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# OPEN FOR BUSINESS: THE IMPACT OF THE CFPB ON SMALL BUSINESS

## HEARING

BEFORE THE

SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

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# OPEN FOR BUSINESS: THE IMPACT OF THE CFPB ON SMALL BUSINESS

**THURSDAY, JULY 28, 2011**

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT, AND REGULATIONS,
COMMITTEE ON SMALL BUSINESS,
*Washington, DC.*

The Subcommittee met, pursuant to call, at 1:35 p.m., in room 2360, Rayburn House Office Building, Hon. Mike Coffman (chairman of the subcommittee) presiding.

Present: Representatives Coffman, West, Hanna, and Altmire.

Chairman COFFMAN. The Committee is called to order.

Good afternoon.

July 21st, 2011, marked the 1-year anniversary since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The date also marked the day where the Consumer Financial Protection Bureau assumes authority for regulating consumer financial products and services.

While milestones are usually celebrated, this one is marked by uncertainty, because the true effect of this bureaucracy remains to be seen. The CFPB was given extraordinary broad oversight powers to fundamentally change the way both banks and nonbanks are regulated. In the rush to establish the CFPB, I believe that a fundamental element of regulation was lost—that is, a comprehensive review of how rules will affect the industry and whether the financial products are meeting the needs of consumers.

All of us in this room today are consumers of goods and services. I don't think anyone here wakes up in the morning and says, "I want to be a victim of unfair, deceptive, or abusive practices." No one here wants to end up in bankruptcy. No entrepreneur wakes up in the morning and says, "I am going to start a business, and it will fail." Our society is built on the optimism of entrepreneurs who will wake up in the morning and say, "I have a great idea for a business."

With this optimism about business creation comes the responsibility to make the right decisions to best position your business for success. What we need to do is create a vibrant marketplace. Creating onerous rules and regulations on an industry is not the answer and is likely to have an adverse effect by driving many providers out of the marketplace.

A banking relationship is a partnership. A bank that abuses its customers might make money in the short term, but they will not be in business for very long. We need to find a system that goes

after those bad actors without impeding the ability of good actors to help build their communities.

I am looking forward to hearing from both the CFPB to see how they envision the new bureau operating and learn about what provisions they are putting into place to protect small businesses from the burdens of overregulation. I am also looking forward to hearing from small businesses about how the new bureau will affect them and their businesses.

With unemployment remaining above 9 percent, we need to do everything we can to avoid further burdening our job creators with regulation that will not add meaningful protections.

With that, I would like to yield to Ranking Member Altmire for his opening statement.

Mr. ALTMIRE. Thank you, Mr. Chairman.

It was just over 1 year ago that the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed in to law. Perhaps no other part of this law has attracted as much attention as the creation of the Consumer Financial Protection Bureau. Last week, the Bureau officially assumed its duties, making this an ideal time to step back and take stock of how this law will affect our Nation's small businesses.

While the authority of this new regulator will primarily extend only to financial products that are marketed to consumers, its rules will affect small-business owners as well. According to the last Federal Reserve survey on small-business finance, nearly half of all small firms use personal credit cards to finance their enterprise. In another survey, one in five entrepreneurs reported using a home equity loan for business purposes.

These findings guarantee that the rules developed by the Bureau will inevitably have an impact on access to capital for small businesses. It is imperative that, as the agency develops these regulations, we bear in mind the needs of small businesses and not further worsen the current credit shortage for small firms.

For precisely this reason, significant efforts were made to ensure that potentially negative effects on the small-business community were mitigated by excluding merchants and retailers, as well as businesses that are already subject to insurance or securities regulation at the State level. Additionally, some entire industries were excluded from the Bureau's authority, such as realtors and auto dealers. Clearly, lawmakers recognize that small businesses were not the cause of the financial crisis and should, therefore, not bear the burden of the new regulations.

An additional safeguard is the Bureau will be subject to the Regulatory Flexibility Act and the Small Business Regulatory Enforcement Fairness Act. These laws will ensure that small businesses have the opportunity to participate in the CFPB's rulemaking process. This will help reduce the potential impact on small businesses while minimizing additional cost for small firms.

So, Mr. Chairman, since we are approaching a vote, if I could just insert the rest of my statement into the record, and we could move on with the hearing.

Chairman COFFMAN. They have just called votes. Welcome to the United States House of Representatives. I think this is going to be a long series, so it looks like it is going to be about an hour. We

are going to recess for an hour. Then we will come back immediately after the last vote to resume our hearing. I apologize for that, but welcome to representative government.

Let's recess for the vote.

[Recess.]

Chairman COFFMAN. The committee is now in session.

I would like to take a moment to mention that the Subcommittee has received a statement for the record from the Independent Community Bankers of America. And, without objection, I would like to insert this statement in the record.

Hearing none, the statement will be inserted into the record.

[The statement of the Independent Community Bankers of America follows on p. 66.]

Chairman COFFMAN. If Committee members have an opening statement prepared, I ask that they be submitted for the record.

I would like to take a moment to explain the timing lights for you. You will each have 5 minutes to deliver your testimony. The light will start out as green. When you have 1 minute remaining, the light will turn yellow. Finally, it will turn red at the end of your 5 minutes. I ask that you try to keep to that time limit, but I will be a little lenient as you finish.

Our first witness today is here representing the Consumer Financial Protection Bureau. Dan Sokolov—have I got that right?

Mr. SOKOLOV. Yes.

Chairman COFFMAN. Dan Sokolov is deputy associate director for Research, Markets, and Regulations. This division is responsible for understanding consumer financial markets and evaluating whether there is a need for regulation and the cost and benefit of potential or existing regulation.

Prior to joining the CFPB, Mr. Sokolov held positions with the Department of the Treasury and served as an attorney for the Federal Reserve.

Mr. Sokolov, we look forward to your testimony.

## STATEMENT OF DAN SOKOLOV, DEPUTY ASSOCIATE DIRECTOR FOR RESEARCH, MARKETS, AND REGULATION, CONSUMER FINANCIAL PROTECTION BUREAU, WASHINGTON, D.C.

Mr. SOKOLOV. Thank you, Chairman Coffman and Ranking Member Altmire, for inviting me to testify today on the subject of small business and the Consumer Financial Protection Bureau.

The CFPB is the Federal agency accountable for establishing clear rules of the road for the consumer financial marketplace. And, Mr. Chairman, you mentioned the importance of a vibrant marketplace; that is precisely what we are striving for.

Although the Bureau's jurisdiction is very limited with regard to small-business credit, we take our responsibilities in this area very seriously. We recognize that small businesses are critical to the Nation's economy and that small financial services providers are a critical source of products and services for millions of consumers.

Today, I want to provide a brief update on the standup of the CFPB, as well as explain our efforts to reduce and avoid unwarranted regulatory burdens on small providers and how we at the

CFPB believe we may be able to assist small-business borrowers over time.

The Bureau opened for business last Thursday, July 21st. Inspectors general of the Treasury Department and Federal Reserve Board have reported favorably on our efforts to stand up this agency. We are already at work strengthening consumer financial markets. We are working toward a market where consumers can readily see prices and risks and compare products so they make the choices that they believe are best for them.

We have taken input from thousands of individual consumers and mortgage lenders and brokers on how to simplify Federal mortgage disclosures and make them less burdensome. We are launching our program for supervising the largest banks and their affiliates. We are taking our first consumer complaints about credit cards. And Holly Petraeus has set up a strong Office of Servicemember Affairs, reaching out to military families and working to address the unique financial challenges that they face.

To fulfill the mandate established by Congress, we have hired an expert staff from the private, public, and nonprofit sectors. They are striving to build an agency that is smart, effective, and balanced.

At the CFPB, we have been building in to the agency's DNA extensive outreach to small financial institutions such as community banks and credit unions. We believe in the importance of a financial services marketplace where small providers can thrive.

We will work to reduce regulatory burdens on small financial service providers wherever possible, and we can take as an example disclosure reform. We understand lenders' deep frustration with the current mortgage forms required by Federal law. They are complicated, sometimes duplicative, and more costly to fill out than they need to be. So we have solicited feedback from thousands of consumers, lenders, and brokers to help us make the disclosure simpler to use and easier to complete.

Minimizing regulatory burden will continue to be a priority for us. Often, a regulation is not the best answer to a problem. Congress has given us many different tools to address problems in consumer financial markets. We will strive to address problems as we see them as effectively as we can and through the least burdensome means available to us.

In addition, we will consider the potential benefits, costs, and impacts of proposed regulations for consumers and covered persons, including small lenders. We will diligently comply with the Regulatory Flexibility Act, and we will follow the requirements of the Small Business Regulatory Enforcement Fairness Act, known as SBREFA.

Our statutory objectives and statutory authorities do focus on financial products and services for consumers. The Bureau does not have jurisdiction over business credit, except in limited cases where Congress has explicitly and affirmatively granted the Bureau such jurisdiction.

We recognize that a vibrant small-business sector is critical to our economy, and we are aware that many small businesses today report having difficulty obtaining credit—a difficulty rooted in the most severe financial crisis since the Great Depression.

So, although our role with respect to small-business credit is quite limited, we hope to help many small-business owners in three ways: First, we will implement diligently the Equal Credit Opportunity Act. This law prohibits discrimination in business lending.

Second, as required by law, we will provide the public new data that may shed new light on the demand for and supply of small-business credit. We will move deliberately and we will consult widely to attempt to maximize the benefit of these loan data for small businesses and to minimize the cost for the lenders that will report the data.

Third, we will work to ensure that consumer credit histories are as accurate as possible. More accurate credit histories would help startups. New businesses owners frequently rely on their personal credit histories to apply for their first business loan.

We believe that a fairer and more transparent consumer financial services marketplace will be a boon to financial services providers of all sizes, and a more level playing field will benefit the smaller ones in particular.

Thank you, and I look forward to your questions.

[The statement of Mr. Sokolov follows on p. 25.]

Chairman COFFMAN. Thank you, Mr. Sokolov.

The CFPB recently sent a letter to the CEOs of financial institutions informing them that they are now subject to the jurisdiction of the Bureau. Twenty-six of these lenders are on SBA's list of 100 top SBA lenders. These 26 lenders issued a total of 5,334 loans, for approximately $1.5 billion.

That is just looking at SBA's top 100 lenders and only at their SBA-backed loans. Is CFPB considering how actions against larger institutions will impact small-business lending?

Mr. SOKOLOV. So, the letter you are referring to the CEOs, Mr. Chairman, was sort of introducing our program of supervision. That is a program that is, by statute, now focused on the depositories side. It is focused on insured depositories and credit unions with more than $10 billion in assets and their affiliates, just to put that in to full context.

And that process of supervision, which is essentially working with the institutions by sending examiners to them and understanding how they operate and understanding their businesses and understanding where there may be questions about their compliance with applicable Federal laws, that process is focused on the consumer protections. And, as I said, our jurisdiction over business credit is quite limited.

The main exception is in the area of implementation of the Equal Credit Opportunity Act. And, in that area, as we are required, we will—you know, that will be an important part of our process.

Chairman COFFMAN. Okay.

Federal Reserve Chairman Bernanke recently stated that there has been no examination about the impact that the new regulatory environment will have on the overall economy.

Has CFPB done any such study on how the Bureau, fully implemented, will affect the economy?

Mr. SOKOLOV. Mr. Chairman, could you repeat the question again?

Chairman COFFMAN. Sure. Federal Reserve Chairman Bernanke recently stated that there has been no examination about the impact of the new regulatory environment, what it will have on the overall economy.

Has your organization done any studies about its—when you are fully implemented, what impact it will have on the economy?

Mr. SOKOLOV. Well, we are still the process of, well, building out our processes. As I said, we have launched our supervision program. We are taking complaints from consumers on credit cards.

We are working diligently to—in the area of regulations, our focus is on regulations that Congress has directed us to adopt and implement—directed us under the Dodd-Frank Act. And so, you know, in cases such as that, we are doing Congress' will where Congress has made judgments about the benefits of certain policies for the economy.

Chairman COFFMAN. One of my concerns about CFPB is that, when you have an agency charged with looking for problems, they have a tendency to find them, whether they exist or not.

How will we know when we have a financial system that is free of abusive practices? What steps are in place or benchmarks exist to know if CFPB has achieved its mission?

Mr. SOKOLOV. So, we, indeed, are focused, as part of our core mission, on working toward a marketplace that is free of unfair, deceptive practices. It can be challenging to identify the full range of acts and practices in an economy as large as ours. We are going to use all available sources of information, though, to see where risks to consumers may lie and where compliance risks my lie.

And our sources of information will include, as I mentioned, our examination function, which is one of the important tools that Congress has provided us and a tool that we can use to try to provide a level playing field between institutions that have bank charters and financial services providers that compete in the same market but are not banks. And we have a research capacity that we are building, as well. We have teams that are designed to be expert in particular markets, where often we are hiring people who have expertise in specific industries.

So we plan to take in information from a wide variety of sources to best understand what is going on, to be responsive and to have a smart, balanced, and effective approach.

Chairman COFFMAN. Thank you.

Mr. Altmire.

Mr. ALTMIRE. Thank you, Mr. Chairman.

As I mentioned in my opening statement, with one in five entrepreneurs reportedly using home equity loans for business purposes and nearly half of all small businesses relying on personal credit cards for capital, consumer financial products provide a critical source of capital for many small firms.

How will your agency tailor its oversight of these products to ensure that small businesses do not find their access to credit unduly restricted by the new regulations?

Mr. SOKOLOV. Thank you, Mr. Altmire, for that question. And we talked a bit about this in our written testimony, as well.

There is certainly some overlap. There are some small businesses that for some periods in the life of the business do use personal

credit. And we are aware of that, and we want to, in fact, as we said, we addressed that in our testimony.

I think that the amount of overlap varies over time. And what we are going to look to, for example, in understanding that overlap is, just as an example, to what extent small businesses are using credit cards that are designed for consumers to make payments and to what extent they are actually borrowing on the card. And we bring some data on that point in our testimony based on a Federal Reserve study and a survey by the National Federation of Independent Businesses.

And we have already started to reach out to these other organizations to make sure that we do understand where this overlap might be.

Mr. ALTMIRE. We on this Committee and back home I, as well, continue to hear from small firms who are concerned that they will be subject to CFPB oversight for financial transactions they provide to other businesses.

Will your agency attempt to exercise oversight over financial products when no consumer is involved?

Mr. SOKOLOV. As I mentioned, our jurisdiction over small-business credit is quite limited. There are a couple of fairly limited provisions in the Truth in Lending Act where Congress has extended protections to business credit cards. And then there is our obligation to implement the Equal Credit Opportunity Act, where we and other agencies are also responsible for enforcing it.

And Equal Credit Opportunity Act prohibits discrimination in lending, both in consumer lending and in business lending. And, therefore, we have to fulfill, of course, and will fulfill diligently the mandate Congress has given us in that area.

Mr. ALTMIRE. The original bill, the Dodd-Frank Act, created new data reporting requirements that are aimed at helping regulators understand credit conditions for small, women-owned, and minority-owned businesses. Some have said these requirements will be burdensome and could raise privacy concerns for those types of firms.

How will you balance these concerns while ensuring policymakers have sound and accurate information on small-business credit?

Mr. SOKOLOV. So, Congressman, you are referring to section 1071 of the Dodd-Frank Act, which does amend the Equal Credit Opportunity Act to add this data collection on small-business lending. And this is potentially an important source of data to better understand demand conditions and supply conditions in the market for small-business lending, where data, to date, have tended to be somewhat limited. So we see it as potentially a boon to have these data, as a boon both to small-business borrowers and to lenders to better understand the market.

Now, inevitably, with the data collection nothing is free. There is some cost involved. Congress has set the parameters for this data collection, but, within that, where we have discretion about how to do it, we are going to seek to make the most of the benefits of these data for the public and only impose the burdens that are necessary to achieve those benefits. And we intend to make sure that the data have integrity and will be useful in the end.

And the issue of privacy that you mentioned of course is an important consideration—a consideration that has arisen in other data collections. And those issues are important, and we intend to pay attention to them.

Mr. ALTMIRE. Thank you. No further questions.

Chairman COFFMAN. Mr. West.

Mr. WEST. Well, thank you, Mr. Chairman, Mr. Ranking Member.

And thank you for being here today.

One of the things that I continually hear from our district down in south Florida is small-business owners and their access to credit. Of course, everything worth reacting to can sometimes be worth overreacting to, with Dodd-Frank.

Do you think that we need to have regular review of some of these regulations to make sure that they are effective and efficient and not constraining, as far as its relationships with our community banks and also our small-business owners?

Mr. SOKOLOV. That is a good question. And the Dodd-Frank Act, to some extent, contemplates this, because it does provide that for significant regulations that the Bureau adopts, that we should be assessing the regulation within—I think it is about 5-years. And so that is a statutory requirement and one that we intend to follow diligently.

