Statement of Richard H. Neiman
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at the Consumer Financial Protection Bureau
"Symposium on Dodd-Frank Act Section 1071"
November 6, 2019

This is a time of great opportunity for improving access to capital for small businesses. Innovations in technology and business models have demonstrated the potential for more accessible, inclusive lending. At the same time, minority, women-owned, and small businesses continue to struggle to access the capital they need. The last decade has also seen the rise of irresponsible small business lending practices that have drawn comparison to the mortgage market in the leadup to the subprime mortgage crisis.[1]

If implemented well, the small business data collection program required under Dodd-Frank Act section 1071 could help encourage the market to better address both the lack of access to affordable capital, and the rise of irresponsible lending. And in doing so, Section 1071 could model a market-based, pro-innovation approach to regulation.

LendingClub is America's largest online credit marketplace, facilitating personal loans, auto loans, and small business loans. Borrowers access lower interest rate loans through a fast and easy online or mobile interface. Investors provide the capital to enable many of the loans in exchange for earning interest. We operate fully online with no branch infrastructure and use technology to lower cost and deliver an amazing experience. We pass the cost savings to borrowers in the form of lower rates and investors in the form of attractive returns, helping people achieve their financial goals every day. To date, LendingClub has facilitated over $50 Billion in loans.

Since expanding into small business lending in 2014, LendingClub has made responsible lending core to our effort to address the gap small businesses face in access to capital. Small businesses today find themselves between a rock and hard place. On one side, access to capital can be hard to come by at brick and mortar banks, and slow and difficult to obtain even for businesses that are approved. On the other side, businesses are besieged by alternative lenders promising a fast, easy processes, but that may come with very high rates and the risk of debt traps. LendingClub strives to solve both of these problems and has seen remarkable results reaching the businesses that need us.

[1] For example, "Why Online Small Business Loans Are Being Compared to Subprime Mortgages," Forbes, Dec 10, 2015.

If a business has access to capital from traditional bank loans, LendingClub strives to help that business access a loan at a similar price, but in days instead of weeks or months. If a business is unable to access capital from traditional bank loans, and is instead considering high-cost alternative lenders, we strive to offer access to financing at a fraction of the price they would otherwise pay, and in a more transparent, affordable, responsible structure.

LendingClub's small business loan program operates in close partnership with Opportunity Fund, a leading nonprofit community development financial institution (CDFI) and the largest microlender in the United States, and with Funding Circle, a leading fintech lender to small businesses. This innovative model combines the complementary strengths of fintech and of community development lending, to reach underserved borrowers that neither sector could serve on its own. LendingClub brings core capabilities in technology and data, including process automation, digital underwriting, digital customer experience, and online customer acquisition. Opportunity Fund brings its expertise in serving underserved entrepreneurs with high-touch customer service, technical assistance, as well as the appetite to work with entrepreneurs who many banks may see as too risky, with the goal of ultimately proving that those business owners are creditworthy. Funding Circle complements this partnership with an expertise in serving relatively larger and more established small businesses.

Small businesses served have included truckers, childcare centers, software companies, manufacturers, lawn and tree services, beauty shops, construction firms, restaurants, physical therapists, theaters, cleaning services, lumber companies, and more.

In 2015, LendingClub co-founded the Responsible Business Lending Coalition (RBLC), a unique cross-sector organization of companies and nonprofit organizations brought together by a shared mission of increasing small businesses access to responsible lending and addressing the rise of irresponsible small business lending.[2] The RBLC began its work by launching the *Small Business Borrowers' Bill of Rights*, the first cross-sector consensus on responsible small business lending standards. The *Small Business Borrowers' Bill of Rights* has been signed by over 100 companies and nonprofit organizations serving small businesses.[3] In 2018, inspired by the *Small Business Borrowers' Bill of Rights*, the California legislature passed the first small business financial protection law of the modern era, CA SB 1235, by a bipartisan margin of 72-3 in the California Assembly, establishing truth in lending protections for California's small businesses.

I would like to share the perspective of LendingClub, as a fintech company invested in innovation and expanding access to responsible lending to underserved communities. If implemented well, Section 1071 could be a model of a market-based, pro-innovation approach to regulation. Specifically, through the light-touch of simply creating transparency into what works and doesn't work, government can create incentives that encourages growth of successful models.

Today, we do not know how much small business lending is happening, and to whom, and at what prices. The most recent data that I am aware of on the demographics of small businesses borrowing from banks

[2] The RBLC's members are the Aspen Institute, a nonpartisan policy studies organization and the facilitator of the coalition; Lending Club, Funding Circle, and StreetShares, three leading FinTech innovators in marketplace lending; Accion and Opportunity Fund, the two largest nonprofit CDFI small business lenders; Opportunity Finance Network, the trade association of the CDFI sector; Community Investing Management, an impact-driven investor in small business financing; and Small Business Majority, a nonprofit trade association and advocate for small businesses.

