[Journal of Civil Rights and Economic Development](https://scholarship.law.stjohns.edu/jcred)

[Volume 36, Summer 2022, Issue 1](https://scholarship.law.stjohns.edu/jcred/vol36/iss1) Article 5

# Why Bigger Is Not Always Better: Dodd-Frank & Its Impact on Small Banks & Businesses

Sarah King

Follow this and additional works at: https://scholarship.law.stjohns.edu/jcred

This Notes and Comments is brought to you for free and open access by the Journals at St. John's Law Scholarship Repository. It has been accepted for inclusion in Journal of Civil Rights and Economic Development by an authorized editor of St. John's Law Scholarship Repository. For more information, please contact selbyc@stjohns.edu.

# WHY BIGGER IS NOT ALWAYS BETTER: DODD-FRANK & ITS IMPACT ON SMALL BANKS & BUSINESSES

SARAH KING*

*"As battle-scarred survivors of a financial crisis and deep recession, community bankers today confront a frustratingly slow recovery, stiff competition from larger banks and other financial institutions, and the responsibility of complying with new and existing regulations. Some observers have worried that these obstacles--particularly complying with regulations--may prove insurmountable."*[1]

## INTRODUCTION

Imagine that the year is 2006. Along with partners and investors, you have just taken one of the biggest risks of your life and founded a small business. Specifically, your business acts as a broker of financial instruments known as energy derivatives; it matches buyers and sellers of futures, options, and other derivatives, and a portion of the money made from the trade is collected as a fee for your services. For the most part, the business runs smoothly. You're rarely stressed, your customers are satisfied with your services, and you and your co-workers make good money.

Imagine that the year is 2008. A financial crisis devastates the world economic markets and puts Wall Street in a tailspin. Excessive risk-taking by large banks and the collapse of the U.S. housing market are largely to blame, but you are far removed from the core of the economic meltdown. In fact, small businesses like yours pose barely any risk to the financial system when compared to the institutions that caused the 2008 collapse. Your business

* J.D. Candidate, St. John's University School of Law, May 2022.

1 Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, Remarks at "Community Banking in the 21st Century," a Conference Co-sponsored by the Federal Reserve System and the Conference of State Bank Supervisors, St. Louis, Missouri (Oct. 2, 2013), https://www.federalreserve.gov/newsevents/speech/bernanke20131002a.html.

emerges from the recession relatively unscathed, but other institutions are not so lucky.[2]

Now imagine that the year is 2010. Your business is finally turning a profit and things are looking up. Then comes Dodd-Frank. The Dodd-Frank Wall Street Reform and Consumer Protection Act[3] introduces a regulatory framework to prevent the Great Recession of 2008 from happening again in the future. In practice, however, Dodd-Frank causes more harm than good for you, even threatening your collapse.

The most detrimental impact of Dodd-Frank is its high compliance costs. You must now comply with a slew of regulatory requirements that take precious time and money away from serving your clients. The Act adversely affects your business in ways that Congress did not imagine. Dodd-Frank does not discriminate when it comes to the financial instruments it regulates—therein lies the problem for your small business. Dodd-Frank regards your business and the derivatives it handles as posing the same large risks as other types of businesses, even though the actual risks posed by your business and theirs vary dramatically.[4]

You think to yourself, *why am I being regulated for something I had nothing to do with*? Eventually, the incredible workload you take on to comply with Dodd-Frank becomes too much. You are forced to shut down your business in 2014, abandoning everything you worked so hard to accomplish over the past few years.

This scenario, based on the true story of Brad Schaeffer, provides one example of how Dodd-Frank overwhelmed the entities it strove to regulate.[5] There are many others.[6] Chris Dodd,

---

[2] *E.g.*, Ian Mount, *And 7 Businesses That Did Not Survive*, N.Y. TIMES (Dec. 30, 2009), https://www.nytimes.com/2009/12/31/business/smallbusiness/31deaths.html.

[3] The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified at 12 U.S.C. §5301 et seq.).

[4] *See* Brad Schaeffer, *The Dodd-Frank Effect: 'Too Small to Succeed,'* WALL ST. J. (Apr. 9, 2014), https://www.wsj.com/news/archive/years (click on "April" in the "2014" column, then click on "April 9," then go to page 2 and scroll down to the article) ("[T]the law considers a utility looking to hedge its long-term exposure to fluctuating gas prices, and the brokers who facilitate such deals, to be as much a threat to global order as cowboy credit-default-swap speculators stacking up insane leverage.").

[5] *See id.*; *Restoring Credit to Main Street: Proposals to Fix Small Business Borrowing And Lending Problems, Hearing before the Subcomm. on Economic Policy*, 111th Cong. 2 (2008) (Statement of Sen. Jeff Merkley) (discussing an Oregon company that suffered due to banks cutting their credit lines post-Dodd-Frank).

[6] *See, e.g.*, James Murphy, *What the Administration's Stance on Dodd-Frank Means for Small Business Lending*, FORBES (Apr. 21, 2017), https://www.forbes.com/?sh=5e216d7

namesake of the Dodd-Frank Act and chief engineer of the bill, even admitted in 2010 that "[n]o one will know until [the Dodd-Frank Act] is actually in place how it works."[7] In the ten years since its passage, Dodd-Frank's impact has been much more wide-ranging than lawmakers anticipated.[8] The regulations imposed on banks and securities, futures, and derivatives markets have proven to be immensely burdensome.[9] More specifically, small banks have had to revise their practices and reduce their lending to comply with Dodd-Frank, and small businesses have suffered as a result.[10]

In May of 2018, Congress took an important step to address these problems when it passed the Economic Growth, Regulatory Relief, and Consumer Protection Act to lessen the regulatory burdens on small banks.[11] The Act exempted small and mid-sized banks from stress testing requirements and other standards, releasing them from the stranglehold of Dodd-Frank regulation.[12] One small bank CEO described the 2018 revision as "kind of like the Super Bowl" for small banks.[13]

---

82254 (search the title of the article and then click on the article) ("By increasing capital reserve requirements and regulatory costs, many small banks facing a profit crunch have been forced to close or consolidate."); Bob House, *The Dodd-Frank Act Debate and How It Affects Small Business Owners*, INC. (Apr. 26, 2017), https://www.inc.com/ (search the title of the article and then click on the article).

7 David Cho et al., *Lawmakers Guide Dodd-Frank Bill for Wall Street Reform into Homestretch*, WASH. POST (June 26, 2010), https://www.washingtonpost.com/wp-dyn/content/article/2010/06/25/AR2010062500675.html.

8 *See* Hester Peirce et al., *How Are Small Banks Faring Under Dodd-Frank?*, 7–8 (Mercatus Ctr. At George Mason Univ., Working Paper No.14-05, Feb. 27, 2014), https://www.mercatus.org/system/files/Peirce_SmallBankSurvey_v1.pdf (noting that although the purpose of the law was to rein in large Wall Street firms and prevent future financial crises, the impact caused by Dodd-Frank is much broader than originally expected).

9 *See generally id.* (discussing the burden placed on small banks by increased regulation and providing survey data to illustrate this point).

10 *See id.* ("Dodd-Frank has proved burdensome to small banks, and customers are seeing the effects of the increased regulatory burden through reduced product and service offerings as small banks rethink their lines of business and consider consolidation activity.").

11 *See* Mark V. Nuccio & Richard Loewy, *Rolling Back the Dodd-Frank Reforms*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 13, 2018), https://corpgov.law.harvard.edu/2018/06/13/rolling-back-the-dodd-frank-reforms/ ("Although heralded in the media as a dramatic step away from regulatory reforms introduced by Dodd-Frank, the changes included in the Act will generally have the greatest impact on small banks.").

