December 14, 2020

The Honorable Kathleen Kraninger
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

Re: 1071 SBREFA Outline

Dear Director Kraninger:

The Consumer Bankers Association (CBA)[1] greatly appreciates the opportunity to comment on the Consumer Financial Protection Bureau's ("CFPB" or "Bureau") Small Business Regulatory Enforcement Fairness Act ("SBREFA") outline concerning the small business lending market and the pending rulemaking pursuant to Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[2] Section 1071 amends the Equal Credit Opportunity Act ("ECOA") to require financial institutions to compile, maintain, and report information concerning credit applications made by women-owned, minority-owned, and small businesses. Under Section 1071, every financial institution must inquire of any business applying for credit whether the business is a small business, or a women- or minority-owned business, maintain a record of the information separate from the application, and report the information along with related information about the application to the CFPB. The information must be made public on request in a manner to be established by regulation and will be made public annually by the Bureau.

As we have maintained since the promulgation of Section 1071, CBA and its member institutions strongly believe that the CFPB should keep top of mind that although Section 1071 mandates this rule, it is not as simple as data collection efforts undertaken on other lending products such as residential mortgages. The notion that business lending parallels nicely to residential mortgage lending is misplaced. The use of Home Mortgage Disclosure Act ("HMDA")-like reporting for business lending activity to ferret out potential

[1] The Consumer Bankers Association is the only national financial trade group focused exclusively on retail banking and personal financial services—banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation for its members. CBA members include the nation's largest bank holding companies as well as regional and super-community banks that collectively hold two-thirds of the total assets of depository institutions.
[2] Pub.L. 111-203.

discrimination is, in our opinion, a tremendously flawed premise because the two types of transactions differ inherently in many key aspects:

- Residential lending all share the same type of collateral. Business lending may not be secured at all, and when secured, the type of collateral varies tremendously.
- Residential lending has (with rare exceptions) consumers as the applicants. Business lending involves loans to all sorts of applicants, ranging from sole proprietors to sophisticated corporate structures.
- Business loans are often renewals rather than new loans. These renewals are not akin to refinances in the residential world.
- Business loans have much shorter and varied durations.
- The appropriate property address for a business loan to use for reporting and analysis can be debated with no easy or right answer.
- Capturing business loan applicants for reporting and analysis can be debated with no easy or right answer given the various ownership and structures.

We believe the CFPB should keep in mind that the dissimilar nature of business lending presents two-fold challenges:

1) Determining which data fields to mandate be collected, developing standard values to be reported for many of the fields, and proposing workable rules for how to collect and report the data will be tremendously difficult, at least if the goal is to have a thoughtful, achievable rule that yields useful data.
2) Constructing fair lending analysis approaches that will yield meaningful and appropriate conclusions for business lending is likely even more challenging.

Considering these issues and the need to streamline the credit process to extend credit with greater speed to qualified applicants, CBA and its member institutions cannot stress enough the importance of well-balanced rules under Section 1071 in order to avoid overly burdensome data collection requirements that could stifle small business lending, greatly increase compliance costs for small business lenders, and open the door to costly litigation. Key to this rulemaking will be the ability for lenders to address 1071 reporting compliance with already existing reporting systems (e.g., Community Reinvestment Act, FinCEN Beneficial Ownership Rules, etc.) to ensure as little disruption in the market as possible. These systems will need to be automated and accurate. Adherence to systems already in place will allow lenders to streamline the collection process.

To this end, CBA recommends the Bureau consider implementing a phased approached to Section 1071 data collection. The ultimate intent of the 1071 statutory text and the goal of any subsequent rulemaking is to provide meaningful data that accurately assesses the current state of small business lending and, as a result, cure for discrepancies in the market. Additionally, as previously noted, implementation of this process will be complicated and burdensome for lenders of all kinds. Accordingly, we recommend the Bureau begin the 1071 data collection process with a narrowly proscribed subset of small

business lending (e.g., new originations) in order to fine tune the process of 1071 data collection before requiring reporting on multifaceted products and services. Beginning with a narrow subset of products will allow for the collection of more informative data at the start of the 1071 collection process. This initial process will help inform the approach taken to any expanded collection and will alleviate many of the unnecessary costs associated with a full-blown initial collection.

Again, we thank you for your consideration and we look forward working with the CFPB as it assesses the issues surrounding Section 1071 and small business data collection.

Small Business Definition

CBA believes there are several important issues that need to be addressed for the purpose of streamlining the 1071 rulemaking. These include:

- Limiting the collection to women or minority owned "Small Business" entities only,
- Simplifying the definition of "Small Business" to one that is easily applied at time of application,
- Defining products in scope for reporting (e.g., home equity lines of credit, lines of credit, brokerage secured accounts, letters of credit, etc.), and
- Defining transaction types that are in scope (e.g., new loans). CBA believes modifications to existing loans are not in scope.

Limiting Data Collection to Woman- and Minority-Owned Small Business

As the CFPB noted in the SBREFA Outline, a strict reading of the statutory language would mandate lenders to collect information for ALL entities, large or small, that are at least 51% owned by women and/or minorities and for ALL small businesses, regardless of ownership characteristics. This strict interpretation, of course, poses many issues with the scope of the proposed data collection and the logistical burden it would require. It would be reasonable to assume Congress did not intend to have lenders collect this type of information on large companies.

In light of the comprehensive coverage of women-owned and minority-owned businesses within the scope of small businesses, the Bureau is considering proposing that the data collection and reporting requirements of its eventual 1071 rule would apply to any application to a financial institution ("FI") for credit only for small businesses. The Bureau is concerned that a requirement to collect and report 1071 data on applications for women-owned and minority-owned businesses that are not small businesses could affect all aspects of FIs' commercial lending operations while resulting in limited information beyond what would already be collected and reported about women-owned and minority-owned small businesses.

CBA strongly supports and agrees the scope of the statute should be limited to women- or minority-owned small businesses, rather than all commercial loan applicants. Including large businesses that are women - or minority-owned would substantially increase regulatory burden without providing additional insight into small business financing practices or meaningful tools for determining discrimination because loans to larger businesses are more heterogeneous and therefore less comparable.

