Patterns of Disparity:
Small Business Lending in Fresno and Minneapolis-St. Paul Regions

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Pictured on the cover is Lonnie McQuirter, a member of Main Street Alliance and owner of 36 Lyn Refuel Station, a convenience store in Minneapolis, MN.

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EXECUTIVE SUMMARY

Small, local businesses create economic opportunity within neighborhoods, increase local employment opportunities, and generate higher levels of income growth within neighborhoods. For small neighborhood businesses to start and to grow, they need access to capital. Bank loans to businesses are an important element for success because businesses that have access to adequate levels of capital grow more rapidly, hire more workers, and make more investments than businesses that do not have access. Since the Great Recession, mainstream financial institutions have reduced their small businesses lending, leading some businesses to resort to alternative, non-bank financial technology (fintech) lenders for needed capital. While small businesses could potentially benefit from having an additional source of capital that fintech lenders provide, many of those new lenders only provide loans with exceedingly high interest rates, onerous terms, and relatively poor customer service.

This report is the final in a series of four reports on bank lending to small businesses. A variety of cities and regions were selected from across the United States to determine whether systemic problems exist or whether problems related to declines and disparities in lending are isolated. Earlier reports covered the following regions: Chicago, Illinois; Los Angeles/San Diego, California; Buffalo, New York; New Brunswick, New Jersey; Detroit, Michigan; and Richmond, Virginia.

This report examines bank lending to businesses in the Fresno County, California, and the Minneapolis-St. Paul, Minnesota, regions. The purpose is to determine the extent to which banks are meeting the credit needs of small businesses throughout those two regions. The focus of the report is on the smaller value loans under $100,000 that are most likely to support smaller, local businesses that provide employment and wealth-building opportunities for local residents.

Findings:

- Small business lending nationally grew rapidly between 2001 and 2007, dropped dramatically between 2007 and 2010, and then increased slowly through 2015 according to data reported under the Community Reinvestment Act (CRA). Overall, the total number of loans in 2015 was down over 56 percent from the peak in 2007 and down by three percent since 2001, while the total dollar amount of loans decreased by 33 percent between 2007 and 2015 and is still slightly lower than the total in 2001.

- The number of CRA-reported loans under $100,000 nationally in 2015 remained 58 percent lower than in 2007 and two percent lower than in 2001, while the total dollar amount of those loans decreased nearly 47 percent from its peak in 2007 but rose by 16 percent, from $67.0 billion to $77.9 billion, between 2001 and 2015.

- The number of CRA-reported loans nationally to small businesses with gross revenues under $1 million was just 15 percent higher in 2015 than in 2001, but 41 percent lower than the peak in 2007, while the total dollar amount of those loans in 2015 was down over 41 percent from the amount in 2007 and down 21 percent since 2001.

- Between 2008 and 2015, the number of CRA-reported loans under $100,000 to businesses in the Fresno region dropped by over 45 percent, while the total dollar amount of those loans dropped by over 37 percent. In the Minneapolis-St. Paul region, the number of CRA-reported loans under $100,000 dropped by just under 40 percent between 2008 and 2015, while the total dollar amount of those loans dropped by over 38 percent.

- Nationally, businesses in low-income census tracts comprised an average of 9.3 percent of all businesses for the period 2012-2015, but they received only 4.7 percent of CRA-reported bank loans under $100,000 and only 4.9 percent of the total dollar amount of those loans. If those businesses had received loans in proportion to their share of businesses overall, they would have received over 687,600 more loans totaling over $8.8 billion more than they actually received between 2012 and 2015.

- In the Fresno region, businesses in low-income census tracts constituted an average of 16.3 percent of all businesses in the region between 2012 and 2015, but they received only 7.1 percent of CRA-reported bank loans under $100,000 and 7.4 percent of the total dollar amount of those loans during that period. If those businesses had received loans in proportion to their share of all businesses in the Fresno region, they would have received over 4,100 more loans totaling over $56 million more than they received between 2012 and 2015.

