

April 14, 2017

United States Senate
534 Committee on Banking, Housing, and Urban Affairs
Dirksen Senate Office Building
Washington, DC 20510
submissions@banking.senate.gov

**Re: Request for Proposals to Foster Economic Growth –
Enhanced Financial Protections for Small Businesses**

To Members of the Committee:

In response to the Committee’s request, we propose that Congress enact legislation responding to widespread calls for expanded financial protections for small businesses. Under current law, small businesses have few federal safeguards against financial abuse. When a deceptive loan or other financial product saps the financial strength of a small business, the damage does not fall exclusively on the business and its owner; its customers, employees, suppliers, state and local governments, and its community’s economy are also hurt. In aggregate, these harms to individual small businesses hamper the nation’s economic growth. By protecting small businesses from financial abuse, Congress can boost their potential to grow the economy.

Small Businesses are Key Drivers of Economic Growth

Small businesses are a primary driver of job growth and wealth creation in the United States, providing more than half the country’s jobs and two-thirds of net new jobs.¹ They employ half of the nation’s private sector workforce--about 120 million people--and are responsible for creating the majority of the net new jobs since 1995.² These small firms are powerful drivers of innovation; they employ more than 40 percent of high-tech

¹ U.S. Small Business Administration, “Small Business Trends” (Apr. 14, 2017), <https://www.sba.gov/managing-business/running-business/energy-efficiency/sustainable-business-practices/small-business-trends>.

² Michael Mazerov and Michael Leachman, Center on Budget and Policy Priorities, “State Job Creation Strategies Often Off Base” (Feb. 3, 2016), <http://www.cbpp.org/research/state-budget-and-tax/%20state-job-creation-strategies-often-off-base>; U.S. Small Business Administration, “Small Business Market Update,” *Small Business Bulletin*, (June 2015), https://www.sba.gov/sites/default/files/Small_business_bulletin_June_2015.pdf; Bureau of Labor Statistics, Business Employment Dynamics. Reported in SBA’s Office of Advocacy Fact Sheet, “Role of Microbusinesses in the Economy.”; Wiens, Jason, and Jackson, “The Importance of Young Firms for Economic Growth,” 2015, <http://www.kauffman.org/what-we-do/resources/entrepreneurship-policy-digest/the-importance-of-young-firms-for-economic-growth>.

workers in the U.S. and produce 13 times more patents per employee than larger firms.³ They also reinvest their profits in the local economy, causing “ripple effects” that lead to higher employment rates, greater investment in infrastructure, and more vibrant communities⁴ – and communities better able to withstand economic downturns.⁵

Not only do they create more jobs than their larger counterparts, but small, independent businesses also recirculate a greater share of every dollar in the local economy. Local small businesses are more likely, for example, to buy goods and services from local sources, hire local employees, and pay taxes to local and municipal governments. By retaining their wealth locally, small businesses create a “virtuous cycle of local spending” that results in more tax revenue, more jobs for residents, and more investments in infrastructure and education.⁶ Not surprisingly, compared to big-box retailers, communities with small businesses have stronger local economies, characterized by higher income growth, lower levels of poverty, and more employee retention during economic downturns.⁷

Furthermore, small businesses ownership itself can be an important avenue of economic mobility and wealth creation.⁸ Business equity represents one-fifth of total household wealth nationwide, making it the second largest source of wealth beyond home equity.

³ Karen Mills, “Is a Gap in Small-Business Credit Holding Back the American Economy?” *Harvard Business School* (July 21, 2014), <http://hbswk.hbs.edu/item/is-a-gap-in-small-business-credit-holding-back-the-american-economy>

⁴ “Indie Impact Study Series: Salt Lake City, Utah,” *Civic Economics* (Aug. 2012), <http://localfirst.org/images/stories/SLC-Final-Impact-Study-Series.pdf>.

⁵ Giuseppe Moscarini & Fabien Postel-Vinay, “The Contribution of Large and Small Employers to Job Creation in Times of High and Low Unemployment” 102 *American Economic Review* 2509-39 (2012).

⁶ “Indie Impact Study Series: Salt Lake City, Utah,” *Civic Economics* (Aug. 2012), <http://localfirst.org/images/stories/SLC-Final-Impact-Study-Series.pdf>; Garrett Martin and Amar Patel, Maine Center for Economic Policy, “Going Local: Quantifying the Economic Impacts of Buying from Locally Owned Businesses in Portland, Maine” (Dec. 2011), <http://www.mecep.org/going-local-quantifying-the-economic-impacts-of-buying-from-locally-owned-businesses-in-portland-maine/>.

⁷ Giuseppe Moscarini and Fabien Postel-Vinay, “The Contribution of Large and Small Employers to Job Creation in Times of High and Low Unemployment,” *American Economic Review*, October 2012, <https://www.aeaweb.org/articles?id=10.1257/aer.102.6.2509>; Anil Rupasingha, Federal Reserve Bank of Atlanta, “Locally owned: Do local business ownership and size matter for local economic well-being?” (Aug. 2013), <https://www.frbatlanta.org/-/media/Documents/community-development/publications/discussion-papers/2013/01-do-local-business-ownership-size-matter-for-local-economic-well-being-2013-08-19.pdf>.

