finalizing their report. And it will come out hopefully later this month or early next. But the general findings, at least for Kabbage, our novel way of using non-traditional data to look at cash flow underwriting, is a very strong proxy to actual business health. And we've done it in a way that controls for and eliminates any sort of unintended bias or disparate impact, because we're only leveraging that business-specific data, such as the PayPal, or the Square, or the Amazon, or Etsy, or the bank account or inventory data that has very little to do with that individual consumer.

THOMAS KOST: Scott, are there any other products in the marketplace that we should be talking about that haven't been mentioned by our panelists so far.

SCOTT TALBOT: No, I mean, I think we've covered the major players. I know you're going to do merchant cash advances on the next panel. The only piece I would like to add to the discussion is that when you look at the repayment terms, some of them can be open-ended in that it's based on the cash flow. And so calculating APR in that context is impossible or requires a number of assumptions. Thus, again, I'm not ragging on APR, I'm simply pointing out that there are challenges. If you've got an open-ended repayment based on your cash flow, which is a great

feature, difficult to calculate the APR. Again, pivoting to total cost of capital is another way to think about it.

There are benefits to APR as a measurement. We're all familiar with it. But I think it's important to understand, in this new context, there can be challenges to the metric.

SAM TAUSSIG: I guess one thing we haven't talked about is how the loans or other products are actually made. In Kabbage's case, we do partner with a bank. So as I said at the beginning, we partner with Celtic Bank. So Celtic Bank is the lender. They are the true lender behind the program. Kabbage has automated the Celtic Bank credit underwriting process. And we operate under the Bank Service Company Act to extend that credit as part of the Kabbage Celtic program across the country.

And so this is one way that many fintechs work. There are true standalone fintechs as well that have gone out and gotten different state licenses. You've seen a progression towards fintechs that want to become banks, and you have fintechs that offer a mix of all products, whether it's a merchant cash advance, state-regulated term loan, federally-insured depository bank, a partnered term loan, or a variety of other services out there.

And so as you regulators, reporters, academics, other interested parties go and look at and examine this space, it is important to think very carefully about what is the underlying business model. Because that underlying business model sometimes dictates the types of products that can be offered, or in some cases, can't be offered.

THOMAS KOST: Lew, why don't you talk a little bit about Square's relationships with banks, and as Sam alluded to, Square's pending application to become chartered.

LEWIS GOODWIN: Sure. And as Sam talked about, they issue through Celtic. And currently Square Capital issues their loans through Celtic Bank as well. And as I earlier mentioned, as we at Square Capital got into this business, we wanted to understand how viable it was. And as we've seen under 700,000 loans as well as \$4.5 billion, we've decided that that would be best if we could actually issue those ourselves.

And so Square Capital or Square has filed an application with the FDIC in the state of Utah to become an industrial loan corporation. And we are currently going through that process right now for approval of that. And then at that point we would issue those directly through Square's financial services.

THOMAS KOST: Gwendy, do you want to talk about Opportunity Fund's relationship with the institutional players.

GWENDY BROWN: Sure. banks are an incredibly important part of our ecosystem, primarily as far as providing capital. Under their regulatory obligation through the Community Reinvestment Act, CRA. So that's an important, real piece of this ecosystem and an important part of our lending. We also work with banks as referral partners. And then also, I alluded to it earlier, but we've recently expanded our partnership with the Fintech Lending Club to be able to lend now in

44 states around the nation, and partner with them, and utilize their technology which is a real win-win as well.

MALINI MITHAL: So we've been talking a lot about leveraging technology and using non-traditional data to assess risk and make underwriting decisions. Can we dig into that a little bit more? I think this is a topic that you've brought up a few times, Sam. So can you kind of dig in and talk a little bit more about how your company does this.

SAM TAUSSIG: Sure. So if you think about how a bank's traditional credit model is developed, yet it basically takes some very finite attributes about a business, often related to the business applicant, the owner, the consumer of the business, such as their FICO score, their income. They take these attributes and gradually expand, very slowly, into other attributes that they feel is representative of that business's success or predictive of that business's success. That underwriting process, be it in-person or automated, has been incredibly slow and expensive to develop over time, with very limited quantified testing as it applies to the entire small business population.

And so if you think about small businesses, they're not the same. They don't congregate in one place and like, "we're the small business people." They are so diverse, be it socioeconomically, racially, by gender, by geography, by industry, by age, et cetera, et cetera, that it's incredibly difficult to apply one underwriting methodology that has a lot of variables to that population.

So if you think about small circles gradually expanding over time, that's a traditional bank underwriting process. Kabbage went the other way around. We take the entire population of data that a small business wants to consent and offer to us that is part of their business operations, and we look for regressive patterns over that. And so we look at how does income from inventory sales, PayPal, Square, other credit card receivables-- Visa, MasterCard-- cash in the till, invoices, things like that, how does that all relate to their bank account information, to their accounting information, et cetera? Where is the cash going out? Is it going to marketing? Is it going to buying raw goods and raw products? Is it going to inventory? How much is going to payroll and other expenses?

And we build the three statements for the small business on the back end, leveraging the most predictive underwriting attributes for that business, which again is cash flow. So if you think of Kabbage, we take the entire universe of data and whittle out, specific to that one business, what indicators are key to their success. And we purge the consumer indicators like a FICO score that are not necessarily indicative of success.

Because small businesses, they have people behind them. Those people get sick, and have medical debt, they have student debt, they have emergencies. But they also might just be leveraging their credit to start their business. And so the success of the individual does not necessarily equate to the success of the business. And we look at only what matters to the cash flow transaction data. And that's why we've been so successful in leveraging non-traditional attributes, and why we offer an open ecosystem to connect to for whatever you're logging or doing business on, to let that data work for you as a business owner.

THOMAS KOST: So we're running out of time. And I want to give everybody an opportunity to offer some closing thoughts. So maybe a minute each. We'll go down the panel, and people can talk to the important trends in the marketplace that are likely to become more prominent in the coming years, and sort of what the future of this space looks like. So I'll start with Claire, and we can just move down.

CLAIRE KRAMER MILLS: Yeah, as the marketplace evolves, I think one thing that we're a little bit at a loss for is longitudinal data on what's happening to borrowers over time, and are these products working for them, and controlling for all of this specifics that you're mentioning that are very individual to the business, has this infusion of capital. And I think, in many ways we've all stated, this is-- it's unleashed new financing. But I think being able to see how that financing is managed over time and whether it's really enabling business growth, I think that's going to be a really important consideration going forward.

SAM TAUSSIG: I would encourage observers to pay attention to two things. Fintech banks, we've always been very supportive of all different chartering options at Kabbage, be it a multitude of state chartering options, federal, with the OCC, the FDIC, depository, non-depository. I keep a very close eye on that.

The other thing I would encourage observers to watch is disclosure. So Kabbage and OnDeck created the SMART Box, which is a commercial disclosure tool that looks a lot like the consumer TILA box. We show total cost of capital, APR, monthly payment schedule, cents on the dollar, prepayment indicators, et cetera, et cetera. We've been updating that. There's a multitude of states, California and New York to name two, that are pursuing commercial truth in lending disclosure laws. We're very supportive of those kind of efforts because the small business, given the multitude of products in the space, should have all of the information available to make a smart, informed choice and do cost comparisons, apples to apples.

LEWIS GOODWIN: And look, I think it's an exciting time for small business. I think that five years ago, a lot of these options weren't available. And we're opening up channels through each of our products that we talk here, and others that you'll hear throughout the day. And I think it's important to make sure that it's fair and transparent, that borrowers understand what they're getting into, what they've signed up for, and that it isn't punitive to them, that it helps the small business grow.

And one of the things that we see-- because we get daily payments, we don't wait 30 days and hope that they're going to make that payment-- we're seeing the health of that business every day. And so that helps us help the business in any way that we can, to help-- we can contact them to see if they are having trouble with their processing, if they're having issues in one way or another.

I think it's a really exciting time for small business. And I think there's a lot of options, and want to make sure that it's fair and transparent to them.

GWENDY BROWN: Well, my panelists all said it very well. I would just add that, with the multitude of data that all of the lenders and financing companies have, making sure that that data

is available back to the small business owner. Lenders know how long it will likely take a small business to repay. And therefore, the business owner should know that, what they're predicted, how long it will take them, what they expect their monthly payment will be, what they expect their APR will be. It may change over time. But again, we know they're sharing that data with investors, we know they have that data internally. So the business owners should have access to it to make sure that that intelligence is actually helping them be successful and choose the right product.

SCOTT TALBOT: I agree.

[CHUCKLING]

The one trend I would look for is continued convergence between traditional players and new players as they move into the space. I think that's an important trend to follow.

MALINI MITHAL: OK, great. Thank you so much to our panelists. This was a great panel. And with that, we will go ahead and get the panel 2 panelists up here. Thank you so much.

[APPLAUSE]

JASON ADLER: Great. So good morning, everyone. And thanks again for being here today. I'm Jason Adler. And I'm an acting assistant director in the Federal Trade Commission's Division of Financial Practices.

COURTNEY ESTEP: And I'm Courtney Estep, and I'm an attorney in the Division of Financial Practices.

JASON ADLER: We have a really great set of panelists here today for this discussion, and a lot of content to cover. So I'm going to briefly introduce each of them, and then refer you to their bios for more info. So starting down on the end, we have Kate Fisher, who is a partner at Hudson Cook. Next we have Jesse Carlson, who is the senior VP and general counsel of Kapitus. Scott Crockett is the founder and CEO of Everest Business Funding-- or Everest Business Financing. Sorry. Jared Weitz is the CEO of United Capital Service. And Ami Kassir is the founder and CEO of Multifunding LLC.

So just one logistical issue to talk about before we get started-- for the panelists, if you want to talk while someone else is talking, if you have something to contribute, just remember to turn your note card up on one side so that we know to call on you. So we're planning on this panel to discuss how merchant cash advances work, and recent reports of abuses in the sale, marketing, and collection of these products. So with that, I'll turn it over to Courtney and we can jump right in.

COURTNEY ESTEP: For audience members who are unfamiliar with what a merchant cash advance is, let's walk through the basics. Who would like to discuss what a merchant cash advance is and how it differs from a loan or other forms of credit?

JESSE CARLSON: Well, a merchant cash advance is a somewhat pejorative term for the factoring of future receivables. It is a purchase and sale transaction. So rather than giving a loan, a company like Kapitus will purchase the future receipts of a business at a discount.

There are two basic types of this type of factoring transaction-- a credit card MCA or factoring transaction, and an ACH factoring transaction. The credit card factoring transaction is essentially the closed ecosystem. We purchase a percentage of their credit card receipts, and the credit card processor batches out a percentage of those receipts to us as repayment. An ACH factoring arrangement is similar in that we're estimating their total future cash flow, and have an estimated payment that we draw through an ACH debit to the operating account of the business.

It is important to note that, in a purchase transaction, there is no absolute right to repayment. The risk we are taking is that the receivables are not generated. Largely, these products work the same as, for example, the product that Square offers and described. That is denominated as a loan and would have an absolute right to repayment.

KATHERINE FISHER: Sure, I could speak to the legal distinction between a purchase of future receipts and a loan. And first, thank you for having me here today. In a loan, the borrower promises to repay the lender. In a purchase of future receipts, the business promises to deliver a percentage of its revenue, only to the extent that revenue is created. If sales go down, then the business has a contractual right to pay less. If sales go up, the business may have to pay more. In New York, which has the most developed case law in this area, courts examine whether the funder is absolutely entitled to repayment. Courts generally look at whether a contract allows a business to adjust its payment, along with the ebb and flows of its income. And courts look at whether there is a fixed payment term or maturity date, because a fixed payment term or maturity date would be inconsistent with the purchase of future receipts.

The contractual events of default also distinguish a purchase of future receipts from a loan. In a loan, a borrower is in default for failure to pay. In a purchase of future receipts, a business whose revenue has dropped is in default only if the business fails to communicate accurate financial information to the funder. The business also promises not to engage in certain bad acts, such as diverting money to multiple bank accounts. But again, the key distinction is that, in a purchase of future receipts, there is no absolute obligation to repay.

JASON ADLER: And we'll dig into the legal landscape here a little later. But-- and Scott, I'll turn to you next, but could we have some of the panelists comment on why a small business might be attracted to a merchant cash advance as opposed to other forms of credit.

SCOTT CROCKETT: Yeah, I'll take that. I think I've had several business owners that we've worked with who would describe it more as something akin to temporary equity than they would a traditional business loan, in terms of the risk that we're taking. Again, we're purchasing a percentage of their future revenues, and we're taking the risk as to whether or not those revenues are going to take place.

And I'll give you two examples, both of them seasonal. One, Everest, we provided an advance to a resort in Georgia to get through their seasonally-slow period in the winter. And the business

owner came back each year, so utilized the product two or three times. And then the third year, the business owner didn't come back. And we developed a relationship with them. And we actually gave them a call, and just kind of curious as to why they weren't using the product. And the business owner said, we sold the resort to Marriott.

And he said, it was great being able to utilize a merchant cash advance from your company, because if I hadn't, I would have probably had to have sold a portion of the equity of my business, whether it be to a private equity fund or an investor. And so in that sense, we served the role of being a temporary kind of equity partner to the business owner. Again, that was off of kind of a seasonal need.

I'll give you another example of not as happy an outcome for the business owner. But we had a restaurant in the Keys that had a seasonally-slow period in the summer, before Hurricane Irma. We made an advance to them. And unfortunately, the hurricane-- so again, we made an advance. We're purchasing a percentage of their future revenue. And then we're assuming that risk of whether that revenue is going to take place, just like the business owner is assuming the risk of what's going to happen with the business on a forward basis.

In this case, unfortunately-- thank God nobody was hurt. But the restaurant was destroyed by the hurricane. And in that instance, again, back to Kate's point about no absolute right of repayment, the business owner didn't owe us anything, because we had purchased revenues that then never materialized.

And so I think they're two totally different examples. Both happen to be based off of a seasonal need with different outcomes. But I think it highlights the utility of the product for a small business owner.

COURTNEY ESTEP: Let's talk more specifically about the characteristics of an MCI. The cost of financing an MCI is usually expressed as a factor rate. How large is the typical factor?

