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Small Business Loan Data:

Recommendations to the Consumer Financial Protection Bureau for Implementing Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

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About the National Community Reinvestment Coalition

The National Community Reinvestment Coalition is a nonprofit, nonpartisan association of more than 600 organizations dedicated to the mission of building and protecting wealth in America's underserved communities. For more than 20 years, we've advocated to ensure vibrant communities for America's working families by actively promoting access to basic banking services and products, homeownership and the development of affordable rental housing, local business growth, workforce training, and strong consumer protections in the financial sector. To learn more about NCRC, visit our website at www.ncrc.org.

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Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires the Consumer Financial Protection Bureau (CFPB) to improve the publicly available small business loan data. Specifically, the enhanced data is to include the race and gender of the small business owner applying for the loan and other details such as the revenue size of the small business and the action taken on the loan (approval or rejection).

The Dodd-Frank law states that the purpose of Section 1071 is to "facilitate enforcement of fair lending laws and enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses." By identifying needs and opportunities, the objective of the data collection is to motivate financial institutions to increase their lending to meet the credit needs of traditionally underserved small businesses and neighborhoods.

Better data on lending markets improves access to credit. Former Supreme Court Justice Louis Brandeis stated that "sunlight can be the best disinfectant and the electric light the best policeman."[1] Data, the sunlight, motivates lenders to identify missed and profitable opportunities. The data also enables community organizations, public officials, regulators, the media, and other stakeholders to hold lenders publicly accountable for meeting credit needs.

Improving publicly available data, analyzing access to credit, and removing barriers to access becomes imperative when considering the significant role of small businesses in the United States economy. Microbusinesses, defined as firms with five or fewer employees, are about 92 percent of all businesses in the United States.[2] Women- and minority-owned firms are engines for job creation. For example, women-owned businesses account for $1.3 trillion in revenue from more than 8.3 million individual firms.[3] Both women- and minority-owned firms have grown faster than their counterparts during the last several years. Yet women- and minority-owned firms have not realized their full potential since, according to research discussed below, they face lower approval rates than male-owned and non-minority-owned businesses and are more hesitant to apply for loans because they fear rejection. Fully understanding these barriers to credit through improved data availability is not only good for women- and minority-owned businesses but benefits the entire country as a result of gains in employment.

1 Prepared Remarks of CFPB Director Richard Cordray at the Greenlining Institute's Economic Summit, April 4, 2014, available via http://www.consumerfinance.gov/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-greenlining-institutes-economic-summit/.

2 Association of Enterprise Opportunity, *Bigger than You Think – The Economic Impact of Microbusiness in the United States*.

3 National Women's Business Council, *The Economic Impact of Women-Owned Businesses in the United States*, available via http://www.nwbc.gov/research/economic-impact-women-owned-businesses-united-states.

Required Data Elements

The Dodd-Frank law requires several data elements such as the race and gender of the small business owner. As the CFPB develops a regulation to implement Section 1071 of the Dodd-Frank law, the National Community Reinvestment Coalition (NCRC) recommends the following for the required data elements:

- *Race and Ethnicity:* The disclosures regarding race and ethnicity need to be implemented carefully to reflect the variety of racial and ethnic groups in this country. For example, it is probably not enough to require disclosures of whether the business is Asian or Hispanic. The CFPB should consider sub-categories to fully capture the experiences of Asians and Hispanics of various nationalities in the marketplace. The Affordable Care Act provides a refined model for this type of disclosure that is not onerous.

- *Revenue Size of Business:* The required disclosures regarding revenue size of the small business must be sufficiently detailed so that policymakers and the general public can track loans to microbusinesses which are disproportionately owned by women and minorities. The largest database currently available, the Community Reinvestment Act (CRA) data, has only two revenue categories – above and below $1 million in revenues – that do not provide sufficient information on lending to microbusinesses.

- *Action Taken on Application:* The current CRA data has information only on originations, not applications or denials. Adding information on which borrowers applied and which were denied will provide much-needed information on demand for credit and the responsiveness of lenders to loan demand.

- *Loan Type and Purpose*: Small businesses need credit in several different forms, including non-credit card loans, credit card loans, refinances, renewals, lines of credit, and personal loans to the business owners. In addition to traditional bank lending, small businesses have increasingly turned to alternative lending such as factoring, merchant cash advances, peer-to-peer lending, and other new forms of lending. While factoring has been around for decades, other lending types are more recent. Concerns have arisen about the high cost of some of this lending and the potential for abuses. The CFPB must create a database that captures a plethora of loan purposes and types so that regulators and members of the public can track lending and be able to determine if it is responsibly meeting credit needs.

Discretionary Data Elements

Section 1071 empowers the CFPB with discretionary authority to require additional data elements. The CFPB has an opportunity to further enhance Section 1071 data so that it comprehensively captures access to credit for different types of businesses and helps the public understand barriers to access.

- *Pricing Data:* In the early 2000s, the Federal Reserve Board recognized the importance of pricing data and required that it be added to the Home Mortgage Disclosure Act (HMDA) data to track trends in subprime lending. Likewise, high cost lending is a concern in small business lending. The CFPB must implement price data disclosure similar to the further enhancements in pricing information in the HMDA data required by Dodd-Frank. The current data collection by the Community Development Financial Institutions (CDFI) Fund can provide a model since it has pricing information and also data on points and fees and loan terms.

- *Creditworthiness:* The Dodd-Frank law requires data on creditworthiness in HMDA data. Likewise, the CFPB should collect data on creditworthiness for small businesses since creditworthiness is an important issue in small business lending, both the creditworthiness of the owners of small businesses as well as the creditworthiness of the small businesses (in the case of older and more established businesses).

- *Number of Employees:* Definitions of small businesses vary widely. The Small Business Administration (SBA) defines some types of small businesses as those with up to 500 employees, while a common definition of microbusinesses is five employees or less. The Section 1071 data must have information on the number of employees so that regulatory agencies and the public can track differences in access to credit for small businesses of varying sizes.

- *Other Data:* Collateral pledged by borrowers, start-up status of the business, and loan performance are additional data elements that would help the regulatory agencies and the public understand and rectify barriers in access to credit.

Types of Institutions Required to Report

- *Comprehensive Coverage:* Section 1071 provides broad authority to the CFPB to collect data from depository institutions and non-depository institutions that make small business loans. In order for regulators and the public to fully understand lending patterns, a comprehensive picture of the lending marketplace is needed. HMDA covers about 80 percent of loan transactions, which is a percentage that should be matched or exceeded by comprehensive coverage of small business lenders.

- *Expand Coverage to Include Banks and Non-Banks:* Currently, most of the publicly available data is submitted by large banks. The data disclosure must also include smaller banks, credit unions, and non-depository lenders including factors and merchant cash advance specialists. Data disclosure must include these lenders since they serve different types of small businesses with loans featuring various terms and conditions.

Collection of Data

- *Streamline Data Collection:* Several agencies currently collect small business loan data with different specifications for reporting the data and publicly releasing the data. These agencies are the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Small Business Administration (SBA), and the Community Development Financial Institutions (CDFI) Fund.

- Under Section 1071, the CFPB must centralize this data collection to make it easier for financial institutions to report the data and the general public to use it. Similar to the procedures for HMDA data collection, the bank agencies (FRB, FDIC, and OCC) can collect data from the banks they supervise and then send the data to the Federal Financial Institutions Examination Council (FFIEC). The SBA and CDFI Fund should do likewise, especially for the data that banks submit to them. Under the oversight of the CFPB, the FFIEC then would compile the data, remove errors from the data (requiring resubmissions from lenders when needed), and then publicly disseminate it.

Public Dissemination and Accessibility

- *Financial Institutions:* Under Section 1071, the CFPB mandates the format of data that financial institutions provide to the public upon request. This is important because under HMDA, financial institutions abused their leeway to provide members of the public with unusable formats like PDF documents totaling hundreds of pages. The CFPB must mandate data submission in easy-to-use formats for data analysis as well as summary tables.

- *Dissemination by the CFPB:* Under Section 1071, the CFPB is required to disseminate data to the general public on an annual basis. It must do so in an easy-to-use section on its webpage with user guides and data usable for novices to advanced users.

Introduction

Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires the Consumer Financial Protection Bureau (CFPB) to improve the publicly available small business loan data. In particular, the enhanced data is to include the race and gender of the small business owner applying for a loan and other details such as the revenue size of the small business and the action taken on the loan (approval or rejection).

The Dodd-Frank law states that the purpose of Section 1071 is to "facilitate enforcement of fair lending laws and enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses." By identifying needs and opportunities, the objective of the data collection is to motivate financial institutions to increase their lending to meet credit needs of traditionally underserved small businesses and neighborhoods.

This white paper is intended to provide tools for the CFPB and other stakeholders for implementing Section 1071 as well as provide a detailed rationale for Section 1071. It will discuss why data collection is important and provide insights into how to collect data for the required data elements. Since the CFPB has discretion to include additional data, the white paper will discuss other data variables that research and experience reveal are important for considering access to credit. In addition, a section of the paper will discuss the types of lending institutions that should report the data so that a comprehensive view of lending markets can be gleaned from the data.

Predecessors of Section 1071

Fortunately, the CFPB can learn from existing and ongoing efforts to collect data on small business lending. The CFPB's counterpart agencies annually collect data on various aspects of small business lending. In addition, notable private and nonprofit initiatives regularly collect data. While these existing data collection efforts provide useful opportunities for the CFPB and stakeholders to develop best practices for data collection, the current data collection is no substitute for a comprehensive collection effort under Section 1071. Each of the current efforts have limitations, and they provide fragmentary and incomplete pictures of lending patterns in the small business marketplace.

The federal banking agencies implement a small business data reporting requirement from the Community Reinvestment Act (CRA) regulations. Banks and savings and loans with assets above $1 billion are required to submit data annually to the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC). These agencies, in turn, release the data publicly through the Federal Financial Institutions Examination Council (FFIEC). The FFIEC provides publicly available data on loans by census tract income category, revenue size of the small business (above and below $1 million), and by categories of dollar amount (below $100,000, $100,000 to $250,000, and above $250,000) for each depository institution. For the market, as a whole, the publicly available data disclosure is more detailed and provides information on loans for each census tract.

The Small Business Administration (SBA) provides data on SBA programs including 7a, 504, and the microloan program to members of the public upon request. The National Community Reinvestment Coalition (NCRC) has obtained data on a county level and by race and gender of the small business borrower for the various SBA programs. In contrast, the CRA data on small business lending does not include information on the demographics of the small business borrower. Like the SBA, the Community Development Financial Institutions (CDFI) Fund provides data upon request. Located within the Department of the Treasury, the CDFI Fund offers subsidies, programmatic support, and monitors the activities of CDFIs. CDFIs are financial institutions which have a primary mission of promoting community or economic development and serve a defined population or target area which is underserved by mainstream financial institutions. The data provided by the CDFI Fund is available on a county level and includes lending by type of CDFI and by loan purpose and use (financing businesses, microenterprises, or commercial and multifamily real estate).

Private and nonprofit sector entities have also undertaken ambitious data collection efforts. The Ewing Marion Kauffman Foundation created a survey of businesses across the country that started in 2004. Each year from 2004 through 2011, the Foundation asked these businesses follow-up questions, allowing researchers to ascertain how the characteristics of the businesses and their credit needs evolved over time. The survey contains a number of questions about access to credit including whether the loan application was approved or denied, whether the small business owner feared rejection and did not apply for loans, the reasons for loan denial, and the types of collateral required to receive loans.[4]

The Graziadio School of Business and Management at Pepperdine University, with the support of Dun and Bradstreet Corporation, produces a quarterly survey of the demand by small and medium-sized businesses for credit and capital and the level of accessibility of credit and capital. Questions include the success rate of obtaining access to debt and equity, sources of debt (family, credit card, small business loans) and purposes for seeking loans (expansion, cash flow needs, refinance existing loans).[5]

The FIELD program at the Aspen Institute conducts an annual survey called the U.S. Microenterprise Census. During 2012, FIELD identified 816 microenterprise programs that offered technical assistance and loans across the United States. The data collected

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4 Alicia Robb and Josesph Farhat, *An Overview of the Kauffman Firm Survey, Results from the 2011 Business Activities*, June 2013, Ewing Marion Kauffman Foundation.

