Testimony of

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On behalf of

The National Association of Federally-Insured Credit Unions

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Introduction

Good morning Chairman Meuser, Ranking Member Landsman, and Members of the Subcommittee. My name is Michael Wilson, and I am testifying today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU). I currently serve as Chief Experience Officer of Members 1st Federal Credit Union, headquartered in Enola, Pennsylvania. With nearly $7 billion in assets, over half a million members, and 60 branch locations across nine counties in Central Pennsylvania, my role is ensuring an exceptional member experience on behalf of the entire credit union in all interactions and delivery channels—including its branch operations, online banking, customer service, business development, and mobile app. In this role, I provide leadership and direction for the credit union's retail, operations, and customer service areas as well as public relations, marketing, community outreach, internal and external communications, and financial literacy. As you may know, NAFCU is the only national organization that exclusively represents the interests of the nation's federally-insured credit unions at the federal level. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding the 1071 rulemaking process at the Consumer Financial Protection Bureau (CFPB or Bureau).

My credit union's story began over 72 years ago when nine people put money into a pot, evolving into Naval Supply Depot Mechanicsburg Credit Union with a desk and small counter at the Naval Supply Depot, to what is today a full-service financial institution that exists to help families flourish and better the communities we serve. As a credit union, our "people helping people" philosophy is at the core of everything we do. We build personalized, meaningful relationships and provide unparalleled experiences to our members—from advice and support to a full suite of financial tools designed to help our members live well financially. Members 1st has always been a place where members come first.

The credit union proudly serves nine counties—Adams, Berks, Cumberland, Dauphin, Lancaster, Lebanon, Lehigh, Perry, and York—with nearly 60 branch locations across its footprint. Within the very mission statement of Members 1st is the importance of personal relationships: *We serve*

our members, associates and communities through support, empowerment and meaningful relationships. Because our members span five generations, we offer a variety of choices to suit their lifestyles and transaction preferences. Over the past 72 years, the credit union has perfected its in-person experience for members. As the digital space continues to evolve, so does our commitment to delivering an unparalleled digital experience to our members. In addition to our 24/7, robust digital banking platform, which features online banking and our mobile app—giving members the ability to manage their finances anytime, anywhere—our innovative MyConcierge™ service provides an added layer of convenience. Through MyConcierge™, members have direct access to a personal, local, dedicated point of contact who makes it their goal to help our members achieve their financial goals. Whether you are in one of our branches, on our app or website, or talking to one of our associates on the phone, you will experience the same level of personalized member service.

Corporate social responsibility and community involvement are of paramount importance to Members 1st. In the very fabric of Members 1st's principles are cornerstone values related to supporting community engagement and diversity. There is an entire team at Members 1st dedicated to meeting the outreach needs of the community. Members 1st feels a moral obligation to support the community—not only with logos and sponsorships, but also with significant involvement, presence, and support from its associates to help make Central Pennsylvania a better place to live and work. To further expand upon serving its members, associates, and communities, Members 1st launched the Members 1st Charitable Foundation in 2021 to further its commitment to help communities at the grassroots level after seeing the impact of COVID-19 on consumers, businesses, and non-profits. Members 1st is grateful for the opportunity to serve its members, associates, and communities. We appreciate the opportunity to share our views on the impact the CFPB’s 1071 Small Business Data Collection rule will have on small financial institutions like mine.

Background on Credit Unions

Credit unions serve a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system serves to promote thrift and make financial services available to all consumers, many of whom would otherwise have limited access to financial services. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes" (12 § USC 1752(1)). Congress established credit unions as an alternative to banks and to meet a precise public need, and today credit unions provide financial services to over 135 million Americans. Since President Franklin D. Roosevelt signed the Federal Credit Union Act (FCU Act) into law nearly 89 years ago, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

1. Credit unions remain totally committed to providing their members with efficient, low-cost, personal financial services; and,
2. Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

The nation's approximately 4,800 federally-insured credit unions serve a different purpose and have a fundamentally different structure than traditional banks. Credit unions exist solely for providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions, united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors, something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration, epitomizing the true volunteer spirit permeating the credit union community. Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. Since the Great Recession, consolidation of the commercial banking sector has progressed at an increasingly

rapid rate. At a time when for-profit banks are deemphasizing the human touch for financial services, credit unions are second-to-none in providing their members with quality personal financial services at the lowest possible cost.

Credit Unions as Small Business Lenders

Credit unions have a long history of helping underserved communities due to their cooperative structure, and nothing demonstrates this better than response to the COVID-19 pandemic, when NAFCU members extended loans through the Paycheck Protection Program (PPP) to small businesses that had been turned away by for-profit banks. According to a NAFCU survey of our members, 87 percent of respondents had small business members join their credit union to secure PPP funding in 2020 and 2021.

