Prepared Remarks of CFPB Director Richard Cordray at the Small Business Lending Field Hearing

Los Angeles, Calif.

By Richard Cordray – **MAY 10, 2017**

Thank you all for coming. It is good to be here again in Los Angeles. Today, the Consumer Financial Protection Bureau is announcing an inquiry into ways to collect and publish information about the financing and credit needs of small businesses, especially those owned by women and minorities. We are well aware of the key role they play in our lives. Small businesses help drive America's economic engine by creating jobs and nurturing local communities. It is estimated that they have created two out of every three jobs since 1993 and now provide work for almost half of all employees in the private sector. Yet we perceive large gaps in the public's understanding of how well the financing and credit needs of these entrepreneurs are being served.

As you probably know, Congress provided the Consumer Bureau with certain responsibilities in the area of small business lending. And there is a strong logic behind this. When I served as the Ohio Attorney General, we recognized the need to protect small businesses and nonprofit organizations by accepting and handling complaints on their behalf, just as we did for individual consumers – an approach that proved to be very productive. In addition, the line between consumer finance and small business finance is quite blurred. More than 22 million Americans are small business owners and have no employees. And, according to data from the Federal Reserve, almost two-thirds of them rely on their business as their primary source of income.

Congress specifically has charged the Consumer Bureau with the responsibility to administer and enforce various laws, including the Equal Credit Opportunity Act. Unlike other consumer financial laws, the ECOA governs not only personal lending, but some commercial lending as well. In fact, we have now conducted a number of ECOA supervisory examinations of small business lending programs. Through that work, we are learning about the challenges financial institutions face in identifying areas where fair lending risk may exist, and we are assisting them in developing the proper tools to manage that risk.

In the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress took a further step to learn more about how to encourage and promote small businesses. To help determine how well the market is functioning and to facilitate enforcement of the fair lending laws, Congress directed the Consumer Bureau to develop regulations for financial institutions that lend to small businesses to collect certain information and report it to the Bureau. The Request for Information we are releasing today asks for

public feedback to help us better understand how to carry out this directive in a way that is careful, thoughtful, and cost-effective.

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We have considerable enthusiasm for this project. In my own case, I have seen firsthand how small business financing can have a big economic impact. When I served as the Treasurer of Ohio, we had a reduced-interest loan program to support job creation and retention by small businesses. The way the program worked was that the state could put money on deposit with banks at a below-market rate of interest, and this deposit was then linked to a same-sized loan to a small business at a correspondingly below-market rate. This so-called “Linked Deposit” program had been authorized more than twenty years earlier, but had gradually fallen into disuse.

At its core, however, the program made good sense. Small businesses are often in desperate need of financing to update and expand their operations, and if they can get inexpensive financing, they often can fertilize their ideas for growth and be even more successful. So we diagnosed the program and found that after its initial success, it had become too bureaucratic. We heard from both banks and businesses that the program, which was still paper-based, was so slow and cumbersome that nobody wanted to use it.

So we changed all that. We put the process online, rebranded it as the “Grow Now” program, and made specific commitments to those who wanted to participate in it. We told them they could fill out a typical application in 30-60 minutes, and we promised them they would have a yes-or-no answer on their application within 72 hours. That was not easy, and it required very close coordination with the banks that took part in the program. But we did it, and the “Grow Now” program really took off. Only about $20 million had been allocated when we started, but in less than two years we deployed more than $350 million, helping about 1,500 small businesses create or retain approximately 15,000 jobs across the State.

It was also exciting and interesting to see how the businesses were able to use the loan funds. I can recall a construction business in northeast Ohio that needed a loan to buy a large piece of equipment so the company could compete for new and different jobs. They got the money, they got the equipment, and they thrived. I recall a manufacturer in northern Ohio that needed money to turn their factory sideways on their property so they could utilize more space and employ more people. We funded the build-out, they executed on it, and they met their goals for growth of output, revenue, and jobs. And I recall a company in western Ohio that started out as a caterer, began making their own tents for events, recognized that they might be able to succeed as tentmakers, and needed financing to be able to bid on a major project with the U.S. Department of Defense. We got them the loan, they got the bid, and *Inc.* magazine named them one of its 500 fastest-growing businesses of that year!