5 Description of the Pepperdine survey can be found in Josh Silver, Archana Pradhan (NCRC), Spencer Cowan (Woodstock Institute), *Access to Capital and Credit in Appalachia and the Impact of the Financial Crisis and Recession on Commercial Lending and Finance in the Region*, July 2013, funded by the Appalachian Regional Commission (ARC), available via http://www.ncrc.org/images/accesstocapitalandcreditInappalachia.pdf.

includes demographic information on the microenterprises receiving loans and technical assistance. Data for evaluating program success is also collected including information on staffing of the microenterprise programs, costs incurred by the programs, the number and performance of loans, and the types of technical assistance provided. Interested stakeholders can access survey data from http://www.microtracker.org.

Each of these public- and private-sector efforts to collect data provide valuable insights for the CFPB as it undertakes collections per Section 1071. Yet these efforts cannot substitute for data collection under Section 1071. Each of these efforts provides just a subset of the information needed to provide a comprehensive view of access to loans for small businesses. Moreover, the current databases lack common variables enabling them to be linked together in order to create a comprehensive database.

Reasons to Collect Data

Small businesses have contributed significantly to job creation. Access to credit and capital enables small businesses to grow and add employees and jobs. As demonstrated above, public and private efforts have engaged in data collection because stakeholders believe it is important to track access to credit, identify barriers to access, and use data analysis as part of the effort to overcome barriers to access.

Proving that better data on lending markets improves access to credit is difficult. Evidence, however, suggests that former Supreme Court Justice Louis Brandeis is correct that "sunlight can be the best disinfectant and the electric light the best policeman."[6] Data, the sunlight, motivates lenders to identify missed and profitable opportunities. The data also enables community organizations, public officials, regulators, the media, and other stakeholders to hold lenders publicly accountable for meeting credit needs. After Congress improved Home Mortgage Disclosure Act (HMDA) data in 1988 to include the race and gender of loan applicants, lending increased to traditionally underserved populations. For instance, from 1993 through 1995, conventional (non-government-insured) home mortgage lending to African-Americans and Hispanics surged 70 percent and 48 percent, respectively. In contrast, the increase was just 12 percent for whites.[7]

Small Businesses: Engines of Job Creation and Employment

Analyzing access to credit and removing barriers to access becomes imperative when considering the significant role of small businesses in the United States economy. According to the Association for Enterprise Opportunity (AEO), microbusinesses, defined as firms with five or fewer employees, are about 92 percent of all businesses in the United States. Constituting 25.5 million businesses, microenterprises accounted for 26 million jobs in 2011. The number of microenterprise jobs exceeded the number of

6 Prepared Remarks of CFPB Director Richard Cordray at the Greenlining Institute's Economic Summit, April 4, 2014, available via http://www.consumerfinance.gov/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-greenlining-institutes-economic-summit/.

7 NCRC, *Home Loans to Minorities and Low- and Moderate-Income Borrowers Increase in 1990s, but then Fall in 2001: A Review of National Data Trends from 1993 to 2001*. Available upon request

jobs in the public sector at the federal, state, and local levels combined. The number of microenterprise jobs is also double the number in the manufacturing sector.[8] The Aspen Institute reports that small businesses create between 65 and 90 percent of all jobs.[9] Likewise, the SBA calculates small businesses account for 60 percent of net new jobs created from mid-2009 to mid-2012.[10]

Figure 1: Microbusiness Employment Compared to Industry Sectors

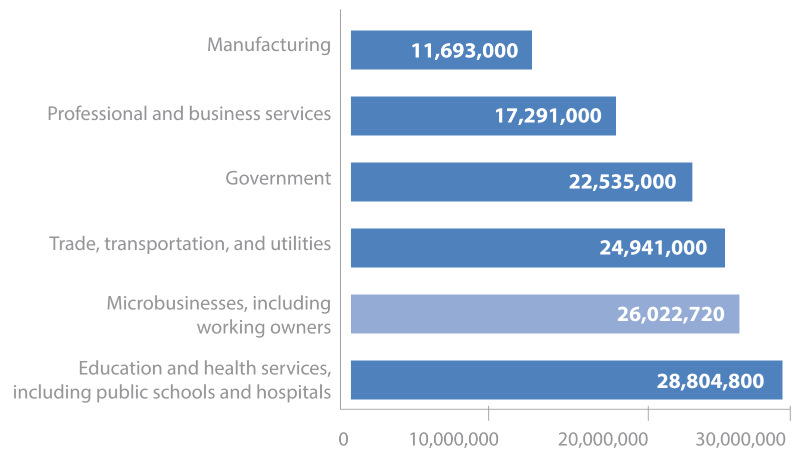


Figure Source: Association of Enterprise Opportunity, *Bigger than You Think – The Economic Impact of Microbusiness in the United State,* p. 6.

Women- and minority-owned firms are also engines of economic growth. Women-owned businesses account for $1.3 trillion in revenue from more than 8.3 million individual firms.[11] A 2013 report on the state of women-owned businesses in the U.S. conducted by American Express' OPEN showed that the employment growth of women-owned businesses between 1997 and 2013 was more than the growth rate of all but the largest, publicly traded firms.[12] This is not surprising given that women-owned businesses grew by 20.1 percent between 2002 and 2007, according to the U.S. Census.[13]

8 Association of Enterprise Opportunity, *Bigger than You Think – The Economic Impact of Microbusiness in the United States*. The SBA similarly finds that 99 percent of all businesses in the U.S. are small businesses with less than 500 employees; see *Statistics of U.S. Businesses*, U.S. Static Data, Office of Advocacy, U.S. Small Business Administration (Link to data sheet: www.sba.gov/sites/default/files/static_us_11_0.xlsx).

9 Elaine L. Edgcomb and Tamra Thetford, *Microenterprise Development as Job Creation*, Aspen Institute.

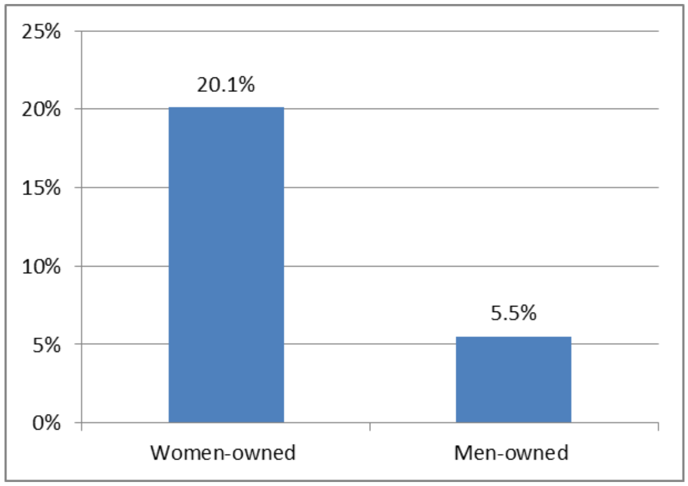
10 U.S. Small Business Administration, Frequently Asked Questions, March 2014, available via http://www.sba.gov/sites/default/files/FAQ_March_2014_0.pdf.

11 National Women's Business Council, *The Economic Impact of Women-Owned Businesses in the United States*, available via http://www.nwbc.gov/research/economic-impact-women-owned-businesses-united-states.

12 *The 2013 State of Women-Owned Businesses Report, A Summary of Important Trends, 1997-2013*, Women Able and American Express OPEN, available via http://www.womenable.com/userfiles/downloads/2013_State_of_Women-Owned_Businesses_Report_FINAL.pdf.

13 *Women's Employment During the Recovery*, U.S. Department of Labor, May 3, 2011, available via http://www.dol.gov/_sec/media/reports/FemaleLaborForce/FemaleLaborForce.pdf.

Figure 2: Employment Growth of Women-Owned Businesses Compared to Men-Owned Businesses Between 2002 and 2007



Data Source: *Women's Employment During the Recovery*, U.S. Department of Labor, May 3, 2011, p. 2.

Earlier in the 2000s, minority-owned firms employed a workforce of 4.7 million with an annual payroll of $115 billion. In addition, over the last two decades, the growth in the number of minority-owned firms and their gross receipts outpaced the growth of non-minority-owned firms.[14] Immigrants have contributed to the growth of minority-owned small business. Immigrants are more than twice as likely to start new businesses as non-immigrants. A 2012 report published by the Partnership for a New American Economy found that they also start more than 25 percent of all businesses in seven out of eight sectors of the U.S. economy, including construction, retail trade, leisure, and hospitality.[15] The study also found that immigrants were responsible for 28 percent of new businesses founded in the U.S. in 2011 and are expected to lead growth over the next decade.[16]

Anil Rupasingha of the Federal Reserve Bank of Atlanta further documents the importance of locally owned microbusinesses for job creation. According to Rupasingha, locally owned businesses employed 100 million workers as opposed to 31 million employed by non-locally owned establishments (the headquarters were located in a different county than the plant or business). Econometric analysis revealed that locally owned businesses had favorable impacts on a county level, increasing income and employment growth, and that the impact was larger for smaller locally owned businesses. Rupasignha concludes that local entrepreneurship can help distressed counties diversify their employment base and grow economically, and that it might be more feasible for distressed counties to support local businesses than attract

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14 Minority Business Development Agency (MBDA), *Disparities in Capital Access between Minority and Non-Minority Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs*, January 2010.

15 *Open for Business How Immigrants Are Driving Small Business Creation in the United States*, The Partnership For a New American Economy, August 2012 available via http://www.renewoureconomy.org/sites/all/themes/pnae/openforbusiness.pdf.

16 Ibid.

larger enterprises with distant headquarters. He concludes his article by stating that policymakers may want to identify and seek to remove technological obstacles or barriers in access to credit impeding the growth of local businesses.[17]

Empirical research by the Aspen Institute reinforces Rupasingha's findings about the economic benefits of microbusinesses. According to their Microenterprise Census, microenterprises provide important opportunities for traditionally economically challenged communities to rebuild. For 2011, FIELD's survey revealed that 56 percent of microenterprises assisted by microenterprise programs were owned by women, 58 percent were owned by people of color, and 71 percent had incomes at or below low- and moderate-income levels (80 percent of area median income).[18] In addition, microenterprises offered opportunities to escape poverty and earn a livable wage. Owners of microenterprises had a median hourly wage 53 percent higher than the federal minimum wage. Workers at microenterprises receive a median hourly wage that is 38 percent higher than the federal minimum wage.[19]

Barriers to Access to Credit for Small Businesses

Access to credit is essential for small businesses to grow and realize their potential. The Aspen Institute's logistic regression analysis indicates that receiving a loan increases the chances of microenterprises creating jobs by 302 percent.[20] In addition, Federal Reserve surveys report that 90 percent of small businesses used credit in 2003 compared to 80 percent in 1998.[21] Despite the importance of access to credit for job creation, significant barriers to fair access persist.

