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Dianna Seaborn
Director, Office of Financial Assistance
Office of Capital Access
Small Business Administration
409 3rd Street SW
Washington, DC 20416

Re: Affiliation and Lending Criteria for the SBA Business Loan Programs – RIN 3245-AH87

Dear Madam:

We are writing in response to the Proposed Rulemaking (RIN 3245-AH87) to amend various regulations governing the Small Business Administration's (SBA) 7(a) and 504 Loan Programs, including use of proceeds for partial changes of ownership, lending criteria, loan conditions, reconsiderations, and affiliation standards to expand access to capital to small businesses and drive economic recovery. In this comment letter, we will describe Upstart Network, Inc. ("Upstart"), explain our interest in the proposed rulemaking, and provide technological advantages of updating the affiliation and lending criteria to be more at par with the speed of doing business.

About Upstart

Upstart is the leading artificial intelligence ("AI") lending marketplace, which is designed to improve access to convenient and affordable credit while reducing the risk and costs of lending for our bank and credit union partners. By leveraging Upstart's AI marketplace, which harnesses over 1,000 data points that go beyond a traditional credit score, Upstart-powered banks and credit unions of all sizes can offer higher approval rates and experience lower loss rates. Those banks and credit unions are able to simultaneously expand access to credit and deliver the exceptional digital-first lending experience their customers' demand, the same experience that 7(a) small business customers deserve. Upstart has helped its bank and credit union partners serve over 2.5 million customers, originating over $30.5 billion in loans while fully automating 75% of those loans.[1]

[1] As of 9/30/2022. Fully Automated metric is calculated on a quarterly basis.

Lending is centuries old, but has changed little in recent decades. Traditional lenders use simple FICO-based credit scoring models to decide who is approved for credit and at what interest rate. While simple and intuitive, these “scorecard” methods are limited in their ability to quantify risk. Four in five Americans have never defaulted on a credit product, yet less than half have access to prime credit.[2] The implication is eye-opening. With a smarter credit model, such as the AI-based methods developed by Upstart, banks and credit unions approve almost twice as many borrowers at generally lower interest rates and with fewer defaults.

Upstart is one of the first companies to apply AI to the multi-trillion-dollar credit industry by using non-conventional variables at scale to provide superior loan performance and improve consumers' access to credit. We currently work with bank and credit union partners to help them originate small business (SMB) loans, personal loans (e.g., loans that are used for consolidation of high-cost credit card debt, cover wedding expenses, fund home improvements, or pay for large or unexpected medical costs), auto refinance loans, and other small dollar loans.

Results from an internal access to credit comparison demonstrate the ability of our approach to expand access to credit in a financially safe and sound manner. The Upstart model approves 43.4% more borrowers than traditional credit-score only models and yields 43.2% lower average APRs for approved loans.[3] The Upstart model approves 43% more Black borrowers than a traditional model, while offering those customers APRs that are 23.8% lower than a traditional credit-score driven lending model.[4] Similarly, the Upstart model approves 45.6% more Hispanic borrowers than a traditional credit-score model while offering APRs that are 25% lower than a traditional model.[5] As a result of its innovative approach to underwriting, Upstart is uniquely positioned to help our bank and credit union partners meet the credit needs of their entire communities, particularly low-to moderate-income (“LMI”) communities and communities of color.

Generally, all financial institutions, but the largest banks, face challenges in building advanced credit underwriting models in-house. Small and intermediate-sized banks with more limited resources are especially disadvantaged given the resource-intensive nature of building and managing such technology. While many fintech companies have decided to compete with banks or become a bank themselves through either a charter application or acquisition of a bank, Upstart has chosen the decidedly different path of partnering with banks and credit unions to help them better serve their customers. Upstart provides the technology to banks and credit unions

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[2] According to an Upstart retrospective study completed in December 2019.

