Recommendations of the Small Business Lending Subgroup

Executive Summary

Small business lenders are seeking more clarity and consistency in the legislation and regulation of commercial lending activities. This subgroup seeks (1) to promote consistency in the development, interpretation and application of laws and regulations relating to small business lending across the states and (2) to ensure a more level playing field for lenders while also promoting increased protections and transparency for borrowers. To achieve this, we propose the following recommendations described in further detail below:

1. Maintain important distinctions between consumer and commercial lending when legislating or regulating such lending activities
2. Develop a model definition of “commercial loan” to avoid uncertainty and misclassification, and discuss challenges of developing a model definition of “small business”
3. Develop principles for the treatment of commercial loans made to sole proprietorships
4. Establish consistent disclosure standards for commercial lending products, based on the specific recommendations below.

An Overview of Small Business Lending in the U.S.

The U.S. Small Business Administration found that small businesses comprised 99.9% of all businesses in the United States.\(^1\) Small firms employ approximately 62 million people in the United States, a remarkable number representing almost half of the private sector workforce.\(^2\) Since 1995, small employers have created about 60% of all net new jobs in the U.S.\(^3\) At the same time, the number of banks in the United States available to serve these small businesses has decreased by 271 between June 2016 and June 2017 to only 5,787 banks.\(^4\) As the number of small and regional banks declines, online lenders have emerged as an increasingly important alternative source of capital for small businesses. Online lenders have an approval rate of about 71%, compared with approval rates of 35% at large banks, 47% at small banks, and 26% at credit unions.\(^5\)

Currently, about 24% of small businesses seeking loans apply with online lenders.\(^6\) Applicants to online lenders report being attracted by the speed of credit decisions, improved funding chances, and lack of strict collateral requirements.\(^7\) In addition, online lending platforms are reaching underserved small businesses that traditional banks have long struggled to serve, including younger businesses, smaller businesses, innovative start-ups, owners with lower personal credit scores or “thin” credit files, and women-, veteran- and minority-owned businesses. Online lending platforms are also helping to promote greater financial inclusion by defining creditworthiness through innovative data and underwriting. These innovations allow online lenders to more accurately model risk and predict default, while simultaneously lowering costs of capital, improving customer experience, and expanding access to underserved communities.\(^8\)
Commercial lending is subject to extensive federal lending laws, including key regulations governing fair lending and anti-discrimination (ECOA), the use of credit reports (FCRA), economic and trade sanctions screening (OFAC), anti-money laundering, bankruptcy, and fair trade and business practices (UDAP). Oversight and supervision of commercial lending in the United States generally follows one of three paths:

1) Chartered banks that engage in commercial lending are overseen by the relevant state and/or federal banking regulator.

2) Non-bank commercial lending platforms that lend directly to small businesses are overseen by state regulators in the U.S. states and territories in which they do business. Under this model, the online small business lender operates as a direct lender and, where applicable, as a state-licensed lender in those states that require licensing with respect to such direct lending activities. Direct lenders typically do not rely on depository institutions to originate loans, but rather make the loans themselves and hold those loans on their own portfolios, relying on capital sources – including credit facilities, whole loan sales, and securitizations – to fund originations. State-level laws applicable to non-bank commercial lenders address important topics including information security, cybersecurity, privacy, licensure, restrictions on loan terms/fees/charges, reporting and record keeping, disclosure requirements, and brokering and referral requirements.

3) Some non-bank commercial lending platforms act as service providers to chartered banks, which control and oversee the commercial lending programs. Such programs are supervised by the state and/or federal regulator of the chartered bank. Under this model, the online lending platforms provide services for an issuing depository institution to process loans and then, in many cases, purchase those loans to hold on their books or for sale to investors as whole loans or by issuing securities. In this model, the issuing depository institution originates loans to borrowers that apply on an online platform. Under this model, lending platforms do not originate the loans, but rather act as technology or outsource vendors. The issuing depository institution is expected by its banking regulator to oversee the lending platform as a bank service company or a third-party service provider.

Operating a non-bank commercial lending program under a multi-state legal framework can be both overly duplicative in some respects and vastly inconsistent in others, creating significant operational challenges to the growth and development of an efficient nationwide platform. Below are a few examples of the complex web of multi-state laws applicable to commercial loans:

- **Usury Limits**: Colorado has a rate cap of 12%; Florida has a rate cap of 18% on loans less than $500,000 and of 25% on loans over $500,000; Hawaii has no rate cap; and Indiana has a rate cap of 21% on loans less than $50,000 but no rate cap otherwise. This is just across four states, state-specific usury limits vary dramatically and include many different inclusions, exclusions and dollar thresholds.

- **Broker Licensing Rules**: 11 states require loan brokers to be licensed; 13 states regulate loan brokers but do not require them to be licensed; and 26 states do not have licensing requirements with respect to commercial loan brokers.
Loan Disclosure Requirements: Commonly used pricing metrics like annualized interest rates are calculated differently across states and depend in part on individual state court interpretation, rather than aligning with a single objective standard or calculation methodology, reducing their ability to function as reliable benchmarks or enable comparisons by potential borrowers.

As demonstrated by the examples above, this fragmented 50-state regulatory approach drives up operating costs for lenders, diverts important compliance resources, undermines efficiencies, stifles innovation and can ultimately make credit less affordable and less available for small businesses.

This working group focused on ways to streamline the multi-state regulatory model with respect to commercial lending and promote continued innovation at the state level to provide greater access to capital for small businesses. Our suggestions aim to strike a balance between fostering greater efficiency and coordination among relevant state and federal regulators while maintaining important protections for small business borrowers.

RECOMMENDATIONS

1. Distinguishing Between Consumer and Commercial Lending in Policymaking

We caution against repurposing or replicating consumer lending obligations in the context of small business lending. There are significant fundamental differences between consumer and commercial lending, including the use of funds, default risks, level of borrower sophistication, underwriting processes and loan structure. These differences must shape distinct legal frameworks and regulatory approaches with respect to commercial and consumer lending.

Commercial loans are typically structured, risk-rated and priced differently from consumer loans in important ways. When underwriting, small business lenders use many traditional underwriting inputs, but also utilize real-time business accounting, payment and sales history, online small business customer reviews, and other non-traditional or alternative data. Generally, when consumers take out a loan, they are not making an income-generating investment that would increase the funds available to pay the loan back. Unlike consumer loans, commercial loans are normally used to generate revenue by enabling a business to purchase equipment or inventory or hire additional employees. Thus, “affordability” for small business borrowers means assessing the cash flow impact of the loan on the business’ sustainability, comparing the cost of the loan to the return they expect to earn from investing the loan proceeds, and comparing cost of the loan to other financing options the small business may consider. To reduce costs, small business borrowers may seek out shorter-term financing they can repay quickly with the return on their investment, while other small business borrowers may seek out longer-term financing that provides lower payment amounts.

