



November 9, 2020

Mr. Grady Hedgespeth
Assistant Director
Office of Small Business Lending Markets
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

SUBMITTED VIA ELECTRONIC MAIL TO 2020-SBREFA-1071@cfpb.gov

Re: Written Feedback by SER Luz Urrutia following the Section 1071 SBREFA Panel

Dear Mr. Hedgespeth:

Opportunity Fund is grateful for the opportunity to participate as a Small Entity Representative (“SER”) in the Consumer Financial Protection Bureau’s (“CFPB” or “the Bureau”) Small Business Regulatory Enforcement Fairness Act (“SBREFA”) panel, which was convened in October 2020 to provide perspective regarding the small business implications of the Bureau’s forthcoming Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“the Dodd-Frank Act”) final ruling.

Small business ownership drives economic mobility, creates jobs, and sustains families and communities. Yet entrepreneurs of color, low income individuals, immigrants, and women are disproportionately denied vital capital and support. After ten long years, we are looking forward to the Bureau’s implementation of Section 1071 to better understand the small business lending landscape and assess the needs of small businesses who are seeking affordable and responsible financing. We believe that a rule that is broad and expansive with minimal exemptions, covers a broad range of products and collects pricing data in the form of APR will help the small business lending ecosystem better serve small businesses. Implementing Section 1071 will help lenders across the country, including Opportunity Fund, better connect underserved entrepreneurs to working capital and resources in order to build a more inclusive economy for everyone.

As mentioned in this letter and via my verbal remarks during the SBREFA meetings, we need a rule that is broad and expansive and includes all financial institutions and products (including MCAs, factoring and leasing) that are sought out by small businesses. Additionally, a pricing data point in the form of APR is needed to understand what products are offered to whom and at what cost.

About Opportunity Fund

Opportunity Fund is the leading non-profit financial institution founded in 1994 that drives economic mobility by delivering affordable capital and responsible financial solutions to determined entrepreneurs and communities. A nationally recognized leader among Community Development Financial Institutions (CDFIs), Opportunity Fund is the largest nonprofit microlender in the U.S. by portfolio size. We achieve our mission by providing micro and small business loans from \$2,600-\$250,000, with a particular focus on low and moderate-income entrepreneurs, minority, and women-owned businesses across 45 states. In addition, we offer business advising and technical assistance to our clients and any small business who may need this support.

Approximately 62% of Opportunity Fund's clients are low- to-moderate income; 74% are ethnic minorities, and 37% are women. These clients have an average credit score of 679, with approximately 7% having little to no credit history. Our loans provide disadvantaged entrepreneurs access to affordable credit to grow a business; support themselves and their families; create and retain jobs; and generate economic activity in their neighborhoods.

2020 has been a very difficult year for small businesses across the country, [especially for minority and women-owned businesses](#). Opportunity Fund is working in overdrive to ensure that small businesses have the support to weather this pandemic, because even relatively small amounts of capital can make a huge difference for these entrepreneurs and their communities. In FY20 we invested \$111,456,308 in small businesses and their communities. We provided \$65 million in small business loans, \$35 million in New Markets Tax Credits financing to high-impact community real estate projects, and \$14 million in Paycheck Protection Program (PPP) loans. While the industry average PPP loan size was \$101,000, our average PPP loan size was \$14,829, going to some of the smallest and most vulnerable businesses in our country.

Implementing Section 1071 is Urgent Now More than Ever

There is currently no single comprehensive data set available to analyze trends within the U.S. small business lending industry. Section 1071 mandates that the CFPB collect data on small business credit, including data on race and gender. This data collection and reporting is critical to understanding the credit needs and financing outcomes of small business owners in today's lending marketplace—particularly for minority and women entrepreneurs.

The following Section 1071 recommendations, when implemented, will provide critical data points regarding the financing needs of small business owners and the outcomes of their applications. These insights are necessary to enable lenders, advocates, investors and the public sector to better meet the needs of *all* small business owners. We believe that the marginal added costs for lenders to collect and report this data is entirely offset by the increased benefits to disadvantaged entrepreneurs and their access to responsible capital.

The time to act is now. The legislative intent of Section 1071 of the Dodd-Frank Act is to gain a full picture of minority-owned and women-owned small businesses and their obstacles in accessing credit. Given the catastrophic economic impact of COVID-19 on small businesses across the country, Section 1071 is now more urgent than ever. Minority-owned businesses, in particular, have been hit the hardest. Therefore, the scope of any proposed rule should ensure that the vast majority of minority and women-owned businesses are covered in the rulemaking.