Research commissioned by the Minority Business Development Administration (MBDA) finds that minority-owned firms are less likely to receive loans than non-minority-owned firms. Among firms with gross receipts under $500,000, 23 percent of non-minority-owned firms received loans compared to 17 percent of minority-owned firms. Among high-sales firms (firms with annual gross receipts of $500,000 or more), the disparity remains, with 52 percent of non-minority-owned firms receiving loans compared to 41 percent of minority firms. In addition, the average loan received by high-sales minority firms was $363,000 compared to $592,000 for non-minority-owned firms.[22] These findings are not random chance. Regression analysis finds that after controlling for education, credit score, experience, number of owners, and firm age, minority-owned firms received loan amounts that are 35 percent lower than non-minority-owned firms.[23]

17 Anil Rupasingha, PhD, *Locally-Owned: Do Local Businesses Ownership and Size Matter for Local Economic Well Being?* Federal Reserve Bank of Atlanta, Community and Economic Development Department, August 2013.

18 U.S. Microenterprise Census Highlights, FIELD Trendlines Series, Aspen Institute, Issue 5, June 2013.

19 Edgcomb and Thetford, op. cit., p. 8.

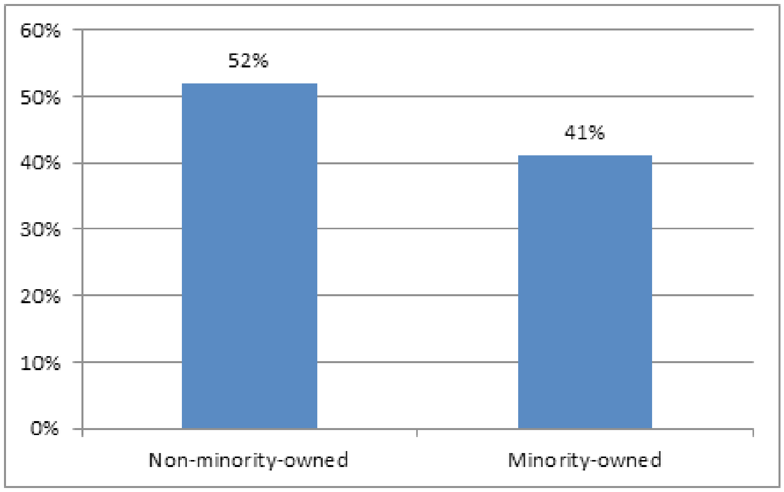
20 Edgcomb and Thetford, op. cit., p. 12.

21 Elizabeth Laderman and Carolina Reid, *The Community Reinvestment Act and Small Business Lending in Low- and Moderate-Income Neighborhoods during the Financial Crisis*, Federal Reserve Bank of San Francisco, October 2010, available via http://www.frbsf.org/community-development/files/wp2010-05.pdf.

22 MBDA, Disparities in Capital, op cit. p. 5.

23 MBDA, Disparities in Capital, op cit, p. 39.

Figure 3: Racial Disparities in Lending for High Sales Firms: Percent of Firms Receiving Loans



Data Source: Minority Business Development Agency (MBDA), *Disparities in Capital Access between Minority and Non-Minority Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs*, January 2010, p. 35.

Access to loans for minorities has likely worsened as a result of the recession. The *Wall Street Journal*, for example, reports that African-American businesses received 2.3 percent of SBA loans in 2013, down from 11 percent in 2008.[24] While it is likely that access to credit will improve for all small businesses, including minority-owned and women-owned, as the economy rebounds from the recession, access to credit will also likely remain constrained for minority-owned and women-owned small businesses. The research showing less access to credit for minority- and women-owned small businesses covers several years and various economic conditions.

Women-owned firms also experience disparities. Women-owned firms had a loan approval rate that was 15 to 20 percent lower than their male counterparts according to a research study released by Biz2Credit.[25] Regression analysis based on Kauffman Firm Survey data on start-ups and their experience over time reveals that women-owned business are less likely to have debt financing.[26]

Disparities in access to credit are a significant factor impeding the full growth and potential of minority-owned, women-owned, and very small businesses. Just considering minority-owned businesses, MBDA calculates that if minority-owned firms had reached economic parity in 2002, these firms would have employed 11.4 million more workers

24 Ruth Simon and Tom McGinty, *Loan Rebound Misses Black Businesses*, Wall Street Journal, March 18, 2014.

25 Biz2Credit Analysis of Women-Owned Businesses Identifies Challenges for Female Entrepreneurs Seeking Small Business Loans, March 27, 2013, available via http://www.biz2credit.com/research-reports/analysis-of-women-owned-businesses.html,

26 MBDA, Disparities in Capital, op. cit., p. 43.

and would have had payrolls $2.39 trillion larger. According to MBDA, economic parity is achieved when the level of business activity of a business group is proportional to that group's representation in the adult population of the United States.[27] Lack of access to credit is not solely responsible for the lack of economic parity, but considering the Aspen Institute's estimate that firms are 300 percent more likely to create jobs if they receive loans, lack of access is certainly a large factor in the lack of economic parity. This is not just an issue for traditionally underserved communities; it is an issue for the entire country, since impediments to access retard business development to the tune of millions of jobs and trillions of dollars in payroll.

Collect Data so That Data Illuminates Markets and Does Not Obfuscate or Result in Market Distortions

Section 1071's data requirement must be implemented carefully so that its full potential to identify and rectify unmet credit needs can be realized. Section 1071 requires several pieces of data regarding the demographics of the small business owner, action taken by lenders on applications, and the type and purpose of the loan. This data needs to be collected in a thoughtful and detailed manner so federal regulatory agencies and members of the public can assess whether the demand for various types of credit is being met in a responsible manner. The CFPB also has considerable discretionary data collection authority which, if used in an effective manner, could significantly enhance the ability of the data to shed light on whether creditworthy businesses are receiving loans with sustainable and affordable terms and conditions.

The discretionary authority can be also instrumental in collecting more information on the size and type of small businesses receiving loans. There are a variety of definitions of small businesses. The SBA defines a small business as businesses with up to 500 employees, while other organizations focus on the smallest businesses and define microbusinesses as those with five employees or less.[28] Section 1071 presents an opportunity to collect detailed data on the number of employees in a business, revenue size of the business, and other information such as sector that will enable researchers and stakeholders to focus on access to credit for the businesses with which they are most concerned.

As well as requiring detailed data for small business demographics and loan characteristics, the CFPB needs to use its authority under Section 1071 so that the data captures a great majority of small business loan transactions in order to produce an accurate reflection of lending patterns and market activity. For example, if the data omits loan activity from a significant segment of financial institutions, it could indicate that a particular segment of businesses are receiving few loans, when in fact they could be receiving a substantial number of loans. At the same time, however,

27 MBDA, Disparities in Capital, op. cit., p. 7.

28 For the SBA definition of a small business, see http://www.sba.gov/content/what-sbas-definition-small-business-concern.

while the particular segment of businesses could be receiving a significant number of loans, the loan terms and conditions could be onerous and/or abusive. Thus, the data needs to include a substantial majority of financial institutions making loans in the small business marketplace, and the data needs to have sufficient information on loan terms and conditions so that the public can judge whether credit needs are being met in a responsible fashion. In this regard, HMDA serves as a useful precedent. HMDA data captures about 80 percent of loan originations.[29] In addition, the Dodd-Frank law requires the CFPB to collect detailed information on loan terms and conditions in HMDA data, which will improve HMDA's ability to assess whether credit needs are being met in a responsible manner.

In addition to being comprehensive in its coverage of the marketplace, the small business data needs to be collected in a manner that does not constrain lending activity or influence it in a counterproductive manner. For instance, if the CFPB determined that collecting some indicator of creditworthiness of small businesses was important, the data should be collected in a way that does not inadvertently favor one particular credit scoring model. This type of data collection could imply that the CFPB favors that model and may discourage other competing and innovative models used in assessing borrower creditworthiness. Instead of revealing the credit score model used in the data, the CFPB could instead opt to report "normalized" quintiles or quartiles of creditworthiness of borrowers. This would inform the public at large how the lending institution judged the creditworthiness of applicants and how those judgments may have influenced the lender's actions without suggesting that one particular credit score model is preferred.

Section 1071 also contains provisions protecting borrower privacy. This is of paramount importance, and this paper offers recommendations for reconciling detailed data disclosure with borrower privacy. Also, the paper provides guidance for how to disseminate the data to the public in easy-to-use formats.

These principles of comprehensiveness and illumination should be guiding principles to thinking through how to collect data for the variables required by the Dodd-Frank statute as well as possible variables that the CFPB has the discretionary authority to collect.

29 Allen Fishbein and Ren Essene, *The Home Mortgage Disclosure Act at Thirty Five: Past History, Current Issues,* Joint Center for Housing Studies, Harvard University, August 2010, available via http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/mf10-7.pdf.

Required Data Elements

Section 1071 of Dodd-Frank requires the CFPB to collect the following:

- Race, gender, and ethnicity of the principal owners of the business
- Gross annual revenue of the business
- Census tract in which the business is located.
- Type of action taken with respect to the application
- Type and purpose of the loan or other credit being applied for
- Amount of the credit or credit limit applied for and amount approved

This paper will now discuss each of these required data elements and will offer thoughts as to the rationale for collecting the data elements and the mechanics or methods for collecting these data elements.

Race, Ethnicity, and Gender

Section 1071 requires financial institutions to collect information on the "race, sex, and ethnicity of the principal owners of the business." The section further defines a minority-owned business as one in which "more than 50 percent of the ownership or control of which is held by 1 or more minority individuals and more than 50 percent of the net profit or loss of which accrues to 1 or more minority individuals." Women-owned businesses are similarly defined with 50 percent or more of the ownership and profits accruing to women.

Rationale:

A number of studies employing various data sources and surveys reveal the likelihood of discrimination in certain types of lending. These surveys reinforce the need for more comprehensive and regular data on the demographics of the borrower. In some cases, the surveys have been discontinued, such as the Survey of Small Business Finances that was sponsored by the Federal Reserve Board. In other instances, the data sources are ongoing surveys but are surveys of borrower experiences, not data submitted by individual lending institutions. It would therefore not be possible to hold individual lending institutions accountable for any violations of fair lending laws using the data reported in this section of the white paper.

Supplementing data from the National Survey of Small Business Finances with creditworthiness data obtained from Dun and Bradstreet, Cavaluzzo, Cavauluzzo, and Wolken examined the interplay among demographic characteristics of small business borrowers, market concentration, and the ability to access credit. A series of regression analyses revealed that increases in market concentration as measured by the Herfindahl-

Hirschman Index (HHI) indices result in African-Americans and women being more likely to experience denials of loan applications. Additionally, results show that African-Americans and women are more likely to have unmet credit needs (as measured by a fear to apply because of possibilities of discrimination or actual rejection) when market concentration increases. Finally, a one percentage point increase in concentration as measured by the HHI index causes an 11.40 basis point increase in the price of a line of credit for Hispanic small businesses.[30]

Mitchell and Pearce also use the Survey of Small Business Finances and find that African-American and Hispanic business owners are less likely to have bank transaction loans than whites after controlling for market and business characteristics, but that there is no statistically significant difference in the likelihood of receiving a bank line of credit. The authors hypothesize that bank transaction loans are more likely to involve automated underwriting which may disadvantage minority applicants whereas bank line-of-credit lending may involve "relationship lending." In relationship lending, a bank has established an ongoing relationship with a borrower and has more insight into a borrower's creditworthiness. The authors regard line-of-credit lending as "quintessential" relationship loans since line-of-credit lending represents a sustained commitment on the part of the bank to make periodic loans to borrowers over a specified time period.[31] The implication of Mitchell and Pearce's research is that gender and race data need to be supplemented by sufficient data on different loan types, since outcomes for borrowers and underwriting approaches are likely to vary based on different loan types.

