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National Association of Federally-Insured Credit Unions

January 6, 2022

Comment Intake
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

RE: Section 1071 Small Business Lending Data Collection (RIN: 3170-AA09)

Dear Sir or Madam:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the Consumer Financial Protection Bureau's (Bureau) Section 1071 Small Business Lending Data Collection Proposed Rule (Proposed Rule). NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 127 million consumers with personal and small business financial service products. NAFCU and its members appreciate the Bureau's dedication to ensuring small businesses are adequately protected under the *Equal Credit Opportunity Act* (ECOA) and section 1071 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act). NAFCU's members have a proud history of looking beyond traditional financial metrics to serve their communities' small businesses, including many woman- and minority-owned businesses that may not be served by national banks and online-only financial technology companies (fintechs).

However, there is widespread concern that the Proposed Rule's complexity and significant one-time and ongoing compliance costs will weigh disproportionately on credit unions in ways that ultimately lead to fewer and less favorable outcomes for all small business borrowers. The likely net effect of the Proposed Rule's expansive coverage and intensive data collection and reporting requirements is that the credit unions that have supported millions of small business successes across the country will quickly become uncompetitive and may be forced out of small business lending altogether.

NAFCU urges the Bureau to adopt common sense definitions, right-sized thresholds, and a reasonable, phased mandatory compliance schedule to ensure that credit unions' support of their small business members is not jeopardized by unnecessary section 1071 compliance burdens. NAFCU also recommends that the Bureau delay any further section 1071 rulemaking until it is clear the COVID-19 pandemic has ended. The Bureau cannot accurately assess the likely impacts of an intensive rulemaking until America's "new normal" is established and reliably measurable.

General Comments

Section 1071 of the Dodd-Frank Act amended the ECOA to require that covered financial institutions collect and report certain information regarding credit applications made by women-owned, minority-owned, and small businesses. In section 1071, Congress charged the Bureau with

developing and implementing regulation reasonably designed to facilitate the enforcement of fair lending laws and to enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses. The Proposed Rule would require covered financial institutions to collect and report on a total of 21 discrete small business lending data points, including eight discretionary data points.

Small businesses, as the Bureau recognizes, are irreplaceably important. The strength and resiliency of our national and local economies fundamentally depend on the diversity of their small businesses and those small businesses having adequate access to affordable, high-quality credit. This access, in turn, depends on the competitiveness and diversity of the small businesses lending market. Congress plainly recognized this relationship when it charged the Bureau with developing regulation that enables small business stakeholders to track the lending outcomes and likely capital needs of communities' small businesses.

Unfortunately, the Proposed Rule, if adopted as written, risks irreparably undermining the competitiveness and diversity of today's small business lending market – a market that has changed significantly since the Dodd-Frank Act's passage more than a decade ago. As the Bureau explains, when the Dodd-Frank Act was passed, credit unions and banks represented nearly all of the small business lending market. Few fintechs even existed, let alone specialized in small business products. In recent years, however, as the Bureau points out, fintechs' small business lending is estimated to have grown by as much as 90 percent year-over-year. Fintechs' partnering with national banks and fervent promotion of invoice factoring as a small business credit alternative further fuel shifts away from more traditional, in-community small business borrowing.

Even if loan originations under the Small Business Administration's (SBA) Paycheck Protection Program (PPP) serve as only a rough indication of small business lenders respective market shares, the program's startling evidence of big banks' and fintechs' pronounced and growing dominance is relevant. JP Morgan Chase Bank, N.A. (JPM Chase) executed in excess of 250,000 PPP loans. BlueVine, a fintech younger than the Bureau, executed roughly 155,000 PPP loans. It is a simple economic fact that any adopted form of the Proposed Rule will raise compliance costs for all covered financial institutions. The net effect of increased compliance costs on different types of covered financial institutions, however, is neither as simple nor uniform. For such firms as JPM Chase and BlueVine, the Proposed Rule's one-time and ongoing costs will be negligible, if noticeable – not only because such behemoths can cost-effectively develop complex compliance tools in-house but because even those costs will be allocated across hundreds of thousands of transactions.

