

CFPB Finalizes Section 1071 Small Business Lending Data Rule*

Dodd-Frank Act Section 1071 amended the Equal Credit Opportunity Act to require financial institutions to compile, report, and maintain specified information regarding certain women-owned, minority-owned, or small business loan applicants, in accordance with regulations to be issued by the CFPB. After a long wait, on September 1, 2021, the CFPB issued its proposal to implement Section 1071 (“Proposed Rule”), and then (finally) finalized the rule on March 30, 2023 (the “Final Rule”).

Covered Financial Institutions. The Final Rule would only apply to financial institutions that originate at least 100 credit transactions in each year of the preceding two calendar years that result from covered applications. Note that under the Proposed Rule the threshold was 25 credit transactions originated in each year of the preceding two calendar years, and the increase under the Final Rule is a welcome change.

Covered Credit Transactions. The Final Rule requires covered institutions to collect data in connection with covered credit transactions with small businesses. The Final Rule defines a small business as a business with \$5 million or less in gross annual revenue for its preceding fiscal year. Covered credit transactions include business-purpose loans, lines of credit, credit cards, and merchant cash advances. There are some exceptions to the definition of covered credit transactions, such as HMDA-reportable transactions (which was added in the Final Rule), insurance premium financing, trade credit, and others.

Reportable Data. The Final Rule requires covered financial institutions to compile and report certain data points for reportable applications received from a small business, which include an oral or written request for a covered credit transaction made in accordance with procedures used by the financial institution for the type of credit requested. There are exceptions to what applications qualify as “reportable applications,” such as reevaluation requests and extension requests (unless the request seeks additional credit or line increases), inquiries, and prequalification requests, etc.

For all reportable applications, the data points that would need to be compiled and reported include (among others):

- A unique identifier;
- The application date, method and recipient;

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- The action (and the date of the action) taken by the financial institution on the application, and denial reason (if applicable);
- Credit type, purpose and amount;
- A census tract based on an address or location provided by the applicant;
- Gross annual revenue for the applicant's preceding fiscal year;
- The applicant's minority-owned business status, women-owned business status, and LGBTQI+-owned business status; and
- The applicant's principal owners' ethnicity, race, and sex (note that the Final Rule removes the proposed requirement for lenders to determine principal owners' race and ethnicity based on visual observation and last names for in-person applications).

“Firewall” Requirements. The Final Rule requires a covered financial institution to build a “firewall” to prohibit those participating in the credit decision from having access to the applicant's responses regarding whether the small business is women-owned or minority-owned, and the principal owner's race, ethnicity, and sex.

Effective Date and Compliance Date. The Final Rule will be effective 90 days following the Final Rule's publication in the Federal Register. As of April 7, 2023, the Federal Register Office had not yet published the Final Rule.

In order to determine when a financial institution must begin complying with the Final Rule, a financial institution must determine the applicable compliance date tier. Generally, the compliance date tiers in the Final Rule differ depending on the number of covered originations that a financial institution originated in 2022 and 2023. Additionally, in order to be required to comply with the final rule in a given year, a financial institution must be a covered financial institution (as discussed above) for that year. In brief, the earliest compliance date will be October 1, 2024 for financial institutions that originated at least 2,500 covered originations in both 2022 and 2023, with delayed compliance dates in 2025 and in subsequent years depending on the number of originated covered transactions each year.

Tools and Guidance. The CFPB has also issued materials and tools to assist financial institutions in complying with the Final Rule.

The Final Rule and the additional materials and tools that the CFPB have issued to assist financial institutions comply with the Final Rule may be found on the CFPB's website at <https://www.consumerfinance.gov/1071-rule/>.

We will discuss the Final Rule in much more depth during the May 19, 2023 BCG Monthly Telephone Briefing for BCG members.