Center for Responsible Lending
National Association for Latino Community Asset Builders
National Coalition for Asian Pacific American Community Development
National Alliance of Community Economic Development Associations
National Fair Housing Alliance
United States Hispanic Chamber of Commerce
National Asian/Pacific Islander American Chamber of Commerce and Entrepreneurship
National Council of Asian Pacific Americans
National Federation of Filipino American Association
Main Street Alliance
Partner Community Capital
League of United Latin American Citizens
Small Business for America's Future
Empowering Pacific Islanders

Comment to the Consumer Financial Protection Bureau on the Notice of Proposed Rulemaking Small Business Lending Data Collection Under the Equal Credit Opportunity Act Regulation B Docket No. CFPB-2021-0015 RIN 3170-AA09

January 6, 2022

Submitted electronically to www.regulations.gov

January 6, 2022

Director Rohit Chopra
Attn: Comment Intake—Section 1071 Small Business Lending Data Collection Bureau of Consumer Financial Protection
1700 G Street NW Washington, DC 20552

Re: Docket No. CFPB-2021-0015, Small Business Lending Data Collection Under the Equal Credit Opportunity Act (Regulation B)

This letter is submitted on behalf of a broad coalition of national and community-based organizations that share a common interest in advocating on behalf of small businesses owned by people of color and women. We appreciate the opportunity to comment on the proposed rule amending Regulation B to implement changes to the Equal Credit Opportunity Act (ECOA) made by section 1071 of the Dodd-Frank Act.

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. CRL is an affiliate of the Center for Community Self Help, a national community development organization which includes two credit unions and a non-profit loan fund all of which seek to help low-wealth borrowers buy homes, start and build businesses, and strengthen community resources, across the United States. We refer to this family of companies as "Self-Help."

NALCAB is a national non-profit membership association of mission-driven opportunity and economic development organizations that serve diverse Latino communities in 40 states, Washington D.C., and Puerto Rico. NALCAB works to strengthen the economy by advancing economic mobility in Latino communities.

National CAPACD is a coalition of nearly 100 community-based organizations spanning 21 states and the Pacific Islands. Its members work in low-income Asian American and Pacific Islander (AAPI) communities and neighborhoods to build social and economic justice for all. National CAPACD supports its member organizations to employ a diverse set of strategies tailored to local community needs, including small business training and technical assistance, housing counseling and financial empowerment services.

CRL, NALCAB, and National CAPACD, along with the eleven undersigned organizations submitting these comments represent a broad and diverse group that includes national community development organizations, credit unions, civil rights advocates, and mission-driven non-profits and share a common interest in advocating on behalf of small businesses owned people of color and women.

I. Introduction

From the Big Tech firms to Main Street shops and restaurants, every business at its inception was a small business. The ability to start and grow a business has been and remains a pathway to economic prosperity for millions of Americans. Next to owning a home, business equity is the second largest source of wealth in the United States. Business owners' wealth is nearly 2.5 times higher than their non-business owning counterparts. This difference in wealth is compounded for men and women of color— for example, the median net worth of Black and Latino business owners is each over ten times higher than the median net worth of Black people and Latinos generally.[1]

But it is challenging to start and even more difficult to scale a business without access to capital. That is especially true for people of color given the enormous wealth gap that exists in the United States. Thus, it is hardly surprising that businesses owned by people of color are underrepresented relative to their population size especially when it comes to businesses with employees. For instance, Black people represent 13.4 percent of the U.S. population, but Black-owned businesses make up 2.2 percent of the nation's 5.7 million employer businesses; indeed, only 3.8 percent of Black-owned businesses are employer businesses, a rate nearly one-fifth the rate for whites.[2] Similarly, Latino people represent 18.5 percent of the U.S. population, but Latino-owned businesses make up 5.8 percent of the nation's employer businesses, and just 7.8 percent of Latino-owned businesses are employer businesses.[3]

And although Asian-owned businesses are not, in the aggregate, underrepresented in terms of business ownership rate, existing data that treats Asian business owners as a homogenous identity with shared economic realities inadequately captures the immense economic divide across the AAPI population. When viewed as an aggregate, Asians have a higher median household income, $85,800, and a lower likelihood to live in poverty, 10 percent, than the U.S. population at large. However, when looking at individual ethnic groups within the US population, economic prosperity is widely varied. For instance, the median household income for Indian Americans is $119,000, whereas among Hmong Americans' median household income is $68,000. Similarly, while only 6 percent of Indian Americans are living in poverty, 16 percent of Hmong Americans are living in poverty.[4] Because there is substantial variation of economic outcomes within the AAPI community, Asian Americans have the greatest level of economic

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[1]Darity Jr. *et al, What We Get Wrong About Closing the Racial Wealth Gap,* *https://socialequity.duke.edu/wp-content/uploads/2020/01/what-we-get-wrong.pdf*

[2] Calculations for employer businesses made using the U.S. Census Bureau's 2018 Annual Business Survey "Statistics for Employer and Nonemployer Firms by Industry, Sex, Ethnicity, Race, and Veteran Status for the U.S.: 2018"; population statistics calculated from the U.S. Census Bureau's 2019 American Community Survey "Annual Estimates of the Resident Population by Sex, Age, Race, and Hispanic Origin for the United States".

[3] *Ibid*

[4] Pew Research Center, *Fact Sheets: Asian Americans,* https://www.pewresearch.org/social-trends/collection/asians-in-the-united-states/

inequality within any racial group in the U.S.[5] By flattening the economic realities of the AAPI community, which consists of 22 million individuals from over 20 different countries, into a singular racial demographic, the economic challenges faced by Asians are hidden within the aggregated data.

Furthermore, without accounting for differences in economic opportunity across ethnic groups, the AAPI community is often perceived as a "model minority" surpassing national averages in wealth building and business ownership. However, viewing Asian American, and Native Hawaiian and Pacific Islander (NHPI) groups as a singular racial designation masks many of the unique barriers to starting and growing businesses faced by these different ethnic groups. For instance, as previously mentioned, some racial groups are underrepresented in terms of business ownership. Often conflated with Asian business ownership rates, when viewed as a separate racial category, NHPI individuals represent 0.25% of the population, but NHPI-owned businesses constitute only 0.12% of the nation's employer owned businesses.[6]

Moreover, variation in wealth building opportunities to different ethnic groups across the AAPI community is not limited to business ownership. Analyzing disaggregated data from Home Mortgage Disclosure Act (HMDA), the Consumer Financial Protection Bureau found that the factors determining the affordability and likelihood of approval for a mortgage vary across different ethnicities within the AAPI community. For example, NHPI borrowers were less likely to take out a conventional loan than Asian borrowers. Evident of this difference, more than a third of Filipino borrowers took out FHA or VA loans whereas only 4% of Chinese borrowers took out FHA or VA loans.. These differences provide just one example of how access to credit varies across different ethnicities within the AAPI community.[7]

In addition to there being fewer wealth building opportunities, such as small business ownership, available to people of color, small businesses owned by people of color tend not only to be smaller but also to have lower cash reserves and are more financially fragile than white-owned businesses. For example, a study by the JP Morgan Chase Institute found that while over half of all US small businesses had more than two weeks of cash reserves, 94% of small businesses in majority Black communities and 89 percent of small businesses in majority Hispanic communities had fewer than two weeks of cash reserves.[8]

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[5] Pew Research Center, Income Inequality in the U.S. Is Rising Most Rapidly Among Asians, https://www.pewresearch.org/social-trends/2018/07/12/income-inequality-in-the-u-s-is-rising-most-rapidly-among-asians/

[6] Calculations for employer businesses made using the U.S. Census Bureau's 2018 Annual Business Survey "Statistics for Employer and Nonemployer Firms by Industry, Sex, Ethnicity, Race, and Veteran Status for the U.S.: 2018"; population statistics calculated from the U.S. Census Bureau's 2019 American Community Survey "Annual Estimates of the Resident Population by Sex, Age, Race, and Hispanic Origin for the United States".

