CONFERENCE OF STATE BANK SUPERVISORS

September 14, 2017

The Honorable Richard Cordray
Director
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

Re: Request for Information (RFI) regarding the Small Business Lending Market, Docket No.: CFPB-2017-0011

Dear Director Cordray:

The Conference of State Bank Supervisors ("CSBS" or "state regulators") appreciates the opportunity to comment on the Consumer Financial Protection Bureau's ("CFPB" or "Bureau") request for information regarding the small business lending market and section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA 1071"). CSBS is the nationwide organization of state banking and financial services regulators from all 50 U.S. states, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. State regulators are the chartering, licensing and supervisory authorities for over 78% of the banks in the United States and over 20,000 non-depository financial services providers.

State regulators are charged with protecting consumers and ensuring the safety and soundness of the financial institutions they supervise. In addition, many state regulators have an additional responsibility to promote local economic development. Of the 4,537 state-chartered banks, 93% are community banks according to the FDIC's research definition[1]. These banks hold a relatively small percentage of total industry assets, but are responsible for more than 45% of small loans to businesses. State regulators firmly believe that lending should be fair, and all qualified small business owners should have access to credit. However, state regulators are concerned that new small business data collection requirements pursuant to DFA 1071 will have a disproportionate impact on community banks and impede access to credit by small businesses.

The Department of the Treasury recently issued a report[2] ("Treasury Report"), which among other things, urges Congress to repeal DFA 1071. The specific quote applicable to DFA 1071 contained in the Treasury Report states:

> "Although financial institutions are not currently required to gather such information, many lenders have expressed concern that this requirement will be costly to implement, will directly contribute to higher small business borrowing costs, and reduce access to small business loans.

[1] See: https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf

[2] A Financial System that Creates Economic Opportunities Banks and Credit Unions U.S. DEPARTMENT OF THE TREASURY Report to President Donald J. Trump Executive Order 13772 on Core Principles for Regulating the United States Financial System.

> The provisions in this section of Dodd-Frank pertaining to small businesses should be repealed to ensure that the intended benefits do not inadvertently reduce the ability of small businesses to access credit at a reasonable cost."

State regulators recognize that the outright repeal of the small business data collection requirement is outside the control of the Bureau, but we agree with the findings of the Treasury Report with respect to the imposition of additional reporting requirements and urge you to delay implementation of a new data collection process for small business loans until Congress can fully consider Treasury's recommendation.

State regulators' proximity to the financial institutions they supervise gives them a unique understanding of the wide variety of financial firms and loan products offered in the small business lending space. Furthermore, state regulators believe that it is critical for community banks to operate within a regulatory environment that allows them to continue to serve as an important source of small business credit in communities across the country.

Studies have established that long-term lending relationships between banks and businesses are valuable to small firms in terms of increased credit availability and protection against adverse credit shocks.[3] These long-term banking relationships are valuable to community banks and ultimately provide significant economic benefit to the communities where the banks and small businesses operate. Small businesses and start-ups report greater overall satisfaction and higher approval rates at small banks than with larger institutions[4]. The relationship lending model utilized by community banks and preferred by small businesses and start-ups closely aligns the interests of the borrower, bank, and community.

THE SMALL BUSINESS LENDING PROCESS IS NOT STANDARDIZED

The proposed new data collection requirements will require lenders to compile and report a variety of data points regarding small business applications and loans. At a minimum, these new data collection requirements will impose additional and disproportionate compliance costs on smaller financial institutions with limited resources and unnecessarily raise the cost of originating small business loans by all lenders. Community banks exercise substantial discretion and expertise in the small business lending process to evaluate current performance and future operating projections of borrowing entities. The additional discretion utilized in the small business lending process does not lend itself to a standardized reporting format like that of a commoditized real estate mortgage loan. Attempts to standardize and homogenize the small business lending process, while appealing to marketplace lenders that extend credit based on algorithms, will ultimately impede relationship lenders that employ more nuanced methods to extend credit. By fundamentally changing the relationship lending model, entrepreneurs will be denied access to reasonably priced funding options, stifling the opportunities for growth in the economy and job creation.

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[3] "The Benefits of Firm-Credit Relationships: Evidence from Small Business Data," Journal of Finance 49, no. 1 (1994); A.N. Berger and G.F. Udell, "Relationship Lending and Lines of Credit in Small Firm Finance," Journal of Business 68 (1995); and R.A. Cole, "The Importance of Relationships to the Availability of Credit," Journal of Banking and Finance 22 (1998).

