

Uncertain Future For CFPB Small Business Data Rule

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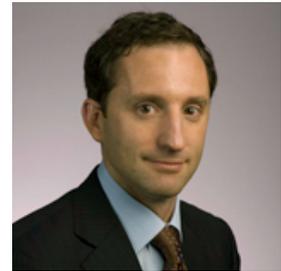
On Wednesday, May 10, the Consumer Financial Protection Bureau issued a request for information (RFI) on the small-business lending marketplace[1] — the first step in an anticipated rulemaking pursuant to Section 1071 of Dodd-Frank.[2] Section 1071 authorizes the bureau to implement rules that will require collection of data on loans made to women-owned and minority-owned businesses in order to monitor for potential violations of the Equal Credit Opportunity Act (ECOA).[3] While this rulemaking has long been anticipated, the chances of it being finalized are far from certain. Strong opposition to Section 1071 by Republicans, along with the fact that the rulemaking process will be finalized under Director Richard Cordray’s replacement, will create serious headwinds. Some members of the business community quickly responded to the RFI, calling for a narrow approach that ensures that any rule does not raise compliance costs that become overly burdensome.[4]

Fair lending risk in small-business lending is not contingent on bureau rulemaking. The scope of ECOA is broad and the law can be enforced not only by federal agencies such as the CFPB and U.S. Department of Justice, but also by private plaintiffs. And in addition to federal law, certain state fair lending laws also cover small-business lending. Accordingly, financial institutions should continue to monitor compliance with fair lending laws as they relate to small business irrespective of the uncertain future of any rulemaking on Section 1071.

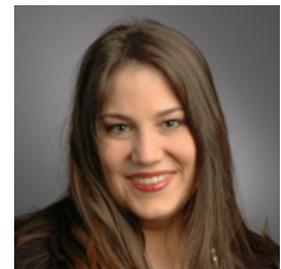
Background

Section 1071 of Dodd-Frank requires financial institutions, for any application of credit for a women-owned, minority-owned or small business, to inquire and track whether each application is for a women-owned business, minority-owned business or a small business.[5] In the first few years since the bureau’s inception, the bureau’s Section 1071 authority had received little attention by both the bureau and outside parties. This changed within the last year as lawmakers from both sides of the aisle focused increased attention in the area. For example, Congress has repeatedly asked Cordray about the rationale, progress and timetable of the Section 1071 rulemaking process.[6] Cordray indicated last month that the bureau was in the early stages of this rulemaking process, was utilizing the CFPB’s supervisory function to “enhance [the] knowledge base” of the bureau, and was in the early stages of reaching out to industry regarding the small-business lending market, leading to the May 10 RFI.[7]

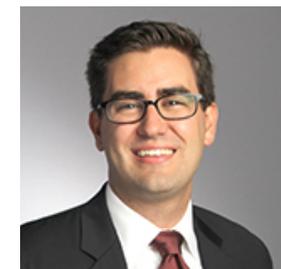
In his May 10 remarks in Los Angeles announcing the RFI, Cordray stressed that the CFPB’s mission, despite its focus on regulating household and personal financial products, could be applied to small-business lending. He said, “the line between consumer finance and small business finance is quite blurred,” citing that 22 million American small-business owners have zero employees.[8]



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Summary of the RFI

The RFI is designed to help the bureau learn about the industry as a first step toward issuing rules for Section 1071. Thus, the RFI specifically asks lenders, businesses and the public to provide information about the types of credit offered to small businesses, and the different types of lenders that offer credit to small businesses. In addition, the RFI seeks information about how burdensome collecting such data would be for creditors. Specifically, the bureau is seeking information on five different topics: (1) the definition of “small business”; (2) different data points to track; (3) the types of financial institutions that lend to small businesses; (4) access to credit and products that are offered to small businesses; and (5) privacy[9]:

- **Definition of Small Business:** The RFI notes that Section 1071 defines small business as having the same meaning as a “small business concern” under the Small Business Act[10], and that the Small Business Administration uses a size-based definition developed by the North American Industry Classification System (NAICS). The bureau specifically notes that if it uses a definition of small business to mean annual revenue of \$1 million or less, it would cover 95 percent of all businesses. The RFI is looking to determine whether NAICS is the proper way to define a small business, whether revenue is the correct metric, or whether it needs to be tailored to industries or loan sizes, or include other factors.
- **Data:** The RFI lists 10 data points the bureau would collect, including the purpose of financing, 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 bureau is seeking comment on the data standards used by lenders for other purposes that it could apply for Section 1071 purposes, whether any of the data required is already collected by the industry, how difficult it would be to obtain the data, and whether there are any privacy concerns with respect to the data collection, among other questions.
- **Financial Institutions Engaged in Business Lending:** Small-business lending expands beyond traditional bank lending, and includes nonbank lenders, including fintech companies, that are not subject to the bureau’s supervisory jurisdiction. As a result, the bureau is seeking information on the types of financial institutions that are engaged in this type of lending. Specifically, the bureau is asking whether certain classes of lenders, like marketplace lenders, brokers, dealers or other third parties involved in the application process for small business financing, should be excluded from the proposed rule.
- **Access to Credit and Financial Products Offered to Businesses:** The RFI identifies term loans, lines of credit and credit card products as types of credit offered to small businesses, and asks whether there are other types of small-business financing that are available and should be tracked for purposes of a proposed rule. In terms of access, the bureau is seeking the types of preapproval or prescreening processes lenders undertake in offering credit, as well as underwriting standards and the types of issues that could prevent a small business from being approved for credit.

