Submitted via the Federal eRulemaking Portal

January 6, 2023

U.S. Small Business Administration
409 Third Street, S.W.
Washington, D.C. 20416

Re: Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization (RIN 3245–AH92)

The Financial Technology Association[1] appreciates the opportunity to respond to the Small Business Administration's proposal to lift its regulatory-imposed limit to license new Small Business Lending Companies to participate in its 7(a) Loan Program.[2] Since the 1980s, the number of SBLC licenses available to non-depository lending institutions, authorized by the SBA and subject to "certain prescribed standards,"[3] has been limited and we agree with the agency that expanding the number of licenses, in line with SBA oversight resources, can "accomplish the goal of expanding capital opportunities to underserved businesses."[4]

Customer-centric innovation is transforming financial access. By using technology like digital platforms, machine learning, automation, and other modern technologies to deliver on consumer demands for financial products and services, financial technology companies are improving efficiency and transparency, broadening equity, access, and inclusion, reducing costs, and increasing choice and opportunities for small businesses. Fintech solutions have emerged as critical tools to bridge physical and virtual activities as people have become increasingly accustomed to digital access.

Diverse fintech products and services provide novel, convenient, and expanded access points into the financial system for small businesses, ranging from mobile money services for basic banking services and payments to digital applications for long-term investing or securing credit. Tailored

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[1] The Financial Technology Association represents industry leaders shaping the future of finance. FTA champions the power of technology-centered financial services and advocates for the modernization of financial regulation to support inclusion and responsible innovation.
[2] 87 Fed. Reg. 66963
[3] 46 Fed. Reg. 41523.
[4] 87 Fed. Reg. 66964.

products empower business owners with different needs and help drive equity in the cost and quality of available services. Lifting the moratorium on the SBA's non-bank licensing capacity and creating a viable pathway, subject to SBA resources, for additional lenders to participate in the program, will expand access for all small businesses to much needed capital, especially those that have been un- or underserved by legacy players in the financial system. This is particularly important in the near-term as, during tough economic conditions, traditional lending institutions tend to pull back on lending to small businesses. For example, a recent research paper "document[s] that finance companies and FinTech lenders increased lending to small businesses after the 2008 financial crisis…[] show[ing] that most of the increase substituted for a reduction in bank lending.[5]

Fintechs play an important role in filling the credit access gap, especially when no other options are available and we encourage the SBA to proceed with this initiative. In particular, we believe that by leveraging technology and nontraditional data, fintechs can better serve small business borrowers in the 7(a) program while maintaining the high credit and compliance standards set by established participants. Of note, some FTA members indicate that small dollar lending is particularly needed by their clients, and the SBA's efforts to expand its licensing approach could assist in providing these small businesses with needed capital.

I. By Leveraging Technology and Nontraditional Data, Fintechs Can Better Serve Small Business Borrowers in the 7(a) Program

Expanding 7(a) licensing to fintechs and tailoring program elements would help the SBA reach un- and underserved borrowers. As discussed above, fintechs are uniquely positioned to leverage innovative technology and nontraditional data to facilitate additional access to the 7(a) program. For example, the borrower application process for SBA lending has been notoriously slow and difficult. Micro-businesses do not have the time or staff support to compile business financial history, tax returns and the plethora of other documentation required to obtain a 7(a) loan. Instead, fintechs are able to leverage technology to bring efficiency to the application process.[6] For instance, many fintechs use APIs to enable applicants to directly, quickly and securely share their cash-flow data from their bank with lenders, which in turn can streamline the application process.

[5] Gopal, M. & Schnable, P. (2022). The Rise of Finance Companies and FinTech Lenders in Small Business Lending, *The Review of Financial Studies*, *35* (11), 4859–4901. https://doi.org/10.1093/rfs/hhac034

[6] One way that the SBA could further reduce the threshold to obtaining SBA financing is by segmenting or correlating required information for a loan with the size of the loan. This will ensure the smallest lenders will be actively participating in 7a and therefore, serving the customers that need these loans the most.

By expanding the number of non-banks in the program, the SBA can leverage fintechs to provide a more streamlined application process, which reduces complexity and time-to-completion for small businesses.

