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September 14, 2017

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

RE: Request for Information Regarding the Small Business Lending Markets (Docket No.CFPB-2017-011)

Dear Ms. Jackson:

The Greenlining Institute commends the Consumer Financial Protection Bureau for its efforts to implement Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Furthermore, we applaud the CFPB's focus on the credit needs of small, women-owned, and minority-owned businesses, and their engagement with the small business lending market.

The Greenlining Institute is a racial equity and policy advocacy organization that works to advance economic empowerment and opportunity for communities of color. As communities of color have been historically disinvested in and redlined from the financial mainstream, Greenlining welcomes and supports collecting and publicly sharing small business lending data that provides industry, small businesses, policymakers, and advocates with a more complete picture of the small business lending environment and its gaps.

This comment letter was written with input from the Greenlining Coalition, a statewide base of organizations representing communities of color across California. Our Coalition is composed of ethnic Chambers of Commerce and business associations, diverse small businesses, technical assistance providers, and community lenders including CDFIs and CDCs.

Why Section 1071 Data Collection is Important

Entrepreneurship is a powerful tool to reduce our growing racial wealth gap and provide people of color with financial security, upward mobility, and self-determination. For our communities, diverse businesses are powerful engines of economic growth and employment, creating jobs at a faster rate than White-owned firms, and are more likely to hire locally. Yet despite diverse businesses' significant economic contributions to their local communities and the nation, the data available suggests that lending to diverse and small businesses remains troublingly low. As a barometer of market conditions in small business finance, Section 1071 will be instrumental in identifying discrepancies in lending and diagnosing remedies to address the barriers described below.

Several studies show that entrepreneurs of color have a harder time securing loans and products that meet their credit needs, even after controlling for creditworthiness other than collateral.[1] A report commissioned by the Small Business Administration found that businesses owned by women and people of color begin with less than half the amount of startup capital than their white and male counterparts. An SBA Issue Brief on the 2012 Survey of Business Owners found that despite comprising 29% of all businesses, only 5% of minority businesses used a

[1] Michael S. Barr, et al., ''The Community Reinvestment Act: Its Impact on Lending in Low-Income Communities in the United States,'' in E. Mayo and C. Guene, eds., Banking and Social Cohesion (2001)

private business loan to start their business. Despite comprising 36% of all businesses, only 5% of women-owned businesses secure private loans. The smallest businesses fare no better, as the Federal Reserve's 2016 Small Business Credit Survey found that "smaller" employer businesses (with less than $1 million in revenue) experience greater dependence on personal finance than larger firms with more than $1 million in revenue.

Moreover, research shows that credit denial rates for entrepreneurs of color - especially for Blacks and Latinos - and women are disproportionately higher than those of their white and male counterparts, even after controlling for variables such as business credit scores, personal wealth, and revenue**.** Ample research also finds that even when minority entrepreneurs do succeed in securing financing, they receive smaller loans and pay higher interest rates than their white counterparts, again, even after controlling for differences in creditworthiness. In fact, analysis of the 2003 Survey of Small Business Finance revealed that while the average loan amount for minority-owned small businesses was roughly $9,300, the average amount for white businesses was $20,500 (see page 35). The survey also discovered that minority businesses pay an average of 7.8% for loans, compared to 6.4% for White businesses (see page 36).

According to a Gallup study (see page 21), Asian Americans nationally report the highest denial rate among minorities for credit for their businesses, at 23% (compared with 20% for African Americans and 19% for Hispanics). The Asian American experience is not significantly different from their situation in pre-Great-Recession 1998, when the Department of the Treasury's Survey of Small Business Finances (SSBF) reported a business loan denial rate of 27.7% for Asian Americans. The SSBF found that in the Pacific Census Division (which includes Alaska, California, Hawaii, Oregon and Washington), 32.5 percent of minority-owned firms reported loan denial. Non-minority owned firms reported a lower rate. However, analysis of the Pacific region from this SSBF revealed that Asian American-owned firms had relatively high rates of loan denial, consistent with national patterns (see page 31).

That diverse entrepreneurs pursue SBA loans only underscores their difficulty in accessing conventional loans from mainstream lenders. Despite assumptions of relative accessibility, SBA loans are a tiny share of total business loans issued, and the number and volume of loans received by diverse entrepreneurs are equally minute. In 2017, African Americans received only 4% of SBA 7a and 2% of SBA 504 loans. In 2017, Latinos received 8% of SBA 7a loans and 7% of SBA 504 loans. In terms of dollar amount, from 2012-2017 African Americans received 2% of the total SBA 7a dollar amount, and 1-2% of SBA 504 loans. In the same period, Latinos received 5-6% of the total dollar amount of SBA 7a loans, and an average 5.6% of total dollar amount of SBA 504 loans. However, from 2012-2017 the total dollar amount of 7a loans over $2 million – huge and inaccessible amounts for truly small firms - increased by 142%.

