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National Association of Federally-Insured Credit Unions

September 13, 2017

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

RE: Small Business Lending
Docket No. CFPB-2017-0011

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I am writing to offer NAFCU's thoughts on the Consumer Financial Protection Bureau's "Request for Information Regarding the Small Business Lending Market."

NAFCU is concerned that future implementation of Section 1071 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) may yield misleading information about credit unions and restrict lending activity as a result of increased compliance costs. Credit unions serve distinct fields of membership, and as a result, institution-level data related to women-owned, minority-owned, and small business lending may appear skewed in relation to other lenders. Given the unique characteristics of credit unions and the limits placed on member business loans (MBLs), the CFPB should seek to exempt credit unions from any future rulemaking that compels disclosure of small business loan information.

Although NAFCU supports an industry-wide exemption for credit unions, we would also like to offer, in the alternative, reasonable parameters to guide the CFPB's implementation plan for Section 1071.

General Comments

Section 1071 of the Dodd-Frank Act assigns the CFPB the responsibility to issue implementing regulations for collection of "small business loan data." In general, Section 1071 aims to facilitate enforcement of fair lending laws and enable communities, businesses and other entities to better identify the needs of women-owned, minority-owned, and small businesses. Section 1071 appears to require financial institutions to collect and report information to the CFPB using procedures similar to those currently used in connection with the *Home Mortgage Disclosure Act* (HMDA).

Section 1071 requires financial institutions (broadly defined as anyone who engages in a “financial activity”) to inquire of any businesses applying for credit whether the business is a small business, women-owned or minority-owned. The CFPB has considerable discretion to grant exceptions for particular types of institutions under Section 1071—a clear indication that Congress anticipated the need for limited implementation in order to offset the burdens presented by an extensive and complex data collection regime.

Given Section 1071’s potentially expansive breadth, NAFCU firmly believes that adoption of tailored exemptions will spare financial institutions significant compliance costs and ensure that the pursuit of business lending data does not result in reduced access to credit, misunderstanding, or disclosure of private borrower information.

While NAFCU acknowledges that taken on its own, Section 1071 is a well-intentioned provision, our member credit unions are concerned that future implementation of this provision could negatively impact credit unions’ ability to lend to women-owned, minority owned, and small businesses. Furthermore, NAFCU notes that credit unions have already achieved one of Section 1071’s objectives— promoting business lending. Notably, credit union small business loan growth dramatically outpaced banks both during and after the financial crisis. Credit unions have maintained strong small business loan growth despite field of membership and other statutory restrictions; however, this trend may slow or even be reversed if the CFPB chooses to impose additional regulatory burdens.

The CFPB should exempt credit unions from Section 1071 data collection.

NAFCU urges the CFPB to exempt credit unions from any future rulemaking under Section 1071 because credit unions’ ability to lend to women-owned, minority-owned and small businesses is already constrained by overregulation. As you are aware, credit unions are not-for-profit, member-owned financial institutions that each serve unique memberships with unique characteristics. In addition to their field of membership restrictions, credit unions are also restricted from a commercial lending perspective by the *Federal Credit Union Act*’s cap on MBLs.¹ As a result, credit unions already face many legal restrictions that affect their ability to extend credit to small businesses. The creation of a new data collection regime would likely frustrate credit union efforts to originate commercial loans at low cost to women-owned, minority-owned and small businesses within their communities.

While an exemption for all credit unions would be a preferable solution given the complexities of differing fields of membership and the statutory MBL cap, NAFCU understands that the CFPB may be considering an intermediate approach to implementation. As an alternative to an

¹ Section 723.8 of The National Credit Union Administration’s (NCUA) regulations specifies that the aggregate limit on a federally insured credit union’s net member business loan balances is the lesser of 1.75 times the actual net worth of the credit union, or 1.75 times the minimum net worth required under section 1790d(c)(1)(A) of the Federal Credit Union Act. A federally insured credit union’s net member business loan balance is determined by calculating the outstanding loan balance, plus any unfunded commitments, and then subtracting any portion of the loan that is sold as a participation interest. *See* 12 CFR 723.8(e). For a credit union to sell participations in a loan it originated, it must retain an interest in the loan.

industry-wide exemption, NAFCU recommends that the CFPB utilize a commercial loan-volume threshold to alleviate regulatory burden. NAFCU could support an approach similar to HMDA's transactional thresholds, such that a credit union that originates few small business loans in a calendar year would be exempt from any reporting requirements established under Section 1071.

