House Small Business Committee
Subcommittee on Economic Growth, Tax and Capital Access
"Financing Through Fintech: Online Lending's Role in Improving Small Business Capital Access."

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Introduction

Chairman Brat and Ranking Member Evans, thank you for the opportunity to testify today on the role fintech plays in helping small business access capital. It is an honor to be here sharing the insights and experience we have accumulated working in this important space.

My name is Trevor Dryer and I am the CEO of Mirador, a small business of 24 employees, headquartered in in Portland, Oregon. In the regulated banking space, Mirador is a 3rd party service provider and is treated as such by bank examiners. The cloud-based Mirador platform is a "white label" technology solution marketed under a bank, credit union or CDFI's brand, enabling them to profitably originate small business loans as low as $2,500, and offer competitive rates by using technology to facilitate some of the more labor-intensive parts of the loan-making process, creating a fast and easy experience for the small business borrower.

Mirador is not a lender. Our technology supports each of the following services for customers who are lending: customer acquisition, application (both online and in branch), loan origination, underwriting, pre-screening or "decisioning," and decline referrals. As a front-end solution with extensive back-end functionality, all aspects of our platform focus on improving the engagement and experience between borrower and lender. Our technology supports: commercial term loans, SBA backed loans, working capital/lines of credit, commercial real estate loans, and small dollar loans.

Our platform is highly–customizable and reflects the existing credit criteria established by our customers. Our role in the loan-making process provides us with unfettered sightlines into current small business lending trends including types of businesses looking for capital, geographic distribution of a sample size of small business loans, credit availability, and the risk appetite for different types of institutions. I can you tell you from my professional work and my personal experience, access to affordable capital remains a major hurdle for small businesses around the United States.

Our customers are regional, mid-sized and community banks, credit unions, CDFI's and other mission-based lenders. Their customers are the small businessmen and women in the communities they service who are seeking loans for as little as a couple thousand dollars, up to several hundred thousand dollars or more.

Mirador is dedicated to the proposition that regulated financial services companies want to serve small businesses in their communities, and are equipped to do so at competitive rates with robust consumer protections. Due to a number of factors including regulatory costs, small business loans below a certain dollar amount are unprofitable for regulated financial services entities. However, with the help of Mirador's technology, our customers make smaller loans profitable once again, increase the profitability for larger loans, improve the customer experience for borrowers, and utilize supplemental underwriting techniques and data sources helping more lenders "get to yes" for qualified small businesses.

Borrower Experience

When a lender partners with Mirador, they license our platform. Again, the platform is highly customizable. We import the lender's credit criteria and integrate the platform into the bank's preferred origination channels, whether in-branch, online or mobile.

Once integrated, applicants seeking a business loan apply through the bank portal either directly on the bank's website, or working with an employee who takes the application information in-branch. Though routed onto the Mirador rails, the borrower's experience remains on the bank's website with the "Powered By Mirador" phrase and logo at the bottom of the screen. All of the branding, marketing and compliance disclosures are determined by the bank and bank regulators.

Applicants will follow simple steps to fill-in their information and, with their affirmative consent, Mirador technology completes a credit memo by pulling additional data from public records, credit bureaus, accounting software, bank accounts and the IRS. The credit memo is transmitted to a bank's loan officer with an indication of credit-worthiness -- again, based on the credit tolerances the bank has provided. The indication is communicated through a GREEN-YELLOW-RED system -- green essentially indicating an approval, red a denial, and yellow a conditional approval pending the acquisition of more applicant information.

The value to the bank is that, up to this point in the lending process, a bank employee has not spent time compiling documents, calling the applicant and calling them again to get more information to compile a complete credit memo. Our lenders report as much as a 69% reduction in time spent per application, and a savings of roughly $1550 per loan origination. Additionally, our lenders see roughly a 60% application completion rate, due to the significantly easier, less labor-intensive application process. Several lenders have reported seeing a 40-50% increase in loan applications after implementing Mirador's technology due to this higher application completion rate, and also being able to attract borrowers disinclined to go through a cumbersome application process.

The value for the borrower is spending less than 10 minutes compiling an application, as opposed to the average time of 30 hours. According to the Joint Small Business Credit Survey Report of 2016[1], borrowers overwhelmingly state "difficulty with the application process" and "long wait for credit decision" as the principle reasons for dissatisfaction with a borrowing experience, far outweighing rates or repayment terms. Mirador works hard to efficiently use the borrower's time.

Our adaptive application experience changes and presents questions based on the borrower's risk. For example, as we collect information we may seamlessly route a borrower into a SBA process if too risky for a conventional term loan. We also use a unique algorithm in compiling the underwriting information for our lenders and to match a borrower with the lender most likely to approve a loan. If the borrower is generally too risky for our partner banks or credit unions, our technology seamlessly routes, with the borrower's consent, the application to a non-profit CDFI. Thanks to this routing ability, the borrower does not need to start the application process

[1] https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-EmployerFirms-2016.pdf

over with the new lender, thus saving significant time. This is also a unique way to increase awareness of low-cost lenders, such as CDFIs, that traditionally do not engage in marketing activities.