- **Privacy:** Section 1071 specifically permits the bureau to “delete or modify data available to the public to advance a privacy interest.”^[11] Given that the collection of small-business lending data would likely be shared as part of the bureau’s routine reporting to both the public and Congress, the RFI seeks information regarding the privacy concerns related to the different types of data being collected.

Challenges at the Bureau Generate Uncertainty on Final Rule

The bureau could face serious roadblocks in its Section 1071 rule-writing process due to the uncertainty surrounding its authority in general. In fact, the bureau’s RFI comes during a time when it faces serious challenges in all three branches of government. In Congress, the House Financial Services Committee just passed the Financial CHOICE Act (CHOICE 2.0) out of the committee on a party-line vote and it is expected to pass the entire House.^[12] CHOICE 2.0 would completely overhaul the agency stripping the bureau of all of its supervisory and some of its enforcement authorities, among other changes.^[13]

Importantly, it is unclear which of these changes could receive 60 votes in the Senate and become law, but among those provisions is a repeal of the bureau’s Section 1071 authority. With respect to the executive branch, there is speculation that Cordray could be removed for-cause by President Donald Trump before the end of his term.^[14] And at the same time, the bureau is challenging a decision by the D.C. Circuit that found the bureau’s structure unconstitutional.^[15] This combination of uncertainty and the high-level issues at play make it very difficult for the Section 1071 rulemaking to proceed predictably.

Even if the bureau overcomes these challenges, it is still unclear whether the Section 1071 rule-writing process will ultimately result in a final rule. First, the typical multiyear timeline for notice-and-comment rulemaking means that any proposed rule will likely not be finalized until well after July 2018, when Cordray’s term expires and when he is replaced by a Republican nominee. Following the RFI process, the bureau would then need to review and incorporate the information into its proposed rule, which also includes lengthy attendant processes such as those required by the Small Business Regulatory Enforcement Fairness Act (SBREFA). After a proposed rule is issued, it is subject to a public notice-and-comment period. The bureau would then take into account public comments before issuing its final rule. Given the significant influence of the CFPB director on rulemaking, a Republican-nominated director could take significant steps to change, stall and even stop altogether the rulemaking process.

Second, even if the rule were to be finalized under Cordray, Republicans have control of Congress and could overturn a final rule via the Congressional Review Act (CRA).^[16] The most recent effort to repeal the CFPB’s prepaid card rule via the CRA failed, but that was likely due to the political appeal of consumer protection rules for prepaid cards and CFPB efforts to delay and improve upon the rule. ^[17] By contrast, Republicans have been united in their opposition to the bureau regulating commercial lending, as evidenced by the repeal of Section 1071 authority in CHOICE 2.0.^[18]

Compliance Remains Key

While the success of a new Section 1071 rule remains uncertain, the bureau is still just as active as in the past with respect to its enforcement activities. And even without Section 1071, which is limited to data collection, the bureau has the power to enforce the Equal Credit Opportunity Act, which prohibits discriminatory lending against women-owned and minority-owned businesses. If the bureau faces difficulty in the Section 1071 rule-writing process, it may begin to engage more aggressively in its efforts to enforce ECOA through public consent orders and lawsuits.

Indeed, in its 2017 "Fair Lending Report" published last month, the bureau said "[g]oing forward, because of emerging fair lending risks in other areas, we are increasing our focus on...small business lending."^[19] Importantly, however, those efforts are more difficult without the availability of a Section 1071 rule. Absent Section 1071, not only are small-business lenders not required to collect data on race and ethnicity of owners, but the law actually prohibits it. And without the availability of the data, it is difficult for the bureau to make claims about broad discrimination on race or ethnicity.

Moreover, lenders need to be aware of fair lending risk outside the CFPB context. Private plaintiffs also have rights of action under ECOA, meaning that enforcement of the fair lending laws as they relate to small businesses can proceed through this route irrespective of federal enforcement or policy priorities. Lenders are also subject to state-level fair lending laws; New York Attorney General Eric Schneiderman specifically identifies "small business loans" in his efforts to enforce the state's fair lending laws.^[20] Accordingly, lenders should continue to monitor their compliance with the fair lending laws, especially with respect to small-business lending.

