Statement submitted to the Consumer Financial Protection Bureau

For the Symposium on Section 1071 on the Dodd-Frank Act

November 6, 2019

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Introduction:
This statement was prepared at the request of the Consumer Financial Protection Bureau (CFPB) for its November 6, 2019, symposium on Section 1071 of the Dodd-Frank Act (Act).

The perspective I offer is that of my own and not that of The Bank of Tampa or the CFPB's Community Bank Advisory Council. In my experience as a compliance professional for over 25 years, financial institutions have difficulty creating and implementing policies, procedures, and practices based on limited guidance from the regulatory agencies. Particularly when there are already "similar-but-different" requirements dictated by other applicable laws and regulations. While the clear objective of a community bank is to comply with the letter and spirit of each applicable law/regulation, in many cases, the implementation and practical application of a regulation presents numerous challenges because of the limited regulatory guidance and overlapping requirements.

Too often, seemingly simple regulatory requirements translate into complex and nuanced policies and procedures. As a banker who strives for compliance, I request that careful consideration be made in crafting the regulation implementing Section 1071 of the Dodd-Frank Act. This is an important consideration because, unlike with the residential mortgage industry, for example, community banks are significant providers of small business loans. Per testimony on July 22, 2019, to the United States House of Representatives' hearing on "How Regulations Stifle Small Business Growth," Mr. Christopher Jordan, President and CEO of The Farmers State Bank (on behalf of the Independent Community Bankers of America) indicated that community banks hold a 47 percent market share of small business loans.[1] Accordingly, any new regulation pertaining to small business lending could have an immense impact on community banks. The bank regulators should take great care in crafting new regulation to avoid any unintended consequences that would impair the ability of community banks to be a major provider of credit to small businesses.

Value of Data Collected:
Upon a thorough review of Section 1071 of the Dodd-Frank Act, which has been written to amend the Equal Credit Opportunity Act (ECOA), it seems that the manner in which data will be requested, particularly the demographic information under Section 704B(e)(2)(G), may result in the collection of insufficient information to assess the business and community development needs of women-owned, minority-owned and small businesses as the demographic information (race, sex, and ethnicity) may only reflect a subset of the business' owners.

Section 704B(b)(1) requires a financial institution to inquire whether the applicant's business is a women-owned, minority-owned, or small business. Specifically, the law reads, "…the financial institution shall—(1) inquire whether the business is a women-owned, minority-owned, or small business, without regard to whether such application is received in person, by mail, by telephone." Based on this wording, I interpret this to mean that a business could only be considered a minority- or women-owned business if it falls outside of the definition of a small business.

[1] Testimony of Christopher Jordan, President and Chief Executive Officer, The Farmers State Bank, before the United States House of Representatives Committee on Small Business Subcommittee on Economic Growth, Tax, and Capital Access Hearing on "How Regulations Stifle Small Business Growth," July 22, 2019, https://www.icba.org/docs/default-source/icba/advocacy-documents/testimony/19-07-22_housesmallbiz.pdf?sfvrsn=30a05517_0

Then, under Section 704B(e)(2)(G), the financial institution will request the race, sex, and ethnicity of the principal owners of the business.

Even without "principal owners" being defined in the Act, it appears that this will pose challenges to users of the data (i.e., communities, governmental entities, and creditors) as they will not be able to determine whether the demographic information provided is reflective of the business as a whole.

This is better explained through examples (for demonstration purposes, the examples below only contemplate a business owner's sex and do not consider race or ethnicity):

Example 1:
Applicant: ABC, Inc.
Principal Owners: Mary, Maria, and Martin
(Ownership: Mary (25%), Maria (25%), Martin (50%))

Without the knowledge of each owner's percentage of ownership, the submission of the demographic information only could lead to an inference on the part of a data user that the business is predominately women-owned. As such, it does not appear that the requested demographic information adds value to the identification of a small business' business and community development needs.

Example 2:
Applicant: DEF, Inc.
Principal Owners: Maria and Martin
(Ownership: Maria 60%; Martin 40%)

Without knowledge of each owner's percentage of ownership, there could be an incorrect inference that the entity is owned 50%-50% between Maria and Martin; it would not be clear that this entity is actually predominately woman-owned.

