NCRC
National Community Reinvestment Coalition

Initial Analysis Of Final Section 1071 Small Business Lending Rule

Published: April 2023

Kevin Hill, *Senior Policy Advisor, NCRC*



About NCRC

NCRC and its grassroots member organizations create opportunities for people to build wealth. We work with community leaders, policymakers and financial institutions to champion fairness in banking, housing and business.

Our members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned business associations, and social service providers from across the nation.

For more information about NCRC's work, please contact:

Jesse Van Tol
President & CEO
jvantol@ncrc.org
(202) 464-2709

Kevin Hill
Senior Policy Advisor
khill@ncrc.org
(202) 383-7710

Andrew Nachison
Chief Communications and Marketing Officer
anachison@ncrc.org
(202) 524-4880

Photo: © ? - stock.adobe.com

KEY TAKEAWAYS:

- **Discrimination in small business lending will be easier to identify and root out.** This is an important new rule that applies to the full spectrum of small business lending, removing fog from a key area of financial service provision that is directly tied to racial wealth divides.
- **Robust implementation will be important.** Some potential soft spots in the final rule warrant close monitoring (and may call for future adjustments) to ensure the rule is best fulfilling its anti-discrimination mission.

Last month the Consumer Financial Protection Bureau (CFPB) finalized rules to implement Section 1071 of the Dodd-Frank Act. The rules will bring much needed transparency to how lenders are serving businesses owned by people of color, women and the LGBTQI+ community. This is an important milestone towards eliminating discrimination in small business lending. It is fitting that CFPB Director Rohit Chopra announced it to a packed room of economic justice advocates and during the National Community Reinvestment Coalition's (NCRC) annual Just Economy Conference.[1] The many NCRC members who shaped the final rule through submitted comments, lawsuits and conversations with elected officials should be proud.

The final rule covers banks, credit unions and online lenders, as well as a wide range of lending products. It is likely to result in increased lending to underserved businesses as lenders will now have to annually report on their lending broken down by race, ethnicity, gender and sexual orientation of the business owners. Improvements to HMDA data in 1990 and 1993 corresponded with a 70% increase in conventional home purchase lending to African Americans, and a 48% increase in lending to Latinx borrowers, from 1993 to 1995.[2] Furthermore, a study by Citigroup estimates that fair access to lending for African American-owned small businesses alone would have resulted in $650 billion in additional business revenue per year, as well as created an additional 6.1 million jobs per year.[3] This shows how increases in lending to underserved small businesses benefit the entire economy by enabling small businesses to expand and create additional job opportunities.

1 Director Rohit Chopra's Prepared Remarks at the NCRC Just Economy Conference.

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

3 Closing the Racial Inequality Gaps: The Economic Cost of Black Inequality in the U.S.

Growth potential aside, this is also a major victory for civil rights and economic justice. Section 1071 data will help community groups and regulators to root out discrimination in small business lending.

There is ample evidence of ongoing discrimination in small business lending. NCRC studies have found that White applicants were given significantly better information about business loan products, particularly information regarding loan fees and during the Paycheck Protection Program.[4] Studies conducted by the Federal Reserve have found that Black-owned businesses are less likely to be approved for financing compared with White-owned firms.[5] The Minority Business Development Agency found that businesses owned by people of color received lower loan amounts than White-owned firms, even after controlling for the sales level of firms.[6]

Apparent discrimination in small business lending is not limited to race. One study found that while LGBTQI+ businesses were equally likely to apply for financing, they were less likely to receive it. The same report also noted that LGBTQI+ owned businesses were more likely than non-LGBTQI+ businesses to be told their denial was due to lenders not approving financing for "businesses like theirs" (33 percent versus 24 percent).[7]

Section 1071 data is meant to help cure these harmful lending patterns by facilitating enforcement of fair lending laws. As with any federal regulation, however, success in Section 1071's broader mission will depend upon fine-grain details of the final rule. This report discusses the specific features of the rule, its strengths and weaknesses, and closes with items that are still open.

Covered Financial Institutions

The final rule identifies which lenders have to comply by defining the "covered financial institutions." A "covered financial institution" is any partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity that engages in any financial activity and that originated at least 100 covered small business loan originations in each of the two preceding calendar years. [8]This definition covers depository institutions (i.e. banks, savings associations and credit unions), online lenders, platform lenders, community development financial institutions, lenders involved in equipment

4 Disinvestment, Discouragement, and Inequity in Small Business Lending and Lending Discrimination with the Paycheck Protection Program.