[3] www.borrowersbillofrights.org

is from the Federal Reserve's Survey of Small Business Finances in 2003. The age of this information illustrates the potential benefits of Section 1071. The SBFF found that, of non-SBA bank lending to small businesses, just 5.5% of dollars loaned were to minority-owned firms. Just 4.4% of dollars were loaned were to women-owned firms.[4,5] In contrast, LendingClub's own program has seen representation of minority-owned and women-owned firms that is over five and four times higher, respectively, than of traditional bank non-SBA lending. Through our partnership with Opportunity Fund, we have seen ever higher representation--57% of the loans have gone to entrepreneurs of color, and 31% to female entrepreneurs.

We believe this success at reaching minority- and women-owned businesses may result from focusing on smaller loan sizes more often needed by minority- and women-owned firms, and by providing an online experience that may appeal to entrepreneurs discouraged by working with brick-and-mortar banks.

The Federal Reserve's recent Small Business Credit Survey found that minority-owned small businesses are discouraged from applying for financing at higher rates. Of the firms not applying for credit, 27% of Non-Hispanic African American entrepreneurs reported this was the result of discouragement. That is more than double the 13% discouragement rate for Non-Hispanic White entrepreneurs.[6]

New research published by the National Community Reinvestment Coalition (NCRC) illustrates some of the reasons for this discouragement. After conducting tests on how individuals of different racial and ethnic backgrounds were treated in the branch when applying, NCRC illustrated a number of differences in treatment in branches, including that, "not one white tester was asked to provide a personal W2 form, while more than 16% of blacks and more than 11% of Hispanics were. Personal W2 forms are not required for a small business loan. Black testers were the *only* group asked about their education level (5%). The tests found that while *all* participants in the mystery shopper tests received poor customer service from bank loan officers, the treatment of black and non-white Hispanics was significantly worse."[7] It is possible that an online experience and automated credit decisions may feel more welcoming to some business owners or reduce the potential for unconscious bias on the part of bank branch loan officers.

There may also be a geographic component to the success of responsible online financing providers. NCRC's research found that, "In fact, in six of seven metro areas analyzed, more than 70% of loans went to middle- and upper-income neighborhoods. The number of bank branch locations declined 10% since 2009, likely affecting small businesses that are highly dependent on local-level banking relationships."[8]

When the geographic distribution of LendingClub's consumer lending was analyzed by researchers at the Federal Reserve Banks of Philadelphia and Chicago, they found that, "LendingClub's consumer lending activities have penetrated areas that may be underserved by traditional banks, such as in highly

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[4] Survey of Small Business Finances, Federal Reserve Board of Governors, 2003. Accessed at: https://www.federalreserve.gov/pubs/oss/oss3/nssbftoc.htm

[5] While the Survey of Small Business Financing found that SBA lending saw higher rates of representation, SBA lending represents just 7% of the $1.4 Trillion small business lending market, according to the CFPB.

[6] Small Business Credit Survey: Report on Nonemployer Firms, Federal Reserve Bank of New York. 2019.Accessed at: https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/sbcs-nonemployer-firms-report-19.pdf

[7] Lee, Mitchell, Lederer, and Williams, "Disinvestment, Discouragement, and Inequity in Small Business Lending." National Community Reinvestment Coalition, 2019. Accessed at: https://ncrc.org/wp-content/uploads/2019/09/NCRC-Small-Business-Research-FINAL.pdf

[8] Ibid

concentrated markets and in areas that have fewer bank branches per capita." The research finds that, "about 40 percent of LendingClub consumer loans were made in [the 10 percent of] markets that experienced at least a 5 percent decline… in bank branches."[9] It is possible that the reach to underserved areas may be similar or greater for small business lending, where traditional bank offerings are even more dependent on branches.

If Section 1071 is enacted, policymakers, community organizations, venture capitalists, banks seeking partnerships, and others would be able to see, in some ways for the first time, which business models are successful at reaching minority-owned, women-owned, and small businesses. This transparency could be a market-based mechanism to draw investment capital and partnerships into what works. Section 1071 does not require public subsidy or mandates, but could create transparency that promotes dynamism within the market.

For this encouragement of innovation to be successful, Section 1071 should include data of a full range of bank and non-bank credit providers, and include the APR of the credit offered. If Section 1071 considers only access to capital but not the cost of that capital, it may detrimentally conflate innovation with irresponsible lending. Research by Opportunity Fund identified that some small businesses today are paying rates of 94% APR, and as high as 358%. Those rates are never disclosed to them, as the Truth in Lending Act does not generally apply to commercial transactions. Opportunity Fund also found Hispanic business owners paying higher rates.[10] To understand the market, access at 20% APR is worth distinguishing from access at 200% APR.