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The moral of this story is that business opportunity – especially opportunities for small businesses – often hinges on the availability of financing. People have immense

reserves of energy and imagination. Human ingenuity is the overwhelming power that allows human beings to reinvent the future and make it so. These forces unleash what Joseph Schumpeter called the “gales of creative destruction” that constantly mold and reshape the patterns of our economic life. Innovation has sharpened our nation’s economic edge for generation after generation, but when credit is unavailable, creativity is stifled.

To make the kind of meaningful contributions they are capable of making to the American economy, small businesses – particularly women-owned and minority-owned businesses – need access to credit. Without it, they cannot take advantage of opportunities to grow. And with small businesses so deeply woven into the nation’s economic fabric, it is essential that the public – along with small business owners themselves – can have a more complete picture of the financing available to this key sector.

Some things we do know. We are releasing a white paper today that lays out the limited information we currently have about key dimensions of the small business lending landscape. According to Census data, and depending on the definition used, there are an estimated 27.6 million small businesses in the United States. We estimate that together they access about $1.4 trillion in credit. Businesses owned by women and minorities play an especially important role in this space. Women-owned businesses account for over one-third (36 percent) of all non-farming, private sector firms. The 2012 Survey of Business Owners, the most recent such information available, indicates that women-owned firms employed more than 8.4 million people, and minority-owned firms employed more than 7 million people. Those are huge numbers: by comparison, in 2014 fewer than 8 million people were employed in the entire financial services sector.

When small businesses succeed, they send constant ripples of energy across the economy and throughout our communities. For example, a 2013 study by the Federal Reserve Bank of Atlanta found that counties with higher percentages of their workforce employed by small businesses showed higher local income, higher employment rates, and lower poverty rates. In order to succeed, businesses need access to financing to smooth their cash flows for current operations, meet unexpected contingencies, and invest in their enterprises to take advantage of opportunities as they arise. Another study found that the inability to obtain financing may have prompted one-in-three small businesses to trim their workforces and one-in-five to cut benefits.

Unfortunately, much of the available data on small business lending is too dated or too spotty to paint a full picture of the current state of access to credit for small businesses, especially those owned by women and minorities. For example, we do not know whether certain types of businesses, or those in particular places, may have more or less access to credit. We do not know the extent to which small business lending is shifting from banks to alternative lenders. Nor do we know the extent to which the credit constraints that resulted from the Great Recession persist and to what extent.
The *Beige Book* produced by the Federal Reserve on a regular basis is a survey of economic conditions that contains a huge amount of anecdotal information about business activity around the country. But it has no systematic data on how small

businesses are faring and whether or how much they are being held back by financing constraints.

Given the importance of small businesses to our economy and their critical need to access financing if they are to prosper and grow, it is vitally important to fill in the blanks on how small businesses are able to engage with the credit markets. That is why Congress required financial institutions to report information about their applications for credit from small businesses in accordance with regulations to be issued by the Consumer Bureau. And that is why we are here today for this field hearing.

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The inquiry we are launching today is a first step toward crafting this mandated rule to collect and report on small business lending data. To prepare for the project, we have been building an outstanding team of experts in small business lending. We are enhancing our knowledge and understanding based on our Equal Credit Opportunity Act compliance work with small business lenders, which is helping us learn more about the credit application process; existing data collection processes; and the nature, extent, and management of fair lending risk. We also have learned much from our work on the reporting of home loans under the Home Mortgage Disclosure Act, which has evolved and improved considerably over the past forty years.

At the same time, we recognize that the small business lending market is much different from the mortgage market. It is even more diverse in its range of products and providers, which range from large banks and community banks to marketplace lenders and other emerging players in the fintech space. Community banks play an outsized role in making credit available to small businesses in their local communities. And unlike the mortgage market, many small business lenders have no standard underwriting criteria or widely accepted scoring models. For these reasons and more, we will proceed carefully as we work toward meeting our statutory responsibilities. And we will seek to do so in ways that minimize the burdens on industry. Our Request for Information released today focuses on several issues.