Mr. WEST. Well, I am concerned with that because, with the last jobs report that came out, small businesses were saying that they are going to freeze hiring for the next year. Seventy percent of them said that. So if we are going to wait 5 years to go back and do a review, that is really not setting the conditions for the growth of our small businesses.

So can we come back and look at a semiannual review and make sure that we include some of the people that this could be affecting—community banks or small-business owners—instead of waiting 5 years for a review?

Mr. SOKOLOV. We have a process, in fact, a statutory process, the Small Business Regulatory Enforcement Fairness Act, that actually provides small businesses the opportunity to provide input before we issue a proposal, in certain circumstances.

Mr. WEST. Was that part of Dodd-Frank?

Mr. SOKOLOV. There were amendments—Dodd-Frank included amendments to the Regulatory Flexibility Act and the related Small Business—the SBREFA. And those amendments, among other things, extended SBREFA obligations to us. We are only the third Federal agency to be subject to SBREFA. And that will be one way that we get input from small businesses even before we have adopted a regulation.

And I think what we are trying to do is, where we can, go beyond the statutory requirements for public comment on regulations. And a prime example of that is how we have been handling the reform of Federal mortgage disclosures. Long before we had put a regulation out there that would implement these reforms to the disclosures, we put initial prototype forms on our Web site, and we created a channel for consumers to respond and a channel for industry to respond. And both channels have produced thousands of comments, often quite detailed comments. And we have used—the won-

ders of technology—we have used the Internet to make it easy to comment and to click on parts of the form and give feedback on specific parts.

And, in addition, we are conducting more controlled laboratory testing of these potential disclosures, where we are going into a room and we ask individual consumers questions about it. And I think maybe for the first time for an agency—in any event, we have found it very productive to also include in this testing lenders and brokers. So we are asking individual lenders and brokers to sit down with us so we can test the forms with them.

And we do round after round of this sort of testing and will continue to use the Internet to allow thousands of others to be able to give input, so that by the time—and, as I had said in my written testimony, we also plan to conduct SBREFA panels around these forms—so that, by the time we get to a final regulation, it will receive that kind of input.

And then, under the Dodd-Frank Act, when we get to the point of implementing these newly reformed disclosures, we will wait an appropriate period of time and come back and review it again.

Mr. WEST. And so, once again, I come back to the original question. You know, what I heard you say was, right now that is 5 years. In the type of fiscal or economic situation in which we find ourselves, where our small businesses are suffering—and I applaud you for looking for their input before the regulation comes in—but can we have a semiannual or an annual review of these regulations so that, once again, we can go back and do the checks and balances and make sure that these things are working properly?

Mr. SOKOLOV. We can certainly consider that. I think an important factor is that, when we review—say, for reviewing a disclosure—let's say we wanted to go back and test the disclosure again and see if it was still working in light of whatever changes in the market may have occurred. It is a pretty extensive process. It takes many months. And it can involve both what we call qualitative testing, where you speak to small groups of consumers and lenders, and then more extensive quantitative and statistically valid testing, something we plan to do after we finish this initial round of qualitative testing. And that can take a while to do correctly to gather useful data.

And when we do that, we want to do it in the most careful way, and we want to put out the results of our testing and research for people to learn from and to comment on and do their own research. So the process of doing good analysis on a regulation that gives you a meaningful answer can take some time.

Mr. WEST. Thank you, Mr. Chairman. I yield back.

Chairman COFFMAN. With no other questions, Mr. Sokolov, thank you so much for your testimony today. I really appreciate it.

Mr. SOKOLOV. Thank you.

Chairman COFFMAN. I want to thank Deputy Associate Director Sokolov again for being here today to tell us about the CFPB, to see how it is structured, and for answering questions about how they are trying to limit the burden of regulations on small business.

I hope that they will continue to think about how small businesses will be affected as they begin to exercise their regulatory au-

thority. We will continue to closely follow the impact of the CFPB on small businesses and want to work with you to reduce the regulatory burden on our Nation's job creators.

I also suggest that your staff listen to our second panel of witnesses so you can learn about the concerns that small businesses have about the CFPB.

I would like now to call the second panel of witnesses to the witness table.

I would now like to welcome our second panel to the hearing.

For the benefit of the witnesses, I will take a moment to again explain the light system that you see before you. You will each have 5 minutes to deliver your testimony. The light will start out as green. When you have 1 minute remaining, the light will turn yellow. Finally, it will turn red at the end of your 5 minutes. I ask that you try to keep it to that time limit, but I will be a little lenient as you finish.

Our first witness is Jess Sharp, executive director of the U.S. Chamber of Commerce Center for Capital Markets Competitiveness. This organization was founded in 2007 with the mission of supporting capital markets that are the most fair, efficient, and innovative in the world.

Prior to becoming executive director at the Center, Mr. Sharp served as deputy assistant to the President for domestic policy and special assistant to the President on the White House Domestic Policy Council.

Welcome, Mr. Sharp. You have 5 minutes to present your testimony.

**STATEMENTS OF JESS SHARP, EXECUTIVE DIRECTOR, CENTER FOR CAPITAL MARKETS COMPETITIVENESS, U.S. CHAMBER OF COMMERCE, WASHINGTON, D.C.; TERRY K. JONES, CHAIRMAN, LEGISLATIVE AND REGULATORY AFFAIRS COMMITTEE, COLORADO MORTGAGE LENDERS ASSOCIATION, CASTLE ROCK, COLORADO; ADAM J. LEVITIN, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER, WASHINGTON, D.C.; AND DANIEL FLEMING, PRESIDENT, FLEMING LEASING, ALEXANDRIA, VIRGINIA, ON BEHALF OF THE TRUCK RENTING AND LEASING ASSOCIATION**

**STATEMENT OF JESS SHARP**

Mr. SHARP. Thank you very much, Mr. Chairman, Ranking Member Altmire, and distinguished members of the Subcommittee.

My name is Jess Sharp. I am the executive director of what we call CCMC, the capital markets shop at the U.S. Chamber of Commerce. I appreciate the opportunity to testify today on behalf of the hundreds of thousands of Main Street businesses that the Chamber represents.

The Chamber firmly supports sound consumer protection regulation that weeds out fraudulent and predatory actors and ensures consumers receive clear and concise disclosures about financial products. But we want to ensure that the Bureau takes a targeted approach to regulation and enforcement, without making sweeping policies that would impose duplicative regulatory burdens on small businesses and, perhaps even more importantly, that would pre-

vent small businesses from obtaining the credit they need to expand and create the jobs we need so desperately in this country.

So I am going to lay out some of our concerns in, sort of, two general baskets.

First, you know, we have concerns that small businesses may be subject to the CFPB's regulation and other oversight because they engage in 1 of the 10 broadly described activities laid out in the law. So they could be directly supervised or regulated by the Bureau. Virtually all of these businesses are already subject to oversight by the FTC. I think it is important to point out that these are not businesses that have been heretofore unregulated. The Chamber fears that overlap and duplication will be inevitable as the Federal agencies sort out lines of jurisdiction and responsibility.

Second, and as has been raised here already today, CFPB regulation may decrease the availability or increase the cost of forms of consumer credit that small businesses use. We have talked about credit cards, I think home equity loans as well, auto title loans. There is a slew of, sort of, nontraditional commercial bank lending instruments that small businesses do rely on.

And this is, of course, particularly troubling given the already challenging lending environment. According to a June 30th story in the Wall Street Journal, quote, "In the past 6 months, only 17 percent of loan-seeking business with less than $5 million in revenue landed bank financing." It is a tough environment out there, and we are concerned about any tools being taken off the table.

Last week, the House approved an important piece of legislation that would make changes to the Bureau's structure and operations to increase its accountability to Congress and to ensure that the Bureau's decisions are based on diverse inputs. H.R. 1315 would replace the Bureau's current single director position with a bipartisan multimember leadership team, giving the agency more stability and balance over the long term, and would give small community credit unions and banks a voice in the process that allows the Financial Stability Oversight Council, or FSOC, to override Bureau regulations that harm safety and soundness.

The risks of agency tunnel vision, overreach, and politicization are real for any government regulator, including the Bureau. If these risks are not properly addressed at a structural level, agencies inevitably will, over time, abandon sound regulatory principles.

I want to speak next about SBREFA. That has also been mentioned here this morning, and it is a very important point. As has already been mentioned, the Bureau is included on the list now of agencies that must follow SBREFA, in addition to the EPA and OSHA. And it is a very important requirement—it is a very important requirement for the Bureau to follow in order to get small-business input up front.

However, the panel process is not a perfect mechanism, and it is not necessarily enough to ensure an independent check on the Bureau's activity that affects small businesses. And so, this Committee's role is incredibly important in overseeing the Bureau's work and its implementation of SBREFA.

Just to mention a few of the concerns we have about how this process could play out: First, the Bureau itself is responsible for

the threshold determination, that a proposed regulation is expected to significantly impact a substantial number of small entities. And the terms "significant" and "substantial" are basically subject to the CFPB's discretion to define.

Second, the Bureau does not have to adopt the panel's recommendations, which are advisory, and need only supply a reasoned explanation for adopting or rejecting them.

Third, SBREFA covers only the rulemaking process. And I think you heard the first witness, Mr. Sokolov, describe that regulation isn't always the best way to go about doing things. They can use compliance assistance, they can supervision, they can use enforcement actions to essentially dictate broader policies. And, of course, none of those are subject to SBREFA or to any sort of formal process whereby small-businesses input is taken.

And just to, again, put a fine point on it, I mean, actions do speak louder than words. And, as has mentioned here this afternoon, the Bureau already does have rulemakings essentially in progress, if not technically: one to merge these two mortgage forms; another to define the types of businesses that the Bureau will supervise in the nonbank space. And in neither case has a SBREFA panel been put together. Now, technically, I guess it is not required at any particular stage. But, you know, if we want to get this right from the beginning, we would encourage the Bureau to begin that process as soon as possible.

So, with that, I thank you all for having me here, and I am happy to answer questions.

[The statement of Mr. Sharp follows on p. 44.]

Chairman COFFMAN. I would now like to introduce our next witness, who came here all the way from my home State of Colorado, Mr. Terry Jones.

Mr. Jones is from the city of Castle Pines, Colorado, where he resides with his wife Carol. Terry Jones has over 40 years of experience working in the mortgage banking industry.

Terry is testifying on behalf of the Colorado Mortgage Lenders Association, where he serves as chairman of their Legislative and Regulatory Affairs Committee.

I am pleased that Terry Jones could be here today, and I look forward to your testimony.

Mr. Jones.

**STATEMENT OF TERRY K. JONES**

Mr. JONES. Good afternoon, Chairman Coffman, Ranking Member Altmire, and distinguished members of the Subcommittee.

The Colorado Mortgage Lenders Association is a 56-year-old organization made up of over 100 companies, employing over 2,500 individuals. Over 75-percent of our members are small businesses that employ less than 25 people.

In my 42-year career in mortgage lending, I have been a loan originator, a manager, an entrepreneur, and a small-business owner. I have always been proud to be part of an industry that helps people and families reach their dreams of homeownership.

I have seen many people in the business start as loan originators and then go on to start their own small mortgage lending businesses. These people have lived their own American dream and, in

doing so, have served the real estate markets and the buyers and borrowers of their local communities.

The Dodd-Frank Act creates a super-regulator for the mortgage lending industry in the CFPB. This is in addition to the oversight already in place by the States, FHA, the VA, Fannie Mae, and Freddie Mac.

The CFPB is tasked with issuing more than 100 mortgage lending rules over the course of the next 18-months. It will be difficult for small mortgage lending businesses to keep up with so many new rules in such a short timeframe. So it is essential for the CFPB to develop an orderly process for its rulemaking initiatives, not only to ensure meaningful input from industry, small business, and other stakeholders, but to develop well-conceived and clear rules that are neither duplicative nor in conflict with those of the States and other agencies.

The CFPB must also develop a process for providing timely, reliable guidance to the industry and to the State regulators well prior to the implementation of new rules.

We believe that the CFPB has a historic opportunity to set the tone for the future regulation of the mortgage lending industry in finalizing the ability-to-repay rule and defining the qualified mortgage as a safe harbor characterized by traditional, well-underwritten, and properly documented loans.

By pursuing such a course, the CFPB can help to preserve the best practices and products of the industry, yet still curb the abuses of the early 2000s. If the CFPB takes this approach, it will be of great benefit to small mortgage lenders because it will create a clear safe harbor that they can rely on when making loans. If the CFPB chooses to adopt the qualified mortgage as a rebuttable presumption, we believe that the increased levels of litigation will force many small lenders out of business.

The CMLA believes a qualified-mortgage safe harbor will define the arena in which most loans will be made. The risk to smaller businesses, in particular, will be too great for most of them to venture outside the qualified-mortgage parameters. Consumers in Colorado and across the country need a viable small-business mortgage lending industry to provide a competitive local alternative to the large national lenders that dominate the marketplace today.

The CFPB is also responsible for enforcement of the SAFE Act, which requires loan officers for nonbank firms to meet education, testing, and financial standards, while bank loan officers need only be registered. This creates an unlevel playing field and additional costs for small, nonbank lenders and creates unequal protection for consumers.

In addition, licensed originators can move freely to depository lenders from licensed originators, but the reverse is not true. A loan originator working for a bank will have to go through the entire licensing process in order to be able to be employed by a small-business lender. We ask that the CFPB undertake rulemaking as soon as possible to create a transitional license to allow registered loan originators to move from depository institutions to nonbank lenders for a limited time while they complete their licensing requirements.

Finally, it is important for the CFPB to address the loan officer compensation rule under the Truth in Lending Act and reconsider some of the rigid requirements that were recently imposed by the Fed on the ability of a small business to pay its employees in a manner consistent with the profitability of the loan products they produce.

Confusing standards and lack of official guidance from the Fed has created some unusual outcomes. For example, the current rule severely impacts revenue bond programs that serve low- to moderate-income and rural borrowers. These programs typically limit fees that can be charged to the borrower, yet the loan officer compensation rule specifies that the loan officer must be paid exactly the same on these loans as any other. This can easily cause losses on these loans, and many lenders will be unable to offer these affordable loan programs. We urge the Bureau to clarify this and other problematic issues with the compensation rule.

We respectfully urge Congress and this Subcommittee to carefully monitor all of these new rules to be certain that they do not unwittingly harm American families, small business, the mortgage market, the housing recovery, or the Nation's economic recovery.

I thank you very much for the opportunity to testify before you today.

[The statement of Mr. Jones follows on p. 30.]

Chairman COFFMAN. Thank you, Mr. Jones.

I would now like to recognize Ranking Member Altmire from Pennsylvania, who is going to introduce our next witness.

Mr. ALTMIRE. Thank you, Mr. Chairman.

And it is my pleasure to introduce Adam Levitin.

Mr. Levitin is professor at the Georgetown University Law Center in Washington, D.C., where he teaches courses in bankruptcy, commercial law, and consumer finance. He has previously served as a scholar in residence at the American Bankruptcy Institute and as special counsel to the congressional oversight panel supervising TARP.

Before joining the Georgetown faculty, Professor Levitin practiced law and served as a law clerk for the U.S. Court of Appeals for the Third Circuit. Professor Levitin holds a JD from Harvard Law School and degrees from Columbia University and Harvard College.

Welcome, Professor Levitin.

**STATEMENT OF ADAM J. LEVITIN**

Mr. LEVITIN. Mr. Chairman Coffman, Ranking Member Altmire, and members of the Committee, good afternoon. My name is Adam Levitin. I am a professor of law at Georgetown University Law Center. My research and teaching focuses on consumer finance and financial regulation. I am also a small-business owner.

The Consumer Financial Protection Bureau has only limited and generally indirect connections to small-business finance. With three very limited exceptions, the CFPB's jurisdiction is restricted to consumer financial products.

While many small businesses use consumer financial products, like personal credit cards and home equity lines of credit, for business transactions, small-businesses owners need, deserve, and

want the same protections on their financial products whether they are using them for personal or business use. Thus, the National Small Business Association has advocated for extending Truth in Lending Act protections to small-business credit cards.

Now, there are only two ways the CFPB might directly affect small-business lending.

First, the Dodd-Frank Act requires the CFPB to collect data on small-business lending under the Equal Credit Opportunity Act. This is to ensure against discriminatory lending in the small-business space. The ECOA data collection requirement will impose some limited costs on lenders, but it will also provide an important protection for small businesses, particularly those owned by women and people of color.

More generally, though, the CFPB has regulatory authority over almost all consumer financial service providers, large and small. The CFPB regulations could affect the cost or availability of business credit, but I want to emphasize, it is simply premature to judge the CFPB's impact on financial service providers or the impact of the CFPB on small-business credit costs and availability. Instead, individual rules will need to be evaluated on their own merits when and if they are proposed.

The Dodd-Frank Act imposes numerous safeguards on CFPB rulemaking to ensure against unnecessary regulatory burdens. CFPB rulemaking and adjudication is subject to the Administrative Procedures Act. It is also subject to the Regulatory Flexibility Act. The CFPB is one of only three agencies required to have regulatory flexibility review panels under the Small Business Regulatory Enforcement Fairness Act.