Defining "Small Business"

The language in subsection 704B(h)(2) reads:

> *"Small Business – the term 'small business' has the same meaning as the term 'small business concern' in section 3 of the Small Business Act (15 U.S.C. 632)."*

We believe it will be very important that the regulations provide very clear and simple definitions of "small," "women-owned," and "minority-owned," as well as the specific information that must be obtained from Covered Entities. Lenders will be asking applicants for the information during the application process. If these requests for information are not clear and simple, applicants are less likely to provide the information, and it is less likely to be accurate if they do provide it. Additionally, the more complicated the terms, the more burdensome it will be on financial institutions application procedures as lenders attempt to convey their meaning to applicants. For many business loans, there is no formal written application. While some business loan applications are taken on paper, many are taken over the phone, and verbally in-person with the banker entering the information into the lender's application system, sometimes by laptop. Especially in verbal circumstances, a complicated question is not likely to result in consistent and accurate responses from as many applicants as possible.

Accordingly, the definition of "small business" that the new Subsection 704B(h)(2) of ECOA appears to incorporate is very impractical. It provides that "small business" has the same meaning as "small business concern" as defined in Section 3 of the Small Business Act.[3] If this is interpreted as incorporating the Small Business Administration's regulatory definition in 13 CFR Part 121 that differentiates the definition of a small business concern by NAICS codes, an applicant would need to apply more than 35 pages of entity categories to identify the criteria to be used to determine if it is a small business. It could also mean utilizing the number of employees for some industries and revenue size for other industries, using the SBA's very specific definition of revenue. Further, for many industries the SBA size standards include entities with up to 1000, or even 1500 employees. Applicants of this size are most often managed by institutions' middle market or corporate banking groups and are often originated on different systems than small business or business banking groups, which could significantly complicate implementation. Moreover,

[3] 15 U.S.C. 632

inclusion of larger and more profitable business could obscure the data about truly small businesses that the Bureau seeks under Section 1071.

Moreover, that very complicated and involved definition must be applied by the applicant during the application process in order to determine whether or not the lender must also inquire about the race, sex and ethnicity of the principal owners, as is required under Section 704B(e)(2)(G). Ironically, in some cases a complicated definition of small business may increase the burden for small business owners who are applying for credit, especially for unsecured credit such as credit cards. For example, certain institutions use credit scoring models, and the application process does not require the institution to gather information on the number of employees and annual revenues of the business – two elements that are essential to the SBA's definition of small business.

Considerations for Defining "Small Business"

For the reasons listed above, CBA has always maintained that the CFPB will need to develop a more appropriate definition of small business; one that is clear and concise so applicants will be able to quickly determine if they qualify as small businesses. A definition as complicated as the SBA definition based on NAICS codes, while appropriate for SBA purposes, would likely increase the number of applicants that decline to respond and would result in questionable data because it would be impossible for that definition to be applied consistently during the application process across the banking industry. Section 3(a)(2)(C) of the Small Business Act authorizes any federal agency to prescribe size standards provided certain conditions are met, including that the definition is proposed after an opportunity for public notice and comment and is approved by the Administrator of the SBA. A definition adopted under this authority would meet the requirement of Section 704B(h)(2) that the term "small business" has the same meaning as the term "small business concern" in Section 3 of the Small Business Act.

The Bureau is considering three alternative approaches for a simple size standard. Under the first alternative, the Bureau is considering proposing a size standard using the gross annual revenue of the applicant business in the prior year, with a potential "small" threshold of $1 million or $5 million. For the reasons discussed below, we believe a $1 million threshold is the most appropriate approach and is more representative of true small businesses and is how most lenders would categorize their small business units within these parameters. A larger threshold would likely distort the data and create unnecessary compliance burdens for lenders.

A simplified definition will help facilitate a streamlined, easily applied standard that can be employed by bankers in a consistent manner across institutions. Accordingly, the definition should not rely on data that is not commonly collected by financial institutions (e.g., number of employees) or combine consumer and commercial debt. Additionally, when determining whether a business enterprise seeking credit qualifies as a "small business", it would be helpful for the CFPB to clarify that "gross annual revenue" of the

applicant business includes the aggregate total of revenue for any relevant affiliates, guarantors, holding companies, or subsidiaries.

Although there is no perfect solution, we believe the Bureau's consideration to use revenue size as a determining factor is the most feasible of all alternatives presented in the SBREFA outline. However, we urge the Bureau to go slightly further and include loan size as a determining variable as well. This would apply to all enterprises (including all parent entities, subsidiaries, and affiliates) that, at time of application, had $1 million or less in prior year gross annual revenue and have requested loan amount of $1 million or less. If the bank does not collect loan amount requested, then revenue of $1 million or less is the sole determinant. For some credit cards and other lending products for which revenue is not collected, the determination may be based on a loan amount requested of $1 million or less exclusively.

Providing a definition of small business such as the above, would allow for somewhat less friction in the process, eliminate confusion, provide for easy application, and allow lenders of all kinds to make as many loans as possible. The Bureau's two other SBREFA outline considerations for defining a small business under Section 1071 do not provide the type of streamlined, easily applied standards. Under the second alternative, the Bureau is considering proposing a size standard of a maximum of 500 employees for manufacturing and wholesale industries and a maximum of $8 million in gross annual revenue for all other industries. This creates two standards, and an $8 million threshold is too high. Under the third alternative, the Bureau is considering proposing a size standard using gross annual revenue or the number of employees based on a size standard in each of 13 two-digit NAICS code categories that applies to the largest number of firms within each two-digit NAICS final rule or otherwise prescribes the size standard for its use. This consideration is unworkable for reason previously stated. Even if just 13 codes were used, lenders and borrowers alike would have great difficulty applying them.

We urge the Bureau to give this issue great consideration to ensure lenders of all types will be able to continue to make loans to small businesses in need and the Bureau will have success collecting the information it seeks on small business lending.

Defining "Women-Owned" and "Minority-Owned"

Similar to the definition of "small business," it is important to have simple definitions of "women-owned" and "minority-owned", so applicants are able to quickly and easily determine if they fit into either of those categories. This will require a very generic definition of "control" and "net profit and loss." The Bureau is considering proposing clarifications for the definition of "women-owned business" and "minority-owned business" by using simpler language that mirrors the concepts of ownership and control

that are set forth in the Financial Crimes Enforcement Network's Section Customer Due Diligence ("CDD") Rule.[4] We support this approach.