Further, commercial lending distinctions already exist under federal law and provide useful guidance. Some examples of these distinctions at the federal level that we believe should be preserved at the state level include, the Graham Leach Billey Act Privacy Rule, the Fair Debt Collections Practices Act, the Electronic Funds Transfer Act, and in the authority of the Bureau of Consumer Financial Protection. Likewise, in the context of mortgage lending, federal regulations correctly recognize the difference in default risk and ability to pay in the context of commercial lending. A business borrower, unlike a consumer borrower, does not stand to lose a home and is not typically required to pledge real property as collateral. In each of these examples, the federal
government rejected the concept of applying consumer-oriented protections to business credit transactions. We would urge states to do the same.

Finally, without clear distinctions between consumer and commercial loans, their benefits and risks can be conflated in a way that harms small business borrowers. For example, small business owners have separate personal and business credit scores. If they are conflated, a business that has a down season could negatively impact the personal credit score of the business owner, and vice versa.

2. Defining a Commercial Loan Based on Use of Proceeds

We recommend the adoption of a standardized definition of “commercial loan” based upon the use of the loan proceeds. The group recommends that the use of proceeds alone should drive the determination of whether a loan is a consumer loan or commercial loan, and notes that this approach is consistent with federal regulations.

If the proceeds of the financing are used by the borrower primarily for personal, family or household purposes, the loan should be deemed a consumer loan. If the proceeds are used by the borrower primarily for commercial, investment or business purposes, the loan should be deemed a commercial loan. Furthermore, in determining the use of proceeds, the lender should be able to rely on the borrower’s stated purpose and should not be required to independently verify that the funds were used for the stated purpose as doing so is operationally infeasible (and, for that reason, is not required under federal anti-money laundering regulations). That said, lenders can and do implement reasonable safeguards to ensure that commercial loans are being used for their intended purpose. [13]

We propose the model definition of “commercial loan”: A “commercial loan” shall mean a loan, line of credit, or merchant cash advance, whether secured or unsecured, which the borrower intends to use primarily for other than personal, family, or household purposes. In determining whether a loan, line of credit or merchant cash advance is commercial, the lender may rely on a written statement of intended purposes signed by the borrower. The statement may be a separate statement signed by the borrower or may be contained in a financing application or other document signed by the borrower. The lender shall not be required to ascertain that the proceeds of the financing are used in accordance with the statement of intended purposes.

Confusingly, states use many different standards to define what constitutes a commercial loan, such as the principal amount of the loan, the size of the business borrower, the number of employees of the business borrower or the entity type of the business borrower.[12] For example, Section 22502 of the California Finance Lenders Law defines a “commercial loan” as “a loan of a principal amount of five thousand dollars ($5,000) or more, or any loan under an open-end credit program, whether secured by either real or personal property, or both, or unsecured, the proceeds of which are intended by the borrower for use primarily for other than personal, family, or household purposes.” While the California definition looks to the use of proceeds to help define a loan, the definition is complicated by an additional dollar threshold that threatens to arbitrarily reclassify a smaller loan to a business as a consumer loan.

Another example is found in the Maryland Commercial Law. While Maryland defines a “commercial loan” in a straightforward fashion in Section 12-101(c), the statute begins to make confusing distinctions when discussing permissible interest rate charges. Section 12-103(e)(1) of Maryland law states that a lender may charge any contracted rate of interest on loans made to
a corporation, but the provision inexplicably fails to list other well-established corporate entities (limited liability companies, trusts, etc.) and further applies arbitrary dollar thresholds to loans made to other business entities. These confusing, conflicting approaches could lead to arbitrary and inconsistent policy outcomes, inadvertently narrow the variety of financing products offered on the market and or even discourage certain types of business entities from operating in certain states.

The Annotated Code of the District of Columbia provides a good example of a definition focused on the use of proceeds and not on the corporate entity. The Code provides that the maximum interest rate is “as agreed” when the borrower “is an individual, group of individuals, corporation, unincorporated association, partnership or other entity, and the loan is made for the purpose of acquiring or carrying on a business, professional or commercial activity.” D.C. Code Ann. § 28-3301(a), (d)(1)(A), (B).

On a related topic, this group recommends that legislators and regulators focus on defining a commercial loan based solely on the use of proceeds, rather than attempting to define a “small business.” This group is sensitive to the challenges of defining a small business in a way that is both simple enough that lenders can comply, clear enough that lenders understand their regulatory responsibilities, and flexible enough to meet the changing dynamics of the business community. Attempts to define a small business have resulted in confusing or arbitrary definitions that often fail to identify a clear point in time at which the determination of the entity’s status as a small business is to be made.

There are many factors which have been used to define small business in the context of commercial lending, including the annual revenue of the business, SBA NAICS codes, the number of employees at the business, and the size of the financing. This group would discourage states from using SBA NAICS codes in the context of defining a small business. Defining small businesses using SBA NAICS-specific size criteria is unnecessarily burdensome and complicated for lenders, regulators and small businesses themselves. We feel that defining a small business based on the number of employees is also unlikely to yield a meaningful comparison metric across industries, given the varying use of contractors and part-time workers and seasonal variances in headcount. Employee-based definitions lead to inconsistent and incomplete categorizations.

While there is not a consensus within the industry as to how to define “small business,” this subgroup agrees that defining a commercial loan on the use of proceeds is clear, easy to administer, and results in the most consistent policy outcomes.

3. Treatment of Commercial Loans to Sole Proprietorships

This group agreed that the treatment and classification of loans to sole proprietorships under state law should be consistent with the proposal for defining commercial loans above. Therefore, we recommend that loans to sole proprietorships be classified as consumer or commercial loans based solely upon the use of the proceeds rather than the entity type of the borrower. Loans to sole proprietors should not be treated any differently from loans to other corporate or business entities to avoid inconsistent policy outcomes.

A sole proprietorship is the most common type of corporate entity, with over 70 percent of U.S. businesses owned and operated by sole proprietors or sole traders, according to the U.S. Small Business Administration. Sole proprietorships often adopt a business name, must comply with general business and licensing requirements, and often establish a separate tax identification
number. Furthermore, the IRS treats sole proprietorships differently from individuals and requires them to make certain tax filings that are not required of individuals.

Despite how common sole proprietorships are in the United States, there are several examples in state statutes where loans made to sole proprietors for a business purpose are either treated differently from loans made to other business entities or risk being reclassified as consumer loans. State laws regarding loans made to “individuals” for business purposes can lead to considerable legal and regulatory uncertainty for small business lenders that serve sole proprietorships. When a lender provides financing to sole proprietorships, there is often a risk such financing will be reclassified as consumer loans because in some states, loans to sole proprietorships are considered loans to individuals.

