

Adapting to CFPB 1071 Small Business Reporting Requirement

Today's Presenter



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Today's Agenda

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Questions and wrap up

Latest Regulatory Updates

CFPB 1071 Small Business Reporting

CFPB 1071 Rule – Current Status Update

- On October 18, 2023, the Senate passed Senate Joint Resolution 32 to disapprove the Small Business Rule
- On December 1, 2023, the House passed the disapproval resolution in a 221-202 vote
- President Biden vetoed the disapproval on December 19, 2023
- On January 10, 2024, the Senate voted 54-45 to override the veto, but that fell short of the two-thirds required to overturn.

CFPB 1071 Rule – Current Status Update

- On July 31, 2023, the court granted a limited injunction to the plaintiffs pending the Supreme Court decision, potentially delaying the future implementation dates of 1071 Small Business Reporting.
- On May 16th, 2024, the Supreme Court reached a verdict 7-2 on *CFPB vs. Community Financial Services Association of America* that the CFPB's funding structure violates the Appropriations Clause of the Constitution. The rule survived the legal challenges.
- CFPB released new effective dates for the three tiers.
- CFPB moving forward on filling 75 additional positions.

CFPB 1071 Rule – Current Status Update

CFPB Pilot Study – Released 11/13/2024

CFPB Pilot Study Finds Differential Treatment in Small Business Lending Markets

Lenders less likely to encourage Black entrepreneurs and more often steer them toward alternative financing

NOV 13, 2024



CFPB 1071 Rule – Current Status Update

CFPB Pilot Study – Released 11/13/2024

- The CFPB conducted matched-pair testing using trained individuals who posed as small business owners seeking credit.
- Testers visited 25 unique bank branches in Fairfax County, Virginia and 25 branches in Nassau County, New York, resulting in a total of 100 in-person test visits.
- Black participants were assigned slightly more favorable financial profiles compared to their white counterparts.
- In many tests, the Black and white participant each met with the same bank representative.



CFPB 1071 Rule – Current Status Update

CFPB Pilot Study – Released 11/13/2024

The study revealed statistically significant disparities in two key areas:

- **Black test participants received significantly less encouragement to apply for loans.** For example, lenders expressed interest in applications from 40% of white participants, but only 23% of Black participants.
- **Lenders were more likely to suggest credit cards and home equity loans to Black business owners:** While lenders discussed requested small business lending products with both Black and white participants, they were significantly more likely to suggest alternative credit products to Black participants, including personal credit cards and home equity loans. Non-requested or alternative credit products were discussed with 59% of Black participants, compared to 39% of white participants.



CFPB Rule 1071 Overview

Overview of 1071 Small Business Reporting rule

Summary of 1071 Rulemaking:

1071 Small Business Reporting

I. What Financial Institutions are covered?

- Any partnership, company, corporation, association (Incorporated or unincorporated), trust, estate, cooperative organization or other entity that engages in any financial activity
 - Banks, Savings Associations, Credit Unions
 - Online lenders, Community Development FI, Government lending entities, nonprofit lenders, Lenders of equipment and vehicle financing
- Institutions that had at least 100 credit transactions to small businesses in each of the two preceding calendar years.



Summary of 1071 Rulemaking:

1071 Small Business Reporting

II. How are Small Businesses being defined?

- **Businesses that had \$5 million or less in gross annual revenue for its preceding fiscal year**
- **A Simplified approach, verses using the SBA's size standards for defining a small business concern**



Summary of 1071 Rulemaking:

1071 Small Business Reporting

NAICS Codes	NAICS Industry Description	Size standards in millions of dollars	Size standards in number of employees
445291	Baked Goods Retailers	\$16.0	
445292	Confectionery and Nut Retailers	\$19.5	
445298	All Other Specialty Food Retailers	\$10.0	
445320	Beer, Wine, and Liquor Retailers	\$10.0	
449110	Furniture Retailers	\$25.0	
449121	Floor Covering Retailers	\$9.0	
449122	Window Treatment Retailers	\$11.5	
449129	All Other Home Furnishings Retailers	\$33.5	
449210	Electronics and Appliance Retailers	\$40.0	
455110	Department Stores	\$40.0	
455211	Warehouse Clubs and Supercenters	\$47.0	
455219	All Other General Merchandise Retailers	\$40.0	
456110	Pharmacies and Drug Retailers	\$37.5	
456120	Cosmetics, Beauty Supplies, and Perfume Retailers	\$34.0	
456130	Optical Goods Retailers	\$29.5	
456191	Food (Health) Supplement Retailers	\$22.5	
456199	All Other Health and Personal Care Retailers	\$9.5	
457110	Gasoline Stations with Convenience Stores	\$36.5	
457120	Other Gasoline Stations	\$33.5	
457210	Fuel Dealers		100