Unfortunately, credit unions have an artificial barrier to being able to do all that they can to help small businesses. When Congress passed the Credit Union Membership Access Act (CUMAA) (P.L.105-219) in 1998, it put in place restrictions on the ability of credit unions to offer member business loans. Credit unions had existed for nearly 90 years without these restrictions. Congress codified the definition of a member business loan and limited a credit union's member business lending (MBL) to the lesser of either 1.75 times the credit union's actual net worth or 1.75 times the minimum net worth of a well-capitalized credit union (12.25 percent).

CUMAA also established, by definition, that only business loans above $50,000 count toward the cap. This number was not indexed and has not been adjusted for inflation in the nearly 25 years since enactment, eroding the de minimis level. Where many vehicle loans or small lines of credit may have been initially exempt from the cap in 1998, many loans that meet the needs of small business today are now included in the cap due to this erosion. To put this in perspective relative to inflation, what cost $50,000 in 1998 costs over $92,000 today, using the most recent consumer price index data. That is more than an 80 percent rate of inflation that is completely ignored by current law and greatly hamstrings a credit union's ability to meet its members' needs.

It should be noted that the government-guaranteed portions of Small Business Administration (SBA) loans do not count toward the member business lending cap, but the non-guaranteed

portions do. This could ultimately lead to a situation where a credit union may be an excellent, or even preferred, SBA lender and ultimately have to scale back participation in Small Business Administration (SBA) programs as it approaches the arbitrary cap. This would likely hit SBA Express loans first, as those have lower guarantees and, thus, may have a bigger impact on money available below the cap.

As such, we would urge Congress to support legislation to modify or remove the arbitrary cap on credit union member business lending. At the very least, Congress should update the $50,000 threshold to reflect inflationary changes over the last quarter century. This was proposed as part of H.R. 5189, the Member Business Loan Expansion Act, a bipartisan bill by Representatives Vincente Gonzalez and Brian Fitzpatrick in the 117th Congress.

While some on the banking side may say that credit unions unfairly compete, we would note that a 2011 study commissioned by the SBA's Office of Advocacy found that bank business lending was largely unaffected by changes in credit unions' business lending, and credit unions' business lending can actually help offset declines in bank business lending during a recession (James A. Wilcox, *The Increasing Importance of Credit Unions in Small Business Lending*, Small Business Research Summary, SBA Office of Advocacy, No. 387 (Sept. 2011)). The study shows that during the 2007-2010 financial crisis, while banks' small business lending decreased, credit union business lending increased in terms of the percentage of their assets both before and during the crisis.

Members 1st FCU's Role as Small Business Lender

Members 1st is proud of its work as a small business lender. We started our member business lending program in 2003, and last year we did $350 million in business lending. We hold $90 million in business deposits. We have over 3,600 business loans on the books with nearly $1 billion in balances. We are proud of our work in Central Pennsylvania. During the pandemic we were the 9th largest PPP lender in the credit union space, in addition to helping our members through a trying financial time. We are also a participant in the 7(a) loan program through the SBA.

Concerns with the Current Rulemaking

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was enacted to respond to the 2008 financial crisis. One of the key provisions of this act was the creation of the CFPB. The Bureau was established to protect consumers from another financial crisis, with institutions below $10 billion exempted from its oversight and enforcement. Everyone agrees that credit unions did not cause the 2008 financial crisis, and that is why NAFCU expressed concerns about the increased regulatory burdens that credit unions would face being subject to new rules from another regulator (the CFPB) in addition to the National Credit Union Administration (NCUA). Unfortunately, our concerns have proven true, as the number of credit unions has declined by over 37 percent since the passage of the Dodd-Frank Act with regulatory burden being the number one reason given for credit unions disappearing.

Included in the Dodd-Frank Act was Section 1071, which amended the Equal Credit Opportunity Act (ECOA) to require financial institutions to report information concerning credit applications made by women-owned, minority-owned, and small businesses. The legislative purpose of Section 1071 is to facilitate enforcement of fair lending laws and to enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses. NAFCU and credit unions support this goal. However, we have concerns about how the CFPB is choosing to carry out its authority. As the Subcommittee looks at the issue of how these new requirements could restrict access to credit for small businesses, especially from smaller lenders, we would like to take this opportunity to share our concerns with the CFPB's notice of CFPB's proposed rulemaking (Proposed Rule) under Section 1071 of the Dodd-Frank Act.

