



GEORGETOWN UNIVERSITY LAW CENTER

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Written Testimony of

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Before the Committee on Small Businesses
United States House of Representatives

“Transparency in Small Business Lending”

September 9, 2020
1:00 pm

Witness Background Statement

Adam J. Levitin is an Agnes N. Williams Research Professor and a Professor of Law at the Georgetown University Law Center, in Washington, D.C., where he teaches courses in bankruptcy, commercial law, contracts, and finance regulation. He is the author of *Consumer Finance: Markets and Regulation* (Wolters Kluwer 2018), *Business Bankruptcy: Financial Restructuring and Modern Commercial Markets* (2nd ed. Wolters Kluwer 2018), and, with Susan M. Wachter, *The Great American Housing Bubble* (Harvard University Press, 2020).

Professor Levitin has previously served as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School, as the Robert Zinman Scholar in Residence at the American Bankruptcy Institute, and as Special Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program (TARP). Professor Levitin has also previously served on Consumer Financial Protection Bureau's Consumer Advisory Board.

Before joining the Georgetown faculty, Professor Levitin practiced in the Business Finance & Restructuring Department of Weil, Gotshal & Manges, LLP in New York, and served as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third Circuit.

Professor Levitin holds a J.D. from Harvard Law School, an M.Phil and an A.M. from Columbia University, and an A.B. from Harvard College. In 2013 he was awarded the American Law Institute's Young Scholar's Medal.

Professor Levitin has not received any Federal grants or any compensation in connection with his testimony, and he is not testifying on behalf of any organization. The views expressed in his testimony are solely his own.

Chairwoman Velázquez, Ranking Member Chabot, Members of the Committee:

Good afternoon. Thank you for inviting me to testify at this hearing. My name is Adam Levitin. I am a Professor of Law at the Georgetown University, where I teach courses in bankruptcy, commercial law, and consumer finance. I appear here today as an academic who studies consumer and small business lending, without any economic interest at issue.

I applaud the Chairwoman for her bill, the Small Business Lending Disclosure and Broker Regulation Act of 2020, H.R. 7889, which would bring much needed protections to small businesses in the credit market.

The US financial regulatory system treats loans made for personal, family, or household purposes differently from loans made for business purposes. While an extensive system of regulation exists to protect consumer borrowers, there is only scant regulation of business loans.

The consumer protection system is premised on the idea that consumers often lack the information, sophistication, and market power to protect their interests. Accordingly, the consumer financial regulatory system forces the provision of information, often in standardized forms, gives consumers certain minimum rights, prohibits certain terms and transactions that are understood to be overreaching and abusive, and creates a non-judicial dispute resolution system.

The protections Congress has given consumers do not exist for businesses, which are often presumed to have greater financial sophistication and savvy. But small businesses often resemble consumers in terms of limited information, sophistication, and market power in credit markets.

Because of a lack of regulation, the nature of information small businesses receive about credit offers varies considerably. Moreover, many small businesses have owners who do not speak English as a native language, placing these businesses at a disadvantage when dealing with often technical credit documents.

Financial and legal sophistication also varies substantially among small businesses. The expertise of most small businesses is neither in finance nor law. Instead, it is in whatever their business is. Most small businesses are not regularly engaged in financing transactions. They rarely have a full time chief financial officer who specializes in financial matters, and when they borrow they are often not represented by counsel.

And small businesses lack the market power to be able to readily negotiate favorable credit terms. Small businesses are often poorly served by the financial system; many financial institutions are uninterested in small business lending in part because of the difficulties in underwriting small business borrowers. The nature of small businesses varies considerably, such that they are not susceptible to automated underwriting, which means that the costs of underwriting a small business loan relative to loan size are larger.

The reason that a borrower takes out a loan does not determine the sophistication of the borrower or the borrower's ability to otherwise protect his or her interests. Moreover, small business borrowing is often tied up with the personal credit and property of the owner

because of personal guaranties.¹ Small business lenders often want the owner's credit score for underwriting, and want the owner's other property as collateral. Moreover, many small businesses have commingled use of property with their owners. A small contractor might use his truck for work, but also to get groceries and to take his kids to school. A computer in a home office might be used for both business and personal work. Accordingly, it makes sense to recognize that small businesses need many of the same sort of protections as consumer borrowers to ensure that they can enjoy fair and efficient credit markets.