Example of SBA's definitions of Small Businesses by NAICS codes



Summary of 1071 Rulemaking:

1071 Small Business Reporting

III. What are the New Effective and Compliance Dates?

- **Tier 1 - 7/18/2025 – 2,500 originations in 2022 and 2023**
- **Tier 2 - 1/16/2026 – 500 originations in 2022 and 2023**
- **Tier 3 - 10/18/2026 – 100 originations in 2022 and 2023**
- **12-month grace period during which the CFPB—for institutions under its jurisdiction—will not assess penalties for errors in data reporting, and will conduct examinations only to assist institutions in diagnosing compliance weaknesses, to the extent that these institutions engaged in good faith compliance efforts.**



Summary of 1071 Rulemaking:

1071 Small Business Reporting

Compliance Date Tier	2025	2026	2027
Tier 1	<p>7/18 to 12/31 Covered financial institutions collect 2025 data</p> <p>No data to report this year</p>	<p>1/1 to 12/31 Covered financial institutions collect 2026 data</p> <p>6/1 Deadline to report data collected in 2025</p>	<p>1/1 to 12/31 Covered financial institutions collect 2027 data</p> <p>6/1 Deadline to report data collected in 2026</p>
Tier 2	<p>Not required to collect data or report data</p>	<p>1/16 to 12/31 Covered financial institutions collect 2026 data</p> <p>No data to report this year</p>	<p>1/1 to 12/31 Covered financial institutions collect 2027 data</p> <p>6/1 Deadline to report data collected in 2026</p>
Tier 3	<p>Not required to collect data or report data</p>	<p>10/18 to 12/31 Covered financial institutions collect 2026 data</p> <p>No data to report this year</p>	<p>1/1 to 12/31 Covered financial institutions collect 2027 data</p> <p>6/1 Deadline to report data collected in 2026</p>



Summary of 1071 Rulemaking:

1071 Small Business Reporting

III. What credit transactions are covered?

- An oral or written request for a covered credit transaction that is made in accordance with procedures used by a FI for the type of credit requested.
- Proposed definition of covered applications is largely consistent with the existing Regulation B definitions with the following exceptions:
 - Reevaluations requests, extension requests, or renewal requests on existing business accounts if requests seeks no additional credit
 - Inquiries and prequalification requests



Summary of 1071 Rulemaking:

1071 Small Business Reporting

III. What credit transactions are covered?

- **Covered credit transactions would include**
 - Loans
 - Lines of Credits
 - Credit Cards
 - Merchant Cash Advances



Summary of 1071 Rulemaking:

1071 Small Business Reporting

III. What credit transactions are covered?

- **Excluded credit transactions**

- Trade credit (Financing arrangements between business without immediate payment to the business providing the goods or services)
- Public utilities credit as defined in Regulation B, 12 CFR 1002.3(a)(1)
- Securities credit as defined in Regulation B, 12 CFR 1002.3(b)(1)
- Incidental credit as defined in Regulation B, 12 CFR 1002.3(c)(1)
- Factoring, leases, consumer-designated credit used for business purposes
- Credit secured by certain investment properties



Summary of 1071 Rulemaking:

1071 Small Business Reporting

IV. What are the reporting requirements?

- **Covered financial institutions required to collect data on a calendar-year basis**
- **Data to be reported (Submitted) to Bureau by June 1 of the following year**
- **Financial institutions would be required to provide certain identifying information about themselves as part of submission of data**



Summary of 1071 Rulemaking:

1071 Small Business Reporting

IV. What are the reporting requirements?

- **Required to maintain recordkeeping for at least three years. This includes:**
 - **Evidence of compliance**
 - **A copy of small business lending application registers**
- **An applicant's responses to Section 1071 inquiries to be kept separate from the rest of the application and accompanying information**



Summary of Proposed Rulemaking:

1071 Small Business Reporting

V. Requirement to limit access to certain data:

- Coined as the “firewall” by the Bureau
- Any officer or employee making determinations concerning the application would be prohibited from accessing an applicant’s responses to inquires of principal owners regarding:
 - Minority owned
 - Women owned
 - Ethnicity
 - Race
 - Sex



Summary of 1071 Rulemaking:

1071 Small Business Reporting

V. Requirement to limit access to certain data:

- **This prohibition would not apply to an employee or officer if the covered financial institution determines it is not feasible to limit data access.**

And

- **The financial institutions provides notice to the applicant regarding that access to the data**
- **The Bureau is proposing sample language that a covered financial institution could use to satisfy the proposed notice requirement**



Data Gathering During Application

Changes to lending processes, loan operations, and data storage

Data Gathering Requirements:

1071 Small Business Reporting

Three Major Data Sets:

- 1. Data points that the financial institution generates**
- 2. Data points that can be provided by the applicant or that the financial institution could determine by reviewing information provided by the applicant or third party**
- 3. Data points that address the demographics of the applicant's owners or ownership status. Generally, a financial institution would be required to ask the applicant to provide this information.**



Data Gathering Requirements

Data Points Chart

1. Unique Identifier (21-45 characters)

UID Example:

10BX939c5543TQA1144M999143X99

LEI

Covered
Application
Identifier

2. Application Date
3. Application Method – in person, telephone, online, mail
4. Application Recipient – direct or indirect via third party
5. Credit Product Type – term loan, line, credit card, etc.
6. Guarantee Type – personal, SBA, USDA, etc.