For example, the Indiana Consumer Credit Code sets no maximum interest rate on “business or commercial purpose loans not made to an individual” but does set a maximum rate for loans “made to an individual for a business purpose.” (Ind. Code § 24-4.5-3-605) When presented with such distinctions, lenders must decide whether a sole proprietorship is considered an “individual” under the law and whether such loan would be regulated as a “consumer related loan” under Indiana law. There is similar uncertainty in Kentucky, Minnesota and Nebraska, where business loans to sole proprietors of less than $15,000, $100,000 and $25,000, respectively, are at risk of being reclassified as consumer loans under state law, which can trigger licensure requirements, interest rate caps, and other important legal and regulatory requirements.

Additionally, in Rhode Island, licensure is not required for (i) loans to corporations, joint ventures, partnerships, limited liability companies or other business entities, and (ii) loans over $25,000 in amount to individuals for business or commercial purposes (R.I. Gen. Laws § 19-14.1-10(b)). This licensing statute creates uncertainty for lenders, who struggle to categorize their business loans to sole proprietorships, are they “other business entities” or “individuals” under Rhode Island law. The New York Licensed Lender Law raises similar questions about whether its licensing requirement applies to commercial lenders that make loans of $50,000 or less to sole proprietors.

Finally, from a policy perspective, if a sole proprietorship were treated as a consumer, the value of its business revenue would likely be ignored in the underwriting process, and some commercial online lenders would not lend to such an entity at all. Both outcomes could restrict or limit the availability of commercial credit to sole proprietorships. Additionally, blurring the lines between a consumer and a sole proprietorship could improperly collapse the distinction between consumer and commercial credit histories, as discussed above. For sole proprietorships to receive commercial credit that does not affect or is not affected by their personal credit history, they must be recognized as business borrowers from a legal and regulatory perspectives.

4. Commercial Disclosure Principles

The Truth in Lending Act, which ensures transparency in lending for consumers, does not provide transparency protections for small businesses. This working group supports transparency in small business financing disclosures, and we are committed to providing small businesses with fair and transparent financing options. Transparent financing disclosures should meet the “4 C’s” of transparency: they are Clear, Conspicuous, Complete, and Comparable across the options a small business may consider. We believe that small business borrowers should be provided with the information they need to understand their loan options and make a fully informed decision.
The Federal Reserve recently surveyed small business owners and found that they “were nearly unanimous in their call for clear disclosure of product costs and terms, and the findings suggest that improved disclosures could benefit both lenders and borrowers.”[14]

Building upon the research conducted by the Federal Reserve, the working group encourages regulators, legislators, industry participants, and other small business stakeholders to engage in additional testing of disclosures with actual small business borrowers to determine which disclosures are most helpful and effective. We strongly advocate a flexible, principles-based approach to commercial loan disclosures that allows the disclosures to develop at pace with the marketplace.

To that end, we recommend the following disclosure elements in the context of commercial lending. We urge you to utilize these recommendations to adopt a national approach that is consistent across the states and aligned with the existing federal structure, which would harmonize the fragmented regulations in different states. We note that some of the metrics recommended below may require estimates or assumptions when applied to certain finance products. Where applicable, we have included notes highlighting these estimations or assumptions.

Recommended Disclosure Elements

1. Financing Amount
2. Disbursement Amount, after any fees deducted or withheld at disbursement
3. Cost Comparison Metrics:[15]
   a. Total Cost of Capital[16]
   b. APR or Estimated APR[17]
4. Term or Estimated Term[18]
5. Periodic Payment Amount:
   a. If payments are a fixed amount, provide the payment amount and frequency (e.g., daily, weekly, monthly), and the average monthly payment amount if payment frequency is other than monthly
   b. If payments are a variable amount, provide a description of the method used to calculate payment amounts and frequency of payments, and the estimated monthly payment amount[19]
6. Description of all other potential fees and charges that can be avoided by the borrower (e.g., draw fees, late payment fees, returned payment fees)
7. Prepayment Charges, or a description of any fees, expenses or charges due when financing is paid in full
8. Collateral Requirements, if any

Manner of Disclosure

These should be presented in writing at the stage when the specific financing is offered, in a form that conforms with the “4 C’s” of transparency: it is Clear, Complete, Conspicuous, and easily Comparable with other options.

Applicability of Disclosure Elements

Small business financing disclosure standards can and should apply to loans, lines of credit, revenue factoring products, account receivable financings, equipment financings, merchant cash
advances and leases. We note that certain of these products, such as accounts receivable financing, merchant cash advances and leases, may not be considered loans. However, we recommend that disclosure standards apply equally to loan and non-loan small business finance products, as well as to both banks and non-banks, to ensure a level playing field.

We recommend turning to the disclosure principles set forth in California SB 1235 (Ch. 1011, Laws of 2018) for guidance, which extends disclosure requirements to any finance providers that provide financing to small businesses and applies the recommended disclosures equally to such providers and their products.

When considering disclosure requirements, we also emphasize the importance of recognizing the unique structure of issuing bank partnerships in this industry and encourage policymakers to consider the challenges of applying disclosure requirements to loans made in the context of issuing bank partnerships. We note that, as described in the CA SB 1235 definition of “provider,” the fact that a provider extends a specific offer of commercial financing or lending on behalf of a depository institution should not be construed to mean that the provider engaged in lending or originated that loan or financing. We would encourage all state policymakers tackling this issue to include that important clarification in any legislation or regulation on this topic.

Additional Resources on Disclosure

The Small Business Borrowers’ Bill of Rights (additional information here)
The SMART Box™ (additional information here)
Many policymakers have struggled with the proper way to categorize, regulate and supervise such relationships. On this topic, we commend the approach taken by the State of Vermont Department of Financial Regulation in September 2018 of expressly exempting from licensing requirements any company that has partnered with an FDIC-insured bank to extend commercial loans for so long as such company is subject to “ongoing monitoring, training, and compliance programs by the FDIC-insured bank to manage the activities” of the company and further subject to “supervision, oversight, regulation, and examination by the FDIC-insured bank’s regulator (if any) and federal regulator.”


Online lenders have implemented certain safeguards to ensure that small business loans are actually used for business or commercial purposes and not used for personal reasons in contravention of their terms, which include the following: 1) in the application process, disclosing to the borrower that the loan may only be used for business purposes; 2) in the underwriting process, reviewing the applicant’s bank accounts to ensure they are business accounts amongst other checks; and 3) in the loan documentation process, requiring the borrower to agree that the proceeds of the loan may only be used for business or commercial purposes. These safeguards protect against the concerns raised by one state regulator that small businesses might be using a business loans to pay off a personal credit cards, and that such loans should, as such, be classified as consumer loans.


Lipman and Wiersch, Federal Reserve Board of Governors, “Browsing to Borrow: ‘Mom & Pop’ Small Business Perspectives on Online Lenders.” June 2018. Two separate focus groups were conducted with a total of 42 small business participants. According to the report, the participants recruited for this study operated small businesses with at least one but no more than 20 employees, and less than $2 million in annual revenues, and came from a wide range of industries, located across the United States. Additionally, all participants had sought credit for their businesses in the prior 12 months.

