December 14, 2020

Comment Intake
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

Submitted via email to 2020-SBREFA-1071@cfpb.gov

Re: Comments on the CFPB Outline of Proposals Under Consideration and Alternatives Considered for Section 1071

Dear Director Kraninger,

The Center for Responsible Lending ("CRL") appreciates the opportunity to comment on the Outline of Proposals Under Consideration and Alternatives Considered for the Small Business Lending Data Collection Rulemaking ("Outline"). CRL is a non-profit, non-partisan research and policy organization that works to ensure a fair, inclusive financial marketplace. CRL's work focuses on those who may be marginalized or underserved by the existing financial marketplace -- people who often are targeted for unfair and abusive financial products that leave them worse off. This includes people of color, women, rural residents and low-wealth families and communities.

CRL is an affiliate of Self-Help, one of the nation's largest community development financial institutions. For forty years, Self-Help has focused on creating asset-building opportunities for families of color, women, rural residents and low-income people and communities, primarily through financing safe, affordable home loans and small business loans. In total, Self-Help has provided more than $7 billion in financing to 87,000 homebuyers, small businesses and non-profit organizations and serves more than 80,000 mostly low-income families through more than 40 retail credit union branches in North Carolina, California, Florida, Illinois, South Carolina, Virginia, and Wisconsin. This includes more than $1.8 billion in loans to businesses, nonprofits, and community development projects.

As a long-time SBA lender, Self-Help also participated in the Paycheck Protection Program (PPP). Over the course of the program, Self-Help received SBA approval for $183 million in loans to 1,758 small businesses and non-profits across the country. These loans have been a lifeline for our borrowers, allowing them to continue employing 19,895 people through the current economic uncertainty. Self-Help's PPP efforts have focused on assisting underserved applicants: by dollar amount, sixty-three percent of the loans are to small businesses and entities led by people of color, and fifty-three percent of loans in low-to-moderate income census tracts. With a median loan amount of $21,000, these loans primarily serve truly small businesses: sixty-nine percent of the loans are under $50,000.

Introduction

It is a truism that small businesses are a critical engine of economic opportunity and growth. This is especially true for communities of color: businesses owned by people of color account for more than 8.7 million jobs at a total annual payroll of $280 billion, and these businesses generate $1.3 trillion in revenue.[1]

[1] 2018 Annual Business Survey

It is also a truism that for small businesses to thrive and grow into larger enterprises they need to be able to access capital. There is now overwhelming evidence that this is far more difficult for businesses owned by persons of color than it is for white-owned businesses. For example, research conducted by a number of Federal Reserve banks has found that in the previous five years, 46% of white-owned businesses with employees accessed credit from a bank compared to just 23% of Black-owned employer firms and 32% of Latino-owned employer firms. Lacking access to credit, 28% of Black owners and 29% of Latino owners relied on personal funds as the primary funding source for their business, compared to just 16% of white business owners. [2]

In large part, these disparate results are attributable to overtly discriminatory practices by lenders. A recent study by the National Community Reinvestment Coalition makes this clear: it found that Black and Hispanic testers when applying for loans were required to produce more documentation to support their loan application and received less information about fees, and less friendly service when visiting a small business lender.[3] But facially neutral practices with disparate effects are also important contributors to the difficulty that Black and Latino business owners have in obtaining credit, as was most recently demonstrated by the Paycheck Protection Program which, by relying on banks as its distribution mechanism, gave a large leg up to existing bank customers, who are disproportionately white, at the expense of businesses owned by persons of color.[4] And, sadly, it is also true that our nation's historical legacy of racial and ethnic discrimination has seeped into the consciousness of borrowers of color to the point of self-elimination from the lending process.[5]

The data collection envisioned by Section 1071 can provide the insights needed to address all of these issues. It can shed light on discrimination by individual lenders and practices with racially disparate effects; indeed the first purpose of the section is "to facilitate enforcement of fair lending laws." At the same time, these data can identify unmet credit needs, especially among women-owned and people of color-owned businesses which is the second stated purpose of Section 1071.

