
CONSUMER FINANCE PODCAST: LOTS OF DEVELOPMENTS IN SMALL BUSINESS FINANCE**HOST: CHRIS WILLIS****GUESTS: JOSH McBEAIN AND CALEB ROSENBERG****POSTED: APRIL 6, 2023****Chris:**

Welcome to the *Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper's Consumer Financial Services Regulatory Practice. And today, we're going to be talking about a recent, very intense flurry of activity related to small business lending.

But before we get into that, let me remind you to visit and subscribe to our blog, consumerfinancialserviceslawmonitor.com, where you'll see all the updates that we're going to talk about today. As well as everything else going on in the consumer finance world.

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Now, as I said, today we're going to be talking about some developments in small business lending, and I've got my colleagues Josh McBeain and Caleb Rosenberg here with me. You've heard them on the podcast before. So Josh, Caleb, welcome to the podcast.

Josh:

Thanks, Chris.

Caleb:

Thanks, Chris.

Chris:

The thing about small business lending is, over the past few years, I feel like we've watched a very slow but very incremental journey in the world of financial services regulation to try to treat small business lending more like consumer lending. To extend consumer-like protections in various aspects of small business lending to those small business applicants and borrowers.

But thus far, it feels like it's been really slow. Like you've had developments occurring at a very slow pace and in a very incremental way. But if we look at the first quarter of this year, 2023, all of a sudden, things took off really, really quickly.

Caleb, Josh, talk to the audience about what has happened over the past 90 days that seems to have really accelerated the trend of consumer-like regulation of small business lending.

Caleb:

Thanks, Chris. There's been a number of developments from some places that we've expected to see in the past, like state-level developments. But also, some federal developments that have both had a slow burn, and some of them have been unexpected in the past several weeks.

One unexpected area that we've seen develop on the federal level is the FTC put out an order requiring information from a number of firms on business credit reporting. They've pointed out that consumer credit reporting is well covered by the Fair Credit Reporting Act. But that for small businesses, a number of the reports are done by Dun & Bradstreet and are not covered by the Fair Credit Reporting Act, because they're not consumer reports.

The FTC is looking into this as, they believe that it can cause confusion for small business owners. It's another example of the consumerization of these products. Regulators began to focus on the small business products in the same way and with the same concerns that they have with consumer products. This is the first [inaudible 00:02:54] that we've seen on small business credit reporting, and it's an important development for the space.

Josh:

Yeah. And following along with that, as we talked about last time, we have four states right now that have passed commercial financing disclosure laws. California and New York, Utah, and Virginia. We now have five other states that have proposed bills in their state legislatures. Connecticut, Illinois, Maryland, Missouri, and Florida.

And also, what's interesting is New York, as has been already mentioned, there's kind of been a slow burn. But New York has finally published its regulation. They did that on February 1st, the New York Department of Financial Services published final regulations for their commercial financing disclosure law. Which has a mandatory compliance date of August 1st, 2023.

So, before the end of the year, commercial lenders in New York will be required to comply with the New York Commercial Financing Disclosure Law. Which is a big development. We'll see where the other five states go, and maybe they'll go nowhere. But if they ultimately become law, that would be a total of nine states. Which would be a pretty significant burden for commercial lenders operating a 50-state program that would have to develop bespoke disclosures for those at least four states, potentially nine. And I think that dovetails nicely into a recent determination by the CFPB. Caleb, do you want to speak to that?

Caleb:

Over the years, I've had the great pleasure of talking to a number of clients about exactly how to do these disclosures. Especially for MCAs and other sales-based financing that don't have interest rates but are required to disclose an APR are contingent. Since they don't have an exact term. But are required to disclose a term. And a number of other issues that just don't quite fit with consumer disclosures that the states are requiring for these products.

The CFPB, in response to a request from industry regarding preemption by TILA issued a pretty conclusory statement that, "Of course, these laws aren't preempted by TILA. TILA only covers consumer credit and not commercial credit." Of course, TILA does have two provisions that do cover commercial credit, but that's not for the disclosures. And they ignored that part. And they didn't go into great detail about the fact that TILA's preemption is focused on preventing confusion and they reserve the terms that are used in TILA for specific use exactly as they're defined by TILA to prevent people from being confused by different disclosures covering different products.