This means that the scope of the definition of small business should be monitored regularly and adjusted as necessary.

What Financial Institutions Should be Included

Opportunity Fund supports the Bureau's proposal to define "financial institution" broadly so that it includes most types of institutions that serve the small business lending market. Today, minority-owned, women-owned, and small businesses are increasingly being served by a large variety of lenders, particularly non-depository institutions. Thus, it is important to define financial institutions broadly so the Bureau can capture the diversity of lenders serving small businesses, thereby providing more comprehensive data on the credit landscape.

To gain a full view of the credit access made available to minority and women-owned small businesses, the Bureau should not provide any blanket exemptions to Section 1071 reporting by financial institution type—regardless of whether they are private, public, or nonprofit. As a nonprofit, non-depository institution lender, we do not seek an exemption for our institution type. CDFIs like us must already report this data to the CDFI Fund in the U.S. Department of the Treasury.

As it relates to other exemptions, we support an activity-based exemption of 25 loans or \$2.5 million in originated loans. The Bureau estimates that this would cover more than 99% of small business originations from depository institutions, which is admirable coverage in dollar terms. The Bureau also indicated that it does not have data that would allow it to estimate the number of applications that would be covered, or the number or value of loans, or applications, from non-DIs. This information is critical to understanding the size of loans made and the size of businesses receiving financing. Because the activity-based threshold is triggered by either a number of loans or by a total dollar value of originations, this will also ensure reporting from any non-depository institution providing a meaningful amount of small business credit in either originations or dollar terms but not holding it on their balance sheets.

We believe the Bureau should similarly be aiming for coverage of at least 90% in terms of number of all transactions, particularly for minority and women-owned businesses. According to a [2019](#) and [2020](#) Federal Reserve's Small Business Credit Survey, 76% of small business owners in America who seek financing are searching for loans of \$250,000 or less; this rises to 80% for Hispanic-owned businesses and 91% for Black-owned businesses. Because minority and women-owned businesses are even more likely to seek smaller dollar amounts, it is imperative

that the majority of these transactions are covered. In summary, an activity threshold should be the only exemption granted to a financial institution (no additional asset-based, financial institution type, or product exemption) since it is a clearer indication of whether a lender is substantially engaged in the business of small business finance or whether a nominal number of loans indicates that small business lending is incidental to its lending activity. It is not the same to make \$2.5 million in loans with an average size of \$25,000 vs. \$2.5 million with an average size of \$500,000.

This is consistent with HMDA rules historically, until 2020 when the threshold was raised to 100 loans.

Defining Small Business: What is a Woman-owned Business? Minority-owned Business?

Opportunity Fund supports the Bureau's efforts to achieve a simple definition of a small business and supports the proposed second alternative definition of a small business as one with gross annual revenues of \$8M or less. Based on the CFPB's analysis, this would cover 99.6% of all employer firms, as well as 99.9% of both women-owned and minority-owned employer firms.

However, it remains critical that the definition of small business include both employer and nonemployer firms in order to capture comprehensive data on the small business credit market, particularly given that most minority-owned and woman-owned small businesses are non-employer firms. For 46% of Black-owned businesses, the owner is the only employee in their own firm.

Minority and Women-Owned Small Businesses

Opportunity Fund generally supports the Bureau's approach regarding the definition of women-owned and minority-owned business whereby a business is considered as such when more than 50% of the ownership is held by one or more women or minority individuals. However, this definition should in no way suggest that race and gender data be collected only on applicants that identify as women and/or minority individuals.

We recommend simplifying the definition as it relates to ownership or control to exclude the language regarding "percent of net profit or loss" that accrues to a specific individual. The initial definition is sufficient for determining ownership and focusing solely on ownership would reduce complexity for lenders and borrowers alike. In addition, defining ownership on a profit/loss calculation may not fully serve the objectives of 1071, in the sense that it may exclude business owners with different types of profit/loss or incentive structures. Like we mentioned earlier, the scope of any proposed rule should ensure that the vast majority of minority and women-owned businesses are covered. This means that the scope of the definition of small business should be monitored regularly and adjusted as necessary to meet the intent of Section 1071.