My testimony proceeds by using a small business loan at a disguised 121% annual interest rate to illustrate some of the problematic issues in small business lending. I then turn to a discussion of how the Chairwoman's bill successfully addresses some of these problems. A final section suggests some clarifications or extensions of the bill.

I. ABUSES IN SMALL BUSINESS LENDING: THE DERAMOS' STORY

In 2015, Homes by DeRamo, a small, Sarasota, Florida, home construction business owned by the DeRamo family, needed cash in 2015 for operating expenses.² An outfit called World Business Lenders, LLC,³ offered the business a \$400,000 loan, due in 9 months, but required the DeRamos to personally guaranty the loan and pledge their home as collateral.⁴ Only about \$393,000 was actually disbursed after fees were deducted. Loan was formally made by Bank of Lake Mills, a tiny two-branch community bank in Wisconsin with no presence in Florida. It is unclear how the DeRamos connected with World Business Lenders in the first place.

Within weeks of making the loans to the DeRamos' business, Bank of Lake Mills assigned the loans to World Business Lenders.⁵ The assignment was signed by a Vice

¹ See Bd. of Gov. of the Fed. Reserve Sys., SMALL BUSINESS CREDIT SURVEY: REPORT ON EMPLOYER FIRMS 5 (2017), available at <https://www.fedsmallbusiness.org/mediaLibrary/fedsmallbusiness/files/2018/sbcs-employer-firms-report.pdf> (finding that 55% of small business employers personally guaranteed their business loans and 33% pledged their personal assets as collateral); Bd. of Gov. of the Fed. Reserve Sys., SMALL BUSINESS CREDIT SURVEY: REPORT ON EMPLOYER FIRMS 8 (2017), available at <https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2018/sbcs-nonemployer-firms-report.pdf> (finding that 39% of non-employer small businesses issued personal guaranties, with 26% pledging personal assets as collateral for business debts).

² Complaint, *DeRamo v. World Bus. Lenders, LLC*, 2017-CA-2438-NC (Sarasota County, Fla. Circuit Court, June 16, 2017) at ¶ 7 (hereinafter "*DeRamo* Complaint"). The facts related here are drawn entirely from public filings in litigation. I have had no contact with the parties, have no interest in the case, and take no position on its ultimate merits. I am aware of the case only because as part of a scholarly project I have been tracking the trail of litigation left by the lender involved. To the extent that the facts alleged in the pleadings were controverted, they were easily confirmed either from public records, the loan documents themselves, or from the lender's own filings in other court cases.

³ For background on World Business Lenders, see Zeke Faux, *Wall Street Finds New Subprime With 125% Business Loans*, BLOOMBERG, May 22, 2014.

⁴ *DeRamo* Complaint at ¶ 8.

⁵ *DeRamo* Complaint at pp. 152, 182. World Business Lenders, LLC subsequently assigned the loans to a securitization vehicle called WBL SPE II, LLC. *Id.* at pp. 184, 187. WBL SPE II, LLC is a wholly owned subsidiary of World Business Lenders, LLC, that World Business Lenders uses to obtain financing. Verified

President of World Business Lenders with a Power of Attorney for Bank of Lake Mills.⁶ The documentation of the DeRamos' loan bears indicia that World Business Lenders was the intended assignee from the get-go: World Business Lenders' address appears in numerous places in the loan documentation,⁷ and the loan documentation even provides for venue and enforcement in New York, where World Business Lenders was located at the time.⁸ The DeRamo case follows a pattern of other transactions undertaken by World Business Lenders with Bank of Lake Mills and pair of other banks, Axos Federal Savings Bank (formerly Bank of the Internet (!)) and Liberty Bank.⁹ In all of these cases, the loans were made by the bank and shortly thereafter transferred to World Business Lenders. In other words, Bank of Lake Mills was little more than an origination agent for World Business Lenders.

The DeRamo loan had a daily interest rate of 0.331515959726%. It also had a 15% prepayment penalty. The loan further gave the lender the right to automatically debit Home by DeRamo's bank account \$3,047.42 every business day, starting four days after the date of the loan.¹⁰ This meant that the loan amortized very rapidly, such that the DeRamos did not have use of the full disbursement for more than a few days: every week they would have over \$15,000 less in working capital.