Simultaneously, a trade group, the SBFA challenged California's disclosures on TILA grounds and First Amendment grounds. Just in the past week, the court decided on a motion to dismiss

and ruled for the SBFA that at least for a purpose of the motion to dismiss California's rule was preempted at least for open-end products and for sales-based financing. And also violated the First Amendment, because it did not require purely factual disclosures involving commercial speech. These are important developments not only for California, but also for New York. Which closely mirrors California's disclosures. And for all of the other states that are examining this and dipping their toes into it, it puts another wrinkle and complication into exactly what people need to comply with, what different states are going to require and potential grounds for challenging them as they move forward.

Josh:

Caleb, if I heard you correctly, did you say that in the same week, the CFPB said, "TILA does not preempt the state laws in Virginia, Utah, New York and California." But a California judge said that, "TILA may preempt California's commercial financial disclosure law." Is that correct?

Caleb:

Yes, and I'm sure that the judge was aware that the CFPB had come down with that. I'm sure that had been filed, but those two are in conflict right now. I don't believe the CFPB formally filed anything in that case, but it's certainly something that I'm sure everyone is going to be following closely in the next several weeks and months.

Josh:

Interesting. Interesting. So last week was pretty exciting, but I think the last item which we got last Thursday was the CFPB finally published the 1071 final rule. And for those who haven't been following this, section 1071 was part of the Dodd-Frank Act that was passed in 2010. It amended ECOA the Equal Credit Opportunity Act. And it required that commercial lenders collect and report certain data regarding applications for credit for small businesses. The congressional intent of 1071 was to increase transparency in small business lending and promote economic development and combat unlawful discrimination. That's been on the book since 2010 when Dodd-Frank passed. But no one has had to do anything, and no one has had to collect any data or do anything with that law, because we've been waiting for the CFPB to publish final rules. Which they did on March 30th. We finally got the final rule for 1071. That now kicks off the timeline for compliance with the rule. And Chris, I know you've already read the 800-page rule, and I think the additional, what? 200-page filing instructions.

Chris:

It's only 123 pages, Josh.

Josh:

Okay, it's all right. I aggressively round it up, but I don't think we're going to get into it in detail here, because it's 800 pages. But I would love to hear your high-level thoughts.

Chris:

Sure. The rule is incredibly complex, very detailed. And sometimes not very intuitive, at least to me, in terms of the way the different parts of it work. And it's going to require a tremendous

amount of work and effort by financial institutions who make small business loans to sort of adapt both the reporting and the collection of the information to whatever products they may offer. Because it covers quite a number of products, basically any kind of business credit. There were a few notable changes from the proposed rule that had come out about a year and a half ago. The Bureau did raise the minimum threshold of the number of loans you have to make in order to qualify to be a reporter under 1071. From 25 in each of the previous two years to a 100 in each of the previous two calendar years. The Bureau also added, in addition to the requirement of collecting, whether it's a minority or women-owned business, it also is now required, and this was not in the proposed rule, to ask if the business is LGBTQI plus-owned or not. That's a brand-new data element that wasn't there before.

One of the other notable things that the Bureau changed in the final rule was they added a whole section on discouragement. That is, that you're not supposed to discourage applicants from providing the 1071 information. And prescribed a series of measurements and monitoring steps that are themselves quite involved and very prescriptive, by my read of them, to try to prevent discouragement. Or to maximize the number of people who respond to the 1071 information requests. Now, to be fair to the bureau, there are also quite a few changes that were intended to make the rule easier to comply with and easier to deal with by financial institutions. We're all taking in the rule, I've just finished reading it, so my brain is turned to pudding at the moment. But once I recover and once the other members of our team recover, including Josh and Caleb, we're going to be doing a whole series of podcasts detailing different aspects of the 1071 rule.

Just like we'll do podcasts to update the audience on all these other developments. The preemption issues, the state disclosure laws and their regulations, etc. So, this episode was really more of just a, "Let's take a look at what's going on over the waterfront." So, you'll know that there's a lot of activity going on in small business lending, but we'll do deep dives on a lot of these things, and especially 1071 in the near future, so you can look forward to that. In the meantime, Josh and Caleb, let me thank both of you for being on the podcast today. And for your future participation, which I'm sure will occur, as we continue to follow these events.

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