Some lenders have high approval rates simply because they charge triple-digit rates, do not disclose those rates, and may also target underserved communities. As a result, data collected for Section 1071 without APR would not be useful at creating transparency into which business models are effective, because it would not enable one to distinguish between high representation achieved through innovation from high representation resulting from charging high rates to lend to businesses that cannot afford the financing and may ultimately default. Worse, data collection without price could have the unintended consequence of incentivizing irresponsible lending, as providers seeking to increase representation of underserved groups could be encouraged to adopt high-cost, high-loss models of lending. If APR is included in Section 1071, it could foster healthy competition in the market, encouraging lower priced credit for our nation's entrepreneurs who we depend on for economic growth, job stability, and healthy communities.

Further detailed recommendations are included in the attached comment letter of the Responsible Business Lending Coalition. With these considerations taken into account, I believe Section 1071 could be a model for market-based, pro-innovation approach to regulation. Thank you for this opportunity to join today's panel.

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[9] Jagitani, J. and C. Lemieux, "Do Fintech Lenders Penetrate Areas That Are Underserved by Traditional Banks?" Federal Reserve Bank of Philadelphia, Working Paper 18-13. March 2018.
[10] Opportunity Fund, "Unaffordable and Unsustainable: The New Business Lending on Main Street." May 2016. https://www.opportunityfund.org/media/blog/unaffordable-and-unsustainable-new-opportunity-fund-report/

RESPONSIBLE BUSINESS
LENDING COALITION

September 14, 2017

Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street NW.
Washington, DC 20552.

Re: Section 1071 and the Small Business Lending Market (Docket No. CFPB-2017-0011)

Dear Ms. Jackson,

The Responsible Business Lending Coalition ("RBLC") writes to express our strong support for a well-considered implementation of Dodd-Frank Section 1071. Small businesses today find themselves between a rock and hard place. They struggle for access to capital on the one hand, but are increasingly targeted with irresponsible lending practices on the other. Section 1071 will help address both access to capital and irresponsible lending problems by bringing much-needed transparency and insight to the small businesses lending market.

Currently, there is no comprehensive information about how much small business lending is happening, who is receiving loans, and at what terms. By providing the first comprehensive and accurate information about the small business lending market, including where gaps exist, Section 1071 will spur innovation within banks, community organizations, fintech companies, and others, to address these gaps and improve small businesses' access to responsible capital.

In the following letter, the Responsible Business Lending Coalition offers a cross-sector industry and nonprofit perspective on how Section 1071 may be implemented without creating unnecessary reporting burdens and achieving Congressional intent to "enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses."[1]

[1] 15 U.S. Code § 1691c–2 - Small business loan data collection

The RBLC and the *Small Business Borrowers' Bill of Rights*

The Responsible Business Lending Coalition ("RBLC") is a diverse association of non-profit and for-profit organizations serving small businesses that have joined together out of concern about the need for increased access to capital, and about the rise of irresponsible small business lending practices.

The mission of the RBLC is to drive responsible practice in the small business lending sector. The RBLC's members are the Aspen Institute, a nonpartisan policy studies organization and the facilitator of the coalition; Funding Circle and Lending Club, two leading FinTech innovators in marketplace lending; Accion and Opportunity Fund, the two largest nonprofit CDFI small business lenders; Fundera, a leading small business loan broker; Community Investing Management, an impact-driven investor in small business financing; and Small Business Majority, a nonprofit trade association and advocate for small businesses.

In 2015, we came together to create the *Small Business Borrowers' Bill of Rights*, a cross-sector consensus on the responsible lending practices that all small businesses deserve. The *Small Business Borrowers' Bill of Rights* has been signed by over 80 for-profit FinTech innovators, nonprofit CDFIs, advocacy and community groups, investors, small banks, lenders, brokers, and marketplaces.[2] These organizations, who have wide ranging opinions on many issues related to small business lending, all agree that small businesses deserve the following six rights:

1. The Right to Transparent Pricing and Terms
2. The Right to Non-Abusive Products
3. The Right to Responsible Underwriting
4. The Right to Fair Treatment from Brokers
5. The Right to Fair Collections Practices
6. The Right to Inclusive Credit Access

In the *Small Business Borrowers' Bill of Rights*, each of these rights is described in detail with specific practices that lenders, marketplaces, and brokers should abide by to uphold these rights for their small business customers. The full text of the *Small Business Borrowers' Bill of Rights* and a list of signatories and endorsers are attached and available online at www.ResponsibleBusinessLending.org.