Definition of small business.

There is no industry-wide consensus on what constitutes a small business loan. While credit unions may consider a business applicant's size when determining which employees have the approval authority to evaluate the loan application, credit unions do not calibrate their approval authority thresholds to detect if an applicant is a small business. Some of our members have reported that an income requirement of \$750,000 or less for a business loan would suggest that the business is small.

NAFCU and our members believe that for the purposes of Section 1071, a small business should be defined in terms of gross annual revenue. Based on the underwriting experience of our members, NAFCU believes that only businesses with revenues of \$1 million or less should be considered small for data collection purposes. In addition, NAFCU believes that a measure of revenue offers a more straightforward assessment of size and avoids unnecessarily complex references to industry type or employee count.

Any data collection that utilizes the Small Business Administration's (SBA) size standards, which reference the North American Industry Classification System (NAICS), would impose tremendous burdens on credit unions. In general, credit unions do not have the systems or personnel necessary to make discerning assessments about industry classifications that are consistent with the 960-page NAICS manual.² As the CFPB acknowledges, NAICS codes are used primarily for federal acquisition and loan assistance purposes. While the SBA's finely tuned size standards may be appropriate gatekeepers for competitive opportunities, they are too cumbersome a tool for ascertaining the existence of a small business loan.

NAFCU also believes that the CFPB's authority to grant exceptions under Section 1071 affords the agency ample discretion to utilize a simplified small business definition. For example, if the CFPB decides to adopt transactional thresholds for determining coverage under Section 1071, those exceptions should not need to reference the SBA's formal definition of a small business under 15 U.S.C. 632(a). This principle should hold true for any threshold test for determining coverage under Section 1071.

Collection of business lending information should be limited to statutorily enumerated data points.

The statutory purpose of Section 1071 is to facilitate the enforcement of fair lending laws and to enable lending that meets the needs of women-owned, minority-owned, and small businesses. To

² See Office of Management and Budget, 2017 NAICS Manual, available at https://www.census.gov/eos/www/naics/2017NAICS/2017_NAICS_Manual.pdf.

monitor fair lending in business lending, Dodd-Frank specifically enumerated seven data points, such as the loan purpose, amount applied for and amount approved, the census tract of the principal place of business, the most recent gross annual revenue of the business, and the race, sex and ethnicity of the business principal owners. The RFI, however, lists additional data points pursuant to the CFPB's discretionary rulemaking authority to carry out the purposes of Section 1071. Any proposal to expand the list of data items in Section 1071(e)(2) must be consistent with Section 1071's purpose of ensuring fair lending and anti-discriminatory practices; however, NAFCU does not believe that there is a compelling need to expand the list of data items contained in Section 1071(e)(2).

Collection of the seven data items would, by itself, impose a significant burden on credit unions. For example, collecting the census tract of the principal place of business would prove frustrating because business owners are unlikely to know their census track off-hand, which would shift the burden to the credit union to supply this data point. Credit unions might also need to ensure that the principal place of business data point is consistently defined if the CFPB adopts its own definition for this term, adding new complexities for lenders that operate in multiple states where principal place of business may be interpreted differently.

In addition, most credit union loan origination platforms are not configured to track both consumer and business applicant data. Upgrading these platforms would necessitate expensive and time consuming changes to core systems. Instituting these kinds of changes to IT infrastructure (or reverting to manual entry systems) would strain resources and raise underwriting costs. In all likelihood, these costs would need to be passed on to the consumer and negatively impact access to credit in the business lending market.