The CFPB is also required to consult with prudential regulators on its rulemakings and to reevaluate those rulemakings within 5-years. Additionally, the CFPB is subject to Financial Stability Oversight Council review for its rulemakings, which is unlike any other bank regulator.

Finally, small banks and all but three credit unions are exempt from CFPB supervision and enforcement. Their supervision and enforcement remains with their existing prudential regulators. Now, I want to emphasize that this is a battery of safeguards that does not apply to any other bank regulator.

It is also important to note that the CFPB is likely to help small businesses. The CFPB can help improve competition in small-business lending by ensuring that consumer financial products which are used by small businesses are fair and transparently priced. Small businesses want to use fair and transparent products.

Second, the CFPB can help small businesses by helping small-business customers. When consumers feel confident that they won't get caught by financial-product tricks and traps, they are going to have greater willingness to make purchases, including from small businesses. And the CFPB can help protect against consumer asset bubbles and, thus, smooth the volatility of consumer spending. That means a more stable business environment, which benefits small businesses.

In short, the CFPB has limited jurisdiction over small businesses. It is subject to numerous safeguards to ensure against excessive regulatory burdens on small business, and it may be able

to help increase the efficiency of small-business lending by increasing consumer confidence and spending stability.

Thank you very much.

[The statement of Mr. Levitin follows on p. 59.]

Chairman COFFMAN. Thank you, Mr. Levitin.

Our final witness to testify here this afternoon is Daniel Fleming, president of Fleming Leasing, a truck-renting and -leasing business located in Springfield, Virginia. Fleming Leasing is a family-owned business founded in 1903, when the transportation services they were providing consisted of a horse and buggy.

Mr. Fleming is testifying on behalf of the Truck Renting and Leasing Association.

Mr. Fleming, you have 5 minutes to present your testimony.

**STATEMENT OF DANIEL FLEMING**

Mr. FLEMING. Thank you, Mr. Chairman. Thank you, Mr. Altmire.

As you said, my name is Dan Fleming. I am president of Fleming NationaLease in Springfield, Virginia. And our company is a member of the Truck Renting and Leasing Association, or TRALA.

I am testifying today on a troubling aspect of the Dodd-Frank Act, namely section 1071, the small-business loan data collection provision.

Fleming NationaLease is a family-owned business with 18 permanent employees with locations in Springfield, Virginia, and Landover, Maryland. We are a proud member of TRALA, an association comprised of about 550 companies, employing 100,000 people, and operating out of 24,000 locations throughout the United States.

Not only are nearly all of TRALA's 550 members small businesses themselves, but the vast majority of the customers that we deal with are also small businesses in search of vehicles and equipment offered for rent or lease at a reasonable price.

Part of the process in acquiring rented or leased vehicles is to fill out an application of credit. As written, section 1071 adds extensive new application requirements to the ECOA. These requirements would be offered by and monitored through the CFPB. While I certainly do not operate a bank, under the definitions listed within this new law I am considered a financial institution because I have an application for credit for my customers.

In my opinion, the small-business data collection provision is counterproductive, contradictory, costly, and confusing.

The provision is counterproductive in that the CFPB was created with the intention of giving consumers protection from the predatory lenders and allowing them to find more options for information in obtaining a loan, but instead is now intended to regulate commercial loans and lenders.

Section 1071 is contradictory in that the statutory language conflicts with existing language already on the books. My understanding is that section 202.5 of Regulation B under the ECOA explicitly says, "A creditor shall not inquire about the race, color, religion, national origin, or sex of an applicant." The personal information should have no basis in determining whether or not someone receives a truck from Fleming NationaLease.

In terms of cost, this could cause a real strain on my bottom line. According to section 1071, after a lender inquires whether an applicant for a loan is a minority, woman-owned, or small business, no one involved in the credit decision can have access to this information. This would require me, the so-called lender under this definition, to completely alter my application process, which would be expensive. If we were to comply with this new regulation, I estimate that we would have to, at a minimum, hire a new part-time employee. That could cost our company somewhere between $10,000 and $20,000 annually. And while that doesn't seem much in the scheme of things, for me it is money that could be spent hiring another mechanic or purchasing a new vehicle, both of which, in turn, makes my company more profitable, but instead would be spent on more administrative burdens.

Lastly, section 1071 is extremely confusing and leaves many questions unanswered regarding what information I am to collect and what definitions will be used to ensure compliance. There also remains a concern over whether or not the CFPB and the Federal Reserve will work jointly to rectify issues that could remain from any exemptions that exist.

Just to touch on this final point, since section 1071 amended the ECOA, both the CFPB and the Federal Reserve now have jurisdiction over entities such as auto dealers. I believe it is imperative that if this new law was to be enacted and enforced, regulators must coordinate their implementation of these new requirements. If not, financial companies might receive different data from the dealers than that which they are required to file with the CFPB and open an entirely new problem.

While I recognize the fact that the CFPB has now decided it will issue a formal rule that hopefully will address and answer some of the confusing qualities within the law, ultimately I remain unconvinced that there is even a reason to have such a rule implemented for businesses like my own. I am not a banker. I lease trucks. To be placed in the same category with a multibillion-dollar financial giant makes absolutely no sense to me. In my opinion, making a truck-leasing company or any small business comply with section 1071 is a mistake.

Thank you for allowing me to issue my testimony today.

[The statement of Mr. Fleming follows on p. 54.]

Chairman COFFMAN. Thank you, Mr. Fleming.

Questions. I will start with Mr. Jones.

On a scale of 1 to 10, how would you rate the CFPB's outreach on the mortgage disclosure forms that they are currently in the process of revising?

Mr. JONES. Thank you, Chairman Coffman.

I would rate them at a 6 or a 7, especially compared to previous regulatory form changes. I think they really have reached out and provided an opportunity for our members and members of the mortgage lending community to comment on those forms.

Chairman COFFMAN. Thank you.

With your 40 years of mortgage lending experience, can you tell me what happens if an entity is seen by its customers as being abusive?

Mr. JONES. I think that if an entity is seen by its customers as abusive, basically, they stop using the lender. I think good businesses in our business and in any business have to be close to their customers. And that, I think, is one of the real benefits of being a small business, being located with your customers in the same towns, going to the same meetings, the same social functions, and the same churches. It is critical that you have good customer relationships.

Chairman COFFMAN. Mr. Sharp, we hear frequently that there is a fight between Main Street and Wall Street. However, our economy is interconnected, and we must make sure both are healthy if we want to grow our economy.

Can you tell me about the impact that financial regulations will have for Main Street small businesses?

Mr. SHARP. Yes, Mr. Chairman. Thanks for the question.

As I said in my testimony, I mean, it is hard to know exactly what the impact will be. And I think we heard that from the first panel, as well. But, again, our concern is that, you know, small businesses have the hardest time and the most expensive time, really, complying with new regulations. And, as you know, there are a flood of regulations headed their way.

In this case in particular, again, our concern is that some companies may be directly regulated who didn't expect to be regulated, as my fellow panelist, Mr. Fleming, has mentioned, and others may find that access to credit lines or to credit instruments that they rely on are either more expensive or unavailable.

So there is no way to know for sure what the impact is going to be, but those are the two areas where we are hopeful that there won't be an adverse impact.

Chairman COFFMAN. Can you tell me how small businesses use the equity in their home to finance small businesses, particularly in the early stages of development?

Mr. SHARP. Sure. I think it is pretty widely accepted that particularly the very smallest businesses, sort of, you know, the two guys in a garage, kind of, you know, very earliest stage of a small business. And I think, you know, if you look at Google or some of the real tech giants these days, you can trace almost all of them back to, again, a couple guys in a garage with either a personal credit card or someone borrowing against their house or borrowing against their car.

Now, of course you grow out of that phase at some point and, you know, you have access to the capital markets. But each of those tools, which are not, you know, designed to be for commercial lending, have become critical lifelines for small businesses.

Chairman COFFMAN. Right.

Based on your experience in government and observing the CFPB, do you think they are prepared to assume authority, or do you feel that they have been rushed?

Mr. SHARP. Well, you know, a year sounds like a lot of time, but it is really not, to stand up a brand-new agency, particularly when you have a responsibility to sort of gather up bits of law, I think, in seven other agencies. I think it is 19 statutes that they are consolidating under one roof.

So we do have a concern that they are moving awfully fast. You know, I think on the transfer date they began to issue—they, the CFPB—began to issue interim final rules, which essentially says, "This is the final rule, but we are going to take comments and adjust as needed." And in some cases, that is probably good; in some cases, you know, we may have concerns. We are trying to keep up, as well.

But I don't think a year is enough time for this bureau to have gone active, particularly without a confirmed director. I think that also creates serious challenges for them.

Chairman COFFMAN. Mr. Fleming, you mentioned compliance costs in your testimony, but can you reiterate how much will it cost for your business to comply with the new data collection requirements?

Mr. FLEMING. Well, again, Mr. Chairman, I am estimating that we could potentially have to add at least a part-time clerk, which, for us, as such a small business that is so flat, that is really a significant investment for us for, really, a position that doesn't add to the bottom line.

I would prefer to spend those funds on, as I said, a mechanic or some equipment that adds to revenue for our customer. You know, we are constantly looking for good, qualified diesel technicians to fix our trucks, to keep them out on the road, to help produce revenue for our company.

So while, again, I said one part-time position seems small, that really would be better used in a revenue-generating-type position rather than just an administrative burden to comply with potentially new Federal regulations.

Chairman COFFMAN. Do you feel taken advantage of by the banks that you work with? If so, I mean, do you just switch banks or providers?

Mr. FLEMING. Actually, we did switch our banking relationship. I wouldn't say felt taken advantage of, but just didn't feel that it was working for us. And we had a relationship with banks out in Ohio and changed those banking relationships.

I think, as other members of the panel said, it is a free market, and there are certainly plenty of other opportunities for us. And we took advantage of other opportunities when they presented themselves.

Chairman COFFMAN. Thank you.

Mr. Levitin, according to the SBA Office of Advocacy, small businesses create 7 out of every 10 jobs in America. Yet, in a recent article, you claimed that small businesses' contribution to long-term, stable employment is limited.

Do you disagree about the importance of small businesses in helping our country recover from 9-percent unemployment?

Mr. LEVITIN. No, I do not disagree with that. I would actually point out that what I said is entirely consistent with the Small Business Administration's Office of the Advocate, that small businesses create a tremendous number of jobs every year, but the general story of small business is, unfortunately, failure. Most small businesses don't last for more than a couple years. So, instead, you just get churning, rather than stable, long-term employment.

Chairman COFFMAN. Okay.

As a professor, I would assume that you see the value of lawyers drafting contracts and committing agreements to writing; this creates certainty. How can plain language increase certainty in contracts? I can see the value in getting rid of some legalese, but don't contracts require some specific language that cannot always be made into, quote/unquote, "plain language"?

Mr. LEVITIN. It really depends on the specifics here. So I think where your question is going, if I understand it correctly, is, how is the CFPB going to help make markets more efficient? And getting rid of unnecessary legalese is certainly something I think everyone at this table would think is a wonderful thing. That is move one.

But, as you point out, not everything can be boiled down to legalese. The second part is simply ensuring that, when a business goes out, or a consumer, actually—well, really, a consumer goes out and compares financial products, they can compare them on an apples-to-apples basis. That is actually very difficult to do right now with many financial products. It is not like going to a grocery store, where there is unit pricing and you can see the cost for an ounce of orange juice of brand 1 and an ounce of orange juice of brand 2. Instead, many financial products are designed in a way that they are too complex to compare on an apples-to-apples basis, knowing what the all-in cost will be.

The CFPB may be able to improve that by encouraging standardization of financial products to the things that consumers really want.

Chairman COFFMAN. Thank you.

Mr. Altmire.

Mr. ALTMIRE. Thanks, Mr. Chairman.

Mr. Levitin, I wanted to follow up on a question I asked to the earlier panel regarding the fact that many entrepreneurs use personal credit cards and home equity loans to finance new business ventures.

Many of you mentioned that in your testimony.

How should, in your opinion, the CFPB account for these small-business owners when drafting regulations specifically for credit cards and home mortgage products?

Mr. LEVITIN. Well, as someone who actually uses a small-business credit card for some purchases, I think it is important to note that many small businesses use the same credit card for both their business transactions and personal transactions.

And so, say you are going and filling up your car with a tank of gas and you use that car partially for business use and partially for your personal use. You want to make sure that you—I think you would want the same protections on that transaction, because you don't know whether that gas you are putting in the tank is going to be used for when you are driving your kids to the soccer game or whether you are using it for work. You don't know, at that point, whether you are doing a business transaction or not, ultimately.

And in situations like that, small-business owners should have the same protections that they have when they are consumers.

Mr. ALTMIRE. For Mr. Jones, over the past 3 years, we have, unfortunately, learned that bad mortgages are costly to everybody.

And to be successful, your business, in particular, has had to make loans that borrowers can repay.

Is there, in your opinion, a potential benefit to the mortgage industry if the CFPB's ability-to-repay rules are structured appropriately?

Mr. JONES. Thank you, Mr. Altmire, for the question.

Yes, I think so. The ability-to-pay rule, again, if it is characterized as a safe harbor, will provide a bright line, especially for small lenders that don't have the ability to hire compliance staff. If you have a 25-person business and you need to hire an attorney to help you interpret the rules and regulations, it becomes a very costly endeavor.

So it is important, if they do characterize it as a safe harbor that is clearly interpretable by small businesses. I think it will be a vast boon to our industry and to the consumers of America, as well.

Mr. ALTMIRE. Thank you.

For Mr. Sharp, many in the banking industry have expressed concern that the Dodd-Frank Act will stifle lending to small businesses, another point many of you brought up.

Hasn't the small-business community been struggling to get credit from banks since well before the financial reform was enacted? And is there something that could be done, perhaps outside of this law, or something different, to help correct for that?

Mr. SHARP. Well, thank you, Mr. Altmire.

First of all, I mean, to answer the first part of your question, yes. I mean, the challenges that small businesses face in the credit markets right now are not unique to 2011 or 2010. I mean, they have been around for several years now, and they are sort of—and it is stagnant. It is not improving, and that is a real concern.

You know, honestly, at this point, I think part of what everybody is hearing is, "Let's not do anything to make it worse." It is not exactly clear what it is that is gumming up the works, but what we know for sure, that, again, the commercial lending markets are not frozen, but, you know, they are not in good shape. Sort of, our message and the message we are hearing from our small-business and Main Street members is, "Let's certainly not take away some of these tools that do seem to be working well now. We can still use our credit cards. We can still borrow money against our car title or our home." Even those markets are functioning fairly well.

So their message to us is, "Do no harm," essentially. And that means working closely with the CFPB to make sure they understand the knock-on effects, you know, to the small-business lending world in the actions they are taking.

Mr. ALTMIRE. Thank you, Mr. Chairman.

Chairman COFFMAN. Mr. West.

Mr. WEST. Thank you, Mr. Chairman and Mr. Ranking Member.

And thanks to the panel for being here today.

Mr. Sharp, I will ask the first question to you, and others from the panel can chime in.

What do you really see, in your assessment, the purpose of the CFPB to be?

Mr. SHARP. I believe the purpose of the CFPB is to find fraudsters in the consumer products market and put them out of

business or, you know, clamp down on their fraudulent practices. Protect consumers against bad actors in the market.

Mr. WEST. Okay.

Anyone else?

Mr. LEVITIN. I would say that is part of CFPB's mission, and that is an important part, but it is broader. CFPB's mission is to ensure that we have fair, transparent, and competitive consumer finance markets. And that is not just getting rid of fraud; that is also ensuring that disclosures are clear, that we can have good price competition in the market.

Mr. WEST. Have we had, prior to this, any other government agency or someone else that was doing this? I mean, do we see this as a redundancy, or do we see this as some type of a duplication of effort out there from the government?

Mr. LEVITIN. Prior to the Dodd-Frank Act, some parts of the consumer finance space were regulated, by a laundry list of Federal agencies. And this was one of the problems, that you had a regulatory market that was splintered. So you had the Federal Reserve, the FDIC, the Office of Comptroller of the Currency, Office of Thrift Supervision, even the Department of Defense and HUD each having little spaces in the market. And many things fell between the cracks.

And, also, those missions—the consumer protection mission given those agencies was typically a secondary and subordinate mission to other missions, particularly to bank safety and soundness, which is just a fancy term for bank profitability.

So, abusive lending practices, the only reason to do them is that they are profitable. Banks don't do them for fun; they do them because they are profitable. But if you are the Comptroller of the Currency and you see your primary mission as ensuring that banks are profitable, that puts you in a bit of a bind, where you are going to be tempted to turn a blind eye to abusive practices because they are profitable. And that is what we saw. That is what led up to the housing bubble.

Mr. WEST. Okay.

So, in your assessment—for the panel—this was something that we needed to institute. This was an agency, a bureau, or a government program, whatever you want to call it, that we needed to institute.

