Advancing Innovation and Fairness in Small Business Finance

Ensuring that Innovation Benefits Small Businesses: The Role of Guardrails

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About

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Panelists

- Cailey Locklair, President, Maryland Retailers Alliance
- Hal Martin, Policy Economist and Director, Small Business Credit Survey Federal Reserve Bank of Cleveland
- Carolina Martinez, Chief Executive Officer, CAMEO Network
- Awesta Sarkash, Public Policy Director, Small Business Majority
- Louis Caditz-Peck, Executive Director, Responsible Business Lending Coalition (Moderator)

Transcript

Louis Caditz-Peck (00:04)

Well great, thanks. Let's have another thank you to Jacob, Phil, Luz, and Mickey was here in this chair. That was incredible. I learned a lot. So we've heard broad economic commentary from Governor Barr. We've heard from innovators about how they're changing the products offered in the market. And on this panel, we're going to start to turn to voices of small businesses to hear what their experience is in the market. And we're going to start to talk about how they are approaching, what's working, what's not working, and what are they doing about what's not working. So I'm going to ask each of these amazing panelists to introduce themselves briefly. And Cailey, let's start with you. You represent a key segment of small business owners in Maryland. Tell us about you and your work.

Cailey Locklair (00:55)

Sure. So, nice to see everybody and I do see some familiar faces, which is nice. I see someone who testified with me in Maryland, which was wonderful. So I run the Maryland Retailers Alliance, the Maryland Chain Drugstore Association and the Maryland Food Industry council. So we do represent some of the largest retailers in the United States all the way down to the designated Main Street program in our state, so over 6,000 mom and pop businesses in Maryland.

Louis Caditz-Peck (01:24)

Thanks, Cailey. Awesta, who does the small business majority represent and why is the organization involved in improving small business financing?

Awesta Sarkash (01:33)

Yeah, thanks Louis. Hi, everyone. So Small Business Majority is a national nonprofit organization with over 85,000 small businesses across the country, 1,500 business and community partners. And we really work on elevating the voices of small business owners to create a healthy ecosystem. And we do that through offering free education resources, policy and advocacy and research and insights. And across all three of those pillars of work, access to capital is really integral to the work that we do because we always say it's the lifeblood of business owners. And so for us, we'll offer a lot of education on access to capital and how to do that safely. We've done research on how small businesses interact with capital and their concerns around lending and predatory lending, and then also doing a lot of federal and state policy work on passing the expansion of truth and lending to small business financing.

Louis Caditz-Peck (02:33)

Thanks, Awesta. Carolina, the CAMEO Network has been just growing tremendously. It was an organization that's been around for a while and it's just getting bigger and bigger. Can you tell us about CAMEO Network and yourself?

Carolina Martinez (02:45)

Sure. Thank you, Louis, for the invitation. I run CAMEO Network. We are a coalition of over 400 organizations, individuals and agencies committed to support small business development growth through financing and business coaching. So we serve mostly as ecosystem builders. And it was really great to hear that we're an ecosystem so much today because really we are looking to support the small business with everything they need to thrive. So we've all talked about coaching and capital and we heard today also about connections to markets, but we also discussed a lot about climate and how we are creating the right regulations for small businesses to thrive. And the culture of being small business friendly. So we are really focused on working on those areas with them and through capacity building and advocacy, we make sure that the small businesses actually can reach their full economic potential.

And one of the things that we've heard a lot from our members definitely has been how challenging it is to find the right capital, the right responsible, affordable capital. So we've been really engaged with the small business responsible lending legislation since 2018 and we've been really excited to be supporting the small businesses in the country.

Louis Caditz-Peck (04:03)

Thanks, Carolina. And how can you tell us about the work that you and your colleagues at the Federal Reserve are doing on small business financing?

Hal Martin (04:09)

I'd be happy to. So I should mention I'm the one who has to give the disclosure up here. The views I share today are my own and not necessarily those of the Federal Reserve Bank of Cleveland or the Board of Governors. That said, I work with a lot of talented folks at the Federal Reserve and we focus specifically on small business issues. It's one of the community development branches of research that the Federal Reserve focuses on. I have the privilege of leading the small business credit survey, which was mentioned in Governor Barr's remarks. And we collect data on more than 10,000 small businesses each year to understand what are their challenges, what are their performance issues, how are they engaging in the credit market and how's that working out for them? And we work to really socialize those both from a community perspective. We work with community partners directly, so nonprofits and civic organizations, chambers of commerce, small state and local government economic development agencies field the survey to their member networks.