NAFCU is also concerned that adding new data points may invite a speculative mode of data collection that exceeds in scope what is necessary for accomplishing the stated purpose of Section 1071. The inclusion of supplemental data points to "reduce the possibility of misinterpretations" might make sense where the loan product being evaluated is standardized (i.e., a residential mortgage). However, a credit facility for a small business, for example, can exist in many different forms. Consequently, the addition of supplemental data points may be unavailing or—in a worst case scenario—even more misleading.³ Accordingly, NAFCU strongly urges the CFPB to limit data collection under Section 1071 to the statutorily enumerated data points.

Business loan data collected by credit unions.

When extending business credit, credit unions typically limit their information collection to data necessary to originate the loan. This information usually includes data to identify the applicant(s), determine the applicant(s)' field of membership eligibility, and underwrite the underlying collateral (e.g., real estate, personal property, etc.). For commercial loans that will be

³ See John Yinger, Evidence on Discrimination in Consumer Markets, 12 J. Econ. Perspectives 23, 27 (Spring, 1998). See also Clogg, C.C. & Haritou, A., The Regression Method of Causal Inference and the Dilemma Confronting this Method, CAUSALITY IN CRISIS 83, 100-01 (R. McKim & S.P. Turner, eds. 1997).

secured by a dwelling, credit unions also collect the information required under HMDA and Regulation C.

In most cases, the originating credit union collects the applicant and loan information. However, because the National Credit Union Administration (NCUA) imposes caps on member business lending, some credit unions rely on loan participations to obtain a profit share on a large loan that might otherwise exceed their aggregate MBL limit.

Typically the credit union selling the participation is the lead lender and collects the borrower's information. In some cases, however, the borrower may contact a credit union that does not assume the role of lead lender, in which case the credit union will forward the borrower's information to the institution that does assume the lead role. Credit unions may also rely on credit union service organizations (CUSOs) to match participants with lead lenders.

In circumstances where the credit union is purchasing a loan participation from a financial institution or CUSO, several conditions must be met, including that the borrower become a member of one of the participating credit unions before the participation is sold.⁴ Validation of the borrower's relationship with the participating credit union may require the originator to forward borrower information to certain participants.

To account for the chain of interactions that may occur prior to a final credit decision on a participated business loan, NAFCU suggests that the CFPB seek to limit reporting responsibilities to a single financial institution. Short of an exemption for all credit unions, only lead lenders should be required to submit Section 1071 data to the CFPB. Likewise, where the originating institution is not a credit union, only the loan participant that maintains a customer relationship with the borrower should be obligated to report Section 1071 data.

NAFCU also asks the CFPB to consider whether data collected from loan participants might be duplicative or unnecessary for achieving the statutory purpose of Section 1071. NAFCU recommends that the CFPB review the extent to which Call Report data submitted to NCUA may obviate the need for institution-level data.

The CFPB should develop formal policies for maintaining the privacy of collected data before considering implementation of Section 1071.

The CFPB's current lack of guidance regarding the privacy protections applied to HMDA data sets a troubling precedent for future implementation of Section 1071. The final HMDA rule does not furnish the promised "balancing test" that will be used to determine "whether and, if so, how HMDA data should be modified prior to its disclosure in order to protect applicant and borrower privacy."⁵ In light of this delay, NAFCU and our members are concerned that the privacy of member small businesses may not receive adequate attention. NAFCU recommends that the

⁴ See 12 CFR 701.22(b).

⁵ See Final Rule, Home Mortgage Disclosure (Regulation C), 80 Fed. Reg. 66127, 66130 (Oct. 28 2015); Fair Lending Report of the Consumer Financial Protection Bureau, April 2017, 82 Fed. Reg. 25250, 25261 (June 1, 2017).

CFPB develop and submit for comment detailed policies for maintaining the privacy of borrower and applicant information before considering implementation of Section 1071.

NAFCU also requests that the CFPB seek to minimize the risk of competitive harm by not publicizing data that can be linked to a specific small business. Section 1071(e)(4) grants the CFPB the discretion to delete or modify publicly available data to advance a privacy interest. Small businesses are particularly sensitive to publicly accessible loan information because of the competitive risks disclosure might entail (e.g., exposure of financial conditions or business strategy). NAFCU recommends that publicly available data exclude key underwriting fields that could be associated with individual borrowers.

