



Towards a More Perfect Credit Market for Small Businesses

Taking the Risk
Out of Small
Business Lending

Small Business Economic Research Forum

May 24, 2016

www.paynetonline.com

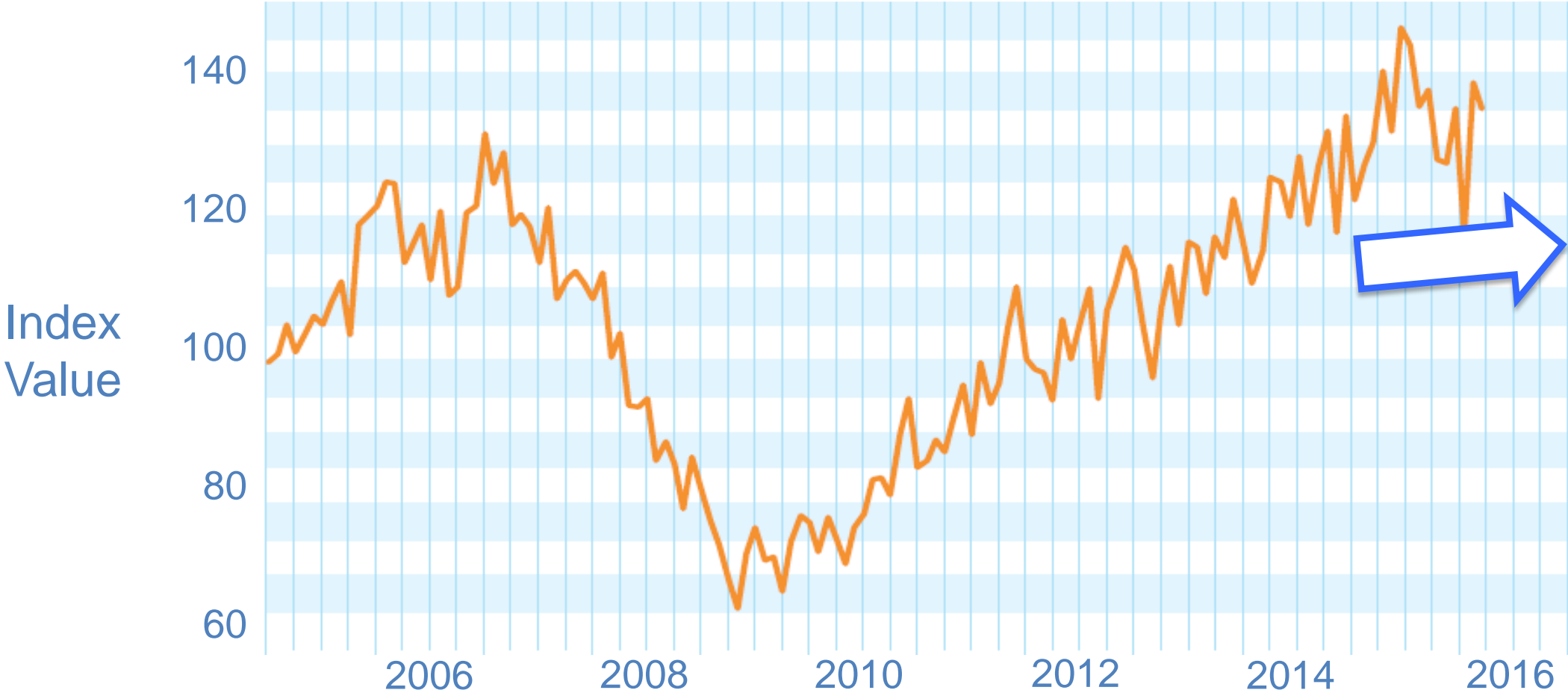
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AGENDA

1. National Business Conditions
2. The Small Business Credit Gap
3. The Unmatched
4. Financial Technology
5. Small Business Credit System
6. Q&A

LENDING ACTIVITY - NATIONAL

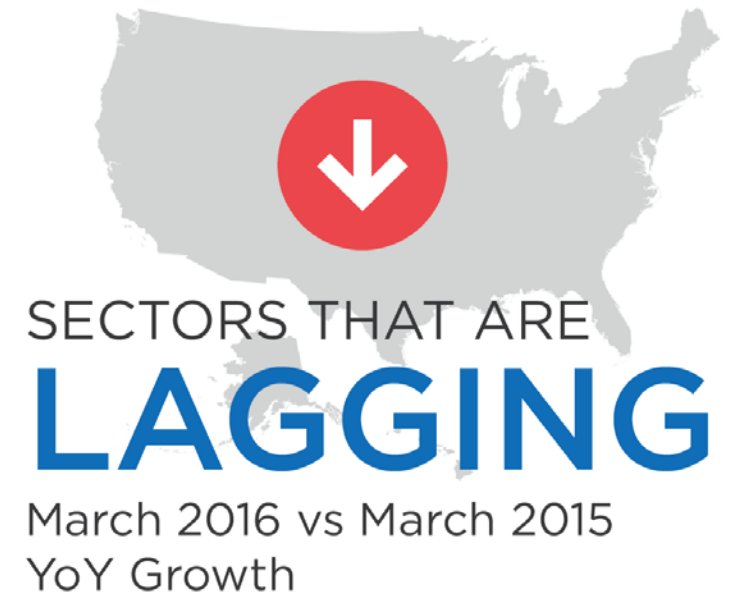
Thomson Reuters/PayNet Small Business Lending Index (SBLI)
(January 2005 - March 2016)