Many credit unions, on the other hand, are themselves small businesses, well below the SBA's $600 million total assets threshold. Some credit unions will not only be forced to purchase comparatively expensive third-party information technology (IT) solutions but will be rendered captive to IT vendors' development, redeployment, and cross-testing timelines over which the credit unions will have no meaningful control. For other credit unions, automated section 1071 compliance tools are likely out of reach, and the process of manually collecting and reporting section 1071 data is likely to result in greater borrower confusion as well as lengthier, more

complicated application processes. Credit unions, too, have little or no capacity to absorb increased compliance costs. 89 percent of respondents to NAFCU's October 2020 *Economic & CU Monitor Survey* said they will be forced to charge higher fees on business products to offset the costs of their collecting and reporting section 1071 data. 44 percent of respondents expected the costs of other credit products to rise as well. Additionally, a majority of respondents indicated that they would expect to change either the set of small business products offered or their underwriting practices in response a section 1071 final rulemaking.

Furthermore, unlike banks and fintechs, federally-insured credit unions are constrained by the *Federal Credit Union Act* (FCU Act) and the *Credit Union Membership Access Act* (CUMAA). The FCU Act provides that a federally-insured credit union may serve only those within the field of membership described in its charter. The CUMAA codified the definition of a member business loan (MBL) and limited a well-capitalized, federally-insured credit union's MBLs to the lesser of either 1.75 times the credit union's net worth or 12.25 percent of its total assets. So constrained, credit unions cannot, unlike banks and fintechs, rapidly ramp up small business lending activities to minimize or wholly offset the Proposed Rule's significant one-time and ongoing costs. The Bureau's ultimate publication of reported section 1071 data also risks credit unions, statutory constrained in whom they may serve and in the scale of their business lending, appearing to run afoul of fair lending laws when no such impropriety, in fact, exists.

Despite many individual credit unions' modest small business lending activity, the credit union industry as a whole brings to bear significant, necessary competitive market pressures that benefit all small business borrowers, not just credit unions' borrowers. For those small businesses in their field of membership, credit unions offer unparalleled in-community support, competitive rates, low fees, and tailored, flexible terms. This nation's credit unions collectively serve roughly one half of all American adults, and the vast majority of American adults not yet served by a credit union are likely eligible for membership in at least one credit union. Credit unions, therefore, represent a real and affordable alternative to big banks and fintechs and, consequently, exert downward pressures on these for-profit lenders' small business loan pricing. NAFCU's *Economic Benefits of the Credit Union Tax Exemption to Consumers, Businesses, and the U.S. Economy*, released in September 2021, shows that the combined benefit to credit union members and bank customers from credit unions' presence in U.S. financial markets was $153 billion over the period 2011 to 2020. In fact, in six of the ten years, benefits to bank customers exceeded benefits to credit unions members, and in two other years, benefits to bank customers and credit unions members were effectively equal.

While the Bureau may regard the prospect of a consolidated and homogenized small business lending market with ambivalence, the Bureau should not assume too much about the ultimate trajectory of small business borrower outcomes under the Proposed Rule. Data collected through the Federal Deposit Insurance Corporation's (FDIC) *Small Business Data Collection Survey* strongly suggests that borrowers satisfaction levels with fintechs is "far lower than with traditional lenders". Fintechs received a net satisfaction score of 33 percent while small depository institutions came in at 73 percent and large depository institutions at 55 percent. In a December 2019 Federal Reserve study of small business borrowers, 63 percent of online lender applicants reported challenges working with their lender. More than half of those respondents reported high interest

rates, and nearly one third of those respondents reported concerns related to unfavorable repayment terms. If the Bureau is to deliver on its section 1071 responsibilities, it must remain careful not to further speed the consolidation and homogenization of the small business lending market.

Covered Financial Institutions

While section 1071 defines "financial institution" to include a reasonably expansive list of different types of entities that may engage in small business lending, section 1071 establishes neither a metric nor a threshold by which to identify those from whom Congress anticipated the Bureau would collect small business lending data. Under the Proposed Rule, any entity meeting section 1071's definition of a financial institution that originated at least 25 covered credit transactions for small businesses in each of the two preceding calendar years would be a covered financial institution. The Proposed Rule's 25 loan-volume threshold was the lowest, non-zero loan-volume threshold considered by the Bureau in prior section 1071 rulemaking exercises.

The Bureau anticipates it could lower one-time section 1071 compliance costs by roughly $120 million and still collect section 1071 data for approximately 94 to 95 percent of all small business loans made by depository institutions if it establishes a 100 loan-volume threshold. However, it is obvious that a 100 loan-volume threshold is much too low still. For decades, mortgage market stakeholders have drawn statistically significant conclusions about the health and fairness of the mortgage market from data collected and reported subject to the *Home Mortgage Disclosure Act* (HMDA), which, the Bureau has estimated, captures something just shy of 90 percent of all available mortgage data. Establishing a 100 loan-volume threshold or any other loan-volume threshold that operates to capture more section 1071 data than is necessary at the expense of small business borrowers runs perfectly counter to the Bureau's section 1071 responsibilities.