Mirador also provides the bank with deeper analytics about their application traffic, loan performance and customer mix. But the real value is getting more small business loans into the hands of creditworthy applicants. Aside from the licensing fee, we are paid for every completed credit memo regardless of the lending decision.

In our mission to provide more small businesses access to capital through traditional, regulated entities, we are working with various groups having a small business customer base. By growing our client base, we envision a neural network of partners, borrowers and lenders passing along customers to ensure that any small business can seamlessly access affordable credit from a traditional, regulated institution without going through the time and trouble of starting the application process over again from the start. As our network continues to grow and the number of small business customers increases, the technology provided by Mirador will only improve.

What We're Seeing

Often the owner of a small business is the CEO, CFO, CIO, CTO and likely the person handling all of the day-to-day work required to keep the business running. In other words, handling the business' finances is just one more task for the business owner and often is the task left to the end of the day during non-business hours. In fact, we have heard reports that less than 10% of small businesses have a CFO or someone looking after their finances full-time.

A study in 2015 by the Cleveland Fed found that the #1 complaint of small business borrowers was that the application process was too cumbersome, and the #2 complaint was that the process too long[2]. Also, the typical hours of operation for a bank branch overlap with the hours the business owner is usually trying to run their business. As such, a time consuming application process becomes extremely difficult.

A 2014 Federal Reserve study calculated the amount of time the average small business owner commits to applying for a small business loan. Whether the loan is $1000 or $1 million dollars, on average it will take over 24 hours to research, fill out the applications, gather documents and submit the necessary information needed by the bank for underwriting[3]. That's 24 hours just to get the process moving forward. There is still the approval process, underwriting and information verification handled by the bank.

It can take weeks for the small business owner to see capital, if approved. I emphasize "if" because underwriting for small businesses is tricky, time consuming and expensive. In fact, it will cost a bank just as much to underwrite a $100,000 small business loan as it does a $1 million loan, a cost which the Oliver Wyman consulting firm found to be between $1600 and $3200 per

[2] https://www.clevelandfed.org/community-development/small-business/about-the-joint-small-business-credit-survey/2015-joint-small-business-credit-survey.aspx
[3] https://www.newyorkfed.org/medialibrary/media/smallbusiness/SBCS-2014-Report.pdf

loan application, regardless of loan size[4]. This leaves very little incentive for the banks to offer small-dollar loans.

From this narrative, it is also easy to see why so many small businesses turn to online lending for their capital needs. In fact, 21% of small business loans are currently going to higher-priced, non-bank lenders, and this number is growing[5]. The online lending community provides 24 hour access, near-instant approvals, and quick turnaround on capital available in smaller cash amounts. For so many small businesses, this is the only logical and available--albeit often expensive-- option to meet their capital needs.

Mirador Financial was created with these small business pain points in mind, but also with the understanding that capital offered by traditional lenders is often less expensive and carries better terms for the borrowers.

Mirador currently works with 20 banks and credit union partners and 4 CDFIs and our network continues to grow. We believe our technology brings the necessary conveniences of online lending to the traditional financial institution space, offering one more option for the small business owner struggling to keep up with their work and make ends meet. To date, we have helped offer over $600 million in loans to over 4,200 customers. These loans range from $1000 to $9.75 million dollars (a SBA 504 loan in a high-priced real estate market) with an average loan size of $123,000, both non-traditional products like merchant cash advance to SBA 7(a) loans. We are crossing the gap between small business, small dollar lending and traditional commercial lending.

While innovation is clearly improving access to capital for small businesses, a number of issues still negatively impact this market and place the borrower at a disadvantage.

To that end, I proffer three policy recommendations which can unlock additional capital for small businesses by further removing pain points for borrowers (and lenders).

<u>Encourage the IRS to automate the 4506T process for a third party to obtain a tax transcript</u>.

Congressman Patrick McHenry (R-NC) and Earl Blumenauer (D-OR), as well as the ranking member of this committee Congresswoman Nydia Velázquez (D-NY), introduced H.R. 3860, the IRS Data Verification Modernization Act of 2017 requiring the IRS to automate the Income Verification Express Services Process by creating an Application Programing Interface (API), which would reduce paperwork and the waiting period that currently burdens lenders and borrowers alike.