NAFCU has a series of concerns about the proposal and its impact on access to credit from credit unions for small businesses that we have shared with the Bureau. These are outlined below:

Covered Financial Institutions

While Section 1071 defines "financial institution" to include a reasonably expansive list of different types of entities that may engage in small business lending, Section 1071 establishes neither a metric nor a threshold by which to identify those from whom Congress anticipated the Bureau would collect small business lending data. Under the Proposed Rule, any entity meeting Section 1071's definition of a financial institution that originated at least 25 covered credit transactions for small businesses in each of the two preceding calendar years would be a covered financial institution. The Proposed Rule's 25 loan-volume threshold was the lowest, non-zero loan volume threshold considered by the Bureau in prior Section 1071 rulemaking exercises. The Bureau anticipates it could lower one-time Section 1071 compliance costs by roughly $120 million and still collect Section 1071 data for approximately 94 to 95 percent of all small business loans made by depository institutions if it establishes a 100 loan-volume threshold. However, it is obvious that a 100 loan-volume threshold is much too low still. For decades, mortgage market stakeholders have drawn statistically significant conclusions about the health and fairness of the mortgage market from data collected and reported subject to the Home Mortgage Disclosure Act (HMDA), which, the Bureau has estimated, captures something just shy of 90 percent of all available mortgage data. Establishing a 100 loan-volume threshold or any other loan-volume threshold that operates to capture more Section 1071 data than is necessary at the expense of small business borrowers runs counter to the Bureau's Section 1071 responsibilities.

Compounding this concern is the Bureau's reliance on NCUA 5300 Call Report data and similar banking industry data. A great deal of small business lending occurs below the relevant $50,000 reporting thresholds. The Bureau may welcome larger covered financial institutions' being required to report even more Section 1071 data than the Bureau now projects. However, the Bureau should be deeply concerned that its overreliance on Call Report data risks the Bureau materially underestimating how many credit unions would likely be covered financial institutions under artificially low 25 and 100 loan-volume thresholds. NAFCU encourages the Bureau to adopt a covered financial institution loan-volume threshold not lower than 500 covered credit transactions.

Chilling Effect on New and Modest Small Business Lenders

The Bureau acknowledges that some credit unions, faced with the Proposed Rule's significant onetime and ongoing compliance costs, may simply be forced to exit small business lending altogether. Other credit unions, the Bureau anticipates, will attempt to manage their small business lending activities so as to narrowly avoid crossing whatever loan-volume threshold the Bureau ultimately adopts. This is bad for small business and shows a lack of understanding about credit unions.

While it is theoretically possible that a credit union or bank could manage its small business lending activity in such a way as to avoid crossing a loan-volume threshold, the theory quickly erodes when one considers the fluidity and iterative nature of most small business lending. Small business lending, particularly at credit unions, is often the product of a lengthy, relationship-intensive process that unfolds over weeks, months, and, sometimes, years. Credit unions and entrepreneurs work diligently alongside one another to understand small businesses' strengths and capital needs and identify appropriate small business solutions. Consider the simplest context, one in which a credit union has never engaged in a credit transaction covered by the Proposed Rule. Aware that not all credit applications are approved and not all approved credit applications result in a member accepting the approved terms, the credit union would rationally work to cultivate small business relationships in excess of its targeted loan-volume. During years-long periods in which application approvals and borrower acceptances are above average, or emergencies press a credit union to redouble its commitment to its community, can the credit union truly be expected to abandon or stall its small business members the moment it unexpectedly meets its target loan volume? Next, consider one of the thousands of credit unions that may wish to better support its small business members by beginning to offer an affordable small business credit card product. If a credit union was simultaneously managing its small business lending activity to ensure it is not exposed to Section 1071 compliance costs it is unable to afford, every new small business credit card account would represent one fewer traditional small business loan it could make, irrespective of a small business member's need. Similar examples are not in short supply, but the effect of each is the same. Credit unions' reliably

managing small business lending activity to a specific loan volume is simply implausible, if not impossible. More likely, these credit unions, too, would be forced to avoid or exit small business lending altogether.

In conversations with members, NAFCU has observed that anxiety regarding Section 1071's future costs may already be having a chilling effect on future plans to expand small business lending operations. After the passage of the Coronavirus Aid, Recovery and Economic Security Act (CARES Act), credit unions expressed optimism that public awareness of the PPP's funding might enhance general demand for SBA loans. Credit unions that had never previously sought to promote small business loan products also expressed interest in sustaining small business lending even after the PPP was exhausted. However, after the Bureau's Section 1071 rulemaking efforts were more widely publicized in September 2020, some credit unions expressed hesitancy about pursuing small business lending due to uncertainties surrounding the costs of Section 1071 compliance. According to a 2011 study from the SBA, while banks tend to reduce lending during economic stress, credit unions continue to lend to small businesses. During the Great Recession, credit union lending offset a proportional reduction in bank lending. The Bureau's January 2020 data point found the number of credit unions offering small business lending products doubled since 2004, from 10 percent to 20 percent. As big banks continue to avoid historically-disadvantaged communities and desert short-lived efforts in others and as community banks continue to merge, the Bureau must be keenly aware of the Proposed Rule's ability to chill small business lending by credit unions, sometimes the only in-community option remaining for small businesses.