Mr. LEVITIN. Without a doubt. The financial crisis in 2008 came out of consumer financial products, out of mortgage products. That was the root of it. And if we want to ensure that doesn't happen again, we need to have better consumer financial protection.

Mr. SHARP. I will just say that, you know, it is no secret that the Chamber didn't support the creation of the Consumer Protection Bureau. And, at this point, you know, our focus is on—you know, it is there, it is up and running, it is no longer an idea on paper. And, you know, our concern now is, as it is beginning, as the gears begin to turn and it begins to issue regulations and begins do its work, our concern is that it not become a sort of duplicator of other agencies' work.

And there are some cases, at least one very obvious one with the Federal Trade Commission, where the Bureau's jurisdiction and the Federal Trade Commission's jurisdictions overlap. And that

was intentional, to some degree. And the law requires the two agencies to prevent, you know, sort of, stepping on each other's toes, you know, to prevent situations where they are duplicating or conflicting with one another. But we do have concern, sort of a general concern, that that will be very difficult to avoid.

Mr. WEST. Mr. Jones and Mr. Fleming, do you believe that the CFPB will enhance free-market competitiveness and entrepreneurial spirit or not?

Mr. JONES. Mr. West, thank you for the question.

We were happy to see the CFPB's move toward consolidating the Truth-in-Lending and the Good-Faith-Estimate disclosures, two forms that have been a challenge for the industry, being administered formerly by two separate Federal agencies that did not always see eye to eye in terms of what should be done. So we do think there is real benefit there.

Another benefit to our industry could be that—our industry is very heavily involved in automation, in order to comply with the multiplicity of rules and regulations that we have. To that extent, I was very encouraged today to hear that the CFPB will be doing an economic cost-benefit analysis to really determine whether or not there will be an economic benefit to their proposed rules and to the extent that that is what we do, then I think it can be a boon, not only to the industry to help to lower some costs, but it also will be a boon to consumers, who hopefully will have less confusing and clearer disclosures.

So there definitely are some benefits.

Mr. FLEMING. Mr. West, since I am a trucker and not a banker, I would be hard-pressed to express an overall opinion of the CFPB. What I am primarily concerned about is just, you know, any new regulations that seem to me, as someone sitting down in Springfield, Virginia, shouldn't really apply to me all of a sudden coming down and creating new regulatory requirements.

So, from that perspective, I am concerned about that section. But, overall, I am certainly not in a position to register an opinion on the group as a whole. So, thank you.

Mr. WEST. Very well.

Mr. Chairman, I yield back.

Chairman COFFMAN. Thank you, Mr. West.

To each of the panelists, if you could identify just one top issue that bothers you about CFPB, just the top issue that you think ought to be changed or improved to improve it, what would that be?

Mr. Jones.

Mr. JONES. Thank you, Mr. Chairman.

I think our top issue with the CFPB will be the clarity of the issues—or the clarity of the rules and regulations that are issued, and the ability to receive and respond to industry input prior to those regulations being implemented.

Chairman COFFMAN. Mr. Sharp.

Mr. SHARP. Mr. Chairman, our primary—the changes that we are pushing for primarily are structural. You know, it is very difficult, as I think we have all discussed today, to know exactly what problems may arise and when and what type, in what sector. So what we are advocating for is replacing the single director with the

panel and ensuring that safety and soundness isn't compromised through a more effective check by the prudential regulators.

So, at this point, we think that, sort of, the best long-term hedge against, you know, poor policymaking by this agency or any other independent agency is, sort of, collaborative decision-making at the top with input from diverse, you know, sectors, bipartisan input. So that is our top priority.

Chairman COFFMAN. Thank you.

Mr. Fleming.

Mr. FLEMING. Mr. Chairman, I think I would just ask the organization to take in to consideration unintended consequences, such as, you know, these data collection requirements that maybe in theory would be of interest and be helpful to the organization, however be burdensome for us small businesses that would have to comply with these new regulations to provide the data.

Chairman COFFMAN. Mr. Levitin.

Mr. LEVITIN. As you might have guessed, I am going to give a rather different answer.

I think the two most important things with the CFPB are, number one, that the Senate should confirm a director; and, number two, if you really wanted to start changing the scope of CFPB regulation, I would strongly urge subjecting auto dealers and realtors to CFPB regulation. There is not a very good principled argument for exempting them.

Chairman COFFMAN. Thank you.

Mr. Altmire, any——

Mr. ALTMIRE. No further questions.

Chairman COFFMAN. Thank you.

Panelists, I just want to thank you all so much for taking the time and coming down to Capitol Hill and testifying today on this very important matter.

With that, the Committee is adjourned.

Testimony of Dan Sokolov
Deputy Associate Director, Division of Research, Markets & Regulations
Consumer Financial Protection Bureau
Before the Subcommittee on Investigations, Oversight, and Regulations
Committee on Small Business
United States House of Representatives
Thursday, July 28, 2011

**Introduction**

Thank you, Chairman Coffman, Ranking Member Altmire, and members of the Subcommittee for inviting me to testify today on the subject of small business and the Consumer Financial Protection Bureau. It is my privilege to serve as Deputy Associate Director for Research, Markets & Regulations at the Consumer Financial Protection Bureau (CFPB).

Small businesses are a critical issue. Half of all American workers are employed by companies with fewer than 500 employees, and small businesses create two-thirds of all private sector jobs. Many small businesses today report having difficulty obtaining credit. These difficulties originated in the most severe financial crisis since the Great Depression and in the recession and credit contraction that the crisis produced.

Failures of the regulatory system were a major cause of the financial crisis. One of the system's most profound failures was the fragmented, unaccountable, and ineffective oversight of consumer financial markets.

To address this failure Congress created the CFPB. We are already hard at work to fulfill the objectives Congress set out for us, including: making sure that consumers have better information for making financial decisions; reducing unwarranted regulatory burdens; leveling the playing field for community banks and credit unions and their competitors; promoting transparent and efficient markets that facilitate access and innovation; and preventing discriminatory practices.

Our statutory objectives and authorities focus on financial products and services for consumers. The Bureau does not have jurisdiction over small business credit except in limited cases where Congress has explicitly and affirmatively granted the Bureau such jurisdiction. The main exception is the Bureau's authority to prevent discrimination in business lending. We may also be able to help many potential small business borrowers with better lending data and more accurate consumer credit histories. In addition, we are already working to reduce burdens on small lenders, and we will continue this work.

**The CFPB is open for business**

The CFPB opened for business last Thursday, July 21. We are already focused on our mission of making consumer financial markets work better. We are working to make rules for these markets more effective, to enforce them fairly and consistently, and to strengthen consumers' ability to

make the decisions that are best for them. Our vision is a market where consumers can see prices and risks and compare products, and firms do not feel pressure to lower their standards to compete.

We are moving in a focused and deliberate way to bring the market closer to this vision. As the Dodd-Frank Act requires, we have begun work on regulations to strengthen mortgage markets. With substantial input from consumers and mortgage lenders, we are working to make federal mortgage disclosures easier to understand and less burdensome. Standards for mortgage servicing and rules requiring mortgage lenders to evaluate borrowers' repayment ability are also key priorities.

We are launching our program for supervising the largest depository institutions and their affiliates. Roughly one-half of our staff will work on supervision and enforcement. Our examiners, many of them with extensive experience with other financial regulators, are beginning their work of ensuring that institutions in our purview comply with consumer financial laws. Rules and procedures are in place to address violations of federal consumer financial laws, and an enforcement team is ready to operate. We are taking consumer complaints about credit cards, with other products to follow. And we are connecting distressed homeowners who contact us with HUD-approved housing counselors.

The expertise and diversity of the team carrying out the CFPB's work will be a tremendous resource. Our leaders and staff come from both the private and public sectors. Some worked for financial institutions in the traditional banking sector, some outside it. Many are seasoned veterans of other federal or state financial services regulators. Some come from nonprofits, others from academia. No viewpoint dominates our staff or leadership other than a commitment to strengthening consumer financial markets. Our expertise and diversity will help keep our actions smart, effective, and balanced.

The Inspectors General of the Treasury Department and Federal Reserve Board have just reported on our effectiveness so far in standing up the CFPB. According to their recent joint report:

> "[W]e found that CFPB identified and documented implementation activities critical to standing up the agency's functions and necessary to address certain Dodd-Frank Act requirements. Furthermore, CFPB developed and is implementing appropriate plans that support ongoing operations as well as the transfer of employees and functions . . . ."

And we are working diligently to execute these plans effectively.

**The CFPB is focused on credit for consumers**

Our focus is on financial products meant for consumers. Our enabling legislation mandates that focus. With narrow exceptions discussed below, the Bureau does not regulate small business credit.

Since 1969 the Truth in Lending Act (TILA), the flagship federal consumer credit law, generally has covered credit only to natural persons, not business entities. And its coverage generally is limited to credit primarily for personal, family, or household purposes, which do not include business purposes. The Dodd-Frank Act applies the same limitation to the scope of the CFPB's new authorities.

Consumers who own small businesses sometimes use consumer credit for a business purpose, but available evidence does not suggest that, as a group, owners borrow heavily for their businesses on credit instruments intended for personal use. For example, a sizable share of small business owners uses personal credit cards to make payments – but only a small share actually borrows (carries a balance) on these cards (12 percent in 2009 according to one survey). A still smaller share borrows significant amounts (6 percent carried a balance larger than $5,000 according to the same survey).[1] The volume of borrowing on personal cards was as small as one percent of total small business borrowing in 2003, the most recent year for which the figure is available.[2] Similarly, there is some evidence showing a subset of small businesses using proceeds from a first or second mortgage to provide capital for their businesses.[3] Some small businesses use personal credit for some periods in their firms' lives; however, available data do not support a conclusion that small business owners as a group rely substantially on personal credit.

Exceptions to the consumer laws' focus on consumer financial services are few, explicit, and well-defined; they also provide significant benefits to small businesses. The Equal Credit Opportunity Act (ECOA) prohibits lenders from discriminating in the provision of business (as well as consumer) credit on the basis of race, national origin, sex, or other protected bases. The Bureau implements ECOA by regulation and supervises compliance with ECOA for certain lenders. In addition, Congress has applied to business cards two credit card protections of TILA – limiting the liability of cardholders for unauthorized use of the card and restricting unsolicited issuance of new cards. Thus, with few exceptions, the Bureau does not have authority over small business credit.

**How the CFPB may help small business borrowers**

Although the CFPB's jurisdiction over small business lending is very limited, we hope to be able to help small business borrowers in several ways. First, our efforts to prevent unlawful discrimination should promote a fairer marketplace and thereby promote credit availability. Second, we will provide the market with better data on small business lending. Third, we may be able to help consumers who rely on their personal credit histories when they apply for a business loan.

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[1] Board of Governors of the Federal Reserve System, Report to the Congress on the Use of Credit Cards by Small Businesses and the Credit Card Market for Small Businesses, May 2010, at pp. 1-2.
[2] Id. at p. 2.
[3] William J. Dennis, Jr., National Federation of Independent Business, Small Business Credit in a Deep Recession, February 2010.

The Dodd-Frank Act helps small businesses by filling a major gap in knowledge about the market for small business credit. Section 1071 of the Dodd-Frank Act amends the Equal Credit Opportunity Act to require that financial institutions collect and report information concerning credit applications made by small businesses and women- or minority-owned businesses. One stated purpose of Section 1071 is to strengthen fair lending oversight. The CFPB and other authorities will be able to use these data to improve the effectiveness and efficiency of fair lending enforcement efforts.

New business lending data will also improve understanding of both demand conditions and supply conditions. Reporting these data publicly, as the Act requires, may tend to make the small business credit market more transparent and efficient.

We will move deliberately and with substantial public input to maximize the benefit of these loan data for small businesses and to minimize the cost for their lenders. To develop implementing regulations we will engage the small business community, business lenders, and civil rights and community development groups.

In addition, the CFPB's efforts to help consumers may in particular help those consumers who decide to start up small businesses using their personal credit histories. Business lenders making loans to new small business owners frequently depend on the personal credit histories of the owners to make a credit decision and set the interest rate and other credit terms. The CFPB will strengthen oversight of the credit reporting system, which should both reduce errors in and increase the accuracy of consumers' credit histories. More accurate personal credit histories should improve the market for small business credit, potentially benefitting both start-ups applying for business credit and the lenders that serve this market.

**How the CFPB may help small business lenders**

Small financial institutions, which frequently make both consumer loans and business loans, are often burdened disproportionately by compliance requirements, as compared to larger institutions. We are working to reduce existing regulatory burdens where feasible and to avoid imposing unwarranted new regulatory burdens. Small financial institutions have also had to compete on a playing field that has tilted too often toward less closely regulated nonbank competitors. We are working to level that playing field.

Our work to make federal mortgage disclosures clearer for consumers and less burdensome for lenders shows our commitment to improving regulation. We understand the deep frustration of lenders that current mortgage forms required by TILA and the Real Estate Settlement Procedures Act (RESPA) are complicated, duplicative, and costly to fill out. We are striving to make the disclosures easier to complete and use. We are interviewing lenders and brokers in our disclosure testing sessions, and thousands of industry participants have submitted comments on prototype forms we have posted on our web site.

Simplifying federal mortgage disclosures is just one example of how we are working to reduce or avoid unnecessary regulatory burdens for small banks. There are many other ways in which we will continue these efforts.

First, we have a large variety of tools besides regulations to fulfill our mandates – including supervision, guidance, enforcement, consumer education, research, and reporting. We expect to conclude in many cases that one or more of these tools would better address a problem, with fewer burdens, than would a new regulation.

Second, we will consider the potential benefits and costs of proposed rules to consumers and covered persons, including small lenders. We will consider specifically impacts on banks and credit unions with assets of $10 billion or less described in Section 1026 of the Act.

Third, under the Regulatory Flexibility Act (RFA), we must generally conduct a regulatory flexibility analysis unless we certify that a proposed regulation will not have a significant economic impact on a substantial number of small entities. In these analyses we will consider the effectiveness and compliance burdens of a proposal versus less burdensome alternatives. Section 1100G of the Dodd-Frank Act amends the RFA to provide that the analysis must describe any projected increase in the cost of credit for small businesses, and significant alternatives in that light, and we will act accordingly.

Fourth, as appropriate we will seek public input on benefits and costs even before we propose a rule. In our project to reform mortgage disclosures we have engaged and continue to engage extensively with lenders about how to reduce compliance burdens – well before our proposing a regulation. We will also follow the requirements of the Small Business Regulatory Enforcement Fairness Act (SBREFA). Generally, unless we can certify a proposed rule will not have a significant economic impact on a substantial number of small entities, before we propose the rule we will seek input directly from small entities about potential costs and potentially less-burdensome alternatives. We plan to use the SBREFA process to supplement our outreach to small mortgage originators in connection with our development of a combined TILA-RESPA disclosure.

Fifth, as required by the Dodd-Frank Act, we will review the effectiveness of a significant rule we adopt within five years of its effective date.

**Conclusion**

Thank you again for the opportunity to discuss the CFPB and small business with the Subcommittee. We look forward to carrying out our responsibilities under the Dodd-Frank Act to strengthen the market for consumer financial services. While the Bureau's statutory role with respect to the market for small business credit is very limited, we will work within that role to strengthen that market, too.

**Statement of Terry K. Jones, CML**

**on behalf of the**
**Colorado Mortgage Lenders Association**

**House Small Business Committee**
**Subcommittee on Investigations, Oversight and Regulations**

**"Open for Business: The Impact of the CFPB on Small Business"**

**July 28, 2011**

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Terry K. Jones, CML
July 28, 2011
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Good Afternoon Chairman Coffman, Ranking Member Altmire, Congressman Tipton and members of the House Committee on Small Business Subcommittee on Investigations, Oversight and Regulations. My name is Terry Jones and I am the Chairman of the Legislative and Regulatory Affairs Committee of the Colorado Mortgage Lenders Association.

The Colorado Mortgage Lenders Association is a 56 year old organization made up of over 100 companies employing in excess of 2500 individuals involved in the Mortgage Lending Industry in Colorado. Over 75 percent of our members are small businesses that employ 25 people or less.

I have been involved in residential mortgage lending for over 42 years. In my career I have been a loan originator, a manager, an entrepreneur and a small business owner. In that time I have always been proud to be a part of an industry that helps people and families reach their dreams of home ownership. I started in the business as a loan originator in 1969 and there are few feelings as satisfying as helping a family through the complexity of the loan process and seeing the keys change hands at the closing table as one more family realizes their American dream of home ownership. I have been equally proud of the entrepreneurial spirit that has been a hallmark of the independent mortgage lender and the mortgage loan originators employed in the industry. I have seen many people start in the business as loan originators and then go on to start their own small business, first as a mortgage broker and then as a mortgage banker. These people have lived their own American dream and in doing so have served the real estate market and the buyers and borrowers of their local communities. Pride of ownership in both homes and small businesses has long been one of the key factors in building strong and prosperous local communities. I am proud to have spent my career as part of that effort.