[7] Consumer Financial Protection Bureau, Data Point: Asian American and Pacific Islanders in the Mortgage Market, https://files.consumerfinance.gov/f/documents/cfpb_aapi-mortgage-market_report_2021-07.pdf

[8] Place Matters: Small Business Financial Health in Urban Communities (jpmorganchase.com)

The consequences of these inequities played out during the pandemic. For example, researchers found that during the first four months of the pandemic, the number of active Black business owners dropped by 19% and the number of Latino and Asian business owners dropped by 10% compared to only a 5% drop for white business owners.[9] Even among those businesses that survived, entrepreneurs of color report experiencing more severe revenue loss as a result of the pandemic than white entrepreneurs; indeed, 79% of Asian-owned firms, 75% of Black-owned firms and 67% of Latino-owned firms report that their businesses are in fair or poor financial condition compared to just over half of white-owned firms.[10]

Because small business owners of color generally have less personal and family wealth on which to draw than white small business owners – according to a study by the JP Morgan Chase Institute, the typical white small business owner has 2.5 times the liquid wealth of the typical Black small business owner and 1.5x time the liquid wealth of the typical Latino small business owner[11] – the credit-granting system has an especially important role to play in enabling businesses founded by people of color to thrive. There is considerable recent evidence, however, that far from meeting the needs of people of color, lenders are affirmatively discriminating against entrepreneurs of color who seek credit. Consider the following:

- A 2020 study analyzing data from the Kauffman Firm Survey (KFS) -- the only nationally representative longitudinal dataset that provides data on new businesses' access to capital, employment activities, credit scores, survival rates, and characteristics of the business owners, including race – found that new Black-owned businesses had only one-third of the capital of new white-owned businesses. After controlling for a wide range of variables, including business characteristics, wealth, and credit score, the authors were able to account for only about one-third of that difference. Moreover, over the seven-year period covered by the study (2004 to 2011) Black-owned businesses were less able to attract capital than white-owned businesses, which was largely attributable to differences in the ability of Black-owned businesses to obtain bank loans and other forms of bank credit.[12]

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[9] The impact of COVID-19 on small business owners: Evidence from the first three months after widespread social-distancing restrictions - Fairlie - 2020 - Journal of Economics & Management Strategy - Wiley Online Library

[10] Federal Reserve Banks, *Small Business Credit Survey: 2021 Report on Firms Owned by People of Color,* *https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2021/sbcs-report-on-firms-owned-by-people-of-color*. *See also,* Federal Reserve Bank of Philadelphia, *Small Business Credit Survey: COVID-19 and Disparate Firm Conditions in the Philadelphia Metro Area,* *https://www.philadelphiafed.org/-/media/frbp/assets/community-development/reports/110321-sbcs-nj-report-final.pdf*

[11] JP Morgan Chase Institute, *Small Business Ownership and Liquid Wealth,* *https://www.jpmorganchase.com/institute/research/small-business/small-business-ownership-and-liquid-wealth-report*

[12] Fairlie, Robb & Robinson, *Black and Whites: Access to Capital Among Minority-Owned Startups,* https://www.nber.org/system/files/working_papers/w28154/w28154.pdf

- Surveys by a consortium of Federal Reserve Banks over the past several years have consistently found large disparities between the ability of white-owned businesses and businesses owned by people of color in obtaining credit. For example, the most recent survey found that Black-owned firms that applied for financing obtained the financing they sought at one-third the rate of white-owned firms, and Latino-owned and Asian-owned firms at 50% and 75% respectively the rate of white-owned firms. Even among firms with (self-reported) good credit scores, Black-owned firms were only half as likely as white-owned firms to obtain the financing they sought.[13]

- Analysis of the 2016 Annual Survey of Entrepreneurs found that business owners of color were nearly 50% more likely than white business owners to report that a lack of access to capital and the cost of capital had negatively impacted their business's profits. In particular, NHPI entrepreneurs expressed the highest level of concern among racial groups that their businesses' profits would be negatively impacted due to a lack of affordable capital. For instance, NHPI business owners were nearly two times more likely than white entrepreneurs to indicate that their businesses' profits were negatively impacted by both lack of access to capital and the cost of capital. Moreover, 6 in 10 NHPI business owners reported not seeking additional financing for their business, despite needing it, because they believed that their business loan would not be approved by a lender.[14]
- Studies of the PPP program have found that, as Brookings researchers wrote, "small businesses in communities of color had unequal access to federal COVID-19 relief."[15] Funds flowed to businesses in communities of color later than for businesses in white communities[16] and, consistent with their smaller size, Black-owned businesses obtained only 25% and Latino and Asian owned businesses only 50% of the amount received by white-owned businesses.[17] In the Federal Reserve Banks survey, there was between a 25 and 30 percentage point gap in PPP loan approvals between Black-owned and white-owned firms.[18] A recent report from Equifax summarizes the multiple factors that

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[13] *Small Business Credit Survey: 2021 Report of Firms Owned by People of Color,* *https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2021/sbcs-report-on-firms-owned-by-people-of-color*

[14] Robb, Alicia & Morelix *Startup Financing Trends by Race: How Access to Capital Impacts Profitability* Available at SSRN: https://ssrn.com/abstract=2859893

[15] Liu & Parilla, *New data shows small businesses in communities of color had unequal access to federal COVID-19 relief,* *https://www.brookings.edu/research/new-data-shows-small-businesses-in-communities-of-color-had-unequal-access-to-federal-covid-19-relief/*

[16] Fairlie & Fossen, *Did the $660 Billion Paycheck Protection Program and $220 Billion Economic Injury Disaster Loan Program Get Distributed to Minority Communities in the Early Stages of COVID-19,* *https://www.nber.org/system/files/working_papers/w28321/w28321.pdf*

[17] Howell *et al, Racial Disparities in Access to Small Business Credit: Evidence from the Paycheck Protection Program,* *https://www.nber.org/system/files/working_papers/w28321/w28321.pdf*

[18] Small Business Credit Survey -2021 Report on Firms Owned by People of Color.pdf (mbda.gov)

contributed to the fact that "PPP funds were not distributed equitably across race and gender."[19]

- A recent study by the National Community Reinvestment Coalition found that Black and Latino testers inquiring about small business loans were required to produce more documentation about their business than white testers; received less information about fees; and were less likely to be invited to schedule an appointment to apply for a loan.[20]

These recent studies confirm findings from a number of earlier research papers. For example, a 2010 study commissioned by the Department of Commerce's Minority Business Development Agency found that the denial rates for firms owned by people of color were roughly three times higher than for white-owned firms; white-owned firms obtained loans that were twice as large as firms owned by people of color; and firms owned by people of color that were able to obtain a loan paid higher interest rates on business loans than white-owned firms.[21] A 2015 study, drawing upon data from the Kauffman Firm Survey, found that, controlling for firm characteristics and owner characteristics, white-owned start-ups receive higher business credit scores than Black-owned start-ups and that even after controlling for these (biased) credit scores, white-owned start-ups were more favorably treated than Black, Latino or Asian owned start-ups with respect to access to credit lines.[22] And several studies using data from the National Survey of Small Business Finances found unexplainable disparities in the approval rates for white-owned firms as compared to firms owned by people of color.[23]

Although these studies are certainly suggestive of deep-seated problems in small business lending, it is nonetheless true that, as the Bureau stated in the proposed rule, "it is not possible with current data to confidently answer basic questions regarding the state of small business lending" and this "limitation is especially the case with regard to the race, sex, and ethnicity of small business owners."[24] The studies just cited are illustrative: the Kauffman Firm Survey, which provides the most robust longitudinal data, is limited to firms started in 2004 and the data ends in 2011; the Federal Reserve Bank surveys rely on a convenience sample rather than one that is nationally representative; and the PPP studies have had to use proxies to estimate racial disparities because the PPP program initially did not collect data on the race or ethnicity of the

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[19] Equifax,*Unlocking Entrepreneurship: The Role of Credit Access in the Small Business Recovery,* *https://www.americanbanker.com/whitepaper/entrepreneurship-role-of-credit-access-in-small-business-recovery*

[20] Disinvestment, Discouragement and Inequity in Small Business Lending (ncrc.org)

[21] Fairlie & Robb, *Disparities in Capital Between Minority and Non-Minority Owned Businesses,* *https://archive.mbda.gov/sites/mbda.gov/files/migrated/files-attachments/DisparitiesinCapitalAccessReport.pdf*

[22] Henderson *et al., Credit Where Credit is Due?: Race, Gender and Dsicrmnaton in the Credit Scores of Business Startups,* *https://journals.sagepub.com/doi/abs/10.1007/s12114-015-9215-4*

[23] Blanchflower *et al., Discriminaiton in the Small Business Credit Market,* *https://www.nber.org/system/files/working_papers/w6840/w6840.pdf* ; Bostic & Lampani, *Racial Differences in Pattern of Small Business Financing: The Importance of Local Geography,* *https://www.semanticscholar.org/paper/Racial-differences-in-patterns-of-small-business-of-Bostic-Lampani/a9db6ed82ea68a1122763a99d2fdae85e07e7fed*

[24] 86 Fed. Reg. 56356, 56362 (Oct. 8, 2021).

owners of the firms seeking PPP assistance. Indeed, in the PPP dataset released by the Small Business Administration for the first round of funding, demographic data is missing from most loans, with only 25% of loan records containing a racial or ethnic designation.[25]

To better understand small businesses in predominantly Latino and AAPI communities' relationship with small business lenders, two of the signers of this letter, the National Association of Latino Community Asset Builders (NALCAB) and the National Coalition for Asian and Pacific American Community Development (National CAPACD) distributed a survey to their respective member groups.[26] Those surveyed consisted of CDFIs, CDOs, and other mission-driven nonprofits that seek to economically empower Latino and AAPI communities. Through the collection of this survey data, NALCAB and National CAPACD were able to learn more about their clients' credit needs, types of credit and financial products used, and the unique challenges faced by their members when securing small business loan products.

