Fintech could enhance small business lending

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New fintech infrastructure could modernise small business loans and streamline the lending process more generally for US banking institutions and consumers.

Bank lending is a multi-billion dollar market in the US, but in terms of core everyday experience, technology and lending don’t function together to the extent that other industries and sectors do. Nearly all of the applications for small bank loans are currently handled offline, requiring archaic systems like PDFs, printers, fax machines and expensive postal fees.

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According to Jerry Ernst, chief executive officer of Horizon Community Bank (HCB) in Arizona, the lender has been looking for some time for a way to utilise technology to carry out transactions with certain types of customers more efficiently - specifically business borrowers that want a relatively small amount of money.

"Given our regulatory environment and the need for prudence and our legacy systems, we could not profit on loans under $300,000, and we were definitely losing a lot of money on business loans under $50,000," he said. "Even if a borrower paid us back the way they were supposed to we would lose – because of our own operating costs."

KEY TAKEAWAYS

- **New fintech infrastructure could modernise small business loans and streamline the entire process for both banking institutions and consumers;**
- **The existing protocols are outdated and inefficient, making loans under a certain threshold unprofitable for lenders;**
- **There are concerns that the technology raises additional cyber security issues but steps are being taken to ensure full compliance with all necessary regulations.**

Some fintech platforms are developing and deploying infrastructure that has the ability to streamline the small bank loan application process by fully automating it. According to Kunal Seghal, founder and chief executive officer at Thrive, no matter the size of a bank or a loan, the process is a series of simple transactions between a business and a customer and can therefore be modernised with relative ease.

"Our goal is to bring lending online by building the digital infrastructure to do that," he said. "That infrastructure does not currently exist, and we think lending should work efficiently on an online basis because essentially all of the components that are needed to underwrite and originate a loan already exist in the organic data."

The technology works by aggregating information such as credit checks and financial history that applicants need for the loan application, extracting the exact information that the banks require and then analysing it using client-specific algorithms to make almost instant decisions.

An early adopter, HCB implied that the Thrive system is already having a positive impact. "We are making more money on these kinds of transactions, and I don’t think there is a better alternative for it," he said.

Larger banks are also investing in similar technologies on a larger scale, including blockchain-based solutions. Ultimately banks of all sizes are looking for streamlined ways to lend money both more cost effectively and more efficiently, to satisfy the customer and shareholders. It’s expected that the larger financial institutions will make further investments in fintech and bitcoin in 2018.

There are of course complications and additional concerns. According to one partner at a US law firm, the main trepidations with this form of automation are risk management, underwriting standards and, perhaps most pertinent, data holding concerns.

"Obviously you need to maintain customer privacy, and the more information you have stored electronically the greater the risk of hacking," he said. "Cybersecurity is a big issue".

Addressing these cybersecurity concerns, Seghal outlined that Thrive has gone to great lengths to ensure that its systems and securements are up to the latest standards. The startup has obtained its service organisation control (SOC) reports, which hold publically traded companies to a certain standard of operation activity under the Sarbanes-Oxley Act.

In addition to this the fintechs have to navigate the Federal Financial Institutions Examination Council's stipulations and have been heavily vetted by the Federal Reserve.

Thrive and other similar fintechs only process the movement of money from consumer to lender, and are therefore not subject to banking regulation that comes with holding funds. To this end it is however largely the banks' responsibility to ensure that they apply to all of the cybersecurity regulations.

"Any time we alter any system we are obligated to do a risk assessment, detail out what is involved and how we can mitigate those risks, ranging from cyber security to know your customer under anti-money laundering rules," said Ersnt. "That framework is in place and as long as we keep the same structure it is only going to be easier to expand."

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