We at CMLA recognize that there were serious excesses in mortgage lending during the recent housing boom and subsequent bust. We firmly believe that Mortgage Lenders and Mortgage Brokers alike need to take responsibility for their share of those problems.

We also believe that while much attention has been focused on the mortgage lending community, there were broad economic issues underlying the "great recession". In the decade of the 2000s, easy monetary policy, prompted in part by an effort to avoid the negative economic consequences of the stock market dot com bubble bursting in 2000, coupled with a complex financial market structure with a voracious appetite for ever more esoteric financial and loan products, fueled a housing boom and fostered an ability of mortgage lenders to offer very easy terms for the purchase and refinancing of residential real estate. This in turn allowed many consumers to purchase a home or to tap the equity in their home at the same time that easy or nonexistent documentation and underwriting policies fueled an unprecedented demand for housing and created an upward spike in home values. Our industry was at the tip of the spear of economic expansion and the housing boom and suffered the consequences of being out in front

when things started to go badly. Those in the mortgage lending industry who contributed most to the lax origination and underwriting standards, the subprime lenders, have fallen by the wayside, either out of business entirely or purchased or merged into other larger institutions. The number of people employed in the mortgage lending industry has fallen by half from its peak in 2006 to today.

While we do not for a moment, ask anyone to ignore the problems of the past few years or of the housing boom and bust of the 2000s, neither the regulators, the congress or the people of the United States should overlook the success of the housing and the mortgage lending industry in the 50 years leading up to 2000 and the contributions we made to the communities of Colorado and America. That was an era of reasonable underwriting standards applied to loans, where borrower's incomes and assets were verified as part of the lending process, and the loans were typically made by a much more diverse industry comprised of smaller, more independent lenders throughout the United States as contrasted to the industry today where a few large lenders dominate the landscape.

Over the course of the past few years, many new laws have been passed by the Congress and the States. New rules and regulations have been issued by State and Federal Agencies in response to the boom and bust of the 2000s that have tremendous impact on the mortgage origination business. Most of these laws and rules seek to curb the abuses of the 2000s, but some do not seem to recognize the successes and experience of the industry in the last half of the 20th century.

For example, as required by the Dodd-Frank Act, the Federal Reserve, the OCC, the FDIC, the SEC, HUD and the FHFA have recently jointly issued a proposed rule requiring five percent risk retention by securitizers of mortgage loans. In crafting the Dodd-Frank legislation, Congress created a category of loan exempted from risk retention called the Qualified Residential Mortgage with the idea that there was a category of properly documented, properly underwritten loans, without the risky features that characterized many of the risky loans from the 2000s that could be exempted from the risk retention requirements. The regulators however, proposed a narrow QRM exemption, one that would require a 20 percent down payment from a new home purchaser (a concept that dates back to 1956 prior to the creation of the private mortgage insurance industry); one that would also require that a homeowner have 25 percent equity in their home in order to be able to refinance to get a lower interest rate; or 30 percent equity if the homeowner wanted to extract some of their equity in a cash out refinance to help send one of their children to college. Coupled with the strict debt to income ratios proposed, only a small percentage of loans outside of the programs of FHA, VA, Fannie Mae or Freddie Mac will qualify for the QRM classification. The QRM proposal does include FHA, VA, and loans that are originated to the guidelines of Fannie Mae and Freddie Mac in the QRM classification and that in many ways does recognize the way loans were made in the last half of the 20th century. The problem is that the future of Fannie Mae and Freddie Mac are uncertain, and without those

programs, a very large percentage of conventional mortgage loans could be excluded from the QRM in the future. That a loan falls outside the QRM does not mean that the borrower will not be able to get a loan, but it does mean that they will almost certainly pay a higher interest rate. Estimates for the amount of the higher rate vary, but range from 35 to 175 basis points higher. CMLA believes that a good borrower taking out a non risky, traditional 30 year fixed rate conventional loan, should be able to get the best rate possible. Subjecting them to unnecessary risk retention requirements only serves to raise their interest rate and make their borrowing more costly. Those same higher rates coupled with the strict underwriting guidelines of today will mean that some borrowers may not be able to get loans at all.

The Dodd-Frank Act passed a year ago, creates a super regulator for the mortgage lending industry in the Consumer Financial Protection Bureau. This oversight is in addition to the oversight already in place by the States, FHA,VA, Fannie Mae and Freddie Mac. The CFPB is tasked with issuing 250 rules and regulations, 110 of which will be mortgage rules over the course of the next 18 months. The Risk Retention rule and the QRM mentioned above are not within the purview of the CFPB, but a similar concept does exist in the ability to repay requirements of Dodd-Frank and the Qualified Mortgage.

Two of the early Rules and Regulations we expect to see out of the CFPB over the course of the next few months that will have direct impact on our industry are (1.) Finalization of The Federal Reserve's proposed rule regarding the ability to repay and; (2.) A rule making effort (which we applaud) to combine and simplify the Good Faith Estimate disclosure form required by the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending disclosure form required by the Truth in Lending Act (TILA).

We believe that the CFPB has a historic opportunity to set the tone for the regulation of the mortgage lending industry in finalizing the Ability to Repay rule and in defining the Qualified Mortgage as a safe harbor characterized by traditional well underwritten properly documented loans, without the risky features that characterized many of the loan products introduced in the decade of the 2000s. By pursuing such a course, the CFPB can help to preserve the best of the practices and products of the last half of the 20th century and still curb the abuses of the 2000s. If the CFPB takes this approach, it will be of great benefit to small business mortgage lenders because it will create a broad safe harbor for traditional mortgages that they can rely on when making loans. CMLA believes such a safe harbor will define the arena in which most loans will be made since we believe that the risks to smaller businesses will be too great for most of them to venture outside the Qualified Mortgage parameters.

The CFPB is also assuming responsibility for the rules and regulations and enforcement of the SAFE Act. CMLA is hopeful that they will listen to the concerns of Mortgage Brokers and Mortgage Lenders who are predominately small businesses whose employees are required to be

licensed by the SAFE Act to provide a transitional license to allow loan originators to move freely from depository institutions to the State Licensed environment and helping to level an already unlevel playing field that is tilted in the favor of the depository institutions. We also hope that the CFPB will provide clarity regarding the already adopted loan originator compensation rule under the Truth in Lending Act and reconsider some of the more rigid requirements that have been imposed on the ability of a small business to pay its employees in a manner consistent with the profitability of the loan products they produce.

We respectfully urge Congress and this subcommittee to carefully monitor all of these new rules to make certain that they do not unwittingly harm American families, small business, the housing and mortgage market or the nation's economic recovery.

Let me begin my more detailed discussion of the rules we expect to see from the CFPB with the proposed rule that we believe can set the tone for all of the rules and regulations to follow and perhaps even influence the agencies who proposed the risk retention rule to reconsider their approach to the QRM and follow suit with a broad QRM much like the safe harbor version of the QM. .

**Ability to Repay and the Qualified Mortgage**

The Federal Reserve Board proposed the ability to repay rule (which is to be finalized by the CFPB) on April 19, 2011 and published it in the Federal Register on May 11, 2011. This rule is likely the most significant change that small mortgage lender will have to deal with from the CFPB in its early days and it is this proposed rule which is of paramount importance to the small business community in our industry.

The proposed rule and its attendant commentary, 474 pages in length, deals with the requirements established by the Dodd-Frank Act that prohibit a creditor from making a mortgage loan unless the originator makes a reasonable determination, in good faith, based on verified and documented information at the time the loan is consummated, that the consumer has the ability to repay the loan, including any taxes and insurance associated with the property.

Dodd-Frank amended the Truth in Lending Act to increase the penalties for violation, including violations of the ability to repay standard and anti- steering provisions. These penalties are applicable to creditors and loan originators alike, and allow consumers who bring timely action against a creditor for a violation of the ability to pay requirements to recover special statutory damages equal to the sum of all finance and fees paid by the consumer unless the creditor demonstrates that the failure to comply is not material. Further the consumer may set off damages in a foreclosure action with no time limit on when such a private action need be filed.

The proposed rule includes the standards that will be used to determine compliance with the ability-to-repay requirement, and these standards include the making of a "qualified mortgage" (QM). Congress included language in the Dodd-Frank Act that is designed to provide some certainty and protection from liability for a lender who makes a QM. This language will benefit consumers by helping to ensure an adequate supply of affordable and high quality mortgages. However, the Federal Reserve states in the proposed rule that it is unclear from the statutory language in the Dodd-Frank Act whether Congress intended that the QM provide a "safe harbor" or merely the presumption of compliance with the ability-to-repay requirement. The proposed rule therefore outlines each of the two options and asks for comments on both.

Alternative 1 in the proposed rule provides for the "safe harbor" QM. In order to qualify for Alternative 1, the "qualified mortgage" must provide for regular periodic payments that do not result in an increase of the principal balance (negative amortization); allow the consumer to defer payment of principal (interest-only payments); or result in a balloon payment; the loan term cannot exceed 30 years; total points and fees payable in connection with the loan generally cannot exceed 3 percent of the loan amount; the loan is underwritten in a manner that includes full amortization and takes account of all mortgage related obligations that are to be paid by the borrower; and the lender considers and verifies the borrower's current or reasonably expected income or assets. Alternative 1 provides both lenders and consumers with a bright line that includes clear standards that must be met in order to make a QM and qualify for the legal safe harbor for compliance with the ability-to-repay requirement. It is worthy of note, that with the exception of the limit on points and fees, this alternative is a very good description of the traditional approach to residential lending that was taken by the vast majority of the industry prior to the boom and bust of the 2000s.

Alternative 2 in the proposed rule provides that a QM must meet the requirements of Alternative 1, as well as additional ability-to-repay requirements. The lender would be required to consider the borrower's employment status, any simultaneous loans, current debt obligations, and the borrower's credit history. If these requirements are met, the creditor is presumed to have complied with the ability-to-repay requirement. Alternative 2 however, provides merely a "rebuttable presumption" of compliance.

CMLA believes that Alternative 1 is essential for both consumers and lenders, especially small lenders, and strongly urged the Consumer Financial Protection Bureau in our comment letter of July 22nd to adopt this approach when finalizing the proposed rule.

There are a number of reasons why a safe harbor is necessary. First, the penalties for non-compliance with the ability-to-pay requirements are severe. If lenders do not have a clear safe harbor, consumers will suffer because lenders will inevitably become much more cautious and risk averse. There is already a great deal of uncertainty and litigation in the mortgage market.

anything short of a safe harbor will invite more of both. The legal reality is that a rebuttable presumption can be overcome by any evidence of a potential failure to comply with the ability-to-repay standard. The lender is then faced with litigation in order to demonstrate compliance. Widespread litigation will invariably increase costs for consumers and may prove to be unbearable for many small businesses.

Second, the legal standards associated with a rebuttable presumption will vary from one court to another and from one jurisdiction to another. The result is likely to be confusion and a significant increase in compliance costs. Again, this will ultimately harm both small business and consumers by making credit scarcer and more costly.

Third, vague regulations can help create an environment where marginal creditors and mortgage loan originators flourish. Reputable creditors and mortgage loan originators strive to operate in compliance, their less reputable counterparts ignore the rules and move to capture temporary market share. Obviously, this is harmful to consumers and to our industry.

Fourth, a bright line safe harbor will encourage use of the Qualified Mortgage, and we believe this will be the primary arena where small businesses without the budget to move outside the safe harbor will focus the bulk of their lending efforts. This in turn will result in increased competition in our industry and an increased supply of affordable and high quality mortgages for consumers. The weak state of the economy has much to do with the lack of a housing recovery. This is no time to make it more difficult for lenders to make quality loans. Rather, this is a time to encourage responsible lending through greater use of Qualified Mortgages.

Fifth, a safe harbor would still permit focused litigation. This type of litigation would deal with whether the lender has met the safe harbor requirements. This degree of litigation is manageable, and reputable lenders will know that they can rely on the "rules of the road" for protection from frivolous and endless litigation.

It is clear to the members of the CMLA that a safe harbor provides the best means to ensure compliance with the ability-to-repay requirements of the Dodd-Frank Act. A safe harbor will help to maintain a steady flow of affordable and high quality mortgages to the largest number of qualified borrowers and at the same time permit small lenders to continue to compete in the arena of the highest quality loans without the higher costs of dealing with a rebuttable presumption approach.

There are aspects of the safe harbor in the proposed rule that CMLA believes need to be clarified and modified. We have expressed these concerns in our comment letter to the Federal Reserve/CFPB but these concerns are indicative of the challenges of interpreting and complying with the complex regulations that face small business today.

The rule as proposed sets a 3 point cap on points and fees for loans within the Qualified Mortgage definition. We recommended that loan originator compensation paid to a loan originator by a creditor, mortgage lender or a mortgage broker should be clearly excluded from this calculation of points and fees to determine compliance with the 3 point cap. The reason for this is simple. The calculation of points and fees already includes the origination fees paid to the creditor, broker or lender in a transaction. Those origination fees are the source of revenue used by the creditor, broker or lender to compensate the loan originator. Including both the origination fees paid to the creditor, broker or lender, and also including the loan originator's compensation paid from those fees, results in double counting the loan originator's compensation.

Second, we recommended that the dollar amount of the smaller loan definition be increased from the $75,000 proposed in the rule. The proposed rule recognizes that the point and fees cap could work to the detriment of borrowers on lower balance loans. Many of the costs that lenders incur on a loan are costs for processing, underwriting, closing and perfecting the final documentation for a loan. These costs may fluctuate with the volume of originations but they are hard costs that must be incurred on every loan and they are not for the most part dependent on the size of the loan. These costs involve salaried employees with their attendant benefit programs, office space, equipment and office supplies and all of the attendant costs of running any business. This translates into a component of the cost of loan origination that is relatively fixed. As the loan amount gets smaller and smaller, that fixed cost becomes a larger and larger percentage of the loan amount, and will eventually reach the point where the origination of the loan becomes economically unfeasible. Since small, locally owned lenders make many of the small loans needed in their community, we feel this increase in the small loan definition is particularly important to small lending businesses.

The average loan for the purchase of a home in Colorado based on the 2009 HUDA data (the most recent year for which HMDA data is available) was $216,600. Our suggestion would be to increase the smaller loan definition to $100,000 with the 3.5 to 5.0 fee scale suggested in Alternative 1 adjusted accordingly.

Third, we believe that fees paid to affiliates for loan services and products should be excluded from the calculation of fees and points so long as they represent charges (such as title insurance charges) that are regulated by or filed with State, Local or Federal governmental agencies or do not exceed an average fee for similar services based on a survey of the local market. It is an accepted practice, permitted under RESPA for lenders to be part of affiliated business relationships that offer "one stop" shopping opportunities to consumers. Those businesses are entities unto themselves and are often small businesses that have their own risks and opportunities for profit. As long as the fees for those products and services do not exceed the

averages for the market or those filed with the appropriate regulators, CMLA does not believe those charges should be included in the 3 point limit.

Finally, the proposed regulations in the definition of a "bona fide discount point" contain a requirement that creditors include in the points and fees calculation, an amount the creditor might expect to receive from the sale of the loan to secondary market mortgage investors. There appears to be a presumption that such an amount would be a positive number. Given the actual experience of the market, that presumption is not necessarily true. The ultimate sale of a loan can result in either a profit or a loss depending on the success of the hedging strategy employed by the creditor. Gain or loss on sale of the loan is generally unknown at the time of origination and likely not even known at closing of the loan.

Introducing estimates that could be a positive or a negative number like these, into the calculation of the 3 point cap serves only to detract from its usefulness in the QM regulation. By introducing uncertainty into the calculation it makes it all the more likely that the lenders who are really trying to comply with the regulation will err on the side of caution, while less scrupulous lenders may exploit the lack of clarity to their benefit and to the detriment of consumers.

**SAFE Act and Transitional Licensing**

The CFPB assumed responsibility for the SAFE Act last Thursday, July 21, 2011. HUD issued a final rule on the SAFE Act on June 30, 2011. The SAFE Act and its rules create a serious imbalance between State Licensed Mortgage Loan Originators and the companies who employ them and the Registered Mortgage Loan Originators who work for depository institutions.

The way the rules are currently structured, a depository institution can hire a Mortgage Loan Originator from a Company employing state licensed mortgage loan originators and that individual mortgage loan originator can begin working and serving customers at their new depository based employer literally the next day. However, should a company which employs state licensed mortgage loan originators (a large number of which are small businesses) attempt to hire an experienced loan originator from a depository institution, that individual, regardless of how experienced or competent, must first comply with the educational and testing requirements for state licensing and go through the process of obtaining a state license before they can originate or work on a mortgage loan in service to their customer base. This process can easily take several weeks or longer. You can imagine that many loan originators (a position which is in many cases a straight commission job) are reluctant to make such a move and suffer the resultant interruption of their income. The net result is an unlevel playing field tilted in favor of the depositories at the expense of those who employ state licensed originators.