The surveyed organizations estimate that about 70% of entrepreneurs they serve are underbanked. That is, they utilize mainstream financial institutions but are not necessarily using the variety of products and services these institutions offer. Among those surveyed, they reported that their clients are are most likely to rely on either family and friends/equity partners (60%) or personal credit cards (58%) as sources of credit for their businesses.When asked to identify what financial products their clients are using, survey respondents indicated that among their clients 28% use leasing arrangements, 21% take out traditional business loans from an FI, and 20% use Merchant Cash Advances (MCAs). These survey findings indicate a reliance on personal and non-traditional sources of spending, which is becoming an increasingly common inequity for entrepreneurs and communities of color.

Still, even within the collected survey responses there were noticeable differences between the financial lending experiences of NALCAB and National CAPACD clients. For example, a higher proportion of clients served by NALCAB member organizations, which are disproportionately Latino-owned businesses, take out loans under $50,000. Another key difference between the two survey groups is that clients served by National CAPACD member organizations are more likely to utilize mainstream banks whereas clients of Latino serving organizations are more likely to utilize nonprofit lenders.

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[25] Small Business Administration, Paycheck Protection Program (PPP) Loan Data – Key Aspects – Updated August 20, 2020, https://www.sba.gov/sites/default/files/2020-08/PPP%20Loan%20Data%20-%20Key%20Aspects%2008212020-508.pdf

[26] National CAPACD and NALCAB, in partnership with the UCLA Center for Neighborhood, distributed a survey questionnaire in November 2021 to better understand credit access among entrepreneurs of color. The survey was conducted via SurveyMonkey and was distributed to small non-profit organizations that provide services to small businesses only. The reported analysis is based on the survey responses collected with a sample size of n=43.

Evident within the survey responses is how the impact of COVID-19 on small businesses was exacerbated for small businesses owned by people of color. Relaying their personal experiences, serving small businesses in Latino and AAPI communities, survey respondents noted how pandemic-induced temporary closures, limited access to affordable, non-predatory credit, and a lack of in-language support from lenders offering PPP loans, were the biggest challenges facing their clients. One survey respondent described how "requests for technical assistance for both accessing relief resources and starting new businesses" tripled. Multiple survey respondents discussed the challenges limited English speakers face when seeking in-language support from their lender. In relaying these challenges, a respondent shared how one of her clients, a Vietnamese business owner, sought assistance applying for PPP loan forgiveness. This client was unsure how to find their PPP loan number, required information for a loan forgiveness application, and their lender did not offer any in-language support. One of the many reasons that small businesses are likely to feel "intimidated by banks and prefer smaller, more relationship-based lenders" is because traditional lenders do not provide inclusive customer service, e.g. translated loan documents, to English-limited borrowers.

As previously noted, many survey respondents are increasingly turning to personal and non-traditional sources of funding and assistance, such as friends and financial services outside of mainstream banking institutions. This represents a growing unreached population whose data cannot be officially collected, exacerbating existing inequities. For example, one grocer from Akron, OH, shared in her survey response that as newly-arrived refugees in the U.S. from Malaysia, "The freedom of being an entrepreneur is what makes me happy. I like being able to work for myself and set my own schedule." She added that she "...always wanted to open a restaurant and own my business but it was scary when we first came over." Undeterred, she took English as a Second Language (ESOL), U.S. citizenship, and sewing classes for a year and was eventually introduced by a friend to ASIA Inc., a linguistically and culturally-competent social service programming organization. ASIA Inc. provided the grocer with technical assistance, translation, and interpretation services necessary to successfully navigate application, loan, licensing, and transactional processes.

This story is echoed by many immigrants; according to the U.S. Current Population Survey, 5.1% of immigrants had their own businesses in comparison to 3.7% of U.S.-born individuals between 2010-2011.[27] As a respondent noted, "A trait of entrepreneurs and immigrants alike is persistence. From navigating taxes to visas, permits and deposits, immigrants develop the resilience necessary to navigate the obstacles of entrepreneurship, where courage and perseverance are often prerequisites for success. Similarly, setbacks when starting a business or selling a product are par for the course for entrepreneurs who must have grit to try again."

[27] Immigrant Policy Center, *Immigration Entrepreneurs: Creating Jobs and Strengthening the Economy,* https://www.americanimmigrationcouncil.org/sites/default/files/research/Hohn_-_Immigrant_Entrepreneurs_012512.pdf

It is precisely because of the challenges that small businesses, and especially those owned by people of color, experience in accessing financing and the lack of reliable data to dimension those challenges that Congress enacted Section 1071 of the Dodd-Frank Act. The purposes of that section are clearly set forth in § 1071(a): "to 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." And the need for the data that the Bureau's proposal contemplates collecting to achieve these purposes could not be more obvious. Without application-level, lender-level data about the characteristics of the applicant, the credit sought, and the action taken on the application (including both decisions to approve or deny and pricing decisions) it is not possible to begin to identify fair lending violations or, at least, fair-lending concerns that warrant further investigation. And without a comprehensive dataset reflecting the types and location of businesses that are unable to obtain the credit they need at affordable prices, both the public and private sector are severely handicapped in developing targeted programs to address inequities in access to credit and to assure that businesses owned by people of color obtain the support they need to realize their full potential and contribute to closing the enormous wealth gap.

Against this background, we turn to the specifics of the Bureau's proposal and offer our comments on a number of critical issues raised by the proposal.

II. The Proposed Rule

The Bureau's proposed rule represents an important step forward in implementing Section 1071, however belated that may be. We appreciate the thought and deliberation that went into crafting the proposal and agree with many – indeed most – of the judgments the Bureau has made along the way. We offer these comments with an eye to lifting up key provisions in the proposal that will have the greatest impact in supporting entrepreneurs of color as well as strengthening the final rule so that it can better achieve the purposes of Section 1071.

In doing so we are mindful that the more than 45 years of experience under HMDA teaches that the development of a data collection and reporting regime is inherently an iterative process. As new products, new underwriting approaches, and new technologies emerge – and as the Bureau gains experience with the data collected under the rule it promulgates – inevitably opportunities will arise to add and refine data points to better achieve the statutory purposes. Thus, we urge the Bureau to approach the rulemaking as the development of version 1.0 of a Section 1071 rule, recognizing that there will be future versions over time.

In concrete terms what this means is that the Bureau should make clear in the preamble to the rule it issues that the judgments it is making are based upon its current understanding and experience and that the Bureau intends to continue to monitor developments in the market and assess the efficacy of the Rule in achieving Section 1071's purposes. By making this clear at the outset the Bureau can lay the groundwork for future evolution of data collection under Section

1071 without being subject to claims that it is acting arbitrarily or capriciously in adjusting the rule going forward.

This is not to suggest that the Bureau should do anything less than optimize the rule that it promulgates based upon the best available evidence at present. For that reason, we offer the following specific comments with respect to various elements of the proposed rule to enable the rule to better achieve Congress' purposes.

A. Definition of Small Business

We agree with the Bureau that to facilitate compliance with 1071, the term "small business" needs to be defined in a manner that is relatively easy to operationalize. However, we believe that the second alternative that the Bureau had put forward in its SBREFA Outline – the alternative that encompassed manufacturing businesses with 500 or fewer employees and other businesses with gross revenue up to $8 million – provided an easily-implement definition which covered the vast bulk of small businesses as defined by the SBA without the complexities of the SBA's NAICS-code based definitions. In contrast, the Bureau's current proposal, by its own calculation, excludes 270,000 businesses that the SBA classifies as small businesses which represents approximately 5% of employer small businesses. 86 Fed. Reg. at 56433. Moreover, the Bureau's analysis shows that those businesses are disproportionately located within retail trades and construction, *id.* – industries in which businesses owned by people of color are most likely to be found. We therefore urge the Bureau to adopt the 500 employee/$8 million test as set forth in the SBREFA Outline.

Even if the Bureau were to decide to adhere to a test based solely on revenue, we believe the threshold chosen should align with SBA's definition of small business. SBA's website states that "most non-manufacturing businesses with average annual receipts under $7.5 million, will qualify as a small business."[28] At a minimum, then, the Bureau should adjust its proposed threshold from $5 million to $7.5 million.