The unique features of credit unions may yield opaque data results and increase the potential for misinterpretation.

The collection of small business lending data from credit unions will likely present challenges for the CFPB in terms of developing a methodology that controls for variables such as field of membership and statutory caps on MBLs.

Credit unions are bound by defined fields of membership, which means that small business lending could be limited by geographic restrictions, employer groups, or other charter-specific language that defines who the credit union may serve. In general, the *Federal Credit Union Act* allows three kinds of field of membership: single common bond charters, multiple common bond charters, and community charters.⁶ Community credit unions have a field of membership that is defined primarily in terms of geographic area, whereas an occupational common bond credit union might have a membership that is limited to the employees of a specific company.

Women-owned, minority-owned, and small business lending activity might look substantially different for credit unions simply because of regional concentrations of businesses. In addition, comparing credit unions' Section 1071 data to bank data could produce misleading results as a result of field of membership restrictions, and the misinterpretation of publicized data could lead to reputational harm.

An abundance of unique field of membership configurations also increases the risk of omitted-variable bias when evaluating credit unions' fair lending compliance. Without consideration of field of membership differences, the aggregate analysis of business data sets could produce misleading conclusions regarding legitimate loan denials. As stated previously, NAFCU believes that collecting supplemental data points to control for field of membership differences would invite inappropriate experimentation not contemplated by Section 1071 and impose enormous costs for reporting institutions.

Adding to the complexities of field of membership, the sheer variety of business credit products may render comparative assessments of underwriting models substantially more difficult.

⁶ See 12 U.S.C. § 1759.

Business products offered by credit unions include business credit cards, vehicle loans, term loans (secured and unsecured), lines of credit (secured and unsecured), letters of credit, commercial real estate loans (owner occupied and non-owner occupied), non-owner occupied residential real estate mortgages and SBA loans (7a, Express and 504 loans). As compared to residential mortgages, the underwriting models used for business products tend to be more varied and would necessarily inject more uncertainty into the process of discerning legitimate underwriting differences.

The statutory cap on MBLs is another factor that will likely frustrate analysis of business lending data for credit unions. As noted above, the ability of credit unions to offer commercial loans is statutorily capped. In 1998, Congress codified the definition of a member business loan and limited a credit union's member business lending to the lesser of either 1.75 times the net worth of a well-capitalized credit union or 12.25 percent of total assets. Currently, NCUA caps aggregate member business loans in a fashion that impairs credit unions' ability to effectively lend to small businesses.

As a result of both MBL caps and field of membership restrictions, data about credit union business lending will not translate easily when compared to other institutions. Accordingly, NAFCU believes that any information collection that mixes credit union MBL data with business loan data from banks and other institutions not constrained by similar limits would be misleading and unhelpful in achieving the statutory purpose of Section 1071.

Conclusion

NAFCU and our members ask that the CFPB exempt credit unions from data collection requirements under Section 1071. Given the unique characteristics of credit unions and complexities discussed above, there is a substantial possibility that misinterpretation of credit union data could work against the statutory purpose of Section 1071. Furthermore, credit unions have and continue to maintain strong relationships with women-owned, minority-owned, and small businesses. An elaborate data collection regime comparable to HMDA would only increase compliance costs and frustrate ongoing efforts to expand lending opportunities for small businesses.

In the alternative, NAFCU asks that the CFPB coordinate with NCUA and the Treasury Department to ensure that future Section 1071 implementation efforts accommodate the unique structure and purpose of credit unions. Doing so would ensure that reporting and collection requirements for credit unions are appropriately tailored to ensure that the statutory purposes of Section 1071 are met without compromising access to credit or imposing unreasonable burdens.

NAFCU appreciates the chance to comment on the Bureau's request for information regarding small business lending. Should you have any questions or concerns, please do not hesitate to contact me at amorris@nafcu.org or (703) 842-2266.

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Sincerely,

Andrew Morris
Regulatory Affairs Counsel