

Senate Pressure May Spur Action On Small Biz Loan Data Rule

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On July 10, 2015, Sen. Cory Booker and 18 other senators, including Sen. Elizabeth Warren, sent a letter to Consumer Financial Protection Bureau Director Richard Cordray urging him to “expedite the agency’s rulemaking around publicly available small business loan data.” This letter is almost certain to spur CFPB action on the only rule-making mandated by the Dodd-Frank Act that the agency has not taken steps to issue. Although the statute was enacted in 2010 and became effective in 2011, this rule has languished even as the CFPB has now turned its attention to discretionary rule-makings not mandated by the Dodd-Frank Act. As a result, financial institutions lending to businesses may now want to consider the potential consequences of the rule and strategies for shaping its final form.



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Overview of the Small Business Data Collection Provisions

The Dodd-Frank Act directs the CFPB to prescribe rules under Regulation B requiring bank and nonbank financial institutions to collect, compile and maintain anonymized data on women-owned, minority-owned and small business applicants, including data on the race, sex and ethnicity of the principal owners of the business. The CFPB must also issue guidance to facilitate compliance. The CFPB issued a bulletin in April 2011 stating that these data collection requirements would not become effective until after the CFPB issues implementing regulations.[1] Some have characterized this requirement as the Home Mortgage Disclosure Act (HMDA) for business lending.

Applicant Characteristic Data

Some of the data financial institutions will have to request from business credit applicants is not typically part of the application process, and responses will have to be maintained separately from the application and application information. Such data includes the status of business credit applicants as women-owned, minority-owned or small businesses, based on the race, sex and ethnicity of the principal business owners, and whether the application is in response to a solicitation from the institution (collectively “applicant characteristic data”). Financial institutions will have to request applicant characteristic data regardless of the channel through which it receives the application, whether in person or by mail, telephone, electronic transmission, or other means. Applicants may refuse to provide this data.

Some business credit applicants may not know whether they are a women-owned, minority-owned or small business, and explaining what businesses fit within each of those categories may be challenging for financial institutions. For purposes of the rule, a small business is determined by reference to the Small Business Administration's industry-specific size standards for qualifying as a "small business concern." A business is minority-owned or women-owned if it meets both an ownership test (more than 50 percent of the ownership or control is held by minority individuals or women) and a net profit or loss test (more than 50 percent of the net profit or loss accrues to minority individuals or women). Importantly, a minority-owned or women-owned business does not have to be a small business. The Dodd-Frank Act directs the CFPB to issue guidance to assist financial institutions in working with applicants to determine whether the applicants are women-owned, minority-owned or small businesses.

The Dodd-Frank Act provides that, where feasible, no loan underwriter or other officer or employee of the institution, or an affiliate, involved in making the credit decision should have access to any applicant characteristic data. This walling-off of persons involved in the credit decision will not be feasible in certain circumstances, as those persons may be the individuals requesting and collecting the data from applicants. Where the institution determines that a loan underwriter or other officer or employee should have access to applicant characteristic data, the financial institution must provide notice to the applicant about the underwriter's access, along with a notice that the institution may not discriminate on the basis of such information.

Application and Underwriting Data

In addition to applicant characteristic data, financial institutions will need to compile and maintain various data they obtain through, or derive from, the application and underwriting process. Such application and underwriting data includes:

- the application number and date;
- the type and purpose of the loan or application;
- the amount of credit or credit limit requested and approved;
- the type of action taken regarding the application and the date of application;
- the census tract where the applicant's principal place of business is located;
- the gross annual revenue of the business for the most recent fiscal year; and
- any additional data that the CFPB requires institutions to collect.

Financial institutions will be prohibited from including any personally identifiable information, such as name, address and telephone number, in the information they compile and maintain.