LENDING ACTIVITY – GROWTH SECTORS

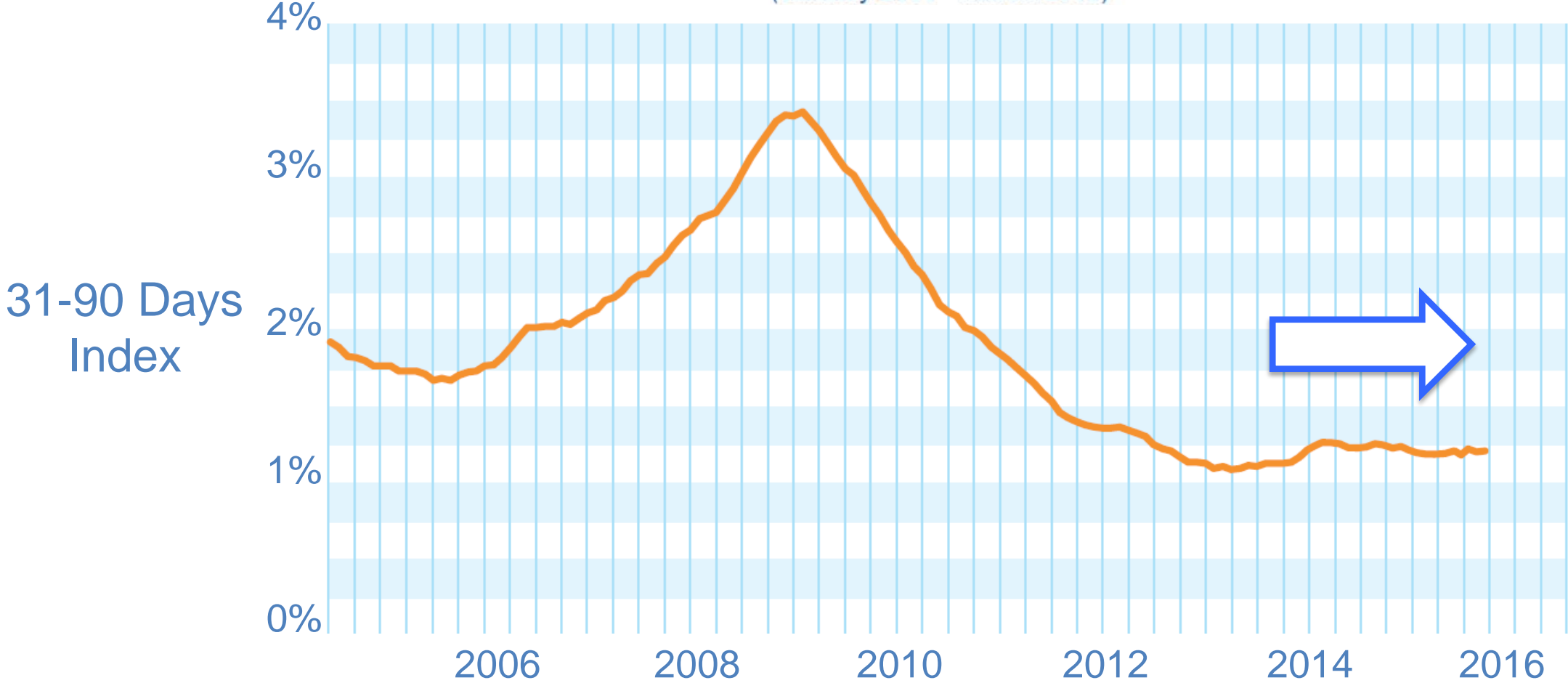


LENDING ACTIVITY – LAGGING SECTORS



LOAN PAST DUES - NATIONAL

Thomson Reuters/PayNet Small Business Delinquency Index (SBDI)
(31 - 90 Days Past Due)
(January 2005 - March 2016)



BIGGEST STATES DELINQUENCY

Credit risk improved in 7 of the 10

- New York (-0.49%)
- California (-0.25%)
- Illinois (-0.26%)

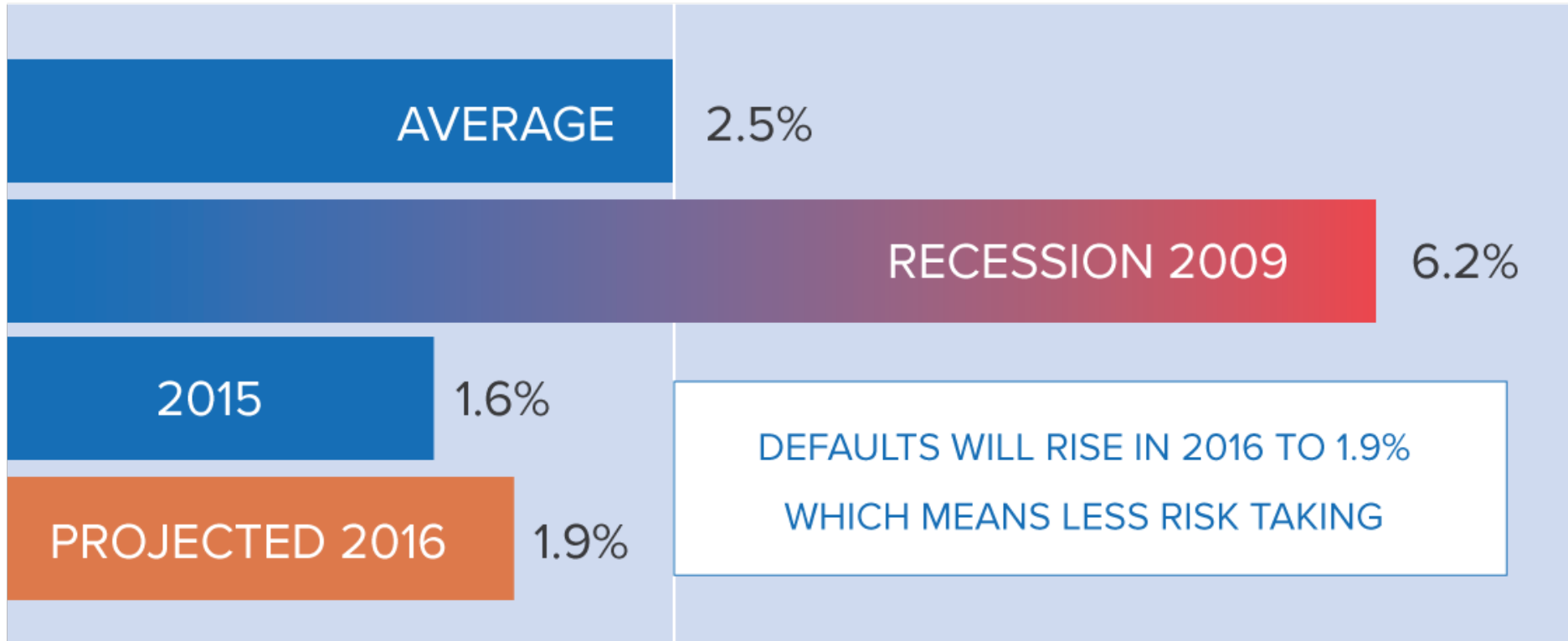
Credit risk has risen the most in

- Texas (+0.42%)
- Michigan (+0.19%)

**Delinquency of 10 Largest States
(31-180 Days Past Due)**

State	SBDI March 2016	YoY Change
New York	1.48%	-0.49%
Illinois	1.41%	-0.28%
California	1.29%	-0.25%
Florida	2.04%	-0.08%
Georgia	2.02%	-0.07%
United States	1.47%	-0.06%
North Carolina	1.55%	-0.04%
Pennsylvania	1.68%	-0.02%
Ohio	1.14%	0.02%
Michigan	1.39%	0.19%
Texas	2.19%	0.42%

DEFAULT RATES - NATIONAL



PRIVATE COMPANY CREDIT MARKET (\$ IN BILLIONS)

\$4.4
TRILLION
IN
OUTSTANDING
CREDIT

SEGMENT	\$ OUTSTANDING
Depository Loan	\$1,799
Other Loans	\$1,221
Trade Payables	\$1,404
Total	\$4,424

SOURCES:

Data obtained from the non-financial, non-corporate and non-financial corporate data from the Federal Reserve Flow of Funds Data. Debt and accounts payable of publicly held companies are subtracted to arrive at this estimate.