JESSE CARLSON: It can vary. It's a case-by-case basis. And we underwrite each of our customers based on the cash flow of the business, and the length of time they're expected, and their revenues. So we, like some of the other companies on the first panel, underwrite to the cash flow of the business. And the cash flow of the business, the amount they want, the risk that's being taken all go into what the discount rate would be. An easier example to express it is our average financing is approximately \$50,000. It's approximately 11 to 12 months. On a \$50,000 funding, we would expect, over the course of the year, we would be purchasing for \$50,000, \$65,000 of the future revenue of that business.

COURTNEY ESTEP: How does that compare to a typical APR for a small business financing loan? And do businesses understand the distinction between the two? As was discussed, there is no interest rate and there is no APR. You can only calculate the APR after the receipts have been delivered, because there is no set repayment period. So there is no term.

However, APR has-- some of the problems with APR were discussed on the first panel, and they're present here as well, in that we are very clear about the total cost of capital, and we

provide that total cost and a very clear disclosure on the first page of all of our contracts. APR, again, because it is designed for multi-year, monthly-pay products, is very difficult to calculate here. And the total cost is more relevant to the business since they are going to look at how much it's going to cost to make the investment in their business. And that is what drives their decision-making. We are very clear on disclosing the total cost.

AMI KASSAR: If I can just jump in-- there's a lot of, I think, confusion created by the simplicity. So if somebody takes an advance or a short-term online loan, one of these for \$50,000, and the payback is \$60,000, that's often quoted to them as a factor rate of, in the market, 20%. And in fact, oftentimes, from my experience, the small business owner or the consumer thinks about that as a 20% rate. And let's just say, if that's on a six-month payback, that APR is closer to 60% or 65%.

And every time someone-- and everyone's in business. If you're making an advance or a short-term loan, more specifically on the advances, you might not know exactly how quickly you're going to get paid back. You have a thesis or a good idea, based on the historical performance of the business, about what your expected return is. If the business owner was properly educated, and had their financials together, and was well prepared, and took the time to go, say, through an SBA process, they could borrow that money at today's rates at 8 and 1/4%, and have 10 years to pay it back. And the impact on that cash flow is dramatic compared to some of these other solutions.

JARED WEITZ: Our experience at Capital Source, as a marketplace consultant and broker, is that oftentimes a merchant has a specific project that they are looking for in a specific time frame. And so what helps them choose one product versus another is that specific purpose. And so not everyone can take the time and/or qualify for an SBA loan or a term loan. Oftentimes, some people can, and don't want to wait because their need doesn't allow them to. We have found that when we speak to merchants they are very educated in their exact purpose that they need the financing for. They understand their time frame. They are negotiating legalese in the contract, and know their specific needs right up front.

JESSE CARLSON: And I would add that an SBA loan will typically require the small business owner to put up their house as collateral and offer a personal guarantee. A factoring arrangement or merchant cash advance does not have a personal guarantee of repayment. It is a performance guarantee. The default is diverting the funds, or not communicating, or not telling you that your business has been destroyed in a hurricane. It's cutting you off, and just not delivering the receivables. If there is a default and it's not repaid, the individual is not liable. So while an interest rate on an SBA loan might be lower, there are drawbacks to that product, too. And we have found that our merchants are very sophisticated in understanding the benefits of flexibility and the lack of a personal guarantee of repayment, versus a lower monthly payment, or a lower computed interest rate, or a longer repayment horizon.

SCOTT CROCKETT: I would just add one final point on that. The MCA space has grown a lot, in the last 10 years especially, and is highly competitive. But when we're dealing with merchants and competing for their business, they're not typically comparing us to whether or not they're going to take out an SBA loan or get merchant cash advance. They've made a decision that this



product, the MAC product, is the right product for them, for a variety of reasons and some of the attributes that we're getting into now. But typically a small business owner that's looking for a small business-- an SBA loan is going to have a different use case than the use case that a merchant's using for an MCA.

AMI KASSAR: Our experience is that, oftentimes, when you're building up a small business, there's going to be some unexpected surprises along the way, not necessarily opportunities. And maybe a customer didn't pay in time, or something didn't quite work out in time, or whatever it might be. And you're in the need. And if you didn't take the time or weren't able to go to your bank in advance, and get a traditional line of credit-- which I don't think anyone should forget that, plenty of the banks in this country, while it's work, and takes you time, you can go get a line of credit for your business for \$25,000, \$50,000, and it will just sit there for when you need it.

But if you're caught in one of those emotional moments, and go to Google, and you put in "I'm looking for money for my business," there is a myriad of offers that are so enticing to offer you money in 24 to 48 hours. And if you jump on that train, and you take a short-term amortization, whether it's an advance or a loan, of some months, oftentimes that cash flow pressure that that instrument creates forces you into a cycle of multi renewals, which is where many people in the MCA or the short-term loan business make their money. And as your credit gets worse, as your situation gets tougher and tougher, you get into situations of stacking, and stacking, and stacking, and multiple renewals. And everyone's often very happy when there are renewals going on.

So these are some of the dynamics that worry me about the nature of the short-term products and the ultimate pressure they can often create on the business owners who get enticed by them. And they certainly are enticing.

COURTNEY ESTEP: Ami, can you explain for those who might not be familiar what stacking is, and how common that is in the industry.

AMI KASSAR: Well, the stats are hard because I don't think anyone in Washington or anywhere truly understands the size and scope of this business. I don't think anyone really knows how many players there are. I don't believe there are any reported requirements for reporting, like they are for banks, as to the size and scope of their loans or their advances. So any data that I have is more anecdotal.

But I will often get a call from a borrower-- just to be clear, we're a loan broker. And just to be clear, about 70% of the work we do is with the SBA. And we'll get a call with someone who took an advance or a short-term loan, and then it became enticing, and there was some cash flow pressure by the first one, and then they took another and another.

And then there's multiple lenders or companies in the business. And sometimes they're classified as A, B, and C credits. And as you take more and more of these, if you fall down that path, the paybacks get faster, and if you calculate them on a IRR and APR basis, they get more expensive. And that's when you get to some of the C-credit players, some of the really predatory-- and I don't think that's the case of anyone here in this panel-- but you start to see some of the really

predatory practices, and confession of judgments, and some of the things that we've recently read about in Bloomberg articles and stuff like that.

But sometimes we can see bank statements or credit card statements where someone has six, seven, or eight of these loans or advances. And they may as well shut their doors at that point.

JARED WEITZ: Some of the things that we've seen-- and to be clear, United Capital Source as well is a broker and a consultant-- we've seen a multitude of cases where folks have had two and three SBA loans at once. And so is that considered SBA loans stacking each other? We've seen cases where someone has a line of credit and accounts receivable financing as well as an SBA loan. And they're coming to us saying, hey, I took these three traditional financings, and I'm looking to clear it up. What should I do?

So I really think it depends on a case-by-case basis. I will say, from what Ami said, yes, there is a level of this space that I think has been a certain way. But I would not let a few bad apples spoil the bunch. The majority of the space is generally working with merchants to increase their business's cash flow and to grow their business.

JESSE CARLSON: And I would add that a lot of the flexibility and availability and speed to funding, the MCA product offers many of the same benefits as the products offered by the individuals on the first panel. Where we see renewals for merchants is either a merchant gets a product for the first time, because there is an education process to explaining that it's not a loan, that it doesn't have an interest rate, that you have the flexibility of paying back a percentage of your credit card receipts as they're generated, and so your payment automatically fluctuates based on the performance of your business. Once it gets past that, the business sees the use case, sees the flexibility, and will come back for the next project or the next need and recognize the benefits of the product.

Most of our renewals, as Ami mentioned, which are customers that come back and take another financing from Kapitius, those tend to be individuals who have identified a specific need, inventory or manufacturing inputs. The business knows what it can make selling inventory. It knows what the return, from the inputs, to its manufacturing business will be. The product is able to finance that need as it arises, essentially in perpetuity, because they're returning that investment to the financing company.

SCOTT CROCKETT: And I would just comment on one of Jesse's comments on the-- relative to the speed. So we'll have a merchant apply with us as a first-time merchant. And to the extent that the merchants that are approved, 90% of them receive the capital within 48 hours. So just to a small business owner that's dealing with all kinds of different challenges, the ability to get non-recourse capital, where the provider of the capital has purchased a future percentage of your revenues of the performance of the business, and to be able to get it in 48 hours, just has a very high utility. And that's on a first-time merchant. A merchant who already has an existing relationship with us typically will be able to get the capital, if they need an advance, the same day.

So for a small business owner who-- and the first use case for why they may reach out to us may be because of some type of acute need. The pizza oven breaks and you need \$50,000 tomorrow, or as quick as you possibly can. So the first time they use it may be because of some type of acute need. And those future receivables will be remitted back to us over whatever period of time it takes for the business to generate them. But the business owner then develops comfort level with the product, with our business and the relationship.

And then we may get a call back a year later, the business owner says-- the same pizza owner-- know the shop next door to me, the hairstylist, just went out of business and I've got an opportunity to expand. So now it's not an acute kind of emergency need for capital. Now this is an expansionary need. And so that business owner being able to call us up at 10:00 in the morning on a Wednesday and have \$75,000 or \$100,000 in their bank account by the end of that day, again, on a non-recourse basis where they didn't have to provide a personal guarantee, unlike some of the panelists that were on the first panel, again, a merchant cash advance, you can appreciate the utility for certain business owners in certain use cases.

JASON ADLER: Can we come back quickly to the cost of financing here and the factor rate in particular. So we'd heard, on the first panel, that one of the concerns is the lack of transparency in this industry around the cost of financing. And Scott and Jesse, I think you commented on the fact that APR might not be, for certain reasons a good comparison for a business to make to the factor rate. How does a business compare-- if a business is considering an MCA, how do they compare the cost of financing for an MCA against other forms of credit?

JESSE CARLSON: We are very supportive of using the total cost of capital metric that was discussed on the first panel by Scott Talbott from the ETA. Unlike a consumer who is borrowing money to meet a personal need, the business is borrowing money or seeking financing to invest. And so they're looking at what the return on that investment is going to be, and what the total cost is. So the apples-to-apples comparison, I think, across all products is what the total financing cost is going to be for the funds, as well as the periodic repayment or the percentage of the receipts that are going to have to be delivered.

For example, a 10-year SBA loan or a five-year equipment lease, if you express that in the total cost of financing in terms of the total interest you will end up paying, those can be more expensive than an MCA or a short-term factoring agreement, because you're paying a lower rate of interest over a longer period of time. So overall, we believe that the best metric is to have a clear total cost disclosure across all small business financing products.

AMI KASSAR: I think, if I may, let's just take an example, someone needs \$50,000. And approximately, if you're going to do that on a 10-year SBA loan product, you're going to have a monthly payment of about \$600, and no prepayment penalty if you can get it done faster. And if you're going to do that on a six-month short-term MCA or short-term loan product, you're going to have approximately a payment of \$600 a day.

And what I believe small businesses have to really be educated and stare at is thinking about, unless things go extremely well, if their business can really afford and handle that \$600 a day. Because oftentimes, if you look at it on an actual cost-of-capital dollars for the longer-term

product versus dollars for the shorter-term product, you're going to have less dollars, although a much, much higher APR or cost of financing on a percentage basis that's really expensive. And it's that enticement of signing up for the shorter, and easier, and more convenient financing that, from our experience, often gets merchants in trouble.

JESSE CARLSON: Well, there's one thing I would add and point out. I mean, we compete with some companies that offer online lending and online loans. And our cost of financing is, overall, comparable to them since we were competing with them and winning business with them. There is a great deal of competition in the industry, across products, across regulatory structures.

But overall, our merchants can compare and have the ability to look at an online loan from a lender like OnDeck, or a line-of-credit product from a lender like Kabbage, and a factoring product that we offer, or in California, where we have a license and offer a loan product. They can look across all of those. And they're sophisticated enough to understand it. And while there are shorter-term, very high-cost products out there, that is not the typical customer we offer. That's not the need we are serving. And while we are aware that it's out there, it is not something that is core to our business.

KATHERINE FISHER: I'd like to address your question about disclosures. Disclosures should serve the broader policy goal of helping small business owners compare costs across different products. And in the business finance space, there is a broad range of different products, including loans and lines of credit, equipment leasing, invoice factoring, purchases of future receivables.

So in order to do an apples-to-apples comparison across these different types of products, a business owner needs to know the total amount of money that's advanced. So in a loan, that would be the principal amount. In factoring, this would be the purchase price. In a lease, this would be the gross capitalized cost. They need to know the amount of any upfront fees. They need to know what their periodic payment is or their expected periodic payment. They need to know the total amount it will cost them, expressed today as total cost of capital. And it's helpful to know what the pre-payment policies are.

That limited number of disclosures would allow a business owner to be able to compare, is an equipment lease a better price for me than a loan, than a purchase of future receivables. There are other disclosures, such as annual interest rate, APR, or factor rate. These really don't translate across products. And if the policy goal is to allow business owners to comparison shop, we should focus on that set of disclosures.

JARED WEITZ: I would just like to add to Kate's point, oftentimes, in roles like myself or Ami's company, when you're presenting all of these options to a merchant-- and thankfully they all exist-- oftentimes a merchant is looking at the total cost of capital, what the repayment method is. But they're, 50% of the time, looking at when they can take advantage of their opportunity. Sometimes, time doesn't allow for that. Sometimes what they would prefer is to go through a program where they understand, I'm taking  $x$  for  $y$ , If I pay it back early, here's my definitive cost. I know I'm using it for this project. I know that I'm going to have it paid back by  $x$ . If I don't, I'm able to lower my payments due to my flow, which other lending products don't offer.

And so it's important to just make sure that the business owners not only know about the cost of capital, but they also know about the rules that follow that cost of capital in case they get into a situation where they're not able to repay. And when you're guaranteeing equipment, inventory, or land through an SBA loan, and if you don't have the ability to pay that loan, you can lose one of those things. And so oftentimes if a merchant is not sure how their "gamble," quote, unquote, will pay off, they will choose an option that may be best suited for their future of their business.

AMI KASSAR: I think we can just take an example just of the pricing mechanism. So right now as we sit here, there's probably some thousands of salespeople on the phone hammering away at small businesses trying to entice them into MCAs or short-term loans. Because frankly, it's quite profitable. And if you're a broker in that business, you don't get paid high commissions. And so on the sales call, if someone was again focusing on the cost of capital, someone might say to a merchant, I'll give you \$50,000, and you'll pay me back \$10,000. So the total back will be \$60,000, and that will be over six months-- so not specifically for an MCA.