12 *See id.*

13 Ty Higgins, *Partial Repeal of "Dodd Frank" Welcomed By Community Banks*, OHIO'S COUNTRY J. (May 25, 2018), https://ocj.com/2018/05/partial-repeal-of-dodd-frank-welcomed-by-community-banks/ (noting CEO of Heartland Bank Scott McComb praised the Dodd-Frank rollback, saying "[t]his result for small banks is kind of like the Super Bowl").

Now though, the delayed roll-out of another Dodd-Frank provision threatens small banks with new regulatory standards. Ten years after its passing, the Consumer Financial Protection Bureau (CFPB) is finally in the beginning stages of putting section 1071 of the original Dodd-Frank Act into effect.[14] Section 1071 aims to improve financial transparency and protect small businesses by requiring financial institutions to record data about credit applications from women-owned, minority-owned, and small businesses.[15] The principle goal of section 1071 is to protect small businesses;[16] but if the language of the provision is not crafted with care and is administered too broadly, small banks—and small businesses by extension—may suffer the same way they did under previous Dodd-Frank regulatory requirements.

This note closely examines the excessive regulation of small banks and businesses under Dodd-Frank, including the latest requirements proposed for section 1071. Having considered the disastrous effects of other Dodd-Frank provisions, this note proposes that section 1071 should employ reporting requirement exemptions for small banks.

Part I of this note discusses the Dodd-Frank Wall Street Reform and Consumer Protection Act in general, provides insight into the legislative history of the bill, and also examines the effect of Dodd-Frank regulations on small banks and small business lending in the years following its passage. Part II explores section 1071 in detail and analyzes the policy rationales behind its enactment and planned implementation. Part III summarizes the current proposals for the implementation of section 1071 reporting requirements currently under consideration by the Consumer Financial Protection Bureau. Then Part IV provides a critique of section 1071, addressing the likely harms the new regulations would impose on small banks and in turn, small businesses. Finally, Part V proposes several solutions to reduce compliance

---

14 *See Consumer Financial Protection Bureau Releases Outline of Proposals Under Consideration to Implement Small Business Lending Data Collection Requirements*, CONS. FIN. PROT. BUREAU 1, 3 (Sep. 15, 2020), https://files.consumerfinance.gov/f/documents/cfpb_1071-sbrefa_outline-of-proposals-under-consideration_2020-09.pdf (describing the recent proposals promulgated by the CFPB to implement section 1071) [hereinafter *Outline of Proposals*].

15 *See* Dodd-Frank Wall Street Reform And Consumer Protection Act, Pub. L. No. 111-203, §1071, 124 Stat. 1376, 2056-59 (2010).

16 *See id.*

costs for small banks to best achieve the goals set out by the Consumer Financial Protection Bureau for section 1071.

## I. BACKGROUND

In 2008, an extreme downturn in America's labor markets and the national economy plunged the country into a crisis.[17] Labeled "The Great Recession," the crisis caused unemployment rates and home foreclosures to reach their highest recorded rates since the Great Depression.[18] Over 230,000 businesses in the U.S. closed during the first quarter of 2009, and over 450 banks failed between 2007 and 2012.[19] Unemployment rates peaked at 10.6% and 60% of households saw a decline in wealth between 2007 and 2009, with 25% losing *over half* of their total wealth.[20] The Recession had many causes, such as low mortgage lending standards, subprime mortgage loans; consumers borrowing an excess of money due to rising home prices; and the Federal Reserve keeping interest rates low.[21] To make sure that the Great Recession never happened again, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[22]

---

[17] *See* Erin Coghlan et al., *What Really Caused the Great Recession?*, UNIV. OF CAL. BERKELEY INST. FOR RES. ON LAB. AND EMP. (Sep. 19, 2018), https://irle.berkeley.edu/what-really-caused-the-great-recession/ (discussing the devastation of the U.S. economy caused by The Great Recession).

[18] *See id.*

[19] *See id.* ("During the first quarter of 2009—the lowest point of the Recession—over 230,000 U.S. businesses closed. From 2007 to 2012, more than 450 banks failed across the country.").

[20] *See* Angus Deaton, *The Financial Crisis and the Well-being of Americans*, NATIONAL INSTITUTE OF HEALTH, 1 (Feb. 2012), https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3290402/pdf/nihms-326996.pdf.

[21] *See* Thomas E. Lambert, *Falling Income and Debt: Comparing Views of a Major Cause of The Great Recession*, 2 WORLD REV. OF POL. ECON. 249, 250 (2011) (listing several causes of the 2008 financial crisis).

[22] *See* Peirce et al., *supra* note 8, at 7.

### *A. The Dodd-Frank Fix*

Dodd-Frank has been called "the most comprehensive set of reforms to our financial system since the Great Depression."[23] At over 850 pages of legislative text and nearly 19,000 pages of regulatory text, Dodd-Frank is a behemoth of a law.[24] To alleviate the effects of the 2008 financial crisis and to prevent any future reoccurrences, the Act employed three pillars: financial stability, transparency in financial markets, and consumer protection.[25] Many aspects of Dodd-Frank, like stress testing for large banks,[26] have been welcome additions and produced positive results.[27] But other aspects of the law were met with worry. Although Dodd-Frank was intended to save the floundering economy by blocking harmful practices in the financial markets, there was considerable concern that the Act would hurt small banks.[28]

### *B. Importance of Small Banks and Businesses*

Small businesses play an extremely important role in the fabric of America. On both a national and local level, small businesses boost economic growth and foster community development.[29] There are more than 27.6 million small businesses in the United

---

23 *The Dodd-Frank Act: Reforming Wall Street and Protecting Main Street*, U.S. DEP'T OF THE TREASURY (January 2017), https://obamawhitehouse.archives.gov/sites/ whitehouse .gov/files/images/Blog/Wall%20Street%20Reform%20Deck%20—%20January %202017.pdf [hereinafter *Reforming*].

24 *See* Peirce et al., *supra* note 8 at 7 (explaining that "[t]he legislative text of Dodd-Frank alone totaled approximately 850 pages. As of mid-November 2013, its new rulemaking had created nearly 19,000 pages of regulatory text, with approximately sixty percent of the rules still outstanding").

25 *See Reforming*, *supra* note 23.

26 *See* Dilara Islam, *New Decade, New Financial Crisis?*, J. OF C.R. & ECON. DEV. (Apr. 22, 2020), https://www.jcred.org/shortreads/qo7annsqwo0deprft1bk4jux1xodl1 (discussing annual stress testing requirements imposed by the Dodd-Frank Act).

27 *See* Michael D. Bordo & John V. Duca, *The Impact of the Dodd-Frank Act on Small Business*, NAT'L BUREAU OF ECON. RES. 28 (April 2018), https://www.dallasfed.org/-/media/documents/research/papers/2018/wp1806.pdf.

28 *See* Suzy Khimm, *GOP Candidates Say Dodd-Frank Kills Small Banks. The Banks Beg to Differ*, WASH. POST (Nov. 10, 2011), https://www.washingtonpost.com/blogs/ezra-klein/post/gop-candidates-say-dodd-frank-kills-small-banks-the-banks-beg-to-differ/2011/11/10/gIQAhgWJ9M_blog.html (listing several political figures who claimed that Dodd-Frank "is a killer for the small banks").

29 *See* Request for Information Regarding the Small Business Lending Market 82 Fed. Reg. 22,318 (May 10, 2017).