We support the definition of a minority individual to be consistent with the definition provided under HMDA.

Financial Products Covered Must Include MCAs, Factoring and Equipment Leasing

Opportunity Fund believes the Bureau's proposed list of covered products under Section 1071 is too narrow and excludes common financing and capital products that many small businesses use to fund their enterprises. Specifically, we urge that Merchant Cash Advances (MCAs), factoring, and equipment leasing be included in the list of covered products.

The justification that MCAs, factoring, and equipment leasing be excluded, because their inclusion may add additional complexity or reporting burdens, is unacceptable. Complexity is not a valid reason to exclude these products. By removing 'complex' product types, the compliance burden is disproportionately placed on providers and products that already meet stringent regulatory requirements, rather than actually leveling the playing field. This further incentivizes a two-tier financial system in which some providers exclude communities of color and others exploit them.

According to a white paper, [Key dimensions of the small business lending landscape](#), published by the Bureau in 2017, the estimated number of accounts for factoring products was estimated to be at eight million, MCAs with one million, and equipment financing at nearly nine million. These three products accounted for over 18 million accounts, 2.5 times the estimated 7 million term loan accounts. While the dollar amount of factoring and MCA products is smaller than term loans, quantifying factoring and MCAs by number of accounts illustrates that these types of credit are widespread. Additionally, leasing products make up 13% of the small business financing market share in dollar terms, further indicating that those products should also be included.

Excluding MCAs, factoring, and equipment leasing as covered products will greatly inhibit gathering insight behind the most vulnerable small businesses who use these products, which Section 1071 intended to cover under this rule. We do not anticipate any significant reporting burdens for financial institutions who provide these products. On the contrary, we expect that more products covered under the rule will allow the Bureau to collect robust data that is needed to fully understand how products are being offered and to whom. Not only should these products be included under the rulemaking, but they should have the same activity-based exemptions as other product types.

The Federal Reserve Bank of Atlanta's [Report on Minority-Owned Firms, December 2019](#) describes MCAs as "credit" and shows that MCAs disproportionately impact minority-owned businesses. According to the report, minority-owned firms more frequently applied for potentially higher-cost and less-transparent credit products (like MCAs and factoring.) Hispanic-owned firms sought MCA products more frequently than White-owned businesses, 15% compared with 8%, respectively. Black-owned businesses applied for factoring more

frequently compared to White-owned firms, 7% and 3%, respectively. Hispanic-owned firms applied for leases more frequently than White-owned firms, 11% and 8%, respectively.”

Additionally, MCAs are often marketed as loans and use underwriting practices that factor in a merchants’ credit ratings and bank balances, instead of their receivables. Truth in Lending legislation passed in several states ([California](#) and [New York](#)) and proposed at the federal level, define small business finance as including factoring, MCAs and leasing.

Mandatory Data Points Must Include Pricing Terms

Opportunity Fund supports the collection of the proposed mandatory data points: whether the applicant is a women-owned business, a minority-owned business, and/or a small business; application/loan number; application date; loan/credit type; loan/credit purpose; credit/limit applied for; credit amount/limit approved; type of action taken; action taken date; census tract; gross annual revenue; race, sex, and ethnicity.

Discretionary Data Points Should Become Mandatory

We support the mandatory collection of the Bureau’s proposed discretionary data points: pricing, time in business, NAICS code, and number of employees.

Collecting the necessary pricing information to compare pricing across products and providers should be mandatory. APR is the only established metric that enables informed comparisons of the cost of capital over time and between products of different dollar amounts and term lengths. APR is the time-tested rate that people know and expect, because it is the legally required standard for mortgages, auto loans, credit cards, student loans and personal loans, including short-term loans. In fact, [the Bureau’s website supports](#) the use of APR by stating that, “APR, or annual percentage rate, is the standard way to compare how much loans cost. It lets you compare the cost of loan products on an “apples-to-apples” basis.”

Small businesses seeking financing from CDFIs like Opportunity Fund are informed about their true cost of capital through an APR disclosure. If we can easily collect and report this data point without additional burdens and costs, other small business lenders should be able to do the same. California and New York have both passed Truth in Lending laws to require that small business lenders (including MCAs and factoring) inform small business owners by disclosing an APR. Both state laws have developed the necessary methodologies to calculate an estimated APR for a range of product offerings. These methodologies should be considered by the Bureau as starting points for calculating comparable pricing terms for a range of small business credit products.

