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September 8, 2017

VIA ELECTRONIC SUBMISSION

Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, D.C., 20552

Re: Comments on Request for Information Regarding the Small Business Lending Market, Docket No. CFPB–2017-0011

The Electronic Transactions Association ("ETA") submits these comments in response to the Consumer Financial Protection Bureau's ("CFPB" or "Bureau") request for information regarding the small business lending market. ETA supports fair lending and increased access to credit for small businesses, including women-owned and minority-owned. ETA appreciates the Bureau's commitment to weighing any benefits of a future proposed rule against the costs associated with instituting new data collection for small business lenders.

ETA is the leading trade association for the payments industry, representing over 500 companies that offer electronic transaction processing products and services and service all parts of the payments ecosystem. ETA's members include non-bank online lenders that make commercial loans primarily to small businesses, financial institutions, financial technology ("FinTech") companies, mobile payment service providers, and mobile wallet providers. ETA member companies are creating innovative offerings in financial services, revolutionizing the way commerce is conducted with safe, convenient and rewarding payment solutions and lending alternatives.

Executive Summary

- *ETA and its member companies support fair lending and are committed to the principles of expanded credit for all.*
- *For many lenders, this data collection would include many new data fields which are not currently collected. The addition of new collections of information will have significant effect on operations and affect the user experience for the borrower.*
- *Section 1071 was designed to help fill the credit gap and was not designed to be a punitive measure or drive punitive actions.*
- *Section 1071 mandates specific statutory data points be collected. These data points are the only ones that should be collected. The CFPB should not use additional discretionary authority to collect additional data points beyond what is statutorily mandated.*
- *This data collection is not HMDA: The small business lending landscape is different from the mortgage landscape.*
- *This rulemaking should provide for exclusions for brokers as they are not lenders.*
- *There are costs associated with any data collection which must be weighed against the benefits for all parties involved including lenders and borrowers.*

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GENERAL COMMENTS

Small businesses are core to America's economic competitiveness. Small businesses employ half of the nation's private sector workforce – about 62 million people – and since 1995 they have created approximately 60 percent of the net new jobs in our country. The number one barrier to growth faced by small businesses is access to financing.[1]

The small business lending industry is responding to the demand for access to credit by small businesses and filling a need for technology-based credit solutions. Small businesses that take advantage of these technology platforms can focus more of their time and effort on growing their businesses, hiring workers, and positively affecting the economy.

Considering the tangible benefits of such technological advancements, ETA urges policymakers to remain thoughtful and forward-thinking in how to best support industry's on-going efforts to provide opportunities for all consumers and small businesses to access and benefit from innovative financial products and services. Efforts by policymakers to regulate financial products and services should be done collaboratively with industry participants and with careful consideration of the many types of business models and products in the marketplace. ETA stands willing to work with the Bureau to create a positive regulatory environment for small business lenders and their borrowers.

ETA and its members support an inclusive financial system that provides high quality, secure, and affordable financial services for the broadest possible set of consumers and small businesses. ETA member companies touch, enrich, and improve the lives of underserved communities while making the global flow of commerce possible. A goal of ETA member companies is to continually enhance the electronic payments and financial ecosystem so that it is accessible for all customers and small businesses, while ensuring their transactions can be completed securely, efficiently, and ubiquitously. A key driver to achieving such an ecosystem is the development of new technologies that allow the underserved to access financial products and services. ETA encourages policymakers to support these goals through policies that support innovation and the use of technology in financial products and services.

Types of Business Models for Small Business Financing

There are many business models in the marketplace that help to provide access to financing for small businesses. They include financial institutions and online small business lenders, as well as non-lender businesses such as brokers and merchant cash advance companies.

[1] International Labour Office, *Small and Medium Sized-Enterprises and Decent and productive Employment Creation,* Report IV, 2015; WEF, *What Companies Want from the World Trading System,* 2015.

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Traditional Small Business Lending (Financial Institutions)

Financial institutions have traditionally been the primary source of small business financing. For example, the overwhelming majority of small and mid-sized businesses report that commercial retail banks (regional or community) are their primary financial institutions.[2] Bank credit is a significant source of external financing for small businesses and provides the largest market share of lending to small business. Bank credit is used by small businesses to maintain cash flow, hire new employees, purchase new inventory or equipment, and grow their business. While online lenders and other new entrants are innovating and gaining market share, the vast majority of loans still come from banks.[3]

Online Small Business Lenders

Many online small business lenders share a number of similarities that include:

- Providing borrowers with fast access to credit that rely on existing data streams rather than a lengthy form process, often providing funding decisions within 48 to 72 hours and in certain instances, as few as 7 minutes.
- Offering small loans with short-term maturities, between 6 and 18 months, although some offer loans up to 36 months.
- Using automated online loan applications (either with data they already have on the customer or data that the customer provides them) and have no retail branches.
- Utilizing electronic data sources and technology-enabled underwriting models to automate processes such as determining a borrower's identity or credit risk. The data sources used include traditional underwriting statistics, but also real-time business accounting, payment and sales history, online small business customer reviews, and other non-traditional or alternative data.[4]

While online small business lenders have many different types of business models, two major business models have emerged.