States, employing 60 million people.[30] It is estimated that the total amount of debt financing (including loans, lines of credit, and business credit cards) available to small businesses is about $1.4 trillion.[31]

It is crucial that small businesses have ample access to credit. Often, small businesses turn to small banks for their financing needs.[32] Classified by the Federal Reserve System as banks with assets of $10 billion or less, there are 6,279 small banks in the United States, making up 98.5% of the total number of banks in the U.S.[33] A recent Federal Reserve survey revealed that 46% of small businesses that applied for credit did so at a small bank, and 22% of small businesses listed small banks as their "primary source of credit."[34]

Importantly, the survey results reveal that small businesses are more likely to be approved for credit when they apply at a small bank, as compared to a larger bank.[35] The human element of a small bank cannot be downplayed when it comes to its relationship with a small business. Small banks often engage with their customers in ways that larger banks cannot, allowing them to forge close relationships and draw repeat customers.[36] In addition, unlike large banks, small banks are better suited to lend to borrowers without extensive credit histories or those with irregular income.[37] For example, small banks are often able to consider soft data, like a borrower's character and ability to manage their finances, to determine whether to offer a loan.[38]

---

30 *See Outline of Proposals*, *supra* note 14, at 4.

31 *See* CONS. FIN. PROT. BUREAU, *Key Dimensions of the Small Business Lending Landscape*, 21 (May 2017), https://www.consumerfinance.gov/data-research/research-reports/key-dimensions-small-business-lending-landscape/.

32 *See id.* at 24. For the purposes of Dodd-Frank, a bank is "an institution organized under the laws of the United States . . . which both accepts demand deposits or deposits that the depositor may withdraw . . . and is engaged in the business of making commercial loans." 12 U.S.C. § 1841(c)(1).

33 *See* Peirce et al., *supra* note 8, at 9.

34 *See* CONS. FIN. PROT. BUREAU, *supra* note 31, at 24, https://bschool.pepperdine.edu/about/people/faculty/appliedresearch/research/pcmsurvey/content/pca-q3- 2016.pdf.

35 *See id.* at 25.

36 *See* Peirce et al., *supra* note 8, at 12.

37 *See id.* (discussing how small banks are able to serve "informationally opaque" borrowers in a way that large banks cannot, which is advantageous for small businesses).

38 *See* Tim Critchfield et al., *The Future of Banking in America: Community Banks: Their Recent Past, Current Performance, and Future Prospects*, FDIC BANKING REV. 4 (2004), http://www.fdic.gov/bank/analytical/banking/2005jan/br16n34full.pdf (explaining how small banks can take soft data into consideration for their lending practices).

Conversely, large banks prefer to use hard data like credit history and other information available from financial statements to make loan decisions.[39] Because small banks can consider soft data, they can lend (and monitor loans they provide) to small businesses in ways that large banks cannot.[40] Small banks are also regionally important; in the Deep South, large banks are scarce, and communities are more likely to turn to small banks for their financing needs.[41]

### *C. The Effect of Dodd-Frank on Small Banks and Businesses*

In general, small banks are disproportionally affected when banking regulations are implemented.[42] Small banks often lack access to the expertise and staffing that a large bank does, making it difficult to comply with regulations in a cost-effective way.[43] For example, JPMorgan's compliance staff of over 5,000 employees is much better equipped than a small bank compliance staff that may total five or fewer to handle the activities associated with regulatory compliance, such as researching and implementing relevant laws and policies and ensuring that the bank acts in accordance.[44] Additionally, small banks are more likely to pass these compliance costs on to their customers.[45] Small banks often

---

39 *See id.* at 4 ("large banks prefer hard data (e.g., credit history, income, debts, and other data available from financial statements and credit reports) and are less willing to lend to "informationally difficult credits.").

40 *See id.*

41 *See* CONS. FIN. PROT. BUREAU, *Final Report of the Small Business Review Panel on the CFPB's Proposals Under Consideration for the Small Business Lending Data Collection Rulemaking*, 4 (Dec. 14, 2020), https://files.consumerfinance.gov/f/documents/cfpb_1071-sbrefa-report.pdf [hereinafter *Final Report*].

42 *See* Peirce et al., *supra* note 8, at 12.

43 *See id.*

44 *See* Dawn Kopecki, *Dimon Tells JPMorgan to Brace for More Regulatory Woes*, BLOOMBERG (Sept. 17, 2013), https://www.bloomberg.com/news/articles/2013-09-17/jpmorgan-s-dimon-says-bank-boosting-compliance-efforts; Peirce et al., *supra* note 8, at 12.

45 *See* Todd Zywicki, *Striking the Right Balance: Investor and Consumer Protection in the New Financial Marketplace: The Consumer Financial Protection Bureau: Savior or Menace?*, 81 GEO. WASH. L. REV. 856, 885 (2013) (analyzing the ways in which the onslaught of regulation occurring after the 2008 financial crisis has had adverse effects, including forcing lenders to withdraw products they previously offered).

raise the prices on the basic products and services they offer substantially to recoup costs of compliance.[46]

Small banks felt these negative effects and many more when Dodd-Frank was enacted in 2010. The Act increased regulatory compliance requirements for small bank operations and added certain lending rules, rendering small banks less efficient and reducing the incentive for these banks to make small business loans.[47] Though the Act was not specific to small business loans and certainly did not set out to impede small business lending, the new rules bogged down banks; for example, the Act imposed heavy documentation, requiring banks to record ratings for every loan they extended.[48] In fact, the percentage of loans extended by small banks to small businesses fell by nearly 18% after 2010—a result that can almost certainly be attributed to the change in the regulatory structure under Dodd-Frank.[49] While total small business loans totaled $711.5 billion in 2011, this number shrunk to $606.9 billion in small business loans by 2011; conversely, large business loans increased during this period.[50] Dodd-Frank also had the effect of slowing business formation; studies show that the Act significantly increased the fixed costs of starting and operating a business (such as compliance costs and increased costs due to documentation required by Dodd-Frank), causing the number of new businesses entering the marketplace to decrease.[51]

Lending and business formation started to rebound only after the 2018 Act that reduced Dodd-Frank regulations on small banks were implemented.[52] The 2018 rollbacks were a welcome change

---

46 *See* Peirce et al., *supra* note 8, at 13.

47 *See* Bordo & Duca, *supra* note 27.

48 *See id.* at 1 (providing an example of an instance where Dodd-Frank increased regulatory compliance requirements for banks which had the effect of disincentivizing lending, especially for stress-tested banks).

49 *See id.* at 4 (providing statistical data that links the decline in loans extended by small banks to small businesses directly to the implementation of Dodd-Frank).

50 *See* Victoria Williams, *Small Business Lending in the United States 2010-2011*, U.S. SMALL BUS. ADMIN. 4 (July 2012), https://www.sba.gov/sites/default/files/sbl_11study%20FINAL.pdf (providing a table that shows the decline in small business loans from 2008-2011).

51 *See* Bordo & Duca, *supra* note 27, at 19.

52 *See id.* at 28. "Our study also provides evidence that the early stages of the DFA had a large negative effect on business entry, in contrast to a smaller and only marginally significant negative effect in latter stages when small banks were granted some exemptions from some provisions of the DFA." *Id.* at 27.

for small banks in particular.[53] The president of a small bank highlighted one such beneficial provision: the 2018 Act exempted small banks from mortgage underwriting standards, which allowed his bank to increase their lending to customers in need.[54] As much as the regulatory rollback aided small banks and businesses, the heads of some small banks complained that the Act did not do enough.[55] Even a former attorney at the U.S. Securities and Exchange Commission recognized the need for less regulation: "Consumers aren't protected if the regulations are so onerous that companies can't lend or provide the financial services that consumers need."[56]

## II. A NEW PROVISION: SECTION 1071

Section 1071 of the Dodd-Frank Act was introduced as an amendment to the Equal Credit Opportunity Act (ECOA), which was originally enacted in 1974.[57] Before Dodd-Frank was passed, the ECOA stipulated that lenders were not allowed to collect race and gender data from customers seeking nonmortgage forms of lending.[58] The Federal Reserve Board assumed that the ban on data collection would prevent lenders from using the information

---

53 *See* Higgins, *supra* note 13; Ryan Tracy & Christina Rexrode, *Why the Dodd-Frank Rollback Has Some Small Banks Yawning*, WALL ST. J. (Apr. 15, 2018, 1:19 PM), https://www.wsj.com/articles/why-the-dodd-frank-rollback-has-some-small-banks-yawning-1523793600 ("[The bill's] 54 sections exempt banks from rules on mortgage lending, trading and regulatory exams—moves that supporters say would help small and midsize lenders by allowing them to spend less time and money thinking about rules from Washington.").