To become a "Signatory" of the *Small Business Borrowers' Bill of Rights*, the CEO or chief executive of a lender, marketplace, or broker must sign an attestation form affirming that the organization abides by each and every relevant practice set forth in the Small Business Borrowers' Bill of Rights. There is no option to abide by certain requirements and ignore others. A signatory's CEO is required to sign a standard Attestation Form designed for either a lender or marketplace, or a broker. Organizations that do not provide lending or brokering services, such

[2] Note that while these 80+ organizations have signed or endorsed the Small Business Borrowers' Bill of Rights, this letter represents the views of the RBLC, and does not necessarily represent the views of all signatories or endorsers of the Small Business Borrowers' Bill of Rights.

as think tanks and advocates, may become "Endorsers" of the *Small Business Borrowers' Bill of Rights*.

<u>The Need for Section 1071</u> (Responsive to Question 15)

Small businesses face a gap in access to capital, and we believe that Section 1071 will help. In the 2016 Small Business Credit Survey of the Federal Reserve, small business employer firms said that the top financial challenge they face is "credit availability or securing funds for expansion."[3] Currently, there is no comprehensive information anywhere about how much small business lending is happening, who is being served, or at what terms. Some of the useful data available, such as the volume of bank commercial loans under $1 million to both small and large firms, suggests that small business loans as a share of bank lending have fallen from 40% in 1995 to 21% in 2016.[4] The Federal Reserve's 2016 survey concludes that 57% of employer small businesses are experiencing a funding shortfall or may have unmet funding needs![5] This lack of access to capital is a critical problem for small businesses, and is preventing significant job creation and economic growth that small businesses could be contributing to our economy.

The lack of access to capital is even more pronounced for women- and minority-owned businesses. Research suggests that loan applicants of similar financial standing fare differently depending on their race and/or gender.[6,7] Women- and minority-owned businesses operate with much less financial capital on average than their peers, even after controlling for credit score and other factors.[8] Black entrepreneurs are nearly three times as likely as White entrepreneurs to have their profitability hurt by lack of capital, and more than twice as likely to have profits negatively impacted by the cost of capital.[9]

Women and minority business owners report at greater rates that they are discouraged from applying for credit due to a fear of denial.[10] New research by the National Community Reinvestment Coalition illuminates some of the reason why. Over the spring and summer of 2017, NCRC performed civil rights testing in which Black and White "mystery shoppers," representing small business owners, visited a series of bank branches in two metropolitan statistical areas. Whether as a result of unconscious bias or for other reasons, notable differences

[3] "2016 Small Business Credit Survey," Federal Reserve Banks of Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, Minneapolis, New York, Philadelphia, Richmond, St. Louis and San Francisco (April 2017). https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-StartupFirms-2016.pdf

[4] Mills, Karen Gordon and McCarthy, Brayden (2016). The State of Small Business Lending: Innovation and Technology and the Implications for Regulation. Harvard Business School Working Paper 17-042.

[5] "2016 Small Business Credit Survey," Federal Reserve. https://www.frbatlanta.org/research/small-business/survey/2016/report-on-employer-firms.aspx?panel=1

[6] Ibid

[7] Alsos, G. A., Isaksen, E. J. and Ljunggren, E. (2006). New Venture Financing and Subsequent Business Growth in Men- and Women-Led Businesses. Entrepreneurship Theory and Practice, 30: 667–686.

[8] Ibid.

[9] Ibid.

[10] Robb, Alicia (April 2013). Access to Capital among Young Firms, Minority-owned Firms, Women-owned Firms, and High-tech Firms. Developed under contract for the Small Business Administration, Office of Advocacy.

in the service emerged. For example, bank staff offered to help a White business owner complete a loan application 27% of the time, and offered to help a Black business owner only 12% of the time. Staff offered to schedule a future appointment for the White business owner 23% of the time, as compared to 8% of the time for a Black business owner. Other differences in treatment were reported. For example, on a number of occasions the bank loan offer servicing a Black small business owner checked a government website during the conversation to verify that the business was registered and in good standing. This did not occur for any White business owner.[11]

These differences in treatment help illustrate why minority-owned small businesses are disproportionally pessimistic about applying and being approved for traditional bank loans. They may also explain why some community development lenders and fintech lenders using nontraditional models are sometime more effectively reaching underserved small businesses. For example, 88% of the small business owners borrowing from Opportunity Fund, the largest nonprofit microlender in the U.S., are ethnic minorities.[12] Two thirds of the loans made in the U.S. by Accion, a leading nation-wide nonprofit lender to small businesses, support business owners in low- to moderate-income households. LendingClub, the largest marketplace lender in the United States, uses technology to better serve small businesses. Financing through LendingClub includes 4x the representation of women-owned businesses, and 5x the representation of minority-owned businesses, by dollar, when compared to estimates of conventional small business lending.[13] In these examples, it is clear that with the right tools and approaches, financial institutions are able to reach the small businesses who need them.