The first type of primary business model for online small business lenders is a state licensed lender. State licensed lenders originate loans and are generally required to obtain licenses or register with individual states in which they lend. State licensed lenders do not rely on depository institutions to originate loans, but rather make loans themselves and either hold those loans in their own portfolios and rely on capital sources including credit facilities, whole loan sales, and securitizations to fund originations.

[2] Arthur B. Kennickell, Myron L. Kwast, and Jonathan Pogach, *Small Businesses and Small Business Finance during the Financial Crisis and the Great Recession: New Evidence from the Survey of Consumer Finances*, 2015.
[3] Karen Gordon Mills and Brayden McCarthy, *State of Small Business Lending: Innovation and Technology and the Implications For Regulation*, Working Paper 17-042, p.5 (2016).
[4] *See* U.S. Department of Treasury, *Opportunities and Challenges in Online Marketplace Lending*, p.5 (May 10, 2016).

The second type of primary business model for online small business lenders is the bank partnership or platform lender model. Platform lenders partner with an issuing depository institution to originate loans and then purchase the loans for sale to investors as whole loans or by issuing securities such as member-dependent notes. In this model, the issuing depository institution originates loans to borrowers that apply on the online platform. The loans are subsequently held by the issuing depository institution for a period of time (typically 1-21 days) and then purchased by the platform lender or directly by an investor through the platform.

Under the bank partnership model, platform lenders are not true lenders because they do not originate the loans. Rather platform lenders are more akin to a technology vendor than a lender. They are also regulated as technology vendors. For example, an online platform lender that meets the statutory definition of a bank service company or a third-party service provider to one or more depository institutions would be subject to the regulation and examination authority of the relevant federal banking agencies under the Bank Service Company Act.[5]

As the market develops and becomes more mature, both state licensed lenders and platform lenders are altering these frameworks to allow more flexibility to provide credit to small businesses. Some state licensed lenders have developed hybrid models, selling some whole loans to institutional investors while retaining servicing responsibilities. The combination of data-driven underwriting, automated and online operations, a lack of legacy systems, and investor capital has allowed online small business lenders to make third-party arrangements to fill a need in the small business lending market.

Non-Lender Business Financing

The small business financing market has a number of participants who help to provide small businesses with access to funding by matching them with lenders (Brokers) or by providing a variety of financing options (Merchant Cash Advance). These non-lenders should not be subject to 1071 data collection requirements.

<u>Brokers</u>

Brokers may perform a variety of services, including assisting borrowers to identify potential financing options, generating leads for lenders, and assisting in the application process. There are a few types of broker business models in the market today, but the common thread among brokers is that **<u>they do not make credit decisions on credit applications</u>**. This important distinction will be discussed in more detail later in this letter.

One prominent broker model is the marketplace matchmaking platform model. Marketplace brokers provide a portal where small business borrowers can go to use the resources and partnerships of the broker to help borrowers with all aspects of getting a loan. In many cases, the borrower fills out (or at times, the company pre-fills on the borrower's behalf such as by using data from their financial management software) an application then is given a choice of financing

[5] 12 U.S.C. §§ 1861-1867.

available from a variety of lenders. The credit decisions and financing is made by independent, third party lenders including traditional lenders, non-traditional lenders, and SBA-approved lenders. Those participating lenders offer term loans, SBA loans, lines of credit, and small business credit cards. Additionally, other types of financing like merchant cash advance or invoice financing may be available. The criteria is established by the participating lender on the platform to give a borrower a clear understanding of the range of financing options available to them. The borrower chooses their preferred choice of loan product and lender and the broker forwards the application information to the lender. The lender makes the credit decision on the application.

Marketplace brokers often serve as highly valuable price and product comparison tools for small businesses. Marketplace brokers play a key role in helping to match borrowers and their individual credit needs to lenders that can provide products which meet those credit needs.

Merchant Cash Advance

Merchant cash advances ("MCAs") are not loans, but rather, they are a sale of a portion of future credit and/or debit card receivables. It is settled law and was recently confirmed by a New York Supreme Court in a published MCA case where the court ruled that the transaction is not a loan and asking the court to convert an agreement to sell future receivable into a loan agreement "would require unwarranted speculation."[6]

MCA companies provide funds to businesses in exchange for a percentage of the businesses' daily credit card income, directly from the processor that clears and settles the credit card payment. A company's remittances are drawn from customers' debit and credit-card purchases on a daily basis until the obligation has been met. Many providers of merchant cash advances form partnerships with payment processors and take a percentage of a merchant's future credit card sales. MCAs offer an alternative to businesses who may not qualify for a conventional loan and provide flexibility for merchants to manage their cash flow by fluctuating with the merchant's sales volume.