54 *See* Tracy & Rexrode, *supra* note 53 (noting that the Dodd-Frank amendment allowed Sidney Smith, president of Port Richmond Savings, and his small bank to do more lending to consumers who don't meet federal criteria).

55 *Id.* ("[S]ome Republicans say it doesn't go far enough to deregulate the industry, echoing complaints from some banks.").

56 Sarah O'Brien, *Dodd-Frank Changed Consumer Protections After the Financial Crisis — Here's How That's Shaking Out Today*, CNBC (Sep. 11, 2018, 8:15 AM), https://www.cnbc.com/2018/09/11/dodd-frank—cfpb.html. Former SEC attorney Marc Leaf worked at the SEC when Dodd-Frank was first enacted. *See id.*

57 *See* CONS. FIN. PROT. BUREAU, *Small Business Lending Data Collection Rulemaking*, https://www.consumerfinance.gov/1071-rule/ (last accessed Nov. 14, 2020); Equal Credit Opportunity Act, 15 U.S.C. § 1691 (2014).

58 *See* Stephen M. Spivey, *A Snake Eating Its Own Tail: The Self-Defeating Nature Of An Overly Broad Implementation Of Section 1071*, 22 N.C. BANKING INST. 107, 110 (March 2018) (citing Richard Cowden, *Lawmakers Question Fed Ban on Collecting Race, Gender Data for Nonmortgage Lending*, BNA No. 137 (July 18, 2007)).

in a discriminatory manner.[59] However, others—including members of Congress and consumer advocates—argued that this prevention of data collection actually limited the ability of regulators to monitor lending practices and identify instances of discrimination.[60]

The ECOA prohibits lenders from collecting certain data from loan applicants, such as their race or gender, for nonmortgage loans.[61] In 1999, the Federal Reserve Board (FRB) proposed an amendment to the ECOA that would have allowed lending institutions to gather data on nonmortgage loan applicants without restriction.[62] The FRB reviewed over 600 public comments solicited in conjunction with the proposed amendment.[63] In 2003, the FRB decided to forego the amendment and preserved the prohibition on data collection but revised the regulation to allow lenders to "self-test" their compliance with the ECOA by collecting data on gender and race for their use.[64] Still, the information collected by lenders was considered privileged and lenders were not required to provide this information to regulators in connection with discrimination investigations.[65] Following the 2003 decision, proponents of data collection continued to argue that the personal information collected by lenders could be used to highlight discriminatory practices, citing the success of the Home Mortgage Disclosure Act of 1975 in helping minorities and other disadvantaged groups to obtain mortgages.[66]

---

59 *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-698, FAIR LENDING: RACE AND GENDER DATA ARE LIMITED FOR NONMORTGAGE LENDING, REPORT TO CONGRESSIONAL REQUESTERS 21 (June 17, 2008), https://www.gao.gov/assets/gao-08-698.pdf.

60 *Id.* ("[O]thers argue that the prohibition limits the capacity of researchers and regulators to identify possible discrimination in nonmortgage lending.").

61 *See id.* (noting that an example of a nonmortgage loan is a small business loan).

62 *See id.* at 2.

63 *See id.*

64 *See id.* at 2–3.

65 *See id.* at 3.

66 *See id.* (explaining that the HMDA required lenders to collect and publicly disclose data regarding race, gender, and other characteristics of mortgage loan applicants. The results of the requirement were that minorities and other groups were more successful in obtaining mortgages, and lenders were less likely to engage in discriminatory lending).

### *A. The Formation and Goals of Section 1071*

On July 16, 2007, several members of Congress wrote to the United States Government Accountability Office (GAO) to once again express the need to review the prohibition under the ECOA.[67] The Congresspeople also asked the Government Accountability Office to conduct a cost-benefit analysis of amending the rule—to consider the advantages and disadvantages to banks and small businesses in requiring banks to obtain and report personal information in the lending process.[68] This prompted another review of the current ECOA prohibition and was the catalyst for what would become section 1071 of Dodd-Frank.[69]

After many years of challenges to the Equal Credit Opportunity Act, a revision was finally born in the form of Section 1071. Section 1071 of the Dodd-Frank Act amended the ECOA by removing the ban against data collection and in a full reversal, required the collection of small business loan data.[70] Congress declared that the intentions behind section 1071 were to: (1) facilitate enforcement of fair lending laws, and (2) enable a variety of organizations to compile and use lending data to identify and expand opportunities for women-owned, minority-owned, and small businesses to thrive.[71] Under section 1071, financial institutions must inquire whether a business applying for credit is women-owned, minority-owned, or a small business, and if so, the institution must keep a record of specific information.[72] The information includes:

> (1) The number of the application and the date on which the application was received; (2) the type and purpose of the loan or credit being applied for; (3) the amount of the credit applied for, and the amount

67 *See* Spivey, *supra* note 58, at 109.
68 *See id.*
69 *See id.*
70 *See* Dodd-Frank Wall Street Reform And Consumer Protection Act, Pub. L. No. 111-203, §1071, 124 Stat. 1376, 2056-59 (2010).
71 *See Outline of Proposals*, *supra* note 14, at 8 (describing the recent proposals promulgated by the CFPB to implement section 1071).
72 *See* Dodd-Frank Wall Street Reform And Consumer Protection Act, Pub. L. No. 111-203, §1071, 124 Stat. 1376, 2056-59 (2010).

> of the credit approved for such applicant; (4) the action taken with respect to such application, and the date of such action; (5) the census tract in which is located the principal place of business of the women-owned, minority-owned, or small business loan applicant; (6) revenue of the business in the last fiscal year of the women-owned, minority-owned, or small business loan applicant; (7) the race, sex, and ethnicity of the principal owners of the business; and (8) any additional data that the CFPB determines necessary.[73]

This information collected by lenders is then submitted annually to the Consumer Financial Protection Bureau.[74] This information is kept by the CFPB for 3 years following its submission and is made available to the public upon request.[75] In addition, the CFPB may compile the data it receives for its own use.[76]

Following Dodd-Frank, section 1071 spent over 7 years in a holding pattern before any steps were taken to implement it.[77] The delay can be attributed to a lack of motivation by the CFPB to set the proposals into motion; in fact, a lawsuit was filed against the CFPB to compel the agency to issue a final rule implementing section 1071.[78] In 2017, the CFPB finally issued a Request for Information Regarding the Small Business Lending Market as mandated by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).[79] This request for comment

---

[73] *See id.* ("Any applicant for credit may refuse to provide this information requested.").

[74] *See id.*

[75] *See id.*

[76] *See id.*

[77] *See* Christopher K. Friedman & Brian R. Epling, *Ready or Not, Section 1071 is Coming: The Upcoming Implement of Dodd-Frank's Women and Minority-Owned and Small Business Reporting Requirements*, BRADLEY LLP (Jan. 15, 2020), https://www.financialservicesperspectives.com/2020/01/ready-or-not-section-1071-is-coming/; 2019 Unified Agenda of Federal Regulatory and Deregulatory Actions Semiannual Regulatory Agenda 86 Fed. Reg. 16,888 (Mar. 31, 2021), https://www.federalregister.gov/documents/2021/03/31/2021-05662/fall-2019-unified-agenda-of-regulatory-and-deregulatory-actions.