Compounding this concern is the Bureau's reliance on NCUA 5300 Call Report data and similar banking industry data. A great deal of small business lending occurs below the relevant $50,000 reporting thresholds. The Bureau may welcome larger covered financial institutions' being required to report even more section 1071 data than the Bureau now projects. However, the Bureau should be deeply concerned that its overreliance on Call Report data risks the Bureau materially underestimating how many credit unions would likely be covered financial institutions under artificially low 25 and 100 loan-volume thresholds.

NAFCU encourages the Bureau to adopt a covered financial institution loan-volume threshold not lower than 500 covered credit transactions.

Chilling Effect on New and Modest Small Business Lenders

The Bureau acknowledges that some credit unions, faced with the Proposed Rule's significant one-time and ongoing compliance costs, may simply be forced to exit small business lending altogether. Other credit unions, the Bureau anticipates, will attempt to manage their small business lending activities so as to narrowly avoid crossing whatever loan-volume threshold the Bureau ultimately adopts. While it is theoretically possible that a credit union or bank could manage its small business lending activity in such a way as to avoid crossing a loan-volume threshold, the

theory quickly erodes when one considers the fluidity and iterative nature of most small business lending.

Small business lending, particularly at credit unions, is often the product of a lengthy, relationship-intensive process that unfolds over weeks, months, and, sometimes, years. Credit unions and entrepreneurs work diligently alongside one another to understand small businesses' strengths and capital needs and identify appropriate small business solutions. Consider the simplest context, one in which a credit union has never engaged in a credit transaction covered by the Proposed Rule. Aware that not all credit applications are approved and not all approved credit applications result in a member accepting the approved terms, the credit union would rationally work to cultivate small business relationships in excess of its targeted loan-volume. During years-long periods in which application approvals and borrower acceptances are above average, or emergencies press a credit union to redouble its commitment to its community, can the credit union truly be expected to abandon or stall its small business members the moment it unexpectedly meets its target loan-volume?

Next, consider one of the thousands of credit unions that may wish to better support their small business members by beginning to offer an affordable small business credit card product. If a credit union was simultaneously managing its small business lending activity to ensure it is not exposed to section 1071 compliance costs it is unable to afford, every new small business credit card account would represent one fewer traditional small business loan it could make, irrespective of a small business member's need. Similar examples are not in short supply, but the effect of each is the same. Credit unions' reliably managing small business lending activity to a specific loan-volume is simply implausible, if not impossible. More likely, these credit unions, too, would be forced to avoid or exit small business lending altogether.

In conversations with members, NAFCU has observed that anxiety regarding section 1071's future costs may already be having a chilling effect on future plans to expand small business lending operations. After the passage of the *Coronavirus Aid, Recovery and Economic Security Act* (CARES Act), credit unions expressed optimism that public awareness of the PPP's funding might enhance general demand for SBA loans. Credit unions who had never previously sought to promote small business loan products also expressed interest in sustaining small business lending even after the PPP was exhausted. However, after the Bureau's section 1071 rulemaking efforts were more widely publicized in September 2020, some credit unions expressed hesitancy about pursuing small business lending due to uncertainties surrounding the costs of section 1071 compliance.

According to a 2011 study from the SBA[1], while banks tend to reduce lending during economic stress, credit unions continue to lend to small businesses. During the Great Recession, credit union lending offset a proportional reduction in bank lending.[2] The Bureau's January 2020 data point found the number of credit unions offering small business lending products doubled since 2004, from 10 percent to 20 percent. As big banks continue to avoid historically-disadvantaged

[1] James A. Wilcox, The Increasing Importance of Credit Unions in Business Lending, SBA Office of Advocacy (Sept. 2011).
[2] NCUA, Member Business Loans; Commercial Lending; Final Rule, 81 Fed. Reg. 13530, 13532 (March 14, 2016).

communities and desert short-lived efforts in others and as community banks continue to merge, the Bureau must be keenly aware of the Proposed Rule's ability to chill small business lending by credit unions, sometimes the only in-community option remaining for small businesses.