THE SMALL BUSINESS CREDIT GAP

\$108 BILLION LOST GDP

in the

CREDIT

GAP

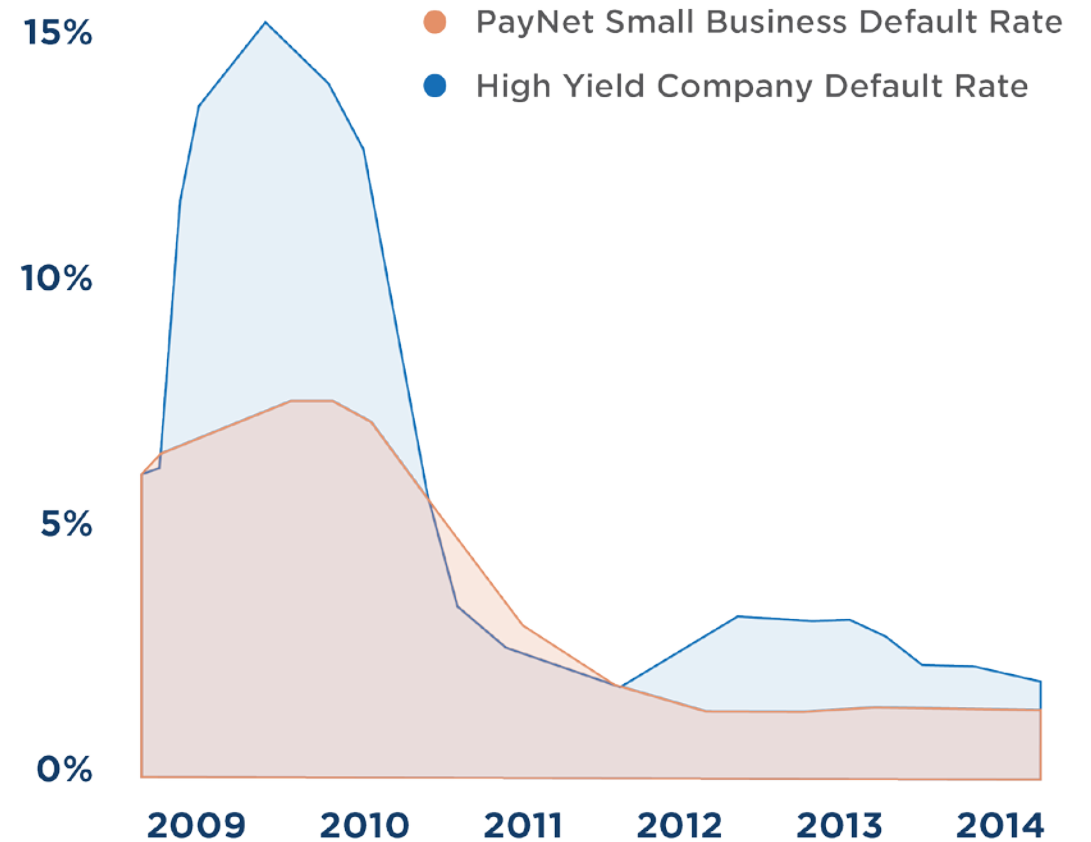
- 16-21% of requests unfulfilled
- 50% of small firms' credit applications completely denied

SMALL BUSINESS CREDIT RISK - MISUNDERSTOOD

Non-Investment Grade Company Defaults Higher Through Business Cycle

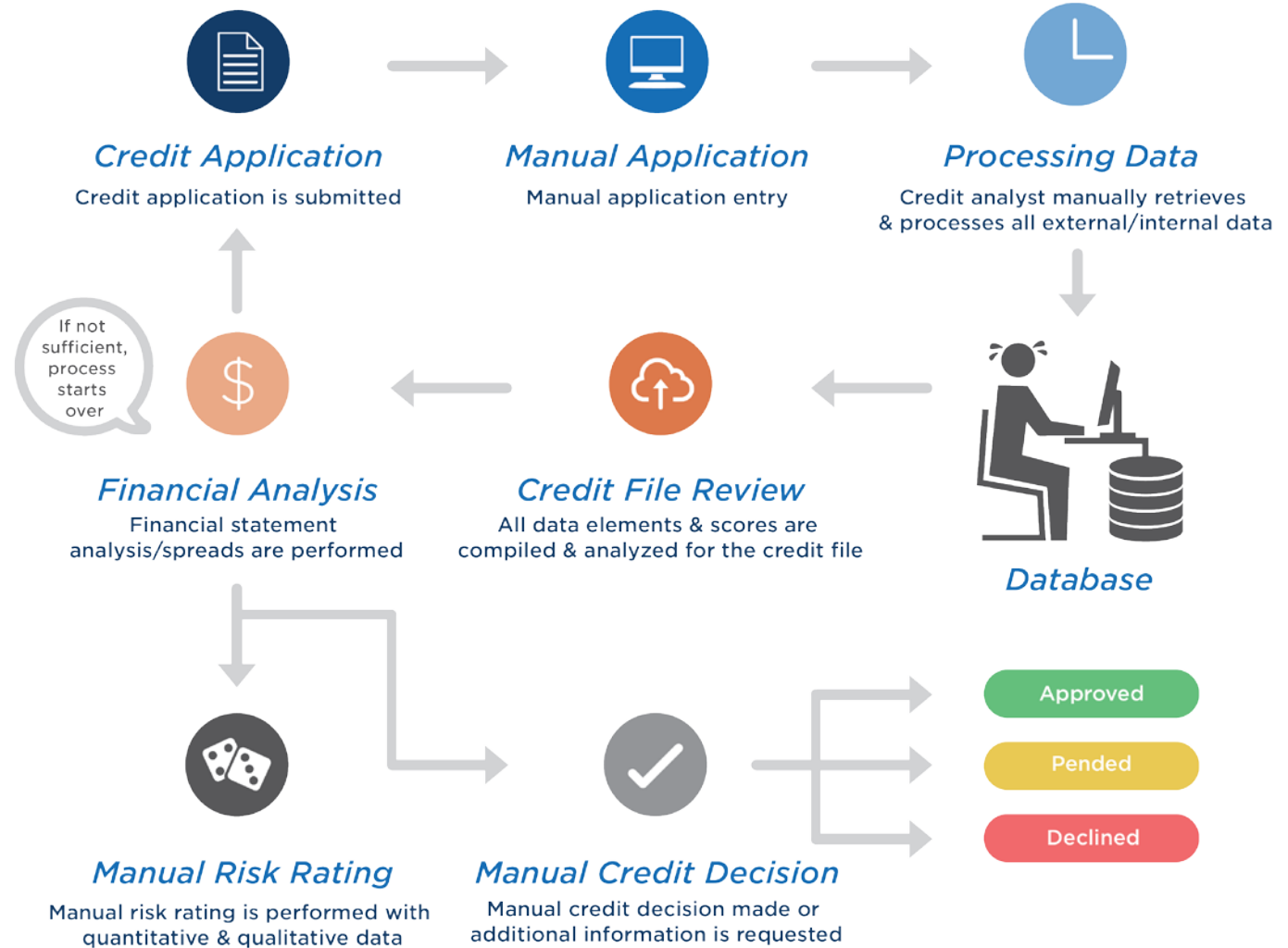
- Recession → Peaked at 15%
- Recovery → About the Same
- Expansion → 2X