Using the Kauffman Firm Survey instead of the Survey of Small Business Finances, Robb nevertheless has outcomes similar to the other studies. Her regression model includes variables on business owner characteristics including credit score, whether the business is high technology, legal form of ownership, industry sector, race, ethnicity, gender, age, years of previous experience, and education levels. After controlling for these variables, Robb finds African-Americans and Hispanics were less likely to have their applications approved than whites, and that the differences in application outcomes widened during the financial crisis. Women were also less likely to have their applications approved than men, but gender difference was not as wide as the racial/ethnic difference.[32]

Method:

A wide body of research presents compelling evidence that minority- and women-owned businesses experience less access to lending than white-owned and male-owned businesses. It is quite possible that discrimination occurs in certain markets or in certain products.

30 Cavaluzzo, K.S., L.C. Cavaluzzo and J.D. Wolken. *Competition, Small Business Financing, and Discrimination: Evidence From a New Survey.* Journal of Business. January 2002, vol. 75, no.4

31 Karlyn Mitchell and Douglas K. Pearce, *Availability of Financing to Small Firms Using the Survey of Small Business Finances* (2005). University of Illinois at Urbana-Champaign's Academy for Entrepreneurial Leadership Historical Research Reference in Entrepreneurship. Available at SSRN: http://ssrn.com/abstract=1509978

32 Alicia Robb, Marin Consulting, LLC, *Access to Capital among Young Firms, Minority Owned Firms, Women Firms, and High Tech Firms*, for the SBA Office of Advocacy, April 2013.

In terms of determining which race or gender owns a business, Section 1071 provides specific instructions requiring that more than 50 percent of the ownership or profits accrue to a particular gender or race. It appears that the SBA also follows this formula based on data that the SBA has provided to NCRC. The SBA data has racial and ethnic categories of African-American, Asian, Hispanic, and Native Americans.

Categories of Asian and Hispanic may not be able to effectively reflect the diverse experiences of small businesses within the Asian and Hispanic communities. There might be different levels of access to loans depending on the country of origin of a small business owner. The new data collection standards implemented by the Department of Health and Human Services as required by the Affordable Care Act Section 4302 can serve as a model for Section 1071 data collection. The new standards include additional sub-categories that roll up to the Office of Management and Budget minimum standard categories for race and ethnicity. For Asians, the sub-categories are Asian Indian, Chinese, Filipino, Japanese, Korean, Vietnamese, and Other Asian; for Native Hawaiian and Other Pacific Islander, the categories are Native Hawaiian, Guamanian or Chamorro, Samoan, and Other Pacific Islander; and for Hispanics, the sub-categories are Mexican/Mexican American/Chicano(a), Puerto Rican, Cuban, and Another Hispanic/Latino.

Finally, the immigrant status of the small business owner may play an important role in influencing access to credit. The CFPB could readily add a data field with a categorical variable (yes/no) indicating if the business owner was foreign born. The data should also include data fields indicating the language used in the transaction. One data field should indicate whether English or another language was used in verbal communication between the lender and borrower. Another data field should indicate whether English or another language was used for the loan documents. Inconsistences in the language used for the verbal and written communication could lead to exploitation of borrowers that speak English as a second language. Comparing data on language to data on loan terms and conditions would be an important part of assessing if lenders are meeting credit needs in a responsible manner.

Gross Annual Revenue of the Business

Section 1071 requires lending institutions to report "the gross annual revenue of the business in the last fiscal year of the women-owned, minority-owned, or small business loan applicant." No further instruction is provided by the statute, providing the CFPB with some discretion.

Rationale:

Gross annual revenue size of the small business is a critical data element since research shows that smaller businesses are less likely to receive loans. In a report conducted for the Appalachian Regional Commission (ARC), NCRC obtained Pepperdine survey data (see above for a description of the Pepperdine survey) that revealed approval rates for businesses of various revenue sizes. As revealed by survey data for the first quarter of 2012, just 18 percent of the small businesses with revenues less than $500,000 who sought loans obtained them. In contrast, 35 percent of the businesses with revenues between $500,000 and $1 million and 55 percent of the businesses with revenues between $1 million and $5 million received loans.[33]

Method:

Revenue categories should be more detailed than those in the CRA small business loan data. In the CRA small business data, the revenue categories are small businesses with revenue below $1 million dollars and small businesses with revenues above $1 million. Just the one example above from the Pepperdine survey reveals the inadequacies with this classification since businesses with revenues below $500,000 had markedly less access to loans than businesses with revenues above this amount.

In order to capture microenterprises, the revenue categories need to be expanded. The Association of Enterprise Opportunity (AEO) has a further breakdown for the smallest microbusinesses as those with gross sales and receipts below $50,000.[34] The CDFI Fund also uses $50,000 as a category in the data it makes publicly available. At a minimum, the revenue categories should include businesses with annual revenues $50,000 and below, $50,000 to $100,000, $100,000 to $500,000, $500,000 to $1 million, $1 million to $5 million, and $5 million and above. According to the Census Bureau, 1.3 million firms had receipts less than $100,000, 2.3 million firms had receipts between $100,000 and $500,000, and about 909,000 firms had receipts between $500,000 and $1 million in 2007.[35] The Census Bureau data supports AEO's classification in that a classification system that does not have separate categories below $500,000 will fail to adequately capture the experience in the lending markets for large numbers of small businesses.

An important issue in the CRA small business loan data is that for a sizable number of loans, the revenue size of the small business is unknown because the bank did not consider revenue size in its underwriting.[36] This could be the case, for example, in credit card lending. However, the publicly available data provided by the FFIEC does not indicate for which loans the revenue size is unknown. When analysts seek to calculate the percentage of loans for businesses of various revenue categories, the percentage can be incorrect since it is not possible to subtract from the denominator the number of loans for which revenue size is unknown. At the very least, reporting institutions should be required to indicate the loans for which revenue size is unknown so that the data's accuracy can be improved.

33 Josh Silver, Archana Pradhan (NCRC), Spencer Cowan (Woodstock Institute), report funded by ARC, op. cit., p. 86.

34 AEO, Bigger than You Think, op. cit.

35 See https://www.census.gov/econ/smallbus.html.

36 Community Reinvestment Act: Interagency Questions and Answers, March 2010, p. 11670, Sections _.42(a)(4)-2, 42(a)(4)-3, 42(a)(4)-4 discuss revenue of small business and that lending institutions are not required to ask for revenue size. Lending institutions report "revenues not known" on loans for which they do not collect revenue information. However, the FFIEC does not include a code in the publicly available data that indicates when revenue is unknown. See http://www.ffiec.gov/cra/pdf/2010-4903.pdf.

The inaccuracy due to loans for which revenue is unknown impairs regulatory enforcement. For example, the CRA exam for East Boston Savings Bank reports that the bank issues a higher percentage of its loans than the aggregate (all other banks, as a group) to businesses with revenues of less than $1 million. However, the CRA exam acknowledges that it is unknown to what extent the bank exceeds the aggregate. The exam states:

> The disparity between the aggregate and Bank performance can, in part, be explained by a significant volume of business credit card lending by larger, nationwide institutions, which often do not perform underwriting that considers GAR (Gross Annual Revenue) information. Therefore, it is reasonable to assume that a significant portion of the aggregate data comprises loans to businesses upon which GAR information was not relied on, rather than to businesses with GARs over $1 million.[37]

In sum, this inaccuracy diminishes the ability of even regulatory agencies to adhere to their CRA responsibilities in assessing whether banks are meeting credit needs of small businesses.

Census Tract in Which Business is Located

Section 1071 requires lending institutions report the "census tract in which is located the principal place of business of the women-owned, minority-owned, or small business loan applicant."

Rationale:

The geographical location of the business is critical for regulatory enforcement of the Community Reinvestment Act (CRA) and the fair lending laws. Designed to combat redlining, CRA exams measure whether banks are making loans in low- and moderate-income census tracts and thus whether they are meeting credit needs in these tracts. While progress has been made in combating redlining, fair lending issues remain according to a recent paper by Robb and Bates. Robb and Bates' econometric analysis shows that minority-owned firms are more likely to receive loans in census tracts with higher levels of poverty. They suggest that banks are attuned to their CRA responsibilities and will make more efforts to lend to creditworthy or marginally creditworthy minority-owned firms in lower income census tracts.

Likewise, Robb and Bates show that minority-owned firms are more likely to be approved for loans if they are located in minority census tracts, which shows banks' attention to fair lending and redlining concerns. However, fair lending enforcement has not been completely successful since minority-owned firms are less likely to be approved when they are located in non-minority neighborhoods.[38] Data must capture the location of the

37 See 2011 CRA exam of East Boston Savings Bank, http://www2.fdic.gov/crapes/2011/33510_111117.PDF.

38 Timothy Bates and Alicia Robb, *Has the Community Reinvestment Act Increased Loan Availability Among Small Businesses Operating in Minority Neighborhoods*, Urban Studies Journal, May, 2014.

business in order to measure the effectiveness of CRA and fair lending enforcement and to identify areas where enforcement needs to be improved.

Because Robb and Bates showed uneven progress in meeting credit needs of traditionally underserved borrowers, improved data on business location is needed to continually track lending in neighborhoods. Employing the CRA small business loan data, Reid and Laderman's analysis illustrates that more steps need to be made to increase access to all neighborhoods. During the economic boom years from 2004 and 2007, their analysis reveals that low- and moderate-income (LMI) and African-American neighborhoods did not benefit as much as middle- and upper-income neighborhoods (MUI) from the increase in small business lending. Moreover, the contraction in lending was greater in LMI than MUI neighborhoods between 2008 and 2009. By 2009, there was one loan per 22.6 small businesses in MUI neighborhoods but just one loan per 28.4 small businesses in LMI neighborhoods.[39]

Method:

Since location is a significant part of CRA and fair lending enforcement, lending institutions must be instructed to provide the census tract location of small business loans. Currently, the interagency CRA Question and Answer (Q&A) guidance advises banks that "prudent banking practices and Bank Secrecy Act regulations dictate that institutions know the location of their customers and loan collateral." The agencies further advise banks to obtain addresses beyond a post office box. In cases where only rural route numbers are provided, the agencies state that the banks still usually know the census tract location of the businesses. In cases that census tracts cannot be geocoded, the bank is to report census tract or county as "unknown."[40]

This guidance for banks reporting under CRA appears to strike a reasonable balance in exhorting banks to make strenuous efforts to obtain census tract locations for loans. In fact, comparing CRA small business lending reporting to HMDA reporting, NCRC found tracts unknown for about four percent of the small business loans and five percent for conventional home purchase loans (reported under HMDA).[41] This suggests the CRA regulation may have tighter reporting requirements than HMDA for census tract location. The CFPB regulation should also require rigorous reporting of loan location.

Currently, the FFIEC publicly reports loans by individual census tracts for the aggregate (all banks, as a group) on a county level. For individual banks, the FFIEC publicly reports data by income category of census tracts. For example, for a fictitious bank such as "Main Street Bank," the data disclosure would report how many loans were in low- or moderate-income tracts. The data will not report how many loans were issued by Main Street Bank in each of the census tracts in the county. In contrast, HMDA data reports data by each

39 Laderman and Reid, Federal Reserve Bank of San Francisco, op. cit., p. 6.

40 Community Reinvestment Act, Interagency Questions and Answers, March 2010, p. 11669, http://www.ffiec.gov/cra/pdf/2010-4903.pdf.

41 NCRC calculations using 2012 data reported on the FFIEC webpage; table 2-1 CRA National Aggregate for small business data and Table 7-2, Conventional Home Purchase Loans.

census tract for individual banks. Members of the public can more effectively hold banks accountable for making loans in various neighborhoods if the data is reported for each census tract. Below, suggestions are offered for overcoming an issue of borrower privacy that has made the agencies reluctant to release data for each tract for individual banks.

Type of Action Taken with Respect to the Application

Section 1071 requires lending institutions to report "the type of action taken with respect to such application." The statute does not provide further instruction, providing the CFPB with discretion in how to report action with respect to the application.

