Small Business Lending Data Collection Under the Equal Credit Opportunity Act (Regulation B)

Submitted by mlongacre@csbs.org on Thu, 01/06/2022 - 13:59

Comment Intake – Section 1071
Small Business Lending Data Collection Bureau of Consumer Financial Protection
1700 G Street NW
Washington, DC 20552

Re: Proposed Rulemaking: Small Business Lending Data Collection Under the Equal Credit Opportunity Act (Regulation B)

Docket No. CFPB-2021-0015 RIN 3170-AA09

Dear Sir or Madam,

The Conference of State Bank Supervisors ("CSBS") appreciates the opportunity to comment on the Notice of Proposed Rulemaking ("NPR" or "Proposal") issued by the Bureau of Consumer Financial Protection ("CFPB" or "Bureau") titled "Small Business Lending Data Collection Under the Equal Credit Opportunity Act (Regulation B)" to implement the small business lending data collection requirements set forth in section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

State regulators are charged with protecting consumers and ensuring the safety and soundness of the financial institutions they supervise. Their proximity to financial institutions and the communities they serve gives them a unique understanding of the wide variety of market participants operating in the small business lending space. In addition to their supervisory responsibilities, state regulators are committed to fostering economic development opportunities within their states.

State regulators recognize that the Bureau is statutorily required to implement the data collection requirements set forth within section 1071. However, we are concerned that the regulatory burdens and costs associated with implementing the data collection and reporting requirements, as proposed, will have a disproportionate impact on smaller financial institutions that provide the majority of small business credit in rural and underserved areas.

The Bureau's proposal will likely hinder the ability of community banks to continue to serve as an important source of small business credit in communities across the country. Given this implication of the Bureau's proposal, CSBS recommends that the Bureau:

- provide an exemption for smaller financial institutions;
- only require the collection of the mandatory data points;
- work with the appropriate federal agencies to align data collection and reporting requirements within this rule, the Call Report, and the CRA and HMDA regulations; and
- lengthen the implementation timeframe.

The small business lending process is not standardized.

During recent testimony before the Senate Committee on Banking, Housing, and Urban Affairs, CFPB Director Rohit Chopra highlighted the importance of relationship banking and emphasized that

"preserving relationship banking is critical to our nation's resilience and recovery, particularly in these times of stress." State regulators believe that the Bureau can develop a rule that achieves its statutory objectives while also minimizing the burden on community banks and preserving relationship banking.

The process of lending to small businesses is often an art, rather than a science, as lenders tailor loans to meet the unique credit needs of each small business. Community banks exercise prudent discretion and demonstrate expertise in the small business lending process by crafting loans best suited to the current performance and reasonable operating projections of borrowing entities. Attempts to standardize and homogenize small business lending, while appealing to marketplace lenders that extend credit based on limited data and algorithms, will ultimately impede relationship lenders that employ more nuanced methods of extending credit.

CSBS annually conducts the National Survey of Community Banks through which community bankers have historically expressed increasing concern about their ability to compete with larger institutions that are better positioned to offer loans based on quantitative criteria such as credit scores. However, the 2021 survey revealed that community bankers are optimistic about the prospects for small business lending.

More than 40% of bankers expect[ed] the dollar volume of small business loans that are transactional in nature to decline relative to those that are relationship based. If the Bureau does not tailor its proposal, this sentiment will likely reverse, which may lead small businesses to other avenues for credit as opposed to traditional forms of credit. In the sections that follow, CSBS offers several recommendations we ask the Bureau to consider as it implements the 1071 rulemaking.

The Bureau should provide an exemption for smaller financial institutions.

State regulators believe the Bureau should reconsider the proposed definition of "covered financial institution" and provide an exemption for smaller financial institutions. During the rulemaking process, the Bureau sought feedback on the necessity of including asset-based or activity-based exemptions for particular categories of financial institutions. Despite several stakeholders advocating for an exemption, the Bureau moved forward with a "one-size-fits-all" approach in which any financial institution that originated at least 25 covered credit transactions for small businesses in each of the two preceding calendar years would be subject to the rule. This was the lowest lending frequency threshold considered by the CFPB during the Small Business Regulatory Enforcement Fairness Act ("SBREFA") Panel process. Small Entity Representatives (SERs) on the Panel offered extensive feedback on exemptions, which should be revisited and given thoughtful consideration prior to finalizing the rule.

The Bureau offers little rationale for selecting 25 loans as a reporting threshold, indicating that a low threshold would subject more institutions to reporting and thus produce more data to review. Further, the Bureau makes no attempt to explain how it plans to usethe data to achieve the goals of section 1071. State regulators believe a threshold of 25 credit transactions in each of the two preceding calendar years is too low to provide meaningful statistical value relative to the costs that will be imposed on the smallest reporters. The costs of compliance, estimated to range from $58,400 to $95,200 per year, could lead

lenders to reduce their small business lending footprint, exit the small business lending market altogether, or consider pursuing a merger partner. For entities that choose to continue providing credit to small businesses, the

higher costs will be passed on to small business borrowers, making loans less affordable and ultimately reducing access to credit. In sum, CSBS encourages the Bureau to reconsider the scope of its proposal and provide an exemption for small banks.

The Bureau should only require the collection of the mandatory data points.

The Bureau should limit the reportable data to the statutorily mandated data points required by section 1071. The Bureau should refrain from using its discretionary authority to require collection of additional data points until it is proven that the discretionary information is necessary to fulfill the purposes of section 1071.

The Bureau proposes to exercise its discretionary authority to require financial institutions to collect information on pricing, time in business, the North American Industry Classification System (NAICS) code, and the number of workers. While the Bureau believes these data points will better facilitate enforcement of fair lending laws and help identify business and community development needs for small businesses, the Bureau has failed to identify how this additional information will be utilized and disregards the increased burdens the additional data collection will impose on small financial institutions.