5 Mind the Gap: Minority-Owned Small Businesses' Financing Experiences in 2018.

6 Disparities in Capital Access between Minority and Non-Minority-Owned Businesses

7 LGBTQ-Owned Small Businesses in 2021. Center for LGBTQ Economic Advancement & Research (CLEAR) and the Movement Advancement Project (MAP)

8 Section 1071 Final Rule. Page 61.

and vehicle financing, farm credit system lenders, commercial finance companies, merchant cash advance providers, governmental lending entities and nonprofit lenders. The CFPB's decision to include a wide range of lenders aligns with the commonsense principle that the same activities should have the same regulations, regardless of the type of institution conducting those activities. This will also allow the agency to make comparisons between different types of institutions – though it is yet unclear if the public will gain the same insights, as the CFPB has not yet said which 1071 data will and will not be included in public portals. The agency should include this type-of-institution category in the datasets it publishes.

100 Loan Threshold

Not all institutions that meet the CFPB's definition of a covered lender will actually have to report 1071 data. The rules apply only if a covered institution made at least 100 loans in each of the previous two years.[9] While the CFPB notes this will cover 94%-95% of all bank small business loans, it also restricts the agency's and the public's reach. Two-thirds of all banks make fewer than 100 small business loans per year and will remain out of view for those seeking to uncover and combat discriminatory practices or patterns. [10]

That is a significant concession to industry preferences compared to the CFPB's initial proposed rule. The CFPB first proposed setting this threshold at 25 loans, and estimated this would have covered 70%-73% of all banks.[11]

Raising the loan volume threshold will not only limit the scope of data gathering. It also tends to weaken the analytic potential of some of the data the agency will gather, because there will be fewer peers in the data for smaller banks that are close to the 100 loan threshold. This hinders the statutory purpose of 1071 data to facilitate enforcement of fair lending laws.

It is also important to remember that the CFPB's estimates that the 100 loan threshold covers 94%-95% of bank reported small business loans does not factor in lending from non-bank lenders, such as online lenders. Non-bank lenders accounted for 39% of small business financing in 2019, or $550 billion.[12] The CFPB is unable to provide estimates of how much total small business lending will be covered at a 100 loan threshold due to a lack of data. The CFPB won't know how many non-bank lenders are covered by the 100 loan threshold until these institutions have to start reporting, but since non-bank lenders account for about 2 out of 5 small business loans, the threshold may need to be lowered in the future in order to maintain coverage of 94%-95% of total small business lending.

9 Section 1071 Final Rule. Page 61.

10 Section 1071 Final Rule. Page 231.

11 Section 1071 Final Rule. Pages 214 and 231.

12 Section 1071 Final Rule. Pages 26 and 33.

Covered Lending and Data Points

The final rule defines a covered small business loan as an extension of business credit under Regulation B of the Equal Credit Opportunity Act (ECOA).[13] This includes loans, lines of credit, credit cards, merchant cash advances and credit products used for agricultural purposes. The language of Section 1071 requires the data to include:[14]

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

H. Any additional data that the CFPB determines would aid in fulfilling the purposes of this section

The last point gave the CFPB discretionary authority to add additional data points. The final rule maintains the discretionary data points offered by the CFPB that reflect key factors in the loan approval process, and also allows for comparisons based on pricing that could indicate fair lending issues. Specifically, covered lenders will now report:

13 Section 1071 Final Rule. Page 60.

14 Dodd-Frank Wall Street Reform and Consumer Protection Act. Page 683.

A. Pricing information including interest rate, total origination charges, broker fees, total amount of non-interest charges over the first annual period and whether the loan[15] contains prepayment penalties[16]

B. How long the applicant has been in business[17]

C. North American Industry Classification System (NAICS) code, in order to compare lending by business sector[18]

D. Number of employees, in order to better understand the job maintenance and creation that small business credit is associated with and help track that aspect of business and community development[19]

E. Application method [20]

F. Application recipient or channel (broker, other third party, or originator)[21]

G. Denial reasons[22]

H. Number of principal owners of applicant business, defined as any individual who directly owns 25 percent or more of the equity interests of a business[23]

LGBTQI+ Status

The CFPB added that covered institutions will also have to request information on the sexual orientation of the business applicant.[24] As discussed earlier, businesses owned by members of the LGBTQI+ community experience discrimination in small business lending. By including sexual orientation in 1071 data, it will provide a much better sense of how these businesses are being served, and will be able to better identify discrimination based on sexual orientation.

