

**STATEMENT FOR THE RECORD
BEFORE THE ILLINOIS HOUSE FINANCIAL INSTITUTIONS AND LICENSING
COMMITTEE ON HOUSE BILL 3064: TRUTH IN LENDING ACT**

March 28, 2023

Tasha Brown
Midwest Director, Small Business Majority

Thank you, Chair Croke, Vice-Chair Avelar and members of the committee.

My name is Tasha Brown and I am the Midwest Director for Small Business Majority, a national small business organization that empowers America's diverse entrepreneurs to build a thriving and equitable economy. Small Business Majority is also a founding member of the Responsible Business Lending Coalition (RBLC), a network of for-profit and non-profit lenders, investors and small business advocates, who organized in 2015 around a shared commitment to promoting innovation in small business lending and growing concerns about the rise of deceptive and irresponsible small business financing practices. As the only cross-sector collaboration, the RBLC is uniquely positioned to promote responsible practices in small business financing.

Thank you for the opportunity to share comments about HB 3064, which would enact critical protections for small business borrowers in Illinois that are falling prey to predatory lending practices.

There are few protections provided to small business owners seeking financing because the federal Truth in Lending Act does not apply to most commercial financing. HB 3064, modeled after successful Small Business Truth in Lending laws enacted in California and New York, would provide commonsense protections for small business borrowers in Illinois. The bill is applicable to financing products below \$2.5 million because smaller, Main Street businesses are the ones being misled by the lack of transparency today. This legislation provides transparency about the financing product, tells the online lender how to calculate the Annual Percentage Rate (APR) and what to disclose to the borrower.

The original rationale for not extending federal truth-in-lending or disclosure protections to commercial loan transactions was based on the belief that businesses had much greater financial expertise at their disposal—they had comptrollers or chief financial officers on staff, or CPAs who could provide financial advice when they sought financing. This is certainly true for some businesses, but not for most small businesses. A majority of small businesses in the U.S. are sole proprietors, not corporations. They operate home day care centers; cleaning and landscaping businesses; food trucks, catering firms and cafes; small retail shops; hair and nail salons. They manage their finances using QuickBooks, often in the evenings or around their core working hours. They may or may not have a part-time bookkeeper or accountant to help them set up their books, or an accountant or tax prep firm that helps them file taxes.

This legislation is needed because small businesses in Illinois could unknowingly agree to higher-cost loan terms because lenders can legally offer opaque terms through deceptive practices. A common reality for small businesses is thinking you're paying one price for your loan, and instead realizing, sometimes too late, that your actual APR is in fact in the triple digits. Sometimes borrowers discover that there are additional costs associated with their loan that they were not made aware of.

APR is the only metric that enables an individual to make apples-to-apples comparisons among financing products with different fees, interest, and term lengths over a common unit of time. As has been

documented by research conducted by the Federal Reserve, small business owners applying for financing online may receive offers that quote prices in very different ways. For example, they may be offered a five-year term loan with a 15% interest rate and \$1,000 origination fee, a 12-month cash advance with a 4% fee rate (not an interest rate), and a credit card with a 24.9% APR.¹ It is extremely difficult for borrowers to analyze and compare the relative costs of these products and to determine their potential effect on their cash flow. As a result, small businesses today are often overpaying for financing, sometimes with devastating results for the business.

In fact, Federal Reserve research indicated that minority-owned firms more frequently applied for “potentially higher-cost and less-transparent credit products,” specifically merchant cash advance and factoring products. This practice reinforces existing access to capital disparities and diminishes entrepreneurship. Small businesses recognize the need for this type of protection, which is why 75% of small businesses nationwide support this type of legislation.

Additionally, we hear firsthand from small business owners in our network that they are being taken advantage of by a lack of transparency in financing agreements and inability to negotiate terms. Below are several stories of business owners that highlight common experiences among small business borrowers.

For example, the owners of an airplane charter business felt they had done their research and that they understood the terms of their financing. They thought the interest rate they were presented with at the time was APR, but they later found out that was not the metric they were provided, and that they were in fact paying an estimated APR of 100-140%.

One business owner shared with us that they felt they had been “set up for failure” when taking out a merchant cash advance. She said, “The payment process was impossible to keep up with. There was no way for us to keep on paying \$5,000 daily. We tried to get help, but the lender did not change our agreement until we started to miss payments and the confession of judgment they filed shut down our bank account.”

Similarly, the owner of a pharmacy said he initially thought he understood the conditions of his financing agreement, with the exception of the factor rate. When he asked about APR, he was met with comments like, “We don’t know what that would be, but here is your factoring rate. That is our calculation for repayment.” The lender led him to believe that if he did run into any questions or issues, that he could just reach out to them and work it out over the phone. He trusted that the financing company would not try to take advantage of him because he viewed them as being no different from any other lender, and he assumed there were rules in place to prevent them from doing so. He said, “I thought this was a normal way to get capital like a traditional loan without having to jump through so many hoops like one would for regular banks.”

In another example, a home improvement and solar panel installation company that has been in business for more than 20 years reported that they have sought out traditional capital several times, but most banks either want too much collateral to secure the financing or refuse to lend to them at all. This business ended up turning to merchant cash advances to sustain the business during the recession. When the lender reached out to the owner about consolidating his three MCAs, he thought he was agreeing to a straightforward consolidation in which the lender would pay his outstanding debt and that he would make payments to the lender on a weekly or monthly basis. However, the lender started changing the terms in the days leading up to the signing of the contract.

Lastly, the owner of a pet food manufacturer and distributor, which has since been forced to close, experienced similar issues with accessing financing. The business was strapped for cash after a shipment “went rogue” in customs and they lost revenue from the missing product. The business owner sought out traditional, long-term capital, but for the amount of money he needed, the process would have taken much too long. He ended up taking out a \$40,000 merchant cash advance, with an agreement to repay \$62,000; however, the lender now claims he owes \$100,000.

It's important to note that the anecdotes above are just a few examples of how borrowers have been impacted by a lack of transparency. This is why Illinois small business owners need committee members to pass HB 3064 because APR is the only metric that enables an apples-to-apples comparison of financing products of different types, amounts and lengths. Despite what you might hear from some witnesses today, this bill will not outlaw any financing products or restrict access to capital in any way. Requiring price transparency for Illinois's small businesses is a benefit to the entire small business ecosystem.

You may also hear from companies that offer merchant cash advances that they can't estimate APR and disclose them. That is incorrect. Some merchant cash advance providers already disclose APR. And as of December 9, 2022, all financing companies serving small businesses in California are disclosing APR and starting on August 1, 2023, providers in New York will be as well.

We strongly encourage Illinois to follow suit and implement HB 3064. Illinois's small businesses are depending on it.