Covered Applications

NAFCU appreciates the Proposed Rule's providing that "a financial institution has latitude to establish its own application process or procedures". Small business lending, particularly at credit unions, is often an iterative process tailored to borrowers' unique needs and not a rote walk-through or fill-in-the-blank template.

NAFCU is, however, concerned by the Proposed Rule's not adopting Regulation B's definition of a "complete application". The Bureau's adopting a "complete application" definition, as opposed to the Proposed Rule's comparatively open-ended definition of an application, would alleviate the significant burden covered financial institutions would have in collecting section 1071 data from unengaged applicants who have no intention of completing the application process. Unnecessary compliance costs that would in short order translate to higher small business borrowing costs would be avoided, and the integrity of valuable section 1071 data on the most important small business lending activity would be protected.

While it may be convenient for the Bureau to have data regarding incomplete applications when it explores fair lending issues related to borrower discouragement, there is no indication that Congress intended for section 1071 to mirror the requirements found in the HMDA and Regulation C. Furthermore, it appears plausible that many incomplete applications could be the product of borrower confusion regarding the need to supply unfamiliar, deeply personal data points rather than the product of borrower discouragement. To the extent that borrower discouragement intersects with more easily measurable fair lending concerns, the Bureau will have more than sufficient section 1071 data, in addition to its existing examination authorities, to investigate ECOA violations involving small business lending products.

Small Business Definition

The Proposed Rule would define a small business as any business with prior-year gross annual revenue of $5 million or less. NAFCU supports regulation that enables credit unions to more quickly and confidently support their communities' small businesses. Also, as previously expressed, NAFCU appreciates the obvious benefits of any easy to apply small business definition based on gross annual revenues. However, as discussed more fully in other sections, credit unions generally anticipate being forced to pass along their section 1071 compliance costs to small business borrowers in the form of higher fees.

Small business lending fees are, like many sales taxes, regressive in nature, disproportionately expensive for small businesses borrowing the least. It is altogether possible that fees for the smallest dollar small business lending products could increase to such a proportion that the smallest dollar products altogether disappear from the small business lending market or are offered only by the least scrupulous, least regulated small business lenders. A gross annual revenue

threshold must, therefore, operate to cost-effectively capture only the data reasonably necessary to enable stakeholders to draw statistically significant conclusions about the health and financial needs of truly small businesses.

Based on the underwriting experiences of its members, NAFCU recommends that the Bureau adopt a small business definition based on a $1 million prior-year gross annual revenue threshold.

Covered Credit Transactions

The Proposed Rule broadly defines a covered credit transaction to include any extension of business credit other than trade credit, public utilities credit, securities credit, and incidental credit, which are expressly excluded. The Bureau anticipates explaining in the Official Commentary that factoring, leases, consumer-designated credit used for business purposes, and credit secured by certain investment properties are not covered credit transactions. Under the Proposed rule, credit unions' small business loans, lines of credit, and credit cards would all be covered credit transactions. If a credit union offers its small business members a merchant cash advance (MCA) product, that too, would be a covered credit transaction under the Proposed Rule. To gauge the size and distribution of the small business lending market comprised of these products, the Bureau relied on 2019 NCUA Call Report data and similar banking industry data. However, the Proposed Rule offers no *de minimis* threshold below which an otherwise covered credit transaction would not count toward a financial institutions' loan-volume threshold.

NAFCU recommends that the Bureau put its assumptions into practice and establish a *de minimis* threshold applicable to all covered credit transactions that tracks the NCUA Call Report threshold, currently $50,000. Congress' decision to exclude member loans under $50,000 from credit unions' MBL caps and the NCUA's corresponding decision to exclude such loans from Call Reports reflect a general, reasoned understanding that burdensome reporting requirements frustrate very small businesses' access to affordable, high-quality small dollar loans. Small dollar loans are particularly important to sole proprietorships. And, as the Bureau makes extensive note, the majority of women- and minority-owned businesses are sole proprietorships. In the alternative, NAFCU recommends that the Bureau delay any further section 1071 rulemaking until the Bureau is prepared to present a more transparent methodology describing the likely coverage of financial institutions based on lower covered credit transaction thresholds.

NAFCU also recommends that the Bureau expressly exclude small business credit cards from the Proposed Rule's definition of a covered credit transaction. An informal survey of a cross section of NAFCU members suggests that the vast majority of credit unions' new small business credit card account limits are well below the NCUA 5300 Call Report threshold – with median limits hovering tightly around $10,000. NAFCU understands from other industry stakeholders that similar trends persist in nearly every identifiable sub-section of the banking industry.

