



January 6, 2022

The Honorable Rohit Chopra
Director, Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

Re: Notice of Proposed Rulemaking on Small Business Lending Data Collection, Docket No. CFPB-2021-0015; RIN 3170-AA09

Dear Director Chopra:

The Office of Advocacy of the U.S. Small Business Administration (Advocacy) submits this letter in response to the Bureau of Consumer Financial Protection's (CFPB) notice of proposed rulemaking (NPRM) on small business lending data collection. The proposed rulemaking would implement section 1071 of the Dodd-Frank Act.

Advocacy recognizes the importance of the goals of Section 1071. If implemented properly, the information could provide valuable insight into lending practices and possibly fill gaps in data describing lending for small, minority or women owned businesses. It may also facilitate enforcement of fair lending laws and enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses.¹ However, Advocacy is concerned that the CFPB's approach may be unnecessarily burdensome to small entities, may impact the cost of credit for small businesses and may lead to a decrease in lending to small, minority- and women-owned businesses. Advocacy is also concerned that the manner in which the statute is being implemented may lead to false assumptions and produce skewed results. In particular, Advocacy is primarily concerned about the definition of small business, the scope of coverage, the discretionary data points, the visual identification requirement, the implementation date, and the cost of credit for small businesses.

¹ 15 USC 1691 c-2.

Extension Request

On November 23, 2021, the Office of Advocacy submitted a request for extension of the comment period for this rulemaking. As noted in the letter, the proposed rule is over 900 pages and seeks important information about the potential costs of the proposal. The small entities that will be required to comply with the regulation are in the best position to provide the CFPB with information about the potential costs associated with the proposal, but the amount of time provided for the comments is insufficient. This information is crucial for determining the economic impact of the rule and for considering less costly alternatives as required by the Regulatory Flexibility Act (RFA). Advocacy reiterates the need for an extension of the comment period for this rulemaking and reserves the right to submit supplemental comments.

Advocacy Background

Advocacy was established pursuant to Pub. L. 94-305 to represent the views of small entities before federal agencies and Congress. Advocacy is an independent office within the U.S. Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The Regulatory Flexibility Act (RFA),² as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),³ gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.

The Small Business Jobs Act of 2010 requires agencies to give every appropriate consideration to comments provided by Advocacy.⁴ The agency must include, in any explanation or discussion accompanying the final rule's publication in the Federal Register, the agency's response to written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.⁵

Section 1071

In 2010, Congress passed the Dodd-Frank Act. Section 1071 of that Act amended the Equal Credit Opportunity Act (ECOA) to require that financial institutions collect and report to the CFPB certain data regarding applications for credit by women-owned, minority-owned, and small businesses. Section 1071's statutory purposes are to (1) facilitate enforcement of fair lending laws, and (2) enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses. Section 1071 specifies a number of data points that financial institutions are required to collect and

² 5 U.S.C. § 601 et seq.

³ Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).

⁴ Small Business Jobs Act of 2010 (PL 111-240) § 1601.

⁵ Id.

report, and also provides authority for the CFPB to require any additional data that the CFPB determines would aid in fulfilling section 1071's statutory purposes. Section 1071 also contains a number of other requirements, including those that address restricting the access of underwriters and other persons to certain 1071 data, recordkeeping, publication of 1071 data, and modifications or deletions of data prior to publication in order to advance a privacy interest.

Section 1071 directs the CFPB to prescribe such rules and issue such guidance as may be necessary to carry out, enforce, and compile data pursuant to section 1071, and permits the CFPB to adopt exceptions to any requirement or to exempt financial institutions from the requirements of section 1071 as the CFPB deems necessary or appropriate to carry out the purposes of section 1071. The CFPB is proposing to add a new subpart B to Regulation B to implement the requirements of section 1071.3. Key aspects of the CFPB's proposal are summarized below. If finalized, the CFPB's proposed rule would create the first comprehensive database of small business credit applications in the United States. This would include critical information about women-owned and minority-owned small businesses to help regulators and the public identify and address fair lending concerns. The database would also enable a range of stakeholders to better identify business and community development needs and opportunities for small businesses, including women-owned and minority-owned small businesses.

