



Transparency in Small Business Lending

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Submitted by:

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Chairwoman Velazquez, Ranking Member Chabot, and distinguished members of the Committee, good afternoon. Thank you for inviting me to speak with you today about the lack of transparency in small business lending, and the urgent need to provide entrepreneurs with the information they need to make informed financing decisions.

My name is Yanki Tshering and I am the Executive Director of Business Center for New Americans (BCNA). BCNA is a Treasury-certified Community Development Financial Institution (CDFI) and Small Business Administration (SBA) Microlender and Community Advantage lender based in New York City. BCNA was founded to help hardworking immigrants and refugees pursue the American dream. For over two decades, we have provided financial counseling and loans to help clients start or grow a business, buy a home, or save for the future.

In addition to my role leading BCNA, I have also served on the board of the New York State CDFI Coalition since 2015. This coalition strives to efficiently and effectively support the 80 CDFIs in New York State so that they can in turn ensure access to capital for individuals to achieve their financial goals and also serve the needs of their communities.

Background on BCNA

BCNA's mission is to create pathways to self-sufficiency for immigrant and refugee entrepreneurs in New York City by providing access to affordable credit, empowering them with financial education, and offering training in best business practices and technology.

Each year, BCNA is approached by approximately 8,000 refugees and immigrants who seek microloans and advice on how to start or expand micro and small businesses. Approximately 10% of them go on to become our loan clients, or receive technical assistance delivered through one-on-one sessions or group workshops. Many prospective clients learn through discussions with BCNA that they are not yet ready to start a business and may return to us in the future once they have taken steps to prepare.

Our micro and small-business clients range from the street vendor who comes once a year to borrow \$500 to fund his inventory of roses for Valentine's Day, to the deli owner client with 6 stores and 80 employees.

Target clientele are groups with proven barriers to access resources in the mainstream financial marketplace: new immigrants, refugees, aspiring minority and women entrepreneurs, low-income people and low-wealth businesses. BCNA clients are unable to secure loans from traditional banks due to credit issues, length of time in business, or size of loan request. While we make loans up to \$250,000, many requests are for loans that range from \$500 to \$5,000 that are not profitable for banks to make and therefore not available from traditional financial institutions. Often these clients do not have the credit history required to qualify for a loan. More often than not the loans that we provide, help our clients establish credit history and eventually they may qualify for a line of credit or another loan product from a bank. The provision of training and education on establishing a credit history and one-on-one assistance takes time and effort

that are not cost effective for banks. In fact, a number of banks have supported us so that we could increase our capacity to provide credit builder loans and workshops to educate clients about establishing positive credit history.

In keeping with historical trends, 95% of 2019 borrowers were refugees or immigrants. They hailed from 55 countries and 62% were women. Most are of modest means: 93% low-income (earning 80% or less of Area Median Income or AMI); this included 31% in the very low-income subset (30% to 50% AMI) and 41% extremely low-income (< 30% AMI). At \$34,800, median borrower household income was just over half the NYC \$60,762 benchmark.

BCNA serves exceptionally diverse clients:

- Formal education from elementary school to PhDs
- Professional and vocational backgrounds include physicians, lawyers, attorneys, accountants, farmers, musicians, hair braiders, and nomads
- Countries of origin from Azerbaijan to Zambia- currently many from western Africa, former Soviet Union, south Asia
- Languages include Spanish, Russian, French, Bangla, Urdu, Nepali, Tibetan, Arabic, many African dialects
- Ages 19 to 70 (most 22-49 years)
- Over 90% identify as part of minority groups

In line with this diversity, in 2019 BCNA loans supported businesses in 26 distinct market sectors including car/taxi services, day care centers, grocery and retail stores, legal and medical providers, food carts, restaurants and beauty salons. Most clients live in economically distressed and highly distressed communities. Many also operate their businesses in distressed areas ensuring underserved communities have access to the types of food, retail goods and services that contribute to a higher quality of life.

