COMMITTEE ON SMALL BUSINESS
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COMMITTEE ON FINANCIAL SERVICES
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SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

Congress of the United States
House of Representatives
Washington, DC 20515

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November 12, 2015

The Honorable Mary Jo White
Chair, U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

The Honorable Richard Cordray
Director, Consumer Financial Protection Bureau
1700 G Street, NW
Washington, D.C. 20552

Dear Chair White and Director Cordray,

I write to request information regarding online lending and its impact on small businesses. It has come to my attention that small business consumers and retail investors that participate in the online lending market may face undue risks, and lack basic consumer protections, as a result of the current regulatory environment.

In the aftermath of the 2008 financial crisis, credit markets – especially for small businesses – became illiquid. Bank lending to small businesses contracted at twice the rate of the overall market, 18 percent in June 2008 to nine percent in June 2011. As a result, many firms were forced to turn to non-traditional sources. One alternative that emerged was online lending.

Online lending, a broad term which includes balance-sheet lenders, bank-backed lenders, and online brokers, involves originating loans outside of the traditional consumer banking system. These lenders typically use specially-designed internet platforms to gather information from small business borrowers and make lending decisions using proprietary algorithms that incorporate everything from credit scores to social media presence.

Although the majority of online lending volume goes to personal loans, small business lending is becoming increasingly popular. In fact, the industry had doubled in size every year for the past four years, topping $14 billion in new loan originations in 2014. While the banking sector has pointed to lower demand as the reason for reduced lending activity, the year-over-year growth of online lending clearly suggests that small business loan demand remains high.

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Online lending offers a number of benefits to both small businesses and investors. For small business borrowers, the biggest advantage is being able to access capital after being denied by traditional lenders. Online lending platforms typically provide businesses with loan sizes that are too small to be profitable for banks, typically under $35,000. It should be noted, for traditional lenders, it costs the same amount to underwrite a $30,000 loan as it does a $300,000 loan.

Additionally, online lending's use of the internet and other technological innovations significantly cut processing times down compared to traditional loans. With the typical SBA 7(a) loan taking as much as six weeks to close, borrowers utilizing an online loan product can receive funds in a matter of days, which could be the difference between survival and failure.

Although online lending provides advantages to both investors and borrowers, there are some drawbacks. Lending platforms reserve the right to reject small business applications, just like banks. The Federal Reserve found that as online lending has grown in popularity for small firms, the rejection rate has greatly increased. At the time of the report, an average of only 8 percent of business loan applications was accepted by the platform. The report was silent on the cause for such a low acceptance rate.

Investors are also vulnerable to more risk in online lending, compared to other investment categories. This includes exposure to individual-borrower creditworthiness, ability to collect repayment, a general lack of collateral, and liquidity risk. As highlighted below, the uncertain regulatory environment is also a contributing factor.

In 2011, a report issued by the Government Accountability Office (GAO) found that overlapping jurisdiction of multiple regulatory agencies, including the SEC, state securities regulators, state banking regulators, the FDIC, and the CFPB created confusion for the online lending industry. The GAO proposed two approaches for federal regulation of online lending: one SEC-centered the other CFPB-centered. Although the GAO report was issued over 4 years ago, I am unaware of any additional actions by federal regulators to consolidate or streamline federal regulation of online lending.

In July 2015, the Treasury Department issued a Request for Information (RFI) to gather information about online small business lending. Earlier this month, Treasury officials highlighted a number of concerns they discovered following the RFI. Specifically, officials expressed concern over consumer protection issues and creating a level playing field for small business borrowers.

In response to the GAO report and Treasury's recent comments following the RFI, I write to request information concerning your agencies' regulation of the online lending marketplace for small businesses. In this regard, I would be appreciative if you would answer the following questions:

1. What federal laws under your agencies' respective jurisdiction apply to small business borrowers and retail investors participating in the online lending marketplace?
2. What is your agencies' current role in regulating or overseeing the online lending marketplace for small business lending and extensions of credit?

3. What resources have your agencies devoted to the regulation of online lending marketplaces?
4. Do you believe that your agencies possess the necessary legal authorities to protect small business borrowers and retail investors as it relates to the online lending marketplace?
5. What statutory changes, additional legal authorities, and resources are necessary to support your agencies' roles in the regulation of online lending as it relates to small business loans and extensions of credit?

The online lending market has evolved dramatically, experiencing a level of growth and popularity that could not have been contemplated even five years ago. Clearly there are gaps in the regulatory framework, as shown in the 2011 GAO report, which must be addressed. I look forward to your response and, as appropriate, working with you to implement commonsense safeguards that protect both investors and small business borrowers while also enabling innovation.

Sincerely,

Nydia M. Velázquez
Member of Congress