Data Gathering Requirements

7. Loan Term Flag – Is loan term applicable?
8. Loan Term Value – Loan term in months
9. Credit Purpose – Purchase, Construction, Refi, etc.
10. Amount Applied for Flag – Did applicant request an amount?
11. Amount Applied for Value
12. Amount Approved or Originated
13. Action Taken – Originated, denied, withdrawn, etc.
14. Action Taken Date
15. Denial Reasons – Business characteristics, cash flow, collateral
16. Pricing – Interest Rate Type – Variable, fixed, etc.
17. Pricing – Initial Rate Period, if Variable



Data Gathering Requirements

- 18.Pricing – Fixed Interest Rate Value
- 19.Pricing – Variable Interest Rate Value
- 20.Pricing – Variable Interest Rate Margin Value
- 21.Pricing – Variable Interest Rate Index Name
- 22.Pricing – Total Origination Charges
- 23.Pricing – Total Broker Fees
- 24.Pricing – Initial Annual Charges
- 25.Pricing – MCA/Sales Based Financing Costs Flag and Value
- 26.Pricing – Prepayment Penalty Availability
- 27.Pricing – Prepayment Penalty Included
- 28.Census Tract – Address Type
- 29.Census Tract – Tract Number



Data Gathering Requirements

- 30. Gross Annual Revenue Flag and Value (reuse previously collected gross annual revenue information when the data were collected within the same calendar year as the current covered application)
- 31. NAICS Flag and Code
- 32. Number of Workers
- 33. Time in Business Type and Value
- 34. Business Ownership Statuses
- 35. Number of Principal Owners Flag and Value
- 36. Ethnicity of Principal Owners 1-4
- 37. Race of Principal Owners 1-4
- 38. Sex/Gender of Principal Owners 1-4



Data Gathering Requirements:

Data points that the financial institution generates

Data point	NPRM section	Description	Data elements to be reported
Unique identifier	107(a)(1)	FI would report an alphanumeric application or loan identifier unique within the FI to the specific application.	Unique alphanumeric application or loan number not to exceed 45 characters. Must begin with the FI's Legal Entity Identifier (LEI).

Application date	107(a)(2)	FI would report application date using either: (i) the date the application was received by the FI; or (ii) the date shown on a paper or electronic application form.	A complete calendar date (i.e., month, day, and year).
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Three day grace period for Safe Harbor

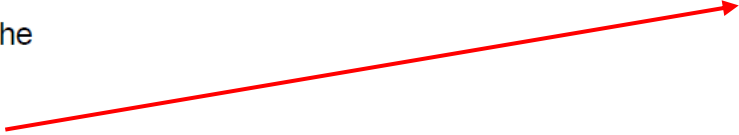


Data Gathering Requirements:

Data points that the financial institution generates

Credit type	107(a)(5)	FI would report credit type in three parts: (1) credit product (from specified list); (2) guarantee(s) (from specified list); (3) loan term.	One of the credit products from the following list: (1) Term loan—unsecured; (2) Term loan—secured; (3) Line of credit—unsecured; (4) Line of credit—secured; (5) Credit card; (6) Merchant cash advance; (7) Other sales-based financing transaction; (8) Other (with additional information provided via free form text); (9) Not provided by
Credit purpose	107(a)(6)	FI would report credit purpose(s) from a specified list.	Up to three credit purposes from the following list: (1) Purchase, construction/improvement, or refinance of owner-occupied dwelling(s); (2) Purchase,
Action taken	107(a)(9)	FI would report one of five specified actions taken on the application.	One of the following: (1) Originated; (2) Approved but not accepted; (3) Denied; (4) Withdrawn by applicant; (5) Incomplete. Incomplete applications would include (1) instances where an FI took adverse action on the basis of incompleteness, and (2) instances where the FI provided a written notice of incompleteness and the

construction/improvement, or refinance of non-owner-occupied dwelling(s); (3) Purchase, construction/improvement, or refinance of non-owner occupied, non-dwelling real estate; (4) Purchase, construction/improvement, or refinance of owner-occupied, non-dwelling real estate; (5) Purchase, refinance, or rehabilitation/repair of motor vehicle(s) (including light and heavy trucks); (6) Purchase, refinance, or rehabilitation/repair of equipment; (7) Working capital (includes inventory or floor planning); (8) Business start-up; (9) Business expansion; (10) Business acquisition; (11) Refinance existing debt (other than refinancings listed above); (12) Line increase; (13) Other (with additional information provided via free-form text); (14) Not provided by applicant



Data Gathering Requirements:

Data points that the financial institution generates

Pricing information 107(a)(12)

FI would report pricing information for originated credit and credit that is approved but not accepted.