Named a top 10 U.S. microlender by CNN Money and a top SBA microlender in NYC for 10 years, BCNA is the second most prolific SBA microlender nationwide and an Aeris-rated CDFI (A- 3-star rating) affirming strength of the business model. Aeris provides CAMEL-like financial and impact performance analysis of CDFIs for investors. BCNA has made over \$ 32 million in micro and small business loans to businesses in New York City and provided training and advice to over 10,000 businesses.

One of those 10,000 businesses is Vladimir Teriokhin, the owner of Haute Knit which produces knitted garments for New York design houses. He was initially ecstatic when he was approved for a \$35k loan from an alternative lender found online, but gradually realized to his horror that they were deducting daily repayments of \$268 from his bank account and he was paying over 61% in annualized interest. Vladimir came to BCNA and we were willing to provide a loan so that he

could pay off this high interest loan. We were then shocked to learn that all interest and fees were required to be paid for the full amount even he was able to pre-pay this loan.

The Need for Small Business Lending Transparency

Now, more than ever, small businesses in New York and across the country are suffering from a lack of access to responsible credit – a problem that has been exacerbated by the lack of transparency requirements for financing providers. The Truth in Lending Act, originally passed in 1968, requires lenders to clearly disclose their pricing and terms to consumers but does not apply to financing for commercial purposes. This simply means that small business owners like Vladimir are left to face a Wild West of unregulated and increasingly complex financial products without any consistency in how the lenders explain or present their products to borrowers.

Larger, more established businesses may be able to hire an attorney who can translate confusing term sheets into digestible language so the entrepreneur can truly understand what is being offered to them and make an informed decision. However, as members of the Committee know very well, the overwhelming majority of small businesses are quite small, having 20 or fewer employees.¹ The businesses BCNA typically serves are family owned and operated micro and small businesses, and the majority of them come to us to get credit up to \$50,000, as they cannot access this financing from banks.

We regularly assist clients who have encountered alternative loan products such as merchant cash advances (MCAs) that they did not understand – at times, with dire consequences.

Transparency Problem #1: Alternative “Rates” That Appear Inexpensive

Many alternative lenders including MCAs disclose a “simple interest rate” or “fee rate” that looks like a standard annual percentage rate (APR), but is not.² These “rates” give small business borrowers the impression that the products are inexpensive, when in fact the true APR is quite high. Confusion presents a significant problem, especially for the low-income immigrant and refugee populations we serve, because in the end they simply cannot afford the high cost of these products. Business owners take out these loans thinking they are getting a good deal, but are quickly unable to keep up with expensive daily or weekly payments that put everything they have built at risk. A loan that lacked clear APR disclosure put Valdimir into a debt spiral; before long he was using all his credit and incurring more debt to keep up with the daily payments that were stripping assets from his personal and business accounts.

Transparency Problem #2: Renewals

While MCAs often have 6-18 month original repayment terms, MCA companies frequently encourage their borrowers to “renew” or refinance partially-repaid debt with some additional

¹ <https://www.census.gov/programs-surveys/ase/data/tables.html>

² <https://www.federalreserve.gov/publications/files/what-small-business-borrowers-find-when-browsing-online-lender-websites.pdf>

cash out. What MCAs do not disclose is that the borrower must pay full finance charges twice on the unpaid balance that is carried over into the renewal. Borrowers often do not understand the structure of the renewal until they discover that they have only received a small amount of additional funds, and that a large portion of their new loan has gone to cover the duplicate finance charges.³ It is important that borrowers are given better information to understand the full cost of the renewal before sales agents pressure them into accepting the renewal that may bring no financial benefit to the small business.

The MCA business model built upon renewals warrants the disclosure of an estimated APR for MCA products, even though their initial terms may be under one year. One provider claims that 75% of their MCA customers renew, meaning that in most cases, these short-term loans are actually repaid over longer periods of time.⁴

Transparency Problem #3: Lack of Clear Prepayment Language

We have other clients who have come to us and in certain cases we are unable to help them as we cannot extend any additional debt for a business that has taken on a high-cost loan and then had to take on more debt to make payments on the initial loan. What is often heartbreaking is that even if we were able to extend credit to refinance the business out of a high-cost loan, the borrower would often still have to pay the full amount of the fees and interest despite prepayment. They are devastated to find out that the lender charges high prepayment penalties that were not made clear to them.

