

## Data Collection for Small Business Lending: How Much Is Enough?

On May 10, 2017, the US Consumer Financial Protection Bureau (“CFPB” or “Bureau”) took its first major step toward fulfilling its statutory obligation to implement the small business lending data collection requirement of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). Following a Los Angeles field hearing during which Director Richard Cordray emphasized the importance of small businesses to the US economy and the need for these businesses—particularly those owned by women and minorities<sup>1</sup>—to have access to financing, the Bureau issued two documents: a white paper<sup>2</sup> setting out the “limited information” the Bureau currently has about “key dimensions of the small business lending landscape” and a Request for Information (“RFI” or “Small Business Lending RFI”) designed to enhance its understanding of how small business lending works.<sup>3</sup>

As mortgage lenders subject to the Home Mortgage Disclosure Act (“HMDA”) can attest, data collection obligations can create enormous compliance burdens and significant enforcement risk for lending institutions. Perhaps more importantly, the data elements that the Bureau ultimately requires in its rulemaking will serve as the foundation for fair lending examinations and enforcement in the small business lending space.<sup>4</sup> Because the Bureau’s work on this issue is in its early stages, there is still opportunity for interested stakeholders to contribute to the Bureau’s understanding of the small business lending market.

### Section 1071 of the Dodd-Frank Act and Small Business Lending Data

Section 1071 of the Dodd-Frank Act amended the Equal Credit Opportunity Act to require institutions that receive credit applications from women-owned, minority-owned or small businesses to collect certain information about the requested credit and applicants and to deliver that information to the Bureau annually.<sup>5</sup> Section 1071 requires the Bureau to “prescribe rules and issue guidance” to implement this requirement and, importantly, authorizes the Bureau to adopt exceptions and “conditionally or unconditionally” exempt any institution or class of institutions from having to comply. Although Section 1071 became effective on July 21, 2011, the Dodd-Frank Act’s designated transfer date, the CFPB issued public guidance assuring that it would not expect compliance until after it had issued implementing regulations.<sup>6</sup>

The primary purpose of Section 1071 is to facilitate fair lending enforcement in the small business space.<sup>7</sup> Unlike mortgage lenders, who for decades have had to collect and report race, ethnicity and other information about home loan applicants, small business lenders typically do not collect or retain demographic information about their customers. Although the Bureau can and has brought fair lending actions against non-mortgage lenders<sup>8</sup> by using proxying methodologies to impute borrower race, ethnicity and gender,<sup>9</sup> the Bureau’s use of proxies has generated considerable

controversy,<sup>10</sup> and there is no dispute that fair lending risks can be evaluated more reliably with actual data.

## Small Business Lending RFI

The Small Business Lending RFI is designed to increase the CFPB's admittedly limited understanding of the current small business lending marketplace; the Bureau characterizes the RFI as its "first step" in implementing Section 1071.<sup>11</sup> The RFI requests information on the following topics.

### 1. SMALL BUSINESS DEFINITION

A critical aspect of the Bureau's 1071 rulemaking will be how the rule defines the term "small business." Not only will the definition determine which loans will ultimately become the subject of fair lending scrutiny, it also will be among the factors that influence how challenging it will be for institutions to interpret and comply with the rule.

There are many definitions of the term "small business." Section 1071 indicates that small business has the same meaning as the term "small business concern" in the federal Small Business Act. The Small Business Act authorizes the Small Business Administration ("SBA") to establish size standards, and the SBA has developed multiple standards, including widely used industry-specific standards that are used to determine eligibility for federal contract and loan assistance programs. The Small Business Act also allows the SBA to approve size standards developed by other federal agencies that meet certain requirements.<sup>12</sup>

The CFPB wants to explore an alternative definition of "small business" that would align with current small business lending practices and work in the context of an information-gathering rule. Common factors currently used to classify business size include annual revenue, industry, loan size, aggregate credit exposure or some combination of these factors.<sup>13</sup> In the RFI, the CFPB notes that under almost any definition

of "small business," a large percentage of women-owned and minority-owned businesses would be covered.

The RFI poses a series of questions about how lenders currently define "small business" and asks commenters to describe what potential burdens and challenges may arise if the Bureau were to adopt SBA standards.