And then we also work to make a lot of our findings available, not just at the national level, although that is a focus, and I should take one second to plug the fact that our 2024 data will be featured in our Thursday report on employer firms. So that's our once a year release. We also work to socialize local insights. So we produce state and MSA chart books wherever we can. And that's partly why we survey so broadly so that we can give insights in different geographies and across different sections of small business owners to really highlight what's going on from time to time throughout the small business credit space.

Louis Caditz-Peck (05:44)

Thank you. Hal. Starting with you, Cailey in the conversation, the Maryland Retailers Alliance has become a very big advocate in Maryland for small business financing standards. How did that happen? What got you involved?

Cailey Locklair (05:58)

So we had a Latina small business owner on our board and she had two toy stores in Maryland. They were wonderful toy stores and she had financial issues. Just like all small businesses, started to run into some, one had to do with utility problems, etc. And she maxed out her credit card, she went to the banks, she could not find any sort of lending and so she took out her first merchant cash advance product to the tune of somewhere around $60,000 and the interest rate, she couldn't claw her way out of, climb her way out of, and then she took out a second one and that's ultimately what killed both of her businesses. And she was in business for 15 years. So it was a really sad situation and we always ask our members, "What can we be proactive on? What can we do?" Because we say "no" a lot and our legislature, surprise, surprise, represents businesses and so we're always looking to work with them on issues.

And she brought this issue to me and I came across the Bloomberg expose that's out there and we were just in shock. And so the first bill we introduced was flat out a ban on merchant cash advance products and that's where we started. And I had the opportunity to meet Louis and some other wonderful folks nationally who helped provide us a lot of education and I think this year was our seventh year introducing the truth in lending bill. So that's been our path, but it's something I've just become personally, I think, passionate about. I know Maryland led the way on payday lending. I think almost five decades ago, our state capped payday lending and it's been really frustrating for us to not be able to pass our bill.

Louis Caditz-Peck (07:55)

Yeah, thanks Cailey. And just any clarification, I'll just clarify, the Responsible Business Lending Coalition, what did we share with you guys about the position that we were advocating for policy-wise?

Cailey Locklair (08:04)

What do you mean?

Louis Caditz-Peck (08:05)

So with respect to the initial approach of banning a product versus other approaches.

Cailey Locklair (08:10)

Sure, that there are responsible lenders out there. So at the time, we certainly did not realize that there were folks that were creating transparent documents for businesses and the documents that I was given by her and other small businesses were shocking. And we went to folks and calculated it and it was over 100% interest and it was just something that they could not discern in any way.

Louis Caditz-Peck (08:36)

Thanks, Cailey. And so we came together on common ground around setting standards of responsible practice, room for all products in the market as long as they're responsible in their behavior. So how we heard Governor Barr speak earlier with a broad view of the economy and you are in there with the data coming straight from small business owners with a bottom-up perspective on what's happening in the market. Do experiences like Cailey's board members show up in the data that you look at?

Hal Martin (09:04)

I would say they show up in a couple of ways. So one of the things we ask about is the challenge is that small businesses that are applicants for different types of loan products and with different types of lenders experience, about a quarter of our sample has applied for an online loan in recent years, and about 15% of finance companies, which is a related type that we're collecting information about. And what I would say links up is that we see them tell us certain things about why they apply to those types of lenders. They're looking for the convenience factor. They like the fact that there's no collateral requirement often. They like that there's an advertised speed of decision-making. You can have your decision very quickly. So these are the things they tell us are important about going in to apply to these types of lenders.

On the back side, I think we also see that there's more dissatisfaction with those types of lenders. So they tend to underperform small and large banking institutions in terms of borrower satisfaction for those who receive their loans. And they tend to also note that they have trouble with the unfavorable terms that they have to repay by. So the fact that they were looking for convenience going in and that they note that they have a lot of trouble with unfavorable terms and high interest rates on the back end, I think, is very consonant with what you're describing. That's very different from what their experiences are with small and large banking institutions.