To calculate APR and Total Cost of Capital for certain products, the lender must make certain assumptions which may not be borne out or ultimately reflect the costs accruing to the borrower. To provide the APR for merchant cash advances or other products without a fixed term, the provider must estimate the term. To provide the Total Cost of Capital for a line of credit product with no set draw amount, the provider must assume a draw amount. Recent Federal Reserve research stressed the value of disclosure even if estimations are required: “Importantly, nearly all [small businesses participating in the focus group] said this level of detail, even if estimated or presented as a range, should be available” (Federal Reserve, June 2018).

The Total Cost of Capital is the total dollar cost to be charged to the borrower, assuming the borrower pays according to the original payment schedule, and the Total Cost of Capital includes and lists all fees and charges that cannot be avoided by the borrower (e.g., origination fee, interest expense, and other upfront fees). When providing the Total Cost of Capital for a line of credit product, we recommend assuming the entire line amount is drawn at the time of disbursement. In such case, we recommend further that disclosures explain that the Total Cost of Capital is estimated based on an initial draw of the full line amount held for the full term, and that such amount will not be accurate if the business draws a different amount for a different period of time.

Several participating firms believe that APR, or Estimated APR, is the most important element of a disclosure standard, and a disclosure without APR would be insufficient. When providing Estimated APR for a financing with a variable term, we recommend calculating based on the daily, weekly or monthly delivery of receivables or payments from the business that is assumed by the lender in the underwriting process. In such case, we recommend further that disclosures explain that the Estimated APR is intended as a good faith estimate and may not be accurate if the business repays more quickly or slowly than the Estimated Term.

When providing the Estimated Term for products with variable payments and/or no fixed term, we recommend providing the total number of months assumed by the lender in the underwriting process.

To calculate the average monthly payment for certain products, the lender must make certain assumptions which may not be borne out or ultimately reflect the costs accruing to the borrower. This working group felt that small businesses should be provided with the estimated monthly payment in dollars to allow easy comparisons of costs across products and to empower small businesses owners to understand the effect of the financing on their monthly revenue and expenses.
Recommendations of State Licensing Subgroup

Executive Summary

The State Licensing Subgroup identified numerous licensing-related processes and procedures that differ widely among the states and made several recommendations streamline the licensing process and ensure full use of NMLS. The group's focus was to:

- Identify specific pain points in the licensing process
- Develop recommendations for consideration by state regulators
- Drive towards parity and harmonization of state requirements

I. Overarching recommendation: Industry recommends states use NMLS for licensing and adopt the State Examination System (SES) once it is launched.

Electronic licensure for the application process through NMLS is preferred. Most, if not all, states currently utilize NMLS for mortgages, but not all states do for consumer finance. We would like to see all states onboard NMLS for all of the consumer finance licenses. Currently, the amount and repetitiveness of paperwork needed for small loan or consumer finance licenses seems archaic and inefficient. We recommend that regulators consider replacing the mail-in-paper application process with an electronic system where documents can be uploaded as they are gathered and the applicant can hit "submit" once ready.

Further, if a state is on NMLS, then they should be so fully for the licensing process. Some states are on NMLS, but still require a fingerprinting, background checks, or supplemental questionnaires outside of NMLS. Wisconsin is an example of this. Wisconsin is on NMLS, but they also require quite a bit of additional information and supplemental questionnaires to be mailed in. Some states also require receipt of an original bond, but a copy upload to NMLS or use of the Electronic Surety Bond functionality would be much preferred. A more streamlined process allowing all documentation to be submitted online would be more efficient and ideal.

We recommend that for states that use NMLS for licensing, to use it exclusively and not require additional mail ins or checklists.
Bringing all state non-depository financial services license types on to NMLS drives regulatory efficiencies for both regulators and industry. The SES, for instance, will encourage use of common audit standards and sharing of examination results among state regulators. NMLS also provides a high degree of security protection for submitted data and ensures confidentiality and privilege standards for each state regulatory authority. The SES will also move exams to a more risk-based approach, calibrating exams for the lenders in states partially determined by volume.

II. Common licensing issues identified by industry

1. Differentiation in state reporting requirements.

We view this as the biggest opportunity for the industry and regulators to work together to make the biggest difference. The proposed changes could be the easiest to streamline with positive efficiency impacts.

Typically, the peak periods for consumer finance reporting are March and April of each year. One date, month, or even quarter by which companies have to report may be ideal as the longer the reporting deadlines linger throughout the year, the more difficult it becomes internally to pull the data efficiently. At a minimum, we recommend regulators to publish all reporting and filing deadlines in one place (e.g., at one place on the state’s licensing website and/or on NMLS).

Another issue among reporting is that there are different and distinct reporting requirements and formats from state to state. Currently, state requirements and reporting line of questioning is all over the place. Sometimes regulators themselves do not understand what the crux of their questions seek, which leads to differences in interpretation and inconsistencies among different lenders as well as internal operations.

We recommend that regulators use a simple or standard line of questioning, using consistent and clearly defined terms. Most states ask for similar information but with different wording or formats. But to streamline reporting questions, these four questions seem to be what every state ultimately requests:

(1) How many loans did you originate in 20xx?
(2) How much in principal did you originate in 20xx?
(3) How much in interest and origination fees did you collect in 20xx from loans originated in that year? and
(4) How much in principal did you charge off in 20xx?
States can adopt common standards and a line of questions (e.g., similar to what the mortgage industry uses with the Mortgage Call Report) and not require reporting beyond those standards. It would be much easier and much more efficient to apply the same set of questions to each state than it would be to compile answers to different questions in different reports for states when states generally seek the same information. To the extent that a state needs to assess fees, such as Washington or California, it could either be built into the common report or sent separately based on the answers in the common report.

As a final note to reporting issues the industry sees, we recommend that the states revisit allowing licensees to use a fiscal year versus calendar year financials when reporting. Currently, some states accept a company’s fiscal year while others insist on calendar years. If a licensed broker or lender is a public company, sharing unaudited calendar year financials (versus fiscal year audited financials) can create other concerns outside of regulatory worries.

2. Wide range of **renewal** timelines and requirements.

Similar to the disparity in reporting requirements mentioned above, license renewals cover a wide range of time periods and requirements. NMLS makes this easier with end-of-year deadlines. But with states that do not use NMLS, the renewal time frame widely varies throughout the year, which limits companies’ resources and internal efficiencies. We recommend that regulators consider one month or quarter in which renewals are due and also adopt across-the-board requirements for their renewals. It would also offer regulators and industry more room for flexibility if licensed activity could be continued while renewal requests are pending.

3. **In-state physical office** requirements.

Several states—Nebraska, Nevada, Virginia, and Mississippi to name a few—require licensees to maintain a brick-and-mortar office in their jurisdiction. With online lenders, the physical office requirement creates additional administrative burdens and expenses for industry and regulators without providing a clear benefit to customers. For example, one Fintech lender has received requests for over $90 million in loans from over 500 Nevada-based businesses but it is unable to help because of the archaic brick and mortar requirement.