More Volatile too → +20%



CORPORATE LOAN UNDERWRITING PROCESS

- Top 30 Bank
- Difficult Application Process
- 2-3 weeks for a decision.



THE LENDING PROBLEM

Manual Underwriting of Small Business Loans is not Profitable

\$100,000 Loan Example

Loan origination	\$1,000 - \$1,500	Operations	\$250
Underwriting	\$1,000	Monitoring	\$500
Loan review	\$100	Compliance	\$250 - \$500

Total

\$3,100 - \$3,850

Interest Income (assume 6.25% loan)	\$6,250
Loan cost to bank (3%)	\$3,000
Total non-interest costs to generate loan	\$3,100 - \$3,850

Net Income

(\$600) to +\$150

AN EFFICIENCY PROBLEM – LOAN REVIEW

1 Loan Review Costs over \$1,000



3 Departments Touch the Review



2 Days Work Time, 1 Week Calendar Time



people	task	Current Process Costs			
		time (hours)	costs	external costs	total cost
loan officer	collect F/S from customer	1.0	\$48.08		
	prep paperwork	1.0	\$48.08		
	input data into db	0.5	\$24.04	\$50.00	
	spread f/s	1.5	\$72.12	\$100.00	
	credit memo	1.0	\$48.08		
	cash flow analysis	2.0	\$96.15	\$100.00	
	assign rating	0.5	\$24.04		
	submit to credit dept.	0.3	\$12.02		
	dept. total	7.8	\$372.60	\$250.00	\$622.60
	credit analyst	cash flow analysis	2.0	\$76.92	\$100.00
credit memo		1.0	\$38.46		
assign rating		0.5	\$19.23		
document workpapers		0.5	\$19.23		
dept. total		14.5	\$153.85	\$100.00	\$253.85
administration	develop sample plan	1.0	\$38.46		
	audit loan	1.0	\$38.46		
	adjust ratings	2.0	\$76.92		
	dept. total	22.5	\$153.85	\$0.00	\$153.85
cost/credit		44.8	\$680.29	\$350.00	\$1,030.29
number of credits					1,000
AbsolutePD Cost					0
total operating costs					\$1,030,288

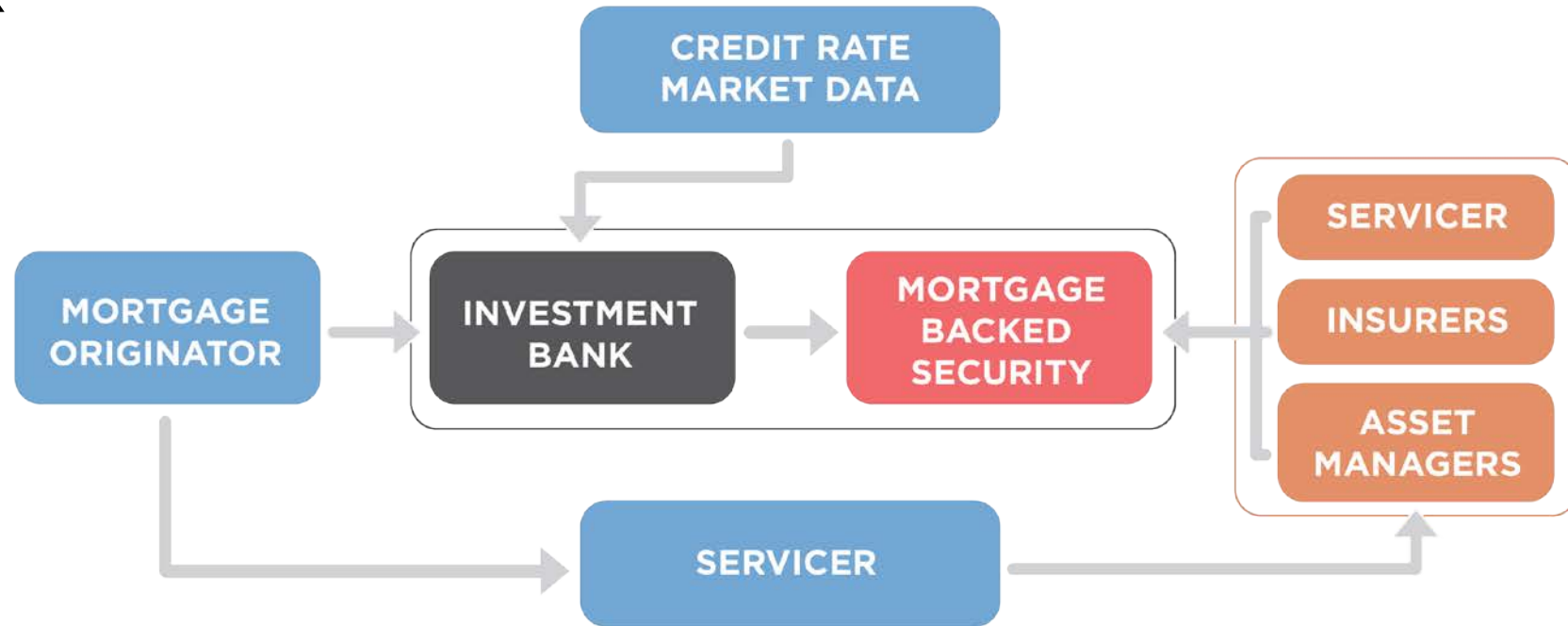
U.S. CAPITAL MARKET SYSTEM

- 2014 Capital Markets issuance \$2.2 trillion.



