



The Consumer Financial Protection Bureau is soon to finalize Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Section 1071)

Why financial institutions should begin preparing for the proposed changes impacting small business lending

Section 1071 would address fair lending concerns related to small businesses

The Consumer Financial Protection Bureau (CFPB) will soon finalize its September 2021 notice of proposed rulemaking (NPRM) implementing small business lending data collection requirements as part of Section 1071.¹ This NPRM introduces a substantial shift in how both banks and nonbanking institutions, including fintech companies, manage small business lending across the entire life cycle. Though the issuance of the final rule is not expected until March 2023 (with compliance required 18 months thereafter), financial institutions' compliance with the changes will require a major transformation effort across the three lines to address the impacts across people, process, and technology.²

For decades, small businesses have been a cornerstone of the "American Dream," an opportunity for entrepreneurs and the foundation of communities across the country. According to the US Small Business Administration Office of Advocacy, in 2021 there were 32.5 million small businesses in the United States,

employing 46.8% of the workforce. Approximately 43.1% of businesses are women-owned, 19.0% of businesses are minority-owned, and 13.3% and 6.6% are owned by Hispanics and veterans, respectively (figure 1).³ For small businesses to be successful, funding is a critical component, and while banks and credit unions remain a key source for capital, many small businesses struggle to access affordable loans. It is a foundational responsibility of the CFPB to gather additional data regarding whether and how these small businesses can access credit to enable enforcement of fair lending laws.

The NPRM includes adding a new subpart (subpart B) to the Equality Credit Opportunity Act (Regulation B) to implement Section 1071's requirements. The proposed requirements would apply to "covered financial institutions" that engage in small business lending and would require the collection and reporting of data on loan applications. This NPRM would enable the first comprehensive database of small business credit applications in the United States, allowing regulators to identify and address fair lending concerns related to small businesses. More broadly, the change would also provide insights into business and community development needs and opportunities for women and minority-owned small businesses.⁴

It is critical that financial institutions consider acting now, especially if an institution is not experienced with requirements around the Home Mortgage Disclosure Act (HMDA) and the regulatory expectations for collecting and reporting timely, accurate, and complete data. Financial institutions will need to understand and consider both the changes their fair and responsible banking risk management programs can begin to take to prepare for implementation and the impacts of the NPRM to the entire small business lending life cycle.