Example 3:
Applicant: GHI, Inc.
Principal Owners: Mary and Martin
(Ownership: Mary 35%, Martin 35%, Maria 10%, Mara 10%, Mario 10%)

Again, unless the percent ownership and demographic information of all owners were to be provided, it would not be discernable that this is a predominately women-owned business.

I am not suggesting that additional data referenced under Section 704B(e)(2)(H) of the Act include an indication of percentage of ownership or that demographic information be requested on all owners. While the regulation could be written to request percent ownership and demographic information of all owners, the ability for a financial institution to capture and accurately report this information would be an insurmountable task. It is also likely that, given the volume of optional information that would be requested under Section 704B(e)(2)(G), a large percentage of applicants would opt to not provide the information.

Overlap with the Community Reinvestment Act (CRA):
Aside from the issues noted above, the impact of Section 1071 of the Dodd-Frank Act creates redundancies for banks as they are already subject to similar requirements under the Federal Reserve's Community Reinvestment Act (CRA). Like the Equal Credit Opportunity Act (ECOA), the CRA is an established fair lending regulation, in conjunction with the Home Mortgage Disclosure Act (HMDA) and Fair Housing Act. In fact, under "Congressional findings and statement of purpose," the CRA states, "…regulated financial institutions have continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered."[2] Prudential banking regulators perform examinations of banks' compliance with the requirements of the CRA, with exam results publicly available.

While the CRA itself is generally blind to borrowers' personal characteristics such as race, the Federal Reserve Bank of Minneapolis provides a clear explanation of how the CRA interacts with the other fair lending regulations: "An examiner's review of a bank's CRA performance might inform reviews relating to the bank's compliance with fair lending laws and regulations. When examiners are reviewing data about the bank's performance context and lending activity, for example, they might come across data or information that raise fair-lending red flags. Also, they might learn about potential fair lending issues when meeting with members of a bank's local community while conducting the CRA examination."[3] It should also be noted that members of the public have a role in a bank's CRA examination process as they can provide comments to the institution regarding its CRA performance and the comments are taken into account by examiners during a CRA examination.[4]

While the missions of the CRA and Section 1071 of the Dodd Frank Act are similar, the requirements imposed on banks for compliance have nuanced, yet significant, differences. For example, the definition of a small business loan differs between them. Additionally, while both address the borrowing entity's gross annual revenues and census tract data, the requirements for capturing the data differ. Invariably, institutions subject to both regulations will be overburdened with how to implement the "similar-but-different" requirements.

New compliance requirements layered on top of existing similar requirements translate to added costs, whether it be for training, additions to head count, acquiring new software systems, or making changes to existing system specifications, etc. This is in addition to ongoing confusion that may ensue with employees trying to keep the requirements between the two overlapping laws straight. Accordingly, I suggest that consideration be given to exempting financial institutions subject to the Community Reinvestment Act.

The Importance of Crafting a Regulation that can be Understood, Followed, and Measured:
As inferred above, there is little value derived from the data collected by banks subject to requirements of multiple regulations with "similar-but-different" purposes. If banks subject to the CRA are required to comply with Section 1071, the following are questions and potential "pain points" that I request be considered as

[2] The Community Reinvestment Act (12 USC Chapter 30 Section 2901)
[3] Ben Horowitz, Federal Reserve Bank of Minneapolis, "Fair lending laws and the CRA: Complementary tools for increasing equitable access to credit," March 18, 2018, https://www.minneapolisfed.org/publications/community-dividend/fair-lending-laws-and-the-cra-complementary-tools-for-increasing-equitable-access-to-credit
[4] Testimony of Sandra F. Braunstein, Director, Division of Consumer and Community Affairs, Before the Subcommittee on Domestic Policy, Committee on Oversight and Government Reform, U.S. House of Representative, "The Community Reinvestment Act and fair lending examination processes," October 24, 2007, https://www.federalreserve.gov/newsevents/testimony/braunstein20071024a.htm

the implementing regulation is written. These items are addressed as they appear in the Act and are not necessarily based on significance.

1. **Information Gathering:**
   Under Section 704B(b), a financial institution shall inquire whether the business applicant is a women-owned, minority-owned, or small business, without regard to whether such application is received in person, by mail, by telephone, by electronic mail or other form of electronic transmission, or by any other means, and whether or not such application is in response to a solicitation by the financial institution; and maintain a record of the responses to such inquiry, separate from the application and accompanying information.