And the merchant might say, I don't want to pay back \$10,000. That's too much. And then the salesperson-- the other person-- will say, OK, I can give you a payback of \$7,000. So you'll pay me back \$57,000, and you'll pay that back over three months. So your payback will be less. And in that process what happens is that the daily payment goes higher, and the rate of return for the MCA or the lender goes higher also.

COURTNEY ESTEP: How do funders typically underwrite their MCAs? And what information do they consider, and how is that information different from what a traditional bank might consider?

JESSE CARLSON: Our underwriting process is geared toward-- under about \$3 million, a bank will underwrite a small-dollar commercial loan to the personal credit of the owner of that business, largely. What we do is underwrite to the cash flow of the business or the receipts that they're iterating through their credit card processing. So our underwriting process looks at a number of different data points, largely geared toward looking at the cash flow of the business and what that business can support in terms of generating the offer.

So our typical application process requests three months worth of bank statements that we then analyze using computer-assisted algorithms. But we don't believe that computers can do underwriting entirely at this point, or the technology is not there. So we have individual underwriters look at the risk score that's generated through our algorithm, the bank statements of the business, and for larger financings, we'll also speak to the merchant. And one of the things that's clear in that merchant interview is we want to be sure that they understand how much that payment is and whether they're comfortable with it. And so we are very clear in disclosing what the daily cost is going to be.

So from that, we get an offer, and that's generated and given to the merchant. If the merchant accepts that and signs the contract, we can fund them the same day. So

The data sources for the underwriting are largely geared toward getting out the cash flow of the business and the key indicators toward the health of the business, and deemphasizing the personal credit of the guarantor.

SCOTT CROCKETT: Yeah, I'd just add-- I think Jesse summed it up well. The other thing would just be, each business is different. You'd look at different SIC codes-- you'd underwrite different SIC codes differently depending on whether or not they're subject to seasonality or different-- typically, seasonality would be the biggest one. But Jesse covered most of them.

JASON ADLER: We heard from an earlier panelist that there's maybe been a move away from considering on personal credit scores as part of the underwriting process for sole proprietorships, or generally. Jesse, Scott, is that something you consider?

JESSE CARLSON: We do pull the personal credit of the owner of the small business. However, that is deemphasized in our underwriting as a key indicator of the health of the business or whether we should finance that merchant. So it hasn't been completely eliminated, I think, as some others have. But it has been significantly deemphasized in order to expand the opportunities available to small businesses, some of whom, as we've heard on the first panel, will have less than perfect credit due to their entrepreneurial spirit.

SCOTT CROCKETT: And they might not necessarily have bad credit. But just they might be a thin credit file, a new entrepreneur. And so deemphasize as well the personal credit of the business owner. And it's much more focused on the cash flows, historical and what we deem to be or estimate are going to be the prospective cash flows of the business.

COURTNEY ESTEP: How do MCAs typically get paid back? Is it a percentage basis, a daily fixed rate?

JESSE CARLSON: It's always going to be a percentage of the receipts that are generated by the business. And I would add that our underwriting processes look very closely at the remit rate, or the percentage of the receipts that are going to be servicing-- we're going to be paying back the receipts that we have purchased.

There are two basic methods of repayment, as I think I said quickly in my opening remarks. One is a split of the credit card batches. So in the credit card processor-- for those who are unfamiliar with how credit card transactions work, you swipe your credit card, it goes to the credit card processor, they then disperse the funds to the merchant, usually a day later, after it has been batched. When they're batching out that payment, they will send the percentage of the receipts that have been purchased to us in fulfillment of the obligation to deliver the receipts, and they will send the remainder to the merchant.

For merchants who are not as dependent on credit cards, who don't have as large a percentage of their revenue generated through credit cards, we offer an estimated ACH debit that is intended to look at what's your average on a weekly or daily basis, how many deposits do you have. There will be an ACH that's intended to estimate the percentage of the receivables that we have purchased and is debited to a bank account.

That estimated payment can be what's called true-up, in that a merchant, if they are encountering trouble, can submit their most recent bank statements, provide information to us. And we can adjust that payment to better reflect the percentage of their receipts that are being generated and that we have purchased.

COURTNEY ESTEP: So does the contract contain the percentage and the estimated payment, and the business owner is required to make the estimated payment unless they proactively seek a smaller payment?

JESSE CARLSON: In essence, yes. But again, that's only for the ACH estimated payment. There is no actual stated payment in a credit card factoring contract. Because the split of the batch automatically provides the percentage of the receipts be purchased on a daily basis, almost exactly like the product that Square was describing this morning, which is denominated as a loan.

JASON ADLER: Jesse, can you explain a little bit more of the true-up or reconciliation provision you're talking about, and how it works-- how it's supposed to work, and then, to the extent you've heard anecdotally about how it may go wrong.

JESSE CARLSON: Well, we have approximately 5 to 10 employees who, when the merchants call in, or the merchants miss a payment, or NSF their estimated ACH payment, we proactively reach out to the merchant and ask them what the issues are. They will submit information to our group, who will review their deposits and the receipts that are being generated. And we'll adjust their ACH repayment based on the percentage of receipts purchased.

We also want to work with our merchants. And if they are experiencing a hard time, even if there is cash flow pressure, we also will offer modifications to their estimated repayment obligations or lower their remit percentage in order to get them through a difficult period if they've overextended themselves in some way, or have an unexpected or unforeseen difficulty but are still generating receipts.

Anecdotally, I have heard that there are companies that will not honor those provisions of the contract, and treat the estimated payment that's stated or the estimated ACH debit that stated as an absolute requirement to pay. And so even if they submit information, they will not adjust the debit, or they will continue debiting even after the obligation is repaid. Those are not practices that we condone. We believe that those practices should be prohibited. And it is not how our company operates.

SCOTT CROCKETT: I'd just make a couple of comments on true-up. So and sometimes-- Ami did a good job, I think, with giving examples for folks who might not be familiar with-- they haven't taken out a merchant cash advance. But you have a retail operation in a strip mall, and you needed an advance because you had an opportunity to buy some inventory at a discount from your supplier.

And so you took out an advance from Everest, from my company. And unexpectedly, the city decided to put a new curb cut in front of the retail strip mall that you work at, where your store is

based. And it's going to take them a month to do the curb cut, and that's cutting down on traffic that comes into the center, and that's going to impact their revenues for a month or the time period where their curb cut's getting put in.

That merchant will call us up, explain what happened, show us the bank statements. And we will lower the payments tied to-- as a modification in recognition of the issue that they're dealing with. And so there are, I think, some, as in any industry, bad actors that, as Jesse referred to, may not honor true-ups, I can tell you, at Everest, not only do we honor true-ups, we send out periodic reminders to our merchants to remind them over the course of the transaction that the true-up's available as an option for them if they want to avail themselves of it.

KATHERINE FISHER: I'd like to add, as this industry is maturing, companies are getting better at this. For example, during a recent hurricane, or I believe during fires in California, there were companies that proactively looked at their customer list, and saw who was in those emergency-affected areas, and proactively reached out to those folks to see if they needed a reconciliation.

JARED WEITZ: Yeah, I can tell you from experience, during the last hurricane, all of our funding companies sent us an email, as well as our merchants, to remind us and our merchants that they're going to withhold payments, actually stop payments for two weeks-- this is unsolicited-- to give merchants a catch-up because they understood that there was a hurricane and a storm going on. And then the merchants were encouraged to contact them again after the two weeks to resume payment.

Because we deal with so many merchants, we also have experiences where we have brokered a financing deal to a restaurant. After three weeks of financing, the restaurant has called us, said, hey, the cleaners next door just had a fire, and it shut down half of my restaurant. My revenue's going to drop by 50%. And so we have then reached out to that funding company. That funding company would then lower those payments for that merchant, as they're supposed to.

SCOTT CROCKETT: I think it goes back to the comment I made earlier, about think about the product, in a way, as temporary equity. I mean, we really are playing the role of a partner on a temporary basis with this business owner. And yet we're not getting-- the business owner is not having to give up real long-term equity or ownership in it.

When Harvey went through Houston, we had several hundred merchants that were within 100 miles of Houston. And we proactively reached out to them to find out how they were impacted by the storm, and whether or not the storm was going to impact their ability to meet the daily remittance that was in the contract, the percentage.

So again, a merchant cash advance as a product isn't necessarily going to be the perfect product for every business owner. But for certain types of use cases, it has an incredibly high utility.

JESSE CARLSON: And just to tie it briefly back to the legal nature of the product, the reason that, when there is a natural disaster, we will stop the ACA repayments is that if there is a natural disaster, there are not receipts being generated by that business. And so they have no obligation, if they are not generating receipts, to deliver anything to us.



And so it goes back to the difference between a loan, where if you have a natural disaster, or there's a fire, or a hurricane, or a flood, you still have that repayment obligation. And if you do not meet that repayment obligation, your lender can declare you to be in default. Now I would hope that everyone would work together to recognize that even if they have a loan, when there is a natural disaster, you will need some forbearance. But I think it highlights the legal distinction between a purchase of future receipts and a loan.

JASON ADLER: Ami, did you want to jump in?

AMI KASSAR: Yeah. I think it's important that, at least from my experience and listening to the thousands of phone calls from business owners calling into our shop over the years, most people are calling when they need money in a rush, more so because the city just did the curb cut for 30 days, by your example, and they have a problem. I know people love to talk about the inventory to quick buy and those opportunities. Our experience is that it's much more the first than the latter, that there's some short-term crisis going on that they're trying to get a quick fix to. And that's, at least from our experience, the danger of the situation with the short-term products. It can compound the problem for them.

The other thing that I think is important to note is that-- we haven't really talked about it, but often the distinction, at least for the small business owner or the consumer between a direct lender or MCA company and a broker is very vague. They often don't know the difference in who they're dealing with. But if you're in this broker business, which we are, and you broker an SBA loan product, you can earn a commission from the lender of between 1% and 2% of the face value of the loan. And if you are in the business of brokering MCAs or short-term loans, you can earn anywhere from 6% to up to 20% of the face value of that transaction. So the economics are really driven by encouraging people in the intermediary space to encourage people to take the short-term loans or advances.

JASON ADLER: And that actually transitions us pretty well to the next topic, which is how these products are marketed, the role of lead generators and brokers in the space, and how merchant cash advances are marketed. And I'll start with Jared on that.

JARED WEITZ: Sure. So for us at United, we have taken a digital marketing approach. We believe that that has been beneficial for us, and also the safest way to receive a merchant's information, because it's by them giving it to you. From there, we employ a "consultative sale," quote, unquote, to understand what a merchant's needs are, and then lay out a myriad of options.

I know that there are popular ways of marketing in the industry. Anecdotally speaking, I've seen mailers some of the folks on our previous panel use. We have seen messages, both email and text. And we have seen dialers. I think that, depending on how you're marketing, it's going to also depend on the merchant that you're going to receive in the door. And it's the broker or funding company's job to then educate them properly.

Oftentimes the difference between our industry and another, when we do receive that commission for making a sale is, in the MCA or the funding space, you are responsible to give that commission back if that merchant does not perform or goes into an actual default, up to 90

days in. Versus an SBA loan or something like that, where if that client does go into actual default, you do not have to give that commission back. And so I think that's important. Because on the broker side and on the funding side, we really are taking a ride with the merchant to make sure that the business succeeds.

JASON ADLER: And so there have been some reports of aggressive and deceptive marketing in this space. Can we hear a little bit about some of the tactics you've seen. Ami, do you want to start with that?

AMI KASSAR: Well, often what we see is there's hyper-aggressive marketing on the renewal. This is more so, I think, in the loan space than the MCA space. I can't really specifically speak to it in the MCA space. Because they file the UCCs. And then the B or C players know that they can estimate that, in 90 days, that merchant is up for renewal. And that merchant will get barraged many times on their cell phone-- which is somehow on the UCC records, which I don't really understand-- will get barraged by phone calls.

So if you take a six-month, short-term online loan, you can count on it that in about 75 days, you're going to have-- your phone's going to nonstop, by dozens and dozens of merchants trying to entice you into double-dipping. Which, just to give one note, we did some work with the Responsible Business Lending Coalition early on, with Funding Circle, and Lending Club, and Opportunity Fund, which discourages all the double-dipping. But you will get barraged by shops who are on the phone, or through email, different tactics, trying to get you to renew. And that's often where the process just keeps going.

JASON ADLER: And can you explain what you mean by the UCC filings for the audience who may be unfamiliar with that.

AMI KASSAR: I don't think the MCAs do it. But most short-term online lenders will file a UCC, which is dependent-- whatever position they are, they might not be the first loan, but that means if there's a default, they have the opportunity to come in and seize company assets or try to get company assets.

And so that UCC filing is a public record. And so what many of the players in the industry do is they will get all the UCC filings. And they have a date on them for many of the merchants. And they will actively use that in their marketing for renewals.

JASON ADLER: Jared, in your experience, is that a resource that's used for marketing?

JARED WEITZ: It is. And I think, our experience, we've seen it in a multitude of industries. I know that when you take a piece of equipment, there's a UCC file there. And I know that when you do an SBA, there's a UCC file there. So I think, even personally speaking, when I apply for a credit card and I then get five other pieces of mail from other credit cards. So I think there's a trigger effect in every industry, and definitely up to the end user, in this case being the merchant, to be smart about what they're doing.

I will say that if the original broker and funding company do a good job of it, do their job in explaining the different products, most people are just ignoring those phone calls.

JASON ADLER: So do you think businesses understand that the UCC filings become public?

JARED WEITZ: Yeah, I think that the funding company as well as the broker is explaining that to the merchant. Most merchants that we speak to first say, hey, what's a UCC? And then we go into what it is. We will let them know that they may receive phone calls from other folks that want their business. Because this is how some folks do their marketing. If they trust that we've done a great job for them, bring those offers back to us. If they'd like to speak to those people, they're more than welcome to. It's their business.

JASON ADLER: And so I want to quantify a little bit sort of the marketing in this space. And I'll bring Jesse in on this. How many brokers or how many ISOs might an individual funder work with?

JESSE CARLSON: We have about 100 different brokers. We work with Jared. We have a very successful relationship with Jared. While there are approximately 100 that we do business with-- and part of the way that we weed out people like Ami is describing, and don't work with them is there is an application process to become an ISO or to broker financing transactions to us.

A broker will apply. We will do a background check on them. We will run a clear report on them. And we will include provisions in our ISO or brokering contract with them that require them to not engage in deceptive marketing, to not engage in high-pressure sales tactics. And if they violate those provisions of the contract we will take their commissions back and we will terminate our relationship with those brokers. Of the 100 or so that are active with us at any one time, I'd say 25 to 50 are most of that portion of our business.