We believe the data provided by 1071 will encourage greater investment, among both banks and nonbanks, in models that are successful in serving small, women-owned, and minority-owned businesses. The historical record of HMDA, the Home Mortgage Disclosure Act, provides one example of how data collection has led lenders to pursue opportunities that the data illuminates. In 1989, HMDA was updated to include data collection of applicant demographics, much like Section 1071. From 1993 through 1995, conventional (non-government insured) mortgage lending to Black and Hispanic people surged 70 percent and 48 percent, respectively.[14] It is worth noting that this increase predates the emergence of the irresponsible mortgage products that contributed to financial crises in the 2000s.

Small businesses have struggled with limited access to capital for some time. Increasingly small businesses are also targeted with irresponsible lending practices. These practices have led observers to draw comparisons to the subprime mortgage sector in the leadup to 2008.[15] The

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[11] Bone, Sterling A., Christensen, Glenn L., Williams, Jerome D., Adams, Stella, Lederer, Anneliese and Lubin, Paul C, "Detecting Discrimination in Small Business Lending," September 12, 2017. Available at SSRN: https://ssrn.com/abstract=3035972. And National Community Reinvestment Coalition comment to CFPB on Small Business Data Collection, September 12, 2017.

[12] As measured by Opportunity Fund portfolio volume

[13] Senate Committee on Small Business and Entrepreneurship, "21st Century Barriers to Women's Entrepreneurship," July 23, 2014, citing Temkin, Kenneth et al, "Competitive and Special Competitive Opportunity Gap Analysis of the 7(a) and 504 Programs," Urban Institute. January 2008. Although this may be the most relevant data available, it is aged. Analysis draws on SSBF data from 2003. The lack of more recent data further illustrates the need for Section 1071.

[14] This exceeds the 12% increase in home lending to Whites during the same period. Source: National Community Reinvestment Coaltion, *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*.

[15] For example, "Why Online Small Business Loans Are Being Compared to Subprime Mortgages," Forbes, Dec 10, 2015.

specific problems that led the RBLC to come together and produce the Small Business Borrowers' Bill of rights include:

a) Obfuscation of very high financing costs
b) Misaligned incentives between lenders and borrowers
c) Double-charging borrowers when loans are renewed by "double dipping"
d) Mismatch between financial products' purported use and actual use behavior encouraged by the provider
e) Hidden prepayment charges
f) Misaligned broker incentives steering small businesses into expensive products
g) "Stacking" of too much debt
h) Lack of legal protections in collections, and
i) Need for financial inclusion

Transparency into the small business lending sector through Section 1071 can help steer the market towards better practices, and a better outcome than experienced in subprime mortgage lending.

There is a clear need for achieving Congress' purpose for Section 1071 of "facilitate enforcement of the fair lending laws and enable communities, government entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses." Comprehensive information on existing gaps would enable lenders to be more effective in reaching the underserved small businesses who need them, and would spur further innovations from banks, fintech companies, community groups, advocates, and the public sector.

Recommendations

Implementation of Section 1071 must be designed to avoid undue regulatory burden that may reduce financing to small businesses, discourage new entrants into small business financing, or add unnecessary cost to the small business credit system.

The ease or difficulty that financing providers experience in complying with Section 1071 will vary by the type of organization. Financing providers that utilize technology will generally have an easier time complying than smaller brick-and-mortar lenders, for example. Larger banks, and especially fintech companies, are already accustomed to storing data in structured environments for easy analysis. Sophisticated banks and fintech companies may use systems to "permission" which employees are able to access specific data points, such as personally identifiable information (PII). This same capability could be easily applied to restrict access to demographic information. Many technology companies are also accustomed to automating data transfers. Critically, the CFPB should structure implementation of the 1071 program to make it possible for 1071 data reporting to be completely automated.

On the other hand, smaller firms using paper and manual processes are likely to require greater resources and process changes to comply with Section 1071. Complying with 1071 will require a certain amount of investment for any firm. As discussed below, most firms are not collecting demographic information about applicants, and some are not collecting other data points such as NAICS and census tract. To reduce the adverse impacts of compliance costs for all firms, we offer the following recommendations.

Small Business Definitions (Responsive to Questions 1 and 2)

Defining small businesses using SBA NAICS size criteria would be unnecessarily burdensome and complicated for lenders, researchers, and small businesses themselves. A much simpler approach is needed.

We recommend that the CFPB define small business non-equity financing rather than defining what a small business is. This will avoid the complications that produced the SBA's complex NAICS-specific size criteria, as well as some of the complication of addressing multiple-entity relationships identified in Question 2d.

Specifically, we suggest that "small business non-equity financing" be defined as financing below $1 million, exempting financing to larger firms. Larger firms might be described as those with higher annual receipts of more than $10 or $20 million.