Small businesses can have complex ownership structures. Accordingly, a CDD approach would limit 1071 data only be collected on self-identified beneficial owners with 25% or more ownership of each borrowing entity. Also, since guarantors may or may not have ownership interests, we recommend that the data not be collected on a non-owner guarantor or minority (less than 25%) owner of the borrowing entity. Additionally, if an owner of the borrowing entity is another company and not an individual, we recommend that 1071 data not be required for the owners of that business, as this would add an unworkable level of complexity during the application process.

These principles are consistent with compliance with the CDD Rule. Under the CDD rule, covered financial institutions must establish procedures to:

- Identify each natural person that directly or indirectly owns 25% or more of the equity interests of a legal entity customer (the "ownership prong");
- Identify one natural person with "significant responsibility to control, manage, or direct" a legal entity customer (the "control prong"), which may be a person reported under the ownership prong; and,
- Verify the identities of those persons according to risk-based procedures, which procedures must include the elements currently required under the Customer Identification Rule at a minimum.

Identification of those beneficial owners must be conducted at the time a new account is opened.

Scope of 1071 Data Collection

Section 1071 requires FIs to collect and report information regarding any application for "credit" made by women-owned, minority-owned, and small businesses. Although the term "credit" is not specifically defined in section 1071, ECOA defines "credit" as "the right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer its payment or to purchase property or services and defer payment therefor." The Bureau is considering proposing that a covered product under section 1071 is one that meets the definition of "credit" under ECOA and is not otherwise excluded from collection and reporting requirements. Specifically, the Bureau is considering proposing that covered products under section 1071 include term loans, lines of credit, and business credit cards. We agree with this approach and offer our previously submitted thoughts for further consideration.

[4] 31 C.F.R. Parts 1010, 1020, 1023, 1024 and 1026.

We believe the scope of Section 1071 should be limited to loans for commercial and industrial purposes to business entities where the revenues from the on-going business operations of the business enterprise are the primary source of repayment of the loan. Thus, section 1071 should not apply to the following loan types:

- Loans primarily for personal, family and household purposes.
- Loans secured by real estate other than loans secured by owner-occupied commercial real estate where the primary source of repayment is the cash flow from the ongoing business operations of the owner/operator or an affiliate of the owner of the real estate.

Additional Considerations:

Many small business loans are made to organizations in which an "owner" is hard to ascertain or does not exist at all. For purposes of 1071, we recommend the CFPB create a list of exemptions for these organizations. Some considerations include:

- Commercial loans are sometimes made to trusts. The trust may be a single purpose trust, such as a land trust that is established only to hold specific real estate, a traditional estate planning vehicle or, though more infrequently, a business trust. We recommend that loan applications by trusts be excepted from the coverage of Section 1071. Including trusts within the Section 1071 regulations could raise difficult issues regarding who should be considered for data collection purposes - the settlors, beneficiaries, trustees or some combination thereof, what is the "net profit or loss" of the trust, as well as who is entitled to that net profit or loss. Under these circumstances, the burdens associated with involving trusts within Section 1071 coverage would not be justified by the minimal information that would be generated with respect to loans to trusts.
- Nonprofit organizations also appear to require special treatment, at a minimum, under the final regulations. By definition, a non-profit does not have "net profit or loss" that accrues to individuals, and generally does not have owners. Consequently, it would be difficult, if not impossible, to determine if a nonprofit is a minority-owned or women-owned business. Depending on the ultimate definition of a small business, it may also be difficult to apply that definition to a nonprofit. For these reasons, we recommend that loan applications from nonprofit organizations also be exempted from the coverage of Section 1071.
- Public agencies would rarely be considered a small business. Additionally, they have no identifiable individual owners.
- Commercial loans are sometimes made to corporations which are owned by other corporations, which may, in turn, be owned by other corporations, limited liability companies, or individuals. We recommend that such loans be excepted from the coverage of section 1071, or, if not excepted, that the CFPB provides clear definitions of how such loans should be reported.

- Similarly, we recommend that publicly traded companies also be exempted from coverage of Section 1071. It is very unlikely that a public company will be a women-owned, minority-owned or a small business because these organizations are generally not owned by one man or woman. Given that share ownership of public companies is often held by intermediaries or in street name, it would be difficult to even obtain the information necessary to make the determination. It does not seem, therefore, that there is much, if any, benefit to be gained from requiring lenders to include in their application processes to inquire and record this information if the applicant is a publicly traded company.
- Foreign owned entities.

Additionally, there are unique situations in which we believe certain credit products should be exempt from the provisions of 1071 or, at a minimum, receive special consideration. These include:

- Credit cards and other forms of open-end credit products should receive special consideration. Traditionally requesting credit line increases ("CLI") is not a cumbersome process. Businesses may need to quickly access additional credit where time is of the essence and the Bureau should consider ways to minimize burden on applicants making such requests. We urge the Bureau to give CLIs further consideration and to not include them in the initial collection of Section 1071 data.
- It is not unusual for business loan customers to have multiple loan facilities with their lenders. For example, the business may require a real estate loan to purchase its business premises, a term loan to purchase needed equipment, or a working capital line of credit. These may be obtained at once as part of one closing transaction, and as a result of one application process, or they may occur over a period of time resulting in multiple applications. It would seem appropriate, therefore, to have special rules for the recurring application situations.
    - With respect to any of the information required to be gathered/recorded under Section 1071 that a lender does not normally gather with each application, we recommend that lenders be permitted the option to use the answers provided by an applicant for up to three years from the date of an application for which the information was gathered, rather than being required to re-ask the questions for each application.[5] Under this scenario, the lender would not be required to re-ask the race, sex or ethnicity of the principal owners of a Covered Entity and, instead, would be entitled to use the information on record from the previous inquiry for a three year period. Additionally, if a lender does not re-ask for the gross annual income for a new credit application because it is relying on its records from a previous transaction, the lender would not be required to re-ask for that information.

