

Small Business Truth in Lending

Commonsense transparency standards for small business financing



RESPONSIBLE BUSINESS
LENDING COALITION

November 2021

There is broad agreement

between small business groups, nonprofit CDFIs, for-profit fintech lenders, and civil rights groups on the need for Truth in Lending to be applied to small business financing.



National Urban League



RESPONSIBLE BUSINESS LENDING COALITION



USHCC
UNITED STATES HISPANIC CHAMBER OF COMMERCE





Federal Reserve Bank of Philadelphia President Patrick Harker

September 29, 2017

“
I hear these stories constantly, about a small business in particular getting into a situation where they **didn't quite know what they signed up for**, and then they walk into their community bank and say, 'I've gotta get out of this deal, **it's killing me.**' And so, there are good actors and bad actors...”



Small Business Truth in Lending is More Crucial Than Ever

- The Truth in Lending Act (1968) requires transparent APR disclosure for consumer financing. Unfortunately, it does not apply to most small business financing.
- Over the last decade, some financing companies have begun describing their prices in confusing or misleading ways. Some take advantage of small businesses with offers of fast cash—without disclosing APRs that can be 350%+.¹
- Transparency in the financing market will enable price competition and drive down the cost of capital for small businesses as they rebuild from the impacts of COVID.



¹Opportunity Fund, "Unaffordable and Unsustainable: The New Business Lending on Main Street," May 2016.



Consumer Financial
Protection Bureau

What is APR?

“ The APR, or annual percentage rate, is the standard way to compare how much loans cost. It lets you compare the cost of loan products on an ‘apples-to-apples’ basis. ”

CFPB says

Tip: Focus on APRs. If you want to compare the cost of a payday loan to the cost of an installment loan or a credit card, focus on the APRs.

Source: www.consumerfinance.gov/consumer-tools/credit-cards/answers/key-terms/; www.consumerfinance.gov/ask-cfpb/my-payday-lender-said-my-loan-would-cost-15-percent-but-my-loan-documents-say-the-annual-percentage-rate-apr-is-almost-400-percent-what-is-an-apr-on-a-payday-loan-and-how-should-i-use-it-en-1625/

This is a common small business financing disclosure today.

Should a business owner take this offer, or a 20% APR loan?

1. PURCHASE AND SALE OF FUTURE RECEIPTS

Purchase Price:	\$21,500
Purchased Percentage:	15%
Purchased Amount:	\$31,175
Specified Daily Amount (Estimated Average Monthly Sales x Purchased Percentage / Average Business Days in a Calendar Month):	\$174