HOME MORTGAGE CREDIT SYSTEM

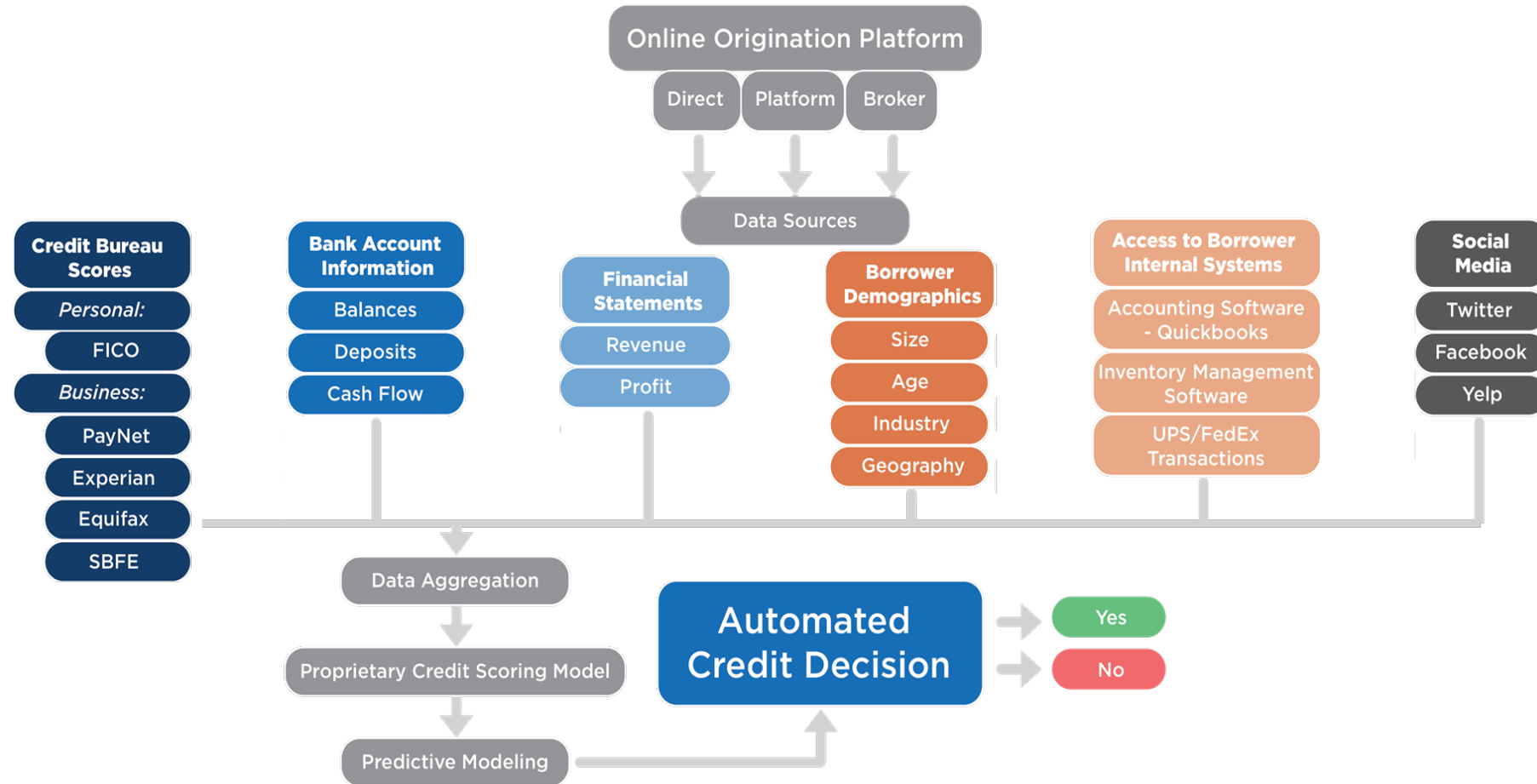
1. Loan issue/warehouse
2. Loan bid/sold to I-bank
3. I-bank creates MBS
4. Bond Tranches Issued
5. Investors buy for risk and maturity
6. Investor collects scheduled payments via a servicer intermediary