Under the Proposed Rule, as written, a credit union's approving even marginal small business credit card account limit increases would push the credit union closer toward whatever loan-volume threshold the Bureau ultimately adopts. It seems likely, therefore, that absent the Bureau either establishing a meaningful *de minimis* threshold or expressly excluding small business credit

cards from the Proposed Rule's definition of a covered credit transaction, every credit union that offers even a single small business credit card product will ultimately become a covered financial institution on that basis alone. Furthermore, the Bureau estimates that roughly three-quarters of credit unions do not yet offer a small business credit card product. Any one of that number that subsequently offers its small business members an alternative to high-fee, high-interest small business credit card products pushed by big banks and fintechs would likely find itself soon exposed to the Proposed Rule's extraordinary compliance costs, irrespective of any other small business activities.

NAFCU supports the Bureau's exclusion of consumer-designated credit transactions from the Proposed Rule's definition of a covered credit transaction and recommends that the Bureau further clarify that it will not challenge a credit union's designating an otherwise covered credit transaction to be a consumer-designated credit transaction. NAFCU believes that preserving such discretion is critical to mitigating overall section 1071 compliance risks given covered financial institutions have no reliable method for validating a latent business purpose in an application for a consumer-designated credit transaction.

Finally, because NAFCU believes it is unlikely Congress intended to include commercial real estate loans made to investors within the scope of section 1071, NAFCU again recommends that the Bureau consider expressly exempting such loans from the Proposed Rule's definition of a covered credit transaction rather than rely on the Official Commentary's operation. It is often the case that these loans' relevant data are already reported under the HMDA. Additionally, commercial real estate loans made to investors are typically made to business entities with complex ownership structures that make it difficult for financial institutions to determine even the identity of all of a borrower's principal owners.

Mandatory Data Points

Credit Purpose

NAFCU recommends that the Bureau further clarify how covered credit transactions should be reported when they are made directly to the sole proprietor of a business, not to the business directly. Credit unions engaged in small business lending to sole proprietors individually may find it confusing to report a loan purpose that implies that the business itself is the recipient.

Amount Applied For

NAFCU recommends that the Bureau grant financial institutions the discretion to report an "amount applied for" that is determined at later stage, rather than at the first request of the applicant, because reporting the first initial credit request could inaccurately represent the lending process. Particularly in transactions involving real estate or equipment, many small businesses will request a much higher loan amount than what is ultimately approved after evaluation of collateral. For startups and sole proprietorships, a lack of sophistication can also lead to similarly unrealistic initial requests. In these cases, credit unions work diligently with applicants to arrive at a more reasonable amount, but such education could take place over a period of weeks or months.

Census Tract

The geocoding requirement will be a source of significant burden for many credit unions, the vast majority of which do not collect census tract information for small business loans. Although some Community Financial Development Institution (CDFI) credit unions collect census tract information, many are completely unfamiliar with how to collect this information—particularly those that are exempt from the HMDA's reporting requirements. Those credit unions that do not use the Federal Financial Institutions Examination Council's (FFEIC) geocoding tool to collect census-tract information will need to acquire a separate software license from a vendor to implement geocoding. There may also be separate related costs for periodic system upgrades.

The FFIEC geocoding tool also does not permit batch inputs, which further slows more manual application processes at credit unions. For credit unions with limited staff, such a bottleneck could mean losing business as members frustrated by longer approval times look elsewhere. NAFCU, therefore, recommends that the Bureau develop a free tool for use by covered financial institutions that permits batch inputs and better enables covered financial institutions to more efficiently, cost-effectively fulfil their section 1071 responsibilities.

Protected Demographic Information and Visual Observation

Under the Proposed Rule, in certain circumstances, a covered financial institution's employee would be forced to determine the ethnicity and race of a small business applicant's principal owner via visual observation.

NAFCU unequivocally opposes the Bureau's adoption of any regulation or examination practice that operates to require that any individual make any visual observation concerning any protected demographic information or similarly sensitive data of a small business applicant's owners. Humans have immense and persistent difficulties accurately and precisely identifying others' race and ethnicity[3]. Routinely inaccurate visual observations of this sensitive data would not only threaten the integrity of other valuable section 1071 data but would add unnecessary friction to small business relationships and give rise to avoidable, unreasonable fair lending risks.