[78] *See* California Reinvestment Coalition v. Kraninger et al., 2019 WL 2117659 (N.D.Cal.). The CFPB claimed that it lacked resources to implement section 1071, but this is inconsistent with Former Acting Director Mulvaney's statement that the agency has all the resources it needs and has requested $0 in funding for the implementation. *Id.*

[79] *See Outline of Proposals*, *supra* note 14, at 4. SBREFA requires the CFPB "to consult with representatives of small entities likely to be affected directly by the regulations [they]

allowed the CFPB to learn more about small business lending data and the potential complexities involved with a collection and reporting requirement.[80] The CFPB also held symposiums and released surveys and reports to better inform their decision-making.[81] On September 15, 2020, over 10 years after the passage of Dodd-Frank, the CFPB released an "Outline of Proposals Under Consideration and Alternatives Considered."[82] This outline described the proposed procedures to implement section 1071 and an analysis of potential impacts on entities directly affected by the section.[83]

### *B. Outline of Proposals for Section 1071 Promulgated by the CFPB*

As the most recent step in the rulemaking process, the Outline is a 75-page report on the plans to implement section 1071.[84] The purpose of this Outline is to solicit feedback on the proposals from so-called small entities, which include small businesses and organizations.[85] There are standards governing which entities can participate in this step of the rulemaking process.[86] Discussed in the proposals is the overall scope of the implementation of section 1071, key definitions, and possible exemptions to be considered under the rule.[87]

---

are considering proposing and to obtain feedback on the likely impacts the rules [they] are considering would have on small entities." *Id.*

[80] *See Request for Information*, *supra* note 29.

[81] *See* CONS. FIN. PROT. BUREAU, *supra* note 57.

[82] *See id.*

[83] *See id.*

[84] *See Outline of Proposals*, *supra* note 14, at 3.

[85] *See* U.S. ENVTL. PROTECTION AGENCY, *Learn about the Regulatory Flexibility Act*, https://www.epa.gov/reg-flex/learn-about-regulatory-flexibility-act#definitions (last visited Oct. 16, 2021). SBREFA defines "small entity" as a small business, small organization, or small governmental jurisdiction.

[86] *See id.* Small business size standards, for example, are usually determined by number of employers or average annual receipts, depending on the industry. *Id.* A small organization is any "not-for-profit enterprise which is independently owned and operated and is not dominant in its field." *Id.*

[87] *See Outline of Proposals*, *supra* note 14, at 1.

i. Definitions in Section 1071

There are several definitional issues presented in section 1071. The current rule uses vague language, leaving many confused about who the rule covers and what must be done to comply. It is critical to the mission of section 1071 that the rule be as clear and concise as possible to ensure that proper data is reported and to avoid any regulatory conflicts. The CFPB has taken a step in the right direction by attempting to provide definitions for some key terms used in section 1071. For example, the Bureau is considering which one of three options would best define a small business:

> 1. Gross annual revenue with a threshold of either $1 million or $5 million;
>
> 2. 500 or fewer employees for manufacturing and wholesale businesses, and $8 million or less in gross annual revenue for all other industries; or
>
> 3. Either [the] number of employees or gross annual revenue based on which of the 13 identified industry groups the small business falls into.[88]

Additionally, the CFPB is proposing a definition for what constitutes a "minority individual" when it comes to a minority-owned business.[89] The definition would mirror that of the HMDA's categories for minorities and would also clarify that a multi-racial person would be considered a minority individual.[90]

ii. The Scope of the Proposed Rule

A major issue surrounding section 1071 is its scope. The text states that "in the case of any application to a financial institution

[88] *See id.* at 16. The 13 industry groups identified by the CFPB include manufacturing, retail trade, agriculture, and mining, among others.
[89] *See id.* at 18.
[90] *See id.*

for credit for [a] women-owned, minority-owned, or small business, the financial institution shall . . . inquire whether the business is a women-owned, minority-owned, or small business."[91] A close reading of the language suggests that lenders must collect data from *all* small businesses, whether or not they are owned by women or minorities and that data must be collected from *all* women-owned and minority-owned businesses whether or not they are small businesses.[92] However, data shows that the vast majority of women-owned and minority-owned businesses are small businesses. For example, 99.9% of all women-owned businesses and 99.9% of all minority-owned businesses fall within the definition of a small business, which is defined as having 500 or fewer employees.[93] Thus, the CFPB is proposing in its Outline of Proposals that financial institutions collect information for all small businesses including ones owned by women or minorities, but leave out women and minority-owned businesses that are not defined as small.[94]

iii. Exemptions in the Proposed Rule

To best reach the goals of section 1071 and make the implementation as effective as possible, the CFPB is considering exemptions for certain small depository institutions (banks) subject to Dodd-Frank.[95] The CFPB has identified multiple options for an exemption provision, including an asset-based threshold level of either $100 million or $200 million and an activity-based metric that would take into account the frequency and dollar amount of loans extended by a lender.[96] These

[91] *See* Dodd-Frank Wall Street Reform And Consumer Protection Act, Pub. L. No. 111-203, §1071, 124 Stat. 1376, 2056-59 (2010).

[92] *See Outline of Proposals*, *supra* note 14, at 10 (emphasis added).

[93] *See id.* at 9 (defining a small business as having 500 or fewer employees).

[94] *See id.*; Alan S. Kaplinsky, *CFPB Issues Report of Section 1071 Small Business Review Panel*, JD SUPRA (Dec. 30, 2020), https://www.jdsupra.com/legalnews/cfpb-issues-report-of-section-1071-84907/ (last visited Oct. 16, 2021).

[95] *See Outline of Proposals*, *supra* note 14, at 11 (noting that "the Bureau is considering whether either or both a size-based or activity-based test might be appropriate to determine when an FI must collect and report 1071 data or should be exempt, given section 1071's statutory purposes . . . .").

[96] *See id.* at 44 ("[T]he Bureau explains that it is considering two potential asset-based exemption threshold levels of $100 million and $200 million of assets for DIs. It is also

exemptions are likely to mitigate the effects of section 1071 that would overburden small banks.[97]

## III: SECTION 1071'S IMPLEMENTATION CONCERNS

It is without a doubt that section 1071 is intended to play a positive role for minority and women-owned businesses. Women-owned and minority-owned businesses play an important role in our society and represent a larger share of small businesses today than at any other point in history.[98] It is estimated that 1,000 new businesses a day are started by women.[99] The data collection like the kind mandated by section 1071 will enable stronger supervision of lending and prevent credit discrimination.[100]

Conversely, the requirements imposed by data collection can create huge compliance costs for lenders.[101] And section 1071 was the only Dodd-Frank provision identified by regulators and industry representatives as "potentially having a direct impact on small business lending by community banks and credit unions" due to the increased compliance burden on small banks.[102] Further, the CFPB has not released any framework describing how they will use the information they receive from banks; the provision imposes a reporting requirement but does not guide how

considering an activity-based metric for determining coverage.").

97 *See* Diego Zuluaga, *Implementation Concerns of Section 1071 of the Dodd-Frank Act*, CONSUMER FIN. (Nov. 6, 2019), https://files.consumerfinance.gov/f/documents/cfpb_zuluaga-written-statement_symposium-section-1071.pdf (stating that data collection requirements are more burdensome for smaller entities).

98 *See ISSUE: Protect Section 1071 of the Dodd-Frank Act to Ensure Better Access to Credit for Small Businesses*, NAT'L CMTY. REINVESTMENT COAL., https://ncrc.org/wp-content/uploads/2017/05/03_fair.pdf (last visited Nov. 16, 2020).

99 *See id.* Around 627,000 total small businesses are started each year, according to the latest statistics from 2008. Julija Andjelic, *42 Small Business Statistics: Everything You Need to Know*, SMALLBIZGENIUS (Jan. 26, 2021), https://www.smallbizgenius.net/by-the-numbers/small-business-statistics/#gref.

100 *See* Zuluaga, *supra* note 97.

