Consumer Financial Protection Bureau December 14, 2020
1700 G St NW
Washington, DC 20552

Dear CFPB Section 1071 Team,

The Responsible Business Lending Coalition[1] ("RBLC") appreciates the opportunity to comment on the Consumer Financial Protection Bureau's ("CFPB" or "the Bureau") "Outline of Proposals under Consideration to Implement Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)."

[1] Responsible Business Lending Coalition. http://www.borrowersbillofrights.org/

The RBLC and our partners represent over 500 nonprofit community organizations, for-profit small business financing companies, community development financial institutions ("CDFI"), advocacy nonprofits, civil rights groups, chambers of commerce, and tens of thousands of small businesses. This unusual combination of for-profit and nonprofit organizations has come together around a mission of driving responsible practices in the small business lending sector. We strongly believe implementing Section 1071 will help address both access to capital and irresponsible lending problems by bringing much-needed transparency and insight to the small businesses lending market.

Section 1071 of the Dodd-Frank Act amended the Equal Credit Opportunity Act ("ECOA"), Regulation B, to require financial institutions to compile, maintain, and submit certain data on applications for credit by women-owned, minority-owned, and small businesses. The Bureau's outline represents the first step in the rulemaking process to implement the statutory directive. The RBLC encourages the Bureau to adhere to Congressional intent to facilitate enforcement of fair lending laws and enable communities, governmental entities, and creditors to identify business and community development needs and opportunities for women-owned, minority-owned, and small businesses. Our comments are not exhaustive but instead prioritize the issues which are most important to the successful implementation of the law.

A comprehensive Section 1071 rule will spur innovation in small business lending, especially to women- and minority-owned small businesses, by creating the first market transparency into lending models that effectively reach these businesses. It will demonstrate that small and diverse businesses can be well-served, and will spotlight products and business models that serve them. This will create market incentives to invest in the lending models that the data show are most effective. Financial institutions that the data indicates are doing a poor job serving diverse and small businesses will begin looking to build, buy, or partner to employ the business models that can reach these markets. This motivation will arise not only from fair lending requirements, but also by demonstration of profitable market opportunities. In this sense, Section 1071 can be a pro-innovation regulation. Simply by creating transparency into the functioning of the market, Section 1071 could harness market forces to spur the development of better, more inclusive small business financing.

For Section 1071 implementation to be successful, the CFPB must ensure that the data collection established in rules provides sufficient information on financing to minority-owned and women-owned businesses to inform ECOA enforcement, future rulemaking considerations, and market behavior. Specifically the RBLC strongly recommends that the CFPB:

1. Include financing products that have a disproportionate impact on minority-owned, women-owned, and small firms, such as merchant cash advances ("MCAs") and factors.
2. Include pricing in the form of Annual Percentage Rate ("APR") among the mandatory data points collected.

In the following comment, we offer recommendations on these crucial topics, and several others.

1. Covered Products Should Include Merchant Cash Advance and Other Common Products

The Bureau's proposed list of covered products under Section 1071 is too narrow and excludes common financing and capital products that many small businesses use to fund their enterprises. Specifically, we urge that MCAs, factoring, and equipment leasing be included in the list of covered products. Therefore, the Bureau should adopt a broad standard or definition of credit that includes all financing products offered to small businesses. Small businesses depend on a variety of financing products for different business use cases and exempting any one product or financial institution ignores the legislative intent of Section 1071, by facilitating the enforcement of fair lending laws for just some products and financial institutions, creating an uneven playing field of compliance requirements among providers, and restricting the ability to identify business and community development needs.

It is particularly important the 1071 rule includes the forms of financing that disproportionately impact minority-owned, women-owned, and small businesses, such as MCAs. Federal Reserve research shows that minority-owned businesses are twice as affected by "*potentially higher-cost and less transparent credit products*"—a phrase the Federal Reserve uses to refer *specifically* to MCAs and factoring financing.[2] Women- and minority-owned businesses are more likely to use these alternative financial products because they often have smaller revenues,[3] which necessitate smaller-dollar loans. Banks are less likely to underwrite smaller loans because their cost structure makes them unprofitable, leaving a wide credit gap for nonbank lenders to fill.[4] A Section 1071 rule would fall far short of its purpose of describing how the capital needs of small, women-owned, and minority-owned businesses are being met, if it excludes the financing products that disproportionately affect these businesses.