Loan size of $1 million is an existing threshold used by the FFIEC in CRA reporting. Moreover, loans of $1 million or less represent the vast majority of loans sought by small businesses, including 96% of loans sought by startup firms according to the Federal Reserve.[16]

Reporting Process and Data Points (Responsive to Questions 3 and 4)

Financing providers that are adept at utilizing technology will have an easier time complying with Section 1071, while organizations less technologically adept will require greater investment and cost to comply. To reduce the compliance burden for all firms, as an overarching principle the CFPB should structure the 1071 program to make it possible for required data reporting to be completely automated.

The CFPB should standardize data formats to match those used in reporting to the USDA, SBA, and Treasury Department's CDFI Fund. Furthermore, the CFPB should cooperate with these agencies to create a single, centralized recipient for this information, which will then distribute it to the relevant agencies. (Responsive to Question 3)

[16] "2016 Small Business Credit Survey," Federal Reserve.

Data points not collected (Responsive to Question 4b and 4c)

NAICS Code - Some financing providers do not collect NAICS code. The NAICS system is quite complex, and requires small business owners or lenders to use a detailed and sometimes ambiguous taxonomy to determine their NAICS code. In some cases, financing providers use SIC codes or other more general industry classifications. We believe NAICS code should be an optional field that is not required if it is unavailable to the reporting organization. (Also responsive to Question 7)

Census Tract - Financing providers often do not collect census tract information. However, census tract information is valuable for determining which geographic communities are being served. The CFPB should provide a tool to enable financing providers to convert address and zip code information to census tract in a completely automated way. Up-to-date tables converting zip codes to census tracts would be one option. Although zip code alone may not always identify a single tract, zip code information is widely held, if not universal, and so would be a lower-burden method of collecting geographic data. Simple software to convert addresses to census tracts is another option. Additionally, when publishing data, the CFPB should consider whether geographic information such as census tract or zip code would compromise borrowers' privacy by allowing the public to infer the identities and financial information of individual firms.

Collection of additional pricing data points

APR - As irresponsible business lending has grown since the passage of Dodd-Frank Act Section 1071, it may be important to understand not only whether financing is being provided, but also at what terms. A whitepaper by Opportunity Fund found that the average APR on products provided by alternative lenders to small businesses that had reached out to Opportunity Fund was 94%, and ranged as high as 358%.[17] Similar research by the Woodstock Institute also identifies APRs ranging up to 350%.[18] If Section 1071 data collection indicates that access to capital is improving, but is blind to whether that capital provided is at 10% APR or 300% APR, Congress' intent will not be accomplished.

If the Bureau collects pricing data in addition to the data points specifically noted by Congress, pricing should be collected in the form of APR. For products such as cash advances or factoring which may not have a fixed APR, a projected APR should be used until the financing has been repaid and an actual retrospective APR can be determined. Nearly every financing provider has an annualized return that they expect to earn from a financing transaction, whether or not they are disclosing an estimated annualized cost of capital to the borrower. Additionally, reporting a retrospective actual APR may be important in many cases, because actual use behavior including

[17] Opportunity Fund, "Unaffordable and Unsustainable: The New Business Lending on Main Street." May 2016. https://www.opportunityfund.org/media/blog/unaffordable-and-unsustainable-new-opportunity-fund-report/

[18] Woodstock Institute, "Analysis of Business Loan Terms." http://www.woodstockinst.org/research/analysis-business-loan-terms

prepayment, loan flipping, or "double dipping" may result in higher APRs as terms are shortened and multiple loans may be "stacked."

If pricing data is collected, it should be prohibited from being published broken out by demographic group at a firm level, or it will risk creating significant confusion and undue regulatory burden. Fair lending analysis requires sophisticated techniques to determine whether differences in pricing result benignly from differences in creditworthiness, or represent unequal outcomes. Unfortunately, collecting data to establish creditworthiness in order to perform this analysis requires many more data points than would be prudent for the Bureau to collect. While HMDA data collection may be able to benchmark consumer creditworthiness with a credit score variable, small businesses are much more heterogeneous than mortgage borrowers and not as easily benchmarked. Standard small business credit scores are not available for a very significant portion of businesses, and are not as effective at classifying risk as standard consumer credit scores for consumers. Additionally, small business creditworthiness is evaluated in different ways. Benchmarking may require different data points for different types of business and financing products.