The Small Business Regulatory Enforcement Fairness Act

Section 609 of the RFA requires the CFPB to conduct special outreach efforts to ensure that small entity views are carefully considered prior to the issuance of a proposed rule, if the rule is expected to have a significant economic impact on a substantial number of small entities.⁶ The Bureau convened a SBREFA panel on small business lending data on October 15, 2020 and conducted a virtual outreach meeting with small entity representatives ("SERs") on October 19-22, 2020. In advance of the panel outreach meeting, the CFPB, Advocacy, and OIRA held a series of telephone conferences with the SERs to describe the small business review process, obtain important background information about each SER's current business practices, and discuss selected portions of the proposals under consideration. The panel issued its report on December 14, 2020.⁷

⁶ Section 609 small business advocacy review panels consist of representatives from the rulemaking agency, the Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA), and the Chief Counsel for Advocacy. The panel solicits information and advice from small entity representatives (SERs), who are individuals who represent small entities affected by the proposal. SERs help the panel better understand the ramifications of the proposed rule. The product of a SBREFA panel's work is its panel report and recommendations on the regulatory proposal under review.

⁷ *The Final Report of the Small Business Review Panel on the CFPB's Proposals Under Consideration for the Small Business Lending Data Collection Rulemaking* (hereinafter "Panel Report"), December 14, 2020.

The Proposed Rule

On October 8, 2021, the CFPB published a notice of proposed rulemaking in the Federal Register entitled *Small Business Lending Data Collection under the Equal Credit Opportunity Act*.⁸ The CFPB is proposing to require financial institutions to collect and report Sec. 1071 data regarding applications for credit for small businesses, including those that are owned by women and minorities. The CFPB is not proposing to require that financial institutions collect and report data regarding applications for women-owned and minority-owned businesses that are not small.

Advocacy is primarily concerned about the costs associated with the proposed rule, the definition of small business, the scope of coverage, the discretionary data points, the visual identification requirement, the implementation date, and the cost of credit for small businesses.

The CFPB prepared an initial regulatory flexibility analysis (IRFA) for the proposed rule. The IRFA provides information about the potential economic impact of the proposed rule and considers alternatives that would minimize that impact. Advocacy asserts that the economic impact may be underestimated, the rule may be unnecessarily burdensome for small entities, and there may be less costly alternatives.

The CFPB Underestimated the Costs of the Proposed Rule

In the IRFA, the CFPB estimates that the overall market impact of one-time costs is between \$143 million and \$153 million for small depository institutions and \$63 million for small non-depository institutions. The overall market impact of ongoing costs will be between \$112 million and \$126 million per year for small institutions.

Advocacy asserts that the CFPB may have underestimated the costs of the NPRM. Indeed, the CFPB acknowledges that several SBREFA panel SERs considered its estimate of training costs, for example, to be too low.⁹ Given that compliance potentially involves new software, new forms and applications, and new policies and procedures, one-time training hours could be underestimated in Tables 10-12. Moreover, it is not clear in the analysis who is providing training or how it would be conducted (one-on-one, group, or prerecorded). CFPB should include any cost to provide training either internally or through a vendor.

Furthermore, stakeholders have indicated that other estimated compliance costs are too low.¹⁰ An accurate estimation of the costs associated with the proposed rule is crucial in determining less costly alternatives. Advocacy encourages the CFPB to give full consideration to the cost information that is already in the record and any cost

⁸ 86 FR 56356.

⁹ 86 FR at 56560.

¹⁰ Advocacy understands that the trade associations that represent small financial institutions may be submitting authoritative information about the costs associated with the NPRM.

information that may be submitted and to analyze more fully the financial burden of this rulemaking on small entities.