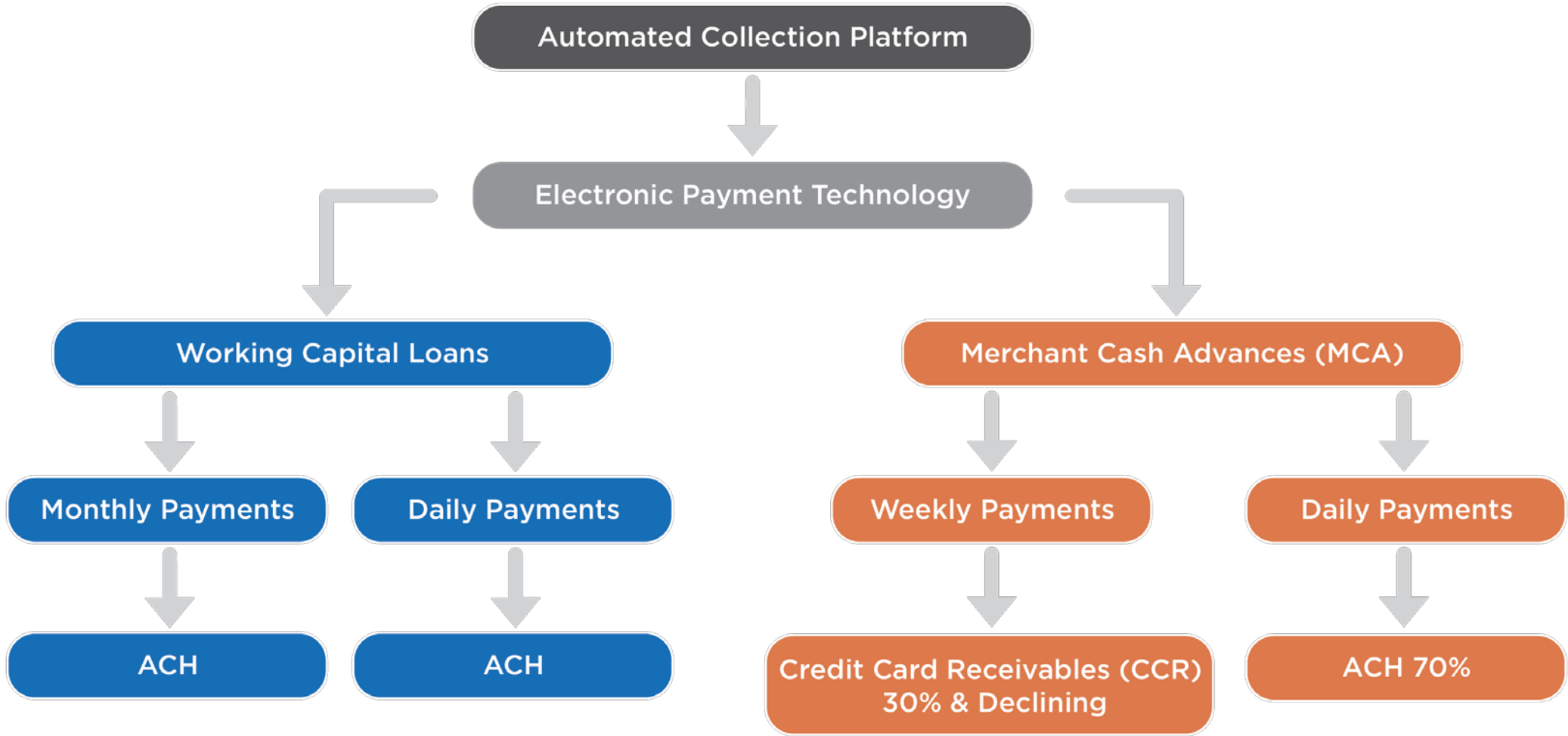
- \$1.7 trillion issued in 2015
- 5.2 million households

JOBS ACT – FINTECH MARKETPLACES

- Software
- Data
- Algorithms
- Credit Analyst



LOAN REPAYMENT



LOAN PAYMENTS vs. FINANCIAL STATEMENTS

PREDICTION MADE BY	ROC STATISTIC 1 YEAR
RiskCalc [®] EDF Credit Measure*	0.820
PayNet Absolute PD [®] **	0.829

Source: Korablev, Irina & Douglas Dwyer. *Power and Level Validation of Moody's KMV EDF™ Credit Measures in North America, Europe, and Asia*. Moody's KMV Company, 2007.

* 1996-2006. Based on US Non-Financial Public Companies with Sales \$30-\$300 Million

** 2012-2014. Based on PayNet Lenders Overall Portfolio

Behavior Models more predictive than Statement Models

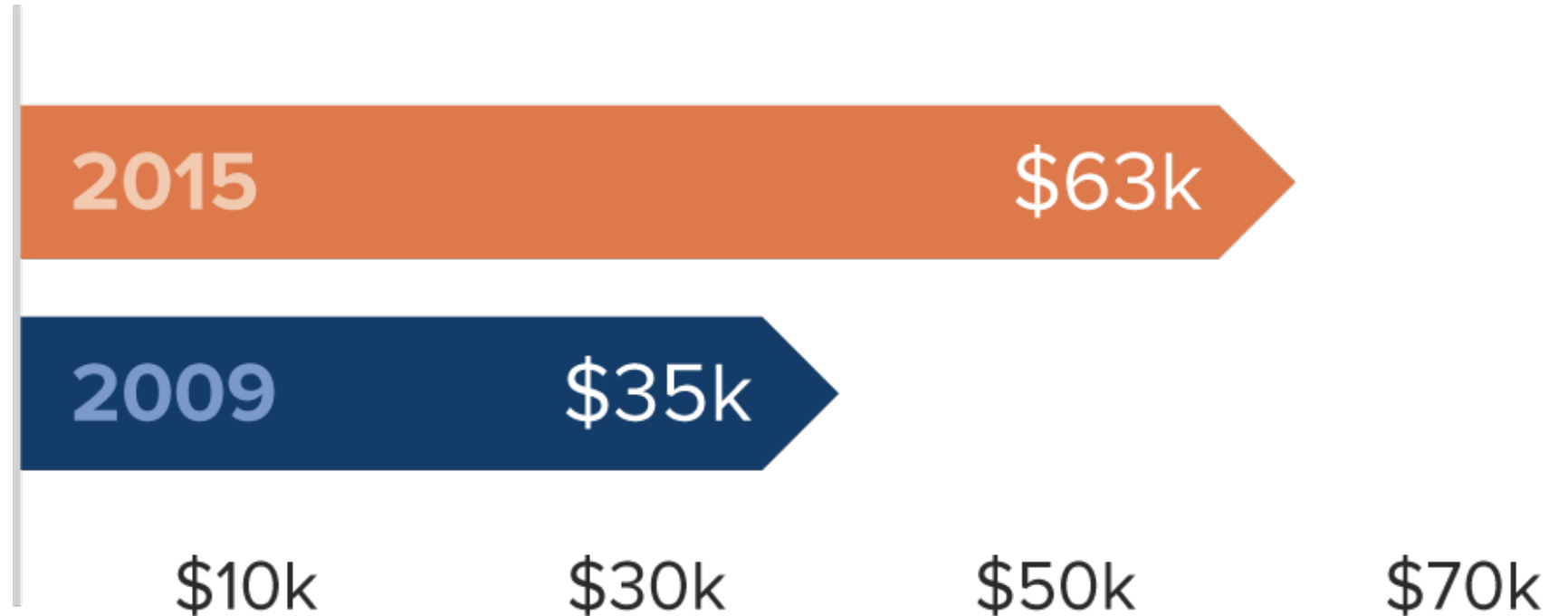
- Not self reported financial statements
- Models include industry, size, geography, collateral, borrowing practices and subtle patterns
- Based on Behavior objectively observed by third parties