The distinguishing characteristic of a MCA is that there is no fixed scheduled payment amount or term. When the merchant makes a sale, and is paid by credit card, a percentage of the transaction is forwarded to the MCA provider. This continues until the total amount of purchased receivables has been paid. The MCA provider receives the purchased receivables in one of the following ways: (i) the merchant's processor forwards the purchased receivables directly to the funder; (ii) the merchant's receivables are deposited into a lockbox account that forwards the purchased receivables to the funder and remits the balance to the merchant; or (iii) the funder is notified of the amount of the credit card receivables generated and the funder debits the purchased portion from the merchant's bank account.

For many small businesses, a MCA is an alternative to a traditional commercial loan because MCAs do not require personal guarantees from the business owner. The performance guarantee

[6] *Platinum Rapid Funding Grp. Ltd. v. VIP Limousine Servs., Inc., No. 604163-15, 2016 BL 275403, (Sup. Ct. June 08, 2016).*

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of a MCA only requires that the owner ensure that the business entity complies with all of the terms and conditions of the MCA agreement.

Regulatory Harmony

ETA and its members support fair lending and have extensive compliance programs in place to address these important issues. Today, laws around discrimination, unfair practices and privacy are already being applied to commercial lenders. In fact, commercial lenders are heavily regulated entities. The Federal Trade Commission enforces restrictions on unfair or deceptive acts or practices. The Securities and Exchange Commission ("SEC") enforces various securities laws applicable to the lenders that sell loans, notes, or interest in securities loans. The Federal Banking Regulators regulate, supervise, and examine issuing banks and their platform-lending partners. The Financial Crimes Enforcement Network ("FinCEN") enforces the Bank Secrecy Act and anti-money laundering requirements. The Bureau enforces the Equal Credit Opportunity Act ("ECOA") and the Fair Credit Reporting Act, which contains requirements applicable to commercial credit. The Small Business Administration administers the Small Business Act and the Small Business Investment Act. On the state level, financial regulators and state attorneys general enforce lender licensing and usury laws. Additionally, platform lenders that partner with banks are subject to Federal Deposit Insurance Corporation requirements and much of the technology that is used by those online lenders is also examined by the Office of the Comptroller of the Currency.

One example of a regulatory requirement that the CFPB should consider when attempting to provide regulatory harmony with any future rule is the FinCEN beneficial ownership rule. FinCEN has recently finalized a beneficial ownership rule, which requires financial institutions to identify and verify the identity of beneficial owners of legal entity customers, subject to certain exclusions and exemptions. When requiring new data collection, the CFPB should work to minimize implementation challenges and duplicative requirements.

Additionally, the Bureau should listen to and carefully consider thoughts on this rule from other regulatory agencies with jurisdiction over small business lending and the economy. For example, a recent Treasury Report recommended the repeal of the application of Section 1071 of the Dodd-Frank Act stating, "Although financial institutions are not currently required to gather such information, many lenders have expressed concern that this requirement will be costly to implement, will directly contribute to higher small business borrowing costs, and reduce access to small business loans. The provisions in this section of Dodd Frank [1071] pertaining to small businesses should be repealed to ensure that the intended benefits do not inadvertently reduce the ability of small businesses to access credit at a reasonable cost."[7]

ETA encourages the CFPB to be sensitive to the risk that additional regulation in this space will ultimately prevent expansion of credit to those not currently served and provide a roadblock on future innovation. ETA encourages the CFPB to take a thoughtful approach to drafting a rule to implement Section 1071. This includes working with industry and other regulators to ensure that

[7] U.S. Department of Treasury, *A Financial System That Creates Economic Opportunities*, p. 108 (June 12, 2017).

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any data collection regarding business lending is done so in a way that minimizes the regulatory confusion possible with so many regulators in this space.

Small Business Lending Is Different Than Consumer Lending

It is imperative that the Bureau not conflate consumer lending with small business lending. Commercial and consumer credit are distinctly different types of credit. Small business borrowers have different needs and objectives in obtaining credit than consumers – often relying on financing to buy inventory, smooth cashflow, and expand their marketing. Small businesses are the backbone of the economy and providing them with that financing enables them to continue to grow. Small business lenders have developed credit products specifically designed to answer those needs and objectives. For example, the length of a small business loan is often measured in months rather than years. ETA cautions that a regulatory approach that would simply apply existing requirements for consumer lending to small business loans would have detrimental effects for both online small business lenders and the small business community.

The use of funds, rather than the dollar amount of the loan, should determine whether consumer-lending laws should apply to a loan. Many of ETA's members provide loans to their customers that average less than $25,000. Small businesses often are looking for small amounts to get them through a period of time (i.e., to cover payroll) or to fund a specific activity (i.e., a new marketing campaign). ETA supports a system that provides small business borrowers with clear information on their rights and responsibilities. The conflation of commercial and consumer credit risks adversely affecting the borrowers' personal cost of borrowing if commercial trade lines are entered as consumer transactions in a credit report. It means that a failed business operation would impede an individual's ability to borrow for commercial or consumer purposes in the future.