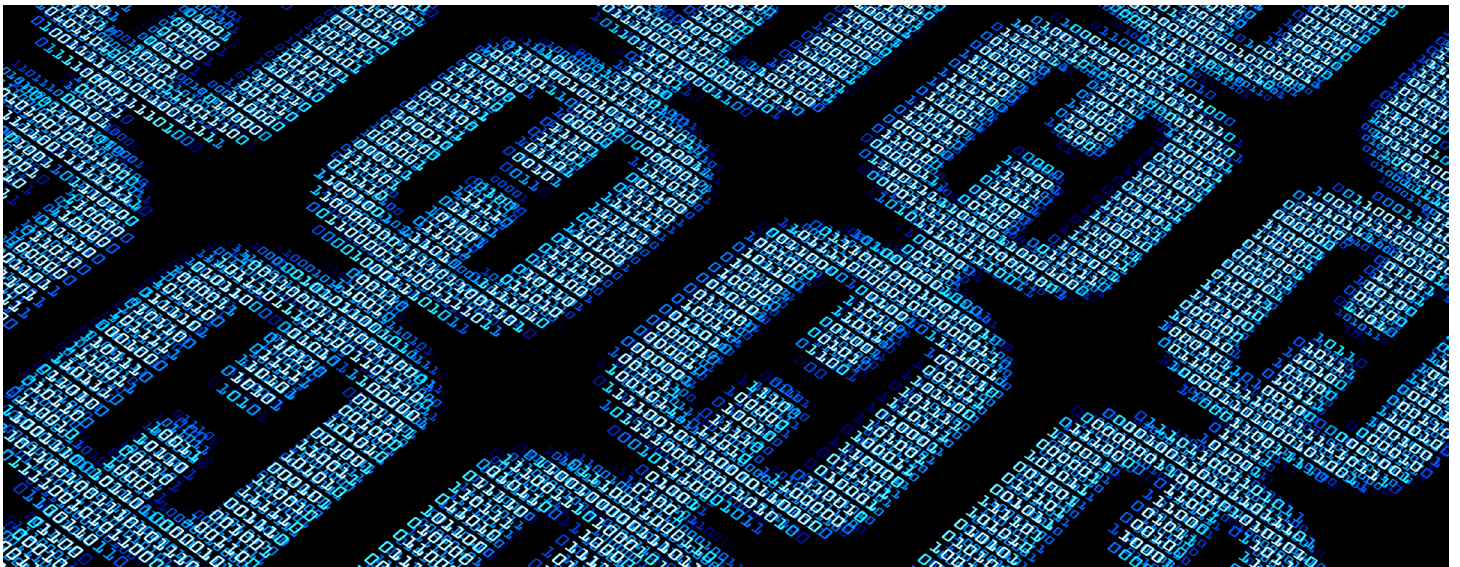
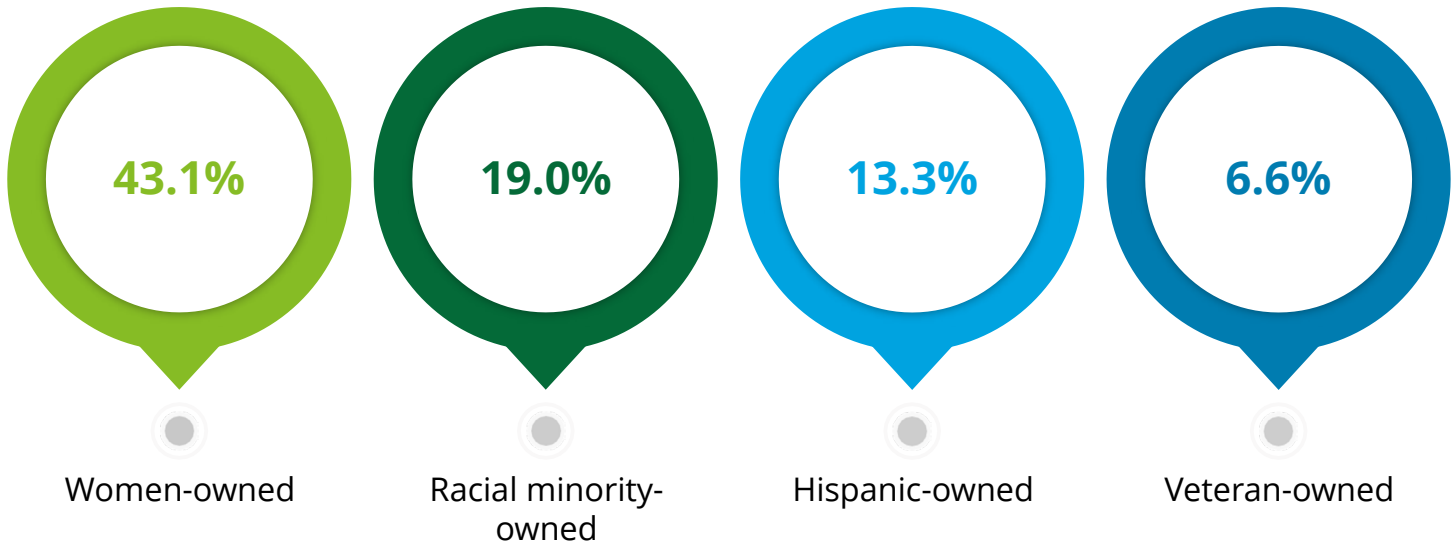


Figure 1. Business ownership by demographic group



Summary of key changes

The proposed updates to implement Section 1071 requirements are focused on the collection and reporting of specific data points related to certain business credit applications. The NPRM clarifies the following terms that are deemed essential to understanding the scope and applicability of the proposed Section 1071 requirements (figure 2).⁵

Figure 2. NPRM terms and descriptions

Term	Description
Covered financial institutions	Any bank, credit union, or nonbank lender that satisfies the origination threshold of at least 25 covered credit transactions to small businesses in each of the two preceding calendar years.
Small business	Maintaining alignment with the definitions set by Small Business Act and Small Business Administration (SBA) regulations for “business concern” and “small business concern,” while seeking SBA approval for an alternative size standard of \$5 million or less in gross annual revenue for its preceding fiscal year.
Covered application	Written or oral request for a covered credit transaction in alignment with the procedures set by the financial institutions for the type of credit requested (a slight shift in definition with the existing Regulation B definition of “application”).
Covered credit transaction	In alignment with Regulation B, includes loans, lines of credit, credit cards, merchant cash advances, credit transactions for agricultural purposes and credit transactions covered by HMDA, with the notation that trade credit, public utilities credit, securities credit, and incidental credit would not be considered covered credit transactions.