Colorado was a late comer to the State Mortgage Licensing Arena. A result of this is that Colorado is one of the first states in the country to license individual mortgage loan originators and as such foreshadowed the SAFE Act which takes the same approach of licensing individual mortgage loan originators. In the process of developing the initial registration and licensing process for individual mortgage loan originators in Colorado, great care was given to trying to create a workable system of licensing that would promote individual responsibility and proven knowledge and competency but not create an even more unlevel playing field by limiting the employment mobility of Bank and Credit Union Loan Officers who were exempt from the licensing requirements of the state.

We in Colorado recognized that requiring non depository based mortgage loan originators to be licensed, while at the same time exempting depository based mortgage loan originators from those licensing and educational requirements would create an imbalance between the two segments of the mortgage loan origination industry in terms of hiring practices that, left unaddressed, would severely limit the mobility of individual mortgage loan originators that worked for depository institutions. Those originators would be unable to seek employment in the non depository based side of the industry without a substantial interruption of their mortgage loan origination business while they underwent the fingerprinting, background check, education and testing requirements necessary to obtain their Mortgage Loan Originator License. Furthermore, because the public nature of the application process for Mortgage Loan Originator Licenses, their current depository based institutional employer would have access to public records identifying new applicants for licenses which would discourage depository based mortgage loan originators from applying for licenses and thus inviting the scrutiny of their current depository based employers and possible repercussions. We also considered that it would be unethical and violate the employee's duty of loyalty were an employee of a depository institution to seek employment at a non depository institution, and remain working for their original depository based employer for the four months or so necessary to complete all of the requirements of obtaining a license.

Our solution in Colorado was to create a temporary license structure allowing a temporary license holder to work under the direct supervision of a licensed mortgage loan originator during the time that he or she was completing the process of obtaining a Mortgage Loan Originator License.

It seems to us that structuring the SAFE Act rules to permit a transitional license under much the same terms as the original Colorado program would serve the interests of consumers and industry participants as well. The SAFE Act requires all mortgage loan originators to undergo background checks, be fingerprinted and then be either registered with the NMLS&R or licensed by their state and registered with the NMLS&R. The SAFE Act imposes educational and testing requirements on licensed mortgage loan originators yet does not make those requirements of

registered mortgage loan originators who are employed by depository institutions. By this structure, the SAFE Act equates employment at a depository based institution with the education and testing requirements necessary for licensed mortgage loan originators. By that same logic, it seems reasonable to grant a transitional license to a practicing registered mortgage loan originator that would allow him or her to accept employment at a non depository institution and then go through the process of obtaining a license while employed by that non depository institution and not interrupting their income stream from employment in their profession. Those registered loan officers will be no less competent when employed by a non depository institution than they were when employed by a depository institution.

It is our hope, and we will petition the CFPB to consider this question, that the CFPB will consider modifying the SAFE Act Rules to permit transitional licensing for registered mortgage loan originators who wish to transition to a state licensed status.

**Loan Officer Compensation**

In August of 2010, the Federal Reserve adopted a final rule that placed restrictions on how mortgage lenders and mortgage brokers may compensate their loan originators. The original proposed rule began in 2009 as a part of revising the Truth in Lending Act's disclosure rules to prohibit unfair and deceptive acts and practices. The Federal Reserve finalized the rule regarding loan officer compensation knowing that additional rulemaking would be needed under Dodd-Frank, but declined to move forward with the overhaul of disclosures at that time.

The Federal Reserve Rule forced a significant change in the compensation practices of virtually every mortgage lender and mortgage broker in Colorado and for that matter, in the country. The Federal Reserve Rule prohibits basing compensation to a loan originator on a loan's terms or conditions, subject to an exception for loan amount. It further prohibits compensation to a loan originator from both the consumer and a party other than the consumer for the same transaction. It also prohibits, and rightly so, the originator from recommending a loan product to a borrower merely to receive greater compensation.

The practical effect of these restrictions has been a significant lessening of the ability of the loan originator to meet their borrowers needs when it comes to negotiating interest rates and fees. Under the current rule the loan originator's compensation program must be the same on every loan regardless of the differences in the loan product. This is particularly troublesome when dealing with some of the programs that serve low to moderate income borrowers and borrowers in rural areas.

Most States and many localities have programs designed to encourage home ownership for low and moderate income borrowers that are funded by issuing tax exempt revenue bonds. In some rural areas of Colorado these programs are the only programs available to low and moderate

income borrowers. These types of programs typically have not only income restrictions on the borrowers but they also restrict the fees lenders may charge the borrowers. In the past loan originators and companies, be they lenders or brokers, typically received less compensation for the origination of this type of loan (which was known to all participants going into the transaction), but did so in an effort to serve low to moderate income borrowers and their communities. Under the Federal Reserve's loan officer compensation rule, loan originators must receive the same compensation on these "bond" loans as they do on any other loan they originate. Since the fees that can be collected are limited compared to non "bond" loans, but loan officer compensation cannot be proportionately limited, such loans can easily result in a loss to the company who employs the originator.

The result is that some companies and their loan originators will no longer offer these programs. An alternative approach for a large lender is to assign all "bond" loans to a loan originator who does not originate any other type of loan program. While this approach may work acceptably for a larger lender, this is a particularly heavy burden on the small lender who does not employ a large force of loan originators. Small lenders are faced with the choice of either originating the loans at a loss or refusing to participate in the program and thus lessening the competitive nature of their loan originators and not supporting low to moderate income lending in their community.

It is difficult to exaggerate the effect of this restriction on permitted compensation structures on the mortgage lending community. Once again it is particularly hard on small companies who do not have the budget to staff up legal and compliance departments to comply or interpret a program where the Federal Reserve itself provides verbal responses to some questions, while making it clear that only written commentary could be relied upon, and then declined to provide requested clarifications prior to the effective date of the rule. Small companies who care about doing a good job and following the rules find doing so with this rule very difficult. If rules are to be issued, small companies need clear and unambiguous rules to follow. We at the CMLA hope that the CFPB will be more clear and deliberate in issuing further rules on loan originator compensation. Further we hope the Congress and this subcommittee will monitor the progress in this area. Small lenders need clear and well defined regulation in order to be able to comply effectively. Small lenders cannot afford to absorb the risk of interpreting rules based on less than clear guidance only to find out later that their interpretation based on further rulings from the agency was incorrect.

**CFPB and the States, Enforcement Coordination:**

The Dodd-Frank Act grants the CFPB authority to license and supervise non-bank lenders. As written, the scope of the CFPB's Authority overlaps considerably with State Regulators. This creates the possibility of duplicative regulation which could lead to not only confusion but conflicting rules and regulations from both State and Federal Regulators.

The states have been working on rules and regulations governing non bank mortgage lenders for the past several years. Colorado, last year added sections to its Licensing and Registration Law to bring non bank mortgage companies under the umbrella of the Division of Real Estate and the Board of Mortgage Loan Originators. Throughout the country lenders have been working hard to comply with this increased level of regulation and the industry has been urging the state regulators to coordinate their activities so that companies will not be faced with duplicative or contradictory requirements from each state they do business in.

CMLA believes that the CFPB should treat its power to supervise and regulate non bank mortgage companies as a backup authority, to be used only in the event that states do not enforce their own laws. The regulatory landscape for non bank mortgage lenders has changed dramatically in the last six years. The CFPB adding an additional layer of federal regulations will only add to lender's costs, and likely not creating any additional benefit to consumers. The costs of the additional regulation will ultimately be reflected in the lenders cost of doing business and the consumers cost of obtaining mortgage credit.

As I have said before, to the extent that small business is to be regulated, it is imperative that such regulations be clear and easily interpreted. Otherwise such regulations will raise the cost of doing business, and ultimately the consumer's price of obtaining a loan. Our hope is that the CFPB will leave the bulk of the rule making and enforcement to the State regulatory agencies that are much closer to the local market, its participants and local consumers.

**Good Faith/TIL combined disclosure**

The Dodd-Frank Act requires that the CFPB, no later than one year after the transfer date, issue a proposed regulation to integrate and combine the Truth in Lending and Real Estate Settlement Procedures Acts required disclosures. CMLA applauds this effort and we agree that it is long overdue. We are pleased to see that Treasury Secretary Geithner and Special Advisor to the President Warren have made this a high priority of the CFPB. We agree that a uniform, simplified disclosure form at both application and settlement will be good for consumers. It is also our belief that a combined, unified, simplified disclosure will be good for small business as well by making compliance with the disclosure rules a much more straightforward process.

**Conclusion:**

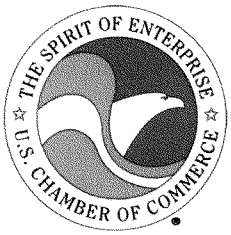
We at CMLA are hopeful that the CFPB, as it begins its task of assuming responsibility for consumer protection in the financial markets will be particularly sensitive to the needs of small business. Small businesses all over the country and certainly in Colorado are one of the prime sources of new jobs and new opportunities in their communities. Small business is a dynamic engine for economic growth. CFPB has a unique opportunity to set the tone for the future regulation of the mortgage lending industry by recognizing and codifying the best practices of

traditional mortgage lending in a broad Qualified Mortgage safe harbor. Such a rule will encourage and support the myriad of small businesses that make up a large part of the mortgage lending industry in the communities across America. They will in turn provide the competition and the entrepreneurial spirit that will provide well underwritten, well documented and well priced loans to the borrowers of their communities.

As the CFPB moves to embrace the responsibility for enforcing many of the laws that govern our industry such as Truth in Lending, the Real Estate Settlement Procedures Act, the SAFE Act etc. it is particularly important for the CFPB to develop an orderly process for its rulemaking initiatives; not only to ensure meaningful input from the industry and other stakeholders, but to develop well conceived and clear rules and a process for providing timely, reliable guidance to the industry well prior to implementation. This is especially important to small businesses.

We appreciate the efforts of this subcommittee to examine the implications and the effects of the CFPB on small businesses in the mortgage lending industry in Colorado. No matter how well intentioned rules may be, they must not be allowed to harm the very consumers they set out to protect or jeopardize the housing recovery or the nation's economic recovery.

I thank you for the opportunity to testify before you today. I will do my best to respond to any questions you may have of me.




# Statement
## of the U.S. Chamber of Commerce

**ON:** **"Open for Business: The Impact of the CFPB on Small Business"**

**TO:** U.S. House Small Business Committee Subcommittee on Investigations, Oversight and Regulations

**DATE:** **July 28, 2011**

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

## INTRODUCTION

Chairman Coffman, Ranking Member Altmire, and distinguished members of the Subcommittee:

My name is Jess Sharp, Executive Director for the Center for Capital Markets Competitiveness at the U.S. Chamber of Commerce. The Chamber is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. I appreciate the opportunity to testify before the Subcommittee today on behalf of the hundreds of thousands of Main Street business that the Chamber represents.

The Chamber firmly supports sound consumer protection regulation that weeds out fraudulent and predatory actors and ensures consumers receive clear and concise disclosures about financial products. We also want to work with the CFPB to ensure that the Bureau takes a targeted approach to regulation and enforcement, taking care to prevent sweeping policies that would impose duplicative regulatory burdens on small businesses and, perhaps even more importantly, that would prevent small businesses from obtaining the credit they need to expand, and create the new jobs that our economy so desperately needs.

The Chamber recognizes that building an agency from the ground up is a tough job. While the Bureau is not fully constituted because it lacks a confirmed Director, the Bureau has already begun its work, issuing requests for information that will lead to changes in mortgage disclosure, and to regulations that will define the Bureau's supervisory priorities among non-bank financial services providers. The Bureau has an opportunity to establish some clear lines of jurisdiction, and to lay out a fully coordinated an accountable process for regulation and compliance that give some certainty to the regulated community.

Ultimately, the goal should be to construct a nimble, effective, efficient, transparent, and fair new agency that fulfills its consumer protection mandate while ensuring that consumers and small businesses continue to have access to affordable credit from a wide range of sources.

## CFPB OVERVIEW – HOW ARE SMALL BUSINESSES IMPLICATED?

The CFPB has broad authority to regulate the consumer financial products and services of banks and non-bank financial institutions, including, credit cards, mortgages, student loans, and payday loans.

However, the Dodd-Frank Act also gives the CFPB the authority to regulate a number of activities that are common to Main Street businesses well outside the financial services sector, and in some cases regulate the service providers to those companies.

In addition to casting this very wide net of coverage, the Dodd-Frank Act also gives the CFPB a very broad standard to enforce – the prevention of "unfair, deceptive, or abusive acts or practices" in the consumer financial products market. While unfair and deceptive practices have been proscribed for years with decades of case law to guide compliance and enforcement, the new "abusive" standard will require immediate interpretation by the Bureau that will likely continue to evolve into the future.

Together, these vague standards give the CFPB tremendous power to interpret its mandate, and give the regulated community, including small businesses, very little comfort that their companies will not feel the weight of burdensome new data collection requirements and regulation by the Bureau. The full universe of covered entities is unknown, and the standards by which those entities will be judged compliant or non-compliant have yet to be written.

## SMALL BUSINESS FACTS AND FIGURES

It is widely recognized that small businesses play a critical role in the American economy, as job creators and as innovators; but they also feel the burden of regulatory compliance costs. According to the Small Business Administration's (SBA) Office of Advocacy[1]:

- There are more than 27 million small businesses in America
- Small businesses are 99.7% of all businesses.
- Small businesses employ just over half of all private sector employees, and pay 44% of total U.S. private payroll.
- Small businesses have generated 64% of net new jobs over the past 15 years, and hire 40% of high-tech workers (such as scientists, engineers, and computer programmers).

[1] Office of Advocacy - Frequently Asked Questions - How important are small businesses to the U.S. economy? | SBA.gov

- A 2010 SBA study found that very small firms with fewer than 20 employees pay roughly $10,585 per employee per year in regulatory costs – or 36% more than larger businesses.[2]

In addition, while the U.S. commercial banking system remains an incredibly important source of credit and capital to small businesses in the U.S., many small businesses do not have the option of relying on commercial borrowing to capitalize their operations. Traditional lending requires credit history, collateral, and financial statements that many start-ups or even ongoing small businesses lack.

To fund and grow their businesses, large numbers of small businesses therefore turn to the very affordable and accessible consumer financial products that individuals and families use to extend their buying power. According to research conducted by the SBA's Office of Advocacy, 80% of small firms used non-traditional sources of credit, such as owners' loans and personal and business credit cards, while 60% used six traditional types of credit, such as credit lines, mortgage loans, vehicle and equipment loans and others[3]. And the Federal Reserve found about 83% of all small businesses used at least one credit card, and about 41% used personal cards rather than business cards, either as a free source of working capital that is paid off every month, or as a readily obtainable revolving loan[4].

## OUR CONCERNS ABOUT THE CFPB'S IMPACT ON SMALL BUSINESSES

The CFPB poses two significant threats to small businesses:

First, small businesses may be subject to the CFPB's regulation and other oversight because they engage in one of the 10 broadly described activities laid out in the law, or are a service provider to one of those companies. Virtually all of these businesses are already subject to oversight by the Federal Trade Commission. The Chamber fears that overlap and duplication will be inevitable as the federal agencies sort out lines of jurisdiction and responsibility. In the meantime, even those businesses that are ultimately deemed to be outside the CFPB's authority may see their compliance costs go up in the short term because there is still so much uncertainty about the extent of the CFPB's jurisdiction

[2] The Impact of Regulatory Cost on Small Firms; Nicole V. Crain and W. Mark Crain Lafayette College Easton, PA
[3] http://www.sba.gov/sites/default/files/09finfocus_0.pdf
[4] http://www.federalreserve.gov/newsevents/conferences/sbc_smallbusinesscredit.pdf

Second, CFPB regulation may decrease the availability or increase the costs of the forms of credit small businesses rely on to provide working capital or credit, as described above – home equity loans, credit cards, etc. In this scenario it is even possible that policies that seem to benefit consumers could indirectly harm their small businesses by limiting their access to the credit they need. This is particular troubling given the already challenging lending environment. According to a June 30 story in the Wall Street Journal, "In the past six months, only 17% of loan-seeking businesses with less than $5 million in annual revenue landed bank financing."[5] When traditional sources of commercial lending dry up, small businesses fall back on the consumer tools available to them.

## RECOMMENDATIONS

*Legislative Changes*

The best way to mitigate against one-sided, or otherwise harmful policymaking is to ensure that decisionmakers are forced institutionally to hear from a diverse range of opinions and viewpoints in a transparent process, and that their decisions are subject to proper oversight and accountability through the public's elected representatives. Last week, the House approved an important piece of legislation that would make changes to the Bureau's structure and operations to increase its accountability to Congress, and to ensure that the Bureau's decisions are based on diverse inputs.

H.R. 1315 would replace the Bureau's current single director position with bipartisan, multimember leadership, giving the agency more stability and balance over the long term, and would give small community credit unions and banks a voice in the process that allows the Financial Stability Oversight Council ("FSOC") to override Bureau regulations that harm safety and soundness.

The risks of agency tunnel-vision, overreach, and politicization are real for all government regulators, including the Bureau. If these risks are not properly addressed at a ***structural*** level, agencies inevitably will, over time, abandon sound regulatory principles.