According to a CFPB white paper, the estimated number of accounts for factoring products was estimated to be eight million, MCAs with one million, and equipment financing at nearly nine million. These three products accounted for over 18 million accounts, 2.5 times the estimated 7 million term loan accounts.[5] While the dollar amount of factoring and MCA products is smaller than term loans, quantifying factoring and MCAs by number of accounts illustrates that these types of credit are widespread. Additionally, leasing products make up 13% of the small business financing market share in dollar terms, further indicating that those products should also be included.

The Bureau is currently proposing to exempt MCAs because "including them may add additional complexity or reporting burden given the unique structure of the transactions." However, much of the regulatory complexity for addressing these products has been resolved at the state level. Both New York and California have passed small business financial protection laws covering MCAs, in part because of concern about how these products are affecting minority-owned businesses. New York's *Small Business Truth in Lending Act* and California's SB 1235 each cover MCAs as a form of "sales-based financing,"[6] providing a regulatory structure, and setting out specific

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[2] Federal Reserve Bank of Atlanta, "Small Business Credit Survey: Report on Minority-Owned Firms," Dec 2019. https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/20191211-ced-minority-owned-firms-report.pdf

[3] Farrell, Diana, Wheat, Chris, and Mac, Chi, JPMorgan Chase Institute, "Small Business Owner Race, Liquidity, and Survival," July 2020. https://www.jpmorganchase.com/content/dam/jpmc/jpmorgan-chase-and-co/institute/pdf/institute-small-business-owner-race-report.pdf

[4] Mills, Karen and McCarthy, Brayden, Harvard Business School, "The State of Small Business Lending: Innovation and Technology and the Implications for Regulation," 2016. http://www.hbs.edu/faculty/Publication%20Files/17-042_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf

[5] Consumer Financial Protection Bureau, "Key dimensions of the small business lending landscape," May 2017. https://files.consumerfinance.gov/f/documents/201705_cfpb_Key-Dimensions-Small-Business-Lending-Landscape.pdf

[6] In the New York Small Business Truth in Lending Act, S5470, sales-based financing is defined as "a transaction that is repaid by the recipient to the provider, over time, as a percentage of sales or revenue, in which the payment amount may increase or decrease according to the volume of sales made or revenue received by the recipient…" See https://www.nysenate.gov/legislation/bills/2019/s5470

standards for calculation of data points such as the estimated APR. The Bureau can limit the complexity of covering this crucial part of the market by utilizing these state-level solutions.

The Federal Reserve in its annual Small Business Credit Survey[7] found that "Hispanic-owned firm applicants sought MCA products more frequently than did White-owned businesses". MCAs are often marketed as loans, use underwriting practices that factor in merchants' credit ratings and bank balances (instead of their receivables), and fail to reconcile the merchants' repayment of the advances. For example, the California Department of Financial Protection and Innovation recently wrote that the MCA agreement "does not put the risk of the 'purchase' of receivables on [the financing company]'s shoulders, but rather the risk of repayment on the merchant's shoulders, just like a loan."[8]

The Bureau is also considering exempting factoring products because "factoring arrangements are generally not considered subject to ECOA or Regulation B". Similar to MCAs, factoring products represent a significant source of capital for small businesses and, therefore, should be covered. The Federal Reserve found that "Black-owned business applicants applied for factoring more frequently compared to White-owned firm applicants."[9] Again, both New York and California have passed laws[10] covering factoring in their respective commercial financing disclosure laws as defined: "The term 'factoring' means a transaction that includes an agreement to purchase, transfer, or sell a legally enforceable claim for payment held by a recipient for goods the recipient has supplied or services the recipient has rendered that have been ordered but for which payment has not yet been made."