Louis Caditz-Peck (10:35)

Thanks, Hal. And digging in further, colleagues of yours have published five plus research reports looking specifically at disclosure practices and how products are being portrayed to small businesses in the market and how small businesses are understanding the pricing data that's being disclosed to them now, whether or not truth in lending standards. What did that research find?

Hal Martin (10:58)

Yeah, so there's a rich line of research going back to about 2019. There's a couple of papers that do a good job pulling some of these threads together. And really the question there is first of all, what are the offers being made? What do they mean? Which are two different questions as we've heard from earlier panelists and then also, what do small businesses make of those offers? And so some of this research was done jointly with a researcher at the board, Barb Lipman and my own colleague at the Federal Reserve Bank of Cleveland, Emory Wersch.

And so they first went out and surveyed the market and said, "Hey, what is a sample of representative-ish offers being made in the market for these types of lenders?" And then they went and crunched the numbers, figured out, much as others have done, if we take the resources that we have, go to the folks that we know are sophisticated in this space and calculate, what do these offers mean? A 9% simple interest rate, what is the APR for that? Well, they calculate that's 45% in the particular example that they were looking at, once you factor in the terms and the fees. What does a 4% fee rate mean? Also about 45% APR by the way. So I would not have guessed that being new to the space, and I think I'm in good company, they did focus groups to also figure out what do small businesses make of these offers? And the guesses are all over the place. This is what you're doing before you sign on the dotted line, you're guessing how much am I going to have to pay? What is the meaning of these repayment terms?

And so I think that's where the disconnect shows up because of course once you've signed on the dotted line, you're bound by those terms and the payments start to roll in. And that's where that dissatisfaction with the unfavorable terms, I think, begins to appear. The only other thing I would point out is in these focus groups when they were shown this is what it really means and also just this is what it's like, there was a very common thread of frustration. We would like to have standard terms. We would like to be able to understand what is meant by these offers. So there's a high degree of demand expressed. If we get this clarity, we could make better decisions. It is a through line that we see in that research, I think.

Louis Caditz-Peck (13:23)

Thanks, Hal. Those reports, I think, are maybe being added to the chat if you're viewing online for you to check out or we can otherwise get them to you if you're interested. Awesta, Small Business Majority represents 85,000 small business owners nationwide? Is that right? And can you share about some of the solutions that the Small Business Majority has been working on to address the problems that have been talked about so far on the panel?

Awesta Sarkash (13:48)

Sure. Yeah, I mean, well one, I'll just say in terms of small business experience, in terms of the numbers, we see only 18% receive loans from traditional banks. We did some polling a few years ago and we'll have forthcoming polling on this as well. 74% of business owners felt that online lending needed to be regulated because 78% of them felt like this was a significant problem. So in terms of numbers, we see a really strong support for doing something or addressing guardrails or something along those lines. But in speaking with business owners, we see this across the board. You can talk to any of my colleagues who interact with this issue a lot. A lot of small business owners tell us that this is something they're concerned with or they were specifically impacted by it.

I also oversee our criminal justice work and we're doing a lot of work around supporting entrepreneurs who have records. My ears really perk up when they say that they're just started a business or they're very new to starting business because the access to capital for them is so low, but the level of desperation is really high because a lot of these business owners are using a business as a way to not recidivate. And I'm always like, "Please look for these signs. If it's too good to be true, it probably is." We're hosting an event in a few weeks in my home state of New Mexico with some incredible indigenous organizations on how to navigate capital for indigenous small business owners. And I say the same thing to them, "These are the things you need to look out for."

And so what we've done outside of being one of the founding members of the RBLC and creating the Borrowers' Bill of Rights is advancing legislation to expand the Truth in Lending Act nationally. And unfortunately in lieu of that, having spent years doing that, trying to pass state policy legislation to make sure that small businesses are protected. And we've seen success in states like California and New York, hopefully someday Maryland, hopefully Illinois, elsewhere, but the patchwork doesn't work. To the point from the panel before, we need uniform law to ensure that the meat of this issue includes APR or estimated APR, knowing what the fees are ahead of time. What I found, and I'm going to try not to end this on a negative note, is good policy is really hard to pass because it's nuanced and there's a lot of complexity in order to support, in this case, small business owners. It is really easy to maintain the status quo.
And so what we're trying to do is make sure that small businesses are protected by passing, in this case, a lot of state legislation, but continuing to advance federal legislation so that small businesses are properly protected. There's uniform law and that

small business owners can make apples to apples comparisons because they do not operate that way right now. They think they're making apples to apples comparisons and we know that they don't know that that's not actually the case and they can't do that.