CRL is therefore pleased that, at long last, the Bureau is moving forward to implement Section 1071. We look forward to the issuance of the Bureau's Notice of Proposed Rulemaking (NPRM) and the comment period that will follow. We submit this comment to urge the Bureau to move expeditiously to issue an NPRM which:

- Limits any exemption from reporting to financial institutions that fall below an activity-based threshold geared to assuring that the loss of data resulting from such exemption does not undermine the purposes of Section 1071
- Defines "small business" in a manner that is easy to implement and that is consonant with the approach taken with the SBA
- Covers merchant cash advances as a form of open-end credit
- Requires the collection and reporting of the key components of pricing

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[2] "Small Business Credit Survey: Report on Employer Firms," 2020. https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2020/2020-sbcs-employer-firms-report.

[3] "Disinvestment, Discouragement and Inequity in Small Business Lending." National Community Reinvestment Coalition, 2019. https://ncrc.org/wp-content/uploads/2019/09/NCRC-Small-Business-Research-FINAL.pdf.

[4] Granja, Makridis, Yannelis, Zwick, *Did the Paycheck Protection Program Hit the Target?,* *https://bfi.uchicago.edu/working-paper/did-the-paycheck-protection-program-hit-the-target/*

[5] Fairlie, Robb & Robinson, *Black and White: Access to Capital Among Minority-Owned Startups,* *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3739651*.

- Provides for quarterly reporting of data by larger financial institutions

Before turning to these specifics, we pause to make one overriding, threshold point.

More than ten years have passed since the Dodd-Frank Act was enacted and the Bureau was directed to conduct this rulemaking. The need for this rulemaking is even greater today as it was then as the current COVID-19 pandemic, which has had such a devasting effect on communities of color including the small business sector within those communities, has made it more urgent to collect the data needed to eradicate discrimination and address unmet credit and capital needs in these communities.

Over the past year, the Bureau has demonstrated its ability to proceed expeditiously through a rulemaking in order to meet self-imposed deadlines. The Bureau needs to demonstrate the same sense of urgency and discipline in this rulemaking. Specifically, the Bureau should commit to conclude the 1071 rulemaking by the end of calendar year 2021 so that the implementation period can begin by the start of the following year. If to achieve that goal the Bureau needs to defer preliminarily resolving some of the questions posed by the Outline and instead propose alternatives in the NPRM, that would be a worthwhile "price" to pay in order to move this rulemaking forward. Indeed, as we discuss below, there may be some questions that are best deferred to allow the Bureau more time to gather additional data or at least to review data submitted through the comment process. In all events, the goal should be a final rule in 2021.

With that in mind, we turn to a number of the specific issues raised by the Outline.

Exemption for Smaller Financial Institutions

The Outline indicates that the Bureau is considering exempting "the smallest FIs, or those with the lowest volume of small business lending" because of a concern that those FIs "might reduce or cease their small business lending activity because of the fixed costs of coming into compliance with an eventual 1071 rule." The Outline offers three alternative approaches: an exemption based on the size of the FI as measured by its assets; an exemption based on the FI's small business lending activity as measured by the number or dollar volume of loans; and a hybrid approach combining the two.

If the Bureau elects to create a small entity exemption, CRL urges the Bureau to adopt the activity-based approach in its NPRM. An asset based test could end up exempting FIs which generate a significant volume of loans merely because those loans represent a large share of the FIs overall assets or because those loans (or other assets) are sold and effectively held off balance sheet. Either result would disserve the purposes of Section 1071. Moreover, to the extent the Bureau is concerned about small FIs exiting the market rather than incurring the costs of complying with 1071, such decisions are likely to be based upon the size of an institution's small business lending activity and not driven by the FI's overall size; thus an activity-based test would be better tailored to meeting the Bureau's stated concern.

In developing a proposal for an activity-based reporting threshold, it is essential that the Bureau keep in mind that, as the FDIC concluded in its Small Business Lending Survey, "the country largely remains segmented into a series of local lending markets rather than constituting a single, integrated market."[6] It is thus essential in order to assure that the data collected under Section 1071 is sufficient to "identify business and community development needs and opportunities of women-owned, people of color-

[6] FDIC, *Small Business Lending Survey, https://www.fdic.gov/bank/historical/sbls/full-survey.pdf*

owned and small businesses" at the local market level. Measuring the effects of a proposed exemption threshold at the national level simply will not suffice. As the Bureau's experience with HMDA illustrates, aggregate-level analyses may obscure the impact of an exemption on, e.g., LMI census tracts, rural census tracts, or, we would add, majority-minority census tracts.