A December 2013 analysis of publicly available data by the California Reinvestment Coalition highlighted a dramatic decrease in SBA lending to minority-owned businesses by major banks. Four of the five major banks – Bank of America, Citibank, US Bank, and Wells Fargo – have also significantly decreased their SBA lending to minority-owned businesses since 2007. JP Morgan Chase Bank entered the California market in 2008 and their lending has increased since then for all but African American businesses. Bank of America (BofA) and Citibank's SBA lending have dropped the most among the major banks between 2007 and 2013 – decreasing their lending by 98 percent and 97 percent, respectively. When looked at collectively, these five banks decreased their lending to minority-owned businesses at an even more dramatic rate. Where overall SBA lending by the five banks dropped by 59 percent, their lending to Latino-owned, African American-owned, and Asian- owned businesses dropped more dramatically– at 63 percent, 85 percent, and 64 percent, respectively.

The aforementioned SBA lending pattern (as measured by either number or volume of loans) to minority-owned businesses simply does not mirror the pattern of the growth in their numbers. According to the SBA's January 2017 Annual Report of the Office of Economic Research (page 24), while the number of African American-owned businesses increased 34.5% between 2007 and 2012, Asian American-owned by 23.8%, Hawaiian/Pacific Islander-owned by 45.3%, Hispanic-owned by 46.3%, Native American/Alaskan-owned by 15.3% - representing a 38.1% growth in the number of minority-owned businesses – the number of non-minority-owned businesses fell 5.5%.

Diverse businesses are poised to take an increasingly significant role in bolstering our national economy. In 2015, national entrepreneurial activity dropped to 12%, down from 14% in 2014. Yet, according to the Kauffman Foundation's Index of Startup Activity, in 2015 almost 40% of new entrepreneurs were people of color. Section 1071 presents a unique opportunity to identify and understand the barriers diverse businesses face, and then deploy tailored solutions informed by data. The need for Section 1071 will only become more pressing as people of color, vastly underserved and unserved by mainstream financial institutions, become the new majority. As the economic prosperity of California and the nation increasingly hinge on the economic contributions of diverse businesses, Section 1071 will be a crucial tool to evaluate our successes in cultivating a truly sound and inclusive economy that benefits all.

How Section 1071 will Ensure the Success of Small and Diverse Businesses

Section 1071 is critical to ensuring the success of small, women-owned, and minority-owned businesses by addressing the following:

- **Revealing the state of small business lending to entrepreneurs of color, women entrepreneurs, and small businesses:** Section 1071 will identify the number and volume of loans going to diverse entrepreneurs, the financial institutions filling the lending gaps for small firms, and the terms of service (please see recommendations below). Currently, only the Small Business Administration (SBA) offers a semblance of national data collection on the race and gender of small business loan applicants. In order to systematically address the lack of capital access for diverse businesses, it is necessary for regulators, advocates, and lenders to have this basic data.
- **Capturing trends in small business market share and access to credit across regions over time:** Section 1071 will identify trends in small business finance across regions and track access to credit over time. After banks retreated from business lending during the Great Recession, the vacuum left behind has fueled a dramatic growth in financial technology firms (FinTech). Just in California, from 2010-2014 online lending companies experienced an over 900% increase in total financial activity relating to consumer and small business lending, according to the California Department of Business Oversight. Although currently collected data does not cover nondepository institutions, online lenders appear to be quickly growing their market presence and share of the small business lending market. In fact, PricewaterhouseCoopers projects that big banks globally could lose almost a quarter of their revenue over the coming years to FinTech lenders offering personal and commercial loans. Despite FinTech's growing market share and high loan approval rates, the 2015 Small Business Credit Survey found that high interest rates and unfavorable repayment terms produced the lowest rate of borrower satisfaction. Other established lenders, such as community banks and community development financial institutions (CDFI's), play an integral role in the world of small business finance. However, geography is a determining factor in access to capital because CDFI's have a reduced presence in certain regions like the west coast. CDFI's also have limited dollars to lend, so they are constrained by their supply. Several Coalition members also raised concerns that CDFI's are lending less to entrepreneurs of color. Although the Opportunity Finance Network's (OFN) national 2015 Side By Side Member Data Analysis reports that 49% of CDFI loans go to people of color, not all CDFI's report to the OFN or to the CDFI Fund. Moreover, even when data on loans to people of color is reported, the data is not disaggregated by racial group. Greenlining believes Section 1071 will enable CDFIs and small business technical assistance providers to identify funding gaps in specific regions and within targeted groups.
- **Tracking race and ethnicity:** When asked if discrimination in small business lending exists, every Greenlining Coalition member answered affirmatively. Researchers have also corroborated that discrimination against people of color still exists in the small business market. By tracking the race and ethnicity of every applicant, Section 1071 will provide information for policymakers and advocates to enforce fair lending laws in the small business sector.
- **Capturing how banks determine creditworthiness:** Section 1071 has the potential to capture the criteria considered by banks to either approve or deny an application (please see Greenlining's recommendations below). Algorithms on creditworthiness are opaque, vary across lenders, and can potentially mask unfair biases that reduce lending to entrepreneurs of color. Capturing the creditworthiness criteria that financial