⁸ Edward N. Wolff, “The Asset Price Meltdown and the Wealth of the Middle Class,” The US2010 Project (May 2013).

Successful entrepreneurship is correlated with wealth, savings, job satisfaction, and upward economic mobility.⁹

Financial Predation Undermines Small Businesses

Small businesses report frequently encountering unfair and deceptive treatment in the financial marketplace. In particular, small businesses express dissatisfaction at the lack of lender transparency regarding the terms of loans.¹⁰ Researchers have confirmed that opaque and confusing disclosures make it difficult for small-business decision-makers to compare loan offers, denying them the benefits of genuine competition and meaningful choice.¹¹ Under these conditions, small businesses are paying shockingly high interest rates (over 350 percent in some cases), hindering their capacity to prosper and grow.¹²

Federal Law Inadequately Protects Small Businesses from Financial Abuse

Minimal federal financial protections exist for small business.¹³

The Consumer Financial Protection Bureau’s (CFPB) core jurisdiction is limited to financial products “offered or provided for use by consumers primarily for personal,

⁹ See, e.g., Vincenzo Quadrini, “Entrepreneurship, Saving, and Social Mobility.” *Review of Economic Dynamics* 3 (1): 3 (2000) (finding that families who owned a business at the end of a five-year period but not at the beginning of that period were more likely to have moved into a higher income group than were other families over the same period).

¹⁰ Twelve Federal Reserve Banks, *2016 Small Business Credit Survey: Report on Employer Firms* (Apr. 2017), at 17, <https://www.clevelandfed.org/community-development/small-business/about-the-joint-small-business-credit-survey/2016-small-business-credit-survey.aspx>.

¹¹ Federal Reserve Bank of Cleveland, *Alternative Lending through the Eyes of “Mom-and-Pop” Small-Business Owners: Findings from Online Focus Groups* (Aug. 25, 2015), <https://www.clevelandfed.org/newsroom-and-events/publications/special-reports/sr-20150825-alternative-lending-through-the-eyes-of-mom-and-pop-small-business-owners.aspx>

¹² Woodstock Institute, “Analysis of Business Loan Terms” (July 12, 2016), <http://www.woodstockinst.org/research/analysis-business-loan-terms> (survey of business loans finding effective interest rates up to over 350%, and include junk fees averaging \$795 per loan); Opportunity Fund, “Unaffordable and Unsustainable: The New Business Lending,” at 6, http://www.opportunityfund.org/assets/docs/Unaffordable%20and%20Unsustainable-The%20New%20Business%20Lending%20on%20Main%20Street_Opportunity%20Fund%20Research%20Report_May%202016.pdf (survey of online business loans finding mean APR of 93.9%).

¹³ See generally Karen Gordon Mills & Brayden McCarthy, “The State of Small Business Lending: Innovation and Technology and the Implications for Regulation,” *Harvard Business School Working Paper* 17-042 (Nov. 29, 2016), at 86-95, http://www.hbs.edu/faculty/Publication%20Files/17-042_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf.

family, or household purposes,”¹⁴ thereby preventing it from using its authority to protect businesses against “unfair, deceptive, or abusive acts or practices” (UDAAPs). Most of the specific statutes the CFPB enforces – such as the Fair Credit Reporting Act,¹⁵ Truth In Lending Act,¹⁶ and the Fair Debt Collection Practices Act¹⁷ – apply only to consumer transactions. These statutes and the CFPB’s UDAAP jurisdiction should be amended to cover transactions with small businesses.¹⁸

In theory, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the National Credit Union Administration could take enforcement actions against the financial institutions they regulate in order to protect small businesses from “unfair or deceptive acts or practices” (UDAPs). In practice, these prudential regulators have rarely done so. The Federal Trade Commission has used its UDAP authority to protect small business against commercial scams perpetrated by non-banks.¹⁹ But it has not used its UDAP authority to stop unfair or deceptive loans (or the sale of other unfair or deceptive financial products) to businesses.

Congress Should Extend Financial Protections to Small Businesses

There is a strong and growing consensus that small businesses should have stronger federal protections in the financial marketplace. In response to a recent request for information, interested parties “across the stakeholder spectrum” told the Treasury Department that “small business borrowers should receive enhanced protections.”²⁰

¹⁴ 12 U.S.C. § 5481(5)(A).

¹⁵ See 15 U.S.C. § 1681a(d) (limiting coverage to transaction “primarily for personal, family, or household purposes”).

¹⁶ See 15 U.S.C. § 1602(i) (limiting coverage to lending to individuals “primarily for personal, family, or household purposes”).

¹⁷ See 15 U.S.C. § 1692a(3) (limiting coverage to “natural persons”).