[3] As of December 31, 2021, and based on a comparison between the Upstart model and a traditional credit-score only model. The APR calculation compares the two models based on the average APR offered to borrowers up to the same approval rate. The hypothetical credit score only model used in Upstart’s analysis was developed in connection with the CFPB No Action Letter access to credit testing program and was built from a traditional credit score only model trained on Upstart platform data. APR for the scorecard was averaged for each given traditional credit score grouping.

[4] As of December 31, 2021, and based on a comparison between the Upstart model and a traditional credit-score only model. Upstart does not collect demographic data on borrowers. Upstart uses standard industry methodology to estimate borrower demographic status to conduct access-to-credit analysis comparing Upstart to traditional credit model outcomes.

[5] As of December 31, 2021, and based on a comparison between the Upstart model and a traditional credit score only model. Upstart does not collect demographic data on borrowers. Upstart uses standard industry methodology to estimate borrower demographic status to conduct access-to-credit analysis comparing Upstart to traditional credit model outcomes.

that allows them to offer fully digital experiences across multiple small business and consumer lending products. Importantly, Upstart's marketplace allows financial institutions of all sizes to launch and maintain top-rated digital lending experiences without a substantial investment in technology and personnel that would be out of reach for all but the largest banks.

Upstart & Small Business Lending

Upstart launched a small business term loan product in the summer of 2022 that provides loans of up to $200,000 in one and two year terms. To date, we have facilitated with a lending partner tens of millions in loan origination volume to small businesses across the country with an average APR that is one-third less than the market average for similar products. These SMB loans are mostly used for working capital, expansion, inventory, business refinancing and payroll.

The SMB lending ecosystem and its status quo has historically relied on underwriting based on scorecard models with human review and demand extensive physical documentation for data gathering and verification, including the SBA's high-friction lending ecosystem. These measures were necessary when implemented decades ago to issue loans with low fraud rates and accurate underwriting – but the lending ecosystem has not kept up with the efficiencies unlocked by AI and digital lending flows.

These outdated scoring models result in poor risk separation, driving down approval rates. For those businesses that do not qualify for traditional lending and go with non-traditional lenders, they face a myriad of complicated products with unclear fees (represented as interest rates, factor rates, processing fees, cash advances, sales-based financing, and more). As you know, businesses across the country don't have access to Federal Truth in Lending Act protections that consumers enjoy. This results in many more businesses qualifying for a loan but only at very high APRs.

Upstart's core capabilities can address these key challenges to improve the status quo for both the lender and the borrower. Upstart is also best positioned to offer solutions for (i) high operational costs that can be automated, (ii) poor evaluation of true lending risk improved via AI, and (iii) a complex, opaque manual process that can be simplified and brought entirely online. These core competencies and world class lending capabilities allows us to meet small businesses where they are at, allowing us to provide lending partners with tools to offer responsible and effortless credit based on their true risk.

Finally, Upstart's SMB lending product was designed with the Responsible Business Lending Coalition's Small Business Borrowers' Bill of Rights in mind.[6] Transparent pricing and terms, non-abusive product offering, responsible underwriting, and a right to inclusive credit access and fair collection practices are at the core of its offering.

[6] See Responsible Business Lending Coalition, Small Business Borrowers' Bill of Rights at http://www.borrowersbillofrights.org/bill-of-rights.html

Fintechs & Upstart provide capital at the demanded "Speed of Business"

Traditional financial institutions have left small businesses behind in tough economic times, when small businesses needed them the most. A 2020 CFPB report examined banking trends in small business lending from pre-Great Recession (2004-2007), through the Great Recession (2008-2009), and then through the post-Great Recession (2010-2017) period. The study revealed that, by 2017, small business lending from banks had not returned to pre-Great Recession levels and, in fact, had only recovered to just half of the lending levels of 2004.[7] This left a void and fintechs stepped in to provide capital to needy small businesses. A 2022 Federal Reserve Small Business Credit Survey (SBCS) of employer small businesses found that compared to 2020, applicants were more likely to apply at an online lender/fintech and less likely to apply at a small bank in 2021.[8] In 2019, the SBCS found a growing number of small businesses apply to online lender/fintechs when seeking credit—rising from 19% in 2016 to 32% in 2018, indicating the increasing importance of the online lending market.[9]