If MCAs and factoring are exempted from Section 1071, the resulting unlevel playing field would exacerbate the irresponsible lending problem impacting minority-owned businesses. These products would gain a regulatory advantage, encouraging the proliferation of what the Federal Reserve has described as "potentially higher-cost, less-transparent credit products"[11] at the expense of responsible financing. And at the expense of the businesses who would suffer as a result. The CFPB should not "pick winners and losers," and it should certainly not pick the winners to be the products that are known to be harming minority-owned and Main Street businesses.

2. Pricing Data Should be Collected As In the Form of Annual Percentage Rate (APR)

The RBLC commends the Bureau on proposing that pricing data be collected and believes it is crucial for the Bureau to collect APR as a mandatory data point for all covered products. Collecting pricing data will help meet the fair lending purpose of Section 1071 as it can enhance the ability to effectively and efficiently enforce fair lending laws. APR is the best pricing metric to collect because it allows for apples-to-apples price comparison between financing of different term lengths, amounts, or product types. It also includes all finance charges, such as

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[7] 2019 Federal Reserve Report on Minority Owned Firms: Small Business Credit Survey
https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/20191211-ced-minority-owned-firms-report.pdf
[8] State of California - Department of Financial Protection and Innovation, "Consent Order for Allup Finance LLC," November 2020. "https://dfpi.ca.gov/wp-content/uploads/sites/337/2020/11/Consent-Order-Allup-Finance-LLC.pdf"
[9] ibid.
[10] The New York State Senate, "NY State Senate Bill S5470B," March 2020.
https://www.nysenate.gov/legislation/bills/2019/s5470
(cont.) California Senate, "Senate Bill No. 1235," Oct. 2018.
https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180SB1235
[11] ibid.

interest and fees, to account for the true, all-in price. It is familiar to borrowers and financiers, vetted by over 50 years of the Truth in Lending Act.[12]

APR can be straightforward to calculate. In fact, many commercial financing providers already calculate and disclose APR, and all who operate in California or New York will soon be required to disclose APR under new state laws. The CFPB can make APR data collection simple by collecting the APR required under relevant state laws or, where no state law is in place, adopting a similar approach to what is required by these laws.

The New York *Small Business Truth in Lending Act* and California's SB 1235 establish that APR for small business financing should be calculated according to the Truth in Lending Act regulations. This APR formula can flexibly accommodate any combination of payment amounts and frequencies. For products like MCAs, providers must use a projection of the borrower's sales volumes to establish the payment amounts and dates that plug in to the APR formula. These financing companies already have those sales projections and must use them to underwrite the financing.

For calculating APR under Section 1071, providers of sales-based financing such as MCAs should use whatever sales projections they used in underwriting. In the highly unlikely case providers do not have sales projections, they should establish sales projections based on the average historical sales of the borrower, as described in the *New York Small Business Truth in Lending Act*.[13] The provider chooses a period of 1-12 months and establishes the sales projections as the average sales over the most recent period of this number of months. To further ensure accuracy in the data, providers of products like MCAs should include the actual retrospective APR of recently paid-off financing in their annual Section 1071 reporting. This way, the CFPB will have a record of APR as anticipated at origination, and then later the actual retrospective APR. This is essentially the flexible "underwriting method" adopted under California's SB 1235 rule[14] and the "opt-in method"[15] in New York.

Considerations for Publication of APR Pricing Data

If pricing data are collected, they should be published in concert with demographic information only in aggregate form, such as at an industry or multi-firm level. At an individual firm level, publication of pricing information by demographic groupings risks creating fair lending conflicts that are not based on adequate analysis. In other words, the CFPB may permit the publishing of the APR range and averages of a certain firm, and the demographics of the applicants the firm has served. It should not permit publishing of the APR averages provided to different demographic groups by that firm, or applicant-level information including both pricing and demographic information. If pricing data are restricted from publication in concert with demographic information at a firm level, this unnecessary confusion can be avoided.

Fair lending analysis requires sophisticated techniques to determine whether differences in pricing result benignly from differences in creditworthiness, or represent unequal outcomes.