Customers are increasingly comfortable interacting with financial service providers online or via phone, versus seeking out a physical location. Online consumer finance lenders already have the processes and systems to support customer inquiry as well as complaints. NMLS has also enabled consistent communications between industry and regulators and it provides a forum to connect customers with state regulators. Online companies are obviously still obligated to maintain a registered agent for service of process in each state where they conduct business. But when a company conducts its business online, maintaining a
physical office runs the risk of creating customer confusion about how customers can best access services.

Moreover, even within a specific state, the in-state physical office requirements may differ from license to license. For instance, Mississippi allows online lending for payday loans via its check casher license, but it requires a Regus office or other physical presence for installment loans via its small loans license. Requiring regulators and examiners to verify the status of the physical office increases the administrative burden for each licensee.

We, therefore, recommend that regulators consider replacing the physical office requirement with a requirement that each licensee demonstrate they have an active registered agent for service in the relevant state. Physical requirements are archaic for today’s technology enabled financial services providers.

4. State-specific experience requirements for qualifying individuals.

Current regulation on experience feels like it is written for brick-and-mortar lenders. We recommend that Qualified Individuals can be located at the company headquarters. Licensees should have the flexibility to have qualified individuals at the company address versus in-state. This should include states with the “responsible individual” requirements.

This is typically found more in the mortgage field. For example, in Arizona, a mortgage licensee must name/hire a “responsible individual” to represent their company in Arizona. This has become a cottage industry in Arizona where these individuals represent dozens of companies. Companies are meeting the letter of the law, but the end result does not seem to meet the regulators’ intent. In Nevada, new mortgage company applicants are required to hire a licensed Mortgage Agent/ MLO with a local residence and two years of recent industry experience who will not work for any other mortgage company. For online companies with headquarters outside of Nevada, this can be an awkward arrangement with the potential to create customer confusion. It is a large administrative burden to find viable candidates for the role who meet a company’s standards.

5. Elimination of paper.

The elimination of paper is another area that we see potential for improvement. This could be an easy change for regulators and industry to agree on. Some examples where paper requirements could be eliminated:

- Surety bonds (move toward electronic surety bonds in NMLS)—Some states want the original paper certificate, whereas some states are ok with a copy. Electronic copies would allow safeguards for both the licensee and the regulators (less paper, less risk of losing the original, etc.). The use of electronic copies also allows for easier tracking of the bonds and updating of any bond changes.
1. Documented proof of income for applicants—We recommend regulators to consider alternate means of proof of income, such as bank account data that can be pulled in electronically. Requiring a customer to scan in documents and email or upload them to the licensee is often burdensome on all parties.

2. Disclosures—We recommend allowing a licensee to provide electronic availability to the borrower versus requiring a handout or pdf to be sent to the borrower.

3. Display of licenses—The preference is to require of online “display” only. Posting licenses on the wall seems antiquated, particularly when regulators or borrowers do not come onsite.

4. Move to electronic examinations (facilitated through SES)

5. Move to electronic fingerprint cards

6. Publications of the intent to apply for a state loan (e.g., DC, Nebraska, New York)—consider online notices to replace actual publications.

7. NY has step-by-step instruction video explaining how to complete the online filing for Tax Facilitator Registration. This allows the applicant to know exactly what information will be required in the online form (usually you cannot see until you’ve completed each page). [https://www.tax.ny.gov/e-services/otc/demos/taxprepreg/taxprepreg.htm](https://www.tax.ny.gov/e-services/otc/demos/taxprepreg/taxprepreg.htm)

6. **Disparity in disclosure** requirements (language and timing).

   Where applicable, we recommend regulators to adopt model language and/or permit use of similar federal requirements (e.g. TILA-RESPA Integrated Disclosures). Some states require disclosures when they may not even apply to a particular lender. This is not limited to mortgage lenders. Some disclosures are required as mere formality even when it bogs down the borrowers with disclosures that may never apply to a borrower or that lender.

   Also, some states require certain font type and sizes when displaying certain disclosures. This particularly becomes an issue when, as is increasingly the case, borrowers view the terms or disclosures on their mobile device. For example, Vermont loan solicitor’s display requirements are very difficult to build in to an online user experience design for a nationwide audience. Some online lenders have opted out of Vermont simply due to the display requirement.

7. **Interpretative differences** among states from very similar statutes

   Many rules and terms are often differently interpreted among the states. For example, several states read the UCCC differently. States may have several ways of interpreting “taking assignment” or “undertak[ing] direct collection of or enforcement of rights against.” Similarly, the definition of “in the business of lending” is interpreted in some states (and supported by statutory provisions and regulations) as meaning origination activities. Other states, however, interpret this “business of lending” to include brokering even though brokering is not included in the statutory language. Several states also interpret terms like “arranging” and “soliciting” differently or have varying interpretations of the definition and permissibility of origination fees, all of which may dissuade online lenders from entering those markets at all. Acceptance of
common interpretations for similar statutory provisions and terms would create efficiencies for both industry and regulators.

8. **Disparity among licenses and laws governing the same loan products and activities**

   We understand that this disparity may require a legislative survey, but it is noted that there are differences among the states’ laws governing the same loan products and activities. For example, there are differences on limits as to when an entity is regulated (i.e., if you fall below a certain threshold, your business is not regulated, such as Arizona statutes of the $10k cap).

   Within the consumer finance licensing framework, some states also have multiple types of licenses that a lender can or must choose from as opposed to one overarching consumer finance license. This can lead to confusion or discrepancy as to which license is or should be chosen by a licensee.

9. **Payment types** should include the ability to accept electronic payments and credit cards.

   Some states require physical checks to be submitted. Getting a check cut in a larger corporation is often not a simple process because it occurs so infrequently. For example, the California DBO requires a physical check to pay an assessment fee. For larger companies, it takes time for a paper check to get issued even when up against time-sensitive state-mandated deadlines. We recommend that payment types should be modernized. Payment via electronic means would alleviate this concern.

10. **Requirements for Control Persons** for license application process (covered in separate subgroup, 2.0 group).

   We recommend a reassessment of the necessity of requiring personal financial statements or information for officers and directors. Aspects of this requirement may add to the difficulty of the process without creating a corresponding benefit for consumer protection. In one example, Virginia requires the spousal participation in the financial disclosure process by requiring a spousal signature on the form. See the [VA application forms CCB-1123 and CCB-1143](#).

### III. Next Steps

We recommend that regulators give an overall consideration that fintech companies cannot always fit within a brick-and-mortar legal framework. Fintechs want to comply with the laws and in no way see themselves as above the laws of each state. But sometimes the laws are written in such a way that online companies cannot enter into a particular state because...
they cannot comply in the online space. Customers are then left with less choices and less access to products that residents of other states often have.

One of the greatest values of financial technology is the efficiency and cost savings of an online-only business with a streamlined product and the ability to pass those cost savings to consumers. When this is done, the marketplace becomes more competitive and customers have more choices better suited to their needs.

