OPPORTUNITY FINANCE NETWORK

December 14, 2020

Ms. Kathy Kraninger
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

RE: Small Business Advisory Review Panel for Consumer Financial Protection Bureau Small Business Lending Data Collection Rulemaking

Dear Director Kraninger:

Opportunity Finance Network (OFN) appreciates the opportunity to comment on the Outline of Proposals under Consideration and Alternatives Considered as part of the Consumer Financial Protection Bureau's (CFPB) Small Business Lending Data Collection Rulemaking. OFN is a national network of more than 300 community development financial institutions (CDFIs) investing in opportunities that benefit low-income, low-wealth, and other under-resourced communities across America. OFN's membership has originated $74 billion in financing in urban, rural and Native communities through 2018.[1]

For mission-driven lenders like CDFIs, increasing access to affordable, responsible capital for underserved businesses is a key component of their strategy. CDFIs provide affordable, responsible capital to businesses that cannot access traditional financing. CDFIs do this while still maintaining strong balance sheets and minimal losses by employing sound and prudent lending practices and working closely with their borrowers to provide training and technical assistance.

OFN is pleased to see the CFPB moving forward with the implementation of Section 1071. The data collection will bring much needed transparency to the small business lending market. The implementation of Section 1071 will provide the first comprehensive dataset on the small business lending industry, allowing for analysis of trends, greater understanding of how financial institutions provide credit to small businesses; and the overall financial health of our nation's small businesses, especially women-owned and minority-owned businesses.

The availability of this information will also spur innovation in the small business lending market. OFN agrees with the Responsible Business Lending Coalition that a comprehensive Section 1071 rule will provide critical insight into lending models that effectively reach women and minority-owned small businesses. It will demonstrate that small and diverse businesses can be well-served and will spotlight products and business models that serve them. The rule's enforcement of fair lending laws is also critically important to identifying patterns of discrimination for small businesses seeking access to credit.

OFN would like to provide the following recommendations:

Definition of small business

[1] Opportunity Finance Network, "Inside the Membership: Statistical Highlights from OFN Membership: 2018", Published December 6, 2019. https://ofn-drupal-pub.s3.amazonaws.com/s3fspublic/insidemembership_fy2018.pdf

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The CFPB should adopt the proposed definition that uses the Small Business Administration (SBA) definition of a small business as one with 500 or fewer employees and up to $8 million in annual revenues. This definition is broad enough to capture a large portion of the small business lending market as well as capture more than 99 percent of women and minority owned small businesses than other definitions under consideration by the CFPB. The Bureau should continue to monitor the U.S. Census Bureau's Annual Business Survey and re-evaluate this approach if minority- or women-owned businesses that are not considered "small" exceed one percent.

Definition of financial institution

The CFPB should adopt the proposed definition which defines a financial institution as: Depository institutions, Online lenders/platform lenders, CDFIs, Lenders involved in equipment and vehicle financing (captive financing companies and independent financing companies), Commercial finance companies, Governmental lending entities, and nonprofit non-depository lenders. This definition will ensure broad coverage of the small business lending market.

OFN is especially pleased to see online and platform lenders covered, as this is a growing segment of the market and many minority-owned small businesses are turning to online products to finance their business needs. The Federal Reserve's 2020 Small Business Credit Survey found that in the past five years, more than one in five firms (22 percent) had applied for financing from an online lender. In fact, black business owners in the survey were more likely to have sought financing from an online lender (27%) than a bank (23%).[2]

In some cases, online and platform lenders are filling the gap and providing access to capital for people with limited access to traditional financial services. However, in other cases, they are offering high-cost products with hidden rates, terms and fees that might damage the long term financial health of the business. Not enough is known about their business models, underwriting methods, and portfolio quality. This data collection presents an opportunity to introduce more transparency in a market that has limited oversight. The current lack of regulation in the market and transparency about loan pricing and terms limits the ability of business owners to make informed decisions. The CFPB's implementation of Section 1071 provides an opportunity to collect and analyze data on the market that is currently unavailable to the public and will provide more insight into the portfolio and asset quality of these lenders.