institutions use to approve or deny a loan will empower diverse businesses and technical assistance providers by making small business lending less opaque and more predictable.

- **Repairing broken trust between communities of color and financial institutions:** Banks' long practice of redlining and most recently, reverse redlining during the housing bubble, have deeply scarred and stripped wealth from communities of color. Section 1071 will be an important step towards addressing communities of colors' distrust of financial institutions by making bank's small business lending practices more transparent.
- **Revealing the extent to which the racial wealth gap is a barrier to entrepreneurship:** Lack of wealth can be a barrier to starting a business because entrepreneurs of color may have less or no collateral to pledge to back up their loans. The historically low levels of owner equity that people of color have held – and the recent blow by the Great Recession to home equity that communities of color amassed – exacerbates the economic challenges entrepreneurs of color face in accessing capital. As one of our Coalition members succinctly comments, "the fact that the racial wealth gap is a barrier to starting a business under today's underwriting standards is one way in which the legacy of racism continues to operate." Moreover, women of color are in the unique position of holding the lowest levels of wealth due to the racial and gender wealth gaps. According to Closing the Women's Wealth Gap Initiative, while median wealth for single White women is $3,210, median wealth for single Black women is $200 and $100 for single Latinas.

Greenlining's Recommendations

The Greenlining Institute and Greenlining Coalition recommend the following:

- **<u>Definition of small business:</u>** A "small business" should be defined as a firm with revenue of $5 million or less. Although there are a range of ways to define a small business, such as by number of employees and industry, this definition is the most encompassing for data collection purposes. Under this definition, data will be collected for 98% of all firms, over 90% of minority firms, and over 99% of all women-owned firms.
- **<u>Geographic areas and data collection:</u>** Data collection must encompass all geographical areas where a financial institution originates a loan. The wave of bank branch closures at the national and global levels has reinforced credit disparities, particularly in rural and remote areas. The CFPB should be wary of focusing more attention and resources on urban areas at the expense of rural areas. This is one weakness of CRA because although it evaluates banks' performance in meeting the credit needs of the communities in which they operate, banks are more likely to undergo "full scope" evaluations in urban areas, and "limited scope" evaluation in rural areas. This disparity in consideration to rural areas removes the incentive for banks to actively meet the credit needs in rural areas.
- **<u>Data collection:</u>** Data collection should cover all lenders, including: community lenders, community banks, national banks, CDFIs, venture capital firms, angel investors, merchant cash advancers, and all nondepository institutions including financial technology companies that originate small business loans.
- **<u>Additional data points that Section 1071 should capture:</u>**
    - **<u>Race and ethnicity</u>**: Further disaggregation of general racial and ethnic categories into subgroups. The general racial groups used are American Indian/Alaska Native, Asian, Black/African American, Native Hawaiian/Other Pacific Islander, White; and for ethnicity: Hispanic/Latino and Not Hispanic/Not Latino. However, within each of these categories, such as "Asian," there are important differences in socioeconomic indicators, such as employment, poverty rates, and education that can determine access to capital. Disaggregation would help shed light on these disparities in access within racial/ethnic groups. The updated 2015 Home Mortgage Disclosure Act rule on race and ethnicity collection is a good example of race and ethnicity disaggregation. The Census Bureau is also working on modernizing their surveys through disaggregation, and their 2015 National Content Test for Minimum Race and Ethnicity Categories is a good resource.
    - **<u>Indicators of loan quality:</u>** Information on loan terms and conditions that indicate the quality of small business loans being issued, including: APR, whether the loan comes with a fixed or variable interest rate, default interest rates and fees, prepayment penalties, and whether the loan

comes with a contract duration (and if so, with what termination fees), covenants, and broker fees, if tacked onto the cost of the loan. It is critical that the CFPB encourages the creation of good, prime loans, not subprime products. The most salient and recent example of communities of color enjoying increased lending – but also wealth-stripping loans - is the 2008 mortgage crisis.