B. Coverage of Merchant Cash Advances

In order for Section 1071 to succeed in achieving its stated objectives as set forth above it is essential that data be collected with respect to the full range of products, and from the full range of institutions, providing financing to small businesses. We view the proposal as an important step forward in this direction. The 25-loan threshold the Bureau has proposed for a financial institution to be exempt from reporting would result in reporting of 98% of loans by depository institutions and even the highest (100-loan) threshold the Bureau has indicated it is considering – while cutting the percentage of depository institutions required to report roughly in half -- would still capture approximately 95% of depository institution small business loans.

[28] https://www.sba.gov/federal-contracting/contracting-guide/basic-requirements

Of particular importance is the Bureau's proposal to include merchant cash advances (MCAs) within the scope of the rule. This represents a substantial improvement over the more cramped approach of the SBREFA Outline.

As the proposal recognizes, even before the pandemic the MCA industry was growing rapidly. This industry offers high-cost credit targeting the most vulnerable businesses, exploiting their difficulties in accessing credit. Indeed, as the proposal notes, the Federal Reserve Banks' 2020 study found that Black-owned small businesses were twice as likely to have applied for an MCA compared to White-owned businesses; Latino-owned and Asian-owned small businesses applied at a rate more than 1.4 times greater than White-owned businesses. Moreover, as the proposal also notes, there is reason to believe that in the wake of the pandemic, businesses owned by people of color – which as previously discussed experienced unique challenges in accessing the PPP program -- are increasingly seeking MCAs to support their recovery from the pandemic. Indeed, in the previously-discussed survey conducted by NALCAB and National CAPACD, twenty percent of respondents' clients used MCAs as a form of credit. Accordingly, understanding the extent to which businesses owned by people of color are dependent upon these predatory products is central to achieving Section 1071's objective.

We do not agree, however, with the Bureau's suggestion, 86 Fed. Reg. 56406, that there is any ambiguity or room for doubt as to whether an MCA constitutes "credit" under the ECOA. ECOA defines credit as "the right granted by a creditor … to incur debts and defer its payment." [29] When a small business obtains an MCA, it incurs a debt: it owes the lender the amount of the advance plus an additional amount calculated by multiplying the advance by the factor rate. The money is not due immediately meaning that payment of that debt is deferred. Accordingly, the transaction falls squarely within ECOA's definition of credit. The fact that the payment schedule may be indeterminate and tied to future sales in no way detracts from the fact that the transaction has created a debt whose payment is deferred. Indeed, that is the way that MCA providers themselves describe their product. For example, the website of one provider helpfully explains, "A cash advance is like a loan in that the lender agrees to give a business owner a certain amount of money up front with the promise of repayment at a future date. That much remains the same between the two. The difference lies in how the forwarded sum is paid back."[30]

Although some MCA providers may attempt to analogize their products to factoring, as the Bureau's proposal notes this analogy is misplaced. A genuine factoring transaction creates a sale of receivables owed to the seller as a result of goods delivered or services provided by the seller to a third party. As the proposal notes, "the transaction … is complete at the time of the sale … meaning no payment is deferred." 86 Fed. Reg. at 56409. Thus, the distinction between MCAs

[29] 15 U.S.C. 1691a(d).
[30] https://www.nationalbusinesscapital.com/difference-between-cash-advances-and-loans-2/

and factoring is clear. At most, the Bureau should rely on its discretionary interpretive authority as an alternative ground for covering MCAs.

The Bureau's proposal draws upon the distinction between MCAs and factoring to exclude factoring from the proposed rule. If the Bureau adheres to that position, it should at a minimum make clear that factoring is excluded only where there is a bona fide sale of an accrued right to payment without creating any obligations – contingent or otherwise – on the seller. In other contexts, lenders have shown great "creativity" in seeking to recharacterize loans as sales or some other contrivance in an attempt to evade their legal obligations. That risk exists here as well and we encourage the Bureau to establish strong guardrails to prevent evasion. The Bureau should make clear that it will monitor the market for, and take action with respect to, any such evasions.

C. Disaggregating Racial and Ethnic Categories

We support the Bureau's proposal that financial institutions request principal owners' ethnicity and race using both aggregate categories as well as disaggregated subcategories, including the disaggregated subcategories with respect to Latino and Asian Americans, Native Hawaiian, and Pacific Islander populations as are used in Regulation C. Disaggregating the data in that way has proven extremely valuable to uncover disparities within the broader groupings as the Bureau's own research has shown.[31] These data will be increasingly effective over the years when comparative data is more available in both (1) facilitating enforcement of fair lending laws, and (2) enabling communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses. Given the proven value of disaggregation, we further support the proposal to include disaggregated categories for Blacks or African American as well.

In order to assure that these data categories are maintained and updated in alignment with OMB Federal Data Standards on Race and Ethnicity the Bureau may want to so provide by rule and allow the specifications to be adjusted in filing instructions that the Bureau issues from time to time rather than limited to those codified in the Official Interpretations.

D. Reporting the Identity of the True Lender

Proposed Comment 109(a)(3)-1,2, and 3 seek to assign reporting responsibility for situations in which multiple financial institutions are involved in a covered credit transaction. Proposed Comment 109(a)(3)-1(i) states a general rule requiring the FI that "made the final credit decision" to report the application, with a sub-rule for cases in which "more than one financial institution approved an application and one of those financial institutions purchased the covered credit transaction after closing." Proposed Comment 109(a)(3)-3 states a separate rule for

[31] CFPB. *Data Point: Asian Americans and Pacific Islanders in the Mortgage Market Using the 2020 HMDA Data,* *https://files.consumerfinance.gov/f/documents/cfpb_aapi-mortgage-market_report_2021-07.pdf*

situations in which an FI makes a credit decision "through the action of an agent." Unfortunately, this set of rules does not address the complexity of lending relationships that exist in the market today.

It has become increasingly common for entities which describe themselves as "financial technology" companies or "fintechs" to effectively rent the charter of a depository institution and make loans through what are euphemistically termed "bank partnerships." A primary purpose of these rent-a-bank "partnerships" is to enable online lenders to evade the limitations of state lending laws, especially usury limits designed to protect against predatory lending, by claiming the benefits of preemption. For example, a company called World Business Lenders, operating through rent-a-bank arrangements with Axos Federal Savings Bank (formerly known as the Bank of the Internet), Bank of Lake Mills, and Liberty Bank has made small business loans, secured by residential property, at APRs of between 72% and 122%, well outside permitted limits in most states.[32]

The precise terms of these so-called "partnerships" are unknown. Typically, in these arrangements the so-called "fintech" markets the loans and creates a website through which applications are received and processed using underwriting methods and criteria developed by the non-bank entity, but which are technically approved by the bank. In order to maintain the veneer of a bank loan, some sophisticated rent-a-bank partners create a structure in which loans are not only originated in the name of the bank but the bank retains technical ownership of the account and even ownership of a small slice of the receivables while substantially all of the receivables are sold on an overnight basis to the non-bank "partner," which assumes substantially all the credit risk and also is responsible for servicing the loans. [33]

From the perspective of the ECOA, in these so-called "bank partnerships" both parties are creditors since Regulation B defines a creditor to include any "person who, in the ordinary course of business, regularly participates in a credit decision, including setting the terms of the credit" or who "regularly refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made."[34] It is therefore essential that data collected under 1071 identify both parties or, at a minimum, identify the party that bears the bulk of the credit risk and for all intents and purposes is the driving force in determining whether to extend credit and on what terms, even if the loan is made in the name of the bank and the bank retains ownership of the account.

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[32] *See* Testimony of Adam J. Levitin Before the Committee on Small Business, U.S. House of Representatives, (Sept. 9, 2020), https://www.creditslips.org/files/house-small-business-testimony-9-9-20.pdf

[33] For an example of such an arrangement in the consumer lending space *see* Elevate Credit Inc., From 10-Q for the period ending Sept. 30, 2019, SEC file no. 001-37680, at 22, 43, https://www.sec.gov/Archives/edgar/data/1413754/000107878219000836/f10q093019_10q.htm

[34] 12 C.F.R. § 1002.2(i).