I would add that Kapitus also has a significant direct sales operation. We use traditional marketing channels-- online, radio, mailers, so how you would see typical financial products typically marketed in other areas.

SCOTT CROCKETT: Yeah. I would just add in, at Everest, we work with probably several hundred ISOs at any one time, brokers. But to get signed up, they need to go through a background check. And we're routinely monitoring them, monitoring their behavior. To the extent that we get complaints about how the brokers have marketed their product, we don't hesitate to discontinue our relationship with the broker. So it's definitely something we're focused on.

JASON ADLER: So I understand there may be monitoring in response to particular complaints. Is there any sort of proactive monitoring to make sure that the outbound marketing is accurate and is clear with consumers?

JESSE CARLSON: We have provisions in our ISO contracts that allow us to audit the marketing and to look at the marketing materials or how the products are being marketed. We periodically

do those. But we can't look at everybody every year. And we generally look to see who is claiming that they've been deceptively marketed to.

We've had we have isolated incidents in which there is documented misrepresentations as to the product or the nature of the product. And in those cases, we hold the ISO or broker responsible and honor whatever they said to the customer.

JASON ADLER: And Scott, do you want to--

SCOTT CROCKETT: No, I was just going to add to that. Yeah, similarly in our contract, we've got the right to audit. We do do spot checks. But not every ISO is being monitored every day. So it is an area that needs focus.

JESSE CARLSON: And I would add, Kapitus was founded in 2006. We've been in this space for a very long time. We have been purchasing future receivables for a very long time. We have a very good sense of who the quality brokers are, and who are the individuals who are less reputable. And we don't do business with people who we don't believe are going to accurately market the products to the customer and give them clear disclosures and a clear understanding of the product. Because we truly want our customers to understand the benefits and drawbacks of the different financing options that are available to them, and to understand the product they're getting into, and to have them succeed.

JASON ADLER: And just anecdotally, do you think that other-- not necessarily your particular companies, but other funders in this space, are they auditing and monitoring their marketing in similar ways?

JESSE CARLSON: Anecdotally, I have heard that some funders have less stringent requirements for their ISOs or their brokering companies. I've also heard of funders who've arranged it so that even though they are working for the funder, they're a 1099 independent contractor. So they're basically a bunch of independent ISOs or brokers all operating under one sort of roof, and marketing themselves as a funding company when it's really a collection of ISOs.

JASON ADLER: So if we can move on to repayment rests, and some of the concerns that we've heard about things like collections of judgment.

COURTNEY ESTEP: Experts have expressed concern that the high costs of MCAs can be too much for small businesses to repay. Ami, in your experience, can businesses commonly pay off their MCAs?

AMI KASSAR: Again, I don't have hard data. Our experience is anecdotal from the people that call us and enter our shop. And we often see experiences where, whether it's a combination of multiple MCAs or short-term online loans, and they started with what might be classified as the A players, and then they move to the B players, and then they move to the C players, and they stack, and they stack, and they stack, and they stack. And it's too late.

So now what we're trying to do is see if we can save their cash flow by refinancing all that stuff into getting, whether it's an SBA or maybe a five-year term loan, and getting their monthly payment down. And oftentimes, it's just an awful feeling. Because people will say to us, that was so enticing, I took it once, and then I started drinking the Kool-Aid and I couldn't stop drinking it. And then there's nothing we can possibly do except for encouraging them to try going to work out with their different vendors or advance companies, and trying to work into arrangements with them. And often many of the providers of capital are not as forgiving as these guys here describe themselves to be.

JESSE CARLSON: I would just add that an MCA has a cost. There's been this assumption that all factoring agreements or MCAs are high costs. The cost of capital for the select products we offer is comparable to some online lending products. And I just want it to be clear that not every MCA is the type of product that Ami is describing or is offered by the type of person that Ami is describing.

AMI KASSAR: Again, I mean, just to be clear, in my world, if you look at the cost of online capital in terms of cash flow, and you compare it to the cost of a five-year note or a 10-year note, the differences are draconian.

JARED WEITZ: I think what I've seen with our merchants and our clients is absolutely the ability to repay. The experiences that we've had have been successful. Clients have used the funding to actually grow their business. I will also mention that it really is up to that merchant, once they receive the funds, to put it to good use and actually use it for the purpose that they said.

I think that broker shops like myself, like Ami, we're doing a great job at explaining exactly what the product is, the total cost, what the total cost is monthly, whether that's paid back daily, weekly, or bi-monthly. And there's generally a very good understanding.

Anecdotally, I've heard that there's a-- and spoken to merchants that have had experiences where had they have not been able to repay. And some of their contracts were not honored, which is why they're back online looking for folks to help them out. That has not been the majority of my experience.

JASON ADLER: So in the interest of time, I want to move ahead to some of the collection issues we've seen, and specifically confessions of judgment. There have been widely-publicized reports about the abusive confessions of judgment to collect on MCAs. And I'll start with Scott, if you could explain how a confession of judgment works.

SCOTT CROCKETT: Sure. A confession of judgment is a legal contract that a merchant would enter into with a funder, where they would agree ahead of the transaction that on certain events of default, that the funder would be able to go into court and be able to automatically get a judgment filed against the defaulted merchant. Does that kind of explain.

JASON ADLER: It does. How are they being used to collect on merchant cash advances?

SCOTT CROCKETT: Yeah. And so look, I think the Confessions of Judgment, COJs, as they're referred to, have gotten a lot of press lately, some of the negative press, that Bloomberg article and so forth. We utilize COJs at Everest-- we choose to only utilize them on transactions of \$100,000 or more, which for us is less than 3% of the transactions that we're doing. And so it's a relatively small percentage of the business. And then in terms of the subset percent of that in which we're actually enforcing it, it's a de minimis amount.

And so I think there's been a lot of debate about COJs and whether or not-- COJs as a legal contract, legal instrument, have been around for hundreds of years. MCAs have been around a relatively short period of time, 20 years, have really grown dramatically in the last 10. And so I think it's a worthwhile debate to discuss about the use of COJs with a merchant cash advance and what's that right balance.

Some of the practices that were highlighted in the Bloomberg articles, and some of the negative press that's been about the use of COJs, I think, have been not representative of how at least companies like Everest, how we use them, relatively sparingly and responsibly. And so I think it's definitely worthy of debate. And looking at-- and I think there's some discussion in New York about whether or not to ban the use of COJs. Or could there be a different approach like some type of guardrails approach where you'd have a minimum. I think Governor Cuomo talked about a \$250,000 minimum. I've seen discussions about a \$50,000 minimum.

And so I think there's this debate that can be had about should a COJ be utilized in the construct of an MCA. But again, I think don't want to throw the baby out with the bathwater. And if it was decided that you were to ban the use of COJs with MCAs, it wouldn't really impact our business dramatically, not very much at all. We would, in certain instances, not advance capital, larger advances. And so you just need to do a cost-benefit analysis as to whether or not that made sense. I know Kate's talked about [INAUDIBLE].

KATHERINE FISHER: Yeah.

JASON ADLER: Kate, in your answer, do you mind, for folks in the audience who may be unfamiliar with reporting on the way confessions of judgment have been used, can you talk about that a little bit.

KATHERINE FISHER: Well, I can't speak to press reports about the different ways that confessions of judgment have been used, because I'm not personally familiar with that. I only know what I've read. I would like to talk about confessions of judgment. And it's helpful to look at the Federal Trade Commission's decision in the '80s, when the FTC banned the use of confessions of judgment in connection with consumer transactions, but determined not to ban the use of confessions of judgment in commercial transactions.

In the FTC's statement of basis and purpose for the Credit Practices Rule, the FTC stated that confessions of judgment were unfair to consumers, in part because consumers cannot reasonably avoid signing a contract that contained a COJ. This is not the case in commercial finance transactions because, typically, a small business is represented by a broker who receives multiple offers from competing financing sources. We've heard about that type of competition today.

With a consumer credit contract, typically a consumer is presented with one "take it or leave it" offer.

In addition, the FTC concluded that consumers were not reasonably able to avoid default. Because frequently, in consumer credit, a default is caused by something that's outside the control of the consumer. For example, they lose their job, they get sick, and things that they can't anticipate and can't control. In the context of a purchase of future receipts, a business always can control whether there is an event of default. Because again, the obligation to repay is tied to the business's actual revenue. So events of default are only specific instances such as diverting funds into different bank accounts. So there is a distinction between the two types of transactions.

JESSE CARLSON: And to your question, I would add that a lot of the abuses of confessions of judgment or their use were driven by quirks in New York law that I know that the state of New York is taking a look at. The way that confessions are entered in by the New York courts is a little bit different than it is in California. And there are fewer protections to ensure that there are protections that prior to entering into them. For example, California requires a wet-signed or original copy of the confession of judgment. New York will take a fax version of it.

JARED WEITZ: I can tell you one of the ways that we've handled it, because we're presenting multiple offers to a merchant often. We are explaining what it is. We actually give them a document that has a definition of what it is so that they're comfortable and they understand it. I can say that 90% to 95% of the financing that we are providing through brokerage to our clients do not have them. In times where there has been high risk, we have advised the merchant we think that this may be an option for you. This funding does have a COJ. Here's what it is. You have to be very comfortable with it before you take it, and then ultimately give them the option.

JASON ADLER: Ami, do you want to jump in.

AMI KASSAR: I don't think I know enough about this.

JASON ADLER: So Jesse, I want to get a little bit more into how the industry has responded to the use of confessions of judgment. The Small Business Finance Association I know is considering codes of conduct relating to the confessions of judgment. Can you talk more about that.

JESSE CARLSON: To be clear, Kapitus does not require as a condition to extending financing that a merchant enter into a confession of judgment, no matter how large the transaction. We have just made a strategic decision to go in another direction. We understand that others believe that it will improve your default rates. That's inconsistent with the data that we've found.

Given that these are primarily used by-- in our anecdotal experience, these are used by companies that may be less scrupulous, maybe engaging in some of the practices that Ami has just described. The SPFA, after we saw the extent of the use of confessions of judgment by those individuals, we, as a trade association, decided to include in our code of conduct an explicit ban on the use of a confession of judgment if you're a member of the Small Business Finance Association.

I would add that, part of the reason we don't include them is we, in our underwriting process going back to our underwriting, look very carefully at the amount that the merchant can afford to repay. There are some companies that may not be as careful in their underwriting, and use more aggressive collection tactics as a means of supplementing. And it's inconsistent with how Scott's company uses them, but there are some people out there who will do that.

SCOTT CROCKETT: I would just comment, in terms of the instances where we're actually trying to utilize or enforce a confession of judgment, it's almost entirely when we believe the merchant's committed fraud. So not in a situation where their business is slowed down or there's some type of payment issue tied to the performance of the business, but in instances where the merchants have diverted funds into a different account or have actually committed fraud, and again, on large transactions. So for us, again, we're only utilizing them on transactions of \$100,000 or more.

And so I think a lot of the behavior highlighted in the press as of late, if you were to put a cap of \$100,000, or \$150,000 I think you would clean up and take care of a lot of the bad behavior that was highlighted in some of the recent press articles.

JESSE CARLSON: And I would add that New York has recently introduced a bill that would prohibit taking a confession of judgment against a non-resident. So essentially the clerks in New York would not be able to enter a confession against a non-resident. So that is also, I think, a step toward reforming some of the unique aspects of New York law that allowed some of the practices that were reported to develop.

JASON ADLER: So we're closing in on the end of this session. And I want to transition to the next session, which is going to get more into the legal landscape of small business financing. But just to touch on it briefly here, as you all know, while the FTC Act applies to the marketing and provision of merchant cash advances, some courts have found that other laws may not, for example, to the extent that MCAs are held not to be loans. State usury laws or licensing requirements typically wouldn't apply. Kate, is that something you could speak to? What are the legal ramifications of MCAs not being considered loans by certain courts.

KATHERINE FISHER: Sure. You're right that a properly-constructed merchant cash advance is not a loan, it's a purchase and sale in courts, and particularly in New York. But there's a growing body of law all over the country to recognize the distinction between a purchase of future receivables and a loan.

There are a lot of consumer protection laws that do apply to these transactions, of course, as you mentioned, the FTC is a powerful authority to prevent unfair or deceptive acts and practices. At the federal level, there's the Fair Credit Reporting Act and Regulation V. This protects individuals and requires permissible purpose to pull up a consumer credit report for a sole proprietor or an individual guarantor of a business. Also the FCRA requires a user to provide notice to an individual if it takes an adverse action on the basis of information contained in a consumer credit report.



The Servicemembers Civil Relief Act applies to sole proprietors and individual guarantors. The Telephone Consumer Protection Act and the CAN-SPAM Act apply. For loans, the Equal Credit Opportunity Act applies. And states are starting to regulate this industry. As you said, it's a distinct industry from business lending. California recently passed a law requiring merchant cash advance transactions, factoring, and loans to provide certain disclosures on their contracts, and other states are considering similar legislation. So I would expect to see state laws continue in this trend, particularly in disclosure laws.

JESSE CARLSON: And I would only add that Kapitus is committed to complying with the laws in all 50 states and the District of Columbia, where we do business. And we structure our financing products to comply with the laws in all of those states. I know that there is an alternate regulatory model that allows a partnership with a bank. The bank will originate the loan, which will allow the exploitation of that interest rate as a way of avoiding the caps on lending that are imposed under certain state law.

So I don't think that structuring the transactions of purchase and sale transaction is a different legal way of getting to the same result, which is to provide capital at the appropriate cost to address the higher-risk nature of small businesses. Because while there are many success stories in small business lending, small businesses do go out of-- not everybody succeeds. Not everybody becomes a tech CEO. Or to use another example, the individual who ended up with-- the Caspers. Not everybody who succeeds. A lot of them fail. And you have to price credit appropriate to the risk.

And I think structuring the transaction as a purchase and sale transaction of receivables is the same way as getting to what a bank partnership does.

JASON ADLER: Right. Well, we are actually heading for a break. So thank you all for participating. This has been a great panel. And we'll break now before the third panel.

JARED WEITZ: Thanks for having us.

[APPLAUSE]

SPEAKER 1: And we're running a few minutes behind. So we're going to take a 10-minute break and begin again at 11:20.