[5] Banks are currently allowed to use revenues that are as much as three years old for CRA reporting.

    - Additionally, many business loans are not fully amortized at maturity, and so may be refinanced; and lines of credit are generally for one or more years in durations with the intention of being renewed upon maturity. We would also recommend that renewals and refinances (whether or not being increased) be exempted from coverage entirely. It does not seem that there is much to be gained with respect to the purposes of Section 1071 from reporting what is merely the continuation of an existing loan.
    - It is also common for business customers to have multiple loans with different lenders. Lenders should not be held accountable for inconsistencies that would exist in information provided to different lenders.
- Secondary market transactions, where a lender is not extending credit or participating in the credit decision, should be exempt from the application of Section 1071. A prime example of this situation would be a lender's purchase from an automobile dealership of loans the dealership made to businesses to purchase automobiles (the loans made by the automobile dealers would appear to be subject to the regulations of the Federal Reserve Board of Governors rather than those of the CFPB). With respect to institutions that purchase these loans from the automobile dealers, we do not think these loans should be covered by the information gathering and reporting requirements applicable to the acquirer and would recommend that the CFPB's regulations confirm this exclusion. As a practical matter, it would be extremely difficult for a third-party purchaser to obtain information from an applicant with whom the purchaser has no direct contact until after the loan is purchased.
- Participation loans should be exempt from reporting because loans tend to be sophisticated deals and generally do not include small businesses. The burden of including these types of loans outweighs whatever benefits there would be in reporting them.
- One of the required fields is the amount of credit applied for. However, credit card applications generally do not involve applying for a certain dollar amount, and applicants do not usually indicate that they are applying for a specific amount of credit. We recommend, therefore, that the information gathering, and reporting requirements provide for flexibility in the event that the information required under Section 1071 is not applicable to a specific product.

The Bureau has listed specific products it is considering <u>not be</u> covered by the 1071 rule: consumer credit used for business purposes, leases, trade credit, factoring, and merchant cash advances ("MCAs"). While we generally agree with the list of products under consideration for exclusion under 1071, we do not believe the Bureau should exclude MCAs. CBA believes MCA's should be included as these mainly offered by non-DIs and is a significant product stream. MCAs are higher cost credit products, and the Bureau should know the extent to which small businesses, including women-owned and minority-owned businesses, are relying on this form of financing. Importantly, MCAs can be the only credit available to the most vulnerable small businesses and so are particularly important for

Bureau data collection and regulation. Exclusion from 1071 reporting will likely dissuade borrowers from using DIs to apply for traditional credit products, due to the collection of 1071 data, and drive them to those non-DIs offering MCAs to their detriment to the extent they were otherwise qualified to obtain traditional credit products on better terms. This would create a significant disadvantage to DIs and would produce an unclear picture of small business lending trends.

While banks are typically the first place small businesses consider when seeking a loan, the landscape for business lending has changed substantially in recent years, with alternative banking options gaining significant credibility. Nonbank alternatives come in a variety of forms, from Peer-to-Peer lenders like Prosper and Lending Tree and B2B lenders like Fundera or OnDeck to Rewards-Based Crowdfunding like KickStarter and Equity-Based Crowdfunding such as OfferBoard. Most of these sources are online-based and sought for their convenience and the ease/speed of obtaining the funds. Despite their small scale, the technology used by these alternative players is fundamentally changing many of the ways in which small businesses access capital and create efficiencies, adding to greater competition in the small business market. Accordingly, we believe all lenders should be covered by any rule promulgated under Section 1071 in order to ensure a level playing field and a complete picture of market.

Most importantly, there needs to be comprehensive regulatory guidance (similar in detail to Regulation C, and "A Guide for HMDA Reporting Getting It Right!") defining the form and content of reporting criteria so lenders understand exactly what information must be requested, and to help ensure consistency of data reporting from all financial institutions.[6]

Definition of an "application"

Section 1071(b) requires that FIs collect and report to the Bureau certain information regarding "any application to a financial institution for credit." Thus, for covered FIs with respect to covered products, the definition of "application" will trigger data collection and reporting under section 1071. The term "application," however, is not defined in either section 1071 or ECOA, though it is defined in Regulation B.

The Bureau is considering proposing to define an "application" largely consistent with the Regulation B definition of that term. That is, as "an oral or written request for an extension of credit that is made in accordance with procedures used by a creditor for the type of credit requested. The Bureau is also considering proposing to clarify certain circumstances that would not be reportable under section 1071, even if certain of these circumstances are considered an "application" under Regulation B. These include:

[6] Under 15 U.S.C. 1691c-2(g) (1) and (3), the CFPB is *required* to provide guidance to (1) carry out, enforce, and compile data pursuant to Section 1071 and (2) facilitate compliance with the requirements of Section 1071, including assisting financial institutions in working with applicants to determine whether the applicants are women-owned, minority-owned, or small businesses for purposes of this section.

- Inquiries/prequalifications;
- Reevaluation, extension, and renewal requests, except requests for additional credit amounts;
- Lender initiated credit line increases;
- Solicitations and firm offers of credit.

While CBA has concerns about the inclusion of requests for additional credit amounts as stated above, CBA generally agrees with this approach and urges the Bureau to further consider the below-referenced obligations of lenders in the 1071 process.

Lenders' Obligation to Inquire During Application Process – Covered Entities

Section 1071 of the Dodd-Frank Act imposes on lenders the obligation to inquire whether or not a loan applicant is a women-owned, minority-owned, or small business (Covered Entity). Applicants are provided with the right to decline to respond to a lender's inquiry under the statute.

While it appears quite clear from the statutory language, we would request that the CFPB's regulations implementing Section 1071 also provide that (a) lenders are not obligated to make any of their own determinations or observations concerning whether or not applicants are Covered Entities, (b) lenders are not responsible for the accuracy of, and may rely on, the responses of the applicants' representatives, and (c) lenders do not need to continually ask, if applicants are not responsive.