If implemented properly and as intended, Section 1071 could help the market address both the lack of access to affordable capital and the threat of irresponsible lending. Merely by providing price transparency, the Bureau can encourage the development of successful lending models. Policymakers, community organizations, investors, banks seeking partnerships, and others

would be able to see, for the first time, which business models are successful at reaching minority-owned, women-owned and other underserved small businesses. Transparency would also attract investment capital and partnerships into models that work. It could be a market-based model and a pro-innovation approach to regulation.

In order to encourage this level of market dynamism, Section 1071 must include APR. Without this one pricing metric, data collection would not be useful in fostering transparency or distinguishing between whether high market penetration is due to innovation or because lenders are charging unaffordable rates to businesses which may ultimately default. [The Responsible Business Lending Coalition](#), which Opportunity Fund is a founding member, will be submitting a more detailed letter to the Bureau on the importance of and proposed methods for collecting a pricing data point in the form of APR.

Opportunity Fund does not anticipate any (significant) costs to collecting, checking, and reporting each data point as we, and many financial institutions, already partake in this data collection in some way for internal or external purposes.

Opportunity Fund believes that any benefits associated with collecting and reporting pricing for all products, in the form of APR, outweigh any cost burdens that financial institutions may experience. At the end of the day, the intent of Section 1071 is to have a full picture of credit access for small businesses and minority-owned and women-owned businesses, and collecting data on pricing will do just that. Therefore, the scope of the rule should not only cover the types of products offered to small businesses but also the pricing associated with them. This will provide insights as to what products businesses are consuming and at what cost.

Irresponsible small business lending has grown since the passage of the Dodd-Frank Act, therefore it is important to understand not only whether financing is being provided, but also at what terms and costs. Opportunity Fund conducted a study, [Unaffordable and Unsustainable: The New Business Lending](#), that offers a first-of-its-kind analysis of the loans and cash advances being offered to small businesses by short-term, high-cost alternative lenders. Using the information provided to us by borrowers who refinanced their high-cost products with us, we found that the average APR on products provided by alternative lenders (MCAs, factoring, etc.) was 94%, and ranged as high as 358%, without those APRs ever having been disclosed to the borrowers. If Section 1071 data collection indicates that access to capital is improving, but is blind to whether that capital provided is at 30% APR or 300% APR, Congress' intent will not be accomplished. Understanding the type of products that small businesses utilize is important but as important is data on which businesses are accessing which types and costs of capital.

Lastly, nearly every financing provider has an annualized return that they expect to earn from a financing transaction, whether or not they are disclosing an estimated annualized cost of capital to the borrower; therefore, there is no excuse to not collect and report to the Bureau.

We also propose that the Bureau collect an additional point regarding the manner in which an application was collected. Proposed response options would be 1) in-person, 2) by phone, or 3) online. The collection of this data point would enable stakeholders to better understand the manner in which an applicant interacted with a financial institution. This would be a critical data point for assessing whether a personal interaction with staff of a financial institution may contribute to discouragement in submitting an application.

Conclusion

Opportunity Fund strongly supports the Section 1071 small business finance data collection effort. It's been 10 years since the passage of the Dodd-Frank Act and we still lack a full understanding of the small business landscape.

As mentioned in this letter and via my verbal remarks during the SBREFA meetings, we need a rule that is broad and expansive and includes all financial institutions and products (including MCAs, factoring and leasing) that are sought out by small businesses. Additionally, a pricing data point in the form of APR is needed to understand what products are offered to whom and at what cost. The cost of implementing a watered down rule with a broad range of exemptions is that it will only be harder to fulfill the intent of Section 1071. A strong rule will help better connect underserved entrepreneurs to working capital and resources in order to build a more inclusive economy for everyone.

Opportunity Fund is grateful to represent underserved small businesses as a Small Entity Representative on the SBREFA Panel and looks forward to working with the Bureau on implementing a strong rule that will truly help small businesses. The rule should be proposed and implemented as soon as possible to yield significant insights for small business lenders, policy makers, advocates, and most importantly, for small business owners, the backbone of our national economy at a time when they are rebuilding and regenerating Main Street from the impact of COVID and beyond.



Luz Urrutia
Chief Executive Officer
Opportunity Fund