December 18, 2015

The Honorable Sherrod Brown
United States Senate
Washington, DC 20510

Dear Senator Brown:

Thank you for your recent letter regarding online marketplace lending. The Small Business Administration (SBA) has been monitoring this emerging market segment and its various business models and lending practices. The Department of the Treasury also recently issued a Request for Information (RFI) to solicit public input on this topic. We are happy to provide you with an update on our work in this area, the responses Treasury received, and how we are coordinating our ongoing work in this area.

As you note in your letter, small business borrowers have long struggled to access credit, and small business loans are down 20 percent since the financial crisis. Both Treasury and the SBA support the safe and responsible expansion of credit access. We do, however, share your concerns regarding the level and clarity of rates and fees charged by some online marketplace lenders. While this new segment remains a very small component of overall small business and consumer lending, the industry is growing rapidly. In 2014, total originations grew to an estimated $12 billion, the majority of which was consumer lending.

Online marketplace lenders that lend to small businesses generally share certain characteristics. First, they provide small businesses with fast access to credit, typically providing funding decisions within 48 to 72 hours. Second, most online marketplace lenders provide smaller-size loans with shorter-term maturities, often with daily remittances of funds directly from linked bank accounts. Typically, these loans have higher – often significantly higher – annual interest rates than small business loans from banks and credit unions guaranteed by SBA. Third, they provide funding decisions through online applications. Last, online marketplace lenders are using new data analytics and alternative supplemental financial information, including real-time business accounting, social media data, in addition to payment and sales history and use of proceeds, to determine a borrower's credit risk, prevent fraud, and monitor a borrower's ongoing ability to repay a loan.

SBA lenders, which are typically banks and credit unions, offer small business borrowers a variety of loans, products, and protections. SBA lenders may make SBA-guaranteed loans as large as $5 million with long-term maturities and affordable interest rates. In addition to setting minimum credit standards for underwriting SBA-guaranteed loans, SBA caps interest rates and fees that lenders may charge to a borrower. Additionally, SBA's bank and credit union lending partners are subject to federal supervision by their primary regulators for compliance with fair lending, data security, and privacy requirements.

SBA has been modernizing its lending platforms to ensure that small business borrowers have options, including reasonably-priced, SBA-supported lending products from banks and credit unions. SBA has significantly streamlined the process for making small dollar loans by, among other reforms, using a proprietary blended credit score to provide speed and certainty on which business loans qualify for an SBA guarantee. SBA's predictive credit scores on smaller dollar loans blend a borrower's personal and business credit history to help evaluate the borrower's ability to repay and have been validated using data on thousands of SBA loans going back several years.

SBA has also developed technology tools to expand opportunities for borrowers and improve loan processing. SBA LINC (Leveraging Information and Networks to access Capital), for example, is SBA's online matchmaking tool for small businesses and lenders. Small businesses seeking capital can enter their capital needs into the tool and get matched with interested SBA lenders. To date, LINC has matched 20,000 unique small businesses with lenders. SBA recently launched SBAOne, an online origination platform providing lenders with automated access to SBA's guarantee, which will decrease the time it takes to deliver SBA-guaranteed loans to small businesses. These new tools, which aim to simplify SBA's processes and broaden lenders' access to potential small business borrowers, are important components of the agency's effort to ensure that smaller community banks and credit unions can effectively and efficiently participate in SBA's loan guarantee programs.

Responses to Treasury RFI on Online Marketplace Lending for Small Businesses and Consumers

Commenters who responded to Treasury's RFI highlighted the importance of keeping the data of borrowers, lenders, and investors secure. Data has a powerful ability to enhance the credit decision-making process, but marketplace lenders must be sensitive to the need for data security. Many stakeholders noted that new underwriting models have yet to be tested through a full credit cycle, and, therefore, it is too early to determine their predictive ability in a more difficult economic environment. In addition, many advocates stated that, while nontraditional data has the ability to make rapid and blind credit decisions, it also has the potential to generate unintended correlations that could result in discriminatory lending.

Commenters expressed almost universal agreement on the need for, and benefits of, greater transparency across all types of small business loans. Many RFI commenters noted that all small business borrowers should receive the same protections whether their lender is a community bank, online marketplace lender, or another non-bank entity. Community banks operate within a framework of prudential oversight and with a business model that has developed based on personal relationships, with direct accountability to depositors, borrowers, and their communities. Competition and innovation are welcome, but innovators should compete on a level playing field to offer an improved borrower experience.

In addition, Treasury received several RFI responses arguing that the same standards of transparency and accountability should also apply to both consumer and small business borrowers. For small businesses, this transparency could require standardization of disclosure and credit performance and standardized "all-in" pricing metrics, so that businesses understand a loan's true cost and can make comparisons across different loan products.

We will continue to work with both federal and state regulators to ensure that innovation in lending proceeds within a framework that protects borrowers and preserves the safety and soundness of participating financial institutions. Both agencies seek to facilitate innovation that increases competition and broadens access to safe and affordable credit for creditworthy small businesses, but we must remain vigilant so that innovation does not harm small businesses or impose undue burdens on borrowers.

Thank you again for your interest in this issue. Should you have any additional questions, please contact us or have your staff contact Drew Colbert, in Treasury's Office of Legislative Affairs, at (202) 622-1900, or Thad Inge, in SBA's Office of Congressional and Legislative Affairs, at (202) 205-6634.

Sincerely,

Anne Wall
Assistant Secretary
for Legislative Affairs
Department of the Treasury

Ann Marie Mehlum
Associate Administrator
for the Office of Capital Access
Small Business Administration

Identical letter sent to:
The Honorable Jeanne Shaheen
The Honorable Jeffrey A. Merkley