Small Business Committee

Subcommittee on Oversight, Investigations and Regulations

**Fintech Transparency in Small Business Lending**

Good Morning Committee Members. It is an honor to testify today at this hearing. My name is Diane Paterson and I am the Reginal Director of the Twin Cities Small Business Development Center, hosted by the University of St. Thomas.

With today's online credit lending environment, where many Fintech services offer a four-minute application and 24-hour turnaround to access funds, the SBDC is seeing small business owners navigating confusing fine print, adverse interest rates, loan terms, and early pay back penalties that have the power to put them out of business.

These lending practices are especially harmful to small, young, less profitable, and minority-owned businesses, who already struggle to access financing because they lack the business history or collateral that traditional banks require. Yes, the ease and speed with which small business borrowers can access Fintech credit is appealing and even beneficial. But these businesses tend to use this loan option in conjunction with other forms of credit, making them financially vulnerable.

The application process for a traditional lender takes days. The approval process itself can take weeks, or longer depending on the meeting schedule of the loan committee. Standing in stark contrast, two Fintech options- Biz2 Credit and Blue Line, advertise four- and five-minute completion times respectively. Both promise next-day availability of funds. While Fintech loans address pain points in the loan application process, these loans subject borrowers to much higher interest rates and other terms that cause many to default.

The biggest issue in Fintech lending practices is the lack of transparency in the price of their products. As consumers, we are accustomed to seeing rates of 3.5% to 4.5%, APR. This commonly understood Annual Percentage Rate terminology is familiar- it makes sense. Fintech borrowers READ rates ranging from 3.5%-4.5%, and assume they are APR. What they do not realize is that the Fintech rates are regularly calculated on a DAILY basis. This results in a lending relationship that subjects the borrower to an interest rate in the range of 58-63%. Simply put, Fintech's lending practices are an issue, with this daily calculation the first of several fine print problems.

Kabbage for example, advertises a "Loan Fee" instead of an interest rate. OnDeck's interest rates are clear, but they range from 24.6%-58.5%. Lending Club, charges 9.77%-35.71% interest, and then assigns an additional loan Origination Fee, ranging from 1.99%-8.99%.

The cost of Fintech credit is high. The terminology is confusing. Adding more fuel to the fire, the repayment terms of many Fintech loans are becoming problematic for borrowers. Fintech loan

repayment terms are traditionally very short- six-twelve months in most cases. This greatly impacts the level of the borrower's monthly debt service. While many Fintech lenders offer weekly installments, this doesn't change the reality that these payments are often too large for a small business' cash flow to digest.

To illustrate, a client of the Small Business Development Center founded a craft brewery operation making gluten-free beer. Due to the nature of their product, they were unable to brew beer using another craft brewer's equipment during the startup phase. As such they financed "new" machinery using a $375,000 loan from a bank. The taproom was an instant revenue generator, but their revenue from distribution lagged behind their projections.

They approached their bank for a second loan for $100,000 to cover working capital, to bridge until the distribution side of the business caught up, but the application was rejected. The brewery had no choice but to seek a $100,000 loan with OnDeck, thinking the interest rate was comparable, or lower, than the bank. The interest rate in reality was 58.6%, with the term of the loan only twelve months. The debt service (principle and interest) payable per month was $11,208.00.

Our office intervened on behalf of our client and asked the original bank to reconsider. The bank initially refused because the $100,000 loan was also subject to a $20,000 pre-payment penalty, pushing the principle owed to $120,000. We worked with the bank to help them understand that without their help, the brewery would likely default on the bank's original loan PLUS the Fintech financing. To ensure the viability of the company, the bank ultimately chose to refinance the Fintech loan. While very positive, this outcome is rare- most businesses would have no choice but to default.

Strong guidelines driving uniformity in Fintech lending practices and fine print language, clearly focused on the borrower's ability to repay, will give consumers the ability to compare loan options apples to apples, and reduce the number of borrowers who default. With new business startups at an all-time high, now is the time to address this issue.