Covered Applications

NAFCU appreciates the Proposed Rule's providing that "a financial institution has latitude to establish its own application process or procedures." Small business lending, particularly at credit unions, is often an iterative process tailored to borrowers' unique needs and not a rote walk-through of a fill-in-the-blank template. NAFCU is, however, concerned by the Proposed Rule's not adopting Regulation B's definition of a "complete application." The Bureau's adopting a

"complete application" definition, as opposed to the Proposed Rule's comparatively open-ended definition of an application, would alleviate the significant burden covered financial institutions would have in collecting Section 1071 data from unengaged applicants that have no intention of completing the application process. Unnecessary compliance costs that would in short order translate to higher small business borrowing costs would be avoided, and the integrity of valuable Section 1071 data on the most important small business lending activity would be protected. While it may be convenient for the Bureau to have data regarding incomplete applications when it explores fair lending issues related to borrower discouragement, there is no indication that Congress intended for Section 1071 to mirror the requirements found in the HMDA and Regulation C. Furthermore, it appears plausible that many incomplete applications could be the product of borrower confusion regarding the need to supply unfamiliar, deeply personal data points rather than the product of borrower discouragement. To the extent that borrower discouragement intersects with more easily measurable fair lending concerns, the Bureau will have more than sufficient Section 1071 data, in addition to its existing examination authorities, to investigate ECOA violations involving small business lending products.

Small Business Definition

The Proposed Rule would define a small business as any business with prior-year gross annual revenue of $5 million or less. NAFCU supports regulation that enables credit unions to more quickly and confidently support their communities' small businesses. Also, as previously expressed, NAFCU appreciates the obvious benefits of any easy-to-apply small business definition based on gross annual revenues. However, as discussed more fully in other sections, credit unions generally anticipate being forced to pass along their Section 1071 compliance costs to small business borrowers in the form of higher fees. Small business lending fees are, like many sales taxes, regressive in nature, disproportionately expensive for small businesses borrowing the least. It is altogether possible that fees for the smallest dollar small business lending products could increase to such a proportion that the smallest dollar products altogether disappear from the small business lending market or are offered only by the least scrupulous, least regulated small business lenders. A gross annual revenue threshold must, therefore, operate to cost-

effectively capture only the data reasonably necessary to enable stakeholders to draw statistically significant conclusions about the health and financial needs of truly small businesses. Based on the underwriting experiences of its members and the SBA's relevant standards, NAFCU recommends that the Bureau adopt a small business definition based on a $1 million prior-year gross annual revenue threshold.

Covered Credit Transactions

The Proposed Rule broadly defines a covered credit transaction to include any extension of business credit other than trade credit, public utilities credit, securities credit, and incidental credit, which are expressly excluded. The Bureau anticipates explaining in the Official Commentary that factoring, leases, consumer-designated credit used for business purposes, and credit secured by certain investment properties are not covered credit transactions. Under the Proposed rule, credit unions' small business loans, lines of credit, and credit cards would all be covered credit transactions. If a credit union offers its small business members a merchant cash advance (MCA) product, that too, would be a covered credit transaction under the Proposed Rule. To gauge the size and distribution of the small business lending market comprised of these products, the Bureau relied on 2019 NCUA Call Report data and similar banking industry data. However, the Proposed Rule offers no de minimis threshold below which an otherwise covered credit transaction would not count toward a financial institutions' loan-volume threshold.

NAFCU recommends that the Bureau put its assumptions into practice and establish a *de minimis* threshold applicable to all covered credit transactions that tracks the NCUA Call Report threshold, currently $50,000. Congress's decision to exclude member loans under $50,000 from credit unions' MBL caps and the NCUA's corresponding decision to exclude such loans from Call Reports reflect a general, reasoned understanding that burdensome reporting requirements frustrate very small businesses' access to affordable, high-quality small dollar loans. Small dollar loans are particularly important to sole proprietorships. As the Bureau makes extensive note, the majority of women- and minority-owned businesses are sole proprietorships. In the alternative, NAFCU recommends that the Bureau delay any further Section 1071 rulemaking until the Bureau is

prepared to present a more transparent methodology describing the likely coverage of financial institutions based on lower covered credit transaction thresholds. NAFCU also recommends that the Bureau expressly exclude small business credit cards from the Proposed Rule’s definition of a covered credit transaction. An informal survey of a cross section of NAFCU members suggests that the vast majority of credit unions’ new small business credit card account limits are well below the NCUA 5300 Call Report threshold – with median limits hovering tightly around $10,000.