If a fixed rate transaction: the interest rate.

If a variable-rate transaction: the margin, index value, and index name. Index name is reported using one of the following: (1) Wall Street Journal Prime; (2) 6-month CD rate; (3) 1-year T-Bill; (4) 3-year T-Bill; (5) 5-year T-Note; (6) 12-month average of 10-year T-Bill; (7) Cost of Funds Index-National; (8) Cost of Funds Index-11th District; (9) Other (with additional information provided via free-form text).



CFPB 1071 Rule

Ownership Definitions

- Principal owner - CDD Rule but only consider direct (not indirect) ownership of 25% or more of the equity of the small business
- Minority/women owned principal owner – CDD Rule but only consider direct (not indirect) ownership of 25% or more of the equity of the small business held by minority or women
- Minority/women-owned small business - More than 50 percent of business ownership or control is held by one or more minority individuals or women, and more than 50 percent of its net profits or losses accrue to one or more minority individuals or women



Data Gathering Requirements:

Required to ask the applicant to provide this information

Minority-owned business status	107(a)(18)	FI would report applicant's response to the FI's § 1002.107(a)(18) inquiry regarding whether the applicant is a minority-owned business.	<p>FI would report applicant's response (yes, no, or "I do not wish to provide this information") or that the applicant did not respond.</p> <p>FI would also report whether it is reporting this information based on previously collected data.</p>	<p>FI would report solely based on applicant-provided information; no verification or visual observation and/or surname analysis would be required or permitted.</p> <p>FI would be required to inform applicant that it is not required to provide this information.</p>
Ethnicity of principal owner(s)	107(a)(20)	Generally, FI would report applicant's response to the FI's § 1002.107(a)(20) inquiry regarding the ethnicity of the applicant's principal owner(s). However, in some circumstances, the FI would report the ethnicity of one or more principal owners based on visual observation and/or surname.	<p>If the FI is reporting applicant-provided information: For each principal owner, the FI would report the aggregate categories and disaggregated subcategories selected by the applicant, that the applicant did not wish to provide the information, or that the applicant did not respond (as applicable).</p> <p>If the FI is reporting based on visual observation and/or surname: For at least one principal owner, the FI would report using the aggregate categories only. For other principal owners, the FI would report that the applicant did not wish to provide the information or that the</p>	<p>FI would be required to inform applicant that it is not required to provide this information.</p> <p>The proposed commentary and proposed sample data collection form include the aggregate categories and disaggregated subcategories that would be used when collecting and reporting ethnicity.</p>

- You might need to collect data on 1-4 Principal owners
- Track date the information was collected. Can you reuse information or does the applicant need to answer them again?



Data Gathering Requirements:

Real Impacts to your Financial Institution

Have you been through a core conversion or bank acquisition recently?

You will face similar challenges

1. System compatibility
2. Data mapping
3. Data migration
4. Testing
5. Staff training



Data Gathering Requirements:

Real Impacts to your Financial Institution

Changes in current Commercial, Commercial Real Estate, Ag lending processes

1. Relationship based lending concepts
2. Application process and platforms
3. Completing the process - Action taken requirements
4. Loan pricing concepts – avoiding fair lending issues
5. Tracking Loan pricing exceptions



1071 Rule Violations and Errors

What's the worst case scenario?

- Non-compliance with the 1071 Rule is subject to administrative sanctions and civil liability in Reg B
- Bona fide error that was unintentional and occurred despite procedures reasonably adapted to avoid such error is not a violation of the Rule if the number of such errors does not exceed the thresholds in the Rule (CFPB to define)
- Four safe harbors related to certain errors in:
 - Census tract
 - NAICS code
 - Small business status determination– not a data point
 - Application date



Commercial & Ag Lending

Impacts to lending culture

Pricing Practices

How lenders price loans

- Benchmark index plus a spread
- Loan Pricing Models
- Rate sheets
- Based on Competitive pressures (Real or Perceived)
- Specials or teaser rates
- Relationship pricing



Types of Loan Pricing Models

Risk based pricing models

- Uses different loan characteristics to adjust price
- Typically used to set a base price (product rate sheet)
- Has some profitability margin baked into base price
- Typically requires a default scenario for each Product
- Helps eliminate fair lending issues