*The Need for Small Business Committee Oversight*

The Bureau, like the Environmental Protection Agency and the Occupational Safety and Health Administration, is statutorily required to convene Small Business Regulatory Enforcement Fairness Act ("SBREFA") panels to assess proposed

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5 http://online.wsj.com/article/SB10001424052702304314404576411901168183390.html?KEYWORDS=EMILY+MALTBY

regulations expected to have a significant impact on a substantial number of small businesses and to recommend less burdensome alternatives. This requirement is a very important part of the Bureau's existing legal framework given the potential harm to small businesses that could result from ill-advised rulemaking in the consumer finance area. But, for several reasons, the panel process is an imperfect accountability mechanism, and one that is unlikely to impose a robust ***independent*** check on the Bureau's activities that affect small businesses. Without this Committee's constant oversight, the Bureau may not fulfill its duties under SBREFA.

First, the Bureau itself is responsible for the threshold determination that a proposed regulation is expected to significantly impact a substantial number of small entities, and the terms "significant" and "substantial" are not statutorily defined. Thus, it will in large part be up to the Bureau whether or not a panel is even convened. Moreover, case law has established that agencies may only consider ***direct*** impacts on small businesses in determining whether or not to convene a SBREFA panel, and may not consider indirect "ripple effects"—even those that are reasonably foreseeable.[6]

Second, the Bureau does not have to adopt the panel's recommendations, which are advisory, and need only supply a reasoned explanation for adopting or rejecting them. If the Bureau's leadership is determined to push ahead with a regulation despite its adverse impact on small businesses, this hurdle will not prove difficult to overcome. This Committee's attention to SBREFA panel findings will help the Bureau internalize the recommendations and revise regulatory proposals in conjunction with the panel's advice.

Third, SBREFA covers only the rulemaking process, and those organizing the Bureau have made clear that its preferred method of regulation will be through supervision/examination and enforcement actions. That means that small business considerations need not be taken into account in all, or even most, of the Bureau's activities. We urge the Committee to pay close attention to the Bureau's use of guidance and memoranda that can bypass rulemaking procedures and, thus, bypass SBREFA.

Indeed, actions speak louder than words, and it is noteworthy that those organizing the Bureau appear to be ignoring SBREFA with respect to the significant rulemaking efforts that they have begun. Thus, there is no indication that the Bureau's organizers have initiated the SBREFA process with respect to their proposed reforms of

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[6] *See Mid-Tex Elec. Coop., Inc. v. FERC*, 773 F.2d 327, 342 (D.C. Cir. 1985).

mortgage disclosure forms[7]—even though these changes plainly will affect small businesses. And the same is true with respect to the recently initiated effort to identify the entities that will be subject to the Bureau's supervision authority[8]—even though the supervision program may include registration and other requirements that would be especially burdensome to small businesses and could adversely affect the availability of the forms of consumer credit on which small businesses rely. Those pointing to the SBREFA process as an important check on the Bureau's authority should explain why the Bureau's organizers have failed to follow the SBREFA process thus far.

While the SBREFA requirement did not take effect until the transfer date, there is no reason why voluntary compliance with SBREFA could not have been part of the initial rulemaking processes that the Bureau's organizers have undertaken. That is especially true when—as in the instance of the mortgage disclosure rule—significant decisions have already been made (narrowing the possible approaches to several different disclosure options), decisions that could and should have been illuminated by the information that the SBREFA analysis would provide.

Similarly, there is no reason why the Bureau cannot voluntarily undertake SBREFA-type analysis before extending to small businesses generally legal principles established in the enforcement context.

In February, the Chamber and a number of other trade associations sent a letter to Treasury Secretary Geithner, laying out a series of additional recommendations to guide the Bureau's development and early decisionmaking, with a specific focus on preventing disparate harm to small businesses. The letter requested the Bureau:

1. *Prevent Duplicative and Inconsistent Regulation of Main Street Businesses*

   As of July 21, 2011, the CFPB has broad new authority from other agencies, and should move to quickly clarify lines of jurisdiction to prevent sending mixed and overlapping messages. The CFPB should make clear its relationship with the FTC and the State Attorneys General as required under Dodd-Frank. In addition, the Dodd-Frank Act gives the CFPB the ability to exempt any category of businesses from coverage under the Act. The Bureau should exercise that authority to relieve from regulation under the Act Main Street

[7] *See* CFPB Mortgage Disclosure Team, "Know Before You Owe: We're Back," *available at* http://www.consumerfinance.gov/know-before-you-owe-were-back/(soliciting public comment).

[8] *See* 76 Fed. Reg. 38,059 (June 29, 2011).

businesses with a minimal, and tangential, involvement in the activities that trigger the Act's coverage—as well as to clarify the scope of the Act's exemptions.

The Chamber followed up with a separate letter on June 16th, 2011 to the CFPB and the FTC calling on the agencies to use an open process to establish a bright jurisdictional line between the agencies to prevent duplication and make clear to the regulated community who they should look to for compliance standards. The Bureau should be responsible for enforcement activity for businesses that primarily provide financial services, and the FTC should be responsible for Main Street businesses that offer a financial service as an adjunct to their primary, non-financial business or are a service provider.

2. *Preserve Small Business Access to Credit*

   The CFPB must keep in mind at every stage of its rulemaking and compliance processes that many small businesses access credit the same way individuals do. Preserving options in the financial products market is good for our job creators, so the Bureau's decisions should be tailored carefully to prevent broad outcomes that dry up essential sources of capital.

3. *Ensure Coordination with Federal and State Prudential Regulators*

   Regulation of consumer financial products can have an impact on an institution's safety and soundness, so the CFPB must move quickly to establish a high-level consultation process with the prudential regulators.

4. *Defer Rulemaking Until After Confirmation of a Director*

   To the extent that the Bureau has limited regulatory authority absent a Director in place, we believe that this authority should not be invoked. Congress intended a confirmed Director to make these decisions, not unelected, non-confirmed bureaucrats.

## CONCLUSION

Small Main Street businesses were not to blame for the financial excesses that led to the recession, but they will help lead this country out of the economic wilderness. We need to ensure that regulatory impediments are not thrown in their path needlessly. Regulation always hits small businesses the hardest, but the CFPB can take steps to exclude companies that are only tangentially involved in the financial services sector, or work closely with covered small businesses up front to reduce the heavy burden of regulation and other compliance costs.

Thank you again for the opportunity to testify before the Subcommittee today. The Chamber looks forward to working with Congress and the CFPB to help achieve these objectives. I am happy to answer any questions you may have.

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON

SMALL BUSINESS
SUBCOMMITTEE ON INVESTIGATIONS,
OVERSIGHT AND REGULATIONS

OPEN FOR BUSINESS: THE IMPACT OF THE CFPB ON SMALL BUSINESS

TESTIMONY OF

DANIEL FLEMING

PRESIDENT

FLEMING NATIONALEASE

AND MEMBER OF THE

TRUCK RENTING AND LEASING ASSOCIATION

JULY 28, 2011

My name is Dan Fleming. I am president of Fleming NationaLease based in Springfield, Virginia and our company is a member of the Truck Renting and Leasing Association – or TRALA. I am testifying today on behalf of Fleming NationaLease as well as TRALA and its Industry Council for Vehicle Renting and Leasing.

Fleming NationaLease is a family owned and operated company offering our customers a complete transportation solution. Our services include full service leasing, truck rental, vehicle maintenance and emergency service. Fleming is a small business with 18 permanent employees with locations in Springfield, VA and Landover, MD. We have annual total revenue of approximately $6 million. We are a member of NationaLease, which is one of the largest full service truck leasing organizations in North America, with more than 600 full service locations throughout the U.S. and Canada.

We are also a proud member of TRALA, an association comprised of about 550 companies, employing 100,000 people and operating out of approximately 24,000 locations throughout the United States. One out of every five trucks on the road today is a leased or rented vehicle and our industry purchases over 35% of all new truck equipment in North America.

The nation's truck renting, leasing and sharing industry is an important part of the American economy, supporting jobs and business activity in communities throughout this country. Our industry is on the cutting edge of purchasing the newest technologies and advancements in truck manufacturing. Our industry is also vital to our struggling economy. Because of the limited access to capital and the uncertainties that remain from purchasing new trucks or equipment, companies are more likely to turn to the commercial renting and leasing industry to accomplish their objectives. From this perspective, not only are nearly all of TRALA's 550 members small businesses themselves, but the vast majority of the customers they deal with are also small businesses in search of vehicles and equipment offered for rent or lease at a reasonable price.

Part of the process in acquiring rented or leased vehicles is to fill out an application for credit. This is often done with minimal administrative costs as the applications are straight-forward and if the lessee or renter has the credit scores and financial wherefore all, then we are eager to do business with them.

As written, Section 1071 of Title 10 of the Dodd-Frank Wall Street Reform and Consumer Protection Act adds extensive new business credit applicant data collection requirements to the Equal Credit Opportunity Act (ECOA). These requirements would be offered by and monitored through a new entity called the Consumer Financial Protection Bureau, or CFPB. While I certainly do not operate a bank, under the definitions listed within this new law, I am considered a "financial institution" because I have an application for credit for my customers.

In my opinion and that of TRALA, the Small Business Data Loan Collection provision is:

- Counterproductive
- Contradictory
- Costly
- Confusing

The provision is counterproductive in that the CFPB was created with the intention of giving consumers protection from predatory lenders and allowing them to find more options for information in obtaining a loan, but instead it is now intended to regulate commercial loans and lenders. By forcing more regulations on small businesses that give credit for things as simple as a truck lease or an application at a hardware store, you likely will force some companies out of the business of giving credit altogether.

Section 1071 is contradictory in that the statutory language conflicts with existing language already on the books. My understanding is that Section 202.5 of Regulation B promulgated under the ECOA explicitly says, "A creditor shall not inquire about the race, color, religion, national origin, or sex of an applicant or any other person in connection with a credit transaction..." As a small business owner, I do not want to know this information. The bottom line for Fleming NationaLease is that if the renter or lessee has good credit and meets our company's basic criteria, they can rent or lease a truck from us. I am concerned that if I was to be forced to ask these questions, what happens to me if I do not give a loan to a small business or minority-owned business or woman-owned business? Will I set myself up for litigation? Will I be called into question for discrimination? The personal information that we would be tasked with collecting should have no basis in determining whether or not someone receives a truck from Fleming NationaLease and therefore I have no desire to collect that data.

In terms of cost – and this is always a primary issue with a company such as mine – this could cause a real strain on my bottom line. According to the language in Section 1071, after a lender inquires whether an applicant for a loan is a small business, minority or woman-owned business, no one involved in the credit decision can have access to this information. This would require me – the so-called "lender" under this definition – to completely alter my application process which would be expensive. The information collected could be lengthy as any additional information that the CFPB decides to request, must be fulfilled. This information would have to be maintained and submitted annually to the CFPB and made available to the public upon request.

As I mentioned, Fleming NationaLease is a small truck leasing company. Currently we have one full-time administrative person working for our company and another that works part-time. If

we were to comply with this new regulation, given the complexity and time-consuming extent of the provision, I estimate that we would have to – at a minimum – hire our part-time employee full-time or hire another part-time employee. That could cost our company somewhere between $15,000-20,000 annually. While that may not seem like a lot in the grand scheme of things, I can assure you that my company and our industry as a whole works on razor-thin margins and this constitutes a large investment on my part. For larger companies with computer-generated complex application processes, the cost to comply would be in the hundreds of thousands of dollars. For me, this is money that could be spent hiring another mechanic or purchasing a new vehicle – both of which in turn makes my company more profitable – but instead would be spent on more administrative burdens brought on by CFPB.

Lastly, while I am not an accountant or financial expert, it seems that Section 1071 is extremely confusing and leaves many questions unanswered. I do not yet know what information exactly I am to collect, what definitions would be used to ensure compliance, what actions are required to obtain this information, and what transactions are subject to the new law. In addition, there remains a concern over whether or not the CFPB and the Federal Reserve will work jointly to rectify issues that could remain from an exemption that exists for the auto dealers.

Just to touch on this final point – since Section 1071 of the Dodd-Frank Act amended the ECOA, both the CFPB and the Federal Reserve now have jurisdiction over certain entities such as auto dealers. As with many of the rulemakings required by the Dodd-Frank Act, I believe it is imperative that if these new laws were to be enacted and enforced, regulators must coordinate their implementation of these new requirements. Given the fact that some of the institutions subject to the CFPB's jurisdiction are indirect lenders, such as equipment and vehicle finance companies, the information that they would need to collect and report on under Section 1071 comes from the dealers who are subject to the Federal Reserve's jurisdiction – not CFPB's. Therefore, it would be crucial that the CFPB and the Federal Reserve work to implement these reporting requirements in a harmonious manner in terms of their effective dates and in terms of what data is required to be collected and reported by both entities. If not, financial companies might receive different data than would be required to file with the CFPB and open an entirely new and confusing dilemma.

While I recognize the fact that the CFPB has now decided that it will issue a formal rule that hopefully will address and answer some of the confusing qualities within the law, ultimately I remain unconvinced that there is even a reason to have such a rule implemented in the first place for businesses like my own.

I remain concerned that this commercial provision has no business being in a consumer bureau at all and that the information the CFPB seeks to gain is not consistent with businesses that deal in credit outside of the world of banking. I am not a banker. I lease trucks. To be placed in the

same category with multi-billion dollar financial giants makes absolutely no sense to me. By forcing these regulations down the throat of the small business community, all you will do is force some companies out of the business of issuing credit or make it so much more complicated and expensive that it will be more difficult to grow our companies and industry in the future.

At a time of historic economic uncertainties, making a truck leasing company – or any small business not directly working in the banking industry – comply with Section 1071 is a mistake and I hope this committee and this Congress can put partisan politics aside and realize the unintended consequences that this provision would have on small businesses and stop it before it takes effect in the near future.

I wanted to express my sincere appreciation to this committee for allowing me to come here today and speak to you on this issue. I am happy to answer to the best of my ability any questions you may have.

Thank you.

Sincerely,

Daniel Fleming
President
Fleming NationaLease

GEORGETOWN UNIVERSITY LAW CENTER

***Adam J. Levitin***
*Professor of Law*

**Written Testimony of**

**Adam J. Levitin**
**Professor of Law**
**Georgetown University Law Center**

Before the United States House of Representatives
Committee on Small Business
Subcommittee on Oversight, Investigations, and Regulation

"Open for Business: The Impact of the CFPB on Small Business"

July 28, 2011
1:30 pm

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**Witness Background Statement**

**Adam J. Levitin** is a Professor of Law at the Georgetown University Law Center, in Washington, D.C., where he teaches courses in bankruptcy, commercial law, consumer finance, contracts, and structured finance. He has previously served as the Robert Zinman Scholar in Residence at the American Bankruptcy Institute and as Special Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program (TARP). Before joining the Georgetown faculty, Professor Levitin practiced in the Business Finance & Restructuring Department of Weil, Gotshal & Manges, LLP in New York, and served as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third Circuit.

Professor Levitin holds a J.D. from Harvard Law School, an M.Phil and an A.M. from Columbia University, and an A.B. from Harvard College, all with honors.

Professor Levitin has not received any Federal grants or compensation in connection with his testimony and is not testifying on behalf of any organization.

Mr. Chairman Coffman, Ranking Member Altmire, Members of the Committee:

My name is Adam Levitin, and I am a Professor of Law at the Georgetown University Law Center in Washington, D.C., where I teach courses consumer finance, contracts, and commercial law. I am also a small business owner; I run a consulting business as a sole proprietor.

A signature achievement of the Dodd-Frank Wall Street Reform and Consumer Protection Act was the creation of the new Bureau of Consumer Financial Protection (CFPB). The creation of the CFPB was a much-needed response to a deep flaw in the regulatory architecture that left consumer financial protection an "orphan mission" among federal regulators, consistently subordinated to the protection of bank safety-and-soundness—that is the protection of bank profitability. A dedicated, unconflicted consumer financial protection regulator is necessary not only to deal with the "bad apples" that exist in any market because of the incentives for consumer financial service providers to eschew transparent products and thus strong price competition.

The CFPB will have only tangential contact with small business lending. Yet, concerns have been expressed over the impact the CFPB will have on small business lending, particularly that the CFPB will increase regulatory burdens on financial institutions, especially the small ones that engage in a disproportionate share of small business lending, and that these regulatory costs will be passed on to consumers. The availability of financing is critical for many small businesses to succeed.[1] Unfortunately, there has been a tremendous contraction in small business lending since the financial crisis in 2008. It bears particular emphasis, however, that this contraction was caused not by regulation, but by a failure to regulate.

The failure to adequately regulate consumer credit markets prior to the creation of the CFPB led to a serious spillover effect on small business lending. This is a problem that could easily recur if there is inadequate consumer protection. Put another way, small businesses are finding it hard to obtain credit today not because of the CFPB, but because there wasn't a CFPB. Inadequate regulation can lead to results as bad, if not worse, than excessive regulation. As it happens, however, the CFPB has been created with numerous safeguards to ensure against unnecessarily burdensome regulations.