AVERAGE LOAN FACILITY AMOUNT \$ in thousands, 2009-2015

AVERAGE FACILITY AMOUNT

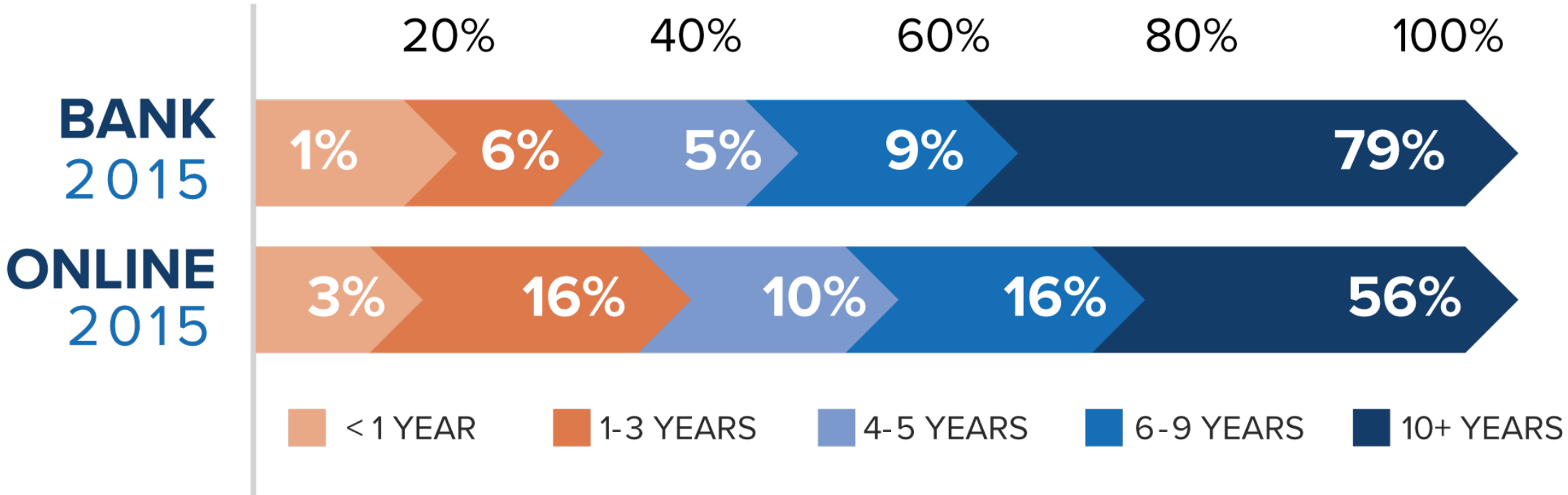
FACILITIES ORIGINATED
2009 - 2015

\$ IN 000'S



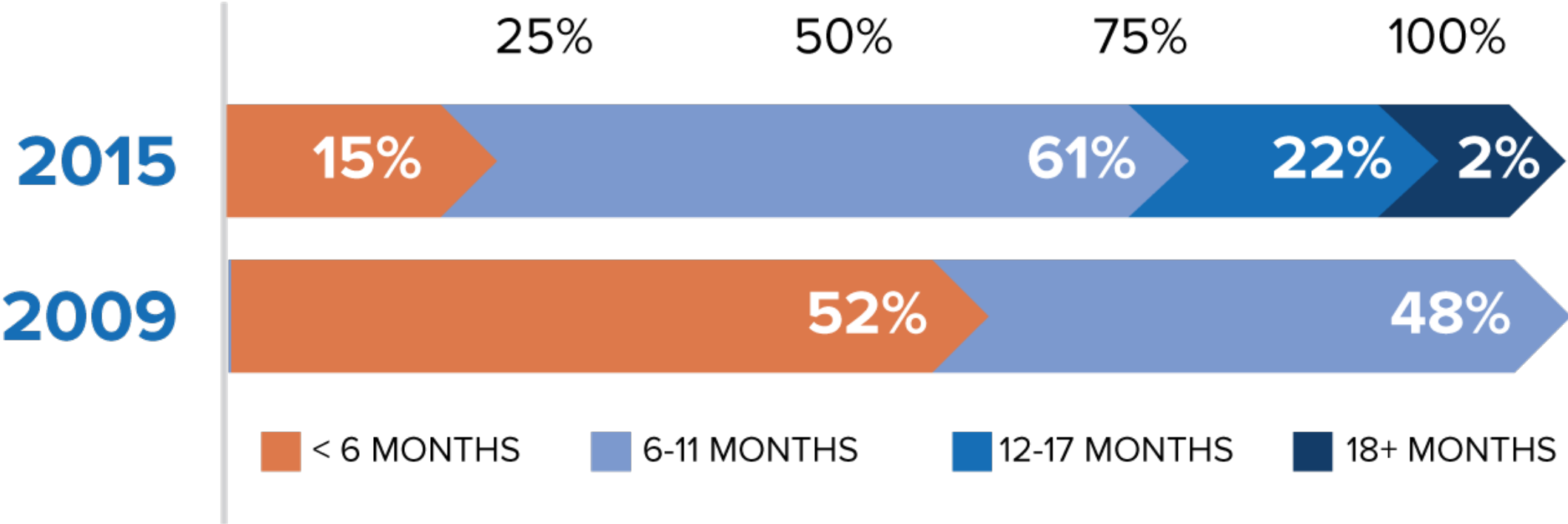
Average Loan Facility Amount has grown 80% over 6 year period