The statutory requirement that lenders "inquire" of the applicant if it is a Covered Entity, recognizes that lenders will generally not be in a position to know at the time of application, and possibly not at any point in the loan underwriting process, whether or not an applicant is a women-owned, minority-owned or a small business. Additionally, in many situations, lenders will not have the ability to make their own determinations, by observation or otherwise. For example, many, probably most, businesses have more than one owner or personnel with authority to apply for credit on behalf of the Covered Entity. When a banker takes a business loan application, the banker will likely be speaking with one representative of the business, who may or may not be an owner. Consequently, the banker may not know or be able to observe whether the applicant is women-owned or minority-owned and will be dependent on the answers of the representative completing the loan application. If the Covered Entity is a corporation or structured legally to distinguish the entity from the individual employees, the individual completing the application may not understand how to complete the monitoring information. The banker may also not have sufficient information to determine the size of the applicant if, for example, the applicant has not provided information concerning its size, and the application becomes withdrawn, closed for incompleteness, or declined.

For the same reasons as noted above, it would also be impractical to require lenders to attempt to confirm the accuracy of applicants' responses. Such a requirement would also

be inconsistent with the statute which contemplates that the information should come from the applicant on a voluntary basis.

Consequently, we request that the CFPB's implementing regulations specifically include language that lenders are only obligated to pose 1071-applicability questions to the representative submitting the application for an applicant business, that lenders may rely upon the answers provided by the representative of the applicant making the application (including a refusal to provide the information under Section 704B(c)), and that lenders have no duty to make and record any of their own observations or determinations. In this regard, Section 1071 should be viewed very differently from the HMDA, which involves circumstances in which bankers are more likely to be able to make certain observations concerning the applicant, because the banker may not have the opportunity to make a visual observation of the owner of the business. We believe clear guidance on the obligations and duties of the lender are important because, although the information is being provided by applicants, lenders will be responsible for reporting the information as provided under Section 1071.

Additionally, there may be circumstances in which an applicant misidentifies as a small business prompting the lender to inquire about race, ethnicity, and/or sex of the principal owners of the applicant, all of which could be violations of the ECOA. We recommend that a safe harbor be adopted and that lenders not be held liable in such scenarios.

Lenders will also need clarity under the regulations as to when their obligation to make these inquiries is fully satisfied. If an applicant is non-responsive, lenders should not be placed in the awkward position of having to continually re-ask questions that may be sensitive for the applicant, and lenders' loan application processes should not be burdened and prolonged by an obligation to continually seek responses. Rather, after having asked the questions once, lenders should only be required to record the applicant's answers. For example, if the representative of the business that is making the application believes s/he should check with the other owners before sharing whether or not the applicant is a Covered Entity, the lender should be able to record that the applicant did not answer and should not have to ask again. If the applicant subsequently volunteers an answer prior to a denial or closing of the loan, as applicable, the lender could update its records.

Lender's Duty to Inquire – Additional Information Concerning Covered Entities

New Subsection 704B(e)(2) of ECOA, contained in Section 1071, requires lenders to compile and maintain certain information about Covered Entities and their principal owners. Some of this information will be available to lenders from their own records, such as the application number and application date. However, for some of the information required by this Subsection, lenders will again be entirely dependent on the individual completing the application. Lenders will be dependent on the individual to provide information concerning the Covered Entities' gross annual revenue, and the sex, race, and ethnicity of the principal owners.

For example, when a business banker takes an application, some of the principal owners of the business may not be present and the representative of the business making the application may not know the race, gender, or ethnicity of the principal owners, or s/he may not feel comfortable sharing the information if s/he does not know that the principal owners wish to provide it. Consequently, s/he may decline to provide the information, in which case the lender would record the declination. Or the representative may explain that s/he will have to check with the principal owner(s) not present; under these circumstances, what information is the lender to report if (a) the application is withdrawn or declined before the representative provides the information or advises that s/he will not be providing the information[7]; or, (b) the application is approved and the loan is closed, but neither the representative nor any of the other owners provide the lender with the information or advise the bank that they will not be providing the information?

Similarly, there will be circumstances in which the applicant has not provided the lender with the applicant's gross annual revenue before the application is withdrawn or declined. Consequently, lenders should not be held responsible if the information is not available because the applicant does not provide it, nor can lenders be responsible for the accuracy of the information. Similar to whether or not an applicant is a Covered Entity, lenders should only be responsible for asking applicants for the information and recording what is provided.

These examples raise a few points of concern, which we request clarification in the CFPB's regulations:

- Similar to the inquiry concerning whether the applicant is a Covered Entity, lenders should only have to request the information under Subsection 704B(e)(2) once, and lenders should be able to rely on the responses of the applicants' representatives without any obligation to make their own determinations or observations, or to otherwise check or correct those responses. In a circumstance in which an applicant has identified itself as a Covered Entity and does provide the lender with its gross annual revenue, the lender may verify that information as part of its normal underwriting process which requires such documentation through, for example, the review of tax returns. Although we do not believe lenders should have the obligation to check the accuracy of applicants' responses, we suggest that if it is the lender's practice to revise the application information in its system to reflect what it believes to be a verified number, the lender should be permitted to report the verified number retained in its system, rather than requiring the lender to maintain both numbers in its system. In any event, the lender's verification of revenue should not result in the lender being required to change the applicant's self-classification as being a small business or not being a small business, e.g., a Covered Entity. As noted, we believe the information that Section 1071 is intending to capture needs to be requested at the time of application, this is especially so for instances in which the

[7] It is common for small businesses to look at obtaining a loan from multiple lenders simultaneously. In the lending arena, borrowers may apply to many lenders to get the best deal and pull through a loan with just one. This apply-and-withdrawal process would greatly skew the industry's data about lending rates.

application is declined and there would be little if any opportunity to obtain the information subsequently. Consequently, the determination of whether or not an applicant is a "small business" needs to be made by the applicant at the time of application so the lender knows whether to ask for the additional information and, for consistency and so as to not place excessive burdens on lenders' application processes, lenders should not be changing the applicant's self-characterization later in the process and then be required to make an additional inquiry of the applicant for purposes of Section 1071.