In the HMDA context, in attempting to calibrate an exemption the Bureau had the benefit of data collected prior to the adoption of the exemption. In the 1071 context, such data is lacking. But we do know that community banks play an outsize role in small business lending; for example, the FDIC's 2012 study of community banks found that they accounted for 46% of loans to farms and businesses,[7] and community banks accounted for 31% of bank PPP loans.[8] Moreover, the FDIC Small Business Lending Survey found that the existing measures of small business lending understate that lending, especially the lending by small banks whose volume is understated by at least 29%.[9]

These considerations counsel drawing an exemption line narrowly, lest the purposes of Section 1071 be frustrated by an overly-broad exemption. If the Bureau elects to propose a single threshold in the NPRM, we therefore support the 25-loan threshold set forth in the Outline. However, in the interest of time – and recognizing the dearth of evidence at this stage both as to the effects of alternative thresholds and also as to the costs of complying with the 1071 Rule – the Bureau may decide to defer reaching a preliminary conclusion on this point and propose alternative activity-based thresholds in the NPRM.

To the extent the Bureau is concerned about the fixed costs of compliance and especially the one-time costs of implementing a reporting system, we urge the Bureau to consider the other tools available to it to mitigate those costs including, potentially, postponing the implementation data for smaller institutions to give them more time to comply (and give their vendors more time to build reporting systems into their regular releases); dedicating incremental Bureau resources to facilitate compliance; and providing smaller institutions with assurances similar to those that have been provided in the past regarding other new rules that supervision during the initial years after implementation will be diagnostic and corrective rather than punitive.[10]

Definition of Small Business

The Outline expresses the Bureau's preference for a "simplified approach" to defining small business, one that "would assist both FIs and applicants seeking to quickly understand whether a business is 'small.'" We agree with that goal. In our view, either of the first two approaches set forth in the Outline – defining small businesses based exclusively on revenue or using the number of employees for manufacturing and wholesale businesses and revenue for the remainder of industries – provides for a practical solution. The second has the advantage of being more consonant with SBA standards and thus capturing a larger share of the entities that the SBA deems to be small businesses. That is a worthwhile

[7] FDIC, *Community Banking Study* (2014), https://www.fdic.gov/regulations/resources/cbi/study.html
[8] FDIC, *The Importance of Community Banks in Paycheck Protection Program Lending, https://www.fdic.gov/bank/analytical/quarterly/2020-vol14-4/fdic-v14n4-3q2020-earlyrelease.pdf*
[9] *Small Business Lending Survey, supra* n.6.
[10] The Bureau took this approach with respect to the implementation of its 2013 mortgage rules and TRID, https://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-cfpb-director-richard-cordray-mortgage-bankers-association/ and also with respect to HMDA, https://www.consumerfinance.gov/about-us/newsroom/cfpb-issues-public-statement-home-mortgage-disclosure-act-compliance/

goal in and of itself and also may expedite the rulemaking by facilitating the process of obtaining SBA approval. Thus, if the Bureau elects to propose a single definition in the NPRM, we recommend the second alternative from the Outline. However, this also may be an area where, in the interest of expediting the issuance of the NPRM, the Bureau should propose both the first and second alternatives.

Product Coverage

Although in most respects we believe the proposals in the Outline will further the purposes of Section 1071, the proposed product coverage contains one glaring and deeply troubling omission: the proposal to exclude coverage of merchant cash advances (MCAs).

The Outline defines an MCA as a "form of short-term financing" in which a "merchant receives a cash advance *and promises to repay it* (plus some additional amount) by either pledging a percentage of its future revenue … or agreeing to pay a fixed daily withdrawal amount to the MCA provider *until the agreed upon payment amount is satisfied.*" As thus defined, there can be no question that an MCA falls squarely within the broad definition of "credit" in the Equal Credit Opportunity Act (of which Section 1071 is, of course, a part): "the right granted by a creditor to a debtor to … incur debts and defer its payment."[11] The fact that the amount of each payment and the number of payments may be indeterminate under an MCA is simply not relevant to the question of whether the agreement creates a debt as to which payment is deferred as the Bureau has recognized in analogous contexts.[12] Indeed, even in the context of factoring – which MCAs emphatically are not – Regulation B recognizes that "a credit extension incident to factoring" is covered by the ECOA.[13]