First, we want to determine how best to define “small business” for these purposes. Despite the great importance of these firms to our economy, there is surprisingly little consensus on what constitutes a small business. For example, the Small Business Administration, in overseeing federal contracting, sometimes looks at the number of employees, sometimes looks at the annual receipts, and applies different thresholds for different industries. For our part, the Consumer Bureau is thinking about how to develop a definition that is consistent with the Small Business Act, but can be tailored to the purposes of collecting business lending data. So we are looking at how the lending industry defines small businesses and how that affects their credit application processes. Having this information will help us develop a practical definition that advances our goals and aligns with the common practices of those who lend to small businesses.

Second, we want to learn more about where small businesses seek financing and the kinds of loan products that are made available to them. Our initial research tells us that

term loans, lines of credit, and credit cards are the all-purpose products used most often by our small businesses. In fact, they make up an estimated three-fourths of the debt in the small business financing market, excluding the financing that merchants or service providers extend to their small business customers to finance purchases of the sellers' own goods and services. But we want to find out if other important financing sources are also being tapped by small businesses. Currently, we have limited ability to measure accurately the prevalence of lenders and the products they offer. We also want to learn more about the roles that marketplace lenders, brokers, dealers, and other third parties may play in the application process for these loans. At the same time, we are exploring whether specific types of institutions should be exempted from the requirement to collect and submit data on small business lending.

Third, we are seeking comment about the categories of data on small business lending that are currently used, maintained, and reported by financial institutions. In the statute, Congress identified specific pieces of information that should be collected and reported. They include the amount and type of financing applied for; the size and location of the business; the action taken on the application; and the race, ethnicity, and gender of the principal owners. Congress determined that the reporting and disclosure of this information would provide a major boost in understanding small business lending. At the same time, we are sensitive to the fact that various financial institutions may not currently be collecting and reporting all of this information in the context of other regulatory requirements. And we understand that the changes imposed by this rule will create implementation and operational challenges.

So we will look into clarifying the precise meaning of some of these required data elements to make sure they are understood and consistently reported. We will be considering whether to add a small number of additional data points to reduce the possibility of misinterpretations or incorrect conclusions when working with more limited information. To this end, we are seeking input on the kinds of data different types of lenders are currently considering in their application processes, as well as any technical challenges posed by collecting and reporting this data. We will put all of this information to work in thinking carefully about how to fashion the regulation mandated by Congress under Section 1071 of the Dodd-Frank Act.

Finally, the Request for Information seeks input on the privacy implications that may arise from disclosure of the information that is reported on small business lending. The law requires the Consumer Bureau to provide the public with information that will enable communities, government entities, and creditors to identify community development needs and opportunities for small businesses, especially those owned by women and minorities. But we also are authorized to limit the data that is made public to advance privacy interests. So we will be exploring options that protect the privacy of applicants and borrowers, as well as the confidentiality interests of financial institutions that are engaged in the lending process.

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The announcement we are making today, and the work we are doing here, reflect central tenets of the Consumer Financial Protection Bureau. We are committed to

evidence-based decision-making. We aim to develop rules that meet our objectives without creating unintended consequences or undue burdens. We want to see a financial marketplace that offers fairness and opportunity not just to some, but to all. A marketplace that does so without regard to race, ethnicity, gender, or any of the other elements of our fabulous American mosaic. We all know that small businesses are powerful economic engines. They supply jobs that lift people out of poverty or dependence, teach essential skills, and serve as backbones of our communities. So we mean to meet our obligation to develop data that will shed light on their ability to access much-needed financing. It is essential to their future growth and prosperity, and therefore to the growth and prosperity of us all. Because what Cicero observed in ancient Rome still holds true today. He said, “Nothing so cements and holds together all the parts of a society as faith or credit.” Our communities depend on both of those precious things just as much today.

As we launch this inquiry, I want to remind all of you that we value the feedback we get. We take it seriously, consider it carefully, and integrate it into our thinking and our approach as we figure out how best to go forward with this work. So we ask you to share your thoughts and experiences to help us get there. And we thank you again for joining us today.