Source: A merchant cash advance contract

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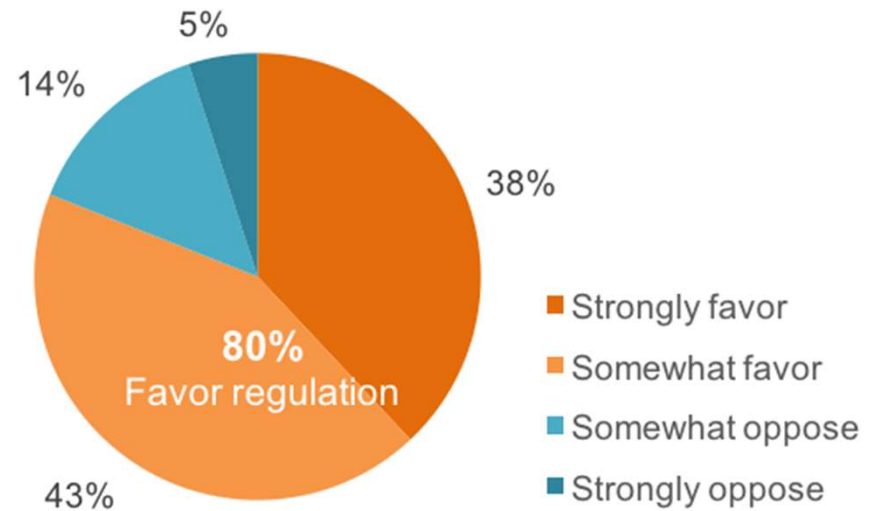
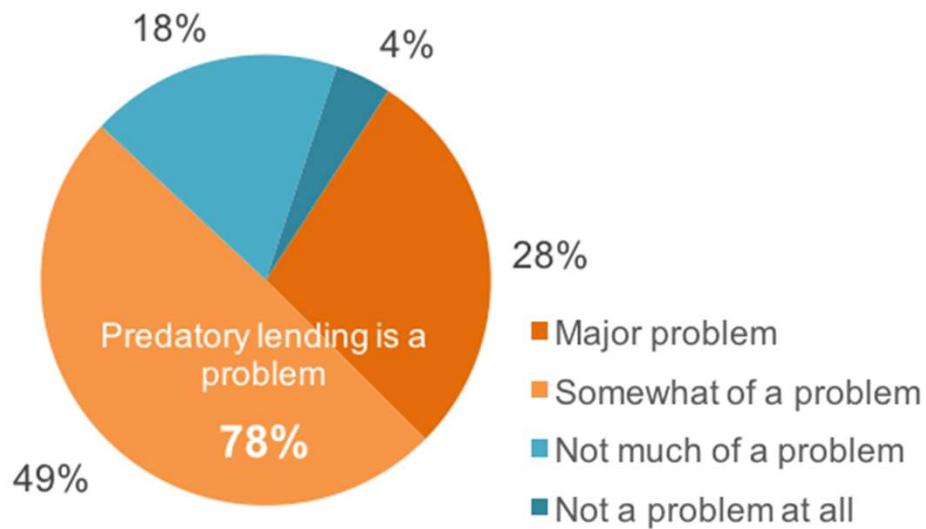
Not disclosed: 127% APR

Source: A merchant cash advance contract



Small Business Owners Want Transparency

Poll: “An overwhelming majority of **8 in 10** small business owners reported that they are in favor of regulating online lenders to ensure interest rates and fees are clearly disclosed to borrowers.”



Poll of 500 small business owners, conducted between Sept 29 and Oct 4, 2017 by Greenberg Quinlan Rosner Research
<https://smallbusinessmajority.org/our-research/access-capital/small-business-owners-concerned-predatory-lending-support-more-regulation-alternative-lenders>



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Research study: “Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites,” Dec. 2019

What some financing providers (e.g. MCAs) disclose today

What they don't disclose

Rate advertised on website	Product details	Estimated APR equivalent
1.15 factor rate	<ul style="list-style-type: none">• Total repayment amount \$59,000• Fees: 2.5% set-up fee; \$50/month administrative fee• Term: none (assume repaid in six months)• Daily payments (assume steady payments five days/week)	Approximately 70% APR



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Research study: “Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites,” Dec. 2019

The Fed found that disclosure of “9% simple interest” (another term for “factor rate”) misled small business owners to believe a 46% APR option was less expensive than a 21.9% APR option:

“The non-standard terminology also proved challenging for focus group participants trying to compare online offerings with traditional credit products. For example, when asked to compare a sample short-term loan product with a 9 percent “simple interest” rate to a credit card with a 21.9 percent interest rate, most participants incorrectly guessed the short-term loan to be less expensive.”

Rate advertised on website	Product details	Estimated APR equivalent
9% simple interest (disclosed)	<ul style="list-style-type: none">• Total repayment amount \$54,500• Fees: 3% origination fee• Weekly payments• Term: six-month term	Approximately 46% APR (not disclosed)

<https://www.federalreserve.gov/publications/files/what-small-business-borrowers-find-when-browsing-online-lender-websites.pdf>



BIPARTISAN POLICY CENTER

Main Street Matters

Ideas for Improving Small
Business Financing

AUGUST 2018



Republican Senator Olympia Snowe



Democratic SBA chief Karen Mills

There is bipartisan agreement:

“ There can also be confusion around some forms of small business credit, called **merchant cash advances**. These products are not classified as loans and, as such, **are not expressed in terms of an APR, making it challenging to compare with other types of credit products.** ”

<https://bipartisanpolicy.org/report/main-street-matters-ideas-for-improving-small-business-financing/>

Bloomberg **Opinion**

Protect Small Businesses From Predatory Lending

By Editorial Board

November 28, 2018, 6:30 AM EST

“ The **best solution** would be for Congress to pass a **truth-in-lending** law for small business, along the lines of the rules that already exist for consumer loans. ”

▶ [Links to Responsible Business Lending Coalition proposal that informed this bill](#)





FEDERAL
RESERVE
BANK
of ATLANTA

**Federal Reserve Small Business Credit Survey:
Report on Minority-Owned Firms**

DECEMBER
2019

“ Minority-owned firms more frequently applied for potentially higher-cost and less-transparent credit products: ”

- Hispanic-owned businesses are about 2x as likely to apply for MCAs, and
- Black-owned businesses are about 2x as likely to apply for factoring financing, compared to White-owned businesses.
- For Black and Hispanic business owners, online lenders are the second most popular source of financing, after banks.

Source: <https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/20191211-ced-minority-owned-firms-report.pdf>



Fed Governor Lael Brainard Speech Sept 30th, 2015

“ Some have raised concerns about the high **APRs** associated with some online alternative lending products. Others have raised concerns about the risk that some small business borrowers may have difficulty fully understanding the terms of the various loan products or the risk of becoming trapped in layered debt that poses risks to the survival of their businesses. ”





New York Fed President William Dudley Speech May 8th, 2015



“ There are individuals who try to **take advantage of owners of new businesses** by providing them with poor advice or overcharging them for credit... It would be helpful to have **consistent standards and transparency requirements** for organizations that lend to small businesses. Such standards and requirements exist for lending to households, and I believe the same justification exists to extend these requirements to small businesses. ”

Can merchant cash advances (MCAs) disclose APR?

1. Yes. Some already do disclose APR.



THE BUSINESS BACKER™



This tool is provided to help you understand and assess the cost of your small business finance product.


SMARTBOX™
Capital Comparison Tool

This Merchant Cash Advance ("MCA") is a purchase of future receivables ("Receivables"), not a loan. If you take this MCA, you will deliver Receivables to us as they are generated by your business (and only if they are generated by your business) and not on any set schedule. There are no fixed or minimum payment amounts and no term or maturity date. In order to compare the cost of this MCA to a loan, SMART Box provides the calculations below based on several assumptions, including that you will deliver the same amount of Receivables each period and that you will deliver all of the Receivables you sold within a predicted period of time. In practice, these amounts will vary. Unlike a loan, this MCA has no payment schedule and no interest rate; your obligation is to deliver Receivables as your business generates them.

Purchase Price Amount	Disbursement Amount (minus fees withheld) ¹	Future Receivables Sold	Predicted Delivery Time ²
\$[0]	\$[0]	\$[0]	[] Months
METRIC	METRIC CALCULATION		METRIC EXPLANATION
Total Cost of Capital \$[0.00]	Future Receivables Sold minus Purchase Price:	\$[0.00]	This is the total amount that you will pay, including up-front fees, for capital. The amount does not include fees and other charges you can avoid, such as fees for reversed payments. ³ It also assumes your business will generate all of the Receivables we are purchasing.
	Origination Fee:	\$[0.00]	
	Other Fees:	\$[0.00]	
	Total Cost of Capital:	\$[0.00]	
Annual Percentage Rate (APR) ⁴ [00.00]%	Assumed [daily/weekly/monthly] delivery of Receivables ⁵ :	\$[0.00]	This is the cost of capital – including fees – expressed as a yearly rate. APR takes into account the amount and timing of capital you receive, fees you pay, and Receivables you deliver. It assumes that your business will generate and deliver the same amount of Receivables each period, and that all of the Receivables will be delivered in the Predicted Delivery Time. While APR can be used for comparison purposes, it is not an interest rate.
	APR:	[00.00]%	

Can merchant cash advances (MCAs) disclose APR?