Types of Loan Pricing Models

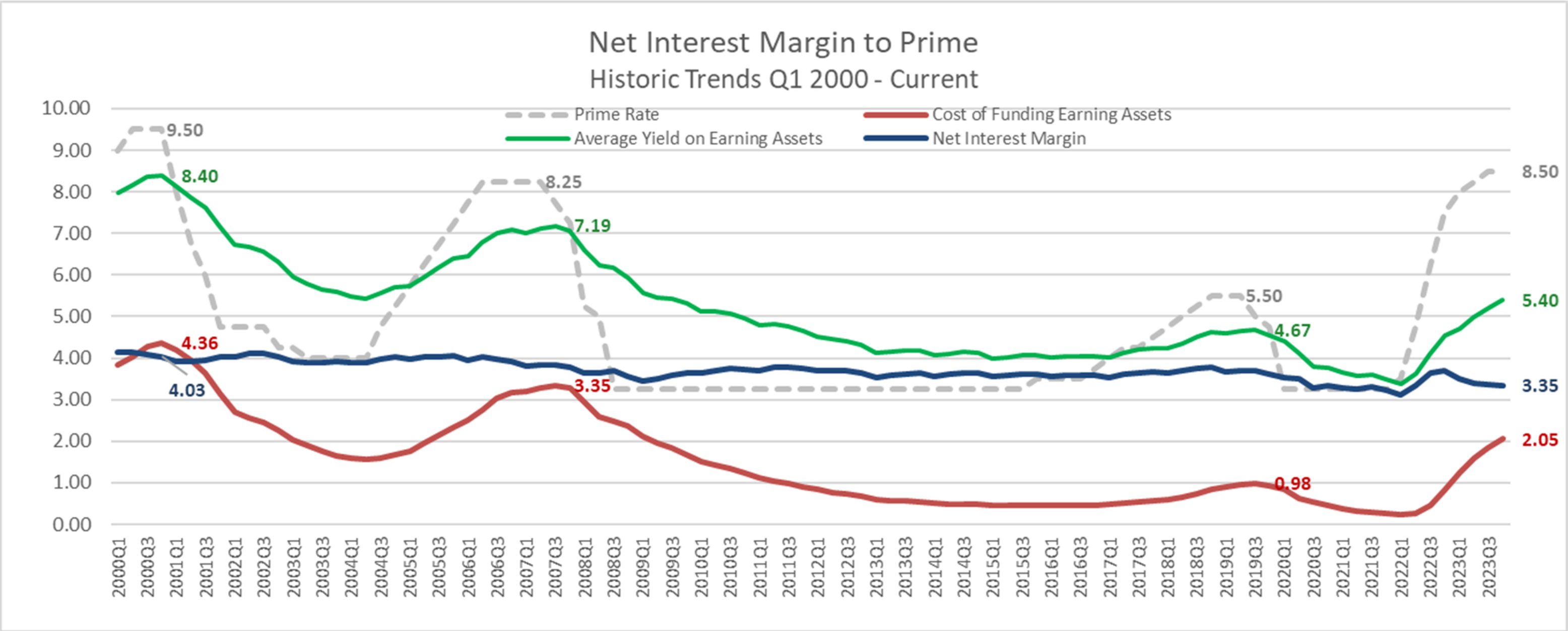
Profitability based loan pricing models

- Uses revenue/expense/risk assumptions to calculate profitability on an individual loan or total relationship
- Expense allocations become a key assumption
- Cost of funds should be forward looking
- Allows pricing flexibility based on profitability targets
- Can be used at ALCO to identify what products to offer or can be used by lending staff to justify exceptions to risk-based models