Exemptions

The CFPB should adopt an activity-based exemption for lenders making fewer than 25 small business loans per year. In order for the rule to be effective, as many lenders as possible must be covered. Exempting key players in the market will undermine the goal of transparency, understanding where credit is flowing and to whom, as well as pricing and terms. Collecting this data is necessary to determine if credit is affordable and responsible. Regulators, consumers, business owners and investors all need clear understanding of the overall market conditions, which is only possible by having as much robust data as possible on all the current actors in the system.

[2] Federal Reserve Banks, "Small Business Credit Survey: 2020 Report on Employer Firms", Accessed December 11, 2020. https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2020/2020-sbcs-employer-firms-report

OFN believes the only lenders that should be exempted from reporting requirements are those making very few (25 annually) small business loans. It is important to collect information from lenders that may be small by asset size but make a high volume of small, high-cost loans. Such products may not be in the best interest of the borrower.

Definition of application

The CFPB should adopt the definition of "application" as proposed using Regulation B's definition of the term application, and that inquiries, prequalification's, and similar should be explicitly clarified as not reportable. This proposed definition of an application, while imperfect, is preferable to the alternative in which the data collection would not be triggered until a completed application is received. This definition would not capture people who are discouraged or turned away earlier on in the process before formally submitting an application and the supporting documentation.

The proposed approach would commence the 1071 data collection requirement only after there is an actual request for credit based on the individual financial institution's policies and procedures, but still early enough in the process to capture incomplete, withdrawn, and denied applications. This will help capture businesses that do not make it through to submitting a completed application and help identify barriers to credit that may emerge early in the process, making the reported data more in line with Section 1071's statutory purposes. Due to the considerable variation in how different lenders consider the moment in which an application for credit is made, CDFIs in OFN's membership asked that the CFPB provide additional guidance for lenders on how to define an application.

Definition of minority, women-owned, and minority-owned

The CFPB should adopt the Home Mortgage Disclosure Act (HMDA) data definition of "minority". that includes African Americans, Asians, American Indians or Alaska Natives, Native Hawaiians or Other Pacific Islanders, and/or Hispanic or Latinos. Status as minority or women-owned business should be determined by ownership or control of 50% or more.

Adopting this definition is consistent with CDFI Fund definitions and would build upon existing definitions and reporting systems. OFN agrees with the National Community Reinvestment Coalition that the collected data should be disaggregated upon collection and reporting to allow for public dissemination of lending practices and to help identify racial discrepancies.

The CFPB should also clarify that a multi-racial person could be considered a minority individual and if small business lenders should be requesting or providing an opportunity for borrowers to share their gender identity to ensure data collection is as comprehensive and complete as possible.

Discretionary Data Points

One of the most important discretionary data points the CFPB must collect is information on loan pricing in the form of an Annual Percentage Rate (APR). APR is the only metric that standardizes cost across products with differing term lengths, rates, and fees. Understanding pricing or interest rate and fees will shed further light on whether the loans are affordable and whether subgroups of small businesses are disproportionately receiving the highest cost loans.

As the Responsible Business Lending Coalition notes in their comments on Section 1071, APR can be straightforward to calculate. In fact, many commercial financing providers already calculate and disclose APR, and all who operate in California or New York will soon be required to disclose APR under new state laws. The CFPB can make APR data collection simple by collecting the APR required under relevant state laws or, where no state law is in place, adopting a similar approach to what is required by these laws. The New York Small Business Truth in Lending Act and California's SB 1235 establish that APR for small business financing should be calculated according to the Truth in Lending Act regulations. This APR formula can flexibly accommodate any combination of payment amounts and frequencies.

The CFPB should also collect data on number of employees, North American Industry Classification System (NAICS) code, and the location of the business.

Product Coverage

The CFPB should adopt a broad standard or definition of credit that includes all financing products offered to small businesses. The CFPB should collect data on both mainstream products such as term loans as well as alternative products like merchant cash advances (MCAs), factoring and equipment lease financing. Excluding these products from this data collection would result in an incomplete picture of the small business lending market. The CFPB's own research estimates that the number of factoring and merchant cash advance transactions is about eight million – seven million for factoring and one million MCAs – a significant number of transactions by any standard.