   While the process of collecting the required data appears simple as described, the method to actually obtain the data seems complex when combined with Section 704B(e)(2)(G). For example, if a financial institution receives a business application, it must first ask if the applicant is a minority-owned, women-owned, or small business. If any of the boxes are checked, a follow up question must be asked to solicit the demographic information of the principal owners.

   At this point, it is not clear how "principal owner" is defined, therefore for consistency purposes: 1) it should be defined in the regulation (and hopefully in consideration of the beneficial ownership requirements under the BSA/AML requirements) and 2) the definition of principal owner will need to be spelled out to the applicant. What happens though if, for simplicity sake, only a portion of the principal owners provide data? Would the rest be shown as not provided? Example, application indicates small business with four principal owners – A, B, C, and D; however, demographic information was only provided by A and B. Would the entry be A and B's information only; A and B along with "not provided" for C and D's or would the whole entry be considered "not provided" as complete information was not provided?

   Additionally, as discussed in the "Value of Data Collected" section above, I believe there may be an inadvertent lack of value in the data requested if it only represents a subset of the owners of a business.

2. **Right to Refuse:**
   Under Section 704B(c), any applicant for credit may refuse to provide any information requested pursuant to subsection (b) in connection with any application for credit.

   While this does appear fair, as the omission of requested information will not have any impact on the credit decision, the issue with this is that it sets up a real opportunity to have unreliable data should a material population of applicants choose to not provide the requested information.

   For this, we can look to HMDA, which has a similar provision. That is, in attempting to interpret HMDA data for fair lending purposes, it is difficult to assess whether discriminatory practices may exist as in many cases, key information, such as the race and ethnicity of the applicant(s) are missing. For example, per the CFPB's recent issuance regarding 2018 HMDA data, it was noted that for first lien 1-4 family owner occupied site-built homes, race and ethnicity data was missing on 12% of home purchase loans and 16%

of refinanced loans[5]. As the information is missing from an arguably material number of entries, it is questionable as to whether reported data is reliable enough to make inferences upon.

It should be noted that the figures above do not reflect race and ethnicity information provided by loan officers who entered information based on their best guess when an applicant chose not to provide it.

My concern is that if a material amount of data is not provided, a user of the data may not have sufficient information to ascertain whether discriminatory practices exist.

3. **No Access by Underwriters:**

Section 704B(d) states, "Where feasible, no loan underwriter or other officer or employee of a financial institution, or any affiliate of a financial institution, involved in making any determination concerning an application for credit shall have access to any information provided by the applicant pursuant to a request under subsection (b) in connection with such application." It also states, "If a financial institution determines that a loan underwriter or other officer or employee of a financial institution, or any affiliate of a financial institution, involved in making any determination concerning an application for credit should have access to any information provided by the applicant pursuant to a request under subsection (b), the financial institution shall provide notice to the applicant 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."

At this time, it does not appear that any financial institution, particularly a community bank, will be able to compartmentalize the data to shield it from an underwriter, but make it accessible for a loan officer, auditor, etc., to collect, record, and validate the information. My recommendation would be to implement the required use of a notice to applicants indicating that an underwriter may have access to the information and that the financial institution may not discriminate on the basis of such information.

4. **Form and Manner of Information:**
   a. **Covered Applications:**

Under, Section 704B(e)(1), for an application to a women-owned, minority-owned, or small business, various information shall be compiled and maintained. Based on this, it appears that information on women-owned and minority-owned entities will be compiled regardless if the business is a small business, which is contrary to the name of the section of the Act ("*Small Business Data Collection"*).

As such, it presents challenges for financial institutions to gather this information from large entities, such as publicly held companies. For example, at time of application, does a public entity have sufficient data to indicate if the majority of its shareholders are women or minorities?

It is also unclear whether entities such as non-profit organizations would fall under the data collection requirements. They do not have "owners" as publicly and privately owned businesses have.

[5] Consumer Financial Protection "Bureau Data Point: 2018 Mortgage Market Activity and Trends, A First Look at the 2018 HMDA Data," August 2019, https://files.consumerfinance.gov/f/documents/cfpb_2018-mortgage-market-activity-trends_report.pdf

b. Type of Action Taken:

Under Section 704B(e)(2)(D), the type of action taken shall be indicated and reported in an annual filing. While this sounds straightforward, this is a "pain point" with institutions that must comply with the Home Mortgage Disclosure Act (HMDA or Regulation C), particularly as it pertains to applications that did not result in origination.