- **Collateral:** If collateral is required, information on the property and assets pledged to obtain a loan or pay for any penalties. This information will provide data on the engagement of entrepreneurs of color with unsecured and secured loans and products. Unsecured loans do not require collateral and are processed faster. Secured loans do require collateral, generally have lower interest rates, longer repayment schedules, but may require more time and paperwork.
- **Creditworthiness Measures:** Information that shows *how* lenders determined creditworthiness is necessary, such as whether the evaluation considered the following: the borrower's personal or commercial credit score, debt-to-income ratio, collateral, the owner's capital investment in the business, or owner's education or experience. Though lender's assessment of creditworthiness varies and remains opaque, these measures are critical in determining the affordability and availability of credit, and are helpful in determining if similar businesses and entrepreneurs receive the same approval rates, type of loans, amounts, and pricing.
- **Product applied for and product received:** If an entrepreneur applies for a specific product or loan amount and they are offered something different instead, information that explains *why.*
- **Type of action taken**: If the applicant is denied, explanation on the reason(s) *why*.

Addressing Industry Concerns

Given community banks' critical role providing small business finance, their importance makes it imperative that they maintain and report data. According to an article published by the Federal Reserve Bank of Dallas, while small business loans comprised between 44-35% of small banks' assets over the last decade, they only comprised 2-3% of assets for large banks. While we acknowledge that community banks will shoulder a higher cost of compliance than larger banks, Section 1071 presents an opportunity to increase their bottom line and client base by revealing trends in lending, and informing business strategies and partnerships with entities affiliated with underbanked entrepreneurs. Data collection will highlight other needs across the market, particularly for underserved entrepreneurs, and better equip community banks to serve their familiar base of local communities and businesses. As local anchor institutions, community banks can pair their unique insight into local credit needs with the data Section 1071 will produce to foster innovation in product and service creation. Finally, community banks should collaborate with the CFPB to inform a well-timed and streamlined systemization of Section 1071. This will help provide adequate time for community banks to establish compliance procedures and mitigate the impact to their bottom line.

Industry must see Section 1071 as more than an onerous data collection rule. Section 1071 can become a pioneering and transformative data set on the small business credit market. The transparency Section 1071 will institutionalize will advance a more accessible, equitable, and competitive lending market.

Closing

Entrepreneurs of color, women entrepreneurs, and small businesses will be empowered to achieve their immense potential when financial institutions increase access to capital. Section 1071 data collection will reveal the unique credit needs of women entrepreneurs and entrepreneurs of color, as well as small businesses that drive economic development in our backyards. For lenders, data will direct them towards targeted solutions, sharper business strategies, and improved product development that will increase productive economic activity. For entrepreneurs and technical assistance providers, data will empower them to make informed decisions about strategies to become capital-ready. For advocates, researchers, and policymakers, data will shed sunlight on unfair lending practices and aid in ending discrimination in small business lending. The data will also point us towards solutions to help diverse businesses develop, scale, and ultimately grow our economy.

The Greenlining Institute is proud to be a thought partner in support of Section 1071. Thank you for the opportunity to comment.

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President

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The Greenlining Coalition

Access Plus Capital
African Americans for Economic Empowerment
American G.I. Forum
Asian Business Association
Asian Inc.
Asian Journal Publications
Asian Pacific Islander Small Business Program
Azul Management Systems Institute
Black Business Association
Brightline Defense Project
Business Resource Group
California Hispanic Chambers of Commerce
California Journal for Filipino Americans
Chicana/Latina Foundation
Community Housing Opportunities Corporation (CHOC)
Community Union, Inc.
Council of Asian American Business Associations (CAABA)
East Bay Asian Local Development Corporation (EBALDC)
El Concilio of San Mateo County
Ella Baker Center for Human Rights
Inland Empire Latino Coalition
Insight Center for Community Economic Development
KHEIR Center
Korean Churches for Community Development/Faith and Community Empowerment
Oakland Citizens Committee for Urban Renewal (OCCUR)
Our Weekly Urban Media Foundation
Pacific Coast Regional Small Business Development Corporation
PROSPERA
Regional Black Chamber of Commerce, San Fernando Valley
Rising Sun Energy Center
The Sacramento Observer
San Francisco African American Chamber of Commerce
Street Level Health Project
The Nehemiah Community Reinvestment Fund
West Angeles Community Development Corporation