[4] See: Small Business Credit Survey 2016, https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-EmployerFirms-2016.pdf.

THE IMPLICATIONS OF FORMULATING A 'SMALL BUSINESS LOAN' DEFINITION

The definition of a "small business" differs from borrower-to-borrower, and attempting to create a generalized data-set to determine compliance with the Equal Credit Opportunity Act ("ECOA") will be ineffective. Small business loans vary both by financial institution and by the business credit product. For example, many small business owners and/or sole proprietors often rely on home equity and/or other sources of consumer financing as a source of initial credit.[5] As the Bureau explores an alternative definition of "small business" that meets the criteria outlined in section 3 of the Small Business Act, it is important to note that bank originated small business loans are tailored to the borrower's unique needs and financing horizons. Attempts to standardize a small business loan definition and establish a generalized data-set will homogenize the loan products available to small businesses and further depress access to credit.

PROBABLE IMPACT OF EXPANDED BUSINESS LENDING REPORTING REQUIREMENTS ON COMMUNITY BANKS

Because of their proximity to the communities and familiarity with the borrowers, community banks lend to small firms that may have been refused funding elsewhere. Through the research that is produced for the annual Community Banking in the 21st Century Research and Policy Conference ("Community Bank Research Conference"), state regulators continue to observe the significant role banks play in supporting local economic growth through lending to small businesses.[6] The Community Bank Research Conference presents an innovative approach to the study of community banks and has brought together academic experts, federal and state policymakers, and community bankers in one forum. The findings from the research are further supplemented by excerpts from interviews of community bankers by state banking commissioners.

In recent commissioner-to-banker interviews, which are conducted in support of the Community Bank Research Conference, it was apparent that smaller businesses rely heavily on lending from small local banks. Some interviews uncovered heightened banker concerns regarding the regulatory burden associated with the expanded business loan data collection and the potential for it to impede lending to small businesses.

2017 COMMUNITY BANK RESEARCH CONFERENCE SURVEY OF COMMUNITY BANKS

As a part of the Community Bank Research Conference, CSBS surveys community banks across the country to gain insight into relevant issues affecting community banks with an emphasis on small business lending. The survey is discussed in more detail below. The goal of the survey[7] is to provide a comprehensive view of key issues facing the community banking industry and evaluate how the industry

[5] 42% of small businesses rely exclusively on their owners' personal credit scores to secure debt, another 45% use both the owner's personal scores and business credit scores. Firms under $1 million are most likely to use a personal guarantee as collateral to secure outstanding debt. Despite applying to large and small banks at similar rates, small firms were most likely to gain approval at small banks. https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-EmployerFirms-2016.pdf.

[6] See: https://www.communitybanking.org/

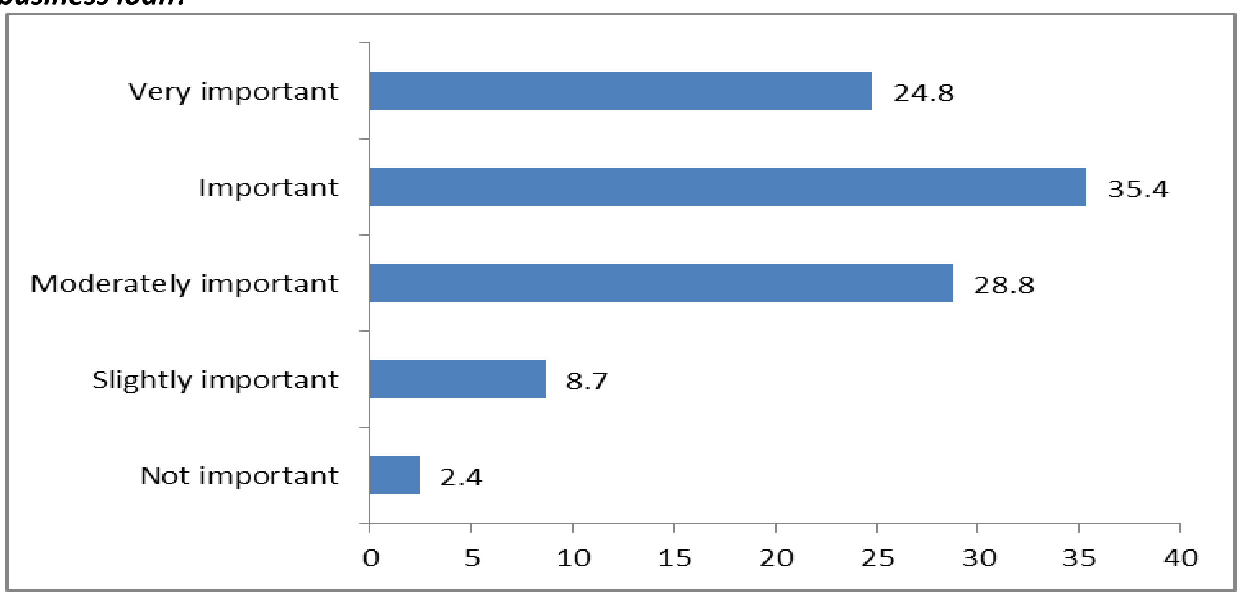
[7] The Survey Research Institute at Cornell University constructed the web interface used by the respondents, handled the technical aspects of data collection, and forwarded the data for analysis to the Federal Reserve/CSBS. Survey responses were received through July, 2017. The final survey sample in 2017 consisted of more than 600 responses from community banks in 30 states. In 2016, there were 557 responses from 26 states.