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[12] Consumer Finance Protection Bureau, "12 CFR part 1026.4 Finance Charge," April 2019.
https://www.consumerfinance.gov/rules-policy/regulations/1026/4/
[13] New York Assembly, "S05470 §803(C)(I)" May 2019.
(cont.) https://nyassembly.gov/leg/?default_fld=&leg_video=&bn=S05470&term=2019&Summary=Y&Actions=Y&Text=Y
The New York State Senate (2020)
[14] California Senate (2018)
[15] New York Assembly, "S05470 Summary," May 2019.
https://nyassembly.gov/leg/?default_fld=&leg_video=&bn=S05470&term=2019&Summary=Y&Actions=Y&Text=Y

While HMDA data collection may be able to benchmark consumer creditworthiness with a credit score variable, small businesses are much more heterogeneous than mortgage borrowers and not as easily benchmarked. Standard small business credit scores are not available for a very significant portion of businesses, and are not as effective at classifying risk as standard consumer credit scores for consumers. Additionally, small business creditworthiness is evaluated in different ways. Benchmarking may require different data points for different types of business and financing products.

In the following pages, we offer comments on several other topics raised in the CFPB's Outline of Proposals.

Scope of the Rulemaking

To uphold Congressional intent, the Bureau should require financial institutions to collect and report applicant data for as many small businesses, minority-owned businesses, and women-owned businesses as is reasonably possible. We believe the Bureau's proposal to only include minority and women-owned businesses that are "small" is a reasonable approach considering this would include 99.9% of all minority- and women-owned businesses. However, the Bureau should monitor the U.S. Census Bureau's Annual Business Survey and re-evaluate this approach if minority- or women-owned businesses that are not considered "small" exceed 1%.

Financial Institutions & Lender Coverage

The small business financing industry comprises various types of providers and products offered by both depository and non-depository providers. In order to derive a complete and accurate understanding of the market, the RBLC supports the Bureau's efforts to define financial institutions broadly, to include most types of institutions that serve small businesses. It is important to get a full understanding of the providers and the market so that regulators can accurately assess the business and community development needs and opportunities for women-owned, minority-owned, and small businesses and facilitate enforcement of fair lending laws across all institutions.

Regarding exemptions, the RBLC supports an activity-based exemption of 25 loans or $2.5 million in originated loans. The Bureau estimates that this would cover more than 99% of small business originations from depository institutions, which is admirable coverage in dollar terms.

Definition of "Small Business" Applicants

Generally, the definition of small business should be inclusive of as many small businesses in every industry as possible and should be clear enough to be efficiently implemented by lenders. In our letter to the Bureau dated September 14, 2017[16] we recommended that the CFPB define small business non-equity financing rather than defining a small business. This approach would avoid the complications that produced the SBA's complex NAICS-specific size criteria, as well as some complications of addressing multiple-entity relationships. However, we understand the Bureau did not adopt our approach of defining small business non-equity financing.

We think the Bureau's proposal to create a size standard using the business applicant's gross annual revenue from the prior year, with a potential "small" threshold is the next best approach. To be as inclusive of as many small businesses as possible in every industry, following Congressional intent, we recommend that threshold be $8 million in gross annual revenues instead of the proposed $1 million or $5 million. $8 million is the most common

[16] Responsible Business Lending Coalition, "RBLC Letter to the CFPB: Dodd-Frank Act Section 1071 Request for Information," September 2017.
http://www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/final_rblc_letter_to_cfpb_on_1071.pdf

size standard threshold and would ensure we capture all small businesses across industries without needing to determine employee count, making it the most efficient definition to implement.

We believe using an $8 million sales threshold for all small businesses has two benefits relative to “Option B” proposed by the CFPB, which we would otherwise favor. Option B defines small businesses as a business with sales volumes below $8 million, except for manufacturing or wholesale businesses, which are considered small businesses if they have fewer than 500 employees. First, a definition based on sales volume only, rather than a combination of sales volume, industry, and employee size, will be less burdensome for providers to apply. It enables more straightforward data analysis whenever the data is used.