While ETA supports transparency in small business credit, we encourage the CFPB to be sensitive to the prospect that enhanced regulation may limit lenders' ability to answer such needs by stifling creativity and innovation. For these reasons, ETA encourages the Bureau to avoid conflating consumer lending with small business lending.

Online Small Business Lending Addresses the Needs of the Underserved

According to a recent study, online small business lending products have the potential to boost economic activity in the U.S. by approximately $698 billion or 3.98 percent of the country's GDP.[8] Small businesses are the backbone of the American economy, creating more than 60 percent of net new jobs and employing approximately half of the workforce in the private sector.[9] Unfortunately, many small businesses are unable to access traditional credit for purposes of growing their

[8] Filling the Gap, Usman Ahmed, Thorsten Beck, Christine McDaniel, Simon Schropp, *Innovations*, Volume 10, number 3/4, p. 36 (2016).
[9] Federal Reserve Banks of New York, Atlanta, Cleveland and Philadelphia, *Joint Small Business Credit Survey Report*, 2014 at p. 4 (released February 2015); Karen Gordon Mills, Brayden McCarthy, *The State of Small Business Lending: Credit Access During the Recovery and How Technology May Change the Game*, Harvard Business School Working Paper 15-004 (July 22, 2014) at p. 3.

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businesses due, in part, to high search, transaction, and underwriting costs.[10] Fortunately, for small businesses, ETA's members and other innovative FinTech companies are expanding access to credit using both traditional data sources and non-traditional data sources such as past transactions and back-end financial data (taxes, receivables, etc.). Modern modeling techniques enable lenders to better understand the credit risk of an individual small business and provide it with targeted funding in a timely manner with a flexible repayment schedule, and often without requiring collateral.

Online small business lenders are willing to provide small businesses with small loan (typically less than $250,000 – and in fact, often less than $30,000) and short terms that are well suited for their day–to–day operating needs or short-term use cases. Using sophisticated, data-driven algorithms to assess the creditworthiness of potential borrowers, lenders are able to reach funding decisions quickly and efficiently and provide access to capital to approved borrowers expeditiously.[11]

These data-based processes are creating new opportunities for borrowers and lenders. The platforms used by ETA members are agile, nimble, scalable, and can work in tandem with related financial service offerings. For example, online small business lending programs can be synced with payment platforms to assist in underwriting decisions in nearly real-time, and provide convenient repayment options for small businesses. FinTech platforms have also been used by Community Development Financial Institutions ("CDFIs") and other non-profit community lenders and development organizations to help increase efficiency in the lending process and identify creditworthy small businesses.

In addition to partnerships with CDFIs, online small business lenders are collaborating with financial institutions to provide small business loans. Because online platforms and systems provide a very efficient and cost-effective mechanism for underwriting smaller commercial loans, FinTech companies can provide a valuable service to traditional financial institutions to expand market reach either by partnerships or white labeling products for traditional financial institutions. For example, JPMorgan Chase uses the OnDeck digital platform to service its small business customers. The loans are Chase-branded, held on Chase's balance sheet, and made using Chase's underwriting criteria,[12] and OnDeck provides technology enablement to support the delivery of Chase's product. What was once a process that could take up to one month for approval now is digital and Chase small business clients can now apply in minutes, decisioning occurs in seconds, and funds are received the same or next-day. This reduction in processing time is a valuable benefit for customers who need quick and affordable access to capital to grow their small businesses.

Another example of innovation in the online small business lending space is PayPal Working Capital ("PPWC"). In late 2013, PayPal, Inc. and WebBank launched PPWC, which enables

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[10] 80 Fed. Reg. 42866, 42867 (July 20, 2015).

[11] State of Small Business Lending at p. 6-7; Scott Shane, *Why Small Businesses Are Turning To Online Lenders* (April 15, 2015), available at http://www.entrepreneur.com/article/245075.

[12] Kevin Wack, *Chase Quietly Launches Its Online Small-Business Loan Platform*, American Banker, (April 12, 2016), http://www.americanbanker.com/news/marketplace-lending/chase-quietly-launches-its-online-small-business-loan-platform-1080382-1.html.

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PayPal merchants to apply for and obtain closed-end loans quickly. These loans charge a single fixed fee, have no periodic interest or maturity date, no late payments, and are repaid through a percentage of the merchants' PayPal sales. In May 2017, PayPal announced that the product had reached $3 billion in funding to entrepreneurs in the U.S., United Kingdom, and Australia. Nearly 35 percent of PPWC loans go to low and moderate-income businesses, compared to 21 percent of FI loans, and more than 61 percent go to entrepreneurs and businesses owned less than five years.