[AUDIO OUT]

SANDHYA BROWN: If everyone can go ahead and get seated, I think we'll kick off panel 3 in just a moment.

Great, let me introduce myself first. I'm Sandhya Brown. I also go by Sandy. I'm an assistant director in the Division of Financial Practices. I'm going to be one of the moderators for panel 3. I'll go and introduce my co-moderator, my DFP colleague, Evan Zullo.

So we're excited for this third and last panel. We're going to be covering consumer protection risks in the small business financing space. Having heard from the first two panels generally about the multitude of products that are available to small businesses who have financing needs, and then hearing sort of a specific deep dive into one particular product, merchant cash advances, hopefully now is our opportunity to talk about specific risks to the small business owners who are on the hunt for financing.

So some of the topics that I'm hoping we'll be able to cover in this next 75 minutes include whether or not small business borrowers are getting the information that they need to get products that suit their needs, the legal landscape and self-regulatory efforts in this space, concerns about brokering practices, or privacy and data security concerns, and lastly we'll also hit upon the efforts that have been undertaken to educate small business borrowers.

So before we get into our discussion, let me briefly introduce our panelists. I will let them also speak to their own bios in the context of answering certain questions. But in the interest of getting into the substance, I will just go ahead and give you names, and titles, and organizations. So immediately to our left is Ky-Nam Miller. He's program director of the California Reinvestment Coalition. Next to him is Bernardo Martinez. He's US managing director of Funding Circle. Next to him is Barbara Lipman. She's project manager in the division of consumer and community affairs with the Federal Reserve Board. Next to Barbara is John Arensmeyer. He's founder and CEO of Small Business Majority. And next to Bernardo is Christin Spradley. She's head of policy and a senior associate general counsel with OnDeck. And lastly, at the end is Sheri McConville she's a supervisory program analyst with the Small Business Administration.

OK, so and thank you to our panelists for participating today. So we'll get right into it. And just as a matter of logistics, to the extent any of our panelists wants to jump in on a question, just kind of raise your finger, and we'll note that is a signal that you want to be called on.

OK, so let's start by exploring what, if any, key information is made available to small business owners when they're shopping for financial products. So what I'd like to hear the panelists talk about specifically is, in the current marketplace, i.e. as things stand today, what information are small business lenders typically providing about their products? Are they telling small business consumers about interest rates, costs, and other key terms? And is there any uniformity in the kind of information that's coming to small business borrowers?

**BERNARDO MARTINEZ:** I mean, I think, in generally speaking terms, what you see in the marketplace is that there is not really a good uniformity in the different products that are in the marketplace. And therefore there's different elements that people are showing up. And actually what it creates is actually some confusion with the small business owners when they're looking for products.

So in our case specifically, we are pretty transparent. We have been a leading an effort on trying to create responsible business terms for small business owners. So we show APRs, the terms, the monthly payments that they have. But there is definitely an opportunity for the industry to create

a broader coalition to create uniformity so people can compare the different products in a similar way.

SANDHYA BROWN: Great. Barbara.

BARBARA LIPMAN: Hi. And I have to start-- I'm sorry-- with the disclaimer that the views here are my own and not necessarily those of the Board of Governors of the Federal Reserve System.

So I'd like to try to tackle that question from the point of view of small businesses that we've been contacting through a series of online focus groups. So as you know, small business owners are notoriously difficult to reach. They're busy running their businesses. So we thought the best way to get to them was through an online format. And we've been contacting small businesses with fewer than 20 employees and less than \$2 million in revenues, and generally talking to the financial decision-makers. The great thing about this format is that we're able to have the small business owners go out and pretend to shop for credit online lenders. And we're also able to have them evaluate mock products based on real products out in the marketplace.

So when we asked them to pretend to shop, they told us what was on their shopping list, and it was of course finding out about costs and in terms, and what the application process would be like, and what information they needed to supply, and how long it would take for a decision. But what they were telling us is that it's very difficult sometimes, depending on the particular lender, to find even some basic information. So of course there's wide variation, and that speaks to the diversity of products that are out there in the marketplace, which I think we agree is generally a good thing. But some of the Lenders are very explicit about their costs and fees and what's involved.

Others however, require a visitor to the website to enter personal or business information before they find out even the basics about the products. So that's something that's problematic for them. On the other hand, finding out how quickly they'll get a decision, that's something that's usually touted upfront in the website. So it really varies depending on the lender, the type of product offered, and the type of information that the small businesses are looking for.

SANDHYA BROWN: Christin or John?

JOHN ARENSMEYER: Yeah. I would second everything Barbara said. There's a wide variety of products out there. And at the end of the day-- well, first I want to make the point that we hear, all the time, gee, why do we need to worry about this, because these are business people, and they're sophisticated, it's not the same thing as the consumer. The reality is that, unless a business is large enough to have controller or a head of accounting, they are no more sophisticated than the average consumer. They may know about their business, they may know about dry cleaning, they may know about running a restaurant, they may know about graphic design, whatever they're doing. They are not any more sophisticated than the average person.

So it's very confusing. They don't get consistent information. There aren't standards out there for them to compare. And even this question of whether a merchant cash advance is a loan or not, I

mean, to the average small business owner, everything is a loan. They're borrowing money in some form. So these kind of legal distinctions are fairly meaningless to them. And right now, it is pretty much the Wild West in terms of any information they can get. And obviously we'll talk more about this as we go forward. But there's a need for consistency and transparency.

SANDHYA BROWN: Did Christin Sheri want to chime in? I apologize, I can't see you clearly, so I can't tell when you're raising your hand.

CHRISTIN SPRADLEY: No, I mean, I think not much to add that hasn't already been said. I mean, I think that in addition to kind of some of the efforts that we've seen to improve the transparency around disclosure of pricing and cost in terms, I think that Barbara's report in particular highlighted that's not the entire story. You also need to be thinking about when is that information made available, how clear are you on the minimum qualifications for your loan, when are you communicating that information, are you able to provide ranges of prices or some of the terms on your website and in all of your marketing materials? So I think it's not just kind of, once you have a specific offer in hand, what are the terms of your offer, but also making sure that businesses are able to access some of that information earlier in the process. I think that's an important piece of it, and it's certainly something that we've heard from customers a lot.

SANDHYA BROWN: I'd love for our panel to talk a little bit more specifically on that point Christin, about when business consumers are getting the kind of information they might need in order to shop between products. I've heard from Barbara and you mentioning the importance of being able to do that up front. Is that not happening now?

CHRISTIN SPRADLEY: I think that there is a tension between what are you able to provide upfront, prior to underwriting, and what do you need to have gone through sort of a full underwriting process to be able to provide. I think that there have been some good efforts in the industry to kind of try and pull the information forward in the process. But I don't know that everybody has gotten there yet. I certainly know that, just from the perspective of somebody, if I'm looking for credit, I want to get a sense of at least what the profile or the bucket is of the types of ranges I could expect.

But then the challenge for our company that's providing it is you also want to avoid, at all costs, kind of the bait-and-switch of providing them with a range, and then having them not fall within that range. And I think that tension, what can you provide prior to underwriting, it's probably one of the biggest pain points for the industry and for customers.

SANDHYA BROWN: Anyone else have thoughts? Barbara?

BARBARA LIPMAN: Yeah, I'd just like to add that, generally, to John's point, the smallest small business owners are somewhat consumer-like in their approach to financing. And some of the products are actually different than typical consumer products. And one of the areas that they find confusing is the repayment terms. So for instance, a number of products are structured such that there's a total amount that you need to repay, and you owe that amount whether you pay it in a week, or a month, or a year.

So when we showed a sample product like that to our online focus group and said, OK, you pay out of, say, daily sales, what's the impact of paying more quickly if your sales are higher. And generally the answer was, well, I'm going to save money. But that's not how the product is structured. So I think information like that is important to convey to small business owners, or at least they're telling us that's the sort of thing they need to know up front.

SANDHYA BROWN: Ky-Nam, I think you had a point.

KY-NAM MILLER: Yeah, I'll just piggyback on Barbara's comments about-- the products are different, but the consumer is the same in many cases. The California Reinvestment Coalition, we're a 300-member org. And a lot of our folks, our members on the ground, are entrepreneurs of color, single proprietors without employees. And they're going out into this market with the same sophistication-- which is to say, not a lot-- as they'd have if they're seeking a regular consumer personal loan.

And the lens that they look at this world through is, well, what's the interest rate? And they might be aware of APR, but that's not what's always disclosed to them in this ecosystem we're describing this morning. It's not even a question of kind of apples to apples or apples to oranges. There's all these different gradations of apples. And they might not understand a factor rate or a simple interest rate is not the same apple that what they see in the personal world. So you have this incongruity between the protections that we've put in place for regular Joe consumers and those same folks who are turning around and get trying to get cash flow for their business.

So I think, from the consumer perspective, that's the big challenge. And it's an acute challenge on the emergent majority of Americans that we see in California, who are majority of color, many limited English proficient, coming from a diversity of backgrounds. And so the system we have in place federally is not protecting those folks adequately.

SANDHYA BROWN: John.

JOHN ARENSMEYER: Yeah. I think, fairly simply, there is a question of math also. I mean, most people when you say an interest rate, you assume annual, generally assume APR if you're comparing it to other kinds of loans you've gotten. And so when you start tossing around rates that are monthly or different periods of time, it's very difficult for consumers and of course the average small business owner to understand that that's not an annual rate. And if they hear 10%, and it's a month, or even two months, it's not the same thing as an annual 10% rate. And there's a lack of transparency as to exactly what the rate is.

Now, it may be that it's perfectly OK for the business to take a short-term loan for what essentially would be a pretty high APR. So we're not saying that's not the case. But they don't even begin to understand the difference between that rate and-- they might see that same number connected to an annual product and not understand the difference.

SANDHYA BROWN: Bernardo.

BERNARDO MARTINEZ: I think one point that is important I've heard here. And we've talked about small business owners are not sophisticated. I would say, actually, they are sophisticated. I think the question is they don't really have time. They're hiring people, they're running their show, they're trying to do multiple things. They lack time. When you look at small business owners' surveys, what they really lack is time.

And what is not really in the industry right now is a clear uniformity process that can actually quickly compare products. And that's what I think we're advocating. I think us and Funding Circle, we believe that uniformity will allow the customer and the small business owner to really quickly assess what is a right choice of product based on what the needs they're trying to solve. If they're trying to do a quick financing because they're going to buy an inventory, maybe a short-term loan makes total sense. But if you're going to do an expansion of your house or the property because you're growing too much, maybe a long-term loan with an installment monthly payment maybe is the right choice for you.

So I think that's the clarity that I think we, as an industry, we need to advocate is that uniformity, how we can measure the different products, and they can really assess, this is the right one for me, and this is not, and therefore they can assess that. But I actually will defer from the other panelists, that they are sophisticated, and it's just time that they're lacking to really assess that because they have other things to achieve in their day-to-day.

SANDHYA BROWN: I appreciate that distinction. I think it's helpful. And I'm going to use it to piggyback into this next question. So let's maybe set aside the question of sophistication, per se. And instead, I think it was suggested, perhaps, on the first couple panels, at least by some panelists, that the small business owners who are interested in financing are actually well-educated, and they are going into the selection of a particular product eyes wide open, recognizing the costs and benefits of that product versus another. I'd be curious to hear whether or not this set of panelists agrees with that idea, that when a small business owner is selecting a particular product, they do truly understand what they're getting.

JOHN ARENSMEYER: I guess I would push back on that a little bit. And of course there's a range here. I mean, obviously there's a few that are very sophisticated, and have accountants, or they're big enough they've got somebody full-time who can explain it to them. And then you've got what Bernardo was saying-- yes, you have business owners that are maybe more sophisticated than the average person, and they don't have time, and they don't have someone sitting there. They haven't taken the time unless someone's sitting there laying out the options for them.

But to pick up on what Ky-Nam said, there are a lot of perfectly bright, and they know their product, but they're not financially sophisticated. They're not even in the categories that Bernardo was talking about. And a lot of these are entrepreneurs in underserved communities, entrepreneurs of color. And they may be immigrants. They may not be fully conversant with English. So I think we need to understand there's a spectrum here. But there are a large number of people that fall on the unsophisticated end of the spectrum. I don't think you can say that all of them are sophisticated as some, they don't have the time.

KY-NAM MILLER: I don't want to carry on the sophistication line too much. Just to say that this is not about people's underlying intelligence or abilities. I think a more kind of interesting perspective of this is how sophisticated is the system in meeting the needs of the consumers who are actually there. The question of, do we have an even playing field, which to me is characterized by transparency and disclosure, that's not the case. That's not what people are operating in today. It's more like a slaughterhouse. It's dark, and you don't know what's coming at you, and you can be harmed by the products out there. So sunlight and disclosure and transparency is the remedy to that.

SANDHYA BROWN: Barbara.

BARBARA LIPMAN: Yes. So in our focus group, as I mentioned, we displayed some mock products based on actual products. If you just ask small business owners, do you think it's easy or difficult to compare these products, they generally say, easy, because they're the financial decision-maker, and they feel like, yes, it's easy. But when you probe and ask specific questions to test their understanding of the products-- is product A cheaper than product B, is product B cheaper than getting something from your credit card, then they're not answering correctly, they're not sure. In some cases, when we asked, what do you think the interest rate is on a product, it varied from 10% to over 50%.

So when you really probe for specifics, it turns out, well, I'm not so sure actually. So I think you have to go beyond, is it simple or easy, and really talk about what we've been talking about here-- what's actually being provided, and how do we make it easy for folks to compare?

BERNARDO MARTINEZ: And I think that's a critical point at the end of the day, how we educate the small business owner to compare those choices in a simpler way that basically puts a level playing field for all the products, that each product will have benefits, and that may be tailored for that small business owner.

But I think it's important that the critical objective of policy should be around creating that uniformity that basically enables that access and understanding across all products, so basically they can have the choices.

SANDHYA BROWN: I just want to make sure I'm not missing anyone. OK, let's actually use that to segue to my next question, which is going to be about what small business financing companies should be offering by way of information that will allow consumers to comparison shop. So as an example, one thing when we do education for consumers, we tell consumers, an easy metric to look for when you are shopping for a loan is an APR. We've obviously heard-- and perhaps many of you will concur-- that an APR may or may not be a feasible metric to use for comparison shopping. But what kinds of information could be provided, and is there any type of metric-- something like total cost of capital-- that could be offered as a way for small business owners to comparison shop for products? Christin.