After four months of payment, the DeRamos refinanced their loan with Bank of Lake Mills, extending the maturity date, and with virtually the same daily interest rate, suggesting that the refinancing was for the purposes of extending the maturity date. They paid the 15%

Petition, *World Business Lenders, LLC v. Arena Limited SPV, LLC*, No. 653229/2019 (N.Y. Sup. Ct. N.Y. County, May 31, 2019), ¶¶ 2, 6.

⁶ *DeRamo* Complaint at ¶ 24.

⁷ *See, e.g., id.* at pp. 13, 31.

⁸ *Id.* at p. 17.

⁹ *See, e.g.,* Class Action Complaint, *Quantum-Mac Int'l, Inc. v. World Bus. Lenders, LLC*, No 1:20-cv-02353 (N.D. Ga. June 2, 2020) (Axos Bank, former BOFI Federal Bank, as rent-a-bank partner for World Business Lenders); *Kaur v. World Bus. Lenders, LLC*, 440 F. Supp. 3d 111, 116 (D. Mass. 2020) (BOFI Federal Bank as World Business Lenders' rent-a-bank partner); *World Bus. Lenders, LLC v. 526-528 North Main St., LLC*, 197 Conn. App. 269, 270-271 (2020) (120% interest rate loan made by Bank of Lake Mills and assigned to World Business Lenders); Complaint, *World Business Lenders, LLC v. Cloud & Willis, LLC*, No. 19-ev-007125 (Fulton County State Court, Ga., Dec. 27, 2019), ¶ 5 (noting that "Shortly after the Loan documents were signed, the Loan [made by Bank of Lake Mills] was sold and assigned to World Business Lenders."); Complaint, *B&S Medical Supply, Inc., N.Y. v. World Business Lenders, LLC*, No. 17-cv-03234-RMB (S.D.N.Y. 2017) (Liberty Bank, Utah, as rent-a-bank partner for World Business Lenders); Verified Complaint, *WBL SPE I, LLC as Assignee of World Bus. Lenders, LLC and of Bank of Lake Mills vs. Jo Juice and Salad Bar, LLC*, No. 32642/2017E (N.Y. Sup. Ct., Bronx Cnty, Oct. 26, 2017) (loan made by Bank of Lake Mills on October 20, 2016, and sold to World Business Lenders on December 2, 2014); Verified Complaint, *World Bus. Lenders, LLC v. Queens Medical Services, P.C.*, No. 600802/2016 (N.Y. Sup. Ct. Nassau Cnty, Feb. 5, 2016) (loan made by Bank of Lake Mills on March 10, 2015, sold to World Business Lenders on March 16, 2015); Verified Complaint, *World Bus. Lenders, LLC v. Michael's Landscaping Construction, LLC*, No. 611675/2016 (N.Y. Sup. Ct. Suffolk Cnty, July 26, 2016) (loan made by Bank of Lake Mills on December 9, 2015, and sold to World Business Lenders on December 14, 2015); Verified Complaint, *World Bus. Lenders, LLC v. ML Seafood Corp.*, No. 511151/2016 (N.Y. Sup. Ct. Kings County, June 30, 2016) (loan made by Bank of Lake Mills on April 30, 2015, and sold to World Business Lenders on May 6, 2015); Verified Complaint, *World Bus. Lenders, LLC v. PM Recycling LLC*, No. 509595/2016 (N.Y. Sup. Ct., Kings Cnty, June 6, 2016) (loan made by Bank of Lake Mills on November 26, 2014, and sold to World Business Lenders on December 2, 2014).

¹⁰ *DeRamo* Complaint at p.11

prepayment penalty to refinance,¹¹ although a simple loan amendment would not have required payment of any fee. They also took out an additional smaller loan from Bank of Lake Mills.¹² In both cases, the loans were quickly transferred to World Business Lenders.¹³

Seven months after the original loan, the DeRamos defaulted on the loans. Less than a year after that, the DeRamos brought suit against World Business Lenders alleging that the loans were usurious.¹⁴ The DeRamos claimed that they were told that the interest rates—*not* the prepayment penalty—was 15%. While the interest rate was in fact disclosed in the DeRamos's actual loan agreement, it was in the form of what appeared to be a miniscule a daily rate with twelve decimal places. In fact, on an annualized basis, the interest rate was over 121%! On the "Business Loan Summary" the DeRamos received, no interest rate was quoted. While the total interest charge was listed, the only number given as a percentage was the prepayment penalty—15%. No annual percentage rate was ever given. In contrast, the APR and finance charge are required to be the most prominent term in consumer credit disclosures.¹⁵

Florida law caps interest charges at an 18% annual rate.¹⁶ So how was World Business Lenders able to charge over 122% annually?¹⁷ Because World Business Lenders had "rented" a bank.