### 2. DATA POINTS

Section 1071 specifies the data fields that financial institutions must collect and report:

- Application number;
- Application date;
- Credit type and purpose;
- Amount applied for;
- Amount approved;
- Type of action taken and action taken date;
- Census tract of the principal place of business;
- Applicant's gross annual revenue in the last fiscal year;
- Race, sex and ethnicity of the principal business owners; and
- Any other data that the Bureau determines would aid in fulfilling the purposes of Section 1071.<sup>14</sup>

The Bureau plans to "explore how to best implement the statutorily-mandated data points" and whether to supplement these data points with a "limited number of discretionary data points" that, among other things, could "reduce the possibility of misinterpretations or incorrect conclusions" arising from more limited data.

The reference to a "limited" number of supplemental data points appears designed to alleviate concerns about the possibility of the Bureau imposing a burdensome, HMDA-like rule that would require enormous and costly implementation efforts. At the same time, the Bureau recognizes that if it does not have sufficient data to explain underwriting and pricing outcomes, it could wind up investigating

potential fair lending claims that could have been ruled out if it had the right information at the outset.

The RFI poses questions about several data-related topics, including the data elements and standards that small business lenders currently use, the potential technological and other challenges presented by the rule and how the CFPB can help mitigate them, variations in data collection across products and by application disposition, what data elements would reduce incorrect conclusions or misinterpretations, and challenges associated with obtaining demographic information about principal owners.

The Section 1071 rulemaking will have major business process ramifications for small business lenders, many of which have not previously needed to gather and report detailed, loan-level information to the government. The rule also will increase regulatory scrutiny in the small business lending space, both in terms of data accuracy audits and fair lending compliance evaluations. For all of these reasons, small business lenders and other interested stakeholders should consider engaging closely with the Bureau on the RFI's data-related questions. Effective industry input can go a long way toward lessening the forthcoming compliance obligations and regulatory risks.

### **3. FINANCIAL INSTITUTIONS ENGAGED IN BUSINESS LENDING**

Section 1071 defines a “financial institution” as “any partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity that engages in any financial activity.”<sup>15</sup> As part of the RFI, the Bureau seeks to understand better the various players in the small business lending industry and obtain feedback from stakeholders on appropriate coverage for the Bureau's small business lending data collection rule.<sup>16</sup> The Bureau is also interested in the extent to which small business lending has shifted from depository institutions to alternative lenders and

the roles of lending marketplaces, brokers, dealers and other third parties in the small business lending application process.<sup>17</sup>

Significantly, the RFI asks whether the Bureau should exempt certain classes of institutions from the data collection rule and whether there are data sources available that would help the Bureau evaluate potential exemptions. Small business lenders should consider whether there is a basis for arguing for their exemption from the rule and whether there is persuasive information that could be presented to support a proposed exemption.

### **4. ACCESS TO CREDIT AND FINANCIAL PRODUCTS OFFERED TO BUSINESSES**

The Bureau requests information related to obstacles faced by small businesses in obtaining access to credit, as well as information about the various financial products and services available to these businesses. The CFPB estimates that loans, lines of credit and credit cards comprise approximately three-quarters of the non-equity financing market. The Bureau is interested in obtaining information related to the products offered to small businesses and potential obstacles that small businesses—particularly women- and minority-owned businesses—face in obtaining access to credit.<sup>18</sup>

The CFPB also is interested in whether there is more or less access to credit for a small business based on its type of business or geographic location. The Bureau's interest in geography and access to credit in the context of small business lending is unsurprising given the Bureau's focus on access to credit and mortgage redlining issues in recent years.

### **5. PRIVACY CONCERNS**

Section 1071 permits the Bureau to delete or modify data before it is released to the public to protect privacy interests. In connection with data collection related to small business lending, the Bureau is interested in understanding the privacy concerns related to the potential

disclosure of the small business lending data elements that are outlined in Section 1071 and in exploring options which protect borrower and applicant privacy, as well as the confidentiality interests of financial institutions.<sup>19</sup>

## 6. RAMIFICATIONS FOR SMALL BUSINESS LENDERS

The Bureau believes that small business lending data collection will help fill gaps in its understanding of the small business lending landscape and help identify potential fair lending concerns related to small business lending, including lending to women- and minority-owned small businesses.<sup>20</sup> And although the Bureau acknowledges that “there are costs associated with any data collection which have to be weighed against the benefits,”<sup>21</sup> any final rule regarding small business data collection will impose a significant burden on small business lenders.

With respect to fair lending compliance, there are additional complexities and nuances associated with small business lending that limit the ability to use statistics to identify potential fair lending violations. For example, unlike mortgage lending, small business lending often involves more subjective underwriting and small business lenders’ processes for documenting their credit decisions may be less formal. Although the Bureau seems to recognize that there are differences between small business lending and mortgage lending by their nature,<sup>22</sup> using small business lending data for fair lending analyses may have significant limitations. Institutions should consider whether and how to raise these issues with the Bureau as it proceeds with the Section 1071 rulemaking.