The Proposed Rule's requiring, in certain instances, that a covered financial institution's employee make visual observations of protected demographic information may, too, expose covered financial institutions to compliance costs related to an evolving patchwork of state personal data privacy laws. While some states' personal data privacy laws provide financial institutions an institution-level exemption, at least one state, California, provides financial institutions only an information-level exemption.[4] To the extent protected demographic information is deemed not to be collected "subject to" or "pursuant to" the *Gramm-Leach- Bliley Act*, Californians may have

[3] Goldstein, A. G., and Chance, J. (1978). *Judging face similarity in own and other Races*. J. Psychol. 98, 185–193; Meissner, C. A., and Brigham, J. C. (2001). *Thirty years of investigating the own-race bias in memory for faces: a meta-analytic review*. Psychol. Public Policy Law 7, 3–35.
[4] Cal. Civ. Code § 1798.145(c)

certain robust personal data privacy rights with respect to their visually observed protected demographic information collected and maintained by covered financial institutions.

Discretionary Data Points

Section 1071(e)(2)(H) requires financial institutions to collect and report "any additional data that the Bureau determines would aid in fulfilling the purposes of [section 1071]." The Proposed Rule would require covered financial institutions to collect and report the following eight discretionary small business lending data: pricing, time in business, North American Industry Classification System (NAICS) code, number of workers, application method, application recipient, denial reasons, and number of principal owners.

In light of the significant one-time and ongoing section 1071 compliance burdens already facing covered financial institutions with respect to their collection and reporting of mandatory data, NAFCU opposes the Bureau's adoption of any discretionary section 1071 data points. The Proposed Rule's discretionary data points represent data that is neither materially useful in fulfilling the ultimate objectives of section 1071 nor reliably obtainable by cost-effective means. NAFCU anticipates that any section 1071 final rulemaking will tend to widen the competitive gulf between credit unions and big banks and fintechs that have the economies of scale and the technological sophistication to automate complex functions. The Bureau's requiring covered financial institutions to collect and report even more, discretionary section 1071 data will only compound credit unions' competitive disadvantages.

For example, NAFCU members who participated in the PPP noted that many small business applicants either did not know what a NAICS code was or how to determine which NAICS code most closely matched their business. Manually collecting just this data point will require a credit union to devote a significant amount of time and resources to ineffective education. One statutory purpose of section 1071 is to facilitate enforcement of fair lending—a goal that is not sector dependent. The identification of business and credit needs can be accomplished without explicit reference to NAICS codes, such as by leveraging already existing data sources and voluntary surveys of business owners. Furthermore, sector-specific analysis of business credit supply and demand is best left to the SBA, which already collects NAICS information through its lending programs.

The risks of the Bureau's collecting the Proposed Rule's discretionary data is not limited to increased compliance costs that drive small business lending costs higher. The Bureau's collection and ultimate reporting of small businesses' time in business, NAICS code, and number of workers, coupled with census tract information, raises serious concerns about small businesses' privacy. Such discretionary data, when made public, could be used to re-identify small business borrowers and help competitors gain impermissible insight into financial information directly bearing on small businesses' long-term financial health and competitive goals.

Firewall

Section 1071 generally contemplates the existence of an information firewall between employees handling inquiries about a small business applicant's status as a women-owned, minority-owned, or small business and those employees engaged in underwriting. Under section 1071(d)(2), if a financial institution discovers that an underwriter or others involved in making a determination regarding an application "should have access" to such information, it must provide an applicant a notice of "the access of the underwriter to such information, along with notice that the financial institution may not discriminate on the basis of such information."

Unfortunately, the Proposed Rule's low loan-volume threshold and expansive covered credit transaction definition will likely operate to require the distribution of the proposed section 1071 information firewall disclosure far more often than Congress intended. Too frequent distribution will produce untenable, negative real-world effects that weigh most heavily on those the regulation is intended to protect.

Many credit unions have small business lending departments comprised of three or fewer employees. Small business lending at such credit unions across the country is more often than not an all-hands-on-deck effort. In operation, the Proposed Rule threatens to create the powerful illusion that these modestly-staffed credit unions are incapable of guaranteeing that protected demographic information will not affect an underwriting decision. The effect will likely be particularly pronounced with respect to women- and minority-owned small businesses, the entrepreneurs of which routinely come face-to-face with the realities of their relative economic disadvantages. A rational entrepreneur of a women- or minority-owned small business would be forced to consider accepting higher interest rates and other onerous credit terms in exchange for the relative peace of mind that a big bank's or fintech's seemingly limitless technology and personnel budgets ensure that protected demographic information remains shielded from underwriters.