### Lead Generation Policy Discussion

**Executive Summary**

Provide background on the use of lead generation, referral and brokering models by online lenders, bank service providers, and other financial services companies. Develop recommendations for more consistent and clarifying definitions of lead generation, referral and brokering activities, emphasize the importance of tailoring any state regulatory structure to the risks and requirements of the activities, and encourage a more consistent approach to state supervision of such activities.

**Focus:** The focus of this working group was primarily to:

- Establish a set of questions to frame policy discussions of lead generation, referral and brokering activities
- Review and discuss current state approaches to lead generation, referral and brokering activities, including definitions and the intersection between the different activities
- Provide regulators and legislators with a thoughtful set of definitions of different referral activities to guide tailored regulatory and supervisory approaches

**Overview**

As the use of brokers, referral partners and lead generators become a more dominant customer acquisition channel in the online lending ecosystem, we’d encourage regulators to recognize that distinct referral activities have distinct risk profiles, and then tailor regulations and legislation accordingly and in a consistent manner.

**Framing Questions**

This working group developed a set of questions to frame any discussion of lead generation, referral or brokering activities. These questions are meant to highlight key distinctions when assessing different referral activities, models, and programs:

- What information does the referring entity collect from (or know about) potential borrowers? Does the referring entity collect any personally identifiable information as defined in Gramm-Leach-Bliley?
- What information about a potential borrower does the referring entity share with the lender (or with other interim lead aggregators)?
What activities does the referring entity engage in vis-à-vis the potential borrower? For example, do they manage the borrower relationship, perform any underwriting tasks, negotiate with the lender on the borrower’s behalf, advise the borrower on the terms of specific loan offers, etc.?

Does the referring entity get compensated by the lender or by the consumer? How is such compensation calculated, on a per application basis, per funded loan, or some other metric?

Key Policy Considerations

This working group also developed a set of key policy considerations for legislators or regulators when considering lead generation, referral or brokering activities.

Supervision and Oversight

- Is the referring entity required to be licensed/registered in, or otherwise make filings with, the state?
- Are there clear definitions of the types of referral activities and referring entities that are subject to the state’s regulatory regime?
- Are regulatory requirements and oversight tailored to the nature of the referral activities?
- Are there duplicative, overlapping or inconsistent regulatory regimes for different referral and lending activities?
- What obligations does the lender have to supervise or oversee its referral partners?
- Are there restrictions on interaction between licensed and unlicensed entities?

Data Protection and Privacy

- Does the potential borrower know what information is being collected and how that information will be used?
- What information should be considered “confidential” in the context of a lead or referral? And, are there different approaches to borrower-supplied estimates versus underwriting outputs?
- Should we think differently about referrals of declined applicants, where the potential borrower has been fully or partially underwritten?
- Is the potential borrower’s data protected? Who can buy the leads or access the borrower’s data?

Duties of Care and Disclosure

- Are potential borrowers aware that lead generators, brokers and referral partners are being compensated for their services and that such compensation may drive their referral activity?
- Are there any duties of care for referring entities?
- What disclosures should be required of lead generators, brokers, referral partners and lenders?
- What should be included in such disclosures and when should they be provided?
- How can states improve transparency in these referral relationships without creating unnecessary regulatory burdens?
- What consents are required from prospective borrowers, when must such consents be gathered and who is required to gather them?
Suggested Definitions for Referral Activities

Currently, many state broker statutes use broad terms such as “arrange,” “assist,” “broker,” “negotiate,” “originate,” “process,” “procure,” “secure” and “solicit” that are, by and large, undefined by the statutes and thus create questions for lenders and referring entities seeking to comply with state law.

The broad definitions used in State broker statutes lead to confusion on the part of the entity that is referring leads as well as the lender receiving the leads. We believe the following definitions would provide clarity among all participants.

- **Brokers** are intermediaries that assess customer financials, typically including PII, and connect applicants to "suitable" lenders. They can be compensated by the lender, the applicant, or both. Their compensation may be contingent upon consummation/funding of the loan and may be tied to the size or success of the transaction. Brokers often “own” the customer relationship and may participate in loan negotiations between the lender and prospective borrower; counsel, advise and make recommendations to the prospective borrower about a specific loan based on that borrower's credit information; assist the prospective borrower in preparing loan documents; communicate lending decisions to a prospective borrower; and maintain a loan servicing function during or after a specific loan procurement, including engaging in any refinancing or renewal negotiations.

- **Decline Referrals** are leads where the initial intermediary has done some level of underwriting and has received some level of confidential personally-identifying financial information from the potential borrower but declined to extend credit and instead transfers or sells the lead and in some cases the information it has collected from the potential borrower to a third party for consideration. The entity provided the decline referral is typically compensated by the downstream third party. They have no continuing interest in any specific transaction but may receive compensation tied to the "quality" of leads provided and may be paid on funded loans.

- **Referral Partners** are intermediaries that collect and forward potential borrower information to lenders. Referral Partners typically pass on customer contact information, but not confidential financial information. Referral Partners are often compensated by the lender either on a flat-fee basis or their compensation may be tied to the "quality" of leads provided and may be paid on funded loans. Referral Partners may distribute to a prospective borrower a lender’s marketing materials or information about the lender and its loan products, or a general description of the lender’s underwriting criteria.

- **Lead Generators** are intermediaries that collect customer information and forward it to "suitable" lenders. The information collected by lead generators may include confidential financial information from the applicant. They are compensated by the lender. They have no continuing interest in any specific transaction but may receive compensation tied to the "quality" of leads provided and may be paid on funded loans.

- **Online Marketers** are intermediaries or portals that advertise products and services on websites, often on a targeted basis, and provide links to third party websites. They are
typically compensated on a click-thru basis. These are advertising relationships, where the referrer is passing on marketing information to a pool of potential borrowers with a link that the customers can click. Confidential information is not shared between the referring entity and the prospective lender; however, the lender may have specified referral criteria for the marketing entity to target.

**Recommend Clarity and Tailoring**

We should encourage states to provide greater clarity on the types of referral activities that require licensure, the acceptable compensation arrangements for different referral activities, and the ways that licensed and unlicensed entities can interact.

Additionally, we request clarity on the regulatory requirements and obligations for different categories of referring entities, and strongly encourage regulators to tailor those requirements and obligations to the risk posed by the nature of the referrals being provided. We encourage states to recognize that distinct referral activities have distinct risk profiles, and then tailor regulations and legislation accordingly. For example, there are important differences among conventional brokering activities where the broker actively manages the customer relationship, referral activities where the referral partner or lead generator and the lender exchange confidential customer data, and passive referral activities where the marketing partner simply provides marketing information to potential borrowers along with a link to the lender’s website. These activities present entirely different risks for borrowers, and the level of regulatory oversight should be calibrated to match those risks. For states that regulate this space, we also strongly advocate for recognition of the fact that there are some “referral” activities that are very low risk and do not warrant regulation or oversight.