¹⁸ These statutes could be amended to include any transaction in which an individual is personally liable (including as a guarantor of debt) or a business entity responsible for the debt falls below an established size threshold (for example, one based on a number of employees or annual revenues).

¹⁹ See, e.g., FTC Approves Final Order in Henry Schein Practice Solutions Case (May 23, 2016), <https://www.ftc.gov/news-events/press-releases/2016/05/ftc-approves-final-order-henry-schein-practice-solutions-case>; FTC Charges Operators of Scheme That Used Fake Government Affiliation to Sell Commercial Trucking Registration Services (Oct. 17, 2016), <https://www.ftc.gov/news-events/press-releases/2016/10/ftc-charges-operators-scheme-used-fake-government-affiliation>.

²⁰ Department of the Treasury, “Opportunities and Challenges in Online Marketplace Lending” (May 10, 2016), at 1, https://www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf.

Market participants and small business advocates have recognized that small businesses need and deserve the same treatment that is already required in consumer transactions.²¹

The distinction between a small business borrower and a consumer seeking credit is “often limited,” as a former Administrator of the Small Business Administration has pointed out.²² Small business owners are typically experts in the products and services they offer, not in finance, and they often have difficulty securing affordable financial or legal advice. For these reasons, small businesses and consumers need the same kinds of protections in the financial marketplace.

Moreover, in practice, there is no sharp delineation between consumer financial products and those for small businesses, often putting the personal financial security of individual business owners at risk. Most small businesses are financed with personal assets²³ and 87% of firms use owners’ personal credit scores to secure credit.²⁴ Even when the business itself takes out a loan, 58% of owners personally guarantee their firms’ debt.²⁵ In fact, personal guarantees are required for Small Business Administration loans.²⁶

CFPB is the Right Agency to Protect Small Businesses

The best agency to oversee protections for small businesses is the CFPB. The CFPB is the primary enforcer of the core statutes that protect borrowers and other users of financial services against misconduct. It can therefore promulgate uniform rules and – with the exception of community banks – supervise and enforce compliance across bank and non-bank financial companies alike.

Moreover, the CFPB already has significant responsibility for small business lending, making it logical to consolidate these functions. The Bureau enforces the Equal Credit Opportunity Act (ECOA), which prohibits discrimination in the provision of business as well as consumer credit. To assist in that work, CFPB will soon systematically collect

²¹ Small Business Borrowers' Bill of Rights, <http://www.responsiblebusinesslending.org/>.

²² Karen Gordon Mills & Brayden McCarthy, “The State of Small Business Lending: Innovation and Technology and the Implications for Regulation,” Harvard Business School Working Paper 17-042 (Nov. 29, 2016), at 99, http://www.hbs.edu/faculty/Publication%20Files/17-042_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf.

²³ Gallup, Small Business Diverse Segments Lending Study - Women Business Owners (May 2015), <http://www.gallup.com/services/183284/small-business-diverse-segments-lending-study-women-business-owners.aspx>

²⁴ Twelve Federal Reserve Banks, *2016 Small Business Credit Survey: Report on Employer Firms* (Apr. 2017), <https://www.clevelandfed.org/community-development/small-business/about-the-joint-small-business-credit-survey/2016-small-business-credit-survey.aspx>.

²⁵ *Id.*

²⁶ Marco Carbajo, How To Build Business Credit For Your Start Up (June 2, 2011), <https://www.sba.gov/blogs/how-build-business-credit-your-start>

data on small business lending²⁷ and likely accept complaints from small businesses.²⁸ These efforts are led by the CFPB’s Office of Small Business Lending Markets, giving the CFPB relevant expertise.²⁹ Recognizing these advantages, the CFPB’s current director favors expanding the Bureau’s jurisdiction to include transactions with small businesses.³⁰

Conclusion

We appreciate your attention to the needs of small businesses and your consideration of this proposal to enact federal protections for small businesses in lending and other financial transactions. For questions, please contact Brian Simmonds Marshall, Policy Counsel at Americans for Financial Reform, at brian@ourfinancialsecurity.org or 202-684-2974.

Sincerely,

Accion Chicago
Americans for Financial Reform
California Reinvestment Coalition
Main Street Alliance
Reinvestment Partners
Woodstock Institute

²⁷ Dodd-Frank Act § 1071.

²⁸ CFPB Turns Attention to Small Business Lending Market, *Bloomberg Law Banking* (June 21, 2016), <https://www.bna.com/cfpb-turns-attention-n57982074513/>.

²⁹ CFPB Announces New Additions to Senior Leadership (Apr. 12, 2016), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-announces-new-additions-to-senior-leadership-20160412/>.

³⁰ Testimony of Richard Cordray, Before the House Financial Service Committee (Mar. 16, 2016) (“[I]f I had my way . . . we would . . . protect not only individual consumers, as our statute authorizes us to do, but also small businesses who often operate in the marketplace with no greater clout than an individual household does. If the Congress sees fit to give us that authority, we will aggressively pursue that. And it would help small business across the country.”).