The Bureau cannot eliminate the section 1071 information firewall disclosure's giving the appearance that credit unions are incapable of adequately shielding protected demographic information from underwriters. But the Bureau should reduce the need for its distribution by adopting section 1071 regulation with common sense definitions and right-sized thresholds.

Reputational Risks Related to Statutory Limitations and Future Balancing Test

As NAFCU has noted more fully in prior comment letters, the publication of small business data from credit unions risks presenting a misleading portrait of overall credit availability due to variables such as field of membership and aggregate MBL limits. As a result of these unique statutory restrictions, credit union lending patterns may not translate easily when compared to other institutions. Accordingly, it is imperative that the Bureau supply a transparent description of the methods and analysis it will apply when evaluating section 1071 data for supervisory purposes.

The Bureau should also recognize that some credit unions may respond to perceived reputational risks associated with data publicization by eliminating certain product offerings or modifying

underwriting practices in a way that reduces the overall diversity of small business products. In such a scenario, small businesses could ultimately find it more difficult to acquire credit on favorable terms if financial institutions seek to flatten pricing artificially because they are concerned by the outward appearance of such discrepancies, even when no discrimination, in-fact, exists.

Credit unions may also need to allocate additional resources to respond to inquiries about section 1071 data from NCUA examiners, who will be performing fair lending analysis of section 1071 data for the first time. To help credit unions better assess possible reputational concerns, the Bureau must also provide a full and complete explanation of any balancing test it intends to use to limit public disclosure of section 1071 data. Merely referencing a conceptual framework and then articulating the full policy later, as the Bureau does in the Proposed Rule and did with the HMDA, will not suffice. For credit unions to accurately assess the full range of privacy and reputational impacts that might be associated with any proposal, there must be a complete understanding of how the balancing test will be applied. For example, credit unions might approach their assessment of the costs of collecting certain data items by considering how it might be used to reidentify a borrower. The risk of reidentification cannot be fully known unless the Bureau provides a complete description of how a balancing test or other methodology for limiting public disclosure works.

One-Time and Ongoing Compliance Costs

NAFCU is significantly concerned that the Bureau has materially underestimated the one-time and ongoing costs credit unions are likely to face under the Proposed Rule. While, like others, NAFCU's members have had insufficient opportunity to explore all options, early indications are that third-party training, information technology, and auditing expenses are likely to be several multiples higher than the Bureau's estimates.

The Bureau's estimates with respect to training, for example, tend to reflect a scenario in which the only staff trained on section 1071 compliance are those staff for whom section 1071 data collection and reporting are a primary, largely autonomous job function. Such a scenario may be realistic at the smallest credit unions that have only two or three staff engaged in business lending and at the very largest credit unions with dedicated fair lending compliance departments. However, for credit unions with modest but not minimal staff, such an expectation ignores the fact that it is often the case that all or most employees are trained on all compliance issues to promote cross-functional efficiencies. Expenses may be driven higher still if the Bureau adopts an insufficient mandatory compliance schedule.

Mandatory Compliance Schedule

The Proposed Rule's 18-month mandatory compliance schedule would be aggressive even for the largest, most technologically savvy credit unions. As discussed above, the vast majority of credit unions likely to be covered financial institutions under the Proposed Rule will be forced to rely on multiple IT vendors to develop, redeploy, and cross-test section 1071-compliant small business lending programs and tools. Furthermore, many credit unions, because they are exempt from the HMDA's reporting requirements, have no preexisting HMDA software solutions or IT vendor

relationships to leverage. These credit unions will require even more time to come into compliance with robust, technology-intensive section 1071 regulation.

Past experience with the Bureau's implementation of the HMDA suggests that the Bureau is likely underestimating the time required for IT vendors to adapt their products to comply with major rulemakings. Relatedly, many NAFCU members who entered the small business lending market for the first time through the PPP to help local businesses reported having done so by relying on existing resources, not new technologies or other efficiencies. That some credit unions may now provide a more diverse range of products does not necessarily equate to greater sophistication or reduced reliance on manual systems. Credit unions across the country have simply worked harder for longer to support their communities' small businesses during the COVID-19 pandemic.