Rationale:

Currently, the largest dataset available to the public, the CRA small business loan data, has information on loan approvals only. In contrast, some surveys such as the Kauffman Firm Survey has information on loan denials as well as approvals.

Laderman and Reid state that their paper discussed above has limitations because the CRA data does not have other action categories. According to Laderman and Reid:

> Our paper cannot tease out how changes in small business lending are driven by changes in supply or changes in demand. The lack of data on small business loan applications severely limits our ability to understand where there is unmet demand for credit and whether or not small businesses in LMI neighborhoods are being denied small business credit by banks. While we do have some information on patterns of small business lending by banks with a CRA obligation, we do not have the ability to assess to what degree those loans reflect a true commitment to meeting the credit needs of the banks' local communities. Access to more comprehensive data on small business lending – especially across the different types of credit markets – would greatly facilitate our understanding of credit barriers and gaps in LMI neighborhoods.[42]

As Laderman and Reid maintain, it is not possible to determine with the CRA small business loan data whether differences in the percentages of loans by demographic category of neighborhood are due to differences in demand or lender action on applications. In order to assess whether credit needs are being met, data on applications and denials in addition to approvals is needed. Moreover, data on denials enables regulators and the public at large to determine if there are fair lending concerns arising from disparate denial rates experienced by different races or genders. As discussed above, the research based on survey data reveals statistically significant differences in denials by race and gender, which suggests that data for individual lending institutions is needed for enforcement purposes to investigate the possibilities of discrimination on the part of certain lenders.

42 Laderman and Reid, op. cit., pgs. 9-10.

Analysis of the application and denial rates by geographical area can also shed light on whether the needs for credit are being met in a uniform manner or if some regions have unmet credit needs. In a report conducted for the Appalachian Regional Commission, NCRC obtained special tabulations from the Kauffman Firm Survey aggregated to the county level in order to assess potential differences in application and denial rates in Appalachia compared to the United States as a whole. From the bar graphs below, it appears that application rates are similar in Appalachia and the nation, but that denial rates are considerably higher in Appalachia.[43] This suggests to policymakers that unmet credit needs are present in Appalachia compared to the nation and that either fair lending enforcement should be increased or the creditworthiness of a segment of small businesses in Appalachia should be improved so that they can receive the loans they desire.

Figure 4: Percent of Respondents Applying for Loans in Appalachia and U.S.

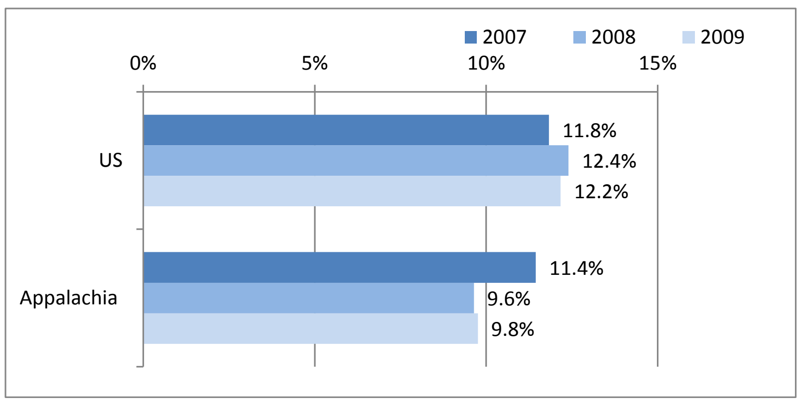


Figure Source: NCRC report for ARC "Access to Capital and Credit in Appalachia and the Impact of the Financial Crisis and Recession on Commercial Lending and Finance in the Region" p. 102.

Figure 5: Percent of Respondents Who Applied for Loans and Were Always Denied in Appalachia and U.S.

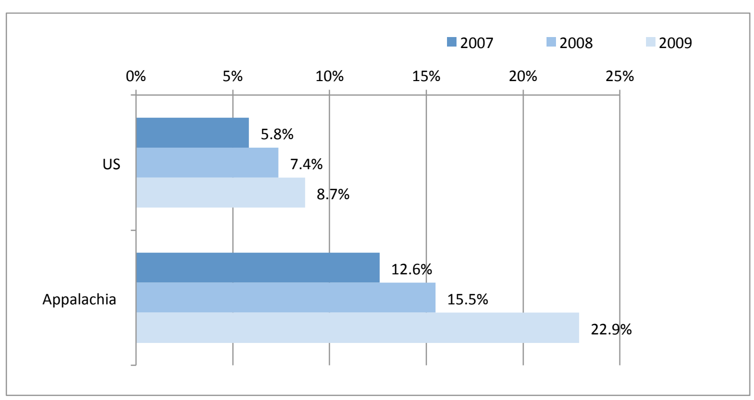


Figure Source: NCRC report for ARC "Access to Capital and Credit in Appalachia and the Impact of the Financial Crisis and Recession on Commercial Lending and Finance in the Region" p. 103.

43 Pradhan, Silver, and Cowan, report for ARC, op. cit., pgs. 102 and 103.

Method:

The action categories in HMDA are a good precedent that can inform the action categories in the small business data. In addition to approvals, HMDA reports whether the loan was denied, if the loan application was incomplete, if the loan was approved but not accepted by the borrower, or if the borrower withdrew the application. All of these categories are important for fair lending enforcement. Disparities in incomplete or withdrawn applications can be due to discouragement and discriminatory treatment applied to women or minorities. Moreover, disparities in approvals not accepted by the applicant can be indicative of less favorable pricing or loan terms and conditions applied to women and minority applicants.

HMDA also requires mandatory reporting of reasons for loan denial for certain lenders. All lending institutions reporting small business data must be required to report reasons for denial. This data can help stakeholders determine if fair lending concerns are present or if underwriting factors need to be addressed or if borrower creditworthiness should be improved. In its survey, the Kauffman Foundation asks respondents to indicate if they were denied loans because of insufficient collateral, business credit history, personal credit history, loan too large, inadequate documentation, or business too new.[44] For HMDA, one of the other denial reasons that could be applicable and possible to modify for small business loan data is debt-to-income ratio, which is an important measure of whether the loan is affordable for the borrower.

Type and Purpose of the Loan

Section 1071 requires financial institutions to report the "type and purpose of the loan or other credit being applied for." The Dodd-Frank law provides no further instructions regarding this data element.

Rationale:

More information on loan purpose is critical because different credit needs are met with a loan origination compared to a renewal, refinance, or a line of credit. Data on loan originations allow researchers and the general public to determine which businesses have basic access to credit while separate reporting on refinances and renewals allows researchers to determine which businesses have additional access to credit. Like loan purpose, loan type provides important insights, particularly regarding loan terms and conditions. For example, credit card lending has shorter terms and is more expensive than non-credit card lending.

Loan purpose: Section 1071 must mandate that originations, renewals, lines of credit and refinances be reported separately in order to provide comprehensive insight into the availability of credit to different types of small businesses. The CRA small business data, which is the largest database currently available, is limited in that it reports loan

44 Alicia Robb and Joseph Farhat, *An Overview of the Kauffman Firm Survey: Results from the 2011 Business Activities*, June 2013.

approvals and has peculiar procedures for reporting lines of credit, renewals, and refinances of loans that make it impossible for researchers and members of the public to separate loan originations from the other types of credit.[45] It is impossible to understand if a plethora of credit needs are being met with the current CRA small business loan data. In contrast to the CRA loan data, survey data has included other types of information in addition to originations but the survey data lacks the regular annual disclosure for lending institutions that the CRA small business data features.

Loan Type: Categories of loan type discussed immediately below include credit card lending, personal loans and home equity loans, factoring, and merchant cash advances.

Credit Card Lending: The other significant limitation in the CRA small business data is a lack of separate reporting for different types of loans. The CRA small business data combines credit card lending and non-credit card lending without the ability to separate credit card and non-credit card lending in analyses.[46] This is a significant limitation because credit card lending has shorter terms and higher interest rates than non-credit card lending. While legitimate and responsible credit card lending serves credit needs, concerns arise when a particular group of borrowers receive a disproportionate amount of credit card loans. The borrower group is receiving loans that have higher rates and may have lower dollar amounts than they need. In fact, the SBA reports that Hispanic and African-American owners are more likely to rely upon credit cards than other businesses.[47]

Stakeholders may want to see if there are policies, programs, or loan products that can be used to strike a better balance between credit card and non-credit card lending. However, the first place to start is to have robust and accurate data that reports credit card and non-credit card lending. The only method to determine this now with the CRA data is to use a proxy: researchers have used an average loan amount of $10,000 or less to determine if a particular bank is predominantly a credit card lending specialist. The banks can be grouped into credit card and non-credit card lenders. Of course, this can obscure the non-credit card loans made by the credit card specialists and the credit card loans made by the non-credit card specialists.

Personal Loans and Home Equity Loans: The lines between consumer, home, and small business lending can get blurred, especially for the smallest businesses. Separate studies find that about one quarter of new small businesses are funded by the personal loans received by their owners and also that one quarter of businesses use the equity in their homes to pledge collateral or to take out a line

45 Community Reinvestment Act: Interagency Questions and Answers, Federal Register, Mach 11, 2010, p. 11667, Section .42-3 for line of credit, Section .42-4 for lines of credit, Section .42(a)-5 on p. 11668 for refinances and renewals. See http://www.ffiec.gov/cra/pdf/2010-4903.pdf

46 Community Reinvestment Act: Interagency Questions and Answers, Section .42(a)(2)-3, p. 11669, http://www.ffiec.gov/cra/pdf/2010-4903.pdf.

47 Small Business Administration, Office of Advocacy. September 2011. Frequently Asked Questions about Small Business Finance. http://www.sba.gov/sites/default/files/files/Finance%20FAQ%208-25-11%20FINAL%20for%20web.pdf.

of credit.[48] In the case of personal loans, the CFPB should consider asking lending institutions for data on borrowers using their personal credit cards or non-credit loans to finance their businesses. For home equity lending, the CFPB is mulling expanding HMDA data to include home equity lending and asking whether the borrowers used the loans for small businesses.

Factoring: The statutory language stipulating that the CFPB is to collect data on "other credit being applied for" is prescient because small businesses obtain credit in a variety of forms in addition to traditional loans. In a factoring arrangement, a small business will sell its receivables to a company called a "factor." The factor will then advance a portion of the receivables to the small business and collect the receivables from the small business customers.

The advantages of factoring is that can provide quick access to cash in five to ten days and is typically used by businesses that are marginally creditworthy and may have difficulty obtaining loans from banks. It can also relieve small businesses of the tasks of collecting receivables from customers. A downside to factoring is that it is an expensive form of credit; the factor will effectively charge an interest rate of around 20 percent by discounting the total amount of receivables and advancing about 75 percent to 80 percent of the receivables to the small business. The other significant drawback is that the small business cedes collections of receivables to the factor. This could be problematic if the factor engages in abusive collection techniques, alienating the customer from the small business.[49]

A description of factoring from a factor company, Catamount Funding, Inc., describes the advantages and disadvantages succinctly:

> Factors provide financing alternatives that may not be available from usual sources for small transitional and rapidly expanding businesses. As sales expand, so does the availability funds from the factoring company. Once the business has been able to build an adequate base of capital from retained earnings, it may move to a less expensive, secured line of credit at a commercial bank. The Factor is often a temporary necessity. However, many companies continue to factor their receivables to obtain the credit services provided and to offer credit more freely than if they were to rely on their own expertise and resources.[50]

48 Scott Shane, *How Personal Credit Affects Small Business Borrowing*, May 26, 2014, available via http://smallbiztrends.com/2014/05/personal-credit-affects-small-business-borrowing.html/print/

49 Tom Taulli, *The Pros and Cons of Factoring*, Bloomberg Businessweek, October 3, 2008, available via http://www.businessweek.com/printer/articles/309958-the-pros-and-cons-of-factoring?type=old_article. Also, Ted Beam, *The Pros and Cons of Account Receivable Factoring*, Core Compass, August 7, 2013 available via https://www.corecompass.com/index.php?option=com_content&view=article&id=1663:the-pros-and-cons-of-accounts-receivable-factoring&catid=30:economy-finance&Itemid=60

50 From webpage of Catamount Funding, Inc., http://www.catamountfunding.com/About/HistoryofFactoring.php

Factoring is a form of credit that is likely to be prevalent among the traditionally underserved small businesses that are a focus of Section 1071. Rigorous data on factoring would therefore further the purposes of Section 1071.