**Examples of State Models**

The few states which have addressed or attempted to address the issue of lead gens, have done so in different ways:

**Virginia Model**

"Arranging or brokering" means, with respect to consumer finance loans, directly or indirectly negotiating, placing, or finding consumer finance loans for others, or offering to negotiate, place, or find consumer finance loans for others. "Arranging or brokering" shall not include lead generation.

"Lead generation" means engaging in a form of marketing activity in which a person collects and transmits a prospective borrower's contact information and minimal information pertaining to potential consumer finance loans. A person does not engage in lead generation if such person collects a prospective borrower's social security number or sufficient personal information to enable a consumer finance company to evaluate, in whole or in part, the prospective borrower's creditworthiness.

**Vermont Model**

Creates definition of “data broker” which includes those businesses that aggregate and sell the personal information of consumers with whom they do not have a direct relationship (as opposed to a financial services provider working directly with its consumer).
Requires the data broker to 1) register with the Secretary of State; 2) have adequate security standards to prevent cybersecurity threats; 3) prohibits acquiring data with intent to commit wrongful acts; and 4) allow consumers to “freeze” their data sharing

**Connecticut Model**

"Lead generator" means a person who, for or with the expectation of compensation or gain: (A) Sells, assigns or otherwise transfers one or more leads for a residential mortgage loan; (B) generates or augments one or more leads for another person; or (C) directs a consumer to another person for a residential mortgage loan by performing marketing services, including, but not limited to, online marketing, direct response advertising or telemarketing.

A licensed lead generator shall not be deemed to be acting as a mortgage lender, mortgage correspondent lender, mortgage broker or mortgage loan originator when engaged in the activities of a lead generator, if such person does not: (1) Obtain compensation or gain contingent upon the consummation of a residential mortgage loan or the receipt of a residential mortgage loan application, or (2) utilize financial criteria particular to the consumer or the residential mortgage loan transaction to selectively place a lead or to steer a consumer to a specific person for a residential mortgage loan.

Requires licensure of lead generators but provides exemptions for, among others, any bank, out-of-state bank, Connecticut credit union, federal credit union or out-of-state credit union, provided such bank or credit union is federally insured. Requires the maintenance of certain books and records.

Further, Connecticut requires that no lead generator may, among other things: (1) initiate any outbound telephone call using an automatic telephone dialing system or an artificial or prerecorded voice without the prior express written consent of the recipient; (2) fail to transmit the lead generator's name and telephone number to any caller identification service in use by a consumer; or (3) fail to comply with FDCPA-like restrictions.

**California (Proposed) Model**

The absence of a clear definition of brokering activity under the California Financing Law ("CFL"), has created uncertainty for commercial lenders and their business partners regarding what activities are permissible and/or subject to licensure in California. The CFL has failed to keep pace with technological innovations in online marketing, referral and brokering activities. Existing uncertainty as to how to apply the CFL to these new technologies and activities has created traps for unwary CFL licensees and, at the same time, made CFL licensure less attractive for prospective licensees. Providing legal certainty will drive appropriate licensure in the state.

In 2018, California policymakers attempted to provide greater clarity on the types of activities that require licensure as a broker and the acceptable compensation arrangements for different referral activities. That legislation ultimately didn’t pass, but an outline of key provisions is provided below:

- Defines a referral as the introduction of a prospective borrower to a finance lender or the delivery of a prospective borrower’s contact information to a finance lender for the purposes of making an introduction.
- Defines a broker as any person who does the following.
Transmitting confidential data about a prospective borrower to a finance lender with the expectation of compensation, in connection with making a referral.

Making a referral to a finance lender under an agreement with the finance lender that any prospective borrower referred by the person to the finance lender meet certain criteria involving confidential data and with the expectation that the person making the referral will be compensated if the finance lender and the prospective borrower enter into a loan agreement.

Participating in any loan negotiation between a finance lender and a prospective borrower.

Counseling, advising, or making recommendations to a prospective borrower about a loan based on the prospective borrower’s confidential data.

Participating in the preparation of any loan documents, including loan applications, other than providing a prospective borrower blank copies of loan documents. However, transmitting information that does not constitute confidential data to a finance lender at the request of a prospective borrower does not, in and of itself, constitute preparation of loan documents.

Communicating to a prospective borrower a finance lender’s loan approval decisions or inquiries involving confidential data.

Charging a fee to a prospective borrower for any services related to a prospective borrower’s application for a loan from a finance lender.

- Defines confidential data as any of the following: bank account number or bank statement; credit or debit card number; credit score, whether self-reported or received from a credit reporting agency; partial or full social security number; personal or business income information, whether self-reported or received from an official source; government-issued identification number; personal employment data or history; date of birth; mother’s maiden name; medical information; health insurance information; insurance policy number; and taxpayer or employer identification number.

- Provides that confidential data does not include any of the following in connection with a consumer loan: name, phone number, physical address, e-mail address, desired loan or financing amount, prospective borrower’s stated purpose for a loan, or prospective borrower’s self-reported range of credit scores or range of incomes.

- Provides that confidential data does not include any of the following in connection with a commercial loan: information that is considered not to be confidential when provided in connection with a consumer loan; business name, phone number, physical address, e-mail address; desired loan or financing amount; self-reported income; and self-reported credit score of a business owner.

- Prohibits a finance lender from passing an additional fee on to a borrower that is attributable to a referral fee the finance lender paid or will pay, but clarifies that a finance lender may charge a borrower additional fees or costs attributable to non-lead generation brokering activities, if the finance lender pays another person or entity for performing any of those acts for a loan made pursuant to the CFL.

- Requires a licensed lead generation broker to provide a specified disclosure to each prospective borrower and to obtain that prospective borrower’s express consent, before performing lead generation activities. Requires the disclosure to be provided before the broker may obtain express consent.
Background on Consumer Lead Generation from the FTC’s “Follow the Lead” Workshop

“Lead generation is the process of identifying and cultivating individual consumers who are potentially interested in purchasing a product or service. The goal of lead generation is to connect companies with those consumers so that they can convert “leads” into sales. A lead can be any consumer who has indicated interest – directly or indirectly – in buying a product or service by taking some action. During the Workshop, we focused on consumers who voluntarily submitted some information online – typically on a website form. Such leads may consist of little more than a consumer’s name and contact information. Some industries like consumer lending, however, may solicit much more detailed and sensitive consumer information, like Social Security and bank account numbers. “

The Process

Generally speaking, consumers’ first interaction with online lead generators starts with a website or sites operated by a publisher or affiliate. Publishers are the consumer-facing marketers in the lead generation ecosystem that promote products or services online. They encourage consumers to submit additional information about themselves to learn more and connect with merchants or advertisers (like retailers or lenders) that can sell them the products or services they are seeking. A publisher’s website typically contains marketing claims and a web form requesting consumer information. While these websites sometimes expressly identify the merchant brands to which they sell consumers leads, others do not – and instead make more generic marketing claims.