The current process requires a lender to submit (often via fax machine) a 4506-T form to the IRS, requesting a tax transcript which is then used to satisfy income verification requirements in the underwriting process. According to the IRS, the lender will receive a response to the request in 2 days or less. However, the typical experience for the lending community is far longer than 2

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[4] https://qedinvestors.com/wp-content/uploads/2015/10/The-Brave-100-The-Battle-for-Supremacy-in-Small-Business-Lending_vf.pdf
[5] https://www.newyorkfed.org/smallbusiness/small-business-credit-survey-employer-firms-2016

days. Forms are faxed back and forth and with some routinely returned for corrections based on clerical errors. In our experience, the 4506-T process averages around a week per request, and longer if the form is returned due to an error. In terms of the overall application process for the small business borrower, this delay is a significant factor in the decision to abandon the loan process and instead seek credit through an alternative source.

The McHenry bill would simply require the IRS to move from a paper-based, fax system to a secure API. Only those third parties authorized by the IRS to pull transcripts under the current vetting process would be able to take advantage of the API. In addition, since a fee is charged "per pull", the IRS could simply increase this fee to cover the cost of converting to an API.

<u>Provide Community Reinvestment Act (CRA) consideration for referrals to Community Development Financial Institutions (CDFIs) and other covered lenders</u>.

Regulated banks frequently partner with CDFIs in order to satisfy CRA obligations with their regulators. Currently, banks obtain CRA consideration for providing capital investments, offering technical assistance and through collaboration with a CDFI on lending. However, banks do not receive CRA consideration from referring borrowers to these same CDFIs when these loans are too risky for the bank to underwrite.

Our CDFI partners are seeing a rise in refinancing in the small business lending space. When the small business faces an immediate need for capital, and the traditional, regulated bank's process is too slow, those businesses frequently turn to alternative lenders where terms and interest rates are unfavorable. Oftentimes speed outweighs cost-of-capital when the alternative means missing opportunities to expand or just keeping the lights on and the doors open. When the urgency is gone, these businesses are left with high interest debt and payments that cut deeply into revenue. In one of many a recent examples provided by a partner CDFI, a refinanced loan saved a small business over $6300 per month in payments. That $6300 a month is another employee or a lease payment on new space for the business. On average, one of our CDFI partners reports saving small business borrowers an average of $3900 per month on the non-bank loans they refinance by extending the repayment term and lending at a much lower APR (typically no higher than 13%).

Given the economic development mission of CDFIs to support small businesses, a successful referral from a bank is something the regulators should incentivize. In collaboration with the NYBDC, we identified an easy and cost effective way to encourage these referrals is through providing CRA consideration. The more options provided to the small business borrower with minimal additional work, the better those businesses are served and the greater impact on the overall economy.

<u>Allow credit reports to transfer with referred loan applications and prohibit credit bureaus from requiring a new inquiry for each new lender</u>.

Most individuals know that credit inquiries affect their credit score. Unfortunately, when applying for a loan, numerous inquiries occur from the various lenders considering the borrower's request, even though the borrower is seeking a single loan. The more inquiries, the greater impact on a credit score and, as credit scores lower the cost of capital increases and becomes more difficult to obtain.

When a small business applies for a loan, they expect the lender to pull a credit report. However, if the lender is unable to approve the loan but can provide a referral to another lender, it is reasonable to expect the credit report to transfer with the application. Unfortunately, the credit bureaus do not allow the reports to transfer and the small business experiences another inquiry on their credit for the same information already obtained for the application that was denied. This is an unnecessary added cost to the application and an unreasonable penalty to the small business.

Unless the credit bureaus willingly change this practice of requiring a new credit report when a loan application is transferred from one institution to another, a statutory requirement should be considered.

Finally, I encourage this committee to continue efforts directed at modernizing and simplifying the loan process through the SBA. The SBA remains a vital source of capital for small businesses, particularly newer businesses and startups. However, the process and technology are cumbersome and keep the SBA from realizing its full potential as a guarantor. Upgrades to their systems must continue or the SBA risks losing its pipeline to online lenders and other fintech players.

SBAOne and SBALinc are the flagship programs offered by SBA to improve the borrower experience and previous SBA Administrator Contreras-Sweet and current Administrator McMahon deserve credit for prioritizing modernization in these areas. SBA staff are working incredibly hard – we know them and we speak to them often – but need to overcome imbedded constraints to really modernize these services.

The private sector, including Mirador, has developed world-class matching technology ensuring that borrowers can be considered by a lender under the most appropriate terms and conditions. If the SBA employed this technology, I am confident that it would enable SBA products to reach more borrowers. SBA should be encouraged to look to the private sector for technology solutions, and to apply such solutions to improve efficiently and the overall borrower and lender experience in SBAOne and Linc. Speaking purely on behalf of my company and our customers, it is in our best interest for the SBA to obtain the best available technology.

Once again, thank you so much for this incredible opportunity. As I am sure everyone on this committee knows, small business is the backbone of our economy. These job creators serve the greater good in their local communities and the entire US economy. We must do everything possible to ensure they continue to grow and thrive, creating jobs and opportunity for Americans.