Although state usury laws cover nonbank lenders, banks are effectively exempt.¹⁸ High cost nonbank lenders engage in a range of transactional devices to evade state usury laws,¹⁹

¹¹ The prepayment penalty appears to have been rolled into the refinancing. The balance at the time of refinancing was approximately \$375,000, *see id.* at ¶ 12 (\$640,000 principal plus finance charges minus \$265,000 in payments). 15% of \$375,000 is approximately \$56,000. With other fees, the refinancing was for \$457,000. *Id.* at ¶ 15.

¹² *Id.* at ¶ 22.

¹³ *Id.* at ¶¶ 20, 24.

¹⁴ The DeRamos allege that they were also told that their refinancing of the loan and a subsequent additional loan would be at 15%. *DeRamos* Complaint at ¶¶ 14, 22. The only 15% figure in the loan documents is for the prepayment premium. *Id.* at Exhibit 1 (p.13).

¹⁵ 15 U.S.C. § 1632(a).

¹⁶ 39 FLA. STAT. § 687.02.

¹⁷ The loan documents, included as attachments the complaint, all provide for a daily interest rate of between 0.331513939726% and 0.335945205479%. *DeRamos* Complaint at pp. 13, 55, 158. On an annualized simple interest basis with a 365-day year, this is between 121% and 122.6%. The DeRamos' loans were only for 300 days, however, so in their pleadings they annualized the ratio of finance charges to principal, which resulted in rates between 72% and 74% interest. *DeRamos* Complaint at ¶ 26.

¹⁸ Technically, federal law does not exempt banks from state usury laws so much as provide a choice of law rule that enables banks to "export" the usury cap from their home state to other states. *See* 12 U.S.C. §§ 85, 1463(g), 1831d. This means that a bank based in a state with no usury cap is not subject to other states' usury caps when it does business in those states.

¹⁹ Examples of other devices include high cost lenders basing themselves offshore and claiming that foreign usury limits apply, *see* First Amended Complaint, *Consumer Fin. Protection Bur. v. NDG Financial Corp.*, No. 15-cv-5211 (S.D.N.Y., Dec. 11, 2015), or partnering with native American tribes or tribal members and sheltering in tribal immunity, *see, e.g.*, Complaint, *FTC v. AMG Services, Inc.*, No. 2:12-cv-00536 (D. Nev. Apr. 2, 2012); First Amended Complaint, *CFPB v. CashCall, Inc.*, No. 1:13-cv-13167 (D. Mass. Mar. 21, 2014).

but their preferred mechanism is to partner with a bank in a “rent-a-bank” arrangement.²⁰ That is precisely what World Business Lenders did.

In a rent-a-bank arrangement, a nonbank contracts for a bank to make loans according to the its specifications and then sell it the loans. The nonbank then claims to shelter in the bank’s exemption from state usury laws and other consumer protection laws, as well as the benefit of the choice-of-law provisions applicable to the bank. And because the loan is not directly made by the nonbank, the nonbank claims that it is exempt from state licensure requirements for nonbank lenders. In exchange for renting out its regulatory privileges, the bank collects a fee.

Because of the involvement of the Bank of Lake Mills, World Business Lenders was able to respond to the DeRamo’s suit that (1) the loan documentation provided that they would be governed by Wisconsin law, which has no usury rate for business loans, not Florida law, and (2) as the bank’s assignee it could shelter in the bank’s exemption from state usury laws.²¹ What’s more, because the DeRamos had defaulted on the loan, World Business Lenders sought a judgment against them (a precondition of allowing it to foreclose) in a counterclaim.²²

The DeRamos’ case ultimately settled privately, but it is illustrative of a larger phenomenon in subprime lending. Rent-a-bank arrangements are common in on-line payday lending, consumer installment lending, “marketplace lending,” and subprime small business lending. Moreover, rent-a-bank lending appears likely to expand in response to the tightening of state usury laws,²³ and a set of new rulemakings by the Office of Comptroller