1. Yes. Some already do disclose APR.
2. Other MCAs advertise their high annualized yields to their investors, but don't disclose these annualized percentage rates to their small business customers.

- The credit quality of the collateral, the performance of s small business loan and MCA portfolio, and proposed pool.
 - The pool comprises short-term loans and MCAs with a weighted-average remaining term or estimated underwritten turn of approximately [9.55] months.
 - The pool has an expected weighted-average annual return on the collateral pool of approximately 48%, which provides a significant level of first loss protection in the form of excess spread.

Can merchant cash advances (MCAs) disclose APR?

1. Yes. Some already do disclose APR.
2. Other MCAs advertise their high annualized yields to their investors, but don't disclose these annualized percentage rates to their small business customers.
3. Numerous online calculators show that it can be simple to compute APRs for MCAs:

<https://www.nav.com/business-loan-calculators/merchant-cash-advance-apr-calculator/>
<https://www.merchantmaverick.com/merchant-cash-advance-calculator/>
<https://www.fundera.com/business-loans/business-loan-calculators/merchant-cash-advance-calculator>
<https://www.nerdwallet.com/blog/small-business/merchant-cash-advance-small-business/>
<https://www.lendio.com/calculators/embed-mca?affiliate=4247260739>
<https://www.americanmerchantbrokers.com/merchant-cash-advance-calculator.html>

MERCHANT CASH ADVANCE
APR Calculator

Advanced Amount	\$ 20,000
Payback Amount	\$ 24,000
% of Future Card Sales	15 %
Projected Monthly Card Sales	\$ 20,000

CALCULATE

Daily Payment	\$100.00
Daily Interest Rate	0.1563%
APR	57.06%
Repaid in about	240 days
Total Financing Cost	\$4,000.00

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If MCAs don't want to disclose their APRs, why isn't "factor rate" sufficient?

1. "Factor rates" are already being disclosed today. The confusion it is causing small businesses is one reason Truth in Lending is needed.
2. Federal Reserve research has demonstrated that "factor rates" too often misguide small businesses towards higher-rate financing.
3. Unlike APR, "Factor rate" does not enable comparison shopping between products of different term lengths, and it does not include fees.

If MCAs don't want to disclose their APRs, why isn't the total cost, in dollars, sufficient?

Disclosure of total cost in dollars is required in the bill, "finance charge."
But without APR, it's not sufficient because:

1. Dollar cost is already being disclosed today. It has not prevented the borrower confusion described in preceding slides.
2. Dollar cost alone does not enable comparison of the cost of financing options with different term lengths, or of different amounts. As a result, it can mislead applicants towards shorter-term, higher-rate financing.

Dollar cost is insufficient without considering time.
Question: Is a \$15,000 lease cheaper than a \$25,000 lease?



\$15,000 total
6-month lease, 2,000 square feet



\$25,000 total
5-year lease, 1,000 square feet

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\$15,000 total

6-month lease, 2,000 square feet

\$15 per square foot per year



\$25,000 total

5-year lease, 1,000 square feet

\$5 per square foot per year

To compare the price, you need to know the amount of time you get to use the house for.

Similarly, APR helps you compare the cost of financing over the amount of time you get to use the financing for.

If MCAs don't want to disclose their APRs, why isn't the total cost, in dollars, sufficient?

3. The dollar cost of a single transaction alone does not enable accurate comparison, because MCA customers often renew their short-term financing over and over again, in payday-like cycles of reborrowing.

According to the website of a leading MCA provider:

Approximately 90% of our Merchant Cash Advance clients participate in the program more than once. In fact, the average customer renews about ten times!

The actual decision small business owners are often making is between borrowing a 6-month MCA on an ongoing basis, or using a 3-year loan on an ongoing basis. APR enables small business owners to compare these costs on an apples-to-apples basis.