First, implementation of the mandatory data points will be burdensome and challenging for reporters. Each data point has several sub-elements, may have to be updated at various stages of the application process, or may be open to various interpretations. For example, the Bureau is proposing section 1002.107(a)(7) which would require financial institutions to collect and report ‘‘the initial amount of credit or the initial credit limit requested by the applicant.” This data point does not initially seem difficult to collect. However, some applicants may not request an amount or may request a range. Some financial institutions will not require such information at the outset. Mandating reporting of a requested loan amount will impose increased compliance burdens and has the potential to disrupt the relationship aspect of small business lending.

Second, the addition of the discretionary data points will impose additional regulatory burden on reporters. Specifically, the Bureau is proposing in section 1002.107(a)(15) to require that financial institutions collect and report an applicant’s 6-digit NAICS code. There are currently 1,057 6-digit NAICS codes. Many financial institutions do not currently collect this information. Applicants may not know their NAICS code or may struggle to determine which code to report especially if the nature of the business changes over time or falls under multiple categories. Moreover, as noted in the proposal, NAICS codes could change based on Small Business Administration (SBA) rulemaking, requiring financial institutions to monitor such developments. The Bureau contends that collecting this information will help them assess community development needs but otherwise fails to explain how the benefits of collecting this data will outweigh the costs and burdens placed on financial institutions. It is particularly noteworthy that elsewhere in the proposal, when defining a “small business,” the Bureau specifically recognized that the NAICS code datapoint is unreliable due to the complexity and burden associated with determining the appropriate code. The Bureau purposefully chose not to usethe SBA’s approach to defining a small business, which bases classification on an applicant’s 6-digit NAICS code. At a minimum, the Bureau should be consistent on what data should be collected, regardless of when in the application process the information is obtained.

Overall, the Bureau fails to provide compelling evidence as to why it is necessary at the outset to collect more than the mandatory data points. State regulators urge the Bureau to limit reporting to the mandatory data collection points and to evaluate the usefulness of this information before exercising its discretionary authority to require the reporting of additional data points.

The Bureau should work with the appropriate federal agencies to align data collection and reporting requirements within this rule, the Call Report, and the CRA and HMDA

regulations.

In its proposal, the Bureau states that while Call Report and Community Reinvestment Act (CRA) data provide some indication of the level of supply of small business credit, the lack of data on small business credit applications makes demand for credit by small businesses more difficult to assess with respect to local markets or protected classes. The Bureau further states that there may be some overlap between what is required to be reported under the Home Mortgage Disclosure Act (HMDA) and what is covered by section 1071 for certain mortgage applications and loans for women-owned, minority-owned, and small businesses. However, the Bureau provides no solution to reconcile instances when similar data will have to be reported for compliance with various regulations.

Overlapping data reporting requests will increase compliance costs, cause confusion for reporters, and diminish the value of the 1071 reporting regime given that in many instances the data already exists. Accordingly, state regulators believe the Bureau should work with the appropriate federal agencies to align data collection and reporting requirements. Aligning the thresholds to those already required by HMDA and CRA could alleviate any inconsistencies and confusion for reporting entities. The Bureau should consider accepting certain CRA or HMDA reporting to substitute for section 1071 reporting to eliminate dual data collection.

The Bureau makes the point that data on small business lending is fragmented, incomplete, and not standardized, making it difficult to conduct meaningful comparisons across products over time. The Bureau further states that the existing data suffer from four material limitations, one of them being the lack of standardization across different agencies. Rather than identifying the deficiency and then proposing an approach that exacerbates the discrepancy, the Bureau should instead work with the appropriate federal agencies to align the data collection and reporting requirements and to reduce the duplication of data collected.

The Bureau should lengthen the implementation timeframe.

The Bureau's proposal would require compliance 18 months after a final rule is published. This is less than the two-year implementation period recommended by many SERs on the SBREFA panel. State regulators believe the Bureau should consider lengthening the implementation timeframe so that financial institutions can be better equipped to compile and accurately report the required data points. The Bureau notes that the proposed approach is a compromise between the two-year implementation period considered during the SBREFA, and a one-year implementation period requested by certain stakeholders. The Bureau believes the statutory purposes of section 1071 are better served by an earlier compliance date that would, in turn, result in earlier publication of data.

Some larger financial institutions might have the resources to quickly develop systems to comply with 1071 reporting requirements, but most community banks will not. Community banks have expressed concerns to state regulators about the need to quickly develop new policies and procedures, hire and train new and existing staff, and establish new relationships with vendors to collect and track the required data. In addition, institutions that are not familiar with federal reporting regimes, such as HMDA, might experience more difficulty in the early stages of implementation. Eighteen months is a short period of time to comply with the rule given the multiple time consuming and costly steps in the implementation

process. State regulators suggest the Bureau meet with bankers and their service providers to understand their limitations and develop a realistic implementation timeframe. Further, the Bureau should also demonstrate its ability to collect the data from all non-bank parties subject to the rule.

Conclusion

State regulators are concerned that, as proposed, the small business data collection and reporting requirements will disproportionately impact community banks and could potentially impede access to credit by small businesses.

While state regulators recognize the Bureau is required to promulgate the 1071 rulemaking, we believe the Bureau can achieve the intent of section 1071 without placing unnecessary burdens and costs on community banks. If implemented as written, the rule could have the unintended consequence of making it more difficult for small businesses to obtain credit. We encourage the Bureau to provide an exemption for smaller depository institutions, require only the collection of the mandatory data points, work with the appropriate federal agencies to align data collection and reporting requirements and lengthen the implementation timeframe. We look forward to working with you as you craft a final rulemaking.

Sincerely,

John Ryan President & CEO

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