Merchant Cash Advances: Like factoring, merchant cash advances are not a traditional form of lending and tend to be used by small businesses that may have difficulties receiving loans due to their start-up status, lack of collateral, or creditworthiness. In a merchant cash advance arrangement, a cash provider will provide a small business a lump sum payment in exchange for a portion of future sales. Small businesses in the restaurant or retail sector receiving credit card payments are typical customers of merchant cash advances.

One drawback, just like in factoring, is cost. Annual percentage rates (APR) can hover between 60 to 200 percent. For example, the *New York Times* recently profiled a retail company that received a merchant cash advance for $200,000 for which the retail company paid $55,000, an APR of 55 percent. The merchant cash advance took 15 percent of the retail company's daily sales until it had recouped $255,000. Critics of merchant cash advance companies state that since these companies are not traditional lenders, they avoid consumer protection regulations applying to banks. Merchant cash advance companies reply that they have adopted prudent practices such as varying the daily amount they receive from a small business' sales depending on the strength and financial condition of the small business.

The merchant cash advance industry is about a decade old, with approximately 50 providers. In contrast, factoring has been around for decades and is apparently more fragmented. Just as in the case with factoring, data collected per Section 1071 on the credit provided by merchant cash advances would be valuable in terms of informing the public on the types and terms of credit available to traditionally underserved small businesses.[51]

Method

HMDA provides a useful model and precedent for collecting useful data on the type and purpose of the loan. In a straightforward manner, HMDA has a separate data field for lenders to indicate if the loan is an origination or refinance. HMDA also has a separate data field to indicate if a loan is a conventional loan or a government-insured loan. Likewise, the data collected under Section 1071 can improve upon the CRA small business loan data and require lenders to indicate type and purpose in separate data fields. Data collected under Section 1071 should indicate if a loan is an origination, refinance, renewal, credit card, or a non-traditional loan such as factoring or merchant cash advance. Data collected under Section 1071 should also indicate if the loan is conventional or a government-insured SBA loan. Finally, home equity loans or lines of

51 John Tozzi, *How Merchant Cash Advances Work*, Bloomberg Businessweek, January 9, 2009, http://www.businessweek.com/printer/articles/32806-how-merchant-cash-advances-work. Amy Cortes, *Can't Get a Bank Loan? The Alternatives are Expanding*, New York Times, March 5, 2014.

credit have been used by small businesses as a means of financing. The CFPB is currently contemplating whether to collect this information under HMDA. If the CFPB opts not to collect this under HMDA, it should collect this data pursuant to Section 1071.

Amount of Credit Applied for and Received

Section 1071 requires financial institutions to report the "amount of credit or credit limit applied for, and the amount of the credit transaction or the credit limit approved."

Rationale

The amount of credit is a data element that is important for the purposes of Section 1071 of enforcing fair lending laws and assessing whether credit needs are met. As discussed above, MBDA finds that minority-owned firms received lower loan amounts than non-minority firms. This finding remains even after controlling for sales level of firms. Disparities in loan amounts received can impede the growth of minority- and women-owned businesses and thus impair overall economic growth. The data on loan amount will enable stakeholders to investigate these disparities and attempt to devise strategies for narrowing or eliminating the disparities. Disparities in loan amounts can manifest themselves in both credit card and non-credit card lending.

Method

HMDA regulations require reporting institutions to show the loan amount in thousands. This appears to be a straightforward reporting requirement that would be suitable for the small business loan data reported under Section 1071.

Discretionary Data Elements

Section 1071 has an important clause allowing the CFPB to collect "any additional data that the Bureau determines would aid in fulfilling the purposes of this section." Since lending markets and credit needs evolve over time, providing the CFPB with discretionary authority is necessary so that data reporting requirements can be updated to capture information on new and emerging needs and developments. Before the CFPB was created by Dodd-Frank, the Federal Reserve Board in the early 2000s promulgated changes in HMDA data collection to capture price information in response to the surge of subprime and high-cost lending. Similarly, the CFPB may need to periodically revise the small business data in future years. In addition, while Section 1071 mandates important data elements, it also omitted other important information. Based on a review of current research, additional data elements that are desirable in terms of fulfilling the purposes of Section 1071 include:

Pricing Data: Pricing data would be key to furthering the purposes of Section 1071, including enforcement of fair lending laws. MBDA found that minority-owned firms paid

7.8 percent on loans compared to 6.4 percent for non-minority-owned firms.[52] Regular and comprehensive data would allow further investigations about whether these pricing disparities continue to exist and the prevalence and extent of the disparities across various types of loans. The CDFI Fund collects robust pricing data from CDFIs. For term loans and lines of credit, CDFIs report the interest rate for each loan and whether the loan is fixed-rate or adjustable rate. CDFIs also report points and origination fees for term loans and lines of credit. This data is an important precedent for any pricing data associated with Section 1071.

Industry: Industry classification is a variable that must be collected in order to assess if differences in access to credit for minorities and women remain after controlling for industry sector. MBDA documents that minority firms are less prevalent in construction and manufacturing, where firms tend to receive higher amounts, and that minority firms are more concentrated in retail trade which have lower loan amounts.[53] The CFPB could adopt the North American Industry Classification System (NAICS) used by federal agencies for classifying business establishments.

Creditworthiness: Research discussed above uses creditworthiness variables to determine if disparities by race and gender in access to credit received remain after controlling for creditworthiness. Just like the research discussed above, NCRC has obtained and used Dun and Bradstreet credit scores for assessing the impacts of creditworthiness on access to credit for small businesses.

However, only the more established small businesses have commercial credit scores. The smallest businesses lack commercial credit scores. Instead, banks use the credit scores of the owners of very small businesses to assess their creditworthiness. A paper conducted for the SBA Office of Advocacy found that most banks (53 percent) did not use credit scores in small business lending. For banks that use credit scores, 43.5 percent of them use the scores of the owners while 9.5 percent use the commercial scores of the small businesses.[54] Thus, the CFPB would want to collect information on the use of personal scores of the owners as well as scores of the small business.

The CFPB should also investigate the prevalence of lending institutions using alternative measures of creditworthiness and the ease of reporting this type of information. For example, newer Internet-based lenders such as OnDeck use their own proprietary credit score.[55] Standardizing all of these different types of credit scores and preserving consumer privacy can be accomplished by normalizing credit scores, which has been a recommendation offered to the CFPB for its HMDA rulemaking by NCRC and allied organizations.

52 MBDA, *Disparities in Capital Access*, op. cit., p. 5.

53 MBDA, *Disparities in Capital Access*, op. cit., p. 41.

54 This study was conducted in 2006 so the use of credit scoring may have changed. See Charles D. Cowan and Adrian M. Cowan, *A Survey Based Assessment of Financial Institution Use of Credit Scoring for Small Business Lending*, for the SBA Office of Advocacy, November 2006, available via http://archive.sba.gov/advo/research/rs283tot.pdf.

55 Penny Crossman, American Banker, *OnDeck Milestone Proves Small Businesses Like Online Loans*, March 7, 2014.

Number of Employees: The number of employees is a key measure of the size of small businesses. A number of organizations including American Enterprise Opportunity define microbusinesses as those with five employees or less. Section 1071 focuses on the smallest businesses in addition to women- and minority-owned business, suggesting that number of employees is a critical data element. As discussed above, along with revenue size, the number of employees is a key variable enabling users of the data to focus on the definition of small businesses that is of most interest to them.

Collateral: The amounts and types of collateral are an important component of underwriting in small business lending and can be a barrier for the smallest businesses. According to businesses involved in Federal Reserve focus groups and meetings, collateral asset values held by their businesses dropped during the Great Recession. As a result, several lenders required additional collateral that small businesses needed for loans, making it harder for small business to be approved for loans.[56] Collateral information will therefore shed light on underwriting changes and approaches during various economic conditions and will help stakeholders better understand fluctuations in access to credit. In addition, the CFPB should consider asking lending institutions to report the value of any personal collateral pledged for loans in addition to collateral owned by the business. According to Robb, start-ups tend to pledge personal assets when securing financing.[57] In addition, personal guarantees were offered on 41 percent of small business loans according to a study using data collected by the Federal Reserve Board.[58]

Start-up Status and Years in Business: Start-up businesses and younger businesses experience more difficulties accessing credit than more experienced businesses. In a recent survey of microbusinesses, CFED finds that younger businesses are twice as likely to indicate trouble accessing credit than more established businesses. In addition, businesses under one year old used an average of 3.9 financial products in contrast to 6.6 used by businesses over 10 years old.[59] An indication of whether a business is a start-up is important and a relatively easy categorical variable to collect. Likewise, it would also be straightforward for lenders to ask and collect the number of years the firm has been in business.

Loan Performance Data: The SBA reports loan performance data including delinquencies for its various programs such as the 7(a) loan program. The loan performance data is another data element that would be instrumental for fair lending enforcement and for

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56 Addressing the Financing Needs of Small Businesses: Summary of Key Themes from the Federal Reserve System's Small Business Meeting Series (2010) available via http://www.federalreserve.gov/newsevents/conferences/sbc_small_business_summary.pdf.

57 Alicia Robb, *Access to Capital among Young Firms, Minority-Owned Firms, Women Owned Firms and High-Tech Firms*, for the SBA Office of Advocacy, April 2013, p. 14.

58 This is data from a 1998 study so the percentages may have changed over the years, but personal guarantees probably remain important, especially for sole proprietors and microbusiness. See John Moon, Federal Reserve Board of Governors, *Small Business Finance and Personal Assets,* in Community Investments, Winter 2009/2010, Volume 21, Issue 3, http://www.frbsf.org/community-development/files/moon_john.pdf.

59 Lauren Williams and Kasey Wiedrich, *In Search of Solid Ground: Understanding the Financial Vulnerabilities of Microbusiness Owners*, CFED, April 2014, p. 13.

helping to determine whether racial or gender disparities can be explained by business necessity (higher delinquency rates for these borrowers) or whether the disparities are wider than necessary to account for differences in loan performance.[60]

Types of Institutions Required to Report

The definition of a financial institution that is required to report data per Section 1071 is broad. Specifically, Section 1071 states, "the term 'financial institution' means any partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity that engages in any financial activity." At the same time, however, Section 1071 allows the CFPB to exempt any "financial institution or class of financial institutions" "conditionally or unconditionally" from reporting requirements if the CFPB believes such exemptions would further the purposes of Section 1071.

Since the purpose of Section 1071 is to facilitate enforcement of fair lending laws and enable communities to identify business and community development needs, the CFPB must develop a rule that provides for broad and comprehensive inclusion of financial institutions that issue small business loans. The ability to engage in fair lending enforcement is impaired if significant numbers of financial institutions are exempted. The CFPB would not be able to effectively compare institutions against their peers to determine which institutions are likely to be engaged in discrimination and are outliers in terms of serving minorities and women-owned small businesses. In addition, the CFPB's and the public's ability to determine unmet needs and opportunities is constrained if a significant number of lenders are exempted. Since data will be lacking on their activities, it will be impossible to know if a gap or unmet need identified by data analysis is being filled by the lenders exempted from data reporting. In addition, if the CFPB collects data on loan price and performance, omissions of groups of lenders will reduce the accuracy of analyses of loan pricing and performance, which is also critical for assessing whether credit needs are being met in a responsible fashion.