Scope of Coverage

The CFPB is proposing to apply the Section 1071 requirements to “covered financial institutions.” A “financial institution” would be any partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity that engages in any financial activity. If a financial institution originated at least 25 credit transactions that would be “covered credit transactions” to “small businesses” in each of the two preceding calendar years, the financial institution would fall within the scope of the proposed rule.¹¹

Stakeholders have indicated that the 25 originations threshold is too low, and that sufficient data to satisfy the requirements of the statute can be obtained at a higher threshold. CFPB states in the NPRM that setting a reporting threshold above 25 originations “would result in the elimination of data that are important in fulfilling the purposes of section 1071.”¹² However, the CFPB has not analyzed the data fully to determine if a higher threshold would garner an appropriate amount of information. Table 18 shows the number of covered small depository institutions for several possible thresholds.¹³ However, this table is incomplete. It may be more meaningful if the CFPB included some estimates of how much data would be foregone (or how much the scope of data would be limited) at each of the origination thresholds.

Moreover, although the CFPB describes an alternative 100-origination threshold, the CFPB could consider other alternatives by supplementing its analysis with an analysis of a 50-origination threshold alternative, a 200-threshold analysis, and a 500 originations analysis. In each case, CFPB should estimate how significant the compliance costs would be for institutions operating at each originations level. Such information would assist in determining a threshold that produces a meaningful amount of data while limiting the burden on small entities.

Definition of Small Business

The CFPB is proposing that covered financial institutions collect and report data regarding covered applications from small businesses. The CFPB is proposing to define “small business” by reference to the definitions of “business concern” and “small business concern” as set out in the Small Business Act and Small Business Administration (SBA) regulations. However, in lieu of using the SBA’s size standards for defining a small business concern, the CFPB’s proposed definition would look to whether the business had \$5 million or less in gross annual revenue for its preceding fiscal year.

¹¹ 86 FR at 56573.

¹² Id.

¹³ 86 FR at 56574.

Advocacy has held several roundtables on the topic of 1071 and submitted a comment letter on the CFPB's request for information on section 1071 on September 17, 2017. At that time, Advocacy encouraged the CFPB to perform outreach with small entities and to work with Advocacy and SBA's Office of Size Standards to develop a workable solution.

Moreover, the SBREFA panel SERs generally preferred a simple small business definition and expressed concern that the SBA's approach to defining a small business, which bases classification on an applicant's 6-digit NAICS code, is relatively complex.¹⁴ The Panel recommended that the Bureau seek to adopt a definition of "small business" for Section 1071 purposes that is easy for small business applicants to understand and straightforward for financial institutions to implement, while still collecting comprehensive data regarding lending to small businesses.¹⁵

Advocacy commends the CFPB for proposing an alternative size standard. At \$5 million, approximately 97 percent of small businesses will be covered. However, some stakeholders have indicated that the \$5 million definition for a small business may be burdensome for small financial institutions to implement to the extent that some small financial institutions may forgo making business loans. Advocacy encourages the CFPB to analyze other possible definitions to determine if there is a lower amount that will garner a sufficient amount of data without creating a situation where smaller banks may decide to discontinue business loans.

Data Points

Pursuant to the Section 1071, a covered financial institution would be required to collect and report certain data regarding covered applications from small businesses. Certain data points such as race, ethnicity, sex, business size, application number, application date, amount applied for, amount approved, loan type, loan purpose, annual gross revenue, census tract, and action taken are required by the Dodd Frank Act. Section 1071 also allows for discretionary data points which are determined by the CFPB.

Visual Identification

Section 1071 of the Dodd-Frank Act provides that financial institutions must inquire about whether a business is women-owned, minority-owned or a small business. It further states that an applicant may refuse to provide the information to the financial institution. The NPRM provides that the applicants do not have to provide the information. However, if the applicant does not provide the information, the financial institution must provide it based on visual observation or surname.¹⁶

¹⁴ Panel Report, page 20.