- A lender should be able to rely on the answers of the representative of the applicant making the application, including with respect to whether the applicant is a small business and whether such small business is minority or women-owned, even if the representative is not a principal owner to the organization which the information may relate.
- For purposes of information and to avoid confusion on the part of loan applicants, we recommend that the CFPB's regulations include standard language that a lender may, but is not required to, use to explain why the lender is inquiring if the applicant is a Covered Entity and requesting information relating to race, ethnicity and sex of the principal owners, the ability of the applicant not to furnish the information, and an affirmative statement that the lender will not discriminate on the basis of the information or whether the applicant chooses not to furnish it. A sample of such standard language, which is solely based on language in HMDA's implementing rule, Regulation C, is as follows: the federal government requires lenders to ask for the following information to monitor compliance with federal laws that prohibit lenders from discriminating, and to assess business and community development credit needs. You may refuse to furnish this information but are encouraged to provide it. A lender may not discriminate on the basis of this information, or on whether the information is voluntarily furnished.
- We believe it is important that the reporting requirements allow for entries that can address circumstances such as those described above. We would recommend "Declined to Answer" if the applicant declined, and "Not Available" for all other circumstances in which the applicant did not provide the information notwithstanding the lender's inquiry, such as a withdrawn application or non-responsiveness on the part of the applicant. We recommend the CFPB create a business-specific information form to gather information from the applying business and that the lender only be required to faithfully report what is provided on the form. Optional use of such a form should be clarified as many loan applications are taken verbally and without the customer completing anything.
- Subsection 704B(e)(2)(E) requires financial institutions to record the census tract of the applicant's principal place of business. This raises the question of the appropriate definition of the "principal place of business." Generally, lenders use the address the applicant provides during the application process for their records. That address may be the physical address where the main local operations are located and may be used for site visit purposes but may not necessarily be the business' headquarters. It will reduce the information-technology burden of compliance with Section 1071 if a lender is able to use as the applicant's "principal

place of business" the address provided by the applicant as part of the lender's normal application process, rather than requiring lenders to also collect and record a different address based on a specific definition in the regulation – such as the state of organization, location with majority of principal officers, location generating the most business for the applicant, headquarters, or some other criteria. Another alternative would be to incorporate the address required under CRA, which is the address where the proceeds of the funds will primarily be used. We think it may be helpful to align the definition with the one currently used under CRA and would appreciate the CFPB to consider conforming definitions to those presently used in the industry to avoid confusion.

Data Points

Section 1071(e)(1) requires each FI to compile and maintain a record of certain information provided by any credit applicant pursuant to a request under section 1071(b), and report that information to the Bureau. The Bureau refers to this information, along with the applicant's responses to the inquiries under 1071(b)(1), as "mandatory data points," which include: (1) whether the applicant is a women-owned, minority-owned, and/or small business, (2) application/loan number, (3) application date, (4) loan/credit type, (5) loan/credit purpose, (6) credit amount/limit applied for, (7) credit amount/limit approved, (8) type of action taken, (9) action taken date, (10) census tract (principal place of business), (11) gross annual revenue, and (12) race, sex, and ethnicity of the applicant's principal owners. CBA believes this mandatory data points sufficiently capture the information sought under Section 1071 and additional data points would be unnecessary, creating more constraints on borrowers and lenders alike.

Timing of Data Collection

Although the definition of "application" triggers a covered FI's duty to collect 1071 data, the statute does not provide further direction on when during the application process information should be collected. The Bureau is considering not specifying a particular time period during the application process when FIs must collect 1071 data from applicants and seeks to provide FIs discretion and flexibility to time 1071 data collection at a point during the application process that works best for their processes and relationships with the applicants and to avoid unnecessary costs, while still fulfilling section 1071's purposes.

CBA fully supports this approach and believes it will allow for more accurate reporting in situations where strict collection mandates would be difficult. Primarily, flexibility in the timing of collection will help alleviate some the additional issues created by point-of-sale lending, such as transactions in the Private Label or co-brand credit ("Point of Sale Credit") market. As discussed below, this unique market illustrates how upfront collection of 1071 information could be extremely impractical for reasons beyond the lenders control.

Point of Sale Credit

Many retailers offer their small business customers the ability to obtain retail credit at the point of sale through a bank partner. The credit could be in the form of private label or cobranded credit cards, or other types of credit originated at or facilitated through retailers, such as revolving lines of credit, installment loans, etc. (collectively, "Point of Sale Credit"). Extension of this credit can occur with a variety of retailers (e.g., warehouse club, home improvement, general merchandise, etc.). For example, a small business may have a membership at a warehouse club, where the small business can obtain a private label credit card. Or a building contracting company may rely on private label credit from a home improvement retailer and its bank partner.

While Point of Sale Credit functions the same as most other types of credit (e.g., credit card, installment loan, etc.), the application process and environment differs from other types of small business credit in a variety of ways and creates a number of policy considerations. As mentioned above, Point of Sale Credit applications typically occur at the point-of-sale of the retail partner. There is no uniformity in the operational experience from one retail partner to another. Some accept applications in the traditional check-out line; some via the customer service desk; some do so via a pin pad or a tablet; and still others continue to issue paper applications. There's also variety of locations where these credit applications are completed: the traditional check-out line, the customer service desk, and online are typical options. Given the variance of the retail partners, applying a one-size-fits-all standard for this type of credit will be problematic. In a typical small business lending transaction (e.g., in a retail banking environment), a bank employee is likely working directly with the owner of the business or another senior executive. The interaction between these two parties has the potential to generate reasonably accurate 1071 data (assuming the applicant is willing to provide it) because the applicant may be more likely to know the answer to the 1071 application questions and the banker would be trained to assist with any questions or nuances. This is not the case in a Point of Sale Credit context.

With Point of Sale Credit, the applicant is not necessarily the owner or other senior executive, but often the person likely to be making purchases using the account (e.g., office manager picking up office supplies at warehouse club). While applying for this type of credit at the point-of-sale, this individual may not know the answers to specific data points, such as whether the business is a small business and, if so, the demographics of the principle owners. In that instance, there are material risks that those individuals proceed to "check a box" simply to submit the application. Furthermore, a retail partner would not be optimally positioned to explain the 1071 questions or assist an applicant with questions about the requested data points.