We are concerned, however, that the Bureau's proposal will not achieve this objective. In an age in which underwriting decisions are made by machine on servers housed in the cloud using algorithms developed by technology companies but approved, at least formally, by a depository, it is far from clear what institution "made the final credit decision." Nor is it necessarily clear which entity is principal and which is agent in these relationships – assuming the principal-agent construct is even meaningful in this context. And, as noted, clever lawyers have found ways of separating ownership of accounts from ownership of receivables and even of splitting ownership of receivables

What is clear in these cases is with whom the predominant economic interest in the loan – or a contemplated loan – lies. Thus, one way to solve the problem discussed above would be, with respect to applications as to which more than one covered financial institution is a creditor under ECOA, to assign reporting responsibility to the FI which has the predominant economic interest in and bears the predominant risk of a loan or that would have had such an interest had the loan been consummated.[35]

An alternative approach would be to add to § 1002.107(a) a new data field, analogous to the "type of purchaser" field required under Regulation C, § 1003.14(a)(11), to capture at the level of the individual application whether the account or receivables have been sold, partially sold, or securitized during the reporting period and, if so, the nature of the transaction and the type of purchaser. Under this approach, FIs also should be required to report whether an application would have resulted in a sale or securitization had the application resulted in a consummated loan pursuant to a forward flow agreement or similar arrangement. And, to assure complete transparency, the Bureau should require identification of the purchaser or would-be-purchaser in a text field.

Regardless of which approach the Bureau chooses, we urge the Bureau, in enumerating the "type of purchaser" field, to avoid the term "fintech" and use the phrase "online lender" instead and to define that phrase to mean entities that have little or no physical, retail presence and that secure applications predominantly through the Internet. The term "fintech" has no fixed definition and, interpreted literally, could refer to any company that delivers financial products or services with the use of technology – which is to say any financial services company. All sorts of entities are

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[35] This approach would closely parallel the approach the Bureau has taken in *CFPB v. CashCall,* No. 2-15-cv-07522 (C.D. Cal) in which it successfully argued that CashCall was the "true lender" with respect to loans made in the name of a tribal entity because CashCall took "the financial risk" with respect to such loans. Memorandum for Partial Summary Judgment at 10. The proposed approach also would parallel the approach state and federal courts have taken in determining who is the true lender in rent-a-charter arrangements. *E.g., CashCall v. Morrisey,* 2014 WL 2404300 (W. Va. May 30, 2014); *BankWest v. Oxendine,* 598 S.E.2d 343 (Ga. Ct. App. 2004); *Spitzer v. County Bank of Rehoboth,* 846 N.Y.S.2d 436 (N.Y. App. Div. 2007); *In re Rent-Rite Superkegs West Ltd.,* No 19-cv-01552 (D. Colo. Aug. 12, 2020); *Eul v. Transworld Sys.,* 2017 WL 1178537 (N.D. Ill, March 30,2017); *Flowers v. EZPawn Oklahoma,* 307 F.Supp. 2d 1991 (N.D. Okla. 2004); *Galeta National Bank v. O'Donnell,* 239 F.Supp. 2d 734 (S.D. Ohio 2002).

claiming the banner of "fintech" because that seems to be a talisman that brings venture capital in its wake. Rather than fueling this trend, we urge the Bureau to substitute the term "online lender."

E. Reporting of Credit Scores

In its proposal the Bureau recognizes that "Collecting credit score and other credit information could be particularly useful for the fair lending purposes of section 1071," but elected not to require such reporting due to the supposed complexity of doing so. 86 Fed. Reg. at 56437. We strongly disagree and urge the Bureau to reconsider this decision.

It is quite common in small business lending for the lender to pull the personal credit report of the owner(s) of the business. This is almost universally true where the applicant is a sole proprietorship but is also the norm for small business lending generally.

Experience with HMDA shows that whenever data users identify racial disparities in lending – either in terms of approval rates or in terms of pricing – questions are raised as to the adequacy of the analysis if it does not control for credit score. Researchers who conduct fair lending analyses therefore generally seek to use such controls.

The Federal Reserve Banks in their annual small business surveys obtain self-reported information from the respondents as to their credit score and those studies have found large disparities in credit access even after controlling for those self-reported credit scores; for example, in the most recent study, among small businesses with high credit scores, Black- and Latino-owned businesses were only about half as likely to obtain the credit they sought as white-owned businesses and the rate for Asian American-owned businesses was more than twenty percent below the rate for White-owned businesses.[36] But if the 1071 dataset does not include credit scores, such analyses will not be possible and some may even attempt to dismiss conclusions drawn from the data on the ground that there is no credit score control. Given that, and in light of the frequency with which personal credit scores are used for small business lending decisions, it is essential to include within 1071 a data field for a personal credit score (along with a field identifying the scoring model used) where a personal credit score that data is used by the lender in underwriting and/or pricing the loan.

There are now a number of vendors that market business credit scores, i.e. scores that claim to reflect the creditworthiness of business entities separate and apart from the creditworthiness of their owners. However, because there are not yet industry-standard scoring models for businesses, requiring reporting of a business credit score may introduce complexities that outweigh the value of the data. But whatever those complexities may be they do not pertain to

[36] *Small Business Credit Survey: 2021 Report on Firms Owned by People of Color,* *https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2021/sbcs-report-on-firms-owned-by-people-of-color*

personal credit scores, which can and should be reported where used in deciding either on whether to make a loan or on the terms of the loan (including size, duration, and pricing).

Importantly, credit score reporting already is required under HMDA and in imposing that requirement the Bureau thoughtfully addressed and provided clear rules of the road to govern reporting in situations where multiple scores are pulled (because of co-applicants and/or because of a tri-merge report). Lenders have been complying with those rules for several years. The rules are, in our view, entirely translatable to the 1071 context and therefore should be.

F. Data Points Related to Pricing

We wholeheartedly supported the Bureau's decision to require lenders to collect and report data not only with respect to their credit decisions but also with respect to the price of the loans that are offered. These data are needed to achieve both of Section 1071's purposes.

The ECOA expressly prohibits discrimination "with respect to any aspect of a credit decision" including not only decisions as to whether to extend credit but also decisions with respect to the terms of any credit offer. Thus, collecting data with respect to loan terms is essential "to facilitate enforcement of fair lending laws"— Section 1071's first stated purpose. This is especially true given the abundant evidence from other markets -- including, for example, residential mortgages[37] and auto lending[38] -- that, when people of color are able to obtain credit, they are on average charged higher prices than white borrowers. Indeed, if the Section 1071 rule did not cover data elements regarding loan pricing, lenders could easily mask discrimination by

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[37] For example, Federal Reserve researchers, using data from 2004 through 2008, found that during the years leading up to the financial crisis, higher-rate conventional mortgages were disproportionately distributed to borrowers of color, including African-American, Latino, American Indians, Alaskan Natives, Native Hawaiians, Pacific Islanders, and Hispanic borrowers. *See* Avery, Brevoort, and Canner, *Higher-Priced Home Lending and the 2005 HMDA Data,* Federal Reserve Bulletin (September 2006), available at http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf. More recently, the Bureau has reported that in 2020, the interest rate on mortgages for Black and Latino borrowers was .0125% higher than for White borrowers and the closing costs for Black and Latino borrowers was, respectively, $1,636 and $1,864 higher than for White borrowers. CFPB. *Data Point: 2020 Mortgage Market Activity and Trends,* *https://files.consumerfinance.gov/f/documents/cfpb_2020-mortgage-market-activity-trends_report_2021-08.pdf* And MIT researchers have found that over the life of a loan, Black homeowners pay almost $54,000 more than White homeowners in mortgage-related costs. Aronowitz, Golding, & Choi, *The Unequal Costs of Black Homeownership, https://gcfp.mit.edu/mortgage-cost-for-black-homeowners/*

[38] Pricing disparities in auto lending were extensively documented as a result of discovery in class action lawsuits which uncovered that Blacks were paying between $330 and $500 more for auto loans. Chen, *Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation, https://law.vanderbilt.edu/files/publications/cohen-imperfect-competition.pdf.* The Bureau's investigation of the practices of indirect auto lenders found that large disparities continued long after those class action lawsuits were settled. More recently, researchers have found that among auto loan consumers of comparable creditworthiness, borrowers of color pay 70 basis points more on their auto loans than white borrowers, increasing loan costs on average by an additional $410. Butler, Mayer, & Weston, *Racial Discrimination in the Auto Lending Market, https://files.consumerfinance.gov/f/documents/cfpb_mayer_racial-discrimination-in-the-auto-loan-market.pdf.*

artificially inflating their "approved but not accepted" rate for minority-owned businesses while offering inferior, unaffordable terms to businesses owned by people of color.

Additionally, data as to loan pricing is needed to "identify business and community development needs and opportunities of women-owned [and] minority-owned" small businesses – Section 1071's second stated purpose. Although there is abundant evidence that businesses owned by people of color are less likely to obtain the credit they seek than white-owned businesses, there is a dearth of evidence regarding the terms on which credit is extended to these businesses. To the extent the data were to show patterns of disparate pricing such as exist in other credit markets, that would identify an acute need for fairly priced, affordable credit, even if the disparities were the result of race-neutral criteria that passed the disparate impact test. This is yet another reason why collecting such data is essential.