²⁰ Financial services firms refer to these relationships solely as “bank partnership” relationships. Critics use the term “rent-a-bank” to describe the relationship. Neither is a neutral term. “Rent-a-bank” may seem inflammatory, but the anodyne “bank partnership” terminology masks the true nature of the relationship and effectively accedes to these arrangements’ legitimacy as a policy matter. Moreover, the contractual documents for these relationships often explicitly disclaim the existence of a partnership. *See, e.g.*, Participation agreement, dated July 1, 2015, by and between Elastic SPV, Ltd. and Republic Bank & Trust Company https://content.edgar-online.com/ExternalLink/EDGAR/0001193125-15-371673.html?hash=949bb7318f6e6488cfa47b9c53666278efec432bfad757d790662bd149ebeb48&dest=D83122DEX991_HTM#D83122DEX991_HTM § 18 (“This Agreement is not intended to constitute, and shall not be construed to establish, a partnership or joint venture among any of the Parties.”), § 19.a (“This Agreement will not create a joint venture, partnership or other formal business relationship or entity of any kind, or an obligation to form any such relationship or entity.”); Participation Interest Purchase and Sale Agreement, dated August 1, 2019, by and between EF SPV, LTD, and FinWise Bank, at <http://dl8rn0p25nwr6d.cloudfront.net/CIK-0001651094/c55a048e-f8bb-41b8-ad10-bafd47e130f9.pdf> (“§ 4.02 Intent of the Parties. This Agreement will not create a joint venture, partnership or other formal business relationship or entity of any kind, or an obligation to form any such relationship or entity.”).

²¹ Defendants, World Business Lenders, LLC’s and WBL SPE II, LLC’s Answer, Defenses, and Counterclaims, *DeRamo v. World Bus. Lenders, LLC*, 2017-CA-2438-NC (Sarasota County, Fla. Circuit Court, June 16, 2017) at pp. 6-7. Florida law specifically exempts banks from its usury laws. 39 FLA. STAT. § 687.12.

²² *Id.* at pp. 9-14.

²³ On October 10, 2019, California enacted the Fair Access to Credit Act (A.B. 539), which created a rate cap of 36% on loans between \$2500 and \$10,000. Previously no rate cap had applied. In response, three nonbank fintech lenders, CURO, Elevate, and ENOVA, each indicated in an investor call that it were considering moving to the bank partnership model to avoid the usury cap. Elevate Credit, Inc., Q3 2019 Earnings Call, Nov. 4, 2019, <https://finance.yahoo.com/news/edited-transcript-elvt-n-earnings->

of the Currency and Federal Deposit Insurance Corporation that provide legal protection to rent-a-bank arrangements against usury law challenges.²⁴

I recognize that the rent-a-bank problem generally lies outside of the purview of this committee (and is not an issue limited to small businesses). Nonetheless, the regulatory vacuum created by rent-a-bank relationships—where neither state nor federal law governs the nonbank that is the true lender—makes it all the more important to strengthen and generally applicable federal regulations and expand them to small businesses.

II. THE SMALL BUSINESS LENDING DISCLOSURE AND BROKER REGULATION ACT OF 2020

The Small Business Lending Disclosure and Broker Regulation Act of 2020 is an important step toward ensuring fair treatment of small businesses in the lending market.

The core provision of the Act is to require for small business loans the disclosure of the total amount of the financing, the finance charges, the finance charges expressed as annual percentage rate (APR), payment amounts, term, prepayment cost or savings, and collateral requirements.²⁵ Clear disclosure of these terms is essential for borrowers to understand the nature of the obligation they are assuming. In particular, it is critical to require disclosure of finance charges in the standardized annual form of the APR. Disclosure of finance charges in a standardized form enables borrowers to more readily understand and compare various credit terms available on an apples-to-apples basis, so the borrowers can make an informed decision about using credit. Informed use of credit is essential for ensuring robust price competition, which is the first line of borrower protection.²⁶ The Act would also prohibit certain non-standardized used of terms.²⁷ And recognizing the variety of forms of small