In short, the unique aspects of the Point of Sale Credit market are not a recipe for quality data. Not only might the 1071 information not be accurate, but its utility from a public policy perspective might also be questionable. Regarding the reporting financial institution, a point of sale lender's application demographics will reflect the demographics and geographic footprint of the retail partner, not the lender's outreach (or lack thereof) to

any particular demographic. With regard to the retail partner, the Bureau should ensure that when publishing the 1071 data, one cannot make partial conclusions about their customer demographics, as the data will not include all patrons of the retailer and could lead to incorrect assumptions.

The setting for Point of Sale Credit applications tends to be a very public place: the retail store itself. We commend the Bureau for recognizing the importance of putting plain language questions and definitions on the application in an attempt to standardize responses and minimize confusion. Despite these clarifications, applicants will still undoubtedly ask the store associate how to answer specific questions. That will not be an informed discussion, nor will it be done privately. We submit that a retail customer service counter—with everything that goes on around it—is not the place to have a private discussion about how to think about the size of the business, or whether the principal business owners are female, or their ethnicity (assuming the applicant knows who truly owns the business).

Requiring new fields on the Point of Sale Credit application will likely lead to an increase in delayed and abandoned applications. For example, the applicant may falsely perceive that their demographic response could negatively factor into the credit decision, and therefore abandon the application at the point-of-sale. Other applicants might feel that it is important to complete all requested fields – including information around demographics – but abandon or pause the application because he or she does not have that information at the time. These questions almost certainly will result in less small business Point of Sale Credit being offered due to delayed and/or abandoned applications.

The provisions that restrict underwriters' access to 1071 data could have a disproportionate impact on Point of Sale lending. While automated underwriting plays a role in Point of Sale lending, manual reviews of application files are not uncommon. This process results in *increased* credit to small businesses. However, if lenders are forced to choose between rebuilding data processes or simply streamlining the application process by eliminating judgmental reviews, it may be that small businesses may be negatively impacted.

For the reasons enumerated above, we urge the Bureau to consider the unique aspects of Point of Sale Credit and act to ensure that the data collection requirements for Section 1071 do not unintentionally impede access to credit or discourage businesses from applying for credit. As you are aware, federal regulators have historically recognized the unique nature of certain Point of Sale Credit products (e.g., Private Label Credit) by excluding it from general requirements of other regulations (e.g., FinCEN's beneficial owner rule; CFPB's Regulation P data sharing opt-out requirements). We believe there are a variety of ways the Bureau could address the aforementioned concerns without sacrificing the integrity of its 1071 data collection, ranging from exempting the transactions to permitting Point of Sale Credit lenders to solicit the 1071 information outside of the point-of-sale environment (e.g., solicit optional response data in a follow up communication within a reasonable temporal proximity to the submission of the application). Our members have begun to socialize the SBREFA Outline with their retail partners and are

working to determine options that balance access to credit with the statutory requirements. We look forward to discussing viable options with the Bureau.

Privacy Considerations Involving Bureau Publication of 1071 Data

The Bureau is examining the privacy implications of FIs' collection, reporting, and disclosure of information pursuant to 1071 and the Bureau's public release of the data. Accordingly, the Bureau is considering proposing to use a "balancing test" that weighs the risks and benefits of public disclosure. Under this approach, data would be modified or deleted if its disclosure in unmodified form would pose risks to privacy interests that are not justified by the benefits of public disclosure in light of the statutory purposes of section 1071. If the risks of disclosing unmodified data outweigh the benefits under the balancing test, the Bureau would determine whether modifications could bring them into balance. The Bureau is considering various approaches that would appropriately advance privacy interests while still providing users with data useful to fulfilling the purposes of section 1071. These approaches could include various statistical disclosure limitation techniques when justified under the balancing test, such as those that mask the precise value of data points to prevent the disclosure of certain data elements.

We disagree with this proposed approach and maintain, for reasons discussed in detail below, the Bureau should issue a clarifying provision for excluding personally identifiable information in compiling and maintaining any record of information from the different stages in the process (e.g., bank systems, regulatory submission file).

Additionally, any considerations for privacy provisions to 1071 data collection, and all other considerations for 1071, should be undertaken in one rulemaking. CBA does not support a bifurcated process (e.g., HMDA) as this will only add to confusion due to lack of clarity at time of compliance.

1071 Data Presents Particular Privacy and Data Security Concerns

Massive breaches of consumers' private information collected and maintained by companies and government--affecting millions or even tens of millions of consumers—have become commonplace, making information protection and data security a matter of highest priority to our members. Even loan-level 1071 data collected and made available to the public in combination with other publicly available data sources, if provided for all data fields, could easily enable data prospectors, bad actors and others to "reidentify" individual borrowers' exceedingly confidential data and exploit it for their own purposes.

A White House report analyzing Big Data's benefits and challenges ("Big Data Report") defined re-identification as the process where previously de-identified information is re-connected to reveal the identity of the person.[8] It noted a "mosaic effect"

[8] The White House, *Big Data: Seizing Opportunities, Preserving Values,* pg. 8 (May 2014)

is used to infer a person's identity from datasets that do not include personal identifiers.[9] The Big Data Report cautions that, even if information does not include personal identifiers, "it is difficult to predict how technologies to re-identify seemingly anonymized data may evolve. This creates substantial uncertainty about how an individual controls his or her own information and identity, and how he or she disputes decision-making based on data derived from multiple datasets."[10] Consequently, if 1071 data are inadvertently or knowingly released to the public, the harm associated with re-identification would be even greater.

As discussed more fully below, CBA strongly urges that 1071 data should not be made publicly available. If it is, the CFPB must adopt detailed rules for collecting and releasing data and *only* after public notice and comment. These rules should specifically address the treatment of each 1071 data field subject to release as well as conditions on release outside government for research or other purposes. Similarly, to protect against data breach, we urge the CFPB to detail the types of data security safeguards it will undertake and publish them for public comment. The possibility of a breach of confidential financial data is even more troubling when consumers cannot control distribution of data concerning them, as seems to be the case with 1071.

