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## THE U.S. REGULATORY ENVIRONMENT FOR ONLINE SMALL-BUSINESS LENDING

*Small-business lenders that proceed online must confront a variety of issues under state and federal laws. The authors discuss in particular exemptions from the TILA for business loans, consumer laws that may apply, and licensing and usury issues. They also address electronic contracting and the new reporting requirements under Section 1071 of the Dodd-Frank Act.*

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The United States is home to more than 28 million small businesses.<sup>1</sup> They are diverse and range from sole proprietorships to companies that employ workers, produce goods or services in supply chains, or serve customers on main street, U.S.A. During and following the financial crisis, bank loans to small businesses fell 18 percent,<sup>2</sup> exacerbating the credit crunch felt by them. Accordingly, a number of new lenders, many of which leverage advances in technology and the availability of data to operate online, burst on the scene to serve the small-business market.

The new lenders emerged in three basic models. The first model, peer-to-peer marketplace lenders, connects prime and subprime small-business borrowers with capital from individuals and institutional investors that are looking for a return on their investment. The second model, borrower-driven broker marketplaces, connects borrowers with traditional and alternative financing sources, from banks and SBA-backed loans to new online lenders. Finally, the third model, balance-sheet lenders, leverages capital provided by institutional investors that they hold on their balance sheet to make loan decisions based on proprietary risk-scoring algorithms that rely largely on cash-flow data.

Regardless of the model used to originate business credit, shared key legal issues emerged. We will explore some of those that are unique to small-business lending,

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<sup>1</sup> U.S. Census Bureau.

<sup>2</sup> FDIC Call Report data, as of January 2015.

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