



The Economy

Rethinking the risks of self-employment

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I always thought self-employment was risky. I was a mortgage underwriter at a community bank from 2003-06. I'd run loan applications through the submission process to Fannie Mae and Freddie Mac. It was clear, based on the automated decisioning, that both of these mortgage giants considered self-employed borrowers to be a higher risk than W-2 employees. Back then, most applications I processed did not come from the self-employed.

I have thought about this a lot since I entered the realm of self-employment myself in 2022. I'm lucky that I bought a house more than a decade ago and refinanced in early 2022, before I became self-employed. I'm lucky that my spouse has a 9-5 job with an employer to offset the "risk" in a banker's eyes.

These days, I know a lot of people who have pursued the self-employment path. Most of them likely have no idea that their career decisions could impact their future ability to get a loan from a bank. They don't consider their future creditworthiness when they decide to become self-employed. They think about how they'll find clients and how they'll collect payment. It isn't until they apply for a loan (or even a credit card) that they realize that they'll have a tougher time compared to the days of their 9-5 jobs.

However, the job market has evolved so dramatically, particularly over the past few years, that banks should rethink their definition of risk.

Self-employment is on the rise

I remember one applicant in particular from my days as a mortgage underwriter. He owned several rental properties and lived off the income they generated. On paper, it was hard to get his loan approved — because, as every self-employed person knows, you do everything you can to reduce your taxable income.

Back then, the types of self-employment were also different. A self-employed person might be an owner of a local restaurant. "Online creator" didn't exist back then.

Today, there are about 11 million full-time creators in the United States. According to a 2022 survey by McKinsey, 36 percent of respondents identified as independent workers. That's an increase of 9 percent since a previous estimation in 2016.

That means traditional loan underwriting may not work for a significant portion of the U.S. population. Automated decisioning needs to change, or banks will need to look at the loan more closely (yes, with a human reviewer) to determine the level of risk based on the sources of income and other factors.

I recently applied for a business line of credit. While I know that the process for a business loan is much different than a consumer loan, I was still amused when the loan underwriter asked, "Do you have an online presence I can review?" I pointed her to my business website and LinkedIn profile as "proof" that I'm running a real business. Is this the future of loan approvals? Who knows.

Re-thinking risk

Many self-employed people earn money in ways that are far different than even a decade ago, especially with the rise in creators, influencers and other types of online businesses. These entrepreneurs (or "solopreneurs," as we like to call ourselves) need very little to get started. A computer and a website can be all it takes.

I'd argue that self-employment can be less risky than a 9-5 job. If someone loses a job, they lose 100 percent of their income. From a bank's perspective, the ability to repay a loan is in jeopardy. For a self-employed person, losing a client or a gig may only be a portion of their income, not their whole income. My business has been stable (even thriving) for most of its 18-month existence. Yet I know that if I want a loan, I don't yet have the two years of tax returns a bank would require.

The tech industry, where I spend most of my time, has laid off hundreds of thousands of people over the past few years. I've known people who have been looking for jobs for months: It's an unbelievably tough market. Many have turned to self-employment, rather than continue an exhausting job hunt. They end up building successful businesses.

I hope banks will find ways to serve this segment of the population. Make no mistake: Some banks out there will benefit from changing the underwriting requirements for self-employed people. I've seen banks with niche loan offerings emerge before, and I'm certain they will again. And I, as a self-employed writer and online creator, am on high alert for that to happen.

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