In order for the pricing data collected under Section 1071 to achieve these purposes, ideally there would be a common metric that could be used to compare offers across applicants of each lender in order to uncover patterns of discrimination by individual lenders and also to be able to compare pricing across different classes of borrowers to identify classes of businesses being systematically shut out from affordable credit. In the consumer finance space, APR can serve both of these purposes. As the proposal notes, several states are now requiring small business lenders to calculate and disclose the APR on their products[39] and legislation recently has been introduced in Congress that would require this nationally.[40]

We recognize that before the Bureau could require reporting of APR as part of a 1071 rule the Bureau would have to define a methodology for calculating APR for products such as MCAs that do not have a ready consumer analog. The Bureau also would have to determine the extent to which concepts and limitations developed under Regulation Z and/or under the Military Lending Act for defining finance charges should be applied to commercial financing and whether and, if so, how to extend those concepts to types of charges that have no consumer finance analog. That may be beyond the scope and timeframe of the present rulemaking. That does not mean however, as the proposal incorrectly asserts, that understanding the components of APR would "provide greater utility to data users," 86 Fed. Reg. at 56456, than would an APR data point. To the contrary, an APR data point, using a methodology defined by the Bureau, would provide a basis for objective comparisons not dependent on the methodology of particular researchers.

Thus, if the Bureau elects not to require APR as a data point at this time, that decision should be predicated squarely on the fact that defining APR for commercial loans is outside the scope and/or timeframe of the present rulemaking. The Bureau should not denigrate the value of APR

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[39] *See* 86 Fed. Reg. at 56368 n.132

[40] H.R. 6054, 117th Cong. 1st Sess; S.3235, 117th Cong. 1st Sess.

or the feasibility of calculating it for small business loans so that, in the future, the Bureau can revisit this issue on a clean slate.

Regardless of whether the Bureau elects to require disclosure of APR along with pricing components or only requires disclosure of pricing components, it is important that the pricing data points that are reported are sufficient to enable data users to conduct the kinds of analyses suggested above regarding pricing disparities and the affordability of credit. The Bureau's proposal makes a good start in this regard but we believe the proposal could be improved in several important respects.

Capturing the True Cost of Merchant Cash Advances – As the proposal recognizes, MCAs are high-cost forms of credit targeted to vulnerable small business owners, especially people of color. It is therefore essential that the 1071 data capture the full cost of MCAs in a manner that allows comparison to other forms of credit and thus to identify needs for affordable credit that are not being met. The proposal falls short of achieving this objective in two respects.

Loan Term -- For merchant cash advances, the Bureau's proposal requires lenders to report, in dollar terms, the difference between the amount advanced and the amount to be repaid. § 1002.107(a)(12)(v). That is, of course, an important element of the cost of an MCA. However, where the costs of a loan are expressed in dollar terms, to truly understand the loan's price and compare it to other loans, it is necessary to know not just the dollar cost but the duration of the loan. For example, a payday loan that requires the borrower to pay $15 per $100 borrowed in two weeks is quite different than, e.g., a six-month installment loan that also requires the borrower to pay $15 per $100 borrowed.

We recognize, of course, that MCAs differ from traditional loans in that they do not have a fixed term. However, many MCAs made within the course of a reporting year will be repaid within that year and as to those loans the Bureau easily could require that the lender report the time period that elapsed between the time the loan was funded and the time it was repaid.

Furthermore, in determining the factor rate or the holdback percentage for an MCA, lenders typically collect data regarding applicants' historical credit card or debit card sales volume (if payments are tied to those sales) or bank deposits (if payments are tied to deposits). Lenders then, for their own business purposes, estimate the period of time it will take for a given loan to be repaid because that will determine the lender's cost of funds and contribute to the lender's risk. Thus, as to MCAs that are made during the course of the year and still outstanding as of the end of the reporting period, as well as MCA offers that are made but do not result in consummated loans, the Bureau could require MCA lenders to report a projection of the term of the loan or putative loan as calculated for purposes of underwriting the MCA. Alternatively, the Bureau could follow the approach of the recently-proposed federal legislation and require an MCA lender to report estimated loan terms for each application based on the applicant's "historical sales volume over a defined period of time that is used for all sales-based financing transactions by that [MCA] provider." [41]

Capturing Pricing on All Offers, including Counteroffers – In order to ferret out discrimination in pricing, it is necessary to have visibility into the pricing not only of originated loans but of offers that are made but not accepted; indeed, to the extent lenders are offering higher-cost loans to businesses owned by people of color, that may be more evident in loan offers that are too expensive for the applicant to accept than in originated loans. Under the Bureau's proposal whether pricing information is required depends on what the lender reports in the "action taken" field: pricing is required with respect to any application for which the action taken is reported as "originated" or "approved but not accepted" but in lieu of pricing information a financial institution shall report "not applicable" if the action taken is reported as "denied," "withdrawn, or incomplete." Official Interpretation § 1071(a)(12) - 1. This creates something of an ambiguity about the reporting of pricing with respect to counter-offers that do not result in originated loans. Proposed Comment 107(a)(9)-2 addresses that situation in a manner that at best creates ambiguity and at worst creates a loophole that would shield the terms of counter-offers from disclosure.

Specifically, the proposed Comment provides: "If a financial institution makes a counteroffer to grant credit on terms other than those originally requested by the applicant (for example for a shorter loan maturity, with a different interest rate, or in a different amount) and the applicant declines the counteroffer or fails to respond, the institution reports the action taken as a denial on the original terms requested by the applicant." In that event, we read the proposal to mean that the lender would not be required to report the terms of the counteroffer given that, as noted above, under the proposed rule the lender reports the term, amount, and pricing as "not applicable" where the reported "action taken" is a denial.[42] However, the proposed Comment provides that if the applicant "agrees to proceed with consideration of the financial institution's counteroffer" and then either accepts or declines the counteroffer, the lender would report the action taken as "originated" or "approved but not accepted" which would then trigger the obligation to report pricing.

This proposed Comment seems to us problematic in several respects. To begin with, the proposed Comment would seem to direct a lender to report that it has denied an application when the lender is prepared to approve the application on different terms than those requested by the applicant, unless the applicant somehow agrees to "proceed with consideration" of the terms of the counteroffer. That would allow lenders to avoid the obligation to report pricing in the situation in which the data is perhaps most important: when the lender is not prepared to make a loan on the terms requested by the applicant but is prepared to make a loan on less desirable

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[41] *See* n.37 *supra.*

[42] *See* Comments 107(a)(4)-5; 107(a)(8)-1; 107(a)(9)-1

terms (e.g. by lending a lower amount, for a shorter period, or at a higher rate) which are not acceptable to the borrower. The same presumably would be true, for example, if the applicant sought an unsecured loan or a loan without a personal guarantee, and the lender counteroffered a secured and/or guaranteed loan. The terms of such counteroffers would go unreported unless the applicant either accepts those terms or somehow agrees to "proceed with consideration" of the counteroffer but then subsequently decides not to accept it.

Furthermore, although the proposed Comment applies where a lender offers "to grant credit on terms other than those originally requested by the applicant," nothing in the proposed rule requires lenders to solicit from applicants the terms they are seeking other than the amount applied for and the credit type. As a result, it is not entirely clear under what circumstances a lender's offer of terms that an applicant does not accept would be treated as a denial (without reporting the loan terms) as distinguished from an "approval not accepted" (in which case loan terms must be reported). This ambiguity is particularly problematic in light of the fact that, in the experience of the Self-Help credit unions (Self-Help), with whom the Center for Responsible Lending is affiliated, borrowers often seek a loan amount but may be less focused on other terms, including how the interaction of the interest rate and loan term affect the payment.

To resolve this uncertainty and assure that the terms of counteroffers are reported, we therefore recommend that whenever a lender makes an offer to an applicant those terms should be reported to the Bureau without regard to whether they conform to the terms requested by the applicant or are a counteroffer. One way to address this would be to modify the specifications for the actions taken field to include counteroffer accepted and counteroffer rejected as discrete options and then require reporting of pricing information with respect to either of these actions taken.

To be sure, there may be cases of the type seemingly contemplated by the proposed Comment in which a would-be-applicant is interested in a particular type of product (for example, a line of credit) and the lender concludes that the applicant is not eligible for that product and inquires as to whether the applicant would be interested in being considered for an alternative product (e.g., a term loan). We expect that most often would occur prior to the application stage and thus the inquiry would not itself create a reportable event under the proposed rule. But if a small business were to apply for a product for which it is not eligible and if the applicant were to elect not to be considered for an alternative product without receiving a counter-offer, then reporting the action taken as a denial would make sense and there would be no pricing information to report. But to repeat, where a lender offers terms to an applicant we urge the Bureau to require that those terms be reported.