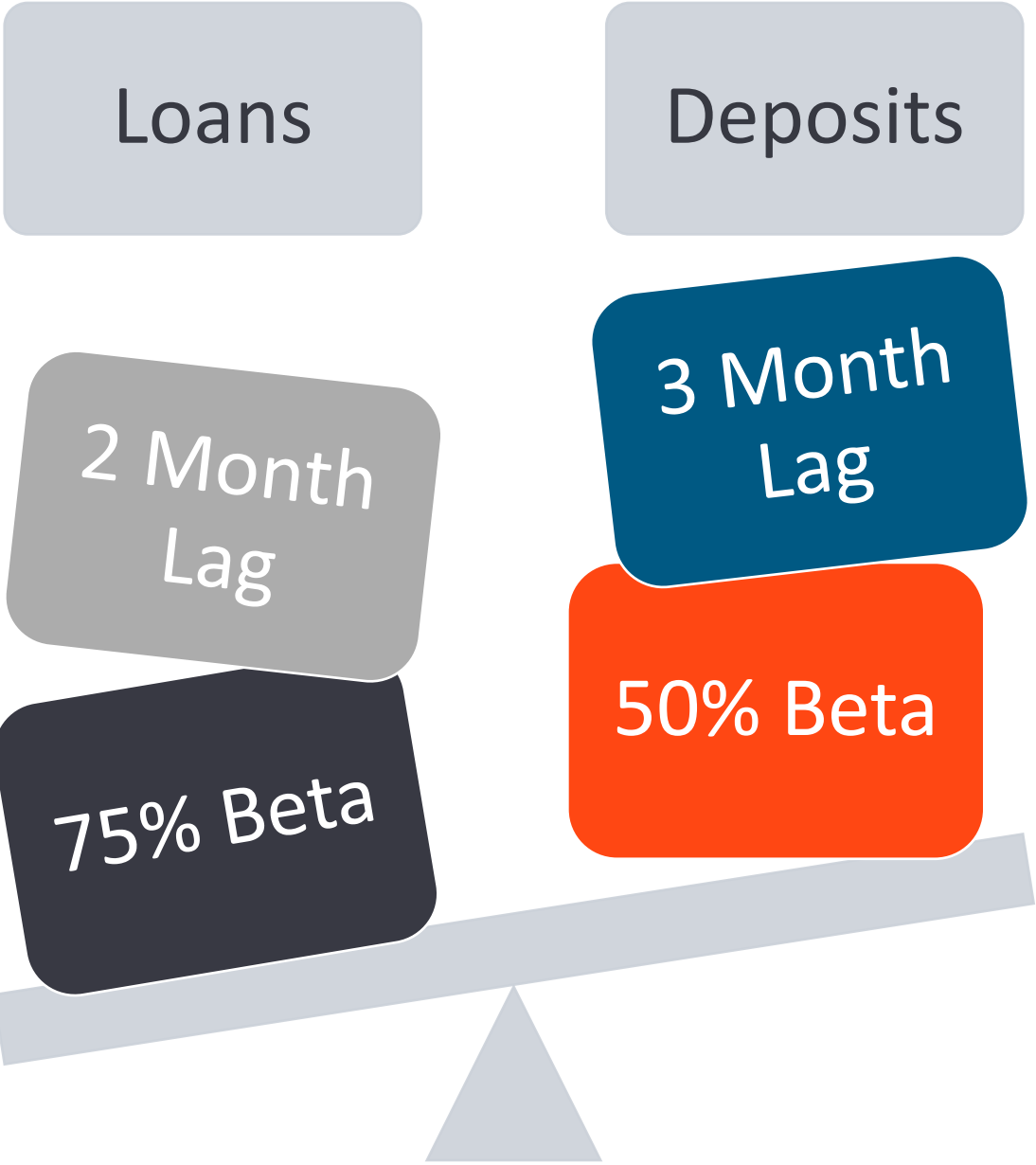


Relationship Lending

Impact of 1071 on Culture

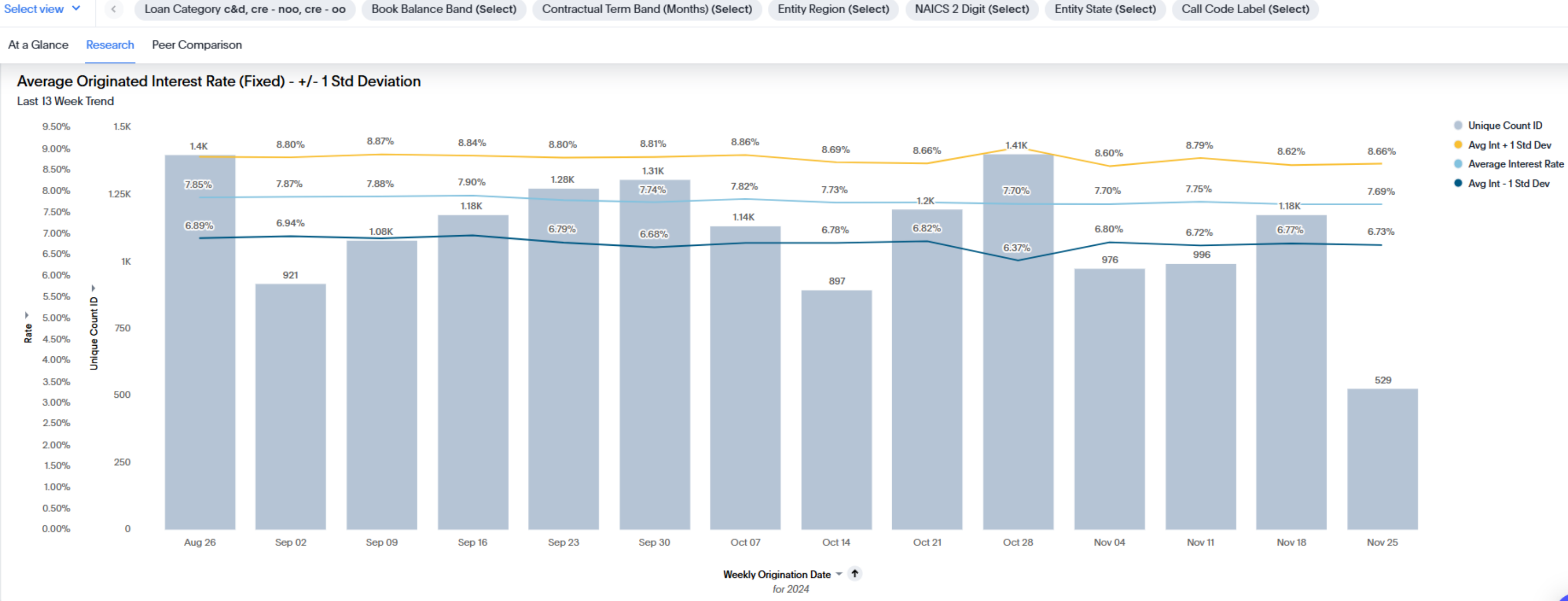


Pricing Strategies



Loan Pricing Challenges

Origination benchmark data



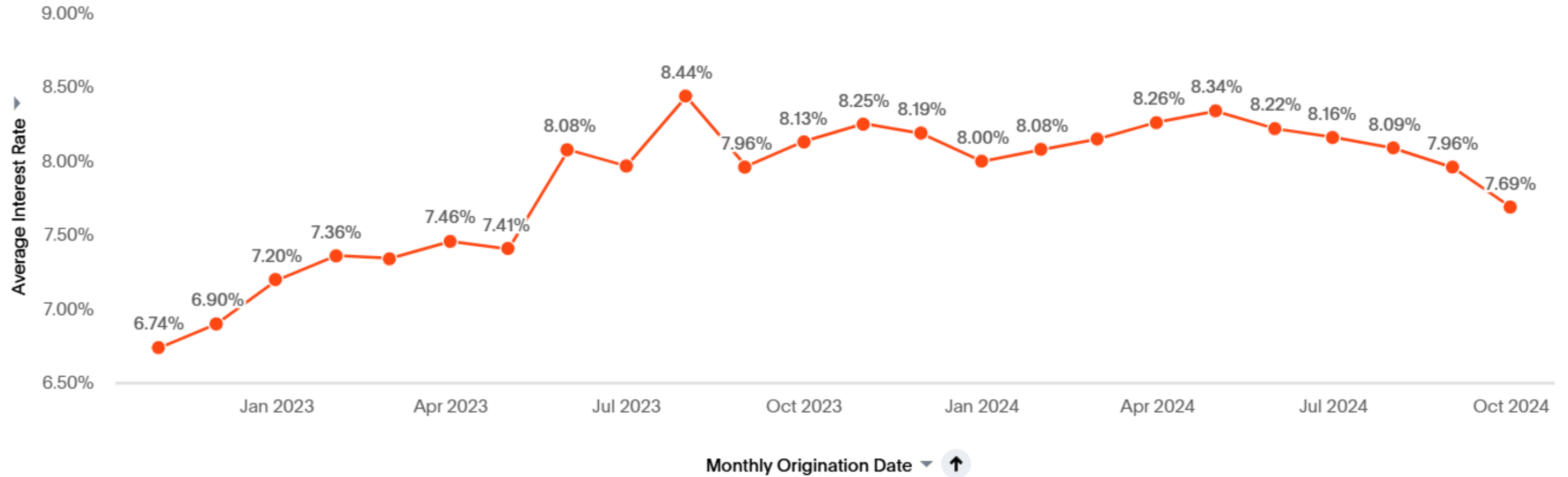
Ag Origination Benchmark Data 2024

Average Originated Interest Rate (Fixed) - Trailing 24 Months

Navigation icons: back, dropdown, menu, and Pin button.

Loan Type

Filters: Origination Date Between (11/01/2022 <= 10/31/2024), Loan Category Click to see filter, Interest Rate Volatility Click to see filter, and a dropdown arrow.