¹⁵ Panel Report, page 47.

¹⁶ 86 FR at 56582.

During the SBREFA panel, the SERs expressed apprehension about visual observation. The SERs supported applicants' self-reporting of principal owners' race, sex, and ethnicity and strongly preferred that financial institutions not be required to report based on visual observation or surname analysis. Some SERs stated that visual observation is both extremely difficult and ineffective, and that collecting demographic information based on visual observation would make staff uncomfortable. Moreover, the financial institution does not always meet with all principal owners of a business in person and financial institutions occasionally meet with a manager or officer who might not be a principal owner.¹⁷ In such a situation, the visual observation is pointless.

Requiring a loan officer to provide information based on visual observation or surname is problematic. The data collected in this way could be corrupted by bias, whether deliberate or not, or other forms of discrimination, which is in direct opposition to the intent of Section 1071. It is doubtful that this problem can be overcome even with specific sensitivity training – an added cost – and good motive. As it goes against the intent of Dodd-Frank to obtain valid information and even well trained and well-motivated financial institutions could make wrong assumptions and taint the quality of the data, Advocacy recommends that this requirement be deleted.

Discretionary Data Points

Section 1071 requires financial institutions to collect and report any additional data that the CFPB determines would aid in fulfilling the purposes of section 1071 such as discretionary data points. The CFPB is proposing several additional data points that rely solely on this authority. Specifically, the CFPB is proposing that financial institutions collect and report data on application channel, application recipient, denial reasons (for denied applications only), pricing information (for applications that are originated or approved but not accepted), NAICS code, number of workers, time in business, and number of principal owners.¹⁸

The SERs provided detailed feedback on the topic of the costs of discretionary data points. For example, one SER stated that the cost of collecting and reporting the discretionary data points under consideration would be significant, and another SER stated that the CFPB should include as few data points as possible to avoid unnecessary costs.¹⁹

Several SERs were concerned about the CFPB potentially making public the pricing data it receives and felt that this choice could be costly and challenging to carry out. They were concerned that bad outcomes could result from possible unjustified fair lending concerns, such as distortions to the market through interference with risk-based pricing. Many SERs remarked that pricing is complex and often unique to the applicant's situation, and may involve extra services bundled with the loan, and without adequate context pricing data could lead to inaccurate interpretations and reputational damage to

¹⁷ Panel Report, page 33.

¹⁸ 86 FR at 56563.

¹⁹ Panel Report, page 35.

financial institutions. Another SER said that pricing for some products may reflect more than just the cost of the loan and may be high relative to other credit products if the covered financial institution is a supportive lender working with less established or higher credit risk applicants over a period of time. Some SERs also expressed privacy-related concerns regarding public disclosure of pricing information.²⁰

Stakeholders are also concerned that the discretionary data points will be costly, particularly the pricing data point, because it can lead to invalid assumptions that may damage the reputation of the institution. Although the CFPB asserts that not collecting pricing information would obscure possible fair lending risk by covered financial institutions,²¹ the price may have nothing to do with the race or sex of the applicant. It may be based on other risk factors such as credit score, time in business, or other factor that may make the applicant a higher risk applicant. Assuming that it is due to a fair lending violation could harm the institution's reputation and business.

There is also a concern that the discretionary data points may interfere with an applicant's privacy. The discretionary data points could be reverse engineered to determine what business was denied credit. This may be especially true in small communities.

Advocacy encourages the CFPB to disregard the discretionary data points. They are not required by the statute, yet they are costly and potentially problematic in terms of privacy. A less costly alternative would be to restrict the collection of data to the statutorily required data points.

Automobile Dealers

Advocacy is concerned about the impact of the rule on small dealerships that may issue credit directly in the form of loans or leases. Those dealerships may be potentially covered by the rulemaking. However, according to the National Automobile Dealers Association, many dealers act as intermediaries between buyers and financial institutions. As such, they may be asked to support financial institutions' compliance with this rule.²² Advocacy encourages the CFPB to work with small automobile dealers to make the direct and indirect impacts of this rulemaking as least burdensome as possible.