Capturing Ongoing Costs – In proposed § 107(a)(12)(iv), the Bureau proposes to require lenders to report scheduled charges during the first year but not thereafter. The risk here is obvious: lenders may choose to offer lower costs during the first year than in subsequent years, and under the Bureau's proposal the ongoing costs would not be captured. The Bureau has asked about the likelihood of this being done "specifically in an effort to avoid reporting the charges for the purpose of 1071." 86 Fed. Reg. at 56460. Given the history of evasionary tactics by FIs, that risk is real and material. But even if the Bureau were somehow to conclude that the risk of deliberate evasion is low, that still would not justify limiting the required data to scheduled first-year charges. Aside from a desire to avoid reporting, lenders may choose to offer reduced costs for the first year of a loan and rely on higher back-end pricing as an acquisition strategy to acquire more business. For example, an issuer of business credit cards or other open-end products may elect to waive a first-year annual fee as part of its acquisition strategy; indeed that would be possible even if it meant that the first year would not be profitable as loss-leader pricing is a well-known strategy. Understanding the true cost of these types of loans is important without regard to whether the reason for charging lower first-year cost is to evade reporting or to acquire more customers. Thus, the Bureau should require reporting not only of scheduled first-year costs (which is necessary in order to capture any costs associated with origination that may be made after closing) but also require reporting of any recurring scheduled cost, or costs scheduled for a year other than the first year, even if the cost is not charged during the first year or not charged every year.

Furthermore, the requirement to report only "scheduled" costs – and presumably not unscheduled costs – creates a risk of evasion other than the one identified by the Bureau: a risk that lenders will structure agreements to permit costs to be assessed in the lender's discretion at unscheduled intervals. MCAs, for example, may include a "collateral monitor fee" which easily could be structured as a fee imposed in the lender's discretion (perhaps with a maximum frequency). To avoid such an evasion, all fees that can be imposed in the lender's discretion other than fees triggered by an action by the borrower such as a late fee, should be reported under Section 1071.

Capturing Prepayment Costs – The Bureau's proposal soundly requires lenders to report whether an offer includes a charge for paying all or part of the principal before the date on which principal is due. But there is no requirement to report the size of any prepayment penalty that can be assessed. We recommend requiring reporting of the maximum amount of a potential prepayment penalty and the period for which a payment in that amount can be assessed.

Additionally, lenders could evade reporting prepayment penalties by structuring loans such that there is no benefit to the borrower for early payment. This is, of course, the case for MCAs and other alternative finance company products but that same structure could be imported into other commercial financing products as well. Similarly, lenders could (and do) structure loan products such that prepayment does not result in the borrower avoiding all future interest charges without characterizing the resulting cost as a prepayment penalty.[43] We therefore recommend that the

[43] For example, some loans offer what is characterized as "prepayment discount," such as in this case where 75% of the outstanding finance charge is assessed as a balloon when a loan is prepaid, discounted from

specification for the prepayment field make clear that "no prepayment" refers only to a loan with a scheduled term which can be prepaid by paying the principal and accrued finance charges and that term loans for which there is an incremental cost associated with prepayment should be reported as carrying a prepayment penalty even if the loan denominates this incremental amount as a "discount" or something else.

Separating Third-Party, Pass-Through Costs from Lender Charges -- Proposed § 107(a)(12)(ii) requires lenders to report "all charges payable directly or indirectly by the applicant and imposed directly or indirectly by the financial institution at or before origination as an incident to or a condition of the extension of credit." Proposed Comment 107(a)(12((ii)-2 appropriately states that this includes amounts charged by someone other than the financial institution if the FI either requires the use of the third party or retains a portion of the fee. We recommend, however, that the Bureau provide for disaggregated reporting of third-party charges that are pure pass-through charges. Such disaggregation will provide for more comparability with respect to charges imposed by the lender including origination fees, points and the like as well as lender mark ups of third-party charges.

We acknowledge that such a disaggregation requirement would be a departure from what is required under HMDA. HMDA requires mortgage lenders to report "total origination charges" which combine lender and third-party costs. That data point was taken from the Loan Estimate form which lenders already were required to compute and disclose to consumers pursuant to the TILA-RESPA Integrated Disclosure Rule (TRID). Using that field as the reportable field under HMDA thus facilitated compliance. There is no comparable advantage to combining origination and third party costs for purposes of 1071 and thus we recommend that the Bureau require they be reported separately.

G. Publication of 1071 Data

It goes without saying that in order to achieve any of Section 1071's purposes it is essential that the data that lenders collect and report to the Bureau be made public in a timely, accessible manner. We offer the following recommendations with respect to what data are made public, when, and how.

The Bureau should, in the text of the final rule, establish a strong presumption in favor of disclosure; permit modification of a data point only where release of unmodified data would cause significant harm to the privacy interest of a small business or its owners; and permit deletion of a data point only where release would cause significant harm that cannot

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100% of the amount that would have been paid had the loan gone to term. *See* Fundera, "OnDeck Business Loans Review for 2021," Nov 26, 2020. https://www.fundera.com/business-loans/lender-reviews/ondeck-reviews (" "OnDeck's loans come with a prepayment discount—if you prepay your short-term loan, OnDeck will forgive 25% of the remaining interest due on your loan.")

be mitigated by modification of the data point – The preamble to the Bureau's proposal contains an extensive discussion of the approach the Bureau proposes to take with respect to the disclosure of 1071 data. In our view, the final rule itself should codify the approach the Bureau will take in order to bind the Bureau and prevent future backsliding with respect to public release. In particular, we believe that there are three elements that should be codified: first, a strong presumption in favor of application-level disclosure in order to achieve Section 1071's purposes; second, a limited exception that would permit data to be modified where such a modification is necessary to avoid compromising the privacy of small businesses or their owners in a manner that would be seriously damaging to them; and third, an even more limited exception that would permit data submitted to the CFPB to be deleted from the public dataset where such damage cannot be mitigated through modification of a data point.[44]

As part of this codification, the Bureau should incorporate a commitment to make public the identity of the financial institution submitting each record. Section 1071 so requires because it imposes disclosure obligations on each individual financial institution with respect to its data if requested by any member of the public.[45] At the same time, the Bureau should make explicit that it will not consider modifying or deleting data from the public dataset merely because data may embarrass, or cause reputational damage to, a particular lender. The very purpose of Section 1071 is to provide the public with access to data that will enable data users to form judgments as to whether particular lenders are, e.g., engaging in redlining or other discriminatory practices or failing to meet their obligations to the communities they are supposed to serve. If data from a particular lender will lead to adverse judgments about that lender, that is all the more reason for the data to be made public. If a lender believes that its 1071 data will provide an incomplete or misleading impression of its business practice, that lender can release additional data to provide greater context. In Justice Brandeis' words, "the remedy to be applied is more speech, not enforced silence."[46]

Indeed, given that Congress, in enacting 1071, already has decided that the identity of each financial institution shall be made public along with its loan application register, we do not believe that the Bureau should give any weight to whatever proprietary or commercial interest financial institutions may claim in seeking to exclude 1071 data from public disclosure. A financial institutions' desire to be shielded from competition, litigation, or adverse publicity is

[44] We also urge the Bureau to leave open the possibility that a particular data field might be modified or deleted for some records but not for others. For example, the risk of reidentification may be considerably lower for a census tract with 1,200 residents as compared to one with 8,000 residents; that is even more true if the Bureau were to modify the geographic field in the public dataset given the wide range of sizes of, e.g., counties. (Counties can range in size from under 100 residents to over 10,000,000.) The risk of harm from releasing a particular data field thus may vary from location to location in ways that warrant different approaches to modification/deletion for different locations.

[45] *See* § 1071(f)(2)(B).

[46] *Whitney v. California,* 274 U.S. 357 (1927)(Brandeis, J., concurring).

not a bona fide privacy interest that needs to be weighed in deciding whether to release particular data fields.

The Bureau should, in the text of the final rule, commit to releasing the public data by a date certain after its submission. The Bureau has proposed to require lenders to report data to the Bureau on a calendar year basis, with reports due on or before June 1st of the succeeding year. Under proposed § 102.110(a), the Bureau will publish such data "on an annual basis" but the proposed rule contains no deadline for such publication. The intersection of these two provisions creates a risk that by the time the Bureau elects to publish the data, they will be quite stale. That would, of course, disserve one of the key goals of Section 1071 as it would be difficult to "identify business and community development needs" with data that are not current.

We agree with the Bureau that it would not be feasible to require 1071 reporting to occur concurrently with HMDA reporting. One way to avoid that while still assuring that the data, when released, are timely, would be to adopt a July 1 – June 30th reporting period. The Bureau has, however, expressed concerns that doing so "could result in additional challenges for financial institutions in complying with the rule, which could in turn make errors in collecting and reporting data to the Bureau more likely." 86 Fed. Reg. at 56494.