NAFCU understands from other industry stakeholders that similar trends persist in nearly every identifiable sub-section of the banking industry. Under the Proposed Rule, as written, a credit union’s approving even marginal small business credit card account limit increases would push the credit union closer toward whatever loan-volume threshold the Bureau ultimately adopts. It seems likely, therefore, that absent the Bureau either establishing a meaningful *de minimis* threshold or expressly excluding small business credit cards from the Proposed Rule’s definition of a covered credit transaction, every credit union that offers even a single small business credit card product will ultimately become a covered financial institution on that basis alone.

Furthermore, the Bureau estimates that roughly three-quarters of credit unions do not yet offer a small business credit card product. Any one of that number that subsequently offers its small business members an alternative to high-fee, high-interest small business credit card products pushed by big banks and fintechs would likely find itself soon exposed to the Proposed Rule’s extraordinary compliance costs, irrespective of any other small business activities. NAFCU supports the Bureau’s exclusion of consumer-designated credit transactions from the Proposed Rule’s definition of a covered credit transaction and recommends that the Bureau further clarify that it will not challenge a credit union’s designating an otherwise covered credit transaction to be a consumer-designated credit transaction. NAFCU believes that preserving such discretion is critical to mitigating overall Section 1071 compliance risks given covered financial institutions have no reliable method for validating a latent business purpose in an application for a consumer-designated credit transaction.

Finally, because NAFCU believes it is unlikely Congress intended to include commercial real estate loans made to investors within the scope of Section 1071, NAFCU again recommends that the Bureau consider expressly exempting such loans from the Proposed Rule's definition of a covered credit transaction rather than rely on the Official Commentary's operation. It is often the case that these loans' relevant data are already reported under the HMDA. Additionally, commercial real estate loans made to investors are typically made to business entities with complex ownership structures that make it difficult for financial institutions to determine even the identity of all a borrower's principal owners.

Mandatory Data Points

Credit Purpose: NAFCU recommends that the Bureau further clarify how covered credit transactions should be reported when they are made directly to the sole proprietor of a business, not to the business itself. Credit unions engaged in small business lending to sole proprietors individually may find it confusing to report a loan purpose that implies that the business itself is the recipient.

Amount Applied For: NAFCU recommends that the Bureau grant financial institutions the discretion to report an "amount applied for" that is determined at a later stage, rather than at the first request of the applicant, because reporting the first initial credit request could inaccurately represent the lending process. Particularly in transactions involving real estate or equipment, many small businesses will request a much higher loan amount than what is ultimately approved after evaluation of collateral. For startups and sole proprietorships, a lack of sophistication can also lead to similarly unrealistic initial requests. In these cases, credit unions work diligently with applicants to arrive at a more reasonable amount, but such education could take place over a period of weeks or months.

Census Tract: The geocoding requirement will be a source of significant burden for many credit unions, the vast majority of which do not collect census tract information for small business loans.

Although some Community Financial Development Institution (CDFI) credit unions collect census tract information, many are completely unfamiliar with how to collect this information—particularly those that are exempt from the HMDA's reporting requirements. Those credit unions that do not use the Federal Financial Institutions Examination Council's (FFEIC) geocoding tool to collect census-tract information will need to acquire a separate software license from a vendor to implement geocoding. There may also be separate related costs for periodic system upgrades. The FFIEC geocoding tool also does not permit batch inputs, which further slows more manual application processes at credit unions. For credit unions with limited staff, such a bottleneck could mean losing business as members frustrated by longer approval times look elsewhere. NAFCU, therefore, recommends that the Bureau develop a free tool for use by covered financial institutions that permits batch inputs and better enables covered financial institutions to more efficiently, cost effectively fulfil their Section 1071 responsibilities.

Protected Demographic Information and Visual Observation

Under the Proposed Rule, in certain circumstances, a covered financial institution's employee would be forced to determine the ethnicity and race of a small business applicant's principal owner via visual observation. NAFCU unequivocally opposes the Bureau's adoption of any regulation or examination practice that operates to require that any individual make any visual observation concerning any protected demographic information or similarly sensitive data of a small business applicant's owners. Humans have immense and persistent difficulties accurately and precisely identifying others' race and ethnicity. Routinely inaccurate visual observations of this sensitive data would not only threaten the integrity of other valuable Section 1071 data but would add unnecessary friction to small business relationships and give rise to avoidable, unreasonable fair lending risks.