Louis Caditz-Peck (17:02)

You're firing me up, Awesta. So let's talk about some of those state policies. Carolina, California was the first state in the country to... Maybe someday, I don't know. California was the first state in the country to pass the small business truth in lending law and has subsequently passed four more small business financial protection and innovation financing laws. Can you share about that first law and what came after that?

Carolina Martinez (17:27)

Sure. So as we've heard today, small businesses, one of the challenges that they have when they're growing their business is finding the right capital for growth. And we've heard from our members, CDFIs, lenders and business coaches alike about how challenging it is for small businesses to find that product and how much it impacts the actual result of whether or not they're successful. And one of the things just last week actually, a CDFI member shared with us that 40% of their loan actually goes into refinancing predatory loans. So it is so significant. Louis mentioned earlier in the panel about how much of capital unmet needs exist for small businesses and how hard it is for CDFIs to be refinancing those loans fast enough. So we had heard a lot about these challenges before. I've been working with the small businesses and for everybody that has worked with the small businesses, you understand that they usually come looking for capital when they need it yesterday.

So they need that speed to find that. And it's been challenging. We mentioned earlier how they access that. So I think I first heard about some legislation that was being processed in California when I first arrived to CAMEO in 2018 when we talked, Louis, at some point the two bills were about to be heard and we were lucky enough in 2018 for California to be the first state to pass a truth in a small business lending bill. And I think really we understood the importance of how much we needed to put some guardrails into lending to make sure that small businesses understood what product they were getting into, what documents they were signing. So we decided to definitely go all in and support the efforts. We were fortunate enough to let a coalition of over 60 organizations that really advocated for this bill to pass actually including Small Business Majority and other FinTech organizations that were interested. We heard earlier that there is a lot of interest from for-profit and non-profit organizations to support these kinds of bills.

So the coalition efforts really focused a lot into educating legislators, making sure that they understood why it was important to pass this bill and why this bill would actually improve the situation of so many small businesses. And as we were doing that, we realized that we were very ambitious in what we wanted to pass in that first bill. So we had to compromise and we prioritized transparency. We heard that again in the panel previously. It feels like every talking point we were thinking, everybody has something in this panel. So that transparency was really making sure that small businesses were able to understand what were the terms of their loans. And to prioritize that, we had to leave out a few key components where we created a different strategy to make sure that we were able to get them eventually into regulation.

And that actually ended up being part of the subsequent bills that CAMEO has been supporting and the coalition has been really working on in California aim to address those components and also close some loopholes. So after our original Truth in Lending bill, we were able to pass, in 2020, another one, 1864 that protects the small businesses from unfair, deceptive and abusive financing practices. And then in 2023 we were able to pass another two bills, one that actually balances junk fees. So all those pressing fees and things that keep adding up into the total that business owners pay monthly and also a second bill that really strengthened the initial Truth in Lending bill. And that really helped because we were able to make it permanent. It initially had a five-year sunset and also, we were able to include APR as part of the bill. So we were able to codify it.

And that was important because up to this point, we had to rely on our regulatory agency, the Department of Financial Protection and Innovation, to include APR in the regulation. And we wanted to make sure that it was the metric that was used by lenders to compare products. And then the final one passed in 2024 last year as a fair debt collection, just making sure that borrowers were not being harassed by lenders when they were collecting. And this year, we are actually sponsoring a couple bills to continue organizing the guardrails for small businesses and one really is to tighten up the reporting mechanism from the original Truth in Lending bill. Right now it is passing through the Senate to and allows to really assess the estimated APR versus the actual one. And we have another one that requires non-bank finance institutions to register with the DFPI, the Department of Financial Protection and Innovation. And right now there is no oversight over non loans products. So we want to make sure that that is also included and that we are able to include the merchant cash advanced companies into this.