is responding to market changes. The development of the survey involved a coordinated effort among state regulators, CSBS staff, representatives from several Federal Reserve Banks, the Federal Reserve Board of Governors, and the academic community. The final results of the survey will be published in October of 2017 in connection with the Community Bank Research Conference.

The survey paid special attention to small business loans, because of the value that small business loans provide to small firms in terms of increased credit availability and protection against adverse economic shocks. The proximity of banks to their borrower enables them to utilize their firsthand knowledge of local business conditions. The success of a community bank is closely correlated with the success of its business customers and the local economy. Such interdependencies are inherent in the reliance of small businesses on banks, from which they receive 90% of their financing—triple the percentage of larger firms. Banks are also similarly reliant on small businesses with nearly 98% of the community banks in our survey responding that they make small business loans.

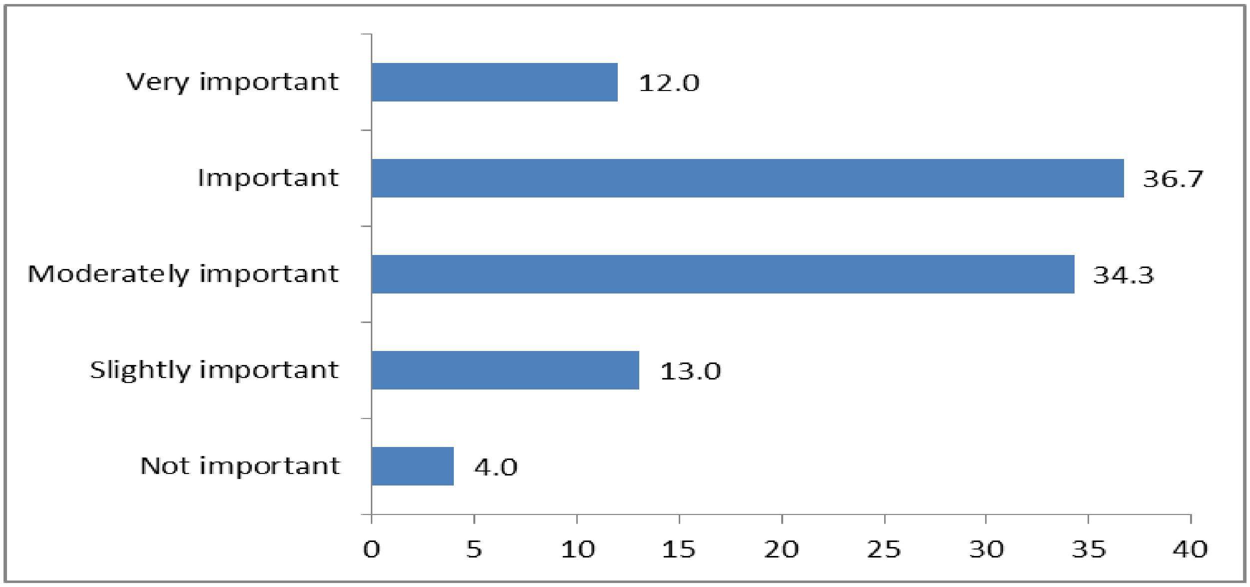
Community banks were asked to rate the importance of a prior lending or deposit relationship in the decision to extend credit to a small business. *Figure 1* shows that lending relationships play a pronounced role in the decision of a community bank to make a small business loan. *Figure 2* further demonstrates how important prior deposit relationships are in the small business lending decision process.