101 *See id.*

102 *See* U.S. GEN. ACCOUNTING OFFICE, GAO-12-881, COMMUNITY BANKS AND CREDIT UNIONS: IMPACT OF THE DODD-FRANK ACT DEPENDS LARGELY ON FUTURE RULE MAKINGS 67 (Sept. 2012) ("Industry officials also have noted that the reporting requirements could lead banks . . . to develop standardized criteria for their small business lending to avoid being criticized or penalized by regulators for being discriminatory. They added that such standardization could then result in less lending to small businesses.").

the information will be used. There is no guarantee this information will support the stated goal of section 1071: to identify and protect the needs of women-owned, minority-owned, and small businesses.

### *A. Compliance Costs*

According to industry leaders and regulators, reporting requirements under section 1071 will cause an increase in the costs associated with small business lending.[103] In its Outline of Proposals, the CFPB highlighted how section 1071 would increase costs for lenders: these costs will vary depending on the type of data storage system a lender uses, the degree of system automation a lender possesses, and the compliance program a lender employs.[104] Generally, small banks do not possess complex data storage systems or system automation, and they typically do not have dedicated compliance departments, so they cannot absorb compliance costs as efficiently as larger institutions can.[105]

The CFPB also analyzed compliance costs as either one-time costs or ongoing costs. A one-time cost is one that a bank incurs only at the outset of its preparation to implement section 1071.[106] Examples of one-time costs are updating computer systems, testing these systems, developing applications to reflect reporting requirements, and developing new policies and procedures.[107] Though the CFPB does not currently have an estimate as to the dollar amount of one-time costs to financial institutions, it is currently surveying to better understand what one-time costs will

---

[103] *See id.*

[104] *See Outline of Proposals*, *supra* note 14, at 46 ("[T]he Bureau identified seven key aspects or dimensions of compliance costs with a data collection and reporting rule: (1) the reporting system used; (2) the degree of system integration; (3) the degree of system automation; (4) the tools for geocoding, (5) the tools for performing completeness checks, (6) the tools for performing edits; and (7) the compliance program.").

[105] *See id.* at 47.

[106] *See id.* at 49 ("'One-time' costs refer to expenses that the FI would incur initially and only once as it implements changes required to business operations in order to prepare to comply with the requirements of the new rule.").

[107] *See id.* (noting that "one-time costs that would be incurred by FIs to develop the infrastructure to collect and report data required by the regulation implementing section 1071" include "[u]pdating computer systems," "[t]esting validating systems," "[d]eveloping forms/applications," and "[p]ost-implementation review of compliance policies and procedures").

be due to section 1071 implementation.[108] The information compiled in that survey will better inform the final rulemaking process.[109]

An ongoing cost is an expense that is incurred repeatedly due to reporting requirements under section 1071. Ongoing costs include internal and external audits; transcribing data; researching and resolving questions; and annual internal checks.[110] To calculate ongoing costs for each financial institution, the CFPB developed formulas that correlate to each activity considered to be an ongoing cost. For example, the formula for transcribing data is a variable cost that can be calculated by multiplying hourly compensation by hours per application by the number of applications.[111]

The CFPB estimates that small bank compliance costs imposed by section 1071 can range from $2,500 to $29,550 in additional costs per year or $145 per application on the high end, depending on the variability of the costs and the complexity of the lenders' systems.[112] These numbers are just for recurring compliance costs; the initial cost of implementing section 1071 may cause this number to rise to a level that is insurmountable for small banks given the narrow profit margin they operate with and the ultra-competitive nature of the banking industry.[113] The ultimate effect of section 1071 may be a reduction in lending to small businesses to avoid having to comply with the reporting requirements. Clearly, this runs contrary to the goal of section 1071 which is to

---

108 *See id.* at 52 ("The Bureau is conducting a survey regarding one-time implementation costs for section 1071 compliance targeted at FIs who extend small business credit.").

109 *See id.* ("Estimates from survey respondents of the one-time costs of complying with a 1071 rule will form much of the basis of the Bureau's estimates for one-time costs in assessing the impact of a proposed 1071 regulation.").

110 *See id.* at 50.

111 *See id.* at 53.

112 *See id.* at 57.

113 *See* Scott A. Burns, *The Costs of Dodd-Frank*, AM. INST. FOR ECON. RES. (May 12, 2019), https://www.aier.org/article/the-costs-of-dodd-frank/ (noting that banks might have to cut fixed operating costs to help pay for higher regulatory costs); Alexandra R. Larch, *The Effect of Dodd-Frank on the Profitability of Community Banks: An Econometric Model*, 9 INQUIRIES J. 1, 1 (2017), http://www.inquiriesjournal.com/articles/1526/the-effect-of-dodd-frank-on-the-profitability-of-community-banks-an-econometric-model (demonstrating the negative impact on bank profitability since Dodd-Frank was enacted and showing a positive correlation between bank profitability and asset size; the smaller a bank is, the less profitable it will be).

identify and support the needs of women and minority-owned small businesses.[114]

## IV. PROPOSED SOLUTIONS: PROVIDE EXEMPTIONS AND CLARIFY DEFINITIONS TO REDUCE COMPLIANCE COSTS

Forcing small banks to comply with section 1071 would drive up compliance costs and hinder small banks from serving the small businesses that section 1071 was designed to protect. To prevent this from happening, the CFPB should employ certain exemptions they identified in their Outline of Proposals, namely exempting small banks with assets under $100 million and amending section 1071 to disallow the CFPB from obtaining any additional data they deem necessary. In addition, the CFPB could remedy compliance costs by acting as an external auditor for banks, or by providing informational material about section 1071 rather than having banks bear the cost of researching the provision themselves.

### *A. Exempting Small Banks, Specifically Those With Under $100 Million in Total Assets*

The definition of a "small bank" has been a source of considerable debate within the financial community. The standard measure of the size of a bank is by assets, but the asset threshold to be considered a small bank varies wildly. While the FDIC has identified small banks as institutions with $10 billion in assets and below,[115] the CFPB proposes two exemptions of either $100 million or $200 million in assets.[116] Though these thresholds are far lower than what the FDIC considers to be a small bank, they would relieve the banks that would be affected most by

---

[114] *See* Dodd-Frank Wall Street Reform And Consumer Protection Act, Pub. L. No. 111-203, §1071, 124 Stat. 1376, 2056-59 (2010).

[115] *See* FED. DEPOSIT INS. CORP., *Defining the Community Bank*, 1 (Dec. 2012), https://www.fdic.gov/regulations/resources/cbi/report/cbsi-1.pdf (noting that a $10 billion size limit has recently been used to define small banks, which are also known as community banks due to the banking services they provide to their local communities).

[116] *See Outline of Proposals*, *supra* note 14, at 44.

section 1071 requirements while still compelling the bulk of financial institutions to comply.

The CFPB has previously exempted smaller institutions from statutory reporting requirements.[117] In 2013, the CFPB chose to exempt small mortgage servicers from requirements imposed by the Real Estate Settlement Procedures Act.[118] The CFPB has also exempted small banks and credit unions from its payday lending rule.[119] Further, a size-based exemption would follow the current regulatory trend toward tailoring regulations to bank size, complexity, and role.[120] Former Federal Reserve chair Janet Yellen remarked that the Fed has focused recently on making sure smaller banks are not unduly burdened by regulations.[121]

The CFPB should move to implement a size-based exclusion for banks with $100 million in assets or less. Though a size-based exclusion could be seen as somewhat arbitrary due to varying definitions of a small bank, it would also provide an efficient and easy solution because the only information required is the value of a bank's assets.[122] A size-based exemption would also avoid the need for small banks to monitor their small business lending activity, as would be the case with an activity-based exemption.[123] An exemption of this kind would allow the CFPB to achieve its goal of facilitating the enforcement of fair lending laws on small business loans while avoiding burdening banks that would struggle to comply with section 1071.