Cost of Credit for Small Entities

Pursuant to 5 USC§603 (d)(1) the CFPB must provide the following in its IRFA:

A description of-

(A) any projected increase in the cost of credit for small entities;

(B) any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any increase in the cost of credit for small entities; and

(C) advice and recommendations of representatives of small entities relating to issues described in subparagraphs (A) and (B) and subsection (b).

²⁰ Panel Report, page 35.

²¹ 86 FR at 56563.

²² Letter from NADA to the CFPB, December 14, 2020.

In the IRFA, the CFPB provides a detailed discussion on the impact of the proposal on small entities. In the discussion, the CFPB acknowledges that financial institutions may raise rates or fees on small business products.²³ The CFPB estimates that the additional costs may be \$28, \$24 or \$7, based on the type of financial institution. Advocacy asserts that the additional costs may be underestimated. If financial institutions charge an application fee, the fee may be a disincentive for small businesses to shop for a better priced loan. As such, the overall cost of credit may be higher than indicated.

Advocacy appreciates the fact that the CFPB has acknowledged that this rulemaking will impact the cost of credit for small businesses. However, the CFPB's obligation under the RFA goes beyond simply acknowledging the increase in the cost of credit. As noted above, the CFPB is required to discuss the alternatives which minimize any increase in the cost of credit, as well as include advice and recommendations from representatives of small entities on the issue. Advocacy encourages the CFPB to take the necessary steps to minimize the additional costs and provide a discussion about the alternatives that were considered to minimize the increase in the cost of credit.

Implementation Date

The CFPB is proposing that its final rule to implement Section 1071 would become effective 90 days after that final rule's publication in the Federal Register. However, compliance with the final rule would not be required until approximately 18 months after publication in the Federal Register.

SERs generally supported a two-year implementation period. Several SERs with completely online operations felt that two years was sufficient time to implement the eventual 1071 rule; some estimated that they could do it in less time. Some other SERs that do not have primarily online operations and do not have experience with other federal data reporting regimes such as HMDA said it would be hard to project how long implementation would take, but that it could potentially take three years or more. One SER said that two years would not be enough as currently there are no data collection vendors for 1071 compliance.²⁴

At Advocacy's roundtable, the participants stated that an 18-month implementation period was inadequate. They indicated that it may take 3 years for small financial institutions to comply with the requirements of 1071. Unlike the implementation of HMDA, the financial institutions are not building on a system that is already in place. Instead, they are developing a new data collection system. As such, sufficient time is necessary for the small financial institutions to comply with the rulemaking. Advocacy encourages the CFPB to consider an implementation period of 3 years or longer.

²³ 86 Fed Reg at 56575.

²⁴ Panel Report, page 39.

Conclusion

Advocacy recognizes the importance of the goals of Section 1071. However, Advocacy is concerned that the CFPB's approach may be unnecessarily burdensome to small entities, may impact the cost of credit for small businesses and may lead to a decrease in lending to small, minority- and women-owned businesses. Advocacy is also concerned that the manner in which statute is being implemented may lead to false assumptions and produce skewed results. For the reasons noted above, Advocacy encourages CFPB to address these concerns of small businesses; we would be happy to lend any assistance we can in minimizing the impact of this important rule.

Thank you for the opportunity to comment on this important proposal and for your consideration of Advocacy's comments. If you have any questions regarding these comments or if Advocacy can be of any assistance, please do not hesitate to contact me or Jennifer Smith at (202) 839-5600.

Sincerely,

/s/

Major L. Clark, III
Deputy Chief Counsel
Office of Advocacy
U.S. Small Business Administration

/s/

Jennifer A. Smith
Assistant Chief Counsel
for Economic Regulation & Banking

Copy to: Sharon Block
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