(Figure 1) Question: How important is a previous lending relationship in making a small business loan?



Source: CSBS 2017 National Survey of Community Banks.

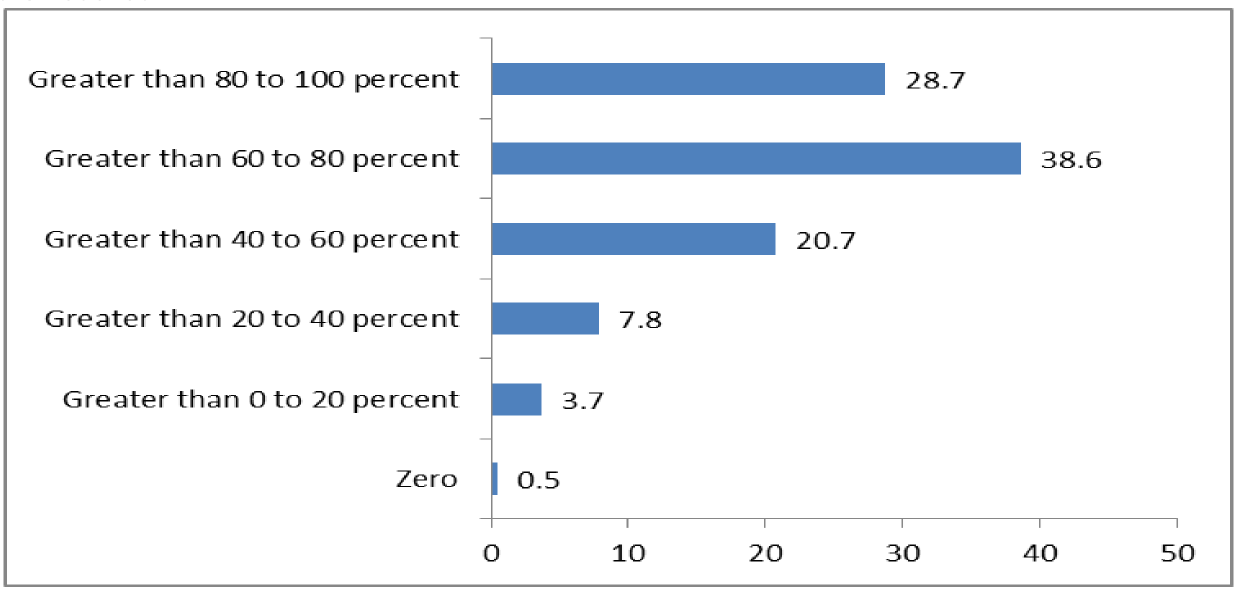
(Figure 2) Question: How important is a previous deposit relationship in making a small business loan?



Source: CSBS 2017 National Survey of Community Banks.

Prior banking relationships remain important factors in the small business lending decision making process. In this regard, nearly 70% of small business loans were made by banks for which at least 60% of them were accounted for by borrowers with a previous deposit or lending relationship (*Figure 3*).

