Statement for the Record from the
Financial Technology Association

Before the
U.S. Senate Committee on Small Business & Entrepreneurship
hearing on

Oversight of the U.S. Small Business Administration and Review of the President's Fiscal Year 2024 Budget Proposal
March 22, 2023

Chair Cardin, Ranking Member Ernst, and members of the committee, thank you for the opportunity to submit a statement for the record in support of the Small Business Administration's (SBA) recent efforts to expand participation in the 7(a) program. The Financial Technology Association (FTA) represents industry leaders shaping the future of finance. We champion the power of technology-centered financial services and advocate for the modernization of financial regulation to support access, inclusion, and responsible innovation. Our members include consumer and business financial services providers, domestic and international payments companies, data aggregators, Buy Now Pay Later providers, earned wage access providers, AI-driven credit underwriting solutions, income verification providers, digital investment advisors, and low-cost investment platforms.

FTA believes that customer choice, trust, and protection is the cornerstone of financial services. By using technology like digital platforms, machine learning, automation, and other modern technologies, financial technology companies are improving efficiency and transparency, broadening equity, access, and inclusion, reducing costs, and increasing choice and opportunities for small businesses. Fintech solutions have emerged as critical tools to bridge physical and virtual activities as people have become increasingly accustomed to digital access.

FTA supports the SBA's proposal to lift its moratorium to license new Small Business Lending Companies (SBLC) to participate in its 7(a) Loan Program.[1] Since the 1980s, the number of SBLC licenses available to non-depository lending institutions, authorized by the SBA and subject to "certain prescribed standards,"[2] has been limited, and we agree with the agency that expanding the

[1] 87 Fed. Reg. 66963
[2] 46 Fed. Reg. 41523.

number of licenses, in line with SBA oversight resources, can "accomplish the goal of expanding capital opportunities to underserved businesses."[3]

Innovative fintech products and services provide convenient and expanded access points into the financial system for small businesses. These services range from mobile banking services and payments to access to digital applications for securing small-dollar loans. For example, a 2022 research paper documents that finance companies and fintech lenders increased lending to small businesses after the 2008 financial crisis. By 2016, nonbank lenders had a market share of close to 60 percent which coincided with a reduction in traditional bank lending.[4] Lifting the moratorium on the SBA's non-bank licensing capacity and creating a viable pathway, subject to SBA resources, for additional lenders to participate in the program will expand small business access to much needed capital. This is especially true for those that have been un- or underserved by legacy players in the financial system.

Leveraging Technology and Nontraditional Data, Fintechs Can Better Serve Small Business Borrowers

Financial technology companies are uniquely positioned to leverage innovative technology and nontraditional data to facilitate additional access to SBA programs. For example, the borrower application process for SBA lending can be protracted and difficult. Micro-businesses do not have the time or staff support to compile business financial history, tax returns, and the plethora of other documentation required to obtain a 7(a) loan. Instead, fintechs can leverage technology to bring efficiency to the application process.[5] Many fintechs use APIs to enable applicants to directly, quickly, and securely share their cash-flow data from their bank with lenders, which in turn can streamline the application process. By expanding the number of non-banks in the program, the SBA can leverage innovation to provide a more streamlined application process, which reduces complexity and time-to-completion for small businesses.

In addition, fintechs can introduce efficiencies into the underwriting process by making it easier for underserved small businesses to obtain funding by automating access to additional funds while eliminating many of the friction points associated with traditional lenders or banks. Traditional lenders and banks typically underserve many small businesses because the companies have been in business for less than two years and therefore lack the revenue or credit history to gain access to the capital they need. However, by leveraging sophisticated analyses and automated processes that better assess a business's health and credit worthiness, fintech companies are able to have a

[3] 87 Fed. Reg. 66964.

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

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

more complete view of a small business. This helps open up funding for underserved businesses that likely would not qualify for capital elsewhere through traditional determinations.

A recent working paper from the Federal Reserve Bank of Philadelphia found that fintech platforms' internal credit scores were able to predict future loan performance more accurately than the traditional approach to credit scoring.[6] Ultimately, by leveraging technology and additional data sources, fintechs are able to use data-backed risk models to enable the youngest and smallest firms to access credit, which can be further amplified if the SBA increases, in line with its resources, the number of Small Business Lending Company licenses it grants.

Fintechs Are Subject to Robust Regulatory Oversight

Fintechs that directly engage in small business lending are subject to certain state licensing and registration requirements, with state regulators conducting examinations, imposing capital and liquidity requirements, defining permissible investments, and enforcing laws that protect customers. For those that offer services through partner banks, they are overseen by their bank partners and are subject to the third-party risk management guidance issued by the federal banking agencies. In these scenarios, the bank partner, as the lender, provides an additional layer of oversight for compliance with applicable federal and state laws. Furthermore, under the 7(a) program, SBLCs are subject to "specific regulations regarding formation, capitalization, and enforcement actions" and enter into a written agreement with the SBA imposing control and funding expectations.[7] Finally, the SBA's Office of Credit Risk Management provides additional oversight to SBLCs by managing program credit risk, monitoring lender performance, and enforcing lending program requirements. These state and federal regulatory requirements create strong guardrails for any fintech that may become an SBLC under an expanded program and differ from expectations set forth under other programs.[8] While not all fintechs are the same, those with robust controls and governance processes and strong bank partner oversight relationships, will be the strongest candidates for participating in any SBA program. In addition, the longstanding state and federal guardrails will provide the credit and compliance parameters necessary to ensure the safety and soundness of the SBA's 7(a) program, while reaching additional small businesses and streamlining the application and underwriting process.

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

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

[8] While the SBA's 7(a) program and PPP are significantly different, it is important to note that fintech participation in PPP was critical to ensuring that underserved customers, who banks either could not or would not serve, were able to access PPP funds. In particular, independent research shows that participating fintechs' use of technologically advanced techniques and alternative data in PPP increased access for underserved small businesses. *See* Howell, S., Kuchler, T., Snitkof, D., Stroebel, J., & Wong, J. (2022). Lender Automation and Racial Disparities in Credit Access. http://dx.doi.org/10.2139/ssrn.3939384. The paper finds that (i) the automated loan vetting and processing systems used by fintechs significantly improved approval rates for Black borrowers during PPP and (ii) fintech lenders were responsible for 53.6 percent of PPP loans to Black-owned businesses, while only accounting for 17.4 percent of all PPP loans.

Conclusion

Fintechs play an important role in filling the credit access gap for small businesses, especially when no other options are available, and support the SBA's efforts to expand 7(a) program participation. We believe that by leveraging technology and nontraditional data, fintechs can better serve small business borrowers while maintaining the high credit and compliance standards set by established participants. Thank you for the opportunity to submit this statement.