According to the 2022 SBCS, the share of applicants receiving all of the funding they sought fell from 51% in 2019 to 36% in 2020 to 31% in 2021.[10] The decline in financing outcomes was particularly pronounced for firms with good credit scores, as the share of low-credit-risk firms that received all the financing sought fell from 45% in 2020 to 39% in 2021.[11] The changes proposed by the SBA in this rule will help increase access to credit and help get small businesses the capital they need to keep their businesses open increasing a SMB's likelihood of receiving all the funding they seek.

59% of American small businesses have unmet funding needs, according to the 2022 SBCS.[12] 50% of Black-owned firms reported unmet funding needs, compared to 45% of Asian-owned firms, 44% of Hispanic-owned firms, and 34% of white-owned businesses.[13]

Fintechs have stepped up to serve small businesses when others couldn't or decided not to. Additionally, banks and credit unions are being intentional about partnering with fintechs, like Upstart, to leverage our technologies to meet the needs of small businesses in their communities. We believe that fintechs better serve small businesses in large part due to their superior digital platforms and technology, to which traditional depository financial institutions are slower to

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7 "Data Point: Small Business Lending and the Great Recession," Consumer Financial Protection Bureau. https://files.consumerfinance.gov/f/documents/cfpb_data-point_small-business-lending-great-recession.pdf

8 See "Small Business Credit Survey: 2022 Report on Employer Firms," at https://www.fedsmallbusiness.org/survey/2022/report-on-employer-firms

9 See "Small Business Credit Survey: 2019 Report on Employer Firms", 2019 at www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/sbcs-employer-firms-report.pdf. Within this report online lenders encapsulate a wide variety of nonbank online-based sources "including retail/payments processors, peer-to-peer lenders, merchant cash advance lenders, and direct lenders. The COVID-19 pandemic disrupted the lending ecosystem making it difficult to account for continued fintech lending trends given the longstanding impacts of COVID-19 to the ecosystem.

10 See "Small Business Credit Survey: 2022 Report on Employer Firms," at https://www.fedsmallbusiness.org/survey/2022/report-on-employer-firms

11 See "Small Business Credit Survey: 2022 Report on Employer Firms," at https://www.fedsmallbusiness.org/survey/2022/report-on-employer-firms

12 See "Small Business Credit Survey: 2022 Report on Employer Firms," at https://www.fedsmallbusiness.org/survey/2022/report-on-employer-firms

13 See "Small Business Credit Survey: 2022 Report on Firms Owned by People of Color," at https://www.fedsmallbusiness.org/survey/2022/2022-report-on-firms-owned-by-people-of-color

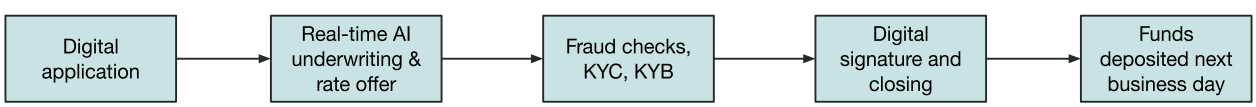
adapt. Fintechs are here to stay and better serve small businesses with the technology and capital that small businesses demand in an increasing digital era and economy.

13 CFR 120.150 on "What are SBA's lending criteria?"

Upstart supports the SBA's proposal to incorporate into the regulations a new requirement that Lenders and CDCs must use appropriate and prudent generally acceptable commercial credit analysis processes and procedures consistent with those used for their similarly-sized, non-SBA guaranteed commercial loans. We agree that aligning processes for guaranteed and non-guaranteed loans would encourage greater participation by Lenders and CDCs in the 7(a) loan program and also encourage Lenders and CDCs to make smaller loans due to the reduced underwriting burden, including time and costs. Today, smaller loan sizes are too often cost prohibitive due to high overhead costs incurred by lenders. As a result, small loan requests are met with lower approval rates which have a disproportionate impact on earlier stage businesses and encourage over-borrowing (i.e., accepting larger loan amounts than a business otherwise needs or wants). When small businesses are able to access the financing they need, they can create jobs, generate revenue, and contribute to the overall prosperity of their local communities.