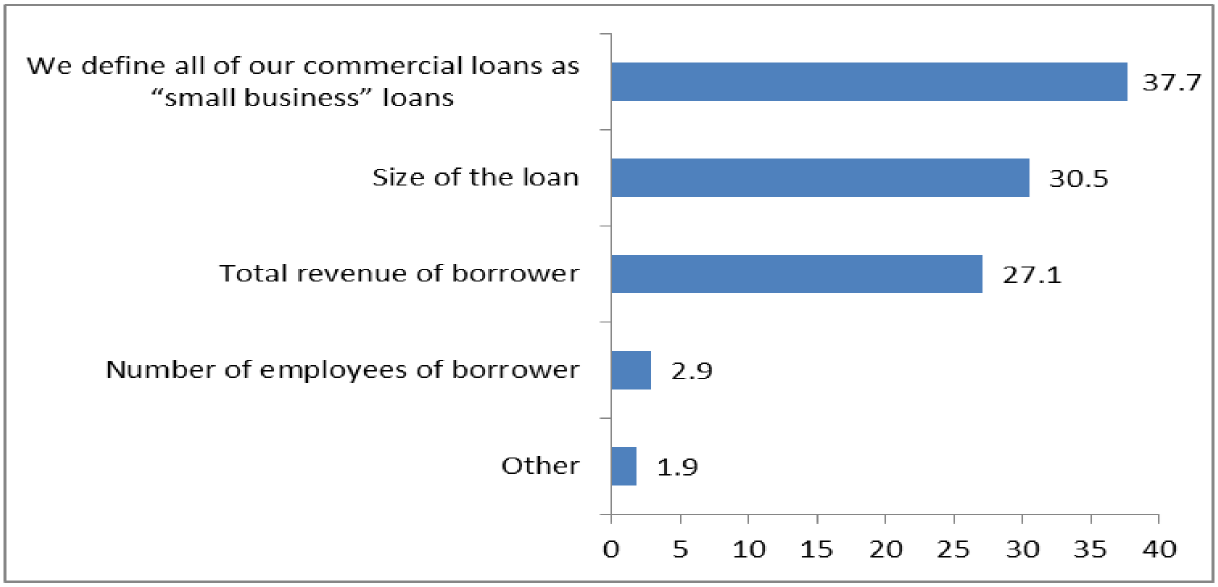
(Figure 3) Question: Of the small business loans that you made in 2016, approximately what percentage was to customers with a previous relationship such as a deposit account or previous loan?



Source: CSBS 2017 National Survey of Community Banks.

Small business loans are defined in the Call Report instructions as commercial and industrial loans, as well as loans secured by nonfarm, nonresidential properties, that have original amounts of $1,000,000 or less. Bankers, on the other hand, have somewhat different perspectives (*Figure 4*). Although 30% of respondents defined small business loans based on size, nearly as many shifted the perspective from loan size to borrower characteristics such as total revenue or the number of employees. And an even larger percentage of community bank respondents defined any commercial loan as a small business loan.

(Figure 4) Question: For your internal purposes, what is the primary factor in defining a small business loan?



Source: CSBS 2017 National Survey of Community Banks.

Small businesses are the cornerstone of our economy, and community banks continue to serve start-ups and established small businesses, allowing for a more diverse and competitive marketplace. Community banks are generally not transaction focused lenders that rely on volume to sustain their business model. Unlike lenders that attempt to commoditize small business loans, community banks focus on building relationships in the community and extending credit to credit worthy business owners who are serving the needs of the local economy.

A relationship lending model simply does not lend itself to an inflexible set of data points contemplated by DFA 1071. The uncertainty associated with the potential use of additional reporting requirements for small business lending could discourage community banks from supporting local economies, particularly when there is so little transparency about the way that the small business loan data will be used in the examination or compliance assessment process.

COMMUNITY REINVESTMENT ACT REPORTING

Institutions that are not exempt from data collection and reporting under the Community Reinvestment Act ("CRA") are already required to collect, maintain, and report information on small business loans originated or purchased for each calendar year. The data that is currently collected for CRA indicates the census tract where small business loans are made and helps regulators evaluate bank lending patterns and unmet credit needs. The data that is collected on small business loans, small farm loans, and community development is already considered during CRA compliance evaluations conducted by the primary federal regulator of all insured institutions. Any additional data collected from firms already subject to review under the CRA would be unnecessary and would not provide sufficient public policy benefit to justify the collection of the added data pursuant to DFA 1071.

CONCLUSION

In closing, state regulators strongly believe that the proposed small business lending data collection requirements would have a disproportionately negative impact on community banks and would disrupt small business lending in local communities. Banks rely on a relationship lending model that considers prior lending and deposit relationships and closely aligns the interests of the borrower, bank, and community.

The additional reporting requirements contemplated by DFA 1071 will not encourage lending, but will likely have the unintended consequence of impeding small business lending due to the lack of transparency around the use of the data in the examination process. In addition, banks already demonstrate their commitment to small business lending through the CRA and expanded reporting is unnecessary. Finally, the Bureau should refrain from implementing this proposal until Congress acts on the recommendation contained in the Treasury Report.

Sincerely,

John W. Ryan
President and CEO