A typology of lenders is helpful in determining how to comprehensively capture the great majority of small business-related lending activity. One benchmark to aim for is that HMDA data, as estimated by the Federal Reserve Board, captures about 80 percent of home loan activity. In order to capture a similar percentage of lending activity under Section 1071, this white paper offers a list of various lending institutions making significant amounts of small business lending. A starting place is to divide financial institutions into two halves: depository institutions and non-depository institutions. Depository institutions include large banks, small banks, and credit unions. Non-depository institutions include factors, merchant cash advance lenders, online lenders, and consumer lenders that also offer small business loans. Each of these are now discussed in turn.

60 Ruth Simon and Tom McGinty, *Loan Rebound Misses Black Businesses*, Wall Street Journal, March 18, 2014. The Wall Street Journal obtained and analyzed SBA data for its article.

Depository Institutions

Under the CRA regulations, large banks with assets of more than $1 billion are required to report small business loan data. In 2012, the most recent year for which industry-wide data is available, these institutions reported approximately 5.9 million loans of a total dollar amount of $206 billion.[61] Large banks are likely to report the majority of loans under Section 1071.

Intermediate Small Banks

Intermediate small banks with assets of between $250 million and $1 billion were required to report small business data but were exempted from this data reporting requirement by the bank regulatory agencies in 2005. While some of these intermediate small banks still voluntarily report this data, the exemption was a mistake and obscures important lending patterns from observation and research.[62] In a report for the Appalachian Regional Commission (ARC), NCRC used data from 2003, one of the last years of reporting for the intermediate small banks. NCRC found that these institutions were important for meeting credit needs in Appalachia. For example, intermediate small banks had a market share of 22 percent of all small business loans issued in the Appalachian portion of Virginia and a 15 percent market share in the Appalachian portion of Maryland. In addition, intermediate small banks had twice as high a market share in rural than urban Appalachian counties (12 percent compared to six percent). Finally, regression analysis revealed that intermediate small banks' lending did not vary based on credit score of the small business. This finding indicates that these banks were more sensitive to the needs of newer or marginally qualified small businesses and was consistent with the "relationship"-based model of knowing customers personally as opposed to a quantitative underwriting approach. Thus the deletion of the data reporting requirement for intermediate small banks frustrates the ability of the public to see if or how credit needs of traditionally underserved small businesses are being met.[63]

According to the FFIEC, the non-reporting banks account for about 13 percent of the small business loans issued by banks.[64] This is a significant amount of lending and capturing these loans would provide a more comprehensive picture of lending patterns, particularly for smaller metropolitan areas and rural areas.

Credit Unions

Credit unions are not small business lending specialists *per se* since their small business lending activities are limited to 12 percent of their assets.[65] However, the credit union

61 See http://www.ffiec.gov/craadweb/pdf/2012/N2-2.PDF.

62 About 300 intermediate small banks still report small business loan data. See http://www.ffiec.gov/hmcrpr/cra_fs13.htm. This shows that the data reporting is not burdensome and that these banks desired to be recognized for their lending to small businesses.

63 National Community Reinvestment Coalition, Access to Capital and Credit for Small Businesses in Appalachia, April 2007, funded by the Appalachian Regional Commission.

64 See http://www.ffiec.gov/hmcrpr/cra_fs13.htm.

65 See http://www.cuna.org/Stay-Informed/Press-Room/Small-Business-Lending/

industry is larger than is commonly assumed with significant amounts of small business loans. According to the National Credit Union Administration, 6,819 federally insured credit unions had 93.8 million members and $1 trillion in assets in 2012. These credit unions also had $41.7 billion in small business loans outstanding.[66] The credit union industry is thus an important source of small business loans and must report data under Section 1071.

Threshold for Reporting

In order to more effectively gauge whether credit needs are being met, a considerably larger number of depository institutions must report data under Section 1071. A useful guide for determining the threshold for reporting is HMDA thresholds that have been used for several years. In the case of depository institutions, the current asset threshold is $43 million dollars and is adjusted yearly for inflation. The CFPB contemplates amending this threshold to 25 loans or more. Given the importance of smaller banks in small business lending and the fact that smaller banks have been reporting HMDA data for several years, it would be sensible to make the thresholds the same or very similar for HMDA and small business data.

Non-Depository Institutions

Factors

As stated above, the factoring industry is fragmented, so attempting to estimate loan volume of factors is difficult. However, a trade association called the American Factoring Association has a publicly available list of approximately 60 of its prominent members.[67] Some of the members include Advance Business Capital, Apex Capital Corp., and Bibby Financial Services, Inc.[68] One bank, Crestmark Bank in Troy, Michigan, is a member of the trade association. Though not a member of the trade association, CIT Bank is a bank based in Utah that engages in factoring as well as traditional and SBA-backed small business lending.[69]

Another member of American Factoring Association, National Bankers Trust, based in Memphis, Tennessee, sells its services with this pitch:

> Like many small businesses, the founders of NBT had also been burned in previous factoring relationships. Dissatisfied and disheartened, they set out to create a company that provides financial solutions (including factoring) for small businesses and entrepreneurs, with three simple and non-negotiable rules as their foundation:
>
> - Treat clients the way we wish to be treated.
> - Believe in what we do for our clients.

66 National Credit Union Administration 2012 Annual Report, http://www.ncua.gov/Legal/Documents/Reports/AR2012.pdf, p. 8.

67 See https://www.americanfactoring.org/

68 See https://www.americanfactoring.org/Members.asp

69 See the bank's most recent CRA exam, http://www2.fdic.gov/crapes/2013/35575_130318.PDF.

- Stand by the results.
  Trucking companies all across America have been selling their accounts receivables to NBT for 20 years. Every trucking company is different and every trucking company's needs are unique. Providing customized solutions is NBT's calling.[70]

National Bankers pitch distinguishes itself from the other factors by suggesting that it is an honest company contrary to the practices of other factors. This suggests that more sunlight needs to be shed on this industry with data disclosure.

Merchant Cash Advance Lenders

As stated above, the merchant cash advance industry is about a decade old, with approximately 50 lenders. One trade association is the North American Merchant Advance Association with 16 members.[71] These members are listed below with estimates of advance volumes (when available):

American Finance Solutions - $100 million in advances since 2006

AmeriMerchant

Business Financial Services – advances to 15,000 businesses since 2001

Capital for Merchants

GRP Funding, LLC

Merchant Advance Funding, LP

Merchant Capital Source

Merchant Cash and Capital –advances of $500 million to 12,500 businesses since 2005

Merchant Cash Group

Merchant Capital Access

Nextwave Enterprises

Principis Capital

Rapid Advance –advances of $500 million to 20,000 businesses since 2005

Retail Capital

Strategic Funding

Swift Capital –advances of $250 million to 10,000 businesses since 2005

70 See http://factoringmadeeasy.com/about.html. Last accessed on April 30, 2014.

71 See http://northamericanmaa.org/

Online Lenders

A number of recent newspaper articles have discussed the rise and emergence of online lenders. The reports suggest that these lenders are positioning themselves between traditional banks and merchant cash advance lenders. According to a *New York Times* article, online lenders offer interest rates that are higher than traditional banks but lower than merchant cash advance lenders.[72] Approval rates are also higher for the on-line lenders than traditional banks. Some of the online lenders such as On Deck Capital are similar to merchant cash advance lenders but borrower payments are constant and do not rise and fall based on sales volume like the payments to merchant cash advance lenders.[73] The interest rates of the online lenders are lower than those of merchant cash advance lenders due to the use of technology and sophisticated underwriting tools including proprietary credit scores and searching for consumer online reviews.[74]

Some of these lenders include Dealstruck, Fundation, Funding Circle, OnDeck, and Kabbage. These lenders are booming; OnDeck recently reported that it has made $1 billion in loans to small businesses.[75] Some of these lenders like Dealstruck use a peer-to-peer model, matching individual investors to individual small business borrowers. Apparently, this is another factor allowing online lenders to offer lower rates since investors and borrowers are matched virtually, reducing the costs of recruiting investors.[76]

Consumer Lenders

Specialists in consumer lending have recently entered small business lending. For example, Progresso Financiero, a consumer lender that specializes in the Hispanic market in California and Texas, has expanded into small business financing. The loans are small, with a loan limit of $2,500. About 10 percent of Progresso's loans are for small business purposes.[77] Likewise, Lending Club, a peer-to-peer consumer lender, has expanded into small business lending. It expects to offer loans between $15,000 and $100,000 for one to five years. Interest rates are likely to range from 5.9% to 29.9%, with an expected average of 12.5% for a three-year loan, similar to its consumer loans.[78] Capturing consumer lenders that make small business loans for Section 1071 will provide additional transparency for the small business loan market.

72 Amy Cortes, *Can't Get a Bank Loan? The Alternatives are Expanding*, New York Times, March 5, 2014

73 Luz Gomez and Elaine L. Edgcomb*, A Newly Crowded Marketplace: How For Profit Lenders are Serving Microentrepeneurs*, FIELD at the Aspen Institute, March 2011.

74 Cortes, NY Times, op. cit., and Crossman, American Banker, op. cit.

75 Crossman, op. cit.

76 Cortes, op. cit.

77 Gomez and Luz, op cit, p. 5.

78 Jeanne Dugan, *Lender Expands to Small Businesses*, Wall Street Journal, March 20, 2014

Discretion to Delete or Modify Publicly Available Data

Section 1071 also allows the CFPB, at its discretion, to "delete or modify data collected under this section which is or will be available to the public, if the Bureau determines that the deletion or modification would advance a privacy interest." The current rulemaking involving HMDA data can provide guidance for resolving tensions between disclosure and privacy. Disclosure and transparency holds lenders publicly accountable for serving credit needs in a responsible and non-discriminatory manner. At the same time, it is not in the public's interest to have a publicly available database which can be used to identify particular businesses by proprietary interests which may then target the businesses with dubious or abusive products or services.

This white paper cannot provide specific guidance to resolve this tension due to unknown loan volumes. In general, HMDA data has been disclosed on an individual loan level and on a census tract level because there have been large enough loan volumes to make it difficult for any interested party to identify a particular loan applicant. In contrast, the current CRA small business data is disclosed by income categories of census tracts due to concerns that a lower number of loans may make it easier to identify particular businesses. However, if the CFPB significantly increases the number of financial institutions required to report data, the number of loans may become large enough to make it more difficult to identify particular small businesses. This would facilitate census-tract-level disclosure and even better yet, could make possible individual-loan-level disclosure.

Another technique to preserve privacy is to use statistical techniques to cloak specific details associated with the data but still provide meaningful disclosure. For example, in the case of credit scores, one approach is providing a normalized score that removes references to specific credit score systems but still provides information on the relative creditworthiness of the small business.

Centralizing Data Collection

As referenced throughout this paper, a number of federal agencies including the CDFI Fund, the SBA, FDIC, Federal Reserve Board, and the OCC collect small business loan data. The CFPB should change this fragmented data collection and instead centralize the data collection. This approach would maximize efficiency and minimizes burden on the institutions required to report.

HMDA provides a precedent for centralizing data collection. Under HMDA, institutions report their home loan data to one of five agencies, depending on which agency is their supervisor.[79] These agencies, in turn, send the data to the FFIEC. After the Federal Reserve Board compiles and cleans the data (removes errors), the FFIEC releases the data to the

79 These agencies are the Office of the Comptroller of the Currency, the Federal Reserve Board, the National Credit Union Administration, the Department of Housing and Urban Development, and the Consumer Financial Protection Bureau.

public. Likewise, under Section 1071, the federal bank agencies can collect the data from the institutions they supervise and then submit the data to the FFIEC for processing and dissemination to the public under the overall direction of the CFPB.