*Comments on the RFI are due by July 14, 2017. If you are interested in submitting comments to the Bureau’s Small Business Lending RFI, please contact us.*

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## Endnotes

- <sup>1</sup> <https://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-cfpb-director-richard-cordray-small-business-lending-field-hearing>.
- <sup>2</sup> [http://files.consumerfinance.gov/f/documents/201705\\_cfpb\\_Key-Dimensions-Small-Business-Lending-Landscape.pdf](http://files.consumerfinance.gov/f/documents/201705_cfpb_Key-Dimensions-Small-Business-Lending-Landscape.pdf).
- <sup>3</sup> [http://files.consumerfinance.gov/f/documents/201705\\_cfpb\\_RFI\\_Small-Business-Lending-Market.pdf](http://files.consumerfinance.gov/f/documents/201705_cfpb_RFI_Small-Business-Lending-Market.pdf). (published at 82 Fed. Reg. 22318 (May 15, 2017)).
- <sup>4</sup> Although the Bureau is still in the pre-rule stage of its data collection rulemaking, small business lending is already a significant focal point for the CFPB. In its most recent Fair Lending Report, the Bureau highlighted small business lending as an area of emerging fair lending risk, and also one of the Bureau’s fair lending priorities for the coming year. See [https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201704\\_cfpb\\_Fair\\_Lending\\_Report.pdf](https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201704_cfpb_Fair_Lending_Report.pdf).
- <sup>5</sup> 15 U.S.C § 16910–2.
- <sup>6</sup> See Letter from Leonard Kennedy to Chief Executive Officers of Financial Institutions under Section 1071 of the Dodd-Frank Act (April 11, 2011), available at <https://s3.amazonaws.com/files.consumerfinance.gov/f/2011/04/GC-letter-re-1071.pdf> (“In light of inquiries we have received regarding the timing of financial institutions’ obligations under section 1071, we have reviewed the statutory text, purpose, and legislative history and conclude that their obligations, including for information collection and reporting, do not arise until the Bureau issues implementing regulations and those regulations take effect.”).
- <sup>7</sup> 15 U.S.C. § 1691c-2.
- <sup>8</sup> See <https://www.consumerfinance.gov/policy-compliance/enforcement/actions>.

- <sup>9</sup> [http://files.consumerfinance.gov/f/201409\\_cfpb\\_report\\_proxy-methodology.pdf](http://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf).
- <sup>10</sup> See *Unsafe at Any Bureaucracy: CFPB Junk Science and Indirect Auto Lending*, Report Prepared by the Republican Staff of the Committee on Financial Services, US House of Representatives (Nov. 24, 2015).
- <sup>11</sup> [http://files.consumerfinance.gov/f/documents/201705\\_cfpb\\_RFI\\_Small-Business-Lending-Market.pdf](http://files.consumerfinance.gov/f/documents/201705_cfpb_RFI_Small-Business-Lending-Market.pdf).
- <sup>12</sup> See 15 U.S.C. § 632(a)(2)(C).
- <sup>13</sup> [http://files.consumerfinance.gov/f/documents/201705\\_cfpb\\_RFI\\_Small-Business-Lending-Market.pdf](http://files.consumerfinance.gov/f/documents/201705_cfpb_RFI_Small-Business-Lending-Market.pdf).
- <sup>14</sup> 15 U.S.C. § 1691c-2.
- <sup>15</sup> 15 U.S.C. § 1691c-2(h)(1).
- <sup>16</sup> [http://files.consumerfinance.gov/f/documents/201705\\_cfpb\\_RFI\\_Small-Business-Lending-Market.pdf](http://files.consumerfinance.gov/f/documents/201705_cfpb_RFI_Small-Business-Lending-Market.pdf).
- <sup>17</sup> <https://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-cfpb-director-richard-cordray-small-business-lending-field-hearing>.
- <sup>18</sup> [http://files.consumerfinance.gov/f/documents/201705\\_cfpb\\_RFI\\_Small-Business-Lending-Market.pdf](http://files.consumerfinance.gov/f/documents/201705_cfpb_RFI_Small-Business-Lending-Market.pdf).
- <sup>19</sup> *Id.*
- <sup>20</sup> *Id.*
- <sup>21</sup> *Id.*
- <sup>22</sup> <https://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-cfpb-director-richard-cordray-small-business-lending-field-hearing>.

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