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[1] https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201705_cfpb_RFI_Small-Business-Lending-Market.pdf. The bureau also released a white paper on the small business lending landscape.

https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201705_cfpb_Key-Dimensions-Small-Business-Lending-Landscape.pdf

[2] Dodd-Frank Act § 1071, codified at 15 U.S.C. § 1691 c-2.

[3] The CFPB's jurisdiction is largely limited to the marketplace for consumer financial products and services and does not encompass commercial lending generally. See 12 U.S.C. § 5481(5). However, ECOA is the one law the bureau has authority to enforce with respect to commercial lending directly, although it does have authority over personal loans and

credit cards that are then used for small business purposes.

[4] Kate Berry, American Banker, Bankers Raise Fears on new CFPB Small Biz Collecting Effort (May 10, 2017), available at https://www.americanbanker.com/news/bankers-raise-fears-on-new-cfpb-small-biz-collecting-effort?utm_campaign=daily%20briefing-may%2011%202017&utm_medium=email&utm_source=newsletter&eid=2428480ec7d2a0e52a8e6fc17c9860a4

[5] 15 U.S.C. § 1691c–2. This rule is most similar to the bureau’s data collection rules under the Home Mortgage Disclosure Act, which requires financial institutions to track the ethnicity, race and sex of mortgage borrowers and applicants. See generally, Regulation C (12 CFR Part 1003).

[6] See March 15, 2017, letter from Rep. Emanuel Cleaver, D-Mo., to Richard Cordray asking the CFPB to investigate discrimination in small-business loans and inquiring about the CFPB’s Section 1071 rulemaking, its supervisory activities with respect to small-business lending by fintech companies, and about small-business lending-related complaint submissions. Somewhat surprisingly, House Financial Services Chair Jeb Hensarling, R-Texas, has also asked about the timing of the 1071 rulemaking process. See House Financial Services Committee Hearing entitled “The 2016 Semi-Annual Reports to the Bureau of Consumer Financial Protection.” (April 5, 2017).

[7] See Cordray letter to Rep. Cleaver. (April 4, 2017).

[8] Prepared Remarks of CFPB Director Richard Cordray at the Small Business Lending Field Hearing, <https://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-cfpb-director-richard-cordray-small-business-lending-field-hearing/>.

[9] See RFI. https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201705_cfpb_RFI_Small-Business-Lending-Market.pdf.

[10] 15 U.S.C. § 632

[11] 15 U.S.C. § 1691c–2(e)(4).

[12] Rachel Witkowski, The Wall Street Journal, House Panel Approves Plan to Undo Parts of Dodd-Frank Financial Law (May 4, 2017), available at <https://www.wsj.com/articles/house-panel-approves-plan-to-undo-parts-of-dodd-frank-financial-law-1493916205>.

[13] <https://www.wsj.com/articles/house-panel-approves-plan-to-undo-parts-of-dodd-frank-financial-law-1493916205>. The bill is available at https://financialservices.house.gov/uploadedfiles/hr_10_the_financial_choice_act.pdf.

[14] <http://www.politico.com/story/2017/04/cordray-ohio-election-banks-237272>. Among the justifications cited

for Cordray's removal are inefficient rulemaking, being late in addressing the Wells Fargo unauthorized consumer accounts issue, and the allegations of racial discrimination at the bureau. See <https://www.wsj.com/articles/youre-fired-trump-should-tell-richard-cordray-1492124207>.

[15] See *PHH Corp. v. Consumer Financial Protection Bureau*, 839 F.3d 1 (D.C. Cir. Oct. 2016). The decision was vacated in February pending a rehearing en banc.

[16] Generally speaking, Congress can use the CRA to nullify a rule by a joint resolution of disapproval within 60 legislative days of the finalization, which when signed by the president effectively gives the rule no effect. See 5 U.S.C. § 801. As of May 9, Trump has signed 13 CRA resolutions into law, with one resolution pending his signature. See <http://www.speaker.gov/general/congressional-review-act-progress-review> (Accessed May 9, 2017).

[17] Gregory Roberts, BLOOMBERG BNA, Time Running Out on Bid to Repeal Prepaid-card Rule, (May 9, 2017), available at <https://www.bna.com/time-running-bid-n73014450637/>.

[18] See H.R. 10 (April 26, 2017). https://financialservices.house.gov/uploadedfiles/hr_10_the_financial_choice_act.pdf.

[19] See Fair Lending Report of The Consumer Financial Protection Bureau (April 2017), available at https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201704_cfpb_Fair_Lending_Report.pdf.

[20] <https://ag.ny.gov/fair-lending>.