1071 Data Fields Must be Kept Confidential and Not Released

The public release of loans rates and terms has anticompetitive implications for lenders. For example, small business lending is often relationship-based, with lenders basing rates and structure on often longstanding relationships with small business customers and an in-depth understanding of their business models. In contrast, it is not nearly as common for a mortgage customer to have multiple loans outstanding, and therefore it has a much smaller impact. The release of this information for public consumption will undermine the relationship advantages a lender has with its customers.

It will also be difficult for any individual or group to analyze the data properly and fairly for many reasons - properly identifying a Covered Entity, relying on an individual's representations, etc. HMDA requires the reporting of rather vanilla type information strictly tied to credit transactions for the purchase, refinance, or home improvement of a dwelling. In contrast, the small business segment of lending offers varied products that make it more difficult to produce across the board analyses. Small business lending takes many forms, and the comparison of this data will be infinitely more complex than that used for HMDA reporting. If the expectation is to obtain information that is sufficient to allow regulators to conduct standard fair lending analyses – underwriting, pricing, and redlining – HMDA-like comparisons will be impossible to make. For example, business loans often lack standard pricing information, and it will be difficult to establish an all-in pricing metric that is effective for comparisons. Also, these loans have much greater variation in duration

http://www.whitehouse.gov/sites/default/files/docs/big_data_privacy_report_may_1_2014.pdf.

[9] *Id.*

[10] *Id*.

and, therefore, these metrics are greatly impacted by duration when trying to combine fees and interest rates. Accordingly, we believe the public reporting of the data will create a substantial and undue burden on lenders to respond to baseless complaints and litigation generated by faulty analyses; however well-intentioned they may be.

Firewall Provisions

The language in new subsection 704B(d) reads:

"Where feasible, no underwriter, or any employee involved in making a determination may have access to the information—and if they do, need to provide disclosure to applicant." - 1071(d). How would DFA firewalls create a problem? What changes would make it less onerous?

Subsection 704B(d)(1) requires financial institutions to prevent underwriters and others "involved in making any determinations concerning an application for credit" from having access to applicants' responses to the question of whether they are Covered Entities, where preventing such access is "feasible." We believe that this feasibility standard should consider whether preventing such access would require a lender to alter its application and/or underwriting systems. Most lenders' application systems either feed directly into the underwriting system or also serve as the underwriting systems. Consequently, prohibiting underwriters from having access will likely require altering at least one system. We would like to suggest, instead, that each financial institution should be permitted to determine whether such segregation of information is feasible under their existing systems and/or lending operations. If a financial institution deems it not feasible, then the financial institution would provide the notice required by subsection 704B(d)(2) rather than altering any of its systems.[11]

Also, this requirement is likely to be very difficult to implement because the description of the employees that trigger the requirement is vague and subjective. It is not clear what is meant by others "involved in making any determinations concerning an application for credit." The general practice concerning business loans is for a banker to take the application and gather the required information, which is then sent to the underwriting department where the credit decision is made. However, "determinations concerning an application for credit" could be interpreted as including any counseling the banker may provide to the applicant concerning the type of product that would best suit the applicant's credit request, and sometimes the banker (or their manager) may have the ability to override the underwriter on certain matters. Consequently, the banker (or the manager) may be considered as one involved in making determinations concerning an

[11] The statutory language in 704(B)(d)2) states that "if a financial institution determines that a loan underwriter …**should** have access…." (emphasis added), suggesting that the underwriter "should" have access whereas it is unclear if the provision includes circumstances in which the underwriter will have access just by the design of the application and the systems. We suggest the CFPB clarify that notice in 704(B)(d)(2) applies in both circumstances.

application for credit. This would appear to require a lender to provide the notice required under Section 704(d)(2) in all circumstances. In any event, lenders may determine that it is better to provide the notice in all situations to cover the possibility that, notwithstanding any safeguards established by the lender, an underwriter or other person involved in making a determination concerning the application inadvertently has access to the information.

Accordingly, we recommend that the CFPB provide a model disclosure with a safe harbor that lenders could provide in any circumstance to cover the possibility that an individual that fits the stated description *may* have access to the subject information, but that does not state that such an individual definitely will have such access. This would alert applicants, as seems to be the intent of the statute, and yet allow lenders to implement a uniform approach that would cover both circumstances where there is such access and where there is not. Additionally, we would request some guidance on the type of employees that are covered and those that are not.

Ultimately, the firewall concept will multiply the regulatory burden for all institutions, since it means the data cannot be collected on the application and must be stored in systems or files that the underwriter cannot access. Additionally, even providing disclosure to the applicant that underwriters *may* see the information will lead the borrower to assume the information is being used in decision making. The very collection of the information will lead borrowers to such conclusions, as evidenced by borrower responses to requests for government monitoring information on mortgage loan applications. Most importantly, the provision is unnecessary, as the very purpose of the rule will be to allow regulators to perform more fair lending analyses.

It is worth noting that lenders, in accordance with HMDA, collect government monitoring information on the Uniform Residential Loan Application, which does not require a firewall. Without evidence to the contrary, the CFPB should consider using its exemption authority and not include this requirement in the implementing regulations for Section 1071.

Compliance Lead Time

The Bureau is considering proposing that FIs have approximately two calendar years for implementation following the Bureau's issuance of its eventual 1071 rule. The CFPB believes this timeline would provide for loan processing and management vendors to adjust their products and services to accommodate 1071 requirements, and for FIs to update or revise their systems and processes and make other changes necessary to meet the new 1071 data collection and reporting requirements.

CBA agrees with this timeline as it is important that lenders have a significant amount of time to implement the new requirements once the regulations are final to determine what changes will be necessary in their procedures, forms, policies, and systems, and then to implement those changes. System modifications require not only time for

development, but also for appropriate testing before being implemented. It is difficult to say exactly how much lead-time lenders will need to implement the regulations without knowing the specific requirements for implementation, which will only be known when the regulations are final. However, based on previous experience, we think that the suggested 24-month period for implementation would be appropriate. In addition, as the information is to be submitted annually, any implementation date would need to take this into account.

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CBA greatly appreciates the opportunity to share our suggestions and to work with the Bureau as it considers the regulation regarding Section 1071. Should you need further information please do not hesitate to contact the undersigned directly at 202-552-6368 or dpommerehn@consumerbankers.com.

Sincerely,

David Pommerehn
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