NAFCU strongly encourages the Bureau to adopt a phased mandatory compliance schedule based on covered financial institutions' loan-volumes that begins no sooner than three years following the Bureau's adoption of a section 1071 final rulemaking. The credit unions, which have the least bargaining power with powerful third-party IT vendors are often the last to receive core system upgrades and must have the time necessary to become fully compliant with a section 1071 final rulemaking.

Coordination of Examinations

Unlike mortgages, which are largely homogenous consumer products, small business loans can vary widely in design and purpose. Accordingly, prudential regulators' examiners applying the same analytical techniques and examination approaches applicable to the HMDA's enforcement to small business data may yield erroneous results. Absent a clear description of the methodologies that might be employed to perform fair lending analysis using section 1071 data, there will likely be a period where prudential regulators' examiners' expectations are in flux and, perhaps, materially inconsistent. To the extent that credit unions are subject to section 1071 reporting, the Bureau must coordinate with other FFIEC agencies, including the NCUA, to develop model examination procedures in advance of the Bureau adopting a section 1071 final rulemaking.

Small Business Lending Data Collection and the SBA

If the SBA again engages in direct small business lending, as a legislative proposal contained in the *Build Back Better Act* would permit, small business borrowers would face two material, perhaps not obvious, risks – higher borrowing costs and a consolidated small dollar lending market. The Bureau cannot be held responsible for the actions of agencies, but the Bureau must remain keenly aware that its section 1071 rulemaking has significant impacts on a small business lending market shaped by powerful private and public competitive pressures.

First, the Proposed Rule's Official Commentary specifically includes "governmental lending entities" within the definition of a financial institution. While the SBA's balance sheet and reach may more closely resemble those of big banks and fintechs than those of a credit union, the SBA, as the PPP made clear, is significantly reliant on manual information processing and the smooth functioning of the individual offices within its vast network. If the SBA engages in direct lending,

it will no doubt meet the Proposed Rule's definition of a covered financial institution. With the lessons of the last two years firmly in mind, the SBA would likely find it necessary to train nearly all employees on section 1071 compliance to ensure modestly staffed offices can meet their section 1071 responsibilities in times of pronounced small business needs. To offset these and other costs related to the collection and reporting of section 1071 data, the SBA would likely be forced to raise the costs of small business lending products that are, for some borrowers, the best available option.

Second, if the SBA again engages in direct small business lending, the SBA would threaten all credit unions' disintermediation in the increasingly important small dollar segment of the business lending market. Not only does the legislative proposal lack the statutory guardrails to prevent the SBA from becoming credit unions' direct lending competitor, but the legislative proposal also risks fintechs, who have never been permitted to originate 7(a) loans, driving credit unions entirely out of 7(a) lending. The legislative proposal's net effect of increasing private-sector competition for ever fewer private sector SBA lending opportunities will chill credit unions' 7(a) lending and lead to a consolidation of small dollar lending to the detriment of small businesses.

As the Bureau contemplates its section 1071 final rulemaking, NAFCU encourages the Bureau to remain keenly cognizant that its decisions will bear mightily on a profoundly complicated and rapidly changing small business lending market. The Bureau cannot be expected to alleviate all the ill-effects of a potential SBA direct lending program, but the Bureau should ensure that its section 1071 final rulemaking does not unnecessarily compound small dollar lending price increases or speed the small dollar lending market's consolidation.

Relatedly, NAFCU encourages the Bureau to oppose an SBA direct lending program and expressly exclude loans extended by depository institutions and backed by a governmental entity from its section 1071 final rulemaking's definition of a covered credit transaction.

Conclusion

NAFCU appreciates the opportunity to comment on the Bureau's Proposed Rule. Section 1071 of the Dodd-Frank Act was written to address economic inequalities much older than even our first form of federal government. That the Bureau approaches such an awesome responsibility at a time when the small business lending market has changed more in the last two decades than in the preceding two centuries makes the Bureau's task all the more challenging. As the Bureau helps this nation move meaningfully along a path to economic inclusion for all, the Bureau must avoid speeding the small business lending market's consolidation and homogenization, particularly at a time when many truly small businesses are only beginning to recover from the shocks of the COVID-19 pandemic.

NAFCU strongly encourages the Bureau to adopt common sense definitions, right-sized thresholds, a reasonable, phased mandatory compliance schedule, and other changes to the Proposed Rule that protect small businesses' access to affordable, high-quality credit from trusted, in-community credit unions.

If you have any questions or concerns, please do not hesitate to contact me at dbaker@nafcu.org or 703-842-2803.

Sincerely,

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