The NPRM outlines a comprehensive listing of more than 20 specific data points as well as supplemental data elements that covered financial institutions would be required to collect and report related to their small business lending process.⁶ The data elements outlined include (1) data elements the financial institution would provide or generate, (2) data elements provided via the application, and (3) data points related to the demographics of the applicant’s principal owners or ownership status.

1. Data elements the financial institution would provide

or generate include unique identifiers for the covered application such as date, application method, and recipient. The action taken by the covered financial institution on the application and applicable data of action would also be included. If the application is denied, a denial reason data point would be required, and if the application was originated or approved, data points related to pricing information would be required.

2. Data elements that could be provided by the

application include data points that could be determined by reviewing the information provided by the applicant. This includes details of the credit being applicable for (e.g., type, purpose, and amount) and applicable information related to the applicant's business (e.g., gross annual revenue, number of non-owner workers and principal owners, time in business).

3. Data points related to the demographics of the applicant's principal owners or ownership status

include the business's status as a minority or women-owned business and the principal owner's ethnicity, race, and sex. These applicant details would likely be requested by the covered financial institution.⁷

As part of implementing the requirements, the CFPB has also outlined detailed instructions for how to collect and report on this information. Specifically, the NPRM includes an expectation for covered financial institutions to not only maintain procedures to collect applicant-provided data, but also maintain specific protocols to limit access to certain data related to covered applications. The proposal also outlines the CFPB's plans to enable submission of the data and its related availability to the public on an annual basis.

Key considerations for financial institutions

While it may feel as if there is significant time before this NPRM is finalized and in effect, mobilization is needed from small business leaders and fair and responsible banking risk management programs within covered financial institutions. As a first step, institutions may consider establishing an enterprise project management office (EPMO) to lead the project plan

development process, including identifying and assessing impacts to people, process, technology, and data collection practices, and documenting detailed action plans with corresponding activities and accountable stakeholders. As they begin to determine the impacts, covered financial institutions should consider the following changes required across the small business lending life cycle and key next steps, including:

- **Establish data capabilities and enabling technology:** The proposed data points for collection and reporting may require enhancements to small business loan applications and corresponding systems to properly capture and ingest the data elements. Additionally, covered financial institutions may also need to enhance existing data models to translate the data elements across multiple systems, including ensuring there are proper back-end data validation processes in place. These data and technology changes will also require updates to first-line business processes and related documentation as well as establishing new controls and reporting routines.
- **Integrate within fair and responsible banking risk management programs:** Covered financial institutions may need to take a closer look at existing fair and responsible banking processes to identify potential revisions. Specifically, it may be necessary for potential enhancements to existing processes and related procedures to align with the required data capture and reporting requirements. Covered financial institutions should also consider developing or revising protocols that limit access to data, in alignment with the proposed firewall provisions and required retention requirements. Front-line representatives will also need training on changes to the loan application process and the importance of nondiscriminatory practices in small business lending.
- **Oversight coordination across the three lines:** The proposed changes will also result in impacts to covered financial institutions' oversight and testing programs for all three lines. The first line should consider updating existing testing programs to ensure proper oversight of potential discriminatory practices, while the second line may need to revise existing fair lending testing programs (e.g., matched pair testing, mystery shopping, application survey tests). Additionally, the third line should conduct independent testing of processes to ensure proper oversight of data collection and reporting requirements.

Conclusion

While the industry awaits the issuance of the final rule and related requirements, covered financial institutions can take tactical next steps to prepare for the final rule's changes. In addition to establishing an EPMO and related resources to review and analyze requirements, institutions can perform initial gap assessments to identify potential impacts to (1) ongoing operations and (2) the related operating model across the small business lending life cycle. Many should also consider drafting comprehensive action plans for implementing these proposed requirements, including activities for enhancing loan applications and corresponding systems; revising processes, procedures, and training; and validating and testing data. Covered financial institutions can review and revise the plan accordingly once the final rule is published.

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Endnotes

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2. CFPB, ["Tenth Status Report,"](#) August 22, 2022.
3. US Small Business Administration, Office of Advocacy, ["2021 Small Business Profiles for the United States,"](#) August 31, 2021.
4. CFPB, ["Summary of Proposed Rulemaking: September 2021 Proposal Regarding Small Business Lending Data Collection,"](#) September 1, 2021.
5. National Archives and Records Administration, ["Federal Register: Small Business Lending Data Collection Under the Equal Credit Opportunity Act \(Regulation B\),"](#) October 8, 2021.
6. CFPB, ["Proposed data points for small business lending data collection,"](#) September 1, 2021.
7. CFPB, ["September 2021 Proposal Regarding Small Business Lending Data Collection."](#)



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