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[1] It is important to note that many small businesses do not rely on financial institution credit. 40% of small businesses either use no credit whatsoever or use only trade credit. Rebel Cole, *Bank Credit, Trade Credit or No Credit: Evidence from the Surveys of Small Business Finances*, report written for the SBA Office of Advocacy under contract number SBAHQ-08-M-0464 (June 2010) at 31, *at* http://archive.sba.gov/advo/research/rs365tot.pdf. *See also* Board of Governors of the Federal Reserve, Report to the Congress on the Use of Credit Cards by Small Businesses and the Credit Card Market for Small Businesses (May 2010), at 1 (noting that 64% of small firms—those with under 50 employees—used business credit cards in 2009). Relatedly, while many small businesses use credit cards, very few of them actually use the cards for their credit function, rather than their payment function. Only 18% of small businesses revolve balances on their cards, with 12% borrowing on personal cards and 12% borrowing on business cards. Board of Governors of the Federal Reserve, Report to the Congress on the Use of Credit Cards by Small Businesses and the Credit Card Market for Small Businesses (May 2010), at 1-2. The others use them for transacting, where they provide liquidity, convenience, and accounting benefits.

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## I. The CFPB Has Very Limited Jurisdiction Over Small Business Financial Products

As an initial matter, it is important to note that the CFPB cannot regulate non-financial businesses of any size,[2] and that it has very limited authority to regulate small business financial products. The sole areas in which the CFPB has jurisdiction are a pair of seldom-invoked provisions of the Truth in Lending Act prohibiting the issuance of unsolicited credit cards[3] and limiting liability of employees to card issuers for unauthorized business card usage[4] and the Equal Credit Opportunity Act (ECOA), which prohibits various discriminatory lending practices,[5] and which was amended by the Dodd-Frank Act to include a data collection provision on small business lending.[6] This means that the CFPB can engage in only very limited regulation of small business financial products, and then primarily to ensure against discriminatory lending, rather than to regulate the terms and conditions of financial products.

The concerns about the CFPB's impact on small business credit, however, are generally not about direct regulation. Instead, they are focused on the possibility that the CFPB will impose additional regulatory costs on small business lenders, who will then pass those costs along to small businesses. These costs must, of course, be weighed against the benefits; it is often too easy to focus on regulatory costs and ignore the benefit side of the scale. As the next section details, however, there are numerous safeguards to protect against excessive regulatory burdens on these lenders.

## II. Numerous Safeguards Protect Against Excessive Regulatory Burdens on Small Business Lenders

The Consumer Financial Protection Act does not, in itself, increase regulatory costs for small business lenders other than through the addition of a data collection provision under the Equal Credit Opportunity Act.[7] While this will impose some costs of lenders, they are comparable to those under the Home Mortgage Disclosure Act, which have not been particularly burdensome and which have been critical for rooting out discriminatory lending and for making mortgage markets more transparent and efficient.

This provision aside, the Consumer Financial Protection Act transfers 18 federal statutes (the "enumerated consumer laws") and the existing regulations thereunder to the CFPB.[8] This transfer does not increase regulatory burdens. The CFPB could add further regulations under these statutes, but so too could the agencies that previously administered them, and these regulations much each be judged on their own merits.[9]

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[2] P.L. 111-203, § 1027(a), 124 Stat. 1376, 1995-1998, July 21, 2010, *codified at* 12 U.S.C. § 5517(a).

[3] 15 U.S.C. § 1642.

[4] 15 U.S.C. § 1645.

[5] 15 U.S.C. § 1691 *et seq.*

[6] Pub. L. 111-203, § 1071, 124 Stat. 1376, 2056-2057, July 21, 2010.

[7] Pub. L. 111-203, § 1071, 124 Stat. 1376, 2056-2057, July 21, 2010.

[8] Pub. L. 111-203, §§ 1002(12), 1061, 124 Stat. 1376, 1957, 2035-2039, July 21, 2010.

[9] While we often speak of "too much" regulation, the issue is seldom the number of regulations, as much as their substance. It is not a case where 11 regulations is too many, 9 too few, and 10 just right, but a case where what matter are the right regulations, not the number.

The Consumer Financial Protection Act also gives the CFPB organic rulemaking power, including the ability to proscribe acts and practices as "unfair," "deceptive," or "abusive."[10] Such regulations must comply with detailed statutory requirements, however, and are subject to review under the Administrative Procedures Act. As with regulations under the existing federal consumer protection laws, the CFPB's use of its organic rule-making power must be evaluated on a one-off basis, as actual rules are promulgated. As discussed below, however, there are several safeguards to ensure that these rules do not overly burden small business lenders.

First, the Consumer Financial Protection Act exempts small banks and credit unions from CFPB supervision and enforcement. The CFPB has no authority to supervise smaller banks and credit unions with less than $10 billion in assets or to enforce Federal consumer laws regarding compliance by these small depository institutions.[11] Instead, existing prudential regulators—the Federal Deposit Insurance Corporation, the Federal Reserve, the Office of Comptroller of the Currency, and the National Credit Union Administration— handle these duties. Non-bank lenders and leasers will be subject to CFPB examinations; these institutions were previously exempt from any federal examination authority, but the Consumer Financial Protection Act has leveled the regulatory playing field.

Second, a major objective of the Consumer Financial Protection Act is the reduction in regulatory burdens. The CFPB is required to identify and address "unduly burdensome regulations," which are a particular concern of smaller financial institutions.[12] As part of these safeguards against unduly burdensome regulation, the CFPB is required to:

- Consult with prudential regulators and State bank regulators in order to minimize the regulatory burden upon lending institutions.[13]
- Consult with the prudential regulators of small banks and credit when proposing regulations.[14] The prudential regulators are permitted to formally object to the rules and their written objections must be included in the rule-making record, along with the Bureau's response to their concerns.[15]
- Evaluate the potential impact of rules on small businesses under the Regulatory Flexibility Act.[16]
- Give small businesses a preview of new proposals and receive extensive feedback from small businesses before even giving notice to the broader public (under the Small Business Regulatory Enforcement Fairness Act).[17]
- Assess possible increases in the cost of credit for small entities and consider any significant alternatives that could minimize those costs.[18]
- Assess the effectiveness of each rule within five years of implementation, including soliciting public comments on whether to change or eliminate the regulations.[19]

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[10] P.L. 111-203, § 1031, 124 Stat. 1376, 2005-2006, July 21, 2010, *codified at* 12 U.S.C. § 5531.

[11] Pub. L. 111-203, §§ 1025, 1026(d)(1), 124 Stat. 1376, 1990-1994, July 21, 2010.

[12] Pub. L. 111-203, §1021(b)(3), 124 Stat. 1376, 1980, July 21, 2010.

[13] Pub. L. 111-203, §1024(b)(2)-(3), 124 Stat. 1376, 1987-1988, July 21, 2010.

[14] Pub. L. 111-203, §1022(b)(2)(B), 124 Stat. 1376, 1981, July 21, 2010.

[15] Pub. L. 111-203, §1022(b)(2)(C), 124 Stat. 1376, 1981, July 21, 2010.

[16] Pub. L. 111-203, §1100G, 124 Stat. 1376, 2112-2113, July 21, 2010.

[17] P.L. 111-203, § 1100G, 124 Stat. 1376, 2112, July 21, 2010; 5 U.S.C § 609; Executive Order 12866 of September 30, 1993.

[18] P.L. 111-203, § 1100G, 124 Stat. 1376, 2112, July 21, 2010.

No other financial regulator must comply with these mandates. These requirements are likely to add at least six months to the rule-making process.

Third, CFPB rulemakings are subject to an unprecedented veto authority. If any member agency of the Financial Stability Oversight Council (FSOC) objects to a proposed CFPB regulation, it can petition the FSOC to get it removed. The FSOC can stay or set aside any regulation passed by the CFPB that it deems to interfere with the "safety and soundness" of the U.S. financial or deposit insurance system.[20] No other agency can have its rules overridden by other federal regulators.

Finally, the CFPB also has the authority to exempt any consumer financial services provider—including small banks and credit unions that provide a disproportionate percentage of small business lending—from its rules.[21]

In short, there are numerous safeguards to ensure that the CFPB does not create excessively burdensome regulations for small business lenders. As the next section details, the CFPB may actually be able to help small businesses in some indirect ways.

**III. The CFPB Can Help Small Businesses**

Many small businesses rely on consumer credit for financing. Many small businesses use consumer credit cards for business transactions,[22] and small business owners often giver personal guarantees of business loans, post their homes as collateral for business loans, or use home equity lines of credit or cash-out mortgage refinancings to finance their businesses. When small business owners use consumer credit, they need, deserve, and want the same protections as other consumers. Thus, small business advocates, such as the National Small Business Association (NSBA) have vigorously advocate for the extension of consumer credit protections to small business credit cards.[23] The NSBA has advocated for the extension of the Credit CARD Act's protections to business credit cards issued to employers with 50 or fewer employees and increasing the TILA exemption for credit cards with limits of $25,000 up to $50,000. As the NSBA has noted, it is "inconceivable that Congress would knowingly allow issuers to perpetuate—with impunity—practices recognized as "unfair" and "deceptive" against America's small-businesses."[24] While the CFPB cannot extend statutory protections to nonconsumer financial products, it can ensure optimal protections for consumer credit products, irrespective of their use. In particular, all consumers, including small business owners, benefit from fair and transparently priced products that they can compare on an apples-to-apples basis. Thus, the CFPB can help small businesses that use consumer credit products by encouraging greater price transparency among financial products.

The CFPB can also help small businesses by helping their consumers. Consumer credit fuels the economy and a fairer and more transparent consumer credit marketplace will result in

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[19] P.L. 111-203, § 1022(d), 124 Stat. 1376, 1984-1985, July 21, 2010.

[20] P.L. 111-203, § 1023, 124 Stat. 1376, 1985-1987, July 21, 2010.

[21] P.L. 111-203, § 1022(b)(3)(A), 124 Stat. 1376, 1981, July 21, 2010.

[22] *See* Board of Governors of the Federal Reserve, Report to the Congress on the Use of Credit Cards by Small Businesses and the Credit Card Market for Small Businesses (May 2010), at 1 (83% of small businesses used credit cards, 64% used small business cards and 41% used personal cards).

[23] NSBA Issue Brief, *Credit Card Reform, at* http://nsba.biz/docs/2011/Credit_Card_Reform.pdf.

[24] *Id.*

greater consumer confidence and less volatility in consumer spending. All of this helps small businesses, which want consumers to be able to make purchases without having to worry about whether they will fall victim to hidden terms or billing tricks and traps from their financial services provider. Similarly, by protecting against consumer credit bubbles fueled by unsustainable underwriting, the CFPB can help reduce volatility in consumer spending, which would create a more stable economic environment for small businesses.

**IV. Conclusion**

The CFPB has only opened for business in the past week. While Congress must remain diligent about balancing regulatory burdens and benefits, the Consumer Financial Protection Act is replete with safeguards to ensure against overly burdensome regulation by the CFPB. These safeguards can always be reexamined in the future if they prove inadequate, but it is important to give the CFPB a chance to do its job before contemplating changes to its structure or authority.

July 28, 2011

# Community Bank Perspective on the CFPB and Small Business

On behalf of its nearly 5,000 community bank members, ICBA is pleased to submit this statement for the record for the House Small Business Subcommittee on Investigations, Oversight, and Regulations July 28 hearing titled: "Open for Business: The Impact of the CFPB on Small Business."

ICBA is concerned about the potential impact of the CFPB on community banks' ability to provide credit to small businesses. Community banks are small businesses themselves and are prodigious small business lenders. They provide small business credit in good times as well as challenging times – supporting the sector responsible for more new job creation than any other. In his recent speech before the ICBA annual convention, Federal Reserve Chairman Ben Bernanke shared new Federal Reserve Bank research that shows that while overall small business lending contracted during the recent recession, lending by a majority of small community banks (those of less than $250 million in assets) actually increased. By contrast, small business lending by the largest banks dropped off sharply. The viability of community banks is linked to the success of their small business customers in the communities they serve, and they don't walk away from them when the economy tightens.

Community banks have sharply different business models than the Wall Street firms, mega-banks, or shadow non-bank financial firms. Community banks did not cause the financial crisis or engage in abusive consumer practices or the sub-prime lending fiasco. Community banks have a much different risk profile because their business model is built on integrity and long-term customer relationships, and they cannot succeed without a reputation for fair treatment. They make loans often passed over by the large banks because community bankers' personal knowledge of the borrower gives them firsthand insight into the true credit quality of a loan, in stark contrast to a statistical model used by a large bank in another state or region of the country. These localized credit decisions, made one-by-one by thousands of community bankers nationwide, will help restore the flow of credit and our economic strength.

**Consumer Financial Protection Bureau**

While we are pleased the Dodd-Frank Act allows community banks with less than $10 billion in assets to continue to be examined by their primary regulators, ICBA remains concerned about CFPB regulations, to which community banks will be subject. ICBA strongly opposed provisions in the Dodd-Frank Act that excluded the prudential banking regulators from the CFPB rule-writing process. Bank regulators are in the best position to balance the safety and soundness of banking operations with the need to protect consumers from unfair and harmful practices and provide them with the information they need to make informed financial decisions.

ICBA believes that legislation recently passed by the House would address key ICBA concerns with the CFPB structure. The Consumer Financial Protection Safety and Soundness



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Improvement Act (H.R. 1315) would improve the CFPB structure so that it is governed by a five-member commission rather than a single director. ICBA has pressed for a commission structure from the very beginning of the CFPB debate. Commission governance would allow for a variety of views and expertise on issues before the CFPB and thus build in a system of checks and balances that would be absent in a single director form of governance. It would help ensure the actions of the CFPB are measured and non-partisan and would result in balanced, high-quality rules and effective consumer protection.

The legislation would also strengthen prudential regulatory review of CFPB rules by reforming the voting requirement for an FSOC veto from a 2/3rd vote to a simple majority, excluding the CFPB Director, and change the standard to allow for a veto of a rule that "is inconsistent with the safe and sound operations of United States financial institutions."

Additionally, the bill would postpone transfer of functions to the CFPB until its Director is confirmed. The CFPB's impact on the financial sector, consumers, and the economy should be matched by the highest standard of accountability. Ultimately, accountability for the actions of the CFPB resides with its Director, appointed by the President and confirmed by the Senate. This basic mechanism of good governance would be undermined if the CFPB were to be operative before its Director is confirmed by the Senate. Given the responsibilities of the CFPB, the agency must have someone in place, on point, and accountable for the actions and activities of this new agency.

Taken together, ICBA believes the provisions of H.R. 1315 would strengthen the accountability of the CFPB, better protect the safety and soundness of the financial system, and provide reasonable measures to insulate community banks from additional regulatory burden.

Community banks are already required to spend significant resources complying with voluminous consumer protection statutes. CFPB rules should not add to these costs. Notably, the Dodd-Frank Act gives the CFPB authority to exempt any class of providers or any products or services from the rules it writes considering the size of the entity, the volume of its transactions and the extent to which existing law already has protections. ICBA urges the CFPB to effectively use this authority to grant broad relief to community banks and/or community bank products where appropriate.

**Communities First Act**

The ICBA-backed Communities First Act (CFA, H.R. 1697) captures many reforms the community banking sector deems necessary to address the difficult and costly regulatory burden they face, including a change to the FSOC veto standard for CFPB rules, very similar to H.R. 1315 discussed above. This legislation was recently introduced in the House and cosponsored by members from both sides of the aisle. ICBA is working to introduce a similar bill in the Senate. Notably CFA would:

- Increase the threshold number of bank shareholders from 500 to 2,000 that trigger SEC registration. Annual SEC compliance costs are a significant expense for listed banks.
- Require the SEC to conduct a cost/benefit analysis for any proposed accounting change.
- Provide relief from new Dodd-Frank data collection requirements in connection with loan applications.
- Extend the 5-year net operating loss (NOL) carryback provision to free up community banks capital now when it is most needed to boost local economies.
- Allow Subchapter S community banks to better raise capital by updating shareholder limit and restriction rules.

These and other provisions would improve the regulatory environment and community bank viability to the benefit of their customers and communities.

CFA was also introduced and advanced during the 109th and 110th Congresses and gained bi-partisan support. In the 110th Congress, CFA was introduced in the House by then-Small Business Committee Chairwoman Nydia Velazquez (D-NY). We urge all members of Congress interested in helping small businesses access the credit they need to support the CFA.

**Closing**

ICBA thanks the House Small Business Committee for its ongoing commitment to small businesses and the community banking sector that partners with them to ensure they have the credit they need to grow, thrive, and create jobs.

Community banks face significant regulatory challenges. The legislation highlighted above – H.R. 1315 and H.R. 1697 – will help to alleviate some of these challenges so that community banks can better serve our communities and promote the economic recovery – a goal we share with this committee.