However, the CFPB should avoid excluding all small banks from section 1071 compliance; an outright exemption could render

---

117 *See* Spivey, *supra* note 58, at 128.

118 *See Mortgage Servicing Rules* U*nder the Real Estate Settlement Procedures Act (Regulation X)*, CFPB-2012-0034, CONS. 12 (Jan. 10, 2014), https://files.consumerfinance.gov/f/201301_cfpb_final-rule_servicing-respa.pdf (setting forth an exemption for mortgage servicers that service less than 5,000 mortgages from the new mortgage servicing rule).

119 *See* Spivey, *supra* note 58, at 128.

120 *See* Jeanna Smialek, *Yellen Says Fed is Working on Tailoring Regulations to Bank Size*, BLOOMBERG QUINT, https://www.bloombergquint.com/global-economics/yellen-says-fed-is-working-on-tailoring-regulations-to-bank-size (last updated Oct. 5, 2017, 5:38 PM).

121 *See id.* (detailing Yellen's comments about the Federal Reserve Bank's commitment to regulatory improvements for small banks).

122 *See* Spivey, *supra* note 58, at 130 (noting that size-based exemptions are bright-line rules that are easy to implement as the only information needed is the value of the bank's assets).

123 *See Final Report*, *supra* note 41, at 11 (explaining why a size-based exemption is preferable to alternative exemption options).

section 1071 ineffective.[124] Setting the size-based exemption at $100 million creates a "sweet spot" between compiling adequate data and excluding only a subset of small banks from regulations. A $100 million threshold would draw a bright line between small and large banks in a way that would prevent section 1071 from being "the last nail in the coffin" for small banks.[125] The CFPB has previously recognized that there are stark differences in the way a small bank operates versus the way a Wall Street bank operates.[126] There is considerable concern that section 1071 burdens on small banks would push customers to Wall Street banks, which were considerable contributors to the financial crisis and were the institutions that Dodd-Frank intended to reform.[127] Section 1071 compliance costs may force small banks to reduce or even cease small business lending activity, which runs contrary to one of the primary purposes of the section: to facilitate access to credit for small women and minority-owned businesses.[128] With a size-based exemption, however, small business owners may be more likely to turn to small banks for financing. Due to the exclusion of these small banks from section 1071 paperwork and compliance requirements, small banks would be able to spend more time serving customers and could be placed at an advantage over larger banks who must comply with the provision, causing customers to seek lending from small banks instead of larger ones.

The CFPB has contemplated size-based exemptions of $100 million and $200 million, as well as numerous alternatives.[129] An exclusion of all small banks (those with $10 billion and below in assets) would exclude nearly half of the loans that section 1071 aims to record.[130] Conversely, a size exemption of $100 million

---

124 *See* Spivey, *supra* note 58, at 128 ("The CFPB should not, however, exempt all community banks, as overbroad exclusions could potentially render Section 1071 ineffective.").

125 *See Final Report*, *supra* note 41, at 132 (explaining that other sections of Dodd-Frank have caused small banks to give up to comply with regulations and that section 1071 may be the final straw for small banks trying to survive).

126 *See id.*

127 *See id.* ("Please do not add additional burden onto small community banks, which could push our customers to the Wall Street banks – the very banks the Dodd-Frank Wall Street Reform act intended to reform.").

128 *See id.* at 149 (explaining that the costs associated with coming into compliance with section 1071 may cause smaller FIs to stop small business lending activity, which would be contrary to the purposes of section 1071).

129 *See id.* (detailing the size-based exemption under consideration by the CFPB).

130 *See* Arthur E. Wilmarth Jr., *A Two-Tiered System of Regulation is Needed to Preserve the Viability of Community Banks and Reduce the Risks of Megabanks*, MICH. ST.

would exempt about 48% of all banks that extend loans to small businesses; the remaining 52% of banks are responsible for around 99% of small business loans and would have to report this loan data under section 1071 to the CFPB.[131] This means the CFPB exemption of banks with assets below $100 million would balance concerns of overburdening banks with regulations and still being able to obtain the small business lending data they desire.

### *B. Amending Section 1071 to Prevent the CFPB from Gathering Information Arbitrarily*

Section 1071 provides that the banks must collect and submit information about loan applicants, including "any additional data that the Bureau determines would aid in fulfilling the purposes of this section."[132] This requirement could prove burdensome for small banks as the CFPB has free reign to compel banks to collect and submit any data they see fit. The 2015 HMDA Final Rule provides a clear example of a discretionary data point requirement that substantially increased the costs of compliance for lenders.[133] The CFPB is now considering a rollback of the 2015 HMDA Rule to lessen the compliance cost burden on banks[134]—but the CFPB should avoid this issue with section 1071 by removing the additional data point provision altogether.

L. REV. 249, 289 (2015) (stating that small/community banks provide about half of all lending to small businesses); *id.* at 370 n.149 (explaining that banks that have less than $10 billion in assets are small/community banks).

131 *See Outline of Proposals*, *supra* note 14, at 12 ("[U]nder the Option A exemption level, roughly 48 percent of all DIs would be excluded from 1071 collection and reporting requirements. However, DIs that would not be exempt under Option A originate, and would report, over 99 percent of small business loans made by DIs . . . .").

132 *See* Dodd-Frank Wall Street Reform And Consumer Protection Act, Pub. L. No. 111-203, §1071, 124 Stat. 1376, 2057 (2010).

133 *See Final Report*, *supra* note 41, at 97 (discussing how the 2015 HMDA Rule addition, which the CFPB is now reviewing for reduction, added the collection of unnecessary discretionary data points and created substantial compliance costs).

134 *See id.* ("Those discretionary data points are now under review for possible reduction."); Eric Skrum, *WBA Asks CFPB to Eliminate Discretionary Data Points From HMDA Data Collection and Reporting*, WIS. BANKERS ASS'N (Oct. 21, 2019), https://www.wisbank.com/articles/2019/10/wba-asks-cfpb-to-eliminate-discretionary-data-points-from-hmda-data-collection-and-reporting ("WBA asked the Bureau to eliminate all discretionary data points the Bureau added to HDMA data collection and reporting . . . .").

Further, there are privacy considerations attached to the "any additional data" provision. For various reasons, spanning from a lack of inclusion to racism in the banking industry, minorities are distrustful of financial institutions.[135] Borrowers may be prevented from seeking loans in the first place if they feel that section 1071 reporting requirements are intrusive and request too much personal information.[136]

Removing this provision and requiring only the enumerated data to be reported would result in $4-5 less cost per application and an estimated reduction of 2 hours spent on internal checks and edits.[137] In addition, removing the arbitrary reporting requirement could reduce future one-time costs that would be spent upgrading systems to capture additional data fields.[138] Small banks would then be able to spend this time and money on other tasks to help their businesses and serve clients rather than spending it complying with unpredictable reporting requirements imposed by the CFPB.

### *C. Amending Section 1071 to Allow the CFPB to Conduct Investigations into Small Banks*

While small banks may not have the resources to bear the costs of section 1071 compliance, the CFPB as an organization has a much larger budget with which they can support the goals of the statute. To divert costs away from small banks, the CFPB should act as an external auditor; the CFPB would then bear the costs of

---

135 *See Final Report*, *supra* note 41, at 136 ("Many minorities do not trust financial institutions and may [i]nstead go somewhere else for funds to avoid too many questions."); Aria Florant et al., *The Case for Accelerating Financial Inclusion in Black Communities*, MCKINSEY & CO. (Feb. 25, 2020), https://www.mckinsey.com/industries/public-and-social-sector/our-insights/the-case-for-accelerating-financial-inclusion-in-black-communities# ("Indeed, almost one in three unbanked households cite distrust of banks as a reason for not having a bank account.").

136 *See Final Report*, *supra* note 41, at 134–36 (demonstrating that privacy is a major concern for borrowers regarding section 1071).