CHRISTIN SPRADLEY: Sure. So I know we'll dive in a little more depth in the future. But one of the things that we found was that there was this sort of-- people were not necessarily speaking the same language. You were getting quoted different metrics, and it wasn't even clear if one

person's calculation of a rate was the same as someone else's. And so a couple of years back, OnDeck, as one of the members of a trade group called the Innovative Lending Platform Association, actually thought, let's ask that question of small business stakeholders. If you're going to look for capital, what do you want and need to know?

I think the results of those surveys, almost 600 small business stakeholders was there's probably not a single bullet, but definitely there should be a floor of some basic metrics that are really helpful to compare that are kind of product-agnostic, don't necessarily favor one or the other, because I know there's the dynamic of, is it short-term, is it long-term, is it a purchase and sale transaction, versus a term loan, versus a revolving line. And there's definitely differences between those.

But some of the metrics that came out at the top of that survey that we conducted were APR-- I think that that's a very useful one, especially considering that many small businesses, when they're approaching a company like OnDeck, are also potentially looking at credit cards, and that's typically the way that those are quoted. We also found that the total cost metric was another useful one, because a lot of businesses do think about their financing in terms of kind of dollars in, dollars out. And that ROI-driven aspect of it also made it useful for them to see that it's going to cost me x amount to borrow this amount of money, and I'll be able to return, is that a good deal for me?

Another metric that we found useful that made it into kind of the top four was an average monthly payment. And I think that's because a lot of payments run on monthly cycles for businesses, so they're used to thinking about, how much am I bringing in a month, how much could I afford to have go out the door in a month?

And then the final one that we found useful but to be honest was kind of a distant fourth was a cents-on-dollar metric, where for every dollar you borrow, how much are you going to pay in fees, again, kind of an ROI-driven way to think about it. But those were four of the metrics that stuck out to us when businesses are thinking about pricing.

SANDHYA BROWN: Anyone else want to jump in? Barbara?

BARBARA LIPMAN: Yeah. Actually we got remarkably similar results in our focus group. We showed folks a sample disclosure box. It had APR, it had cost of capital, it had fees broken out separately, it had payment amounts, cents on the dollar. And most-- like the APR, they're familiar with it. They know what a good rate is when it comes to an APR. But some of them liked the cost of capital and the fees, especially when spelled out.

And then we also asked them, well, what's missing, what wasn't in the box that we showed them. They wanted more details-- what happens if they pay late? They wanted more details about repayment, not just whether or not there'd be savings, but how much savings they would have.

And then some were interested in knowing who has control over the payments. And I think that's getting to the idea of if you have portions taken out of your cash flow automatically, and you



have an emergency, say the roof leaks, do you have control over that cash flow. So they want to know more details about the mechanics of how the payments are made.

SANDHYA BROWN: Ky-Nam.

KY-NAM MILLER: So we really think the gold standard for this is the Responsible Business Lending Coalition's Borrowers Bill of Rights. You can find it at [borrowersbillofrights.org](http://borrowersbillofrights.org). So there's seven elements, with some of them mentioned here. But the financing amount, the APR or estimated APR, the payment amount and frequency term, or estimated term in the case of variable term financing, all upfront and scheduled charges listed with dollar amounts, prepayment charges, and any collateral requirements.

SANDHYA BROWN: And I know we're going to be talking a little bit more about that effort and some other self-regulatory efforts as well. I'd like to shift down to talking a little bit about the legal backdrop against which these transactions and consumers' decision-making is taking place. So everyone from Commissioner Chopra, who kicked off our event, to panelists on the first two panels mentioned-- and I will reiterate here-- the FTC Act, which prohibits unfair or deceptive practices. It does apply to non-bank small business lending. But it is often the case that other protective statutes in this space do not provide coverage for small business owners. One example is the Truth in Lending Act, TILA. So I'd like to hear from our panelists about what the ramifications are for perhaps some of this lack of coverage to small business owners. Bernardo.

BERNARDO MARTINEZ: Well, I think one of the things we have done actually in partnership with Lending Club and Opportunity Fund is actually being proactive about it. And actually we partnered with the state in California, and passed this [INAUDIBLE] small business truth in lending to try to really kind of make an effort to create a standard on how small business lending should look like. And again, it goes back to my first statement at the beginning, it's really about uniformity. We truly believe that that's going to create that stand to help us create, nationally, a process by which small business owners can actually compare and conduct their business and access capital. So that's what we have done.

So we move from just being a victim of the issue, and trying to be proactive with the state of California. And we will continue to work and partner with companies like OnDeck and anyone else who wanted to continue to pursue those efforts in other states. Because we truly believe that having that national framework or state framework will help the small business owners.

SANDHYA BROWN: Christin.

CHRISTIN SPRADLEY: Yeah, I agree with all of that. And to your question of kind of what is the ramification for small business owners that TILA doesn't apply, I think it's exactly what we've all been highlighting, which is you just see a real divergence of practice. And I think it's not just about what is disclosed, but also how is it disclosed and when is it disclosed. And frankly, in an ecosystem like ours that has a lot of different referral relationships, and brokering relationships, and lead generation, it's also who is disclosing it. And I think that the impact without that standardization has been one that the companies on this panel, I think, been proactive on.

I think we had initially hoped, when we were working on the SMART Box initiative back in 2016 that self-regulatory measures would be enough. But I think that the trend that we're seeing now is that policymakers have suggested it may need to go further. There may need to be some sort of codification to actually bring some of the more reluctant actors into the fold.

So I think that's been the outcome that we've seen. I think without TILA, there's definitely some players who have been trying to make progress. But policymakers, particularly at the state level at the moment, are starting to kind of turn those self-regulatory efforts into something that is regulated. And I think that's a really useful tool for those who maybe haven't been at the forefront of some of the efforts.

SANDHYA BROWN: John.

JOHN ARENSMEYER: Yeah, I just want to second what's already been said. I mean, there's a potpourri of tools out there now. We do believe that there's a role for the FTC, under the Deceptive Practices Act-- Unfair and Deceptive Practices Act, absolutely. And people have even made an argument that, well, you can sort of say that small business owners are actually like consumers. But there is no reason we should have to go through those-- I mean, we still think the FTC should do everything they can in this area. Don't get me wrong. But we shouldn't just rely on the fact there may be a couple pieces out there. Or if you're originating through a bank, then there's bank regulation.

So to second what Christin was saying, we need a standard. Now, obviously we would love to see a federal standard. And there is interest. There's been some conversations trying to move that forward. Obviously, absent that, we've been very active in the states. We were working with Funding Circle, and Opportunity Fund, and Lending Club and others. We were very active in getting the California truth in lending bill passed last year. There are now bills in New Jersey and New York, there's talk in other states, and that's great, and we're all going to continue to do that. But at the end of the day, this shouldn't have to be piecemeal. Ultimately, we really want to have one standard that everybody can rely on.

And again, we're not talking here-- this is just one piece of the problem, transparency. And we're just talking about transparency here. And we're not saying that you can't make any of these loans, you can't put any of these products on the market, we're just saying we need to have a set of standards so that small business owners can understand what they're getting.

SANDHYA BROWN: And I'd be curious to hear from other panelists about the tension or sufficiency between the federal laws that cover these issues, state laws, and self-regulatory efforts. Do any of you have feelings that one or-- that some of those are sufficient, versus the need for something more.

KY-NAM MILLER: I live in California, and I've got my biases for SB 1235 and the TILA that we've got there. Maybe it's even a little step better than what's going on in Jersey in New York. But I think I've got to take a closer look at those.

But there's been an advocacy. We need it federally. We had some tools at the CFDB and with the section 1070. And that just hasn't been applied by this administration. So in this void at the federal level, which ideally the FTC could step up under UDAP and do enforcement. State governments and legislatures are the only game in town right now. But we also have to be doing the seed work and working with consumer-friendly legislators to put forth the market legislation so that when the climate is more appropriate here in DC, we have a small business TILA ready to go.

SANDHYA BROWN: Anyone else? Christin.

CHRISTIN SPRADLEY: Yeah, I would just add maybe taking a step back from transparency for a moment, and looking at some of the other regimes. Maybe not surprising from the perspective of an industry player, but we'd love to see standardization. I think that the challenge for us is, currently, even as a non-bank, we're still subject to information security laws, privacy, fair lending, anti-discrimination, fair sales and marketing practices, anti-money-laundering, and sanctions screening, and licensing, and interest rate caps. And when we have 50 different versions of all of those, it really becomes a challenge because the goalposts are just moving on the field.

So I think the slight preference is not sort of-- I don't have an innate preference for federal versus state solutions on any of these. But I do think that some of the efforts to standardize or harmonize those practices across the states would be much appreciated, just as somebody who's trying to comply. So that would be our preference, not kind of inherently favor of one or the other, but something that's certain and that's fairly harmonized.

SANDHYA BROWN: Right. So actually, Ky-Nam, since you happened to mention it, could you describe a little bit about the California legislation and the protection that it offers.

KY-NAM MILLER: Sure. I invite my colleagues to also join. I think they had a more substantial role in it. But I think what's remarkable about it is that it was really the product of a diverse coalition of fintech, CDFIs. We have a 300-member, the California Reinvestment Coalition, Green Lightning Coalition is another 50 members. And it was the product of a large people-of-color coalition partnering with new chairs in the banking committee on the state legislature to put forth really unprecedented bills and public policy. So I think when you have coalitions like that, you get good policies. So Yeah, I'd invite you to add on to what the substance of it was.

JOHN ARENSMEYER: No, I would-- it was a great coalition. And one of the things we've really been excited about-- and we're a founding member of the Responsible Business Lending Coalition, who created the Borrowers Bill of Rights, who said, unlike a lot of other situations that we deal with in a small business advocacy organization, we're actually able to partner with industry members, with CDFIs like Opportunity Fund and Accion, with fintechs like Funding Circle, Lending Club. And we're able to sort of go-- what happened in California was going to the legislature and saying, this is not just a consumer point of view, the industry really wants this. Industry wants standards, industry wants transparency. And so that was very powerful. And I think we I think we can replicate that elsewhere.

And yeah, I mean, there were a set of standards around rates, and terms, and total cost of capital. And the details are being worked out at the regulatory level at the Department of Business Oversight in California now.

So I mean, I would agree, we ultimately want-- we'd love to have a national standard. Now, if you've got a pretty strong state standard, you don't want that to preempt-- you don't want a weaker national standard to preempt a stronger state standard. So that's always going to be an issue. But I'd be the first to agree, Christin that having 50 different standards is probably not ideal.

That said, all of us who are interested in this are going to keep working at the state level. Because I think, as somebody else said here, that's kind of where the biggest opportunity is now. And that may then spark an effort at the federal level to deal with us.

EVAN ZULLOW: John-- or maybe others, too, who worked on the California legislation-- could you talk a little bit about-- there's a lot of discussion about consensus, which is great that you were able to achieve that in connection with that law. But what was sort of the pressure points in terms of metrics to be disclosed? And what were the lines of that debate?

JOHN ARENSMEYER: Well, ultimately the biggest debate was around whether you could use APR. And that actually has not been completely resolved. That's being resolved at a regulatory level. And we wish it had been resolved legislatively, but we were happy that we got everything we did in the bill.

And there's some legitimate questions about certain types of products, MCA products in particular, about calculating APR. We think it's possible. We think, because it is the gold standard, that's what everybody compares, that we need to figure it out, whether you're basing it on the history of the way the MCAs have operated or how they're calculating their return. There's definitely ways to do it.

And that was probably the single biggest-- I mean initially, it was just kind of everybody sort of getting together and figuring it out. But at the end, that that became the biggest area of debate. And it got resolved by being kicked to the Department of Business Oversight.

EVAN ZULLOW: And Christin.

CHRISTIN SPRADLEY: Sure. So I would add, I think, not just in the context of the California legislation, but in some of the other efforts that industry players have been working on for the last couple of years, I think we saw a few key areas where there were some real challenges. You had to kind of wrestle with the issues. And one of the ones that we saw in developing the SMART Box was there's certain metrics that can be challenging for products without fixed terms. For example, we've already heard today some of the challenges of calculating rates for products without fixed terms. That was an issue that we had to wrestle with, and it came up again in California.

Another challenge that we experienced was trying to provide some of the total dollar cost metrics for products without a fixed amount, like a revolving line. That was another area that we struggled with and had to wrestle with in developing the SMART Box.

And then another one was a point that the Barbara has raised a couple of times now, which is prepayment policies. There's a real diversity of different prepayment policies that the companies have in the small business lending space. And that was another area where reaching some sort of consensus and how you could provide enough detail, sufficient detail, but not overwhelm a customer, and make sure that they're getting the piece that they need to know in plain language, that was a real challenge of pre-payment. Because it is very different, I think, from a lot of what you would expect in the consumer context in terms of a fixed fee product, where prepayment doesn't necessarily benefit you. Paying it faster, you're still paying the same fixed fee amount. And I think expressing that in a way that small businesses could understand was something that we definitely had to wrestle with as a group, given the diversity of products.

JOHN ARENSMEYER: One quick comment on prepayment-- I mean, it's so counterintuitive to the average person and every small business owner. You ask people out there, 99.9% would say, yeah, if I pay it off faster, I'm going to save money. And that isn't always the case. You have an effective prepayment penalty even if it's not an explicit prepayment penalty. So that definitely needs to get factored in to-- no pun intended-- that needs to get factored into an analysis of what the rate's going to be, what the cost of capital is.

EVAN ZULLOW: And can anyone that's been involved talk a little bit about-- we know there's been some movement, potentially in other states, similar to California. Have any of our panelists been a part of those discussions? Have they sort of been moving on a similar track, using similar metrics?

JOHN ARENSMEYER: Well there's a bill in New Jersey that's passed the Senate. It's going to be heard by the assembly at some point. I think there's a bill that's finally being introduced in New York. And there was a bill introduced in Illinois a couple years ago. I don't know if and when that's going to happen again. And then there's conversations happening in a bunch of other states as well. And states where we're most active, we're definitely engaging with legislators and with other stakeholders on that. So yeah, there's definitely interest at the state level in dealing with this.

EVAN ZULLOW: Thank you. And Christin.

CHRISTIN SPRADLEY: Yeah, I would say, involved in California efforts, and then in New York I think they saw the efforts that were taking place in California, and the Consumer Protection Committee in New York, both in the assembly and banking, also wanted to approach the topic this year. So that they came to us as developers of the SMART Box and asked for a little bit of guidance. I think that the interesting piece has been not how different they are, but how similar they are. And I think that we've started to develop, kind of nationwide, and I'd say I think a lot of the same folks that are participating in today's event, as was colleagues that are on this panel, really kind of helped develop what we consider to be the floor for disclosure as part of-- the CSBS had a fintech advisory panel.