Upstart believes that the use of data and advanced statistical modeling in small business lending leads to fewer delinquencies and write-offs, as well as extends access to credit for those applicants smaller in size, lacking collateral, or with little or no traditional credit history. Accordingly, Upstart supports the SBA's proposal to add language to §120.150 to permit Lenders, CDCs , and SBA to use a business credit scoring model. At Upstart, we view the use of business credit scoring models as one of many inputs for a holistic credit assessment of a business. Upstart uses the underlying data that goes into the various business credit scoring products (e.g., tradeline data, past repayment data, etc.) in conjunction with many other variables to accurately underwrite a business.

Upstart SMB Application Flow



According to the 2022 SBCS, only 22% of discouraged firms (i.e., those that did not apply for financing because they believed they would be turned down) believed they would not be approved based on the fact they were previously denied funding.[14] While 56% of discouraged firms cited weak business financials as a reason their firm would not be approved for financing, 32% of firms believed lenders are too strict; and 24% of firms believe that lenders do not approve businesses like theirs, whether because the business was too small, too new, or in an

[14] See "Small Business Credit Survey: 2022 Report on Employer Firms," at https://www.fedsmallbusiness.org/survey/2022/report-on-employer-firms

industry lenders view as risky.[15] At Upstart, we optimize for speed to approval, while providing responsible capital based on true risk. By streamlining the approval process and providing a customer experience that is less burdensome than the traditional process, Upstart encourages more businesses to make informed decisions around their financing needs, including setting realistic expectations around the availability of affordable credit. We believe the SBA's proposed changes in § 120.150 encourage and empower Lenders and CDCs to move beyond costly and time consuming traditional processes, that more often than not favor knowledgeable businesses with established banking relationships, and invite otherwise discouraged businesses to make informed decisions.

Conclusion

Fintech lenders have been able to expand credit access to those underserved small business owners who are not likely to receive funding from traditional lenders, according to BIS.[16] Their research also suggests that alternative data about the small businesses and their owners can play an important role in allowing fintech small business lending platforms to expand credit access.[17] As noted above, recent research has supported the effectiveness of Upstart approach to lending. We are committed to providing effortless credit based on true risk and our lending criteria and models have allowed us to expand access, something we hope that the SBA will embrace to expand access and financial inclusion in their 7(a) program.

Upstart supports the SBA proposal to streamline and modernize various regulations governing SBA's 7(a) and 504 Loan Programs, including use of proceeds for partial changes of ownership, lending criteria, loan conditions, reconsiderations, and affiliation standards, to expand access to capital to small businesses and drive economic recovery. We are especially excited about the impact of the proposal to incorporate into the regulations a new requirement that Lenders and CDCs must use appropriate and prudent generally acceptable commercial credit analysis processes and procedures consistent with those used for their similarly-sized, non-SBA guaranteed commercial loans. This change will bring innovation to the SBA program and increase access to capital for many small businesses in need.

Thank you for the opportunity to comment. If you have any questions, please contact Gilberto Soria Mendoza (gilberto.mendoza@upstart.com) or Nat Hoopes (nat.hoopes@upstart.com).

Sincerely,

Nathaniel Hoopes
VP - Head of Government and Regulatory Affairs

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[15] See "Small Business Credit Survey: 2022 Report on Employer Firms," at https://www.fedsmallbusiness.org/survey/2022/report-on-employer-firms

[16] See "The impact of fintech lending on credit access for U.S. small businesses" by Bank for International Settlements at https://www.bis.org/publ/work1041.pdf

[17] See "The impact of fintech lending on credit access for U.S. small businesses" by Bank for International Settlements at https://www.bis.org/publ/work1041.pdf