Compilation and Reporting

The CFPB's regulations will address the form and manner in which financial institutions must compile and maintain for disclosure applicant characteristic data and associated application and underwriting data. Such data will have to be:

- submitted annually to the CFPB;
- retained by the institution for at least three years after the date of preparation;
- made available to any member of the public upon request in a form and manner prescribed by the CFPB; and

- annually made available to the public generally by the CFPB in a form and manner determined by the agency.

The CFPB has discretion to limit the data made available publicly, but only if doing so would advance a privacy interest. The CFPB may also compile and aggregate such data for its own use and make its own compilation of aggregate data publicly available.

Exceptions

The CFPB may adopt exceptions to any of the statutory requirements. The CFPB may also exempt any financial institution or class of financial institutions, conditionally or unconditionally, from the statute's requirements.

Key Takeaways

Here are five key aspects of the small business data collection rules worth considering:

1. Recognize the Twin Risks Posed by an HMDA-For-Business-Lending Rule

Like the HMDA, the small business data collection rule poses two primary risks for financial institutions. The first risk is use of the data by the CFPB, other regulators and private litigants to support fair lending cases and enforcement actions. The CFPB, with its large dedicated fair lending office and public statements on the importance and value of HMDA data in fair lending investigations and cases, will almost certainly use the data on women-owned, minority-owned and small businesses in its fair lending work.[2] The risks to financial institutions are particularly acute if the data is misinterpreted, provides an incomplete or inaccurate picture of the institution's lending practices, or is used to support novel fair lending theories.

The second risk involves errors in the collection, compilation, maintenance and reporting of the data relative to what will likely be very prescriptive regulatory requirements. Such errors under the HMDA have resulted in numerous supervisory and enforcement actions against financial institutions.

Financial institutions should be mindful of both risks when identifying potential concerns with the rule and formulating suggestions they want the CFPB to consider in structuring the rule.

2. Identify Key Differences Between Business Lending and Consumer Lending, and Between Different Types and Models of Business Lending

Business lending differs from consumer lending in important ways, including shorter terms and greater reliance on personal guarantees. Consumer lending tends to be fairly homogeneous — a few key attributes, such as consumer report/credit score, income, prior delinquencies and loan amount, generally drive approval and pricing decisions. Variations in underwriting standards for consumer loans principally relate to differences in the credit product (e.g., first-lien mortgages, home equity lines of credit (HELOCs), credit cards, auto finance loans, student loans) and the creditor's appetite for making riskier loans, rather than to differences in measuring consumer creditworthiness.

By contrast, business lending tends to be more heterogeneous. Many more factors are potentially relevant to the credit decision and those factors can vary depending upon the type of loan involved.

Relevant factors may include the type of business in which the applicant is engaged and the success/failure rates for that type of business, the business experience and history of the principals, the competitive landscape in which that business operates, and the value of personal guarantees of the principals.

In addition, business lending comes in many shapes and sizes. It includes, for example, individually negotiated loans and lines of credit, business credit cards, equipment and fleet financing, and an emerging area of nonbank online small business lending. Thus, unlike the HMDA, which targets a narrow spectrum of homogeneous consumer-purpose home-secured loans, the small business data collection rule the CFPB will be developing must accommodate a wide variety of business lending products and models.

We encourage financial institutions to identify the various types of business lending in which they engage and begin to assess how the small business data collection rule could affect each type of business lending. Doing so will enable financial institutions, on a proactive basis, to provide informed and constructive input to the CFPB in the rule-making process.

3. Consider Additional Data the CFPB Should Require Financial Institutions to Collect and Make Publicly Available

We expect many financial institutions may find it in their best interest to encourage the CFPB to require the collection, reporting and publication of additional data beyond the data specified in the statute.