Section 1071

Section 1071 of the Dodd-Frank Act amends ECOA to include an information collection component to facilitate fair lending to women-owned, minority-owned, and small businesses and to identify business and community development needs and opportunities of such businesses. The purpose of 1071 is to "enable communities, governmental entities, and creditors to identify business and community development needs and opportunities for women-owned, minority-owned, and small businesses."[13] ETA supports fair lending and expanding opportunity for women-owned, minority-owned, and small businesses to access credit.

Section 1071 was designed to help fill the credit gap and was not designed to be a punitive collection mechanism or to drive punitive actions by regulators or plaintiff lawyers. As the saying goes, "If you torture the data long enough, it will confess to anything." Adding any additional data collection, as this rulemaking is likely to do, will present implementation and operational challenges and increase the litigation and reputational risk associated with additional data collection. The Bureau must be vigilant in weighing the costs associated with data collection against the benefits. As the Bureau acknowledges, "…certain financial intuitions may not be collecting and reporting information regarding small business lending in connection with other regulatory requirements and therefore a new data collection could pose implementation and operational challenges."[14] ETA encourages the Bureau to also consider litigation and reputational risk associated with additional data collection.

Gathering information such as whether it is a minority-owned or a woman-owned small business can create operational challenges – as well as application challenges for the borrowers. Many will be asked to self-report – which can present challenges if there are multiple owners of the small business and/or if the co-owner of the business is the other's spouse. ETA recommends that the Bureau provide guidance for self-reporting that all of the industry can use in their products. Alternatively, we would recommend requiring registration of this data with the Secretary's of State, when they register their small business. In doing so, small business lenders could verify this data with the State, rather than asking the small business for additional information during the application process – something that may either slow down or confuse the borrower during the application itself.

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[13] *12 U.S.C. 1691c-2(a).*
[14] RFI P. 22319.

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Scope of 1071 – Exemptions (Brokers)

Section 1071 of the Dodd-Frank Act amends ECOA to include an information collection component to facilitate fair lending to women-owned, minority-owned, and small businesses and to identify business and community development needs and opportunities of such businesses.

Small business lending commonly involves multiple entities in the process, including marketplaces, brokers, lending platforms, banks or other loan originators, and other services providers. ETA recommends that the CFPB identify one party within the lending chain – namely the party making the credit decision to report the data. Requiring multiple entities within the process to be covered by the reporting obligations would cause confusion and would distort the results of the captured information.

Section 1071 applies to financial institutions, but should be implemented narrowly to have the greatest effect for the least amount of burden on lenders as well as borrowers. Numerous business models exist within the small business lending ecosystem. While Section 1071 clearly applies to "lenders," it should not be applied to other businesses that act as intermediaries between borrowers and lenders such as brokers. The Dodd-Frank Act provides the CFPB with authority to prescribe the scope of Section 1071 as necessary and appropriate.

Brokers should not be held to the same reporting standards as small business lenders because they are not "lenders." Brokers may perform a variety of services, including assisting borrowers to identify potential financing options, generating leads for lenders, and assisting in the application process, but they ***do not make credit decisions*** on credit applications.

Section 1071 of the Dodd-Frank Act contains similarities to the information collection function of the Home Mortgage Disclosure Act ("HMDA") reporting requirements. Like mortgage brokers who are ***exempt from HMDA*** reporting requirements for loans where they do not make a credit decision regarding the loan application,[15] brokers should be exempt from similar reporting under Section 1071 where they do not make credit decisions.

HMDA applies to brokers that receive loan applications and make credit decisions to ensure that relevant data is captured even in a situation where the broker rejects an application before a lender receives it. Here, because brokers do not make credit decisions or reject borrowers, all relevant information can be obtained from lenders.

Some brokers will not even have access to the type of information discussed in Section 1071, such as application information, type and purpose of financing, amount applied for, amount approved, etc. Brokers that perform a more limited lead generation function will often not have access to this information, which will be submitted directly by the borrower to the lender.

In sum, small business lenders that make credit decisions are in the best position to provide reporting under Section 1071 to ensure compliance with ECOA. In fact, if brokers were to collect

[15] Official Interpretation to 12 CFR 1003.1(c).

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and report this information, lenders would also be doing so. That would lead to duplicative and incorrect data reporting. Note that small business lenders are subject to an existing and rigorous federal and state regulatory framework, including ECOA. In addition, many small business lenders partner with traditional banks and financial institutions to fund loans, which subjects them to additional federal regulation.

There are other examples where brokers and other intermediaries are subject to different regulation, licensing, or reporting requirements as members of the underlying industry. These examples reinforce that the CFPB should not attempt to force brokers to meet the same standards as small business lenders.