15 For a Merchant Cash Advance (MCA) or other sales-based financing transactions, data collected would include the difference between the amount advanced and the amount to be repaid. The data would be collected for originations and loans approved but not accepted by the applicant.

16 Section 1071 Final Rule. Page 335.

17 Section 1071 Final Rule. Page 394.

18 Section 1071 Final Rule. Page 384.

19 Section 1071 Final Rule. Page 389.

20 Section 1071 Final Rule. Page 288.

21 Section 1071 Final Rule. Page 293.

22 Section 1071 Final Rule. Page 331.

23 Section 1071 Final Rule. Page 473.

24 Section 1071 Final Rule. Page 60.

No Visual Observation or Surname Requirement When Demographic Data Is not Provided by Applicant

The CFPB decided to not require banks to provide demographic information based on a visual observation or surname when the applicant chooses not to provide demographic identifiers themselves.[25] This has the potential to severely diminish the usefulness of 1071 data. The CFPB initially proposed that visual observation or surnames would only be used when not provided by the applicant and a lender meets with one or more of the principal owners in person or over teleconference, which is similar to how Home Mortgage Disclosure Act (HMDA) data works and which the mortgage industry has been following for decades. By eliminating this requirement, large portions of 1071 data may not include demographic data as previous instances where demographic data relied solely on applicant submission in the business lending context indicates that demographic data is then rarely provided. Such blindspots are already creeping into HMDA data, as NCRC researchers have noted, with negative consequences for economic justice work. Such problems will only be magnified in small business lending: Relatively few business loan applicants volunteer demographic information, potentially out of fear that their race or gender affects their access to credit.

Anti-Discrimination Notices to Applicants

The final 1071 rule requires institutions to inform applicants that their institution is not permitted to discriminate on the basis of an applicant's responses about its business status, on the basis of responses about any principal owner's ethnicity, race or sex, or on the basis of whether the applicant provides this information.[26] The final rule also establishes a firewall whereby staff involved in approving applications are not provided with demographic information, with exceptions made for institutions that may have smaller staff and appropriate notices to the applicant in these instances.[27]

Implementation Schedule for Collecting Data

The final rule establishes a tiered schedule for when institutions must start collecting 1071 data, with the highest-volume originators reporting soonest and lower-volume lenders having longer to establish their systems.[28]

Lenders that originate at least 2,500 small business loans annually must collect data starting October 1, 2024.Those that originate between 500 and 2,499 loans annually must collect data starting April 1, 2025. Lenders that originate 100 to 499 loans annually must collect data starting January 1, 2026.

25 Section 1071 Final Rule. Page 5.

26 Executive Summary of the Small Business Lending Rule. Page 7.

27 Section 1071 Final Rule. Page 519.

28 Section 1071 Final Rule. Page 608.

Covered financial institutions must report data to the CFPB by June 1 of the year following the calendar year in which the financial institution collected the data. For example, data collected for 2024 must be reported by June 1, 2025.[29]

Definition of Business Owned by People of Color and Disaggregated Race and Ethnicity Data

The final rule defines a business as owned by a person of color if "one or more American Indian or Alaska Native, Asian, Black or African American, Native Hawaiian or Other Pacific Islander, or Hispanic or Latino individuals hold more than 50 percent of its ownership or control and for which more than 50 percent of the net profits or losses accrue to one or more such individuals."[30] American Indian or Alaska Native, Black or African American, Native Hawaiian or Other Pacific Islander and Hispanic or Latino are defined as aggregate racial or ethnicity groups, and then each of these aggregate groups has additional disaggregated groups that applicants can use to provide more information about their cultural heritage. These additional categories align with the categories currently used in HMDA. The CFPB provides a sample form that institutions can use to collect this data that lists the following aggregated and disaggregated categories for race and ethnicity.[31]

Hispanic or Latino

- Cuban
- Mexican
- Puerto Rican
- Other Hispanic or Latino (Form asks applicant to "Please specify your origin, for example Argentinean, Colombian, Dominican, Nicaraguan, Salvadoran, Spaniard and so on"):

American Indian or Alaska Native

- (Form asks applicant to "Please specify the name of your enrolled or principal tribe.")