In order to exclude MCAs from the reach of 1071, then, the Bureau would have to rely on its exemption authority. But that authority is delimited: the Bureau is authorized to create exceptions "as the Bureau deems necessary or appropriate *to carry out the purposes of this section*."[14] It is simply inconceivable that exempting MCAs – which are targeted at sub-prime business owners who are disproportionately people of color,[15] have costs that translate into triple digit APRs, and "bear a striking resemblance to the destructive cycle of payday lending[16] -- would in any way further the purposes of Section 1071. To the contrary, such an exemption would create a huge blind spot in the 1071 landscape and create an open door to evasions, enabling lenders to restructure their loans into advances to escape reporting under Section 1071.

The only explanation offered in the Outline for the proposed exclusion of MCAs is that their inclusion "may add additional complexity or reporting burden given the unique structure of the transactions." But most of the 1071 data points pertain to the applicant (e.g. revenue, years in business) or the application (e.g. purpose of loan, amount applied for) and those should not be any more difficult to collect for an MCA provider than for any other type of lender. And although the pricing structure of

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[11] 15 U.S.C. § 1691a(d)

[12] *Cf. CFPB v. RD Legal Funding,* No. 1-17-cv—00890 (S.D.N.Y.), https://files.consumerfinance.gov/f/documents/201702_cfpb_RD-Legal-complaint.pdf

[13] 12 C.F.R. 1002.9(a)(3)- Comment 2

[14] 15 U.S.C. § 1691o-2(g)(2),

[15] Mills, *The State of Small Business Lending* at p.45, https://www.hbs.edu/faculty/Publication%20Files/15-004_09b1bf8b-eb2a-4e63-9c4e-0374f770856f.pdf

[16] Opportunity Fund, *Unaffordable and Unsustainable: The New Business Lending,* *https://www.opportunityfund.org/wp-content/uploads/2019/09/Unaffordable-and-Unsustainable-The-New-Business-Lending-on-Main-Street_Opportunity-Fund-Research-Report_May-2016.pdf*

MCAs differs somewhat from other forms of credit, each MCA has an amount that is added to the principal that the MCA must recover to discharge the borrower's obligation so the pricing data point can be easily adapted to MCAs. Accordingly, MCAs should be included within the Bureau's 1071 proposal.

Finally, while we distinguish MCAs from factoring, we concur with recommendation by the National Community Reinvestment Coalition and others to include factoring under coverage of this rule.

Data Points

We generally support the approach taken in the Outline with respect to data points. In particular, we think it is vitally important for the Bureau to exercise its discretionary authority under Section 1071 to collect data on pricing in order to facilitate enforcement of fair lending laws. Absent such data, lenders could, without being detected, artificially inflate their approval rate of applications from people of color by "approving" such loans at exorbitant interest rates. In order to be able to identify discrimination in lending, data is needed both with respect to whether an application was approved and at what price.

The Outline expresses concern that "reporting pricing information across various product types could be complicated to implement." This is an issue with which several states have recently wrestled in enacting disclosure requirements for small business loans, and those states' laws may offer a workable solution to this challenge.[17] However, if the Bureau were to conclude that developing a common metric such as an annualized percentage rate across multiple closed-end and open-end product types is too complex or too time consuming for this rulemaking, the Bureau could sidestep that complexity and still provide transparency into pricing by, at a minimum, requiring reporting of (i) total upfront costs paid by the borrower in connection with the origination of the loan; (ii) the interest rate on the loan; and (iii) annual costs assessed in connection with the loan (including, in the case of open-end credit, costs incurred after origination for advances). Indeed, even if the Bureau were able to define a method for calculating the APR on open-end loans, the Bureau also should require reporting of these pricing components to enhance transparency and enable meaningful comparisons.[18]

We also urge inclusion of a data point about the credit profiles used for the application. Data collection should include whether the credit report used is that of the business or the personal report and score of the principal owner(s). If personal scores are used, the credit score range should be included.

Compiling, maintaining and reporting 1071 data to the Bureau

Section 1071 provides for data to be reported to the Bureau on an annual basis. However, as previously noted, the Bureau has the authority to create "exceptions to any requirement … as the Bureau deems necessary or appropriate to carry out the purposes of this section." We urge the Bureau to include in its NPRM a proposal to exercise this exception authority to require more frequent reporting by larger FIs much as it has done under HMDA.