[063934139.html](https://www.fool.com/earnings/call-transcripts/2019/10/26/enova-international-enva-q3-2019-earnings-call-tra.aspx) (“...California passed a law that caps interest rates on personal loans between \$2,500 and \$10,000. ...As a result, we will stop originating loans through a direct lending channel in California once the law goes into effect. However, we do not believe that it'll have a material impact on our business due to our diversified operating model and additional opportunities. One of those opportunities is to expand our underwriting and technology licensing to our 3 existing FDIC-regulated bank partners in new geographies. In addition, we are continuously looking for additional banks that share our commitment to providing innovative consumer-focused products.”); Enova International (ENVA) Q3 2019 Earnings Call, Oct. 24, 2019, <https://www.fool.com/earnings/call-transcripts/2019/10/26/enova-international-enva-q3-2019-earnings-call-tra.aspx> (“And instead of originating near-prime loans, we plan to market and provide underwriting services for national banks originating in California.”); CURO Group Holdings Corp. (CURO) Q3 2019 Earnings Call Transcript, Oct. 25, 2019, <https://www.fool.com/earnings/call-transcripts/2019/10/25/curo-group-holdings-corp-curo-q3-2019-earnings-cal.aspx> (“Hugh Miller -- *Buckingham – Analyst*: ...So I guess assuming that you are successful at some point in potentially creating a substitute product with the bank in California, can you just give us a sense of kind of how we should think about the start-up process for that type of initiative?... Don Gayhardt -- *President & Chief Executive Officer*: ...we do have a signed agreement....”).

²⁴ 85 Fed. Reg. 33530, 33532 (June 2, 2020) (OCC final “valid-when-made” rule); 85 Fed. Reg. 44146 (July 22, 2020) (FDIC final “valid-when-made” rule); 85 Fed. Reg. 44223 (July 22, 2020) (OCC proposed “true lender” rule).

²⁵ H.R. 7889, Small Business Lending Disclosure and Broker Regulation Act of 2020, §§ 192, 193.

²⁶ See 15 U.S.C. § 1601(a).

²⁷ H.R. 7889, Small Business Lending Disclosure and Broker Regulation Act of 2020, § 195(b).

business financing, it would expand the definition of “finance charge” in the Truth in Lending Act to cover factoring discounts, prepayment penalties, and certain leasing charges.²⁸

To see how important these disclosures are, consider the DeRamo’s loan. The pricing of the DeRamo’s loan was never disclosed as an annual percentage rate of 121%. Instead, it was disclosed in terms of *daily* percentage rate, which makes it look infinitesimally small: 0.331515959726%. Moreover, even the daily percentage rate was not prominently disclosed in the DeRamo’s loan. It was buried in the midst of legalese. No interest rate whatsoever appeared on the summary terms sheet for the loan, and instead, the only percentage rate disclosed on that term sheet was for the prepayment penalty.

The Small Business Lending Disclosure and Broker Regulation Act of 2020 would fix this problem. It would require clear disclosure of the rate being 121% annually. Such clear disclosure would benefit both borrowers and lenders. Borrowers would know exactly what deal they were getting into, and lenders would not have to worry about borrowers claiming that they were snookered into loan terms they didn’t understand. Honest lenders should embrace the proposed regulation because it creates greater clarity about loan terms that will drive the bad actors from the market.

Similarly, section 194 would require waiver of prepayment penalties when a lender refinances a loan from its existing borrower unless there is a tangible benefit to the small business from the refinancing. That provision would likely have prevented the DeRamos from being charged a 15% prepayment penalty for the privilege of refinancing their loan with the same lender for a 5-month extension at the same interest rate. To be sure, nothing would have prevent World Business Lenders from charging a fee of equal amount on the new loan, but such new fee would be a finance charge under the Truth in Lending Act and would therefore have to be disclosed as part of the APR on the new loan.

The Small Business Lending Disclosure and Broker Regulation Act of 2020 also would mandate regulation of small business loan brokers. This too is important for as we have seen repeatedly in other markets—mortgages, auto loans, and online payday and installment loans—loan brokers or auto dealers or lead generators are not incentivized to get the borrower the best deal possible, but are often incentivized to steer the borrower to the highest cost loan.²⁹ Moreover, brokers rarely present borrowers with all financing options in the market, but only the offers from a limited stable of lenders with whom they contract.

Borrowers are frequently unaware that the broker is not working for them, may have adverse financial interests, and may only present offers from a limited number of lenders. Requiring disclosures of loan brokers about their compensation and number of lenders they deal with as well as licensing the brokers to ensure that only reputable parties engage in loan

²⁸ H.R. 7889, Small Business Lending Disclosure and Broker Regulation Act of 2020, § 193.