The Proposed Rule's requiring, in certain instances, that a covered financial institution's employee make visual observations of protected demographic information may, too, expose covered financial institutions to compliance costs related to an evolving patchwork of state personal data privacy laws. While some states' personal data privacy laws provide financial

institutions an institution-level exemption, at least one state, California, provides financial institutions only an information-level exemption. To the extent protected demographic information is deemed not to be collected "subject to" or "pursuant to" the Gramm-Leach- Bliley Act, Californians may have certain robust personal data privacy rights with respect to their visually observed protected demographic information collected and maintained by covered financial institutions.

Discretionary Data Points

Section 1071(e)(2)(H) requires financial institutions to collect and report "any additional data that the Bureau determines would aid in fulfilling the purposes of [Section 1071]." The Proposed Rule would require covered financial institutions to collect and report the following eight discretionary small business lending data: pricing, time in business, North American Industry Classification System (NAICS) code, number of workers, application method, application recipient, denial reasons, and number of principal owners. In light of the significant one-time and ongoing Section 1071 compliance burdens already facing covered financial institutions with respect to their collection and reporting of mandatory data, NAFCU opposes the Bureau's adoption of any discretionary Section 1071 data points. The Proposed Rule's discretionary data points represent data that is neither materially useful in fulfilling the ultimate objectives of Section 1071 nor reliably obtainable by cost-effective means. NAFCU anticipates that any Section 1071 final rulemaking will tend to widen the competitive gulf between credit unions and big banks and fintechs that have the economies of scale and the technological sophistication to automate complex functions.

The Bureau's requiring covered financial institutions to collect and report even more discretionary Section 1071 data will only compound credit unions' competitive disadvantages. For example, NAFCU members who participated in the PPP noted that many small business applicants either did not know what a NAICS code was or how to determine which NAICS code most closely matched their business. Manually collecting just this data point will require a credit union to devote a significant amount of time and resources to ineffective education. One

statutory purpose of Section 1071 is to facilitate enforcement of fair lending—a goal that is not sector dependent. The identification of business and credit needs can be accomplished without explicit reference to NAICS codes, such as by leveraging already existing data sources and voluntary surveys of business owners. Furthermore, sector-specific analysis of business credit supply and demand is best left to the SBA, which already collects NAICS information through its lending programs. The risks of the Bureau's collecting the Proposed Rule's discretionary data is not limited to increased compliance costs that drive small business lending costs higher. The Bureau's collection and ultimate reporting of small businesses' time in business, NAICS code, and number of workers, coupled with census tract information, raises serious concerns about small businesses' privacy. Such discretionary data, when made public, could be used to re-identify small business borrowers and help competitors gain impermissible insight into financial information directly bearing on small businesses' long-term financial health and competitive goals.

Firewall

Section 1071 generally contemplates the existence of an information firewall between employees handling inquiries about a small business applicant's status as a women-owned, minority-owned, or small business and those employees engaged in underwriting. Under Section 1071(d)(2), if a financial institution discovers that an underwriter or others involved in making a determination regarding an application "should have access" to such information, it must provide an applicant a notice of "the access of the underwriter to such information, along with notice that the financial institution may not discriminate on the basis of such information."

Unfortunately, the Proposed Rule's low loan-volume threshold and expansive covered credit transaction definition will likely operate to require the distribution of the proposed Section 1071 information firewall disclosure far more often than Congress intended. Too frequent distribution will produce untenable, negative real-world effects that weigh most heavily on those the regulation is intended to protect. Many credit unions have small business lending departments comprised of three or fewer employees. Small business lending at such credit unions across the

country is more often than not an all-hands-on-deck effort. In operation, the Proposed Rule threatens to create the powerful illusion that these modestly-staffed credit unions are incapable of guaranteeing that protected demographic information will not affect an underwriting decision. The effect will likely be particularly pronounced with respect to women- and minority-owned small businesses, the entrepreneurs of which routinely come face-to-face with the realities of their relative economic disadvantages. A rational entrepreneur of a women- or minority-owned small business would be forced to consider accepting higher interest rates and other onerous credit terms in exchange for the relative peace of mind that a big bank's or fintech's seemingly limitless technology and personnel budgets ensure that protected demographic information remains shielded from underwriters.

The Bureau cannot eliminate the Section 1071 information firewall disclosure's giving the appearance that credit unions are incapable of adequately shielding protected demographic information from underwriters. But the Bureau should reduce the need for its distribution by adopting Section 1071 regulation with commonsense definitions and right-sized thresholds.