BANKS & ONLINE Borrower Tenure

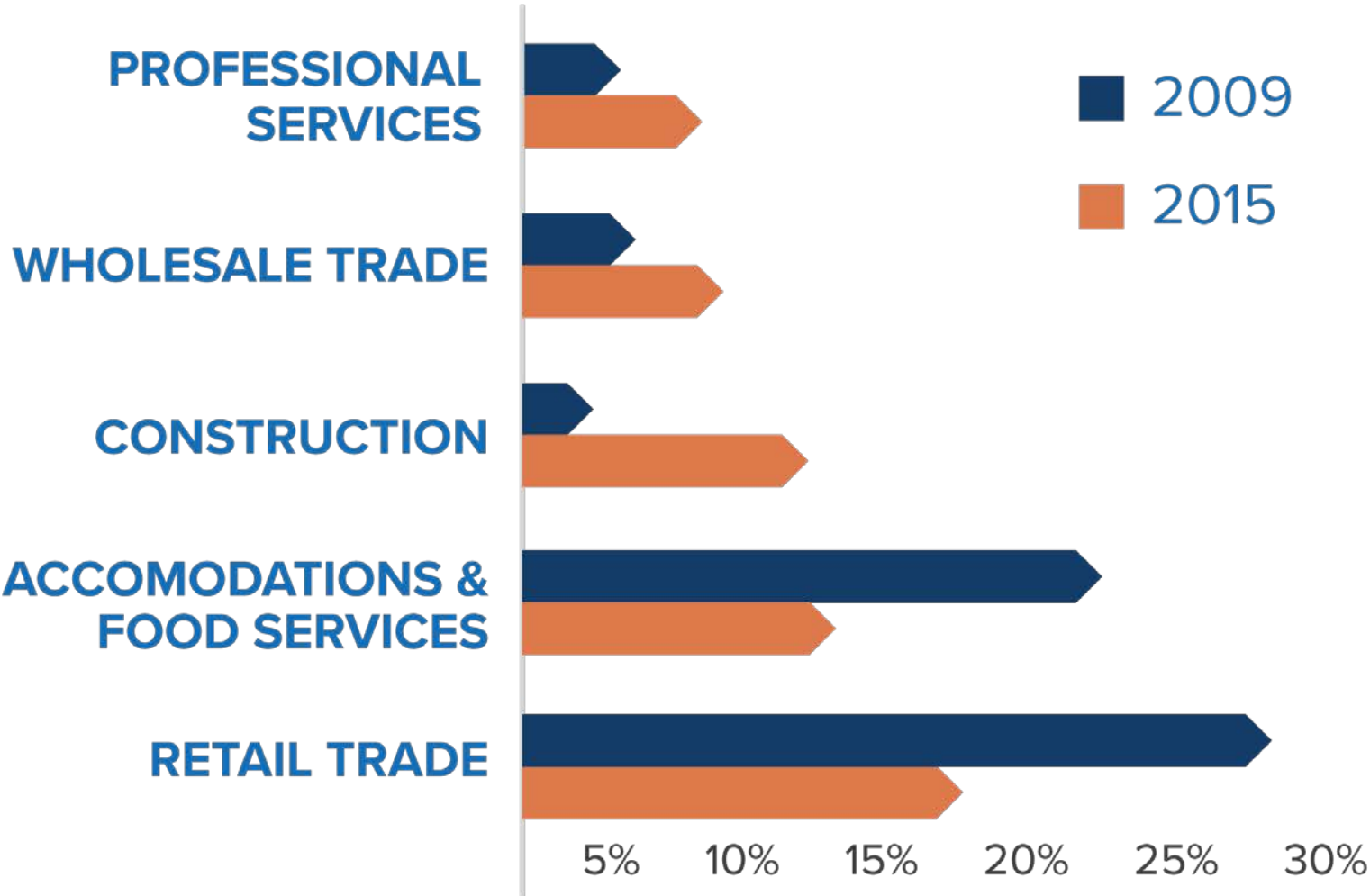


ORIGINATIONS BY LOAN TERM - ONLINE

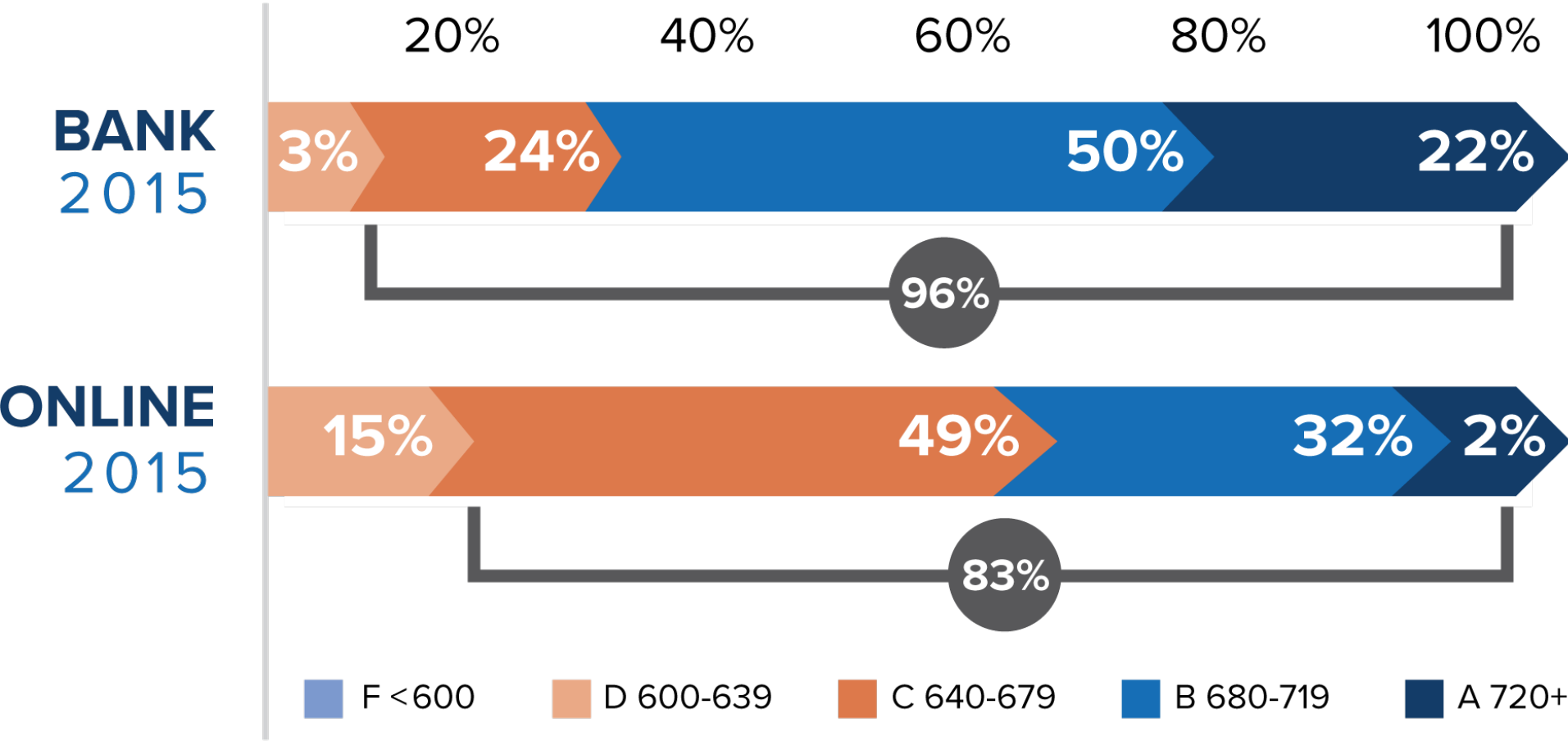
- Loan terms extending over 1 year
- Average Term = 11.1 months



ONLINE – ORIGINATIONS BY INDUSTRY



BANKS & ONLINE Borrower Credit Quality





William Phelan
www.SBInsights.net