These products are also very prevalent source of financing for minority and women owned businesses. Federal Reserve Bank of Atlanta research shows that minority-owned businesses are twice as affected by "potentially higher-cost and less transparent credit products"—a phrase the Federal Reserve uses to refer *specifically* to MCAs and factoring financing. Women- and minority-owned businesses are more likely to use these alternative financial products because they often have smaller revenues and limited collateral, making it more challenging to access small business loans from traditional lenders. These businesses also often need smaller dollar loans. Banks are less likely to underwrite smaller loans because their cost structure makes them unprofitable, leaving a wide credit gap for nonbank and potentially high-cost lenders to fill. It is critically important to understand which businesses are accessing these products and understand the costs.

Even though they might not technically be considered loans, MCAs are often marketed as loans, using underwriting practices that factor in merchants' credit ratings and bank balances (instead of their receivables). This type of credit has been associated with abuses, making disclosure necessary in order to monitor whether disadvantaged small businesses disproportionately receive this type of credit. This is why California and New York cover both products in recently passed commercial financing disclosure laws.[3] The complexity of these products makes it more important to collect information and understand how these products might be impacting small business owners. The data collected about the market for these products would be incredibly valuable and outweighs the potential burden of collecting it.

OFN agrees with the Responsible Business Lending Coalition that if MCAs and factoring are exempted from Section 1071, the resulting unlevel playing field would exacerbate the irresponsible lending problem impacting minority-owned businesses. These products would gain a regulatory advantage, encouraging the proliferation of what the Federal Reserve has described as "potentially

[3] See California SB 1235 and New York State A10118/ S5470.

higher-cost, less-transparent credit products" at the expense of the businesses who would suffer as a result. The CFPB should not "pick winners and losers," and it should certainly not pick the winners to be the products that are known to be harming minority-owned and businesses.

Align Section 1071 Reporting with CDFI Fund Reporting

The CFPB should coordinate data collection and reporting requirements to ensure Section 1071 reporting aligns with CDFI Fund reporting. CDFIs in OFN's membership voiced concerns about the potential for new, duplicative burdensome reporting requirements. CDFIs receiving awards through the CDFI Fund Financial Assistance program are required to report for a three-year period through the CDFI Fund's Transaction Level Reporting (TLR) data points well beyond the scope of Section 1071, including interest rates, origination, points and fees, amortization type, the term of the loan, and payment dates.[4] Some CDFIs also report on lending activity to the: SBA, CRA reporting to banks, OFN's annual member survey, and credit reporting agencies.

In addition, new requirements from the CDFI Fund will expand transaction level reporting requirements to all certified CDFIs. To the extent possible, the CFPB should standardize data formats to match those used in reporting to the Treasury Department's CDFI Fund. There should be interagency coordination to streamline data collection and reporting requirements across agencies to minimize the burden on CDFIs as new requirements are implemented.

Some CDFIs will have to adjust and update processes and systems to comply with Section 1071. The CDFI industry uses several different loan software products. Existing software providers continually modify their systems to comply with the CDFI Fund's reporting requirements. OFN urges the CFPB to work with both the CDFI Fund and loan software providers to streamline the process of integrating new data collection processes into existing systems.

Adequate Guidance and Training on Data Collection Requirements

The CFPB should provide training and detailed guidance and templates to help lenders navigate these new requirements. OFN also encourages the CFPB to explore the possibility of providing small technical assistance grants for CDFIs or other mission lenders to finance the costs of installing new systems and technology or allowing grants from the CDFI Fund or SBA to be used to fund these upgrades. The CFPB should also work with other government agencies to ensure that existing reporting is leveraged where possible, and that the costs associated with the implementation of Section 1071 are not borne by those with the least ability to pay.

Conclusion

OFN appreciates the opportunity to comment on this important data collection that will bring much-needed transparency to the small business lending marketplace. Section 1071 will enable development of targeted policy solutions that address gaps in capital access among small business owners – particularly women entrepreneurs and entrepreneurs of color. OFN encourages the CFPB to continue to ensure people in all communities have access to affordable, responsible financial products and services.

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[6] CDFI Fund, "CDFI Transactional Level Report Data Point Guidance", September 2020. Accessed December 11, 2020. https://www.cdfifund.gov/Documents/8.%20CDFI%20TLR%20Guidance%20Sept%202020.pdf

Thank you for your consideration of these comments. Please contact me with any questions or concerns about these recommendations via email: dwilliams@ofn.org or phone at 202.868.6922.

Thank you,

Dafina Williams

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