Ag Origination Benchmark Data 2024

Average Originated Interest Rate (Fixed) - Trailing 24 Weeks

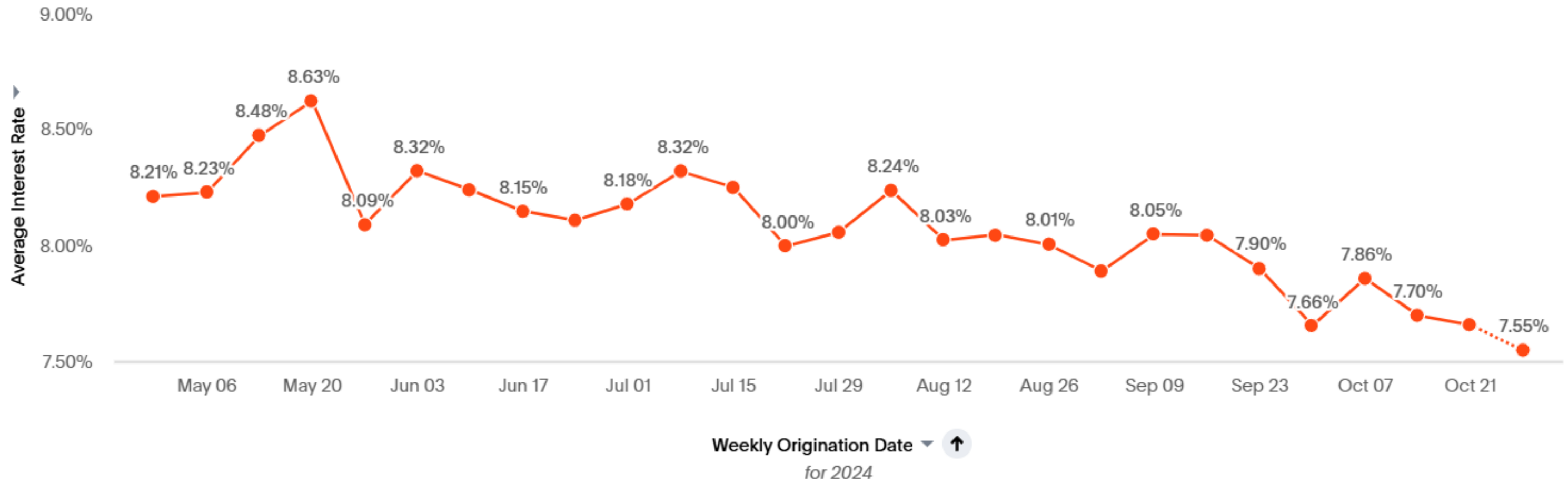
Navigation icons: back, dropdown, menu, and Pin button.

Loan Type

Origination Date Between (05/01/2024 <= 10/31/2024)

Loan Category Click to see filter

Interest Rate Volatility Click to see filter



Loan Pricing Challenges

Relationship pricing

What is your strategic objective?

- Incentive to capture more core deposits
- Reward existing customers
- Maintain ROE/ROA profitability targets
- Drive consistency in loan pricing



Relationship Pricing

Impact of 1071 on Culture

- How to handle loans priced in a different rate environment
 - If you reprice these loans, they would most likely be under water
 - When is the next repricing date?
- How to value core deposits.
 - How long does it take for customer deposits to migrate over
 - Are there covenants in place to raise rates on loans if deposits don't comply
 - What is your financial institution's liquidity situation? Did you allocate existing core deposits to other loans?



Relationship Lending

Impact of 1071 on Culture

The separation between credit applications and relationships

How do you reconcile existing pricing culture with new CFPB 1071 reporting requirements?



Change Management and Section 1071 Adoption

Commercial Loan Workflow Process

- Creates consistency in loan application & underwriting practices
- Employee training and compliance benefits
- Mitigates operational risk
- Enables status reporting for customers and management



Managing Change Effectively

Common Roadblocks to Success

What do you think the biggest challenge is to a successful implementation of a LOS or Loan Pricing solution?

The Technology



The Implementation



The People





Change Management and Section 1071 Adoption

- One of the biggest hurdles of successfully implementing automation and technology
- Most people are change adverse
- Watch for a reversion back to old processes when under pressure
- Hold the line for successful implementations

Managing Change Effectively

Common Roadblocks to Success

- Not understanding the complexity of the problem
- Lack of change management knowledge skills
- Lack of accountability
- Insufficient resources and tight timelines
- Inappropriate organization structure
- Underestimating the ease of change
- Lack of support from senior Management
- Poor cross-functional teamwork
- Minimal or zero follow up of tactical issues



Managing Change Effectively

The Cost of Poor Change Management

According to surveys of global senior executives, the success rate of change initiatives in organizations is as low as 54 percent. And research from McKinsey and Company reflects that 70% of all transformations fail

Impacts of poor change management:

- ✓ Poor productivity and output
- ✓ Low workplace morale amongst employees
- ✓ A decline in the market share
- ✓ Incurring huge financial losses

Managing Change Effectively

5 Steps of Change Management

1. Preparing the organization for change
2. Creating a vision and plan for change
3. Implement the changes
4. Migrating change into culture
5. Review progress and analyze



Questions