For example, under HMDA, it is often difficult to pinpoint if an application should be considered "withdrawn" or "approved not accepted". This may entail back-tracking through emails and client communication logs to see if the client communicated the desire to withdraw the application before the underwriting department approved the request. Similarly, there are cases when it is not clear whether the application should be considered denied versus withdrawn. This also entails back-tracking through emails and client communication logs to determine whether the applicant expressed its desire to withdraw the request before the decision to deny the request was made.

c. Place of Business:

Under Section 704B(e)(2)(E), census tract data of the principal place of business shall be collected and reported. This is another case in which the requirement sounds rather straightforward. However, the requirement is "similar, but different" to the Community Reinvestment Act. Under the CRA, reporters generally collect census tract data on the location of the loan (i.e., where the loan proceeds will be used).

While entities can provide training on the differences between the two regulations to its data collectors, this will likely translate to increased error rates for entities with manual application processes. While streamlined/automated application processes may mitigate the chance for error, implementing such a process would be a costly endeavor for the institution. Further, reporting on the location of where the proceeds will be used would be a better attribute for regulators and communities to use in identifying the business and community development needs and opportunities of women-owned, minority-owned, and small businesses.

d. Gross Annual Revenues:

Under Section 704B(e)(2)(F), data shall be collected and reported on a covered applicant's gross annual revenues (GAR) in the last fiscal year preceding the date of application. At first blush, this seems to be another straight-forward requirement. However, depending on how the law is written, it may become ridden with nuances and exceptions that could result in a complex set of data collection requirements.

For example, how should GARs be reported for applications taken in January or February and the applicant does not have its financials audited or tax returns prepared? Will it be sufficient to report on stated revenues?

On the "similar, but different" theme, under the CRA, large bank reporters report the GARs that were relied upon.

Additionally, unlike with HMDA in which the exact gross annual income amount is reported (rounded to the nearest thousand), under the CRA, GAR are categorized into one of three "buckets": 1) $1MM and under, 2) over $1MM, and 3) not known/not relied upon.

Under HMDA, technical violations may be cited for immaterial deviations from the gross annual income of record (e.g., borrower's income was $27,600 and was reported as 27 versus 28). This is problematic under HMDA and would be the same for 1071 if the same reporting and rounding conventions are used.

It should be pointed out that even though CRA has a different approach to reporting revenues, it is not without its own set of problems. For example, how should GAR be reporting on a newly formed business, particularly when the entity applying for the loan is buying an existing business?

e. Race, sex, and ethnicity of the principal owners of the business:

Under Section 704B(e)(2)(G), race, sex, and ethnicity of the principal owners of the business shall be requested. While this section has already been discussed in this document, it raises an additional question for me.

What about "cross-pollination" of data between loans? For example, Applicant A applies for a home mortgage and race/sex/ethnicity information is reported; what if that individual applies for a small business loan and he/she is the principal owner and he/she chooses not to provide the requested demographic information? Can the financial institution pull in the information obtained from the mortgage loan?

5. No personally identifiable information:

Under Section 704B(e)(3), in compiling and maintaining any record of information under this particular section, "…a financial institution may not include in such record the name, specific address (other than the census tract required under paragraph (1)(E)), telephone number, electronic mail address, or any other personally identifiable information concerning any individual who is, or is connected with, the women-owned, minority-owned, or small business loan applicant." While the privacy aspect of this requirement is appreciated, it could impede data validation efforts.

Conclusion:

The rulemaking for Section 1071 of the Dodd-Frank Act is a daunting challenge, to say the least. To help meet the intent of the law and provide ample opportunity to successful data collection and reporting, it is recommended that the CFPB contemplate the added burden to entities, specifically banks, as they are currently subject to "similar-but-different" fair lending regulations. Irrespective of which entities are subject to these requirements, it is recommended that the Bureau consider implementing the regulation in an iterative rulemaking process with beta-entity participants, representative of the various entities that would be covered under the regulation, to provide feedback on vague and/or complex requirements.