Reputational Risks Related to Statutory Limitations and Future Balancing Test

The publication of small business data from credit unions risks presenting a misleading portrait of overall credit availability due to variables such as field of membership and aggregate MBL limits. As a result of these unique statutory restrictions, credit union lending patterns may not translate easily when compared to other institutions. Accordingly, it is imperative that the Bureau supply a transparent description of the methods and analysis it will apply when evaluating Section 1071 data for supervisory purposes. The Bureau should also recognize that some credit unions may respond to perceived reputational risks associated with data publicization by eliminating certain product offerings or modifying underwriting practices in a way that reduces the overall diversity of small business products. In such a scenario, small businesses could ultimately find it more difficult to acquire credit on favorable terms if financial institutions seek to flatten pricing artificially because they are concerned by the outward appearance of such discrepancies, even when no discrimination, in fact, exists.

Credit unions may also need to allocate additional resources to respond to inquiries about Section 1071 data from NCUA examiners, who will be performing fair lending analysis of Section 1071 data for the first time. To help credit unions better assess possible reputational concerns, the Bureau must also provide a full and complete explanation of any balancing test it intends to use to limit public disclosure of Section 1071 data. Merely referencing a conceptual framework and then articulating the full policy later, as the Bureau does in the Proposed Rule and did with the HMDA, will not suffice. For credit unions to accurately assess the full range of privacy and reputational impacts that might be associated with any proposal, there must be a complete understanding of how the balancing test will be applied. For example, credit unions might approach their assessment of the costs of collecting certain data items by considering how it might be used to reidentify a borrower. The risk of reidentification cannot be fully known unless the Bureau provides a complete description of how a balancing test or other methodology for limiting public disclosure works.

One-Time and Ongoing Compliance Costs

NAFCU is significantly concerned that the Bureau has materially underestimated the one-time and ongoing costs credit unions are likely to face under the Proposed Rule. While, like others, NAFCU's members have had insufficient opportunity to explore all options, early indications are that third-party training, information technology, and auditing expenses are likely to be several multiples higher than the Bureau's estimates. The Bureau's estimates with respect to training, for example, tend to reflect a scenario in which the only staff trained on Section 1071 compliance are those staff for whom Section 1071 data collection and reporting are a primary, largely autonomous job function. Such a scenario may be realistic at the smallest credit unions that have only two or three staff engaged in business lending and at the very largest credit unions with dedicated fair lending compliance departments. However, for credit unions with modest but not minimal staff, such an expectation ignores the fact that it is often the case that all or most employees are trained on all compliance issues to promote cross-functional efficiencies.

Expenses may be driven higher still if the Bureau adopts an insufficient mandatory compliance schedule.

Mandatory Compliance Schedule

The Proposed Rule's 18-month mandatory compliance schedule would be aggressive even for the largest, most technologically savvy credit unions. As discussed above, the vast majority of credit unions likely to be covered financial institutions under the Proposed Rule will be forced to rely on multiple IT vendors to develop, redeploy, and cross-test Section 1071-compliant small business lending programs and tools. Furthermore, many credit unions, because they are exempt from the HMDA's reporting requirements, have no preexisting HMDA software solutions or IT vendor relationships to leverage. These credit unions will require even more time to come into compliance with robust, technology-intensive Section 1071 regulation.

Past experience with the Bureau's implementation of the HMDA suggests that the Bureau is likely underestimating the time required for IT vendors to adapt their products to comply with major rulemakings. Relatedly, many NAFCU members who entered the small business lending market for the first time through the PPP to help local businesses reported having done so by relying on existing resources, not new technologies or other efficiencies. That some credit unions may now provide a more diverse range of products does not necessarily equate to greater sophistication or reduced reliance on manual systems. Credit unions across the country have simply worked harder for longer to support their communities' small businesses during the COVID-19 pandemic. NAFCU strongly encourages the Bureau to adopt a phased mandatory compliance schedule based on covered financial institutions' loan volumes that begins no sooner than three years following the Bureau's adoption of a Section 1071 final rulemaking. The credit unions that have the least bargaining power with powerful third-party IT vendors are often the last to receive core system upgrades and must have the time necessary to become fully compliant with a Section 1071 final rulemaking.

We are supportive of efforts to address concerns about the compliance deadline such as the Small Lenders Exempt from the New Data and Excessive Reporting (LENDER) Act, offered by Representative French Hill.

Coordination of Examinations

Unlike mortgages, which are largely homogenous consumer products, small business loans can vary widely in design and purpose. Accordingly, prudential regulators' examiners applying the same analytical techniques and examination approaches applicable to the HMDA's enforcement to small business data may yield erroneous results. Absent a clear description of the methodologies that might be employed to perform fair lending analysis using Section 1071 data, there will likely be a period where prudential regulators' examiners' expectations are in flux and, perhaps, materially inconsistent. To the extent that credit unions are subject to Section 1071 reporting, the Bureau must coordinate with other FFIEC agencies, including the NCUA, to develop model examination procedures in advance of the Bureau adopting a Section 1071 final rulemaking.