Second, a simpler definition will produce more useful data. A researcher would be unable to use the Option B definition, or the Section 1071 dataset it would produce, for analysis of small business financing with any new data on aggregates of multiple small businesses or financing accounts. They would also not be able to use the Option B definition with data that includes sales volumes, but are not broken out by industry and employee size. These would be very significant restrictions! A complex definition would thus reduce the value of the Section 1071 data for research, economic analysis, legal analysis, investment analysis, advocacy, or any other purposes that would advance the goals of Section 1071 regulation. A simple definition, such as all small businesses with less than $8 million in sales, would cover the market broadly while creating data that can be most easily used to improve lending to small, women-owned, and minority-owned businesses.

Definitions of “Women-Owned Business,” “Minority-Owned Business,” and “Minority Individual”

The RBLC supports the Bureau’s approach regarding the definition of women-owned and minority-owned business whereby a business is considered as such when more than 50% of the ownership is held by one or more women or minority individuals. However, this definition should in no way suggest that race and gender data be collected only on applicants that identify as women and/or minority individuals.

However, Section 1071(h)(5) and (6) that defines a women- or minority-owned business may be problematic for a few reasons:

- “More than 50 percent of the ownership or control” excludes equal partnerships with opposite sex partners. This is particularly an issue with married couples that equally own a business together. We recommend “50 percent or more of ownership or control” to resolve this issue. Not doing so may underreport some women-owned and minority-owned businesses.
- Applicants should be able to self certify that “more than 50 percent of the net profit or loss accrues to one or more minority individuals” and lenders should not be required to verify this information. Any requirement for lenders to make that determination or verify would present an overly burdensome operational requirement.

We recommend the Bureau propose guidance clarifying that a minority individual is a natural person who is Black or African American, Asian, American Indian or Alaska Native, Native Hawaiian or Other Pacific Islander, and/or Hispanic or Latino, which mirrors the terminology of the Home Mortgage Disclosure Act’s (“HMDA”) aggregate categories and would also clarify that a multi-racial person could be considered a minority individual.

Definition of an “Application”

We agree with the Bureau’s proposal to define an application using Regulation B’s definition of the term application, and that inquiries, prequalifications, and similar should be explicitly clarified as not reportable. We understand the desire to try to capture data on "discouragement". The application process can vary greatly between lenders, especially comparing in-person lenders with those online, making "prequalifications" and the like impractical to include in the definition of an application.

Section 1071 data on approval rates will produce inaccurate conclusions if the Bureau does not take into account the different stages at which an application may take place in different forms of financing. For products offered online, an application generally represents the first expression of interest in financing by a small business. Many online applications can be completed in a few minutes, and take place before any conversation occurs between the small business and financing provider.

In contrast, applications at traditional financial institutions often take place after the small business owner has spoken with the financing provider and gathered a range of paperwork required for the application. Those conversations may encourage or dissuade a small business from applying. In some cases, business owners may not apply based on an assumption, whether real or perceived, that they would not qualify.

Minority-owned firms may be disproportionately discouraged through this process. As described in the National Community Reinvestment Coalition research cited above, bank staff offered to help white business owners complete the loan application 27% of the time, and offered to help black business owners only 12% of the time.[17] In an online lending process, these business owners would likely have already completed their application. Because approval rates for traditional, in-person application processes do not include the large percentage of business owners who were discouraged from applying in the first place, approval rates of traditional financial institutions are generally inflated when compared to online loan approval rates.

Race, Sex, and Ethnicity of Principal Owner(s)

The Bureau is considering proposing to define the term "principal owner" in a manner that is consistent with the Customer Due Diligence ("CDD") rule of 25%. However, we believe the Bureau should be consistent with industry practice and apply the SBA definition of principal owner as any owner with 20% ownership or alternatively consider defining a principal owner as one with at least 20% ownership.

Timing Considerations for Collection of Certain Section 1071 Data

It is important that the timing for collecting certain data maximizes participation, reduces friction in the application process as much as possible and is flexible enough that it takes into account the varying application processes of lenders. We believe the best way to do this is to require demographic information be collected during the application process and before the application is considered complete.