Aggregators, generally speaking, are intermediaries that take in leads collected by multiple website publishers and prepare them for sale to their clients – merchants or other aggregators. Aggregators frequently maintain contractual relationships with these clients, the terms of which specify the types of leads the buyer is willing to purchase from the aggregator. One aspect of the aggregator’s role is to identify the leads that would be most valuable or relevant to their clients and to package the leads accordingly. Unless an aggregator chooses to operate its own websites or engage in consumer-facing marketing, its role may be largely invisible to consumers who fill out online forms. Once an aggregator has processed a batch of leads, it may sell those leads directly to an end buyer merchant that can offer products and services. Alternatively, it may sell that batch to yet another aggregator – adding more layers to the lead ecosystem.

Ultimately, the leads that publishers collect, and that aggregators frequently prepare, are sold to end buyer merchants or advertisers that can sell consumers the products and services they are seeking. With the leads in hand, merchants will frequently contact consumers directly to provide additional marketing materials and more specific information about a potential transaction.

The Ping Tree

“According to industry representatives, payday [short term consumer loan] lenders employ lead generators to cater to consumers seeking quick small-dollar, short-term loans. To immediately underwrite and fund such loans, lenders ask their lead generators to collect detailed personal and financial information associated with each loan application, including the consumer’s employers, Social Security number, and financial account numbers. Once the publishers collect and electronically transmit these leads to aggregators, the aggregators use an automated,
instantaneous, auction-style process – known as a ping tree – to sell the leads to lenders or other aggregators. Lenders that access the ping tree provide the aggregator with specific criteria, or filters, to identify the consumers with whom they would like to connect (for example, some lenders may limit their offers to consumers in certain states). The lenders also specify the prices they will pay for individual leads that meet their criteria. Using this information, the ping tree transmits leads through the automated lender network in real time – presenting leads to potential buyers electronically until the lead is matched with, and accepted by, a lender who purchases the lead, and presents the consumer with an offer for a loan. If no lender elects to purchase a particular lead following the auction process, that lead is described as a remnant lead.

Although remnant leads do not result in offers for loans, at least in some past instances aggregators have sold them to clients who offered consumers alternative products they did not apply for, such as credit cards or debt relief programs. The process associated with the ping tree occurs almost instantaneously – so that consumers who fill out a payday loan application online can secure an offer immediately.

Potential Benefits to Consumers

At the Workshop, industry representatives stated that third-party lead generators provide potential benefits to both consumers and competition. Lead generators may have special expertise that connects merchants and interested consumers quickly and cost-effectively. By employing a large number of publishers – each operating its own website with information and offers to consumers – merchants can maximally and efficiently reach potentially interested consumers in the marketplace. Additionally, lead generators may benefit consumers by connecting them quickly with multiple merchants, and their associated offers, that consumers might not find as easily on their own.

Potential Concerns for Consumers

Several key aspects of the lead generation process may be hidden or difficult to understand for consumers. At the outset, consumers who fill out web forms may not realize they are operated by lead generators and instead assume that they are submitting information directly to a merchant or other advertiser. Even if consumers understand that they are submitting their information to a lead generator, they may not know that this information can be sold and re-sold multiple times – and further that, as a result, they may be contacted by numerous marketers that are unfamiliar to them. Additionally, consumers may not be aware that lead generators sometimes sell their information to the companies willing to pay for it (or pay the most for it), as opposed to those best suited to offering them the products or services they seek. Moreover, consumers may not understand that the information they provide in web forms can potentially be verified or supplemented with additional information they did not provide on these forms. Companies should disclose this type of information to consumers clearly and conspicuously to add transparency to the lead generation process and allow consumers to make informed choices about when and how to share their personal information.
APPENDIX 2

Brokering, Referrals and Lead Generation in Context of Small Business Lending

The brokering, referral and lead generation ecosystem differs in the context of small business lending. Referral partners may perform a variety of services, including assisting borrowers to identify potential financing options, generating leads for lenders, and in some cases, assisting in the application process. There are a few types of referral partner business models in the market today, but the common thread among referral partners is that they do not make credit decisions on credit applications.

Many small business lenders have relationships with businesses that provide traditional loan brokerage services. In these relationships, the brokers typically act as intermediaries between potential customers and lenders by brokering business loans on behalf of potential customers. The brokers are typically paid a commission by the lender at the time the term loan is originated, and the lender may or may not recover such commissions upon default of a loan. Brokers will typically serve as the main points of contact with the customer and may help a customer access multiple funding options besides those offered by a specific lender.

For small business lenders, their strategic partners, including banks, payment processors and small business-focused service providers, offer access to their base of small business customers. In these types of relationships, the small business lenders are introduced to prospective customers by third parties that serve or otherwise have access to the small business community in the regular course of their business. These referral partners include, among others, small business-focused service providers, other financial institutions, financial and accounting solution providers, payment processors, and financial and other websites. The lender looks to leveraging the partner’s relationships with small businesses to acquire new customers. In general, if such a referral partner refers a customer that takes a loan from the lender, the lender pays that partner a fee, sometimes a flat fee and other times a fee based on the amount of the originated loan. These referral partners generally provide a referral to the lender’s direct sales team, which serves as the main point of contact with the customer.

Another prominent referral partner model in small business lending is the marketplace (or matching) platform model. Marketplace platforms provide a portal where small businesses can go to use the resources and partnerships of the referral partner to help with certain aspects of getting commercial financing. In many cases, the small business fills out (or at times, the company pre-fills on the small business’s behalf by using data from their financial management software) an application and is given a choice of tailored financing available from a variety of lenders. The credit decisions and financing are made by independent, third party lenders. Those participating lenders may offer term loans, SBA loans, lines of credit, purchasing of future account receivables, invoice financing and small business credit cards. The criteria are established by the participating lender on the platform to give a small business a clear understanding of the range of financing options available to them. The small business chooses its preferred choice of financing product and the platform forwards the application information to the selected lender. The lender makes the credit decision on the application. Marketplace platforms play a key role in helping to match small businesses and their credit needs to a lender that can provide products to meet those credit needs.
Finally, many small business lenders have a network of partners to whom they refer certain declined applicants. In general, if a lender refers an applicant that takes a loan from a decline referral partner, that partner pays the lender a fee, sometimes a flat fee and other times a fee based on the amount of the originated loan. Under this program, the decline referral partner is the main point of contact with the referred business after the referral is made. Some decline partners lend directly to such referred businesses, while other may help the referred business access a comparison platform.

The publisher/affiliate model and ping trees described above are not common in the small business lending context because the application and underwriting processes for small business loans are specialized. Small business lenders rely more on referral partnerships with small business service providers that have existing relationships with the potential customer and (1) don’t provide traditional brokering services and/or (2) have other primary lines of business. We strongly encourage that any regulation of the referral ecosystem in the commercial context accounts for these differences in the models and is tailored to the risks posed by the different models.