Small Business Lending Data Collection and the SBA

If the SBA again engages in direct small business lending, small business borrowers would face two material, perhaps not obvious, risks – higher borrowing costs and a consolidated small dollar lending market. The Bureau cannot be held responsible for the actions of other agencies, but the Bureau must remain keenly aware that its Section 1071 rulemaking has significant impacts on a small business lending market shaped by powerful private and public competitive pressures.

First, the Proposed Rule's Official Commentary specifically includes "governmental lending entities" within the definition of a financial institution. While the SBA's balance sheet and reach may more closely resemble those of big banks and fintechs than those of a credit union, the SBA, as the PPP made clear, is significantly reliant on manual information processing and the smooth functioning of the individual offices within its vast network. If the SBA engages in direct lending, it will no doubt meet the Proposed Rule's definition of a covered financial institution. With the

lessons of the last few years firmly in mind, the SBA would likely find it necessary to train nearly all employees on Section 1071 compliance to ensure modestly staffed offices can meet their Section 1071 responsibilities in times of pronounced small business needs. To offset these and other costs related to the collection and reporting of Section 1071 data, the SBA would likely be forced to raise the costs of small business lending products that are, for some borrowers, the best available option.

Second, if the SBA again engages in direct small business lending, the SBA would threaten all credit unions' disintermediation in the increasingly important small dollar segment of the business lending market. Not only do recent SBA proposals lack the statutory guardrails to prevent the SBA from becoming credit unions' direct lending competitor, but they also create the risk of fintechs, which have never been permitted to originate 7(a) loans, driving credit unions entirely out of 7(a) lending. The direct lending proposal's net effect of increasing private-sector competition for ever fewer private sector SBA lending opportunities will chill credit unions' 7(a) lending and lead to a consolidation of small dollar lending to the detriment of small businesses. As the Bureau contemplates its Section 1071 final rulemaking, NAFCU encourages the Bureau to remain keenly cognizant that its decisions will bear mightily on a profoundly complicated and rapidly changing small business lending market. The Bureau cannot be expected to alleviate all the ill-effects of a potential SBA direct lending program, but the Bureau should ensure that its Section 1071 final rulemaking does not unnecessarily compound small dollar lending price increases or speed the small dollar lending market's consolidation. NAFCU does not support an SBA direct lending program and would urge expressly excluding loans extended by depository institutions and backed by a governmental entity from its Section 1071 final rulemaking's definition of a covered credit transaction.

Recommendations

With the final Section 1071 rule set to be released, NAFCU urges the CFPB to exercise its discretionary authority to exempt smaller institutions from this rule as the compliance costs outweigh any benefit. If such an exemption is not granted under the CFPB's Section 1022

authority, we would hope to see significant changes to the proposed rule as outlined above. Should the Bureau not address these, we urge Congress to step in with your oversight authority and to consider statutory changes to address our concerns such as enacting the Small LENDER Act. Failure to do so would threaten access to credit for many of our nation's main street small businesses who rely on community lenders like credit unions to meet their capital needs.

Furthermore, to help reduce barriers to credit unions providing credit to small businesses, we would urge Congress to take steps modernize the FCU Act's member business loan provisions such as updating the *de minimis* threshold for loans from $50,000 to $100,000 as proposed in the Member Business Loan Expansion Act.

Conclusion

While NAFCU supports the goal of ensuring access to capital for women-owned, minority-owned and small businesses, we believe the costs associated with instituting the proposed Section 1071 small business data collection rule will overshadow any hypothesized improvements in supervisory efficiency or market transparency. Congress also enacted Section 1022 of the Dodd-Frank Act, which requires an assessment of the effectiveness of each rulemaking at the CFPB, and even included a specific exemption provision with Section 1071 itself. The Bureau should exercise the authority granted by Congress to provide small lenders such as credit unions relief from a number of burdens stemming from the Section 1071 rulemaking. The alternative is to impose yet another data collection regime that is certain to exacerbate the cumulative toll of regulatory burden endured since the last financial crisis, particularly for smaller community financial institutions like credit unions that have experienced significant and ongoing consolidation. Section 1071, like many Bureau rulemakings, will likely drive further consolidation, reduced choice, and potentially result in small businesses losing access to trusted, responsible, and affordable community lenders. If the CFPB will not address these concerns in their rulemaking, we would urge Congress step in and make changes.

I thank you for the opportunity to testify today and look forward to answering your questions.