These examples of small business lending transparency problems are not at all isolated to BCNA clients. My colleagues in the New York State CDFI Coalition often serve businesses that have received a predatory loan without realizing the true cost upfront. Debt-burdened businesses will come to CDFIs in a state of crisis, needing to refinance their high-cost debt before large payments cause them to fall behind on other obligations and potentially force the business to close. As mission-oriented CDFIs, we do our best to help these clients, but sometimes it is unfortunately too late. To us, the solution is clear: if these businesses received plain-language disclosures up front, they could have avoided the destruction caused by predatory loans altogether.

Progress Towards Transparency in New York State

The small business lending transparency problem persists, but BCNA and the New York State CDFI Coalition have not sat idly by. Over the course of the past 1-2 years, we worked closely with a broad coalition of CDFI and fintech lenders, advocates, and state legislators to develop a comprehensive small business financing disclosure framework in the state of New York. I am proud to share that the *New York State Small Business Truth in Lending Act (A10118-A/S5470-B)*

³ <https://www.nav.com/blog/15-the-renewal-trap-beware-of-the-mca-refinance-5476/>

⁴ <https://slideplayer.com/slide/7525590/>

passed the state legislature with bipartisan support in July.⁵ Once enacted, this will serve as the nation's strongest small business lending disclosure law, building upon California's SB 1235 with even more clarity for businesses.

Federal Small Business Lending Disclosure Requirements

While I am pleased that we have successfully passed strong protections for small businesses in my home state of New York, countless business owners across the United States remain vulnerable to deceptive, high-cost lending. Chairwoman Velazquez's recently-introduced *Small Business Lending Disclosure and Broker Regulation Act* (H.R. 7889) will ensure that no small business is left behind and extend sensible disclosure protections to entrepreneurs nationwide.

H.R. 7889 importantly requires alternative lenders to disclose an estimated APR for sales-based repayment products like MCAs. These products offer businesses an advance on future receivables typically for a flat fee, and are repaid through daily or weekly automatic debits as a percentage of the business' sales revenue. Right now, sales-based financing providers often disclose the non-standard "rates" described above. Without knowing the true APR, businesses struggle to accurately weigh the costs and benefits of financing their business with an MCA or other sales-based product, a business credit card, an SBA Microloan or Community Advantage Loan, or perhaps a consumer financial product such as a home equity line of credit (HELOC).

This legislation could not have come at a better time, as businesses are now especially vulnerable to predatory lending in the midst of the pandemic. Businesses are having to navigate the process of re-opening their businesses, a process that can bring a new set of challenges and expenses as in the case of restaurants, for example, that need to set up outdoor space and are often serving fewer clients than they used to. They are also now burdened with several months of unpaid rent and other expenses. Businesses in this sector and other sectors like retail that depend on the holiday season for most of their revenue are especially vulnerable to predatory lending as they assume and hope that if they can make it through the next six months, that they will be on track to make the revenue they did before so will apply for loans with terms that seem reasonable and easy to qualify for. Businesses must receive clear information so that they fully understand the terms of these loans before accepting them, as unaffordable financing could put them over the edge under already tenuous circumstances.

It is critical that Congress acts now to advance H.R. 7889 and prevent even more devastation to entrepreneurs that have devoted their lives and livelihoods to achieving the American Dream. This country would not be what it is today without small businesses that create jobs, provide critical goods and services, and add life to the neighborhoods that are part of the cultural and economic fabric of our diverse nation. Thank you for the opportunity to testify before you today. I look forward to answering your questions.

⁵ <https://www.nysenate.gov/legislation/bills/2019/a10118/amendment/a>