- A **Business Broker** is a person who assists buyers and sellers of privately held business in the buying and selling process. In 2010, the SEC published a no-action letter outlining the circumstances where a person (Small M&A Brokers) could assist in the sale of a private business in the United States without registering as a broker-dealer under federal law even if the sale involves the sale of securities and transaction-based compensation is paid. The SEC provides exemptions for Small M&A brokers who do not have the power to bind parties to an M&A; do not hold, control, possess or handle any funds or securities related to the M&A Transaction; and have a very limited role in the transactions.

- **Non-Mortgage Loan Broker** - While some states require a license to make commercial loans, very few states require a license to engage in broker or lead generation activities in connection with non-mortgage commercial credit. Similarly, while nearly every state licenses non-mortgage consumer lenders, few U.S. jurisdictions have licenses for non-mortgage consumer loan broker and lead generation activities. Thus, applying Section 1071 only to entities that "make" commercial loans is consistent with state licensing and supervision of the small business loan market.

Definition of Small Business

ETA is sensitive to the challenges of defining "small business" given the number of current definitions under the SBA and the extensive differences between lenders within the industry. There are many factors which are used by different lenders to define small business. Some of those factors include revenue and number of employees. However, there is not a consensus within the industry as to how to define "small business." As the Bureau moves to define "small business" for the purposes of a rule, it is particularly important to provide a definition that is both simple enough that lenders can comply, clear enough that lenders understand their regulatory responsibilities, and flexible enough to meet the changing dynamics of the United States' business community. The definition should not discourage lending to small and women and minority owned businesses, and should place the minimum burden necessary on lenders and borrowers. Additionally, the Bureau should incorporate guidance regarding account entities that are related to the small business applicant such as parent companies, subsidiaries, and affiliates.

While ETA supports transparency in small business credit, we encourage the CFPB to be sensitive to the prospect that enhanced regulation may limit lenders' ability to answer such needs by stifling

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creativity and innovation. When defining small business lending, the Bureau must make clear distinctions between commercial and consumer credit. The products and the markets for each are distinctly different. Small business borrowers have different needs and objectives in obtaining credit than consumers, and small business lenders have developed credit products specifically designed to answer those needs and objectives. For example, small business loans often have much shorter durations than consumer loans. As such, the use of funds should determine whether consumer-lending laws or commercial-lending laws should apply to a loan. The conflation of commercial and consumer credit risks adversely affecting the borrowers' personal cost of borrowing if commercial trade lines are entered as consumer transactions in a credit report. It means that a failed business operation would impede an individual's ability to borrow for commercial or consumer purposes in the future.

It is a fundamental tenet that lenders are able to rely on the identification by borrowers as to whether the loan is a commercial loan or a consumer loan based on their use of funds. This issue arises most often with sole proprietors that may use a combination of commercial loans, personal loans, and credit cards (both commercial and consumer) to fund small or startup companies. The Bureau should provide guidance that reinforces this principal in any proposed and final rulemaking.

The CFPB should also make clear that lenders would not be required to "follow the money" after the loan is made to determine if the borrower is spending the proceeds from the loan on business or personal means. Specifically, that the time in which the loan is deemed commercial or consumer is set at the time the loan is made and the lender may rely on the word of the borrower as to the use of funds. Lenders are not built nor are they readily able to determine how funds are spent after they are dispersed.

The scope of section 1071 should be limited to loans for commercial and industrial purposes to business entities where the revenues from the on-going business operations of the business enterprise is the primary source of repayment of the loan. ETA urges the Bureau to provide specific guidance for lenders regarding which products would not be considered business loans for data collection purposes. A clear distinction between what is commercial and consumer is important for clarity for both the lenders and the data itself.

Specifically, section 1071 should not apply to the following loan types:

- Loans primarily for personal, family and household purposes.
- Loans secured by real estate other than loans secured by owner-occupied commercial real estate where the primary source of repayment is the cash flow from the ongoing business operations of the owner/operator or an affiliate of the owner of the real estate.
- Consumer credit cards.
- Home equity lines of credit (HELOCs)

Data Points

Section 1071 specifies particular data points that financial institutions must compile, maintain, and submit annually to the Bureau. Those data points include the following:

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- Application number
- Application date
- Type and purpose of financing
- Amount applied for
- Amount approved
- Type of action taken and action taken date
- Census tract of the principal place of business
- Gross annual revenue in the last fiscal year of the applicant preceding the date of the application.
- Information about the race, sex, and ethnicity of the business principal owners.

While the Bureau has authority to require "any additional data that the Bureau determines would aid in fulfilling the purposes of [1071],"[16] ETA urges the Bureau not to use its additional discretionary authority to collect additional data points beyond what is statutorily mandated. Each data field, as we describe in more detail below, includes their own set of challenges for businesses to collect and remit to the Bureau. Adding additional data fields would increase cost of compliance, thereby increasing cost to small business borrowers and ultimately increase time for businesses to apply for credit. Given that small business borrowers are already time pressed, each additional data point represents a hurdle to accessing credit for woman and minority owned small businesses.