²⁹ See, e.g., Laurie Burlingame & Howell E. Jackson, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 STAN. J. L. BUS. & FIN. 289 (2007) (mortgage broker yield spread premiums); Adam J. Levitin, *The Fast and Usurious: Putting the Brakes on Auto Lending Abuses*, 108 GEO. L.J. 1257 (2020) (indirect auto lending). Lead generators for on-line loans also sell the lead to the high bidder, which will need to recover its costs, which likely means a higher loan price.

brokering (using the SAFE Mortgage Licensing Act as a model) is an important step toward ensuring a fairer and more efficient small business lending market.

Perhaps most importantly, the Small Business Lending Disclosure and Broker Regulation Act of 2020 would give the Consumer Financial Protection Bureau the same plenary authority to regulate small business loans as it does for a “consumer financial product or service.” This would enable the Consumer Financial Protection Bureau to use its power to prohibit unfair, deceptive, and abusive acts and practices to regulate small business loans, as well as to enact a “larger participant” rulemaking allowing it to supervise the major players in the small business lending market. UDAAP authority and supervisory are critical gap-filling regulatory tools that enable the CFPB to address problems that legislation cannot readily anticipate,³⁰ and the establishment of an Office of Broker Regulation within the Bureau would ensure a clear locus of responsibility for broker regulation.

III. IMPROVEMENTS AND EXTENSIONS

While I believe that the Small Business Lending Disclosure and Broker Regulation Act of 2020 is an important move in the right direction, I would urge consideration of a few alterations or extensions of the bill.

- In section 191, the definition of “close-end commercial credit” references UCC § 2A-103(j). I would suggest amending to merely reference the UCC. UCC § 1-203, for example, addresses whether a transaction that has the form of a lease is really a disguised security interest. It is important to incorporate that provision into the definition if the UCC is to be referenced in the first instance.
- In section 191, the definition of “Director”—should indicate that the “Bureau” is the Consumer Financial Protection Bureau.
- In section 191, I would suggest considering a narrower definition of small business financing, based not on loan size, but based on the existence of a personal guaranty or some combination of the two.
- Section 192 would amend the Truth in Lending Act to state “This title shall apply to small business financing made to a small business to the same extent as this title applies to extensions of credit made to a consumer.” The term “this title,” refers to the Truth in Lending Act, but problem is that the Truth in Lending Act is not a title of the United States Code. Instead, it is subchapter I of Chapter 41 (the Consumer Credit Protection Act) of title 15 of the United States Code. I do not believe that section 192 of the bill means to apply all of title 15 to small business loans. If the bill is only applying subchapter I of Chapter 41 of title 15, this should be clarified, including whether the Truth in Lending Act’s mortgage provisions would apply to personal guaranties secured by real property.

³⁰ I note that the FTC already has power to prohibit “unfair and deceptive” acts and practices in small business lending under section 5 of the FTC Act, 15 U.S.C. § 45, but has done little with this power.

- I would urge some additional disclosures if a personal guaranty is involved, with the additional disclosures highlighting the fact that a default by the business could result in a loss of personal property by the owner.
- I would urge extending another basic consumer credit protection, the FTC's Credit Practices Rule, 16 C.F.R. Part 444, to small businesses. Doing so would, among other things, prohibit the use of confessions of judgment for small business loans.
- I would also urge a disclosure of any intended transfer of a loan by a lender at the time of origination. If a lender like Bank of Lake Mills has pre-committed to sell loans to a third party like World Business Lenders, that is important information that should be disclosed to the borrower. Borrowers should know who they are going to be dealing with on a loan, not merely the theoretical possibility that a loan can be transferred by a lender.
- I would strongly urge also applying the Electronic Fund Transfer Act to small businesses. In particular, the EFTA prohibits compulsory use of preauthorized electronic fund transfers as a condition of extending credit,³¹ and gives a consumer a right to stop preauthorized electric fund transfers.³² Without such a right, a small business that finds itself in a problematic loan has limited ability to stop paying other than by closing its bank account.

Again, while I think the Chairwoman's bill can be strengthened in places, it is an excellent starting point for bringing much needed protections to small business borrowers.

³¹ 15 U.S.C. § 1693k.

³² 15 U.S.C. § 1693e.