And that was a big topic that we spent quite a bit of time discussing. It was kind of like, what are the areas that disclosure should be, where should we set the floor? And the encouraging thing is that I think a lot of the states that are picking up this effort looked very similar to the recommendations that came out of the CSBS.

EVAN ZULLOW: And Christin, we've been talking about it quite a bit already. But I thought maybe we should drill a little bit more into detail as to what the ILPA SMART Box requires in terms of the standardized information that's provided. And does it change between different product lines, or it's just the same TILA-like box for all products?

CHRISTIN SPRADLEY: Yeah, so we, like I said, sort of developed that after some engagement with a variety of different stakeholders as well as small business owners. And we really tried to make the boxes-- we have three different versions right now. There's a box for kind of a classic term loan, there's a SMART Box for a line of credit or a revolving product, and then there's a SMART Box for a purchase and sale product. So that would include factoring, it would include cash advances or revenue factoring products. And we tried very hard to make them as standard as possible, on the assumption that if you're a small business looking for credit, you're very likely to be approaching companies that offer any one of those three products.

And so we provided the same set of metrics. I kind of already ran through what those pricing metrics were, the four that we settled on. In addition to that, there's also questions that highlight the prepayment policy, as well as the loan amount, the amount that will actually be disbursed into your account, the repayment schedule, like the frequency and the dollar amount, and the APR that's calculated in accordance with TILA for those products.

The exciting piece is that now that the SMART Box-- it fits within one page, we tried to put it in very plain English-- it's been out in the market now for almost 2 and 1/2 years, and we sort of have taken the last 2 and 1/2 years worth of learnings and are looking at revisiting it. And the new sort of exciting developments partially inspired by California are to add in some other questions that I think Barbara's focus group focused on, too, which is, outside of pricing, what else did small business customers need to see? So we're adding in questions about these security interests that may or may not be taken, the collateral requirements, and then whether or not there's any personal guarantee of payment. So those are all advances that are kind of coming soon, based on the feedback that we got after the first couple of years having adopted.

EVAN ZULLOW: And Christin, what does the ILPA require in terms of both the timing and format of the SMART Box disclosure of its members? Are there any sort of baseline requirements as to how and when it's presented to consumers?

CHRISTIN SPRADLEY: Sure. So we actually built out kind of an independent third-party consulting group that, first step, if you're interested in adopting, you come in and they validate your APR to make sure that the calculation's in accordance with TILA. Once the actual product is being sort of built out in people's tech programs, we try to keep the elements and the requirements around the manner of disclosure fairly flexible. So given all the different tech platforms, the fact that the majority of our customers are approaching this on mobile, we wanted

to make sure that no company was completely kind of hamstrung in the way that they presented it.

But we did set some baseline rules. One of them is you have to present the actual full disclosure. It can't just be placed in a hyperlink so that it can't be avoided. And then the other one is you obviously need have to present the entire set of metrics at the time that you present a specific offer to the customer.

The other area where we'd love to see some movement but frankly have sort of experienced some tech challenges around it is, like I said, pulling that forward in the process. It would be great to have, even if it's kind of a shorter, more dynamic version, we'd love to be able to present some of those basic metrics, particularly the cost metrics, earlier in the process. But right now where we have that sort of rule set up is at the time you present them with a specific offer.

EVAN ZULLOW: Thank you. And Barbara.

BARBARA LIPMAN: Yes. And I would just echo that, in the focus groups, folks said that they wanted something like the disclosure boxes early in the process as possible. But a number of them talked about how, if technology can be used to underwrite to them and to market to them, why can it also be used to create a kind of personalized calculator that could give them the opportunity to enter their revenues or their expected cash flows over the next several months, and with slider options, and they could kind of recreate what they think is a reasonable scenario for themselves. And they said, we understand this would be a best estimate. But that was something they were very interested in.

EVAN ZULLOW: And are there-- Barbara or anyone else who has observations-- we've sort of been talking about this kind of disconnect where there are these ILP SMART Box or initiatives have some form of uniform disclosure. But then one panelist referred to it as the Wild West in terms of information presented to consumers. What's your sense of how widely these sorts of standards are actually being adopted by the online lending community?

JOHN ARENSMEYER: Well, I can speak to the-- is this specifically about SMART Box or in general?

EVAN ZULLOW: The SMART Box or disclosures.

JOHN ARENSMEYER: Because we have similar standards in the Borrowers Bill of Rights. As I said, transparency is only the first one. Also there's a whole set of standards around abusive products, around responsible underwriting, fair treatment from brokers, right to inclusive credit access and right to fair collection practices.

So I mean, we've got over 60 lenders or brokers that have signed on to the BBOR, and about 45 endorsers. Now, we simply take the signature of the CEO that they're doing this. So I will say, we don't go out, don't investigate. I don't know if SMART Box, you sound like you maybe have somebody who does a little more checking. But to have to have 60 lenders or brokers, mostly lenders, sign on shows that there's-- and we've had more and more interest over time because I

think lenders are realizing that we really do need these standards. I mean, this is what we're seeing. And it's a way to separate out the responsible actors and responsible products from the not-responsible products.

EVAN ZULLOW: John actually raised two important points that I wanted to touch on briefly. In connection with the Borrower Bill of Rights, and then sort of the principles that underlie them that made those ideas important to that group, when you talk about underwriting, for example, what are some of the main sort of principles or tension points that you see in the industry between those who might want to adopt principles like these and those who do not?

JOHN ARENSMEYER: Well-- I'll just go quickly, and I'm sure other people want to add in. I mean, underwriting is actually-- it's harder. Transparency is, relatively speaking, a lot easier to deal with. Obviously getting inside the head of a-- well, if you have an algorithm, you at least can look at it, but the process for underwriting. But the basic principle is that the lender has made a determination that this loan can be paid back through the cash flow of the business operation, not by the owner personally, not by taking collateral, and most importantly, not by having to take another loan. So that's sort of the basic sort of high-end standard, is that that's where the underwriting should be focused. It should not be focused on those other considerations. I'm not saying you won't take the collateral or the personal guarantee, but that if there's any level of expectation that's how you're going to get paid back, you shouldn't make the loan.

EVAN ZULLOW: And I'd be curious, too, to hear the sort of same principles as they apply to collections-oriented practices. I mean, we talked a lot about that on our second panel. I'd be curious what are the most important principles that you think, and the RBL see, is codified in the Borrower Bill of Rights, related to collections?

JOHN ARENSMEYER: I don't have the actual document in front of me. But it's essentially understanding that-- it's following a set of standards that are non-abusive that are taking into account considerations that have come up that are not-- I know there was a lot of conversation about the confession of judgment clause in the last panel. We don't see any reason why there should be confession of judgment clauses at all. And obviously we've seen, with the Bloomberg article, and there actually was a bipartisan bill introduced at the end the last Congress by Senators Rubio and Brown, to ban them. So it's basically taking a very reasonable approach to going after the debt.

EVAN ZULLOW: Thank you. Does anyone else have other comments?

KY-NAM MILLER: I'll just invoke my ability as having an iPhone up here to read the Borrowers Bill of Rights. So the right to fair collection practices under the Borrowers Bill of Rights are "borrower has the right to be treated fairly and respectfully throughout a collections process, and the right to protections like those guaranteed under the Fair Debt Collection Practices Act."

EVAN ZULLOW: Thank you. So we've devoted a lot of our time to transparency disclosures, because that's a very important discussion going on in this community. We wanted to move on a little bit and touch on some of the other issues that, through our work enforcing the FTC Act and



other laws that we enforce, are of importance to us. And the first of those-- and I thought initially throw this to Barbara, given some of your focus group work, is, thinking, as we were talking about on panel 2, about advertising and marketing more generally, beyond disclosure. Does anyone have any concerns or thoughts about how these products are marketed, if there are issues with aggressive marketing campaigns, harassment, deception of any kind, through any lenders in this community or their proxies.

BARBARA LIPMAN: Well, certainly the focus group participants raised concerns. When we sent them out to pretend shop, we told them, don't actually apply for anything as part of this study. But a number of them, even before they were finished looking at websites, were getting pop-up ads and solicitations, right then and there. Generally-- so a lot of these folks had been seeking credit in the past year. So they noted their experience in general in the past year was that they were getting a lot of emails, snail mail, pop-up ads.

Now, sometimes they said, I know of a lender because of some of the snail mail, or email, or whatever that I'm getting. But generally they characterized it as bothersome or annoying. I think the thing that really kind of set them off, frankly, was the phone calls, which they would get during business hours or all kinds of hours outside of business as well. They characterized these as extremely aggressive. And it was something that they almost universally complained about.

EVAN ZULLOW: And does anyone else have thoughts on that issue? OK, now related-- and it's something we see, and even held a whole full-day workshop about a few years ago-- in all the different sectors that we look at, and that includes financial products and services like lending, lead generators, and brokers, and affiliate marketers are ubiquitous and obviously had a good deal of complexity in terms of who's making what representations to whom in the marketplace. And so I was wondering if anybody has any sort of thoughts on potential concerns or risks associated with that in this sector. I know Christin, you might have done some thinking on what, potentially, their obligations should be to consumers they market to.

CHRISTIN SPRADLEY: Yeah, so the topic of kind of brokering, and lead generation, and that ecosystem was another one that we tackled through that the CSBS panel that a number of-- I think it was about 30 different companies in the industry participated on. And unfortunately, I think that the report that came out of that probably raised more questions than it answered. But we tried to hone in on, if a policymaker is interested in this area, kind of what are the key policy risk or priorities that they should be focused on. And the ones that came out of that group were, first and foremost probably, what should supervision and oversight of a broker look like, whether that's at the state or the federal level?

The other one was that was raised quite often was data protection and privacy of customer information. Because it is getting shared between companies that are not related. The third was really duties of care, like what are the responsibilities of a broker to advise the customer and to be transparent about what sort of advice they're providing and what might be driving that.

And then the fourth area was the one that we've been spending the most time on here so far, which is what are the disclosure requirements on others in the ecosystem besides the lender themselves? And so I think that that's particularly prevalent. I know that Sheri has some good

examples of kind of what it looks like to play almost like matchmaker. And there's quite a few companies that have built their business models around the Match.com for a small business owner. You go in, and the lender has their requirements, you put in your basic information, and then they match you. And what the responsibilities are of those matching platforms or lead generators. And I think it was a topic that there's a lot of different approaches and it's definitely very complex, but I think there's been increasing interest from policymakers to try and dig in on any one of those four policy points.

EVAN ZULLOW: And Bernardo.

BERNARDO MARTINEZ: I think it's important. When we did the Small Business Bill of Rights actually we included a lot of them. Because we felt that it actually needed to encompass not only the lenders but also the aggregators and other participants. Because at the end of the day, there's a conglomerate of different companies that are actually intersecting and interacting with the small business owners. So that's kind of the importance in our coalition, was let's go beyond sort of the traditional lenders and really include all the others.

So as John said, we don't check them, but we basically ask them to every-- I have to sign, basically every year, that we're complying with everything that we said in our Small Business Bill of Rights. And we have a few of them that actually are participating with us. So I think that's really the key part, is when we talk-- I think that's a key part of that project, is include a lot of folks that participate in the market, and basically create sort of a standard, if you will, on how to interact.

JOHN ARENSMEYER: Just really quickly, I actually do have the Borrowers Bill of Rights up here. There's a bunch of standards on the fair treatment by brokers. I'm not going to cite them all, but I think there are a couple that are worth talking about. One is transparent loan options. If the broker has x number of products that he or she thinks fit, then they should disclose all of them, not just one where they may be getting a better fee. Speaking of fees, there should be transparent broker fees. There should be clear, OK, I'm getting paid this way by the lenders.

I'm just going to-- a couple of these-- important disclosure of conflicts of interest, if there are any conflicts of interest with any of the companies. No fees for failure is another one. So I mean, there are a couple others here. We don't need to talk about all of them. But there are definitely things that brokers can and should do in dealing with the borrower.

EVAN ZULLOW: Christin.

CHRISTIN SPRADLEY: Sorry, I just wanted to add to-- just thinking back to what I just said, lest it sounds like we're very negative about that population, I actually think there's a lot of instances in the small business lending space where the referral ecosystem that we built actually leads to really great results. Like you may come in at a bank level, and perhaps you don't fit the bank's credit bucket. So then the bank can refer you to someone else on the ladder, all the way down to relationships that we have with CDFI and community lenders, where someone comes in, they don't hit an OnDeck hard cut, and we're able to pass them off into the hands of another trusted partner who might be able to lend to them.

So I do think, while there's certainly very important guardrails that need to be put into place, it's not a space that's without value. There is definitely a value to the ecosystem that's built up in terms of getting the customer in front of a lender that's a great match for them. But we just want to make sure we have those guardrails in place.

SANDHYA BROWN: Sheri.

SHERI MCCONVILLE: So I guess now probably would be a good time for me to talk a little bit about the lender match tool that SBA has. It's completely free. There's no charges. What it does is it matches a potential borrower with any SBA lender, whether you're a 7(a) lender, a 504 lender, or a microlender.

The lenders sign up, and they pick what dollar amount that they're interested in lending up to, what industries they want, and several other criteria like the states and the counties. And then when the borrowers come in, we ask them a series of questions, and then match them up with potential lenders who match up with them. And then SBA steps away. The lender then has the option to either opt in, opt out, or ask for additional information from the borrower.

Currently we've had 290,000 borrowers that have signed up for it. It's resulted in over 4.3 million matches between-- now, one borrower may match to multiple lenders. And out of that, 587 lenders have opted in. Now, we don't know what happens after they opt in, whether they go with a conventional loan at their bank or if they end up using SBA guarantee.

If there's no match whatsoever, we don't just drop the borrower then. We refer them to their local SBA resources so that maybe they can work with the borrower to come up with some other way of making their business a little bit more profitable or to make some changes there that will allow them to still find financing after they can make a few changes.

Christin talked about it earlier-- the biggest complaint we get is that what happens is we send this borrower information off to the lenders and, then all of a sudden they're being inundated with all these phone calls. And they contact us and they say they want to opt out. It's like, well, the cat's out of the bag. You can't opt out at this point. So that's really been the only downfall that we've had.