The events of the past nine months demonstrate that, in time of economic crisis, policymakers and private actors alike need data in real time in order to gauge what is happening in the market and take appropriate action. The dearth of reliable data about the state of small business lending has hampered

[17] For instance, New York and California provide excellent solutions from which to draw.

[18] For merchant cash advances, instead of requiring reporting of interest rates, the Bureau should require reporting of the "factor rate" which is stated as a multiple of the loan amount and determines the total cost that the borrower will pay along with the percentage of sales revenue assigned to the lender.

the government's response to the crisis. The 1071 rulemaking provides the Bureau with an opportunity to build into 1071 a framework for monthly or quarterly reporting, taking advantage of digital technology that did not exist when HMDA reporting began. The Bureau should at a minimum include this in the NPRM in order to solicit comments.

For smaller entities we agree that annual reporting makes sense. The Outline proposes that the collection would take place on a calendar year basis. However, the Bureau may want to consider having the annual periods run from July 1st to June 30th to avoid burdening FIs and the Bureau with data reporting under HMDA and 1071 concurrently. In all events, and regardless of what reporting period is chosen, we urge the Bureau to establish the implementation date at the earliest possible date after the rule is finalized, even if that means that the initial reporting period is less than a twelve-month period.

Working with Treasury, the SBA and the Prudential Regulators

We recognize that, even on the schedule we have proposed, it will take time before a final rule is issued and implemented. That makes it especially important during this interim period for the CFPB to support businesses owned by people of color by working closely with Treasury and the SBA as the PPP forgiveness process continues, and if PPP is extended in subsequent legislation, to implement and require a robust data collection and public reporting process for all PPP loans and to ensure that SBA and lenders are adequately serving all small businesses and markets. Transparency is essential to this program, and true transparency and impact can only be determined if data is collected and analyzed. Thus, CRL recommends that the Bureau undertake a thorough analysis of the now publicly available PPP dataset. Furthermore, the Bureau should review at least five years of SBA lending data by large, regional, and small financial institutions.

Furthermore, we believe that the CFPB should work with the Treasury, the SBA and the prudential regulators to establish, monitor, and enforce an affirmative duty to fairly serve all small business borrowers; and establish affordable small business lending goals for all credit providers. The prudential regulators should require lenders covered by the Community Reinvestment Act to include a robust small business community reinvestment requirement that includes loans approved for small businesses and for business owners where the business credit runs through the personal credit profile. The CFPB should work with all financial regulators to ensure that equitable small business lending is considered in CRA evaluations.

We also urge the Bureau to more broadly inform lenders of the potential to use special purpose credit programs (SPCPs) in order to facilitate extension of responsible credit favorably designed for underserved communities. The Equal Credit Opportunity Act (ECOA) and Regulation B permits lenders to create special purpose credit programs to target credit to meet the social needs and benefit underserved populations.[19] This tool can be used to help remediate lack of access to safe and responsible credit by small business owners of color who have a history of being denied SBA loans.

[19] To address potential regulatory uncertainty, we point to the recently published work of the NFHA and Relman Colfax PLLC. This work explains how ECOA coexists within the regulatory framework with the Fair Housing Act and sections 1981 and 1982 of the Civil Rights Act of 1866. Relman Colfax LLC and National Fair Housing Alliance, *Special Purpose Credit Programs: How a Powerful Tool for Addressing Lending Disparities Fits Within the Antidiscrimination Law Ecosystem* (Nov. 2020), https://nationalfairhousing.org/wp-content/uploads/2020/11/NFHA_Relman_SPCP_Article.pdf.

The Bureau should coordinate with SBA and the prudential regulators to ensure lenders have confidence that SPCPs do not conflict with other civil rights laws; rather, they promote the purposes of those laws. At the same time, as the Bureau encourages special purpose credit programs (SPCPs), it should clarify that to the extent state laws prohibit considering characteristics in credit decisions when such consideration is needed to administer a SPCP, those state laws are preempted.

Similarly, the Bureau must emphasize that SPCPs are for responsibly designed programs. They are not a license to offer borrowers a slightly less predatory version of a predatory product, which is more likely to extract wealth than to promote financial stability.

Conclusion

We thank the Bureau for consideration of our comments and would be happy to discuss them further.

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