In addition, fintechs have the ability to introduce efficiencies into the underwriting process by making it easier for underserved small businesses to obtain funding by automating access to additional funds while eliminating many of the friction points associated with traditional lenders or banks. Many fintech customers are typically underserved by traditional lenders and banks because they have been in business for less than two years and therefore lack the revenue or credit history to gain access to the capital they need, with a significant percentage being unable to qualify for a loan elsewhere. However, with the complete view of a small business's financial activities that some fintechs have, they can apply sophisticated analyses along with machine learning processes to aid in assessing a business's health and credit worthiness. This helps open up access to funding to underserved businesses that likely would not qualify for capital elsewhere through traditional determinations. For example, a recent working paper from the Federal Reserve Bank of Philadelphia concludes that fintech small business lenders lent more in zip codes with higher business bankruptcy filings and higher unemployment rates.[7] This paper also found that fintech platforms' internal credit scores were able to predict future loan performance more accurately than the traditional approach to credit scoring. Ultimately, by leveraging technology and additional data sources, fintechs are able to use data backed risk models to enable the youngest and smallest firms to access credit, which can be further amplified if the SBA increases, in line with its resources, the number of Small Business Lending Company licenses it grants.

II. Expanding the Number of Non-Bank SBA Licenses Would Not Introduce Unnecessary Credit or Compliance Risks Into the 7(a) Program

As the SBA considers expanding the number of SBLC licenses it issues, it is important to note that fintechs that engage in lending to small businesses directly are subject to certain state licensing and registration requirements, with state regulators conducting examinations, imposing capital and liquidity requirements, defining permissible investments, and enforcing laws that protect these entities. For those that offer services through partner banks, they are overseen by their bank partners and are subject to the third-party risk management guidance issued by the federal banking agencies. In these scenarios, the bank partner, as the lender, will ultimately ensure that all

[7] Cornelli, G., Frost, J., Gambacorta, L., & Jagtiani, J. (2022). The Impact of Fintech Lending on Credit Access for U.S. Small Businesses, *Federal Reserve Bank Philadelphia*, WP 22-14. https://doi.org/10.21799/frbp.wp.2022.14

applicable federal and state laws are followed. Furthermore, under the 7(a) program, SBLCs are subject to "specific regulations regarding formation, capitalization, and enforcement actions" and enter into a written agreement with the SBA, ultimately imposing control and funding expectations.[8] Finally, the SBA's Office of Credit Risk Management provides additional oversight to SBLCs by managing program credit risk, monitoring lender performance, and enforcing lending program requirements.

These state and federal regulatory requirements create strong guardrails for any fintech that may become an SBLC under an expanded program and differ from expectations set forth under other programs, notably the Paycheck Protection Program, which was established at the start of the COVID-19 pandemic to provide emergency access to capital for small businesses. While the SBA's 7(a) program and PPP are significantly different, it is important to note that fintech participation in PPP was critical to ensuring that underserved customers, who banks either could not or would not serve, were able to access PPP funds. In particular, independent research shows that participating fintechs' use of technologically advanced techniques and alternative data in PPP increased access for underserved small businesses. For example, Professor Sabrina Howell of New York University's recent paper finds that (i) the automated loan vetting and processing systems used by fintechs significantly improved approval rates for Black borrowers during PPP and (ii) fintech lenders were responsible for 53.6% of PPP loans to Black-owned businesses, while only accounting for 17.4% of all PPP loans.[9] While not all fintechs are the same, those with robust controls and governance processes and, as appropriate, strong bank partner oversight relationships, will likely be the strongest candidates for participating in an expanded 7(a) program. In addition, the longstanding state and federal guardrails for SBLCs will provide the credit and compliance parameters necessary to ensure the safety and soundness of the program, while reaching additional small businesses and streamlining the application and underwriting process. Therefore, we encourage the SBA to continue its effort to lift the moratorium on SBLCs and, by granting additional licenses in line with the oversight resources the agency has, provide additional access to capital for un- or underserved small businesses.

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[8] *Supra* n. 2 and 13 CFR § 120.470.

[9] Howell, S., Kuchler, T., Snitkof, D., Stroebel, J., & Wong, J. (2022). Lender Automation and Racial Disparities in Credit Access. http://dx.doi.org/10.2139/ssrn.3939384

FTA appreciates the Small Business Administration's consideration of its comments and would be happy to discuss the issues raised in this letter further. Please contact the undersigned at penny@ftassociation.org.

Sincerely,

Penny Lee
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Financial Technology Association