But we've been able to match people across the country, that normally they wouldn't have been able to find financing in their hometown. But because they used this tool, they were able to find a borrower in California when they were in New Jersey that was able to do this kind of deal. So we've had a lot of success with that.

EVAN ZULLOW: Thank you. And Sheri, actually, just by way of background, for audience members that are a little less familiar with SBA loans and the role that SBA plays, can you talk about that a little bit, the role they play versus what the banks and institutions who offer the loans play?

SHERI MCCONVILLE: Right. So SBA has several products that they have. But most of their products are guaranteed loans. In other words, the lender actually makes the loan. But if the loan

goes bad, then SBA guarantees that the lender gets a portion of his money back. And there are several loan programs under that. There's 7(a) loan programs that would be lines of credit small loans larger loans, lines of capital lines of credit. And then there's 504 loans that are mostly used for construction. We also make direct loans to microlenders, and then those microlenders in turn make smaller loans to borrowers. And then if there's a disaster, we also make direct loans to businesses and homeowners in the case of a disaster.

SANDHYA BROWN: Sheri, there had been a suggestion on an earlier panel that SBA loans can be time-consuming or a greater commitment as compared to fintech options. Could you speak to that at all?

SHERI MCCONVILLE: That's probably true, because you're dealing with conventional banks. And these banks have-- y'all talked about all the regulations. And when you're dealing with the government, you have a lot of those. And so it is more time-consuming to get an SBA loan, but your interest rates are probably going to be less. If the borrower has the wherewithal to go through with it, then-- and we're making improvements to try to make it quicker. I don't know what the exact turnaround time is. I'm going to have to go back and ask. But I would be willing to bet a fintech loan is probably much, much quicker.

One of the things I wanted to talk about, and maybe this doesn't have anything to-- we've been doing fintech at SBA before there was ever fintech. And we have developed a lot of open standards that are available to software vendors that work with the lenders to be able to make that process go a lot faster. So there's a lot of vendors that work with multiple lenders. And they have underwriting packages, they have origination packages, and they can work directly with us by calling our open-source web services, and get these loans approved by SBA lot faster. And if you're a preferred lender, you don't have to wait for the government to do anything. If you've checked off all the boxes, then you really can get a loan in a shorter amount of time. So I just wanted to mention that, too. Thanks.

EVAN ZULLOW: Great. And to touch on a couple other consumer-protection-oriented issues, could anybody-- I know Barbara, perhaps in connection with some of your research, you've got some thoughts on this-- talk a little bit about privacy and data security in this space, and if there are any sort of risks or concerns associated with lending and the consumer information associated with these transactions?

BARBARA LIPMAN: Yes, so again, the focus group participants raised concerns about privacy. One of the reasons is they noted they were tracked while they were visiting websites as part of the project. And we've been looking into some of the websites as well.

So I think one of the concerns is the use of trackers on websites. They have multiple legitimate purposes. Some are tracking what the business owner's doing on the website. But some trackers have the ability, even if an owner is just looking around-- I mean, they have two options. They could enter information and provide some basics, or they may just be looking around and not providing anything. In the case where they're providing some information, they're already kind of launching a process where that information could be connected via social analytics trackers or

other types of trackers so that lenders or brokers can start to create a profile of that business and tailor their marketing efforts, for instance.

But even, I think, if there's some anonymity, frankly it's murky and unclear. But there seems to be an ability to through digital fingerprinting and connection through data aggregators to nevertheless start to create a profile, even if that's something that's not particularly desired by the business. And we don't know what the practices are. Frankly this is an emerging area. Obviously it's using artificial intelligence and machine learning to some extent. And you could argue that, to some extent, it helps tailor marketing efforts and exposure to a broader array of tailored products. But there could be unwanted marketing efforts as a result of it. And we don't know, for instance, and I'm not suggesting anyone's doing this, but there could be different pricing offered as a result. It's just something that ought to be on everyone's radar screen that we ought to be monitoring.

EVAN ZULLOW: Thank you. Anybody else have thoughts on that issue?

BERNARDO MARTINEZ: There has actually, lately, been a lot of movement at the state level to really start thinking through privacy. California has a privacy that everyone have to adhere to that. So I think there is a lot of move at the state level to kind of continue to do that. And I think that there will continue to be movement in the industry around that topic.

EVAN ZULLOW: OK, thank you. So let's move briefly onto another topic that's very important to us. Of course primarily the FTC works, through law enforcement, to stop deceptive and unfair practices in the marketplace. But beyond that, we really strive, when we can, to do outreach and educate consumers-- in this case, that would be small business owners-- about how to make informed choices in the marketplace and avoid confusion or potential deception.

And so I just wanted to ask our panelists-- and I know a couple of you have been a part of initiatives or efforts to educate small business owners through your organizations. And so I just want to sort of ask what that looks like and how you're engaged in those efforts. John.

JOHN ARENSMEYER: Yeah. Small Business Majority, in addition to the policy work we do, we have a very robust entrepreneurship program. And that involves a whole variety of ways of educating small business on a bunch of issues. Access to capital has probably become the biggest issue in the last couple of years since we lost that component of the program. It's a combination of in-person seminars, particularly in the states where we have staff on the ground. It is national, and statewide, and regional webinars that we do.

One of the things we do is we partner with business organizations. We have relationships over 1,000 mostly local and regional business organizations across the country. And we partner with them. So they need us coming with our expertise. So we do that, but responsible lending and how to go about it is a huge part of that.

We also are launching-- well, we have a website, [venturize.org](http://venturize.org), which has all of this information on it. And we are now launching a matching tool, similar to what Sheri described, on Venturize, that will take information and connect folks with loans out there. Right now, we have links to--

but part of the matching tool, we have links to a variety of lenders. Obviously a lot of CDFIs, a lot of mission-driven lenders, but also 7(a) lenders as well. The matching tool is being launched initially with CDFIs, particularly focused in certain regions. We just launched in Chicago, we're going to be launching in California. We're going to start with the CDFIs, and we would like to expand that to other types of loans. There may be some opportunities to partner with SBA's matching tool on that.

So I'll sum up by saying it's hugely important to educate small business owners and to provide them with the sorts of tools that SBA is providing now, and that we're providing our Venturize, to enable them to learn. I like the idea of a calculator that you suggested, Christin-- giving me some ideas there. So that's a huge part that we have to remember as part of all this.

EVAN ZULLOW: Thank you. And Christin, did you have a--

CHRISTIN SPRADLEY: Yeah, I was just going to add-- I mean, I think, in a similar vein, there's both kind of our in-house efforts at education, but one partnership that we've found that's been really helpful is we partner with the SCORE Foundation, which has a network of, like, retired executives-- I think it's somewhere around like 11,000 throughout the country-- who can help provide mentorship.

And one thing that I think John touched on earlier that I just think is critically important is that we don't just offer those services to somebody who successfully takes out a loan. It's usually the people who are declined that need it the most. And so we offer and set them up with those mentors whether you're approved or declined. Because in many cases, you want to understand why and how you were declined, and how you could build your business credit and kind of continue up that financial health ladder. And I think that providing that sort of education to all folks, even non-customers, is something that's critically important to us, and I think is shared by a lot of other companies on the panel.

JOHN ARENSMEYER: And actually we have that on our Venturize system. I completely forgot. In fact, I just found out, we have all 900 small business development centers on our Venturize platform now. We connect with SCORE. So yeah, that's absolutely critical to be able to advise people, not only if they're considering a loan, but what happens when they didn't get a loan. Or maybe they shouldn't be applying for a loan yet. Maybe they need to get their act together before they do that.

EVAN ZULLOW: And Ky-Nam.

KY-NAM MILLER: Just briefly, because I know we're running out of time on the panel, but CRC, the California Reinvestment Coalition, is an interesting kind of grassroots and grassroots organization through our membership. So to the extent that we've been doing consumer outreach and education, it's been through-- in language, culturally-competent kind of seminars, with our members on the ground in Richmond and Southern California.

We're also doing an interesting partnership with LA County and this outfit called Fenton Communications on payday lending, and trying to target folks who would be headed towards those types of cash merchants and send them elsewhere.

I also wanted to briefly touch on the data security point that Barbara was mentioning, and just lift up that there's real civil rights implications that go into us, that when you have circumstance-- and I've talked with fintechs, I think some of them in the room have said they can actually tell, with 99% certainty, the race of the borrower, whether it's on the way in on the way out. But there isn't that kind of disclosure of how that data is used. I think we can't just trust that it's going to be used that way. We've seen it kind of happen perniciously in the regulated sector. So as the ecosystem evolves, we want to make sure that there's the same type of democratic oversight for fintech as there is for the regulated banking industry to make sure that we're not widening the racial wealth gap.

EVAN ZULLOW: Great. Thank you. So we have about three minutes or so left. And so actually it's sort of perfect for a little exercise I would propose. So assume we had an audience or a roundtable here, of small business owners of the sort that you work with or lend funds to. And through these sort of educational efforts you've engaged in, how would you, if you just had a few minutes, as we do, what would be sort of the key points or messages that you would convey to them about how to successfully navigate the information in this marketplace, and tips to avoid potential problems or even deception? Anyone have any thoughts? John.

JOHN ARENSMEYER: Well, I mean, there's a conflict here, because a lot of times small business owners want a loan quickly. And so but we tell them, you need to take a little bit of time and figure out-- all of the things we're trying to maybe get into a TILA bill, or that are a part of the SMART Box or the Borrowers Bill of Rights, they need to consider it. Ask what the APR is, make sure you've asked all the questions about prepayment, about fees, and the term. All of the things that we want Lenders to voluntarily provide, we educate borrowers that they need to be asking those questions.

So I mean, we're not saying they have to take three weeks to do this. But just educate themselves and be aware that if they don't, they could really be getting themselves into a trap. The other thing is, don't take the loan if you don't-- it's the flip side of what I said about the lenders. Don't take the loan if you don't think you can pay it back through your normal cash flow. And I'm a former small business owner, so I tend to get pretty exuberant in thinking, yeah, no problem, I can do it.

But you really need stop and think. Because then you have to decide, well, what happens if I can't, and I have to take another one of these loans, and that becomes a death spiral, or I'm going to potentially lose collateral, or I have to cough up money personally. So they really need to be thinking about that, even if it means they have to slow down a little bit before they sign on the dotted line so to speak.

EVAN ZULLOW: Great. Does anyone else have thoughts?

BERNARDO MARTINEZ: I would say, at the end of day, they should start their process with really understanding what they want to do with the lending. I think that's one of the biggest things that we try to do with our small business owners is really have a conversation of what they're trying to use that money for. And when they understand what exactly they're going to do, then take the time-- really take the time to understand what are the different options and which option actually best fits what actually they're trying to do. Because I think that's why they rush into the decision because they haven't spent enough time understanding what they're going to do with the money and really what is the best product for that need that they're trying to serve. So I think that's-- this would really be the time to really understand what they're trying to do and to execute that decision.

EVAN ZULLOW: Great, Thank you. Well, it does look like we're just about to run out of time. And so I'd ask everybody to really thank our great panelists here today. This was a very interesting discussion. Thank you.

[APPLAUSE]

And before we all get up, we're fortunate today, too to have our bureau director, Andrew Smith, to offer some closing remarks. Welcome.

[APPLAUSE]

ANDREW SMITH: So everyone's going to stay here?

[CHUCKLING]

That's OK. I'm good with that. So just a quick disclaimer, I speak for myself only not for the commission or for any individual commissioner. So I wanted to thank you, all of our panelists today, and also to our audience. One of the things that has been surprising to me about small business financing for a number of years is how little scrutiny it's been given, at least at the federal level, with the exception, of course, of the really excellent work and groundbreaking work that the Federal Reserve Board and some of the Federal Reserve banks have been doing on these issues. Maybe that's because people still think that these are \$500,000 bank loans. But I think what I've learned today at least from-- in all of our panels is that that's a bit of a fiction, is that these are smaller loans, given to smaller businesses by people who aren't subject to bank supervision.

So we've covered a lot of ground this morning. We talked about these recent trends in the small business finance market, including the use of technology to offer financing to small businesses. We've talked about the risks to small businesses, including the potential for confusion, deception, unfair servicing, and collection, and even outright fraud. We talked about the laws and rules that would apply to people who are offering financing to small businesses, and efforts by industry, by government, by small businesses to ensure that small businesses understand the cost and terms of these products.



As Commissioner Chopra mentioned this morning, we at the FTC think that we have a special role to play. Unlike other federal regulators, we're not constrained by whether the transaction is for personal, family, or household purposes, that our organic statute, the FTC Act, allows us to address unfair and deceptive practices, even with respect to businesses.

And I want to make clear that we believe strongly in the importance of small businesses to the economy, the importance of loans and financing for small businesses, and the ability of technology to expand access to fair and transparent financing for small businesses. But we believe equally strongly in protecting those businesses from unfair and deceptive practices. After all, if small businesses think that the finance game is rigged, then they won't play. And in that case, we all lose.

The FTC Act gives us broad authority to stop deceptive and unfair practices by non-bank lenders, MCA funders, marketers, brokers, ISOs, lead generators, servicers, and collectors. We are very concerned about reports of unfair and deceptive marketing, sales, and collection practices in the small business finance market.

I want to remind all of you that protecting small businesses is nothing new for the FTC. I would direct you to our Operation Main Street, last summer, when we, with our state partners, brought dozens of actions to protect small businesses from fraud and unfair practices.

Acting to prevent sharp practices by fintech lenders is also nothing new for us. See, for example, our recent cases against Lending Club, SoFi, and Avant. Although financial technologies can evolve quickly, the underlying legal protections for small businesses remain the same, and have proven remarkably adaptable over time. We adapt the FTC Act, the FCR, or the Fair Credit Reporting Act, the Equal Credit Opportunity Act, and other statutes to new technologies and changing circumstances all the time. In fact, it's a point of pride for us. While we recognize the benefits of financial technologies, we expect that even the most innovative companies will observe these baseline consumer protection principles.

So if you're a small business owner and you feel as though you've been harmed in connection with small business financing, you should submit a complaint to us at the FTC, [FTC.gov](https://www.ftc.gov), or 877-FTC-HELP. and to close, we look forward to continuing today's dialogue with industry, with consumer advocates, with our government partners. Don't hesitate to reach out to us in the coming weeks and months, just as many of you have reached out to us in connection with this forum. Thank you all for coming today.

[APPLAUSE]

And that concludes our program.