Asian

- Asian Indian
- Chinese
- Filipino
- Japanese
- Korean
- Vietnamese
- Other Asian (Form asks applicant to "Please specify your race, for example, Cambodian, Hmong, Laotian, Pakistani, Thai and so on.")

29 Section 1071 Final Rule. Page 609.

30 Section 1071 Final Rule. Page 113.

31 Section 1071 Final Rule. Page 812.

Black or African American

- African American
- Ethiopian
- Haitian
- Jamaican
- Nigerian
- Somali
- Other Black or African American (Form asks applicant to "Please specify your race, for example, Barbadian, Ghanaian, South African and so on.")

Native Hawaiian or Other Pacific Islander

- Guamanian or Chamorro
- Native Hawaiian
- Samoan
- Other Pacific Islander (Form asks applicant to "Please specify your race, for example, Fijian, Tongan and so on")

White

The CFPB decided not to add a separate category for applicants from Middle Eastern or North African communities, neither as an aggregate or disaggregated category.[32] This is a missed opportunity as 1071 data would be improved by collecting data on applicants from Middle Eastern or North African communities. It is unfortunate that many individuals of Middle Eastern or North African descent are often left with little choice but to select White despite a long history of discrimination, as noted in comments submitted to the CFPB.[33]

The CFPB cited uncertainty with how to best collect information on this category as a factor in not including it. The CFPB points out that the Office of Management and Budget (OMB) is currently reviewing standards for collecting data on race and ethnicity. The CFPB will review OMB's decisions but is not bound by that agency's decisions.

Determining Sex/Gender of Business Applicants

For determining the sex/gender of an applicant, the CFPB initially proposed that institutions would ask applicants to categorize principal owners based on four categories: "male", "female"," I prefer to self describe", or "I do not wish to provide this information".[34]

The final rule does not offer any of these categories. Instead, the CFPB chose that principal owners will be asked about their "sex/gender" without being given a fixed list of answers.

32 Section 1071 Final Rule. Page 442.

33 Section 1071 Final Rule. Page 439.

34 Section 1071 Final Rule. Page 459.

Applicants must be provided with free-form text to indicate their sex/gender instead of defined categories, and also have the option to not provide this information.

The Williams Institute on Sexual Orientation and Gender Identity Law and Public Policy provides several recommended measures for identifying transgender applicants and other gender minorities that have been tested to accurately identify these groups.[35] It is notable that all of the Williams Institute's recommended survey questions include explicit recognition or discussion of transgender status, and not the free form approach adopted by the CFPB. The CFPB should revisit this and make changes in order to proactively capture data on the gender identity of business applicants. There is ample evidence that transgender individuals face ongoing and pervasive discrimination, but many aspects of the American transgender experience continue to be blind spots due to a lack of data.[36] Ensuring access to credit for businesses owned by transgender individuals has added importance as many transgender individuals seek out jobs that will foster safe and inclusive workplace environments for them, and these opportunities will be curtailed if transgender owned businesses do not have the same opportunities to access small business capital.

No Data on Businesses Owned by People with Disabilities

The CFPB also decided against collecting data on lending to businesses owned by people with disabilities.[37] NCRC and others recommended that this information be included in Section 1071 in order to carry out the objectives of the Americans with Disabilities Act, as well as the interest of Section 1071 in ensuring fair access to small business lending. Furthermore, federal agencies such as the Department of Transportation (DOT) include businesses owned by people with disabilities as a disadvantaged business enterprise (DBE). Some CDFIs already collect this data as part of the SBA's 7(a) loan program. Collecting data on the experiences of small businesses owned by people with disabilities would therefore be consistent with other federal efforts to bolster their prospects and growth. The CFPB appears to believe it lacks legal authority to include this data, as the final rule noted that ECOA, which Section 1071 updates, does not include disability as one of the enumerated bases on which discrimination is prohibited.

35 Best Practices for Asking Questions to Identify Transgender and Other Gender Minority Respondents on Population-Based Surveys (GenIUSS)

36 Injustice at Every Turn: A Report of the National Transgender Discrimination Survey. National Center for Transgender Equality and the National Gay and Lesbian Task Force.

