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CFPB Finally Issues Section 1071 Small Business Lending Data Proposal

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 finally issued its proposal to implement Section 1071.

Covered Financial Institutions. The proposed rule would only apply to financial institutions that originate at least 25 credit transactions in each year of the preceding two calendar years that result from covered applications. If a financial institution was one of multiple financial institutions involved in a credit transaction, then only the financial institution who made the decision to approve the application would count as the originating financial institution. The CFPB is not proposing an exemption based on an institution's asset threshold (which the industry was desperately hoping the agency would do).

Covered Applications. The proposed rule would require covered institutions to collect data in connection with covered applications for credit from small businesses. The proposed rule would define a small business as a business with \$5 million or less in gross annual revenue for its preceding fiscal year. Covered applications would include applications for business-purpose loans, lines of credit, credit cards, and merchant cash advances. If a credit application requests reevaluation, extension, or renewal on an existing business credit account, the request would not be a covered application under this proposal (unless the request seeks increased credit). Also, as proposed, inquiries and prequalification requests would not be covered.

Reportable Data. The proposed rule would require covered financial institutions to compile and report 21 data points including the type of credit applied for, the amount of credit applied for, the amount of credit approved or originated, and whether the application was approved or denied (and the reason for denial if denied). Pricing information regarding the credit would also have to be reported – including the interest rate, total origination charges, broker fees, additional costs for merchant cash advances or other sales-based financing, and prepayment penalties. Covered institutions also would have to report specific information regarding the applicant's principal owners – the race, ethnicity, and sex of small business owners as well as other basic business data, such as the business's annual revenues from its prior fiscal year, the number of non-owner workers, and the time the applicant has been in business.

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If a small business applicant is a minority-owned or women-owned small business, then the covered institution would have to report that information as well. The proposed rule would define a “minority-owned business” as a business for which more than 50 percent of its ownership or control is held by one or more minority individuals, and more than percent of its net profits accrue to one or more minority individuals. The proposed rule would define the term “women-owned business” as a business for which more than 50 percent of its ownership or control is held by one or more women, and more than 50 percent of its net profits accrue to one or more women. As drafted this could mean that a small business applicant could be both minority-owned and women-owned, where the female owners are themselves minorities and they meet or exceed all of the 50 percent thresholds.

“Firewall” Requirements. If adopted, the rule would require 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 ethnicity, race and sex. The proposal includes one exception to this “firewall” requirement. That exception would apply if the “firewall” is infeasible and the financial institution notifies the applicant that employees involved in making the credit decision will have access to that data.

Reusing and Reporting Data. Under the proposal, covered financial institutions would be able to rely on the statements an applicant provides. Additionally a covered financial institution could rely on data it previously collected from an applicant and reuse it to satisfy the data collection requirements if it collected the data in the same calendar year as the application was received and the institution has no reason to believe the previously collected data are inaccurate. The institution would have to report annually the required data it collects during a calendar year to the CFPB by June 1 of the following calendar year.

Effective Date. The rule will be effective 90 days following the final rule’s publication in the Federal Register, with compliance required 18 months following that publication date. Comments on this proposed rule are due 90 days after the proposed rule is published in the Federal Register. As of September 2, the Federal Register Office had not published the proposed rule. We will discuss this proposed rule in more depth during the November 19, 2021 BCG Monthly Telephone Briefing.