It should be noted that the CFPB has promulgated a data collection rule where the Bureau also had authority to deviate from the statutorily required data points. In the HMDA rulemaking, the Bureau expanded well beyond what Congress required. However, the small business lending landscape is different from the mortgage landscape. There is not the same need for the CFPB to collect expanded data fields beyond what was statutorily required in the way it did for HMDA.

For each data point identified in Section 1071, ETA would recommend that the Bureau confirm that lenders may rely on self-reported and third-party sourced applicant data. Requiring lenders to independently verify the reported data points would require time-consuming and costly changes and would undercut the efficacy benefits provided by many lenders to their customers. Additionally, even with such changes, some data points are not independently verifiable by our members, such as the "type and purpose of the loans" or "race, sex, and ethnicity of the principal owners."

Data Fields:

"Amount Applied For"

For this data field, some lenders may have challenges collecting this information without clear guidance from the Bureau about the definition. For example, some lenders offer credit to merchants with which a payment platform partner has an existing business relationship through its payments product. That application currently does not include an amount applied for, because the

[16] 15 U.S.C. 1691c-2(e)(2)(H).

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lender makes a maximum loan offer to the applicant, based on the pre-existing data known to the payments platform and shared with the lender, and then the applicant can choose to accept that amount or instead choose a lesser amount. In such case, it would be difficult to assess the amount applied for (what was applied for? The maximum offer or the amount actually accepted?).

Gross annual revenue in the last fiscal year of the applicant preceding the date of the application.

This data field represents the best example of why clear guidance is important regarding how lenders should approach applications from businesses where they have parent companies, subsidiaries, and/or affiliates. Attempting to include only the gross annual revenue of a subsidiary of a Fortune 500 company would seem to misrepresent the actual revenue from the company as a whole. Likewise, some lenders may include parent companies or subsidiaries, while others do not. That would also lead to inconsistent data being collected. Some small businesses have legitimate reasons to be operating in a segmented way. For example, a limo or car company that operates in three different jurisdictions such as Maryland, the District of Columbia, and Virginia, may have completely different businesses set up in each jurisdiction. While they are jointly owned by the same owner or ownership group, they may be viewed as one by some lenders and separately by others. This represents an opportunity for the Bureau to help provide uniform collection through guidance to lenders on how to assess gross annual revenue of its merchant borrowers.

While the Bureau considers how to provide guidance and a definition of this data field, it is important to realize that not all lenders currently collect this information as part of their application. For example, for some payments companies that also offer commercial lending to small businesses through a bank partner, the only revenue that is considered is that processed through the payments platform. Asking a business to collect new data beyond what is already being collected would change the nature of the credit transaction between the lenders and the borrower.

<u>Beyond APR - Total Cost of Capital</u>

ETA urges the Bureau not to include additional data points outside of those in which the statute requires. However, in the event that the Bureau decides to add additional fields, including a pricing metric, it is imperative that the pricing metric include total cost of capital ("TCC") because annual percentage rate ("APR") is an imperfect measurement for many small business loans.

While APR is often an effective way to compare the cost of credit on long-term consumer loans, such as a mortgage, it does not always provide small businesses with complete information about a financing option. It is critical to note that APR does **<u>not</u>** present the total dollar amount a borrower will pay in interest in a year and the calculation is extremely duration sensitive. In fact, there is an inverse relationship between the APR and the life of the loan, meaning that the shorter the duration of the loan, the higher the APR for the same amount lent.

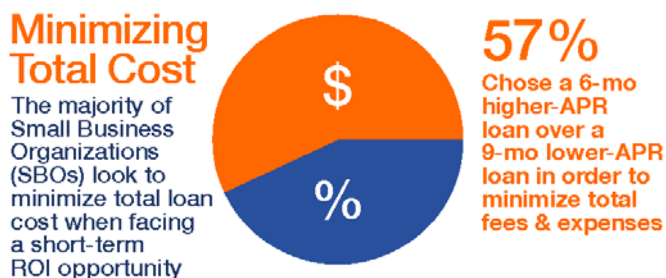
The traditional metric for measuring the dollar cost of commercial loans is the TCC, which enables a small business to determine easily the "affordability" of a loan in the form of principal plus interest expense and to most effectively match the loan to a particular business need or use-case. Indeed, most small business borrowers turn to TCC because it provides clear information for

matching the cost of commercial credit products with the borrowers' expected return on investment. For example, if a small business expects a $10,000 loan to cost $1,000 in interest (or 10 cents for every dollar borrowed), then it is easy to assess if the proceeds will be used to purchase inventory that will drive a 50% profit margin (or 50 cents for every dollar).