37 Section 1071 Final Rule. Pages 281 and 283.

Additional Enforcement and Rulemaking Activities

Enforcement Policy Statement Related to Collection of Demographic Data

CFPB may face some challenges in using 1071 data to facilitate enforcement of fair lending laws, especially in the case of smaller banks, for the reasons discussed above.

In order to prevent large portions of 1071 data from lacking demographic indicators, the CFPB also released an enforcement policy statement saying that it "intends to use its enforcement and supervisory authorities to focus on covered lenders' compliance with these requirements relating to the rule's prohibition against discouraging applicants from submitting responsive information" and that "compliant lenders will seek to maximize the collection of responses from applicants and minimize missing or erroneous data."[38] The CFPB says that it will look for "how a lender's response rates compare to financial institutions of a similar size, type, geographic reach, or other relevant factors."

This analysis will be hindered too, though, by the same reduction in peers for comparison caused by shifting the 1071 threshold from 25 to 100 loans. The CFPB's enforcement policy statement is encouraging, but the likelihood of large amounts of missing demographic data is increased by not requiring a visual observation or surname estimate when not provided by the applicant. It is likely that 1071 data will need to be improved after we know more about the impact of a 100 loan threshold and the optional collection of demographic data from applicants.

Supplementary Proposal to Give Small Lenders With Outstanding CRA Performance More Time

The CFPB intends to issue a supplementary proposal that would further push out the date that the smallest lenders would need to start collecting 1071 data if they have demonstrated high levels of success in serving their local communities, as measured by their performance under the Community Reinvestment Act (CRA) and similar state laws.[39]

The CFPB should reconsider. Small lenders already have 33 months before they need to start collecting data. CRA performance as currently measured does not evaluate banks based on their small business lending to the types of underserved businesses covered by 1071, making it an inappropriate measure of success in serving local communities as it relates to 1071. In addition, only depository institutions are covered by CRA currently, making this proposal irrelevant to all non-bank lenders covered by the rule. Further delays to the data

38 Statement on Enforcement and Supervisory Practices Relating to the Small Business Lending Rule under the Equal Credit Opportunity Act and Regulation B. Page 2.

39 Factsheet: Required Rulemaking on SmallBusiness Lending Data. Page 3.

collection schedule for smaller banks will only exacerbate the issues created by including fewer peers for smaller banks in 1071 data.

Release of Data to the Public

The final rule establishes that 1071 data will be made available to the public on an annual basis, similar to HMDA data. The final rule says that "the CFPB will determine what, if any, modifications and deletions are appropriate after it obtains a full year of data," which according to the schedule will be January 1st, 2026.[40] The CFPB identified the "core risk" animating its filtering of data for public release is the potential that it could be used to re-identify a small business applicant – a standard matter across the agency's portfolio and one it has experience navigating.[41] The agency has a sterling track record on preventing re-identification across its other work. The vast majority of this data should be released to the public.

The CFPB has not finalized a publication schedule yet. The CFPB should release aggregate and institutional 1071 data to the public no later than the fourth quarter of the year following the year that data was collected (i.e. 2025 data should be published by Q4 of 2026). The public has been waiting on this data for long enough, and timely release of data should be a priority.

Conclusion & Recommendations

This final rule provides significantly more information on how businesses owned by people of color, women and the LGBTQI+ community are being served by banks, credit unions, online lenders and others. By increasing transparency of pricing, terms and conditions and action taken on applications, 1071 data is likely to curb excessive pricing, reduce abusive terms and increase access to credit for traditionally underserved small businesses. Addressing these wrongs will bring massive increases in revenue and jobs which benefit the entire economic system – including lenders themselves. Lenders will also realize benefits in terms of improved ability to gauge their competitive position in the market and opportunities for them to identify untapped market segments and serve new customers.

While we applaud the release of the 1071 rule, we hope that the CFPB will make changes if it becomes clear they are needed to best fulfill the rule's purpose of facilitating enforcement of fair lending laws: in particular, with regard to the 100 loan threshold and optionally reported demographic data. The CFPB should also reconsider its proposal to extend the date for smaller lenders with Outstanding CRA performance. The agency's forthcoming publication schedule should prioritize the public interest by committing to publish aggregate and institutional level 1071 data no later than the fourth quarter of the following year the data was recorded.

40 Executive Summary of the Small Business Lending Rule. Page 9.

41 Section 1071 Final Rule. Page 656.