It is not obvious to us, or to our affiliate Self-Help, why it would be more difficult to pull and submit data on applications received during a 12-month period other than a calendar year, especially since any reporting period will have to be programmed as part of the 1071 implementation process. Indeed, there would seem to be administrative advantages to determining whether a financial institution is required to report on a calendar year basis and to have the reporting period start six months after the calendar year so that institutions that become obligated to start reporting have some time to prepare before data collection must begin. And a July 1 to June 30th reporting period would mean that the data being submitted would allow the Bureau to require reporting within sixty days after the close of the reporting period as under HMDA and thus provide for more timely data to be submitted than under the Bureau's proposal.

Regardless of whether the Bureau adheres to the proposal's calendar-year reporting period or adopts some other reporting period, we recommend that the Bureau commit itself (and all future CFPB leaders), by rule, to make the 1071 data public by a date certain each year. For example, under HMDA, each FI's Lending Application Register (LAR) must be submitted by the end of February and made available to the public on a timely request by the end of March[47] and the Bureau, by assuming the responsibility of making HMDA LARs available on behalf of FIs, has effectively committed itself to that deadline. Similarly, following the HMDA model, the Bureau could commit here to making the individual 1071 LARs available thirty days after the submission deadline (under the proposal by June 30th) and to provide a combined public-use

[47] 15 U.S.C. 2803(j)(5).

dataset within six months of the deadline for submission of reports. That would assure that, even if reporting is done on a calendar year basis, the data would be reasonably timely and prevent foot-dragging should future leaders of the Bureau be less committed to the Section 1071 mission.

The Bureau should make the public dataset readily accessible and if any data were to be modified or deleted the Bureau should establish a "bona fide researcher" program to allow researchers to access those data. When the Bureau took over collection and reporting of HMDA data from the Federal Reserve Board, the CFPB provided a robust query tool through which data users could generate reports from the data. The tool the Bureau currently provides to access HMDA data is less robust and allows more limited queries. In preparing to implement Section 1071, the Bureau should recreate the type of querying tool that it previously provided.

Beyond that, assuming that application of the balancing test leads to modification or deletion of certain data fields, the Bureau should, concurrent with release of the first set of 1071 data, create a program whereby bona fide researchers can access the full dataset. The privacy risk here arises from the potential to re-identify small businesses by comparing the data in a LAR with other known data and it should not be difficult for the Bureau to identify bona fide researchers who have no interest in doing so and who are prepared to commit to use the data purely for research purposes without attempting to identify individual applicants. Those researchers should be permitted access to the full data set for research purposes so that the real value of the full data set can be realized.

H. Technical Recommendations to Facilitate Compliance and Assure the Integrity and Usefulness of Data Collected Pursuant to Section 1071

Drawing on the experience of CRL's affiliate Self-Help, we offer the following recommendations that we believe will facilitate compliance and better assure the integrity of the data that is collected.

Covered Application and Credit Product (§ 103(a) and § 107(a)(5)) – Proposed Comment 103(a)- 4 provides that "if an applicant makes a request for two or more covered credit transactions at the same time, the financial institution reports each request for a covered credit transaction as a separate application." Proposed Comment 107(a)(5)-1, in turn, identifies seven discrete credit types -- including (i) term loan-unsecured; (ii) term loan-secured; (iii) line of credit-unsecured; and (iv) line of credit-secured – and provides that "If an applicant requests more the one credit product, the financial institution reports each credit product requested as a separate application." And proposed Comment 107(a)(5)-2 requires lenders to "maintain procedures reasonably designed to collect applicant provided data, which includes credit product." In our view, the conjunction of these proposed Comments may create confusion in the data that is reported.

We understand Proposed Comment 103(a)-4 to apply in situations in which an applicant is seeking two separate loans – for example, a term loan to purchase equipment and a line of credit to purchase inventory -- and agree that in such instances even if there is a single application that application should result in two separate 1071 records. However, in some instances an applicant may be seeking to borrow a certain amount of money and may prefer a line of credit but be open to a term loan, or may prefer an unsecured loan but be open to providing security. It is unclear whether, in such cases, the small business would request multiple credit types in its application and whether the lender's duty to "maintain procedures reasonably designed to collect applicant provided data" would require the lender to instruct the applicant to identify each credit type that would be acceptable. If so, proposed Comment 107(a)(5)-1 would seem to require the lender to report each credit type requested as a separate application even though in the situation just described the applicant is seeking only one transaction and is open to alternative structures and even though there would be only one action taken and one set of terms.

To ameliorate this potential problem the Bureau may wish to reconsider the enumeration of credit types in proposed Comment 103(a)(5)-1. For example, it is not clear that there is value in separating out applications for secured and unsecured lines of credit so long as the 1071 data captures whether an offer by a financial institution or an originated loan is secured or unsecured. (Indeed, the Bureau may want to require a separate data field capturing the appraised value of collateral in relation to the loan amount.) Similarly, with respect to term loans, there may be value in separating out mortgages, auto loans and equipment financing as discrete secured loan types but treating all other term loan applications (including those that may be secured by inventory or receivables) together, rather than treating secured term loans as one category and unsecured term loans as another.

In any event, we urge the Bureau to reconsider the requirement to treat requests for multiple credit types as multiple applications if the applicant is seeking only a single loan. This would mean that separate records would be required only where, as provided in proposed Comment 103(a)-4 the small business is seeking through one application two or more separate loans/lines.

Guarantees (§ 107(a)(5)(ii)) – Proposed Comment 107(a)(5)-4 requires reporting of "the type or types of guarantees that were obtained for an originated covered credit transaction *or that would have been obtained if the covered credit transaction was originated.*" (Emphasis added). The italicized language could be problematic in the case of a declined application because the lender would be speculating as to potential guarantees, such as personal guarantees, from owners or non-owners. We recommend that the Bureau either limit the reporting of this field to offers and counteroffers that are made (i.e. allow financial institutions to report type of guarantee as "not applicable" for declined applications, as is permitted with respect to the loan term and loan pricing data fields[48]) or, for declined applications, require reporting of the guarantee type only if

[48] *See* proposed Comment 107(a)(5)-5.

the requested guarantee were a government or programmatic guarantee (such as an SBA or USDA guarantee or some other third-party guarantee program).

NAICS Code (§ 107(a)(15) – Proposed Comment 107(a)(15)-2 provides that lenders shall maintain procedures reasonably designed to collect NAICS codes from applicants but that if an FI "is nonetheless unable to collect or *otherwise determine* the applicant's NAICS code" the FI may report it as "undetermined." This would appear to impose some obligation on lenders to attempt to seek out the NAICS code where it is not supplied by the borrower. We agree with such a requirement, at least in cases in which the financial institution interacts with the borrower either in person or over the phone. However, it may be more feasible in such cases for lenders to reliably determine a three-digit NAICS code than the full six-digit code and we recommend that the rule permit the submission of a three-digit code where the applicant does not provide a six-digit code. (For applications submitted online or via the mail and processed electronically, requiring lenders to do more than solicit the NAICS code on the application may not be feasible.)

Number of Principal Owners (§ 107(a)(21)) – Proposed Comment 107(a)(21)-3 requires FIs to maintain procedures reasonably designed to collect information from applicants as to the number of principal owners. The Comment goes on to state that "if a financial institution is nonetheless unable to collect or otherwise determine the applicant's number of principal owners" the FI may report the number of principal owners as unknown. The Bureau should clarify what "otherwise determine" means in this context and, in particular, clarify that an FI can limit its investigation to documents (if any) obtained from the applicant in the normal course, rather than creating an obligation to conduct a due diligence investigation of corporate records to ascertain the number of principal owners.

Conclusion

It has now been more than a decade since Congress enacted Section 1071 and directed the Bureau to adopt regulations to implement this section. The need for these data is even greater now than it was in 2010 when the Dodd-Frank Act was enacted. The Bureau should therefore proceed as expeditiously as it can to issue a final rule so that implementation can begin and data can be collected and made public.

Sincerely,

CRL- The Center for Responsible Lending
National Association for Latino Community Asset Builders
National Coalition for Asian Pacific American Community Development
National Fair Housing Alliance
United States Hispanic Chamber of Commerce
National Asian/Pacific Islander American Chamber of Commerce and Entrepreneurship

League of United Latin American Citizens
Main Street Alliance
National Alliance of Community Economic Development Associations
National Council of Asian Pacific Americans
National Fair Housing Alliance
National Federation of Filipino American Association
Partner Community Capital
Small Business for America's Future
Empowering Pacific Islander Communities