Additional data may be helpful in demonstrating the range of legitimate, nondiscriminatory factors used in business credit underwriting and in illuminating the different factors considered in different types of business credit products. The public availability of this additional data may mitigate the risk of uninformed fair lending actions and provide factual support for financial institutions when defending fair lending cases. Such additional data may include:

- the type of business venture and the default rates for that type of venture;
- the length of time the applicant has been in business;
- the monthly cash flow of the applicant for a designated period preceding the application;
- the business experience of the principal owners of the applicant;
- prior delinquencies or defaults by the applicant or its principal owners;
- the amount and timing of the applicant's other outstanding credit obligations;
- and
- as discussed below, the channel through which the application was submitted.

Of course, the collection, reporting and publication of additional data results in added burdens on financial institutions and heightens the risk of violating the technical data collection requirements. Additional data also could result in the disclosure of information traceable to a particular business or business owner, or reveal to competitors certain aspects of an institution's underwriting practices. Therefore, financial institutions, as well as the CFPB, will need to evaluate and balance the advantages and disadvantages of additional data collection requirements. However, in contrast to the HMDA rule, financial institutions may find that more is better in the small business data collection context.

4. Assess Challenges in Collecting Data Through Multiple Channels

The requirement to collect applicant characteristic data regardless of the channel used to submit the application poses challenges for financial institutions and may introduce questions about the integrity of the data collected. For in-person and telephone applications, the live interaction between financial institution employees and business credit applicants provides opportunities for educating applicants about the rule and determining whether the applicant qualifies as a women-owned, minority-owned or small business in ways generally not available through mail or electronic application channels. On the other hand, live employee interaction with the business applicant may require additional disclosures if those employees also are involved in making the credit decision.

Both the response rate and the accuracy of responses may differ depending upon the channel used to collect applicant characteristic data. Such differences could impact perceptions about the financial institution's fair lending practices. Thus, financial institutions may want to identify other channel-based variations they have observed in response rates and data accuracy to inform the CFPB's thinking about the multi-channel aspect of this rule and how that should be reflected in the rule.

5. Consider Exceptions the CFPB Should Adopt

The CFPB will likely use its exception authority to provide full or partial exemptions to some or all smaller financial institutions, as it has done in other rules. Among other things, the CFPB may consider exempting nonbank lenders with annual revenues less than \$35 million and banks with assets less than \$100 million to avoid convening a small business panel.

In addition to one or more smaller financial institution exemptions, financial institutions should consider other exceptions or exemptions they would like the CFPB to adopt for the purpose of establishing some necessary boundaries around this rule and limiting the costs and burdens of the rule. We suggest that financial institutions begin to identify exceptions or exemptions they may want to recommend to the CFPB, including, for example:

- a size-based exception to the women-owned and minority-owned data collection requirements for larger business applicants;
- exceptions for certain types of business credit, such as trade credit;
- an exception for incomplete credit applications;
- exceptions to the public availability of certain data; and
- channel-based exceptions.

Conclusion

There is much to consider in the long-deferred Regulation B small business data collection rules. But with congressional pressure mounting, the CFPB is likely to begin the process of implementing an HMDA-like rule. This article identifies some steps financial institutions can take to prepare for engaging proactively on key issues this rule raises.

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[1] CFPB Bulletin 2011-1 (April 11, 2011), available at <http://www.consumerfinance.gov/wp-content/uploads/2011/04/GC-letter-re-1071.pdf>.

[2] See Prepared Remarks of CFPB Director Richard Cordray on the HMDA Press Call (Feb. 7, 2014), available at <http://www.consumerfinance.gov/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-on-the-hmda-press-call/>; CFPB Bulletin 2013-11 (Oct. 9, 2013) (stating that “the CFPB views the accuracy of HMDA data as an important element of its consumer protection mission.”), available at http://www.consumerfinance.gov/f/201310_cfpb_hmda_compliance-bulletin_fair-lending.pdf; CFPB Press Release, CFPB Takes Action Against Non-Bank and Bank for Inaccurate Mortgage Loan Reporting (Oct. 9, 2013), available at <http://www.consumerfinance.gov/newsroom/cfpb-takes-action-against-nonbank-and-bank-for-inaccurate-mortgage-loan-reporting/>.

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