137 *See Outline of Proposals*, *supra* note 14, at 59 ("Requiring only the collection and reporting of the mandatory data points would result in $4 and $5 less in ongoing costs per application. . . . [R]eporting only the mandatory data points would reduce the total time . . . from 8 total hours to 6 hours.").

138 *See id.* ("Reporting only the statutorily required data points may also reduce one-time costs if institutions must pay a one-time cost to upgrade or integrate their data systems in order to capture the additional discretionary data fields.").

compliance and use its supervisory and enforcement powers to investigate lenders. Doing so would relieve small banks of internal audit costs while still allowing the CFPB to access lending information and identify the development needs of small, minority and women-owned businesses.

When Congress created the CFPB, it conferred upon the agency four tools to carry out its mission of protecting America's consumers: rulemaking, supervision, enforcement, and education.[139] The CFPB can commence enforcement actions against various entities, including the financial institutions covered under section 1071.[140] Under federal commercial law, the CFPB is authorized to gather facts and conduct investigations before instituting judicial or administrative adjudicatory proceedings.[141] Additionally, the CFPB can work in cohesion with other federal and state agencies to investigate and pursue enforcement actions.[142] The CFPB relies on several different sources of information to decide whether or not to open an investigation.[143] For example, the CFPB may decide to pursue action against a bank due to a consumer complaint or a submission to its whistleblower hotline.[144]

Through its enforcement and investigation powers, the CFPB can take on the burden of ensuring compliance with section 1071 rather than small banks self-reporting to the CFPB. As mentioned previously, small banks would struggle to implement the regulatory changes of section 1071.[145] On the other hand, the CFPB has a budget of nearly $230 million to spend on enforcement

---

[139] *See Life Cycle of an Enforcement Action*, CONS. FIN. PROT. BUREAU, https://www.consumerfinance.gov/enforcement/life-cycle-of-enforcement-action/ (last visited Mar. 8, 2021) ("Congress provided the Consumer Financial Protection Bureau with four important tools to carry out the mission of protecting consumers: rulemaking, supervision, enforcement, and education.").

[140] *See id.* ("When a depository institution, company, individual, or other entity subject to our enforcement authority breaks the law, we may take enforcement action against them.").

[141] *See id.* ("We are authorized to conduct investigations before instituting judicial or administrative adjudicatory proceedings under Federal consumer financial law. Enforcement uses investigations to gather facts and identify violations of federal consumer financial law to determine whether public enforcement action is necessary.").

[142] *See id.*

[143] *See id.*

[144] *See id.*

[145] *See Outline of Proposals*, *supra* note 14, at 11–12.

actions.[146] The amount of funding the CFPB directs towards enforcement actions reflects its commitment to ensuring transparency for consumers,[147] which runs closely with section 1071's purpose of facilitating fair lending. To identify needs and provide opportunities for small women and minority-owned businesses, the Bureau should divert funds used in its enforcement work towards becoming an external auditor for the small banks they seek lending information from. Doing so would strike a balance between avoiding burdens for small banks and allowing the CFPB to obtain information enumerated in section 1071.

Further, the CFPB has the power to impose fines on financial institutions that violate regulations.[148] Section 1071 does not currently penalize banks found to exhibit discriminatory lending practices. The CFPB could bolster its efforts to facilitate fair lending even further by amending section 1071 to require that fines be imposed on banks that violate the statute. Under Dodd-Frank, the Bureau is allowed to collect monetary fines and deposit them into the Consumer Financial Civil Penalty Fund (CPF).[149] These funds can then be disbursed to victims harmed by the activities for which the fine was imposed.[150] Civil penalties won from discriminatory lenders could hypothetically be dealt out to the small women and minority-owned businesses that have been discriminated against. The advantages to this are two-fold; lenders are deterred from discriminatory practices, and if the

---

[146] *See* CONS. FIN. PROT. BUREAU, *Annual Performance Plan and Report, and Budget Overview* 1, 10 (Feb. 2021), https://files.consumerfinance.gov/f/documents/cfpb_performance-plan-and-report_fy21.pdf [hereinafter *Annual Performance Plan*]. Enforcement and supervision-related activities represent the largest portion of the CFPB budget at over 39%. *Id.* at 11.

[147] *See id.* at 11.

[148] *See Enforcement by the Numbers*, CONS. FIN. PROT. BUREAU, (Jan. 2021), https://www.consumerfinance.gov/enforcement/enforcement-by-the-numbers/ (providing an infographic exhibiting that the CFPB has ordered over $1.6 billion in civil penalties as a result of enforcement actions); Lisa Rowan, *Will Biden's CFPB Regain Its Edge in a Post-Trump Era?*, FORBES, https://www.forbes.com/advisor/personal-finance/biden-consumer-financial-protection-bureau/ (last updated Mar. 29, 2021, 4:28 A.M.) ("The CFPB quickly became known for its investigations of consumer complaints and hefty fines issued against lenders and other companies that violated financial regulations.").

[149] *See Annual Performance Plan*, *supra* note 146, at 20.

[150] *See id.* ("The Bureau is authorized to use funds deposited in the CPF for payments to the victims of activities for which civil penalties have been imposed under Federal consumer financial laws.").

lenders do discriminate, those harmed will receive financial compensation.

### *D. Providing Government Assistance for Compliance Costs*

Part of the reason small banks are at a disadvantage when it comes to compliance with regulations is that they simply do not have the personnel to handle the research and implementation of sweeping regulatory requirements.[151] In addition to the solutions already under consideration by the CFPB, the government can also play a part in reducing this burden. The Wage and Hour division of the U.S. Department of Labor (DOL) provides a compliance assistance webpage where its users can find information on how to comply with federal employment laws.[152] The goal is to provide "America's employers, workers, job seekers and retirees—with clear and easy-to-access information . . . ." about applicable laws.[153] Providing this kind of information is known as compliance assistance.[154] For example, a user can find a summary of DOL laws, compliance assistance information by law, employee rights materials, and even state and local government compliance assistance.[155]

Currently, the CFPB offers no compliance assistance to the banks it regulates when it comes to section 1071. To lessen the compliance burden on small banks, the CFPB could publish a webpage or circulate materials that would explain the provisions of section 1071 to banks that do not employ a robust compliance team. By publishing a central location where banks could find information on how to comply with section 1071, time spent by small bank personnel to research the provision would be slashed. The main concern with section 1071 implementation for small banks is that time and money will be diverted away from small

151 *See* Peirce et al., *supra* note 8, at 13.
152 *See Wage and Hour Division: Compliance Assistance*, U.S. DEP'T LABOR, https://www.dol.gov/agencies/whd/compliance-assistance (last visited Oct. 12, 2021).
153 *Id.*
154 *See id.* ("Such information and guidance is known as 'compliance assistance.'").
155 *See id.*

business customers to focus on the law;[156] some of these concerns would be abated if the government were to provide some measure of compliance assistance to these small banks.

## CONCLUSION

Now more than ever, small businesses across the country are facing unprecedented hardship. The economic impact of Covid-19 has been catastrophic for women and minority-owned businesses in particular.[157] Given these adverse circumstances, section 1071 is vital for the protection of these businesses and its implementation should be a priority. However, the implementation must be done with small banks as a focal point.

As demonstrated by past applications of regulatory requirements to small banks, overbearing regulation often raises the cost of compliance to unmanageable rates and produces negative results for both small banks and the small businesses they serve. For section 1071 to prove successful in its mission of facilitating enforcement of fair lending laws and determining unmet needs for women-owned and minority-owned small businesses, exemptions should be imposed for certain categories of small banks. These exemptions are paramount to preventing small banks from drowning in overregulation and producing the best results for small banks and businesses alike.

---

156 *See* Peirce et al., *supra* note 8, at 91–92.
157 *See Final Report*, *supra* note 41, at 3.