This paper recommends that all of the agencies currently collecting data collaborate and centralize collection and dissemination through the FFIEC under the overall direction of the CFPB. This is certainly feasible for the agencies that currently regulate banks and could also be implemented for credit unions and non-depository institutions that do not currently report data.

Table 1: Agencies Collecting Small Business Loan Data

Name	Symbol	Reporting Institutions
Federal Reserve Board (FRB)		State member banks with assets >$1.202 billion for 2014 data. Banks below threshold can voluntarily report.
Federal Deposit Insurance Corporation		State nonmember banks (not members of the FRB) with assets >$1.202 billion for 2014 data. Banks below threshold can voluntarily report.
Office of the Comptroller of the Currency		National banks and savings associations with assets >$1.202 billion for 2014 data. Banks below threshold can voluntarily report.
Community Development Financial Institutions Fund		Banks, credit unions, loan funds, venture capital funds.
Small Business Administration		Banks, nonprofit community-based organizations.

The SBA and CDFI Fund are two additional agencies that currently collect small business data. This paper recommends that the SBA allow the FFIEC, under the direction of the CFPB, to collect most, if not all, the data it currently collects. A data field can be added to the data collected under Section 1071 that indicates whether the loan has a SBA guarantee. If the loan has a SBA guarantee, another data field would indicate whether it is a guarantee associated with the 7a, 504, or some other SBA program. Some data collection, particularly from nonprofit lenders that participate in the microloan program, may need to remain with the SBA. But as much as possible, the SBA should transfer its data collection to the CFPB and FFIEC, especially for loans made by banks.

Likewise, the CDFI Fund should transfer the bulk of its data collection to the FFIEC under the oversight of the CFPB. The CDFI Fund receives data from banks that are also certified as CDFIs. The federal bank agencies should collect data from the CDFI-certified banks. The CDFI Fund also collects data from credit unions that are CDFIs. Should the CFPB require data from credit unions, the CDFI could transfer data collection responsibilities to either the credit union regulator (the National Credit Union Administration) or send the credit union data to the FFIEC. At the same time, it may make sense for the CDFI Fund to continue collecting data from small CDFIs that are nonprofit organizations.

If the SBA and CDFI Fund retain data collecting responsibilities, the data fields, variables, and formats should be standardized with the CFPB data collection. Standardization provides opportunities for the public to link the data and to use data from the different agencies for their analysis and research.

Public Access to the Data

The data dissemination responsibilities of the CFPB must be used by the agency to provide easy-to-use and informative data to the public. According to Section 1071, the CFPB has the authority to require a prescribed format for data provided by the financial institutions to the public. The CFPB must require detailed and user-friendly disclosures from the financial institutions. By way of contrast, under the HMDA regulations, some large banks have disclosed data to the public in PDF documents that run hundreds of pages. This is a format that is intended to thwart the public from using the data in a meaningful manner. In order to avoid this, the CFPB must require in its regulations that the financial institutions disclose data in Microsoft Excel format and/or some other easy-to-use format. In addition, the CFPB should design summary tables with key data elements for banks to use when providing data so that members of the public that do not conduct "raw" data analysis can benefit from the summary tables.

In addition to the banks disclosing data to the public, Section 1071 requires the CFPB to make the data publicly available in a format described in regulations implemented by the CFPB. The CFPB should carefully design an easy-to-use web page that contains summary tables and "raw" data available in Microsoft Excel format or similar programs. The HMDA experience is informative and should provide a guide to the CFPB on how to improve data dissemination. For HMDA data, the FFIEC web page has summary tables and raw data while the CFPB enables the user to run queries that also produces raw data in a condensed form. Both the FFIEC and CFPB web pages have useful information but it is confusing for the general public to use two web pages to access HMDA data. In addition, neither web page has a good user manual written for novices and advanced users so that the public can understand the available data and formats.

Conclusion

In response to the financial crisis and risky lending practices, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 mandated changes in consumer protection and safety and soundness laws and regulations that are the largest changes in decades. The CFPB has implemented changes to mortgage lending that are aimed at preventing a repeat of the risky and abusive lending practices that were a significant contribution to the crisis.

It is too easy for Section 1071 of the Dodd-Frank law to become lost in the monumental changes in home mortgage lending regulation. Yet Section 1071 is no less important to small business lending. Through increased transparency of all segments of the small business lending marketplace, the objective of 1071 is to hold lenders accountable for increasing responsible lending to meet the credit needs of women-owned, minority-owned, and other traditionally underserved small businesses. In addition, the increased data disclosure will provide insights into whether and how fair lending and consumer protection law and regulation need to be heightened in order to make the marketplace more efficient and equitable for all small business borrowers.

Small businesses are integral to the economy in terms of job creation. Increasing access to credit for small businesses not only benefits individual entrepreneurs and particular communities but also is vital for rebuilding the economy and climbing out of the Great Recession. Robust and comprehensive data analysis provides a road map for boosting access to credit by identifying unmet needs and opportunities. It is hoped that the recommendations in this paper provide valuable insights for creating comprehensive data that is easily available and can be effectively used by the public.

Appendix

Text of Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

SEC. 1071. SMALL BUSINESS DATA COLLECTION.

(a) IN GENERAL.-The Equal Credit Opportunity Act (15 U.S.C. 1691 et seq.) is amended by inserting after section 704A the following:

"SEC. 704B. SMALL BUSINESS LOAN DATA COLLECTION.

"(a) PURPOSE.-The purpose of this section is to facilitate enforcement of fair lending laws and enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses.

"(b) INFORMATION GATHERING.-Subject to the requirements of this section, in the case of any application to a financial institution for credit for women-owned, minority-owned, or small business, the financial institution shall-

"(1) inquire whether the business is a women-owned, minority-owned, or small business, without regard to whether such application is received in person, by mail, by telephone, by electronic mail or other form of electronic transmission, or by any other means, and whether or not such application is in response to a solicitation by the financial institution; and

"(2) maintain a record of the responses to such inquiry, separate from the application and accompanying information.

(c) RIGHT TO REFUSE.-Any applicant for credit may refuse to provide any information requested pursuant to subsection (b) in connection with any application for credit.

"(d) NO ACCESS BY UNDERWRITERS.-

"(1) LIMITATION.-Where feasible, no loan underwriter or other officer or employee of a financial institution, or any affiliate of a financial institution, involved in making any determination concerning an application for credit shall have access to any information provided by the applicant pursuant to a request under subsection (b) in connection with such application.

"(2) LIMITED ACCESS.-If a financial institution determines that a loan underwriter or other officer or employee of a financial institution, or any affiliate of a financial institution, involved in making any determination concerning an application for credit should have access to any information provided by the applicant pursuant to a request under subsection (b), the financial institution shall provide notice to the applicant of the access of the underwriter to such information, along with notice that the financial institution may not discriminate on the basis of such information.

"(e) FORM AND MANNER OF INFORMATION.-

"(1) IN GENERAL.-Each financial institution shall compile and maintain, in accordance with regulations of the Bureau, a record of the information provided by any loan applicant pursuant to a request under subsection (b).

"(2) ITEMIZATION.-Information compiled and maintained under paragraph (1) shall be itemized in order to clearly and conspicuously disclose-

"(A) the number of the application and the date on which the application was received;
"(B) the type and purpose of the loan or other credit being applied for;
"(C) the amount of the credit or credit limit applied for, and the amount of the credit transaction or the credit limit approved for such applicant;
"(D) the type of action taken with respect to such application, and the date of such action;
"(E) the census tract in which is located the principal place of business of the women-owned, minority-owned, or small business loan applicant;
"(F) the gross annual revenue of the business in the last fiscal year of the women-owned, minority-owned, or small business loan applicant preceding the date of the application;
"(G) the race, sex, and ethnicity of the principal owners of the business; and
"(H) any additional data that the Bureau determines would aid in fulfilling the purposes of this section.

"(3) NO PERSONALLY IDENTIFIABLE INFORMATION.-In compiling and maintaining any record of information under this section, a financial institution may not include in such record the name, specific address (other than the census tract required under paragraph (1) (E)), telephone number, electronic mail address, or any other personally identifiable information concerning any individual who is, or is connected with, the women-owned, minority-owned, or small business loan applicant.

"(4) DISCRETION TO DELETE OR MODIFY PUBLICIY AVAILABLE DATA

The Bureau may, at its discretion, delete or modify data collected under this section which is or will be available to the public, if the Bureau determines that the deletion or modification of the data would advance a privacy interest.

"(f) AVAILABILITY OF INFORMATION

"(1) SUBMISSION TO BUREAU.-The data required to be compiled and maintained under this section by any financial institution shall be submitted annually to the Bureau.

"(2) AVAILABILITY OF INFORMATION.-Information compiled and maintained under this section shall be-

"(A) retained for not less than 3 years after the date of preparation;
"(B) made available to any member of the public, upon request, in the form required under regulations prescribed by the Bureau;

"(C) annually made available to the public generally by the Bureau, in such form and in such manner as is determined by the Bureau, by regulation.

"(3) COMPILATION OF AGGREGATE DATA.-The Bureau may, at its discretion

"(A) compile and aggregate data collected under this section for its own use; and
"(B) make public such compilations of aggregate data.

"(g) BUREAU ACTION

"(1) IN GENERAL.-The Bureau shall prescribe such rules and issue such guidance as may be necessary to carry out, enforce, and compile data pursuant to this section.

"(2) EXCEPTIONS.-The Bureau, by rule or order, may adopt exceptions to any requirement of this section and may, conditionally or unconditionally, exempt any financial institution or class of financial institutions from the requirements of this section, as the Bureau deems necessary or appropriate to carry out the purposes of this section.

"(3) GUIDANCE.-The Bureau shall issue guidance designed to facilitate compliance with the requirements of this section, including assisting financial institutions in working with applicants to determine whether the applicants are women-owned, minority-owned, or small businesses for purposes of this section.

"(h) DEFINITIONS.-For purposes of this section, the following definitions shall apply:

"(1) FINANCIAL INSTITUTION.-The term 'financial institution' means any partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity that engages in any financial activity.

"(2) SMALL BUSINESS.-The term 'small business' has the same meaning as the term 'small business concern' in section 3 of the Small Business Act (15 U.S.C. 632).

"(3) SMALL BUSINESS LOAN.-The term 'small business loan' means a loan made to a small business.

"(4) MINORITY.-The term 'minority' has the same meaning as in section 1204(c)(3) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

"(5) MINORITY-OWNED BUSINESS.-The term 'minority-owned business' means a business-
"(A) more than 50 percent of the ownership or control of which is held by 1 or more minority individuals; and "(B) more than 50 percent of the net profit it or loss of which accrues to 1 or more minority individuals.

"(6) WOMEN-OWNED BUSINESS.-The term 'women-owned business' means a business-
"(A) more than 50 percent of the ownership or control of which is held by 1 or more women; and
"(B) more than 50 percent of the net profit or loss of which accrues to 1 or more women."

(b) TECHNICAL AND CONFORMING AMENDMENTS.- Section 701(b) of the Equal Credit Opportunity Act (15 U.8.C. 1691(b)) is amended-
(1) in paragraph (3), by striking "or" at the end-,
(2) in paragraph (4), by striking the period at the end and inserting "; or"; and
(3) by inserting after paragraph (4), the following:
"(5) to make an inquiry under section 704B, in accordance with the requirements of that section.".

(c) CLERICAL AMENDMENT .-The table of sections for title VII of the Consumer Credit Protection Act is amended by inserting after the item relating to section 704A the following new item:
"704B. Small business loan data collection.".

(d) EFFECTIVE DATE.-This section shall become effective on the designated transfer date.