Louis Caditz-Peck (23:05)

Level playing field. Thank you, Carolina. Cailey, let's talk about Maryland. So you've been maybe the quarterback of that coalition in Maryland working to set standards of transparency in small business financing. Who are your partners in that coalition?

Cailey Locklair (23:22)

And a lot of help from national partners, but everyone from our Bankers Association came out and I think that was a surprise to some folks, to FinTech companies, nonprofit lenders, various nonprofit organizations. I went back and I looked at the letter that we submitted and it's just very impressive. Now we didn't get 60 groups, but that's our new goal for next year. Yeah, very true.

Carolina Martinez (23:48)

We're competitive, so we [inaudible 00:23:50]

Louis Caditz-Peck (23:50)

And so where's the support been in the legislature and how's it gone?

Cailey Locklair (23:56)

I know. We're not giving up, let me say that. So I think we're on our seventh year and the support truly has been in the Senate. The bill unanimously passes every year. I think the first year we didn't get it out of the Senate, but then have unanimously passed it every year since. And then it ends up being held in our House Economic Matters Committee. And I feel like the pushback that we've gotten, we answer every single time. At first it was, "We don't know how to calculate estimated APR." That's where we started. Then we put the safe harbor in there from California to say, "Listen, we're giving you two ways to calculate it. If you are off, you are protected."

And now the second reason that we're getting and why the bill isn't passing is because they will not lend in Maryland to which our response is, "The fourth, fifth largest economy in the world, you all seem to be operating just fine." And we received a question about what lenders had left or not operating in California or New York anymore. We pulled a lot of information around that and were able to show them, "Listen, in fact, we believe that lending has grown there" and showed them that. But unfortunately, this year came out of committee and then was retracted basically, back. So a very frustrating year for us. But again, we're not giving up, so...

Louis Caditz-Peck (25:24)

Mystifying to understand the motivations. Carolina, speaking of that, what are some of the lessons learned from the successes that you've had on those five laws in California?

Carolina Martinez (25:34)

Well, we definitely learned it was not super easy to pass that. We learned a lot of lessons, but I think having open and honest conversations with the legislators really helped. I think that allowed us to strengthen the relationship with who was the bill sponsor, for him to really understand and not only for him but everybody in committees and impact the bill process to understand why it was so important and put a face into that. And actually our bill champion was able to help us not only through that but to the subsequent bills as we put them together. And also, I think we were able to stick to our principles. So it was very important for us to determine what was the bottom line of what we wanted to pass and create a strategy on how we were able to get into that, for example, the APR.

So we also got that quite a bit pushed back into. It's super hard to calculate it and I remember Louis going and explaining how it is not and how they could actually calculate it for their stakeholders, so they should be able to present it to their borrowers. But just stating that has to be the metric to be used is important. And while it took a little while to get it in, we did. And I would say a couple really quick things is seeing the work of the coalition is so important. There is real power in coalition and seeing over 100 organizations signing into the letter, speaking at some point and really was impressive and inspiring and really interested in getting and collecting the stories and data that could put the phase of the people impacted and affected into the desk of the legislators was important.

Louis Caditz-Peck (27:19)

Thank you, Carolina. Let's open the conversation up to others, but I also do want to give a shout out because I promised to. No? Okay, I'm going to do it anyway. Beverly Brown Ruggia, who's the Cailey of New Jersey and advocating for this policy in New Jersey. So thanks Beverly for coming in. Joyce, do we have some questions coming in online? No? All right. We have questions in the room.

Speaker 6 (27:50)

Well, thank you to all the panelists. One of the last panels talked a little bit about open banking and how the ability to share information and data has the capacity to improve the information that we use when we're underwriting and we're looking at small business lending, but at the same time, as we said, small businesses are sometimes really strapped for cash, are going to the first thing that pops up. How do we make sure that we're protecting or educating small businesses when they share their information in an open banking landscape and making sure that they're able to compare products on an open and level playing field, especially as they might get inundated with offers and information about the different products out there. So I guess to boil it down, in an open banking landscape, how do we maintain the same guardrails that you're speaking about when the landscape is shifted?