For these reasons, if pricing data is collected, it should be published in concert with demographic information only in aggregate, such as at an industry or multi-firm level. At an individual firm level, publication of pricing information by demographic groupings risks creating fair lending conflicts that are not based on adequate analysis. In other words, the CFPB may permit the publishing of the APR range and averages of a certain firm, and the demographics of the applicants the firm has served. It should not permit publishing of the APR averages provided to different demographic groups by that firm, or applicant-level information including both pricing and demographic information. If pricing data is restricted from publication in concert with demographic information at a firm level, this unnecessary confusion and undue regulatory burden can be avoided. (Responsive to Question 6)

Outstanding balance or Term length - It may be valuable to know the term length of the financing to understand the volume of capital being provided. A loan is a lease of capital. Just as a 36-month car lease provides more car than a 6-month car lease, in some sense a 36-month loan provides more capital than a 6-month loan. If capital allocation is measured only by the original financing amount, the data will conflate the volume of lending of 6-month and 6-year loans, and so inaccurately portray the degree and manner in which small business are being capitalized. An even more accurate alternative to collecting term length would be to collect the outstanding balance of financing provided.

Collateral – In order to help policymakers, innovators, and others understand small businesses' access to capital, the CFPB may consider collecting collateral information in a simple manner. For example, the Bureau could employ a single categorical variable describing whether or not real estate, equipment, cash collateral, or similar "hard" collateral is required.

The availability of collateral is a major constraint on access to capital for small businesses. Denial for insufficient collateral was the second or third most common reason for credit denial measured in the Small Business Credit Survey of the Federal Reserve. Financing shortfalls based on insufficient collateral affected between 27% and 36% of financing-seeking small businesses, depending on the age and other characteristics of the business.[19] Collateral shortfalls disproportionately affect the credit seeking of minority-owned businesses. For example, while the White homeownership rate in 2015 was 71%, the homeownership rate of Black Americans was 41%.[20] Moreover, the availability of collateral significantly affects the terms at which financing can be offered. A fully-collateralized loan may carry low risk of charge-off losses to a lender, while an unsecured loan may carry significant risk of charge-off if the loan is not repaid. Thus including a simple collateral variable could help explain why disparities may exist, or why loan terms differ.

Identifying Minority-Owned and Women-Owned Firms (Responsive to Question 9)

While financing providers often have some of the data points identified by Congress for collection under Section 1071, in most cases they do not have demographic information of the business owner and may avoid collecting this information for compliance reasons or to avoid the potential practice or appearance of discrimination. (CDFIs and Special Purpose Credit Programs focused on serving underserved borrowers are an exception.) We offer the following suggestions to reduce potential regulatory burden in the collection of demographic data.

Collect data only on the owners identified - We recommend that the Bureau accept demographic information on the business owners known to the financing provider, without requiring information on all owners. Financing providers do not always collect information identifying 100% ownership of every small business they serve. In some cases, a financing provider may work with owners representing only a portion of the ownership that is authorized to act on behalf of the business. Collecting information on every owner may inconvenience small business owners that are not actively participating in a business' financing process and cause undue burden. Financing providers should simply report the demographic information provided by all owners identified.

Demographic data optional to small business owners - While financing providers should be required to seek demographic data and report the data they receive, demographic information should of course be optional for business owners to provide. If small business owners feel that they must provide demographic information to financing providers, this may discourage some applicants who are concerned about discrimination. Again, this may disproportionately discourage borrowing by minority-owned businesses. Research has indicated that African Americans are 37% more likely and Hispanics are 23% more likely than Whites to avoid

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[19] "2016 Small Business Credit Survey," Federal Reserve Banks of Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, Minneapolis, New York, Philadelphia, Richmond, St. Louis and San Francisco (April 2017). https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-StartupFirms-2016.pdf

[20] Urban Institute Housing Finance Policy Center, as cited in Whitehouse, Mark, "Homeownersihp and the White-Black Wealth Gap," Bloomberg, 2/27/17. https://www.bloomberg.com/view/articles/2017-02-27/home-equity-and-the-white-black-wealth-gap

applying for credit because of fear of rejection.[21] While it is important for this information to be optional for a small business owner to provide, the CFPB should be prepared that this may introduce data gaps that reduce the accuracy of the data.

Permit proxy analysis – In some circumstances, it may be appropriate for demographic information to be obtained by the financing provider using proxy analysis as described by the CFPB, such as Bayesian Improved Surname Geocoding (BISG), rather than requesting self-reported information from the small business owner.[22] For example, proxy analysis may be appropriate where small business owners themselves decline to provide demographic information. Proxy analysis may not be sufficient as a general substitution for borrower-collected information, because it can be used only in aggregate and cannot estimate the demographic information of a specific applicant.

Limiting underwriter access to demographic information – Financing providers that are adept at using technology will have an easier time restricting access to demographic information to ensure it will not be used improperly. Many banks and fintech companies use permissioning systems in their databases to limit which employees are able to access certain data points. Additionally, financing providers who operate through online interfaces may be capable of routing information to different functions, so that an underwriter may never see what race an applicant has indicated on their application. However, organizations managing processes on paper may have a difficult time restricting access to data. This is especially true when an underwriter interacts directly with an applicant in person, and is the recipient of the loan application.