Generally, when consumers take out a loan, they are not making an income-generating investment that would increase the funds available to pay the loan back. Therefore, in most situations, the more "affordable" loan for a consumer is one with a longer term and lower monthly payments, even if it results in paying more over the long term. Consumers, therefore, look at APR, which describes the interest and all fees that are a condition of the loan as an annual rate paid by a borrower each year on the outstanding principal during the loan term. APR takes into account differences in interest rates and fixed finance charges that may otherwise confuse a consumer borrower and is most useful in comparing similarly long-term loans, such as 30-year mortgages or multi-year auto loans. Likewise, APR is useful for comparing revolving lines of consumer credit such as credit cards, where the amount borrowed each month changes. APR allows consumers to compare the rate at which an outstanding balance would increase under different credit cards.

While APR describes the cost of the loan as an annualized percentage, TCC represents the sum of all interest and fees paid to the lender. As the Cleveland Federal Reserve recently noted, TCC enables a small business to determine the "affordability" of a product – a key driver for most small business borrowers.[17]Unlike consumer loans, commercial loans are normally used to generate revenue by helping a business purchase equipment, inventory, or hire additional employees. Thus, "affordability" for small business borrowers means assessing the cash flow impact of the loan and comparing the TCC of the loan and the return they expect to earn from investing the loan proceeds. To reduce TCC, many small business borrowers prefer short-term financing they can quickly pay back with the return on their investment ("ROI").

In a recent ETA survey conducted by Edelman Intelligence of almost 600 small business borrowers, a majority of respondents stated that they would look to minimize TCC, rather than APR, when considering loan options in the face of a short-term ROI opportunity.[18]



APR provides a useful comparison for long-term consumer loans and credit cards, but may have less comparative value for small business financing for several reasons. First, APR calculations

[17] CITE

[18] ETA and Edelman Intelligence, Online Lending Drives Main Street Business Growth & Satisfaction (2016).

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are highly duration-sensitive for loan terms of less than a year. In other words, the APR increases rapidly the shorter the loan term. For example, the APR of typical short-term commercials loans will fluctuate widely based on only small differences in the term of a loan. Second, TCC is more useful for comparing the absolute cost of a loan with a small business's expected return from investing the loan proceeds. A business that expects a short-term return on its investment would likely choose a loan with a shorter term and higher monthly payments to minimize TCC, even though that loan is likely to have a higher APR. Third, solely focusing on the effective APR of such loans may not tell the whole story because if the business is successful, and pays the loan back faster, the term decreases and the effective APR increases.

For example, a 6-month loan will have a significantly higher APR than a 60-month loan, but the total dollar cost of the 6-month loan will be much lower than the 60-month loan. Of course, because it is paid back faster, the 6-month loan will have larger periodic payments and therefore the business should ensure it could handle the impact to cash flow. To illustrate these principles, consider the following hypothetical loans:

	Loan Amount	**Loan Term**	**APR**	**Monthly Payment**	**TCC**
Loan A	$10,000	5 years	19%	$259.41	$5,564.33
Loan B	$10,000	6 months	59%	$1,916.67	$1,500.00

As the chart above makes clear, the amount of time the small business has to repay the loan has an important effect on APR – the shorter the loan term, the higher the rate (even if the total dollar cost of credit declines with a shorter loan term). As long as the small business can satisfy the larger monthly payments, a small business borrower would generally seek to minimize TCC by minimizing the loan term.

As a result, a loan with the lowest TCC will frequently be the preferred option of a small business. While APR is the primary metric for comparing consumer loans, and may provide useful information regarding certain types of commercial credit, singular reliance on consumer disclosure standards like APR will not provide small business borrowers with the best or most complete information for comparing credit products. For these reasons, ETA urges the Bureau to confine data collection only to the data fields it is statutorily mandated to collect, but in the event that the Bureau adds a pricing data point, that it consider TCC.

What concerns do financial institutions have about the possibility of misinterpretations or incorrect conclusions being drawn by regulators or other parties from the collection and dissemination of information as part of 1071?

There is considerable concern among lenders that different groups could use the data without regard for context or worse, manipulating numbers for strategic gain, thereby increasing risks such as litigation risk, regulatory risk, reputation risk, and competitive advantage risk.

Information about the race, sex, and ethnicity of the business principal owners

This data field is not currently collected and in most cases, would be illegal to consider in a credit decision. While it would be premature to specify how to comply with collection of this data field without seeing a proposed rule, there is considerable concern among lenders as to how they would limit access to this data field for underwriters. There is no consensus for how to do so at this time because of the numerous business models in this space. However, any guidance provided by the Bureau in this space should take into consideration the many types of entities and business models in the small business lending space and ensure that it is both flexible enough and clear enough for ease of understanding and implementation by all players in the market.

Additionally, many lenders would like to ensure that they can still approve a loan if the customer elects not to provide certain data such as information about race, sex, or ethnicity of the business principal owners. As such, the Bureau should provide clear guidance that this information is voluntary and not required to be provided by the applicant in order to provide credit.

*   *   *

We appreciate you taking the time to consider these important issues. If you have any questions or wish to discuss any issues, please contact me or ETA Senior Vice President, Scott Talbott at Stalbott@electran.org.

Respectfully submitted,

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