Louis Caditz-Peck (28:40)

Anyone want to take a swing at that? I'll just say with respect to the financing products that are ultimately the product of that data, just having a common standard truth in lending framework speaks to that. The question that you're raising about what common guidelines there may be around how data can be used through open banking, I think is a really important one. And I think a lot of people expect the conversation about the Dodd-Frank 1033 rules to be one that continues. And so that'll be a really rich vein of policy making.

Cailey Locklair (29:12)

I would just add to that too. So Maryland is a state, we are different from California, I'm very inspired hearing what you were talking about, where we do not have protections for businesses. And so I think we're up to 17 states now that have passed some sort of data privacy laws, but they're applicable to consumers. So this will be really interesting, I feel like in the business space, business information and what is being shared because that's not being talked about in those conversations.

Awesta Sarkash (29:39)

I also think this is almost solving the wrong problem. We cannot educate every single business owner about how to protect themselves. That's an enormous amount of work. We talk to business owners all the time, and some of them don't know what a CDFI is. Some of them don't know that they can go to their local SBDC to get support in some capacity. They don't know, but they operate the same way they would as a consumer, which is if I go shopping for credit cards, I'm comparing the APRs across the board. So they think it's the same way for small business financing. It's too much of an uphill battle to educate all business owners.

What we can do is educate the pool of lenders about how they should be sharing transparent loan terms and not even educating, we need to pass legislation because there are lenders out there who are not going to be doing that out of the goodness of their hearts. Now, a lot of the good guys are part of the RBLC, doing really good work, but there's a lot of lenders out there who don't care. I mean, truthfully, there are lenders out there who don't care. So that's why I think we just need a federal standard so that this seven years in Maryland, the X number of years in California, the fifth year in Illinois. It's like let's pass the federal standard.

Louis Caditz-Peck (31:01)

I think we've got time for about one or two more questions before we close down online and start to eat. So I see one in the back from Eric. Get into it.

Eric (31:15)

Thank you for the panel, really informative. I also come from a small business family, all the way. Since we're sharing grandfather's stories, grandfather was a logger, his mother was an entrepreneur of a different sort. She was a bootlegger, but an entrepreneur nonetheless. So this really speaks to me. Awesta, you just raised the federal standard, and I may have missed this when I popped out, but first of all, congratulations on the state work. It's inspiring to see. I know you have to get to a tipping point before we talk about that federal standard, but I almost feel like it's a different ballgame at the federal level. And one group that has been mentioned throughout a lot of these conversations is the banks. And so where do they fall on this and what is this strategy? Louis, you laid out those four pillars moving forward, but how do we move this because I mean, not to be crass, but it's dead on arrival right now. And so, how do you think about that next step?

Louis Caditz-Peck (32:12)

Thanks, Eric. I think the example that Cailey gave when speaking about banks of the Maryland Bankers Association is notable and I think what... Would you like to say anything, Cailey, about what motivated them to be involved or I'm happy to speak to it.

Cailey Locklair (32:26)

Well, state politics is something different. So let me say that certainly close relationships between lobbyists and sponsors was really, really helpful for us. But ultimately, they are regulated and they felt like, "We are regulated. Why is this the wild, wild west and these guys are able to get away with all of these different things? They should also be regulated." So when we pitched that argument, that's what brought them to the table in Maryland.

Louis Caditz-Peck (32:52)

I'll also just say RBLC has, like the Fed, a dual mission of fostering the innovation of more and better financing and setting standards that protect small businesses and good actors. And so sometimes there's more opportunity on one and the other. We're continuing to advocate for some policies at the federal level that not only protect small businesses, but also help innovators. And that's some places where we're seeing some traction and we'll keep talking about it over this reception coming up. Thank you everybody for being here and let's talk after.

Joyce Klein (33:22)

So just a quick summing up. Thanks everyone for joining us today. Thanks to folks who joined us virtually. Thanks to those who are in the room. I just want to first of all thank all of our speakers today and everyone who contributed to the session. The one thing I wanted to say is the work continues and we very much invite anyone who's interested in being part of the ongoing work to think about how to advance the dual mission of the RBLC. Whether you're an investor or a lender or a small business advocate, to please reach out. And as we noted, we are a cross sector coalition really trying to advance this work and look forward to all those who want to join us. So thanks again and thanks to those of us who are joining us virtually. And for those who are here in person, we can continue the conversation. Thank you.