Exempting Classes of Financial Institutions (Responsive to Question 10)

While complying with a well-considered implication of Section 1071 may be easier for medium-sized and larger firms, particularly those adept at using technology, it may be relatively more difficult for very small firms. For example, very small traditional lenders operating with paper and manual processes may struggle. New startups entering the small business financing market may have hopes of expanding access to responsible capital, but may need to mature before establishing strong controls. If an exemption is granted to certain classes of financial institutions, it should be focused on only very small firms such as these.

Role of Marketplaces, Brokers, and other 3rd Parties (Responsive to Question 11)

In addition to lenders, reporting under 1071 should be required of brokers, marketplaces, and other third-party entities that facilitate the decisions on whether and how small businesses are

[21] Alicia Robb, *Access to Capital among Young Firms, Minority-Owned Firms, Women-Owned Firms, and High-Tech Firms,* Office of Advocacy, U.S. Small Business Administration, Washington, DC (2013); Michael S. Barr, *Minority and Women Entrepreneurs: Building Capital, Networks, and Skills*, Brookings Hamilton Project (March 2015).
[22] CFPB: "Using Publicly Available Information to Proxy for Unidentified Race and Ethnicity: A Methodology and Assessment," Summer 2014. http://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf

offered credit. Collecting data from brokers and facilitators will help policymakers and others understand the growing role these organizations play in providing small business financing, and the effect they may have on access to capital.

The Bureau can avoid double-counting of loans by including an attribute that indicates if the financing was originated by the reporting entity. Facilitators such as marketplaces and brokers would indicate that they did not originate the loans they are reporting, and these loans could be excluded from aggregate information to ensure that each loan is only reflected once. If a bank or nonbank lender provides credit through multiple facilitators, the Bureau could require these different financing programs to be broken out separately in reporting.

Forms of Financing (Responsive to Question 12)

We support the CFPB in collecting data on the wide range of current (and future) financing products used by small businesses, in order to provide accurate information about market activity and to avoid creating unfair advantages for different financing products. For example, credit cards are an increasingly common source of financing from banks, as small business loans have become less of a focus for many traditional financial institutions. Among nonbanks, cash advances are an important type of non-equity financing for policymakers and others to understand. Cash advances have becoming a significant part of nonbank small-business financing, and in some cases are associated with the irresponsible practices that led this coalition to develop the *Small Business Borrowers' Bill of Rights*, including obfuscation of very high financing costs, misaligned incentives between financing providers and borrowers, double charging borrowers when loans are renewed, hidden prepayment charges, and "stacking" of too much debt.

Definition of Application (Responsive to Question 13)

Section 1071 data on approval rates will produce inaccurate conclusions if the Bureau does not take into account the different stages at which an application may take place in different forms of financing. For products offered online, an application generally represents the first expression of interest in financing by a small business. Many online applications can be completed in a few minutes, and take place before any conversation between the small business and financing provider.

In contrast, applications at traditional financial institutions often take place after the small business owner has spoken with the financing provider and gathered a range of paperwork required for the application. Those conversations may encourage or dissuade a small business from applying. In some cases, business owners may not apply upon realizing they would not qualify. Minority-owned firms may be disproportionally discouraged through this process. As described in the National Community Reinvestment Coalition research cited above, bank staff offered to help a white business owner complete the loan application 27% of the time, and offered to help the black business owner only 12% of the time.[23] In an online lending process, these business owners would likely have already completed their application. Because approval rates for traditional, offline processes do not include the large percentage of business owners who were discouraged from applying in the first place, approval rates of traditional financial institutions are generally inflated when compared to online lending processes.

Small businesses today struggle with access to capital on the one hand, and a rise in irresponsible lending on the other. A well-considered implementation of Section 1071, taking into account the recommendations above and other insights gathered through this RFI, will create tremendous benefit for small businesses and spur innovation in the financing providers that serve them. We welcome further discussion of these recommendations, and can be reached at info@responsiblebusinesslending.org.

Sincerely,

The Responsible Business Lending Coalition

Members of the Responsible Business Lending Coalition include:
Accion
Aspen Institute
Community Investment Management
Fundera
Funding Circle
Lending Club
Opportunity Fund
Small Business Majority

Attachments:

- The Small Business Borrowers' Bill of Rights
- List of signatories and endorsers of the Small Business Borrowers' Bill of Rights

[23] Bone, Sterling A., Christensen, Glenn L., Williams, Jerome D., Adams, Stella, Lederer, Anneliese and Lubin, Paul C, "Detecting Discrimination in Small Business Lending," September 12, 2017. Available at SSRN: https://ssrn.com/abstract=3035972. And National Community Reinvestment Coalition comment to CFPB on Small Business Data Collection, September 12, 2017.