Additional Data Points to Collect

The RBLC believes collecting and reporting the census tract for each application is important to understand the geographic distribution of commercial financing especially in low-moderate income areas.

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[17] Bone, Sterling A., Christensen, Glenn L., Williams, Jerome D., Adams, Stella, Lederer, Anneliese and Lubin, Paul C, "Detecting Discrimination in Small Business Lending," September 12, 2017. Available at SSRN: https://ssrn.com/abstract=3035972.
National Community Reinvestment Coalition comment, "RE: Request for Information Regarding the Small Business Market, Docket No. CFPB-2017- 0011," Sept. 2017. https://ncrc.org/wp-content/uploads/2017/10/ncrc_comment_re._request_for_info_on_small_bus_market2.pdf

Additionally, in an effort to aid the identification of discouragement in the application process, we recommend that the Bureau collect and report the mode of application to either be in person, phone or online.

Considerations for CDFIs

Community development financial institutions ("CDFIs") play an important role in delivering affordable capital to small businesses that lack banking relationships or otherwise cannot access traditional financing sources. As CDFIs are nonprofits often operating on thin budgets, and already report a significant amount of data to the U.S. Treasury Department's CDFI Fund, we recommend that the CFPB collaborate with the Fund to harmonize reporting requirements as much as possible to reduce regulatory burden for these small entities.

Conclusion

The RBLC appreciates the opportunity to provide comments on the Bureau's outline of proposals. As mentioned in this letter, we strongly recommend that the CFPB include pricing in the form of APR among the mandatory data points collected, and include financing products that have a disproportionate impact on minority-owned, women-owned, and small firms, such as merchant cash advances.

We believe the implementation of 1071 to be an important part of making the industry more transparent and inclusive, which will benefit small businesses and the commercial financing industry. Bringing more sunshine to the marketplace will help lenders, policymakers, community organizations, and others create innovative ways of delivering capital to Main Street businesses, particularly as they rebuild during and after the COVID-19 pandemic.

Sincerely,

1. The Responsible Business Lending Coalition

    Members include: Accion Opportunity Fund, Community Investment Management, Funding Circle, LendingClub, Opportunity Finance Network, Small Business Majority, StreetShares, and the Aspen Institute

2. Access Plus Capital
3. Accion Opportunity Fund
4. Accion San Diego
5. American Nonprofits
6. AmPac Tri-State CDC
7. Anacostia Economic Development Corporation
8. Anchor Financial Services
9. Asian Pacific Islander Small Business Program
10. California Association for Micro Enterprise Opportunity
11. California Capital Financial Development Corporation
12. Camino Financial
13. CDC Small Business Finance
14. Centro Community Partners
15. CEDS Finance
16. Coalition for Nonprofit Housing and Economic Development
17. Community Development Services

18. Community Loan Fund of the Capital Region, Inc.
19. Community Reinvestment Fund, Inc.
20. COOK Alliance
21. Credit Builders Alliance
22. Economic Development & Financing Corporation
23. Emory Beacon of Light, Inc.
24. Funding Circle
25. Halo Business Finance Corporation
26. ICA.fund
27. Kiva
28. La Cocina
29. Latino Economic Development Corporation
30. LendingClub
31. Main Street Launch
32. Marketplace Lending Association

    Members include: LendingClub, Prosper, Funding Circle, Avant, Marlette Funding, Affirm, Common Bond, Upstart, Peer Street, Lending Point, College Ave, and SoFi

33. Mission Economic Development Agency
34. Mountain BizWorks
35. Multifunding
36. National Coalition for Asian Pacific American Community Development
37. Next-Financing
38. NYS CDFI Coalition
39. Opportunity Finance Network
40. Pacific Asian Consortium in Employment
41. Prairie Rose Development Corporation
42. Revolve
43. Silver Lining Ltd
44. Small Business Majority
45. SMB Intelligence
46. Street Entrepreneurs
47. Thread Capital
48. TMC Community Capital
49. UpState New York Black Chamber of Commerce
50. Wisconsin Women's Business Initiative Corporation
51. Working Solutions