- In the Minneapolis-St. Paul region, businesses in low-income census tracts constituted an average of 7.6 percent of all businesses in the region between 2012 and 2015, but they received only 3.6 percent of the number of CRA-reported bank loans under $100,000 and 3.2 percent of the dollar amount of those loans during that period. If those businesses had received loans in proportion to their share of all businesses, they would have received over 9,200 more loans totaling over $130 million more than they received between 2012 and 2015.

- In the Fresno region, businesses in predominantly minority census tracts constituted an average of 31.0 percent of businesses in the region between 2012 and 2015, but they received only 18.4 percent of the number of CRA-reported loans under $100,000 and only 18.5 percent of the total dollar amount of those loans during that period. If those businesses had received loans in proportion to their share of businesses overall, they would have received just under 5,700 additional loans totaling nearly $79 million between 2012 and 2015.

- In the Minneapolis-St. Paul region, businesses in majority or predominantly minority census tracts constituted an average of 9.1 percent of businesses in the region between 2012 and 2015, but they received only 5.1 percent of the number of CRA-reported loans under $100,000 and only 4.3 percent of the total dollar amount of those loans during that period. If those businesses had received loans in proportion to their share of businesses overall, they would have received over 9,300 additional loans totaling more than $143 million between 2012 and 2015.

Recommendations for Policymakers:

- **Require all small business lenders (bank and non-bank) to report race and gender of loan applicants and other relevant data.** Under Section 1071 of the Dodd-Frank Act, the CFPB should require small business lenders to report the type of lender, the loan amount requested, the type of loan requested (e.g., term loan, credit card, or merchant cash advance), the action taken on the application, the amount loaned, the Annual Percentage Rate on the loan, whether the loan is payable by Automated Clearing House (ACH) debit, and the lender's default rates, in addition to any borrower demographics and business attributes necessary for fair lending analysis.

- **Investigate potential discrimination.** The disparities revealed in this report, in the earlier reports on business lending in the Chicago, Los Angeles-San Diego, Buffalo, New Brunswick, Detroit, and Richmond regions, and other research on business lending suggest the need for further investigation to determine whether business lenders are complying with the Equal Credit Opportunity Act and providing credit on a non-discriminatory basis to applicants. If further analysis shows violations, both the CFPB and Department of Justice (DOJ) should act to remedy those violations.

- **Strengthen enforcement of existing laws on community investments by banks.** CRA examiners need to be more stringent in the scoring of performance with respect to all types of lending, including small business loans, as well as mortgages and other personal loans. Examiners also need to consider the type of small business loans banks offer, rather than aggregating term loans, lines of credit, and credit cards into a single category. In addition to the lending test, regulators should be more critical in enforcement of the investment and service tests. Regulators should exercise their authority to require banks to obtain non-objection letters from their regulator whenever seeking to close branches in low- and moderate-income neighborhoods.

- **Require non-bank lenders to serve and invest in their communities.** Federal regulators have taken steps to begin chartering non-bank lenders. A federal charter will provide significant benefits to the emerging fintech industry, and, in exchange for those benefits, federal charters for fintech lenders must have financial inclusion requirements and regular opportunities for review and community input, strong protections to reduce the chances that lenders can make predatory loans, and provide the same level of oversight for fintech lenders as for the banks with which they compete or partner. Fintech lenders who receive a federal charter should also be required to report the same data as lenders reporting data to the CFPB under Section 1071 of the Dodd-Frank Act.

- **Support and increase funding for government programs that support lending to underserved communities.** Both Community Development Financial Institutions (CDFIs) and the New Markets Tax Credit (NMTC) program are important sources of business capital in lower-income neighborhoods and communities of color and need to be expanded to increase the level of investment they bring to their service areas.

- **Pass local laws to reward banks that lend to businesses in low- and moderate-income neighborhoods and communities of color.** Local governments should use responsible banking

ordinances that link government bank deposits to community reinvestment performance to encourage financial institutions to make more small loans to businesses in low- and moderate-income neighborhoods and communities of color.

- **Require banks seeking to merge or acquire other banks to commit to increased investment in low- and moderate-income communities.** Mergers and acquisitions present good opportunities for regulators to use their authority under the CRA to require banks to fully meet their obligations to invest in low- and moderate-income census tracts. Previously negotiated community benefit agreements (CBAs) with banks seeking regulatory approval for mergers or acquisitions can serve as performance models for the future.

- **Extend consumer protections to small business loans.** Business borrowers, most of whom assume personal liability for repayment of loans to their businesses, should receive the same types of protections for small business loans as they would receive were the loans for personal use. Lenders should be required to disclose the loan terms clearly, in a way that enables the borrower to understand the cost of the loan and repayment terms; to determine the borrower's ability to repay the loan without additional borrowing; and be prohibited from engaging in abusive collection practices.

Recommendations for Banks:

- **Ensure equal treatment of loan applicants.** Banks should require compliance and fair lending teams to actively take steps to ensure consistency in the delivery of small business products and services. The disparities in lending to borrowers in communities of color identified in this series of reports, and the evidence of small business loan officer discrimination against and discouragement of small business loan applicants from protected classes highlighted in other research reports, raise serious fair lending concerns. Bank training of small business loan officers should emphasize consistent and fair treatment of all loan applicants including, for example, how loan officers offer business cards and assistance or make referrals. Banks should also conduct periodic internal mystery shopping using testers of various backgrounds and protected classes, such as race, ethnicity, national origin, gender, and marital status, to ensure that applicants of different backgrounds receive the same levels of products, services, and assistance. Considering the extent to which lending and banking continues to become more automated, banks should also test their systems to guard against algorithmic bias or other processes that might have a disparate impact on protected classes.

- **Support nonprofit organizations that conduct fair lending training and testing, or fair lending research and advocacy.** The disparities in lending to borrowers in low- and moderate-income communities identified in this series of reports raise concerns about the extent to which banks are meeting their obligations under the CRA to serve the credit needs of low- and moderate-income people and communities, consistent with safety and soundness. Banks should consider supporting nonprofit organizations that conduct fair lending training and testing, or fair lending research and advocacy. To the extent that bank grants or investments in fair lending training, testing, research, and advocacy primarily benefit low- and moderate-income persons and communities, banks can receive favorable consideration under the CRA investment or community development tests.

Introduction – Small, local businesses create economic opportunity within neighborhoods. Local businesses can increase employment opportunities for people living nearby, and that can, in turn, produce higher levels of income growth within the neighborhood. In addition to employment and income, local businesses generate sales tax revenue, provide access to goods and services for neighborhood residents, and can attract new residents to the community.[1] Local businesses also generate more economic impact for the neighborhood than national chains. "For example, a study by the Maine Center for Economic Policy found that every $100 spent at locally owned businesses generates $58 in local impact, while the same amount spent at a national chain store generates only $33 in local impact."[2] A study of the Opportunity Fund's small business microloan program found that it generated nearly $2 of economic activity for every $1 loaned, including about $0.56 in additional wages for the workers at the businesses that received a loan.[3]

Local businesses can also provide residents with a means of wealth building: entrepreneurship. "[S]mall business ownership provides an opportunity for minorities, women, and immigrants to increase their income and independence and to move into the economic mainstream of the American economy."[4] While people of color and women are still under-represented as a percentage of business owners, they did become a larger share of all business owners between 2007 and 2012.[5] "Data from the Kauffman Foundation's Index of Startup Activity indicates that in 2015, 39.3 percent of new entrepreneurs were non-white, compared with 22.8 percent in 1996."[6]

For small neighborhood businesses to grow, they need to be able to access capital. Some business owners have personal assets, such as home equity or investments, or personal lines of credit that they can tap to meet the needs of their businesses. Over 90 percent of small employer firms[7] use the owner's personal credit score when applying for financing, and over two-thirds provide a personal guarantee to secure their debt.[8] Others may be able to borrow from family or

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[1] Bahn, Kate, Regina Willensky, and Annie McGrew, 2016. *A Progressive Agenda for Inclusive and Diverse Entrepreneurship*. Center for American Progress. Downloaded October 15, 2016, from https://www.americanprogress.org/issues/economy/report/2016/10/13/146019/a-progressive-agenda-for-inclusive-and-diverse-entrepreneurship/

[2] Ibid., at p. 5, citing Amar Patel and Garrett Martin, *Going Local: Quantifying the Economic Impacts of Buying from Locally Owned Businesses in Portland, Maine* (Augusta, ME: Maine Center for Economic Policy.)

[3] TXP, Inc., 2016. *Ripple Effect: The Macroeconomic Impact of Small Business Lending, A case study of Opportunity Fund's Small Business Microloan Program from 1995 to 2015.* Downloaded October 17, 2016, from https://www.opportunityfund.org/assets/docs/Ripple%20Effect_The%20Macroeconomic%20Impcact%20of%20Small%20Business%20Lending_Opportunity%20Fund_2016.pdf.

[4] Dilger, Robert Jay, 2013. *Small Business Administration and Job Creation*. Congressional Research Service 7-5700, www.crs.gov.

[5] Bahn et als., 2016, p. 10.

[6] Klein, Joyce A., 2017. *Bridging the Divide: How Business Ownership Can Help Close the Racial Wealth Gap*, Washington, DC: The Aspen Institute, p. 7.

[7] Small employer firms are those with at least one employee other than the owner, fewer than 500 employees, and with annual revenue of less than $1 million.

[8] *2016 Small Business Credit Survey: Report on Employer Firms*. 2017. Downloaded April 12, 2017, from https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-EmployerFirms'-2016.pdf?utm_source=Atlanta+Fed+E-mail+Subscriptions&utm_campaign=2c795a9689-small-business-survey-2017-04-12&utm_medium=email&utm_term=0_b7a27f0b85-2c795a9689-258652333. The survey was conducted

friends. Those personal sources of capital, however, may not be able to provide the amount needed for entrepreneurs in low- and moderate-income neighborhoods or communities of color because those borrowers are less likely to have significant equity in their homes or other assets that can be used to support a business.[9] The downturn in the housing market due to the Great Recession and lack of recovery in some lower-income neighborhoods and communities of color have exacerbated the situation by leaving many homeowners underwater, with negative equity in their homes,[10] depriving them of the equity they may have accumulated before the crash that could have been used to support a business.

Apart from personal wealth, common sources of capital for small businesses are loans, lines of credit, and business credit cards issued by banks and other financial institutions.[11] Bank loans to businesses are an important element for success because businesses that have access to adequate levels of capital grow more rapidly, hire more workers, and make more investments than businesses that do not have access.[12] Conversely, a decline in the availability of bank loans for businesses, especially smaller businesses, has been a serious impediment to the recovery of lower-income neighborhoods and communities of color, which were most adversely affected by the Great Recession.[13] Although some economists question the impact of bank loans on the net long-term growth of jobs throughout the national economy,[14] bank loans can have important local benefits, which is why they are frequently seen as a tool to promote the local job growth necessary for neighborhood recovery and prosperity.

Since the Great Recession, mainstream financial institutions have been reluctant to make small loans to businesses.[15] In response to the difficulty of accessing capital from banks, businesses have increasingly been resorting to alternative, non-bank financial technology (fintech) lenders for needed capital, especially smaller businesses. Twenty-six percent of small employer firms reported applying for capital from a fintech lender, compared with only 12 percent of larger

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by the Federal Reserve Banks of Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, Minneapolis, New York, Philadelphia, Richmond, St. Louis, and San Francisco.

[9] Ibid. See also Fairlie, Robert W., and Alicia M. Robb, 2010. *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs*. Washington, DC: U.S. Department of Commerce, Minority Business Development Agency, 2010. Downloaded December 13, 2016, from http://www.mbda.gov/sites/default/files/DisparitiesinCapitalAccessReport.pdf. See also Robb, Alicia, 2013. *Access to Capital among Young Firms, Minority-owned Firms, Women-owned Firms, and High-tech Firms*. Washington, DC: Small Business Administration, 2013. Downloaded December 13, 2016, from https://www.sba.gov/sites/default/files/files/rs403tot(2).pdf.

[10] Cowan, Spencer and Katie Buitrago. *Struggling to Stay Afloat: Negative Equity in Communities of Color in the Chicago Six County Region.* Woodstock Institute, March 2012.

[11] Business loans, lines of credit, and business credit cards are collectively reported to the Federal Financial Institutions Exanimation Council (FFIEC), which oversees financial institution reporting to regulatory agencies, as "loans." For consistency, this report will, therefore, use the term "loan" to refer to extensions of credit to businesses that would be reported as a loan to the FFIEC.

[12] Cole, Rebel A., 2012. *How Did the Financial Crisis Affect Small Business Lending in the United States*. A report prepared for the Small Business Administration, Office of Advocacy. Downloaded April 11, 2014, from www.sba.gov/advocacy.

[13] Mills, Karen G., and Brayden McCarthy, 2014. "The State of Small Business Lending: Credit Access During the Recovery and How Technology May Change the Game." Harvard Business School Working Paper, No. 15-004, July 2014. See also Cowan and Buitrago, 2012, and Fairlie and Robb, 2010.

[14] Dilger, 2013.

[15] Mills and McCarthy, 2014.

employer firms.[16] The business models for fintech lenders vary, from direct providers of capital to intermediaries (or "marketplace lenders") that connect borrowers with lenders, and include both online lenders and merchant cash advance companies.[17] A California Department of Business Oversight survey of 13 online lenders found that their total business lending nationally increased from 12,868 loans totaling $403 million in 2010 to 240,277 loans totaling $2.94 billion in 2014, an increase of over 1,700 percent in the number and about 630 percent in the total dollar amount of loans.[18] The amount of loans the 13 alternative lenders made nationally in 2014 was 29 percent more than the Small Business Administration made in loans of under $150,000 in FY 2015 through its 7(A) program.[19] Another report stated that marketplace lenders in the United States originated 60 percent more in loans in 2015 than they did in 2014.[20]

While small businesses could potentially benefit from having an additional source of capital from fintech lenders, many of those new lenders only provide loans with high interest rates, onerous terms, and relatively poor customer service. Woodstock Institute's analysis of 15 business loans and Merchant Cash Advances found interest rates ranging from 26 to nearly 368 percent. Every loan with a repayment term of under 250 days, or eight months, had an effective interest rate of over 100 percent, and every loan with a repayment period of less than 150 days, or five months, had an effective rate of over 200 percent.[21] The Opportunity Fund study of 150 fintech loans taken out by 104 businesses in California coming to it to refinance those loans had similar findings; the average interest rate on the loans it analyzed was 94 percent, with a high of 358 percent.[22] Moreover, the Opportunity Fund analysis showed that the average monthly payment on the loans was 178 percent of the net income of the borrower available to pay the loans. As the report states, ". . . every month these borrowers owed more to the lender than they had available from both business and personal net income."[23] A recent survey conducted by the California Reinvestment Coalition (CRC) reveals that high cost, nonbank online lenders are filling the credit void left by big banks that are retreating from small business lending, especially

[16] *2016 Small Business Credit Survey: Report on Employer Firms.*

[17] A merchant cash advance differs from a traditional business loan in the way it is repaid. With a merchant cash advance, the business borrower assigns a percentage of its receipts to the lender instead of making periodic payments of a fixed amount. For example, a business might agree to pay 15 percent of its credit card receipts, up to a total of $56,000, for a cash advance of $38,830, with the payments made every business day until the lender received the full $56,000.

[18] *Survey of Online Consumer and Small Business Financing Companies – 01/01/2010 through 06/30/2015: Summary Report of Aggregate Transaction Data*, available at *www.dbo.ca.gov/Press/press_releases/default.asp*, under the headline California Online Lending Grows by More Than 930% Over Five Years, dated 04/08/2016.

[19] The data are from www.sba.gov/content/sba-lending-statistics-major-programs-09-30-2015, reported on the federal fiscal year. FY 2015 ran from October 1, 2014, to September 30, 2015.

[20] Bulling, Jim, and Michelle Chasser, 2016. *Regulator's notice small business loans are big business.* Downloaded October 17, 2016, from https://www.fintechlawblog.com/2016/07/regulators-notice-small-business-loans-are-big-business/.

[21] The small sample size, 15 loans, and the fact that the loans were not a random sample from a larger population, means that the data provide only descriptive statistics of the specific sample and are not generalizable to the larger field of fintech loans as a whole.

[22] Weaver, Eric, Gwendy Donaker Brown, Caitlin McShane, and Tim St. Louis, 2016. *Unaffordable and Unsustainable: The New Business Lending on Main Street.* Opportunity Fund. Downloaded October 17, 2016, from http://www.opportunityfund.org/assets/docs/Unaffordable%20and%20Unsustainable-The%20New%20Business%20Lending%20on%20Main%20Street_Opportunity%20Fund%20Research%20Report_May%202016.pdf.

[23] Ibid., at p. 7.

for smaller and newer businesses and in the smaller loan amounts that such businesses often seek and require.[24] California-based CDFIs, community lenders, and technical assistance providers reported that nonbank online lenders are the default lender for small businesses that cannot access credit from mainstream retail institutions. Eighty-seven percent of small business organizations responding to the CRC Survey noted that small businesses "often" or "sometimes" turn to Merchant Cash Advance or other lenders that charge a percentage of future credit card receivables or other revenue to pay off the loan; but 64 percent of respondents said that it was "never" beneficial to the small business owner to do so.

The loans that Woodstock analyzed came with fees that amounted to as much as 14 percent of the gross loan amount. For example, the origination fee on most of the loans was around $300, with a high of $2,800. Other fees included a fee, commonly around $395, for setting up the Automated Clearing House (ACH) debit for payment, and a fee of between $100 and $200 for releasing any lien filed under the Uniform Commercial Code.

Two common features of the fintech loans Woodstock Institute analyzed are associated with high levels of dissatisfaction among businesses that received loans: (1) the high interest rates noted earlier; and (2) onerous repayment terms.[25] All but one of the loans analyzed required automatic ACH payments daily (every business day). That requirement means that the business owners have no ability to prioritize payment of the fintech loan among the range of financial obligations that small businesses have, such as payments for payroll, taxes, suppliers, and the rent or mortgage. The fintech loan automatically is paid ahead of any other obligation, directly out of cash flow or retained earnings.

In a survey of businesses by several banks in the Federal Reserve System,[26] businesses that received fintech loans expressed exceptionally high levels of dissatisfaction with the interest rate and repayment terms compared with loans from small or large banks. For example, 70 percent of survey respondents reported dissatisfaction with the high interest rates on fintech loans, compared with 15 percent for loans from small banks and 18 percent for loans from large banks, while 51 percent were dissatisfied with the fintech loan repayment terms, compared with 15 percent for small bank loans and 16 percent for large bank loans.[27]

This report examines bank lending to businesses in the Fresno, California, and Minneapolis-St. Paul, Minnesota, regions.[28] One of the purposes of this report is to determine the extent to which

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[24] Kevin Stein & Gina Charusombat (California Reinvestment Coalition), *Displacement, Discrimination and Determination: Small Business Owners Struggle to Access Affordable Credit - Results from a State-Wide Survey in California* (Sept. 2017).
http://www.calreinvest.org/system/resources/W1siZiIsIjIwMTcvMDkvMTMvMjMvMTcvMDYvODk5L0NSQ19TbWFsbF9CdXNpbmVzc19SZXBvcnQucGRmIl1d/CRC%20Small%20Business%20Report.pdf.

[25] *2016 Small Business Credit Survey: Report on Employer Firms.* See also, *2015 Small Business Credit Survey: Report on Employer Firms*, 2016. Downloaded on October 15, 2016, from https://www.clevelandfed.org/community-development/small-business/about-the-joint-small-business-credit-survey/2015-joint-small-business-credit-survey.aspx.

[26] The Federal Reserve Banks in Atlanta, Boston, Cleveland, New York, Philadelphia, Richmond, and St. Louis participated in the survey and report.

[27] *2015 Small Business Credit Survey: Report on Employer Firms*.

[28] For purposes of this report, the Fresno region is defined as Fresno County. The Minneapolis-St. Paul region includes Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties.

banks are meeting the credit needs of businesses throughout those two regions. Another purpose is to see whether the disparities found in access to credit for businesses in the Chicago and Los Angeles-San Diego regions,[29] in the Buffalo and New Brunswick regions,[30] and in the Detroit and Richmond regions[31]are also evident in the Fresno and Minneapolis-St. Paul regions. As with the earlier reports on small business lending in the Chicago, Los Angeles-San Diego, Buffalo, New Brunswick, Detroit, and Richmond regions, this report focuses on the smaller value loans most likely to support smaller, local businesses that provide employment and wealth-building opportunities for local residents. The third purpose is to see if disparities in access to capital in the Fresno and Minneapolis-St. Paul regions between 2012 and 2015, a period of slow economic growth, are consistent with those revealed in a report on small business lending in the Chicago region[32] during the period from 2008 to 2012, when bank lending contracted dramatically.

Background and Context for the Analysis of Lending Patterns

One consequence of the Great Recession was reduced access to credit, especially for businesses needing small loans. Senior loan officers and business owners agreed that credit contracted dramatically between 2008 and 2010, with differing opinions for more recent years. Loan officers thought conditions had improved, with credit more readily available, while business owners felt that they had not improved significantly.[33] Data on business lending show that both are true; business lending has increased since 2010 but has, for the most part, remained well below the levels of the years leading up to the Great Recession.

The primary source of data on small loans to businesses[34] at the neighborhood level is from reports that large financial institutions insured by the Federal Deposit Insurance Corporation (banks) must submit to the Federal Financial Institutions Examination Council (FFIEC) under

[29] Cowan, Spencer M., 2017A. *Patterns of Disparity: Small Business Lending in the Chicago and Los Angeles-San Diego Regions*, Woodstock Institute, January 2017. For that report, the Chicago, Illinois, region was defined as Cook, DuPage, Kendall, McHenry, and Will counties, and the Los-Angeles-San Diego, California, region was defined as Los Angeles, Orange, and San Diego counties.

[30] Cowan, Spencer M., 2017B. *Patterns of Disparity: Small Business Lending in the Buffalo and New Brunswick Regions*, Woodstock Institute, April 2017. For that report, the Buffalo, New York, region was defined as Erie and Niagara counties, and the New Brunswick, New Jersey, region was defined as Mercer, Middlesex, Monmouth, Somerset, and Union counties.

[31] Cowan, Spencer M., 2017C. *Patterns of Disparity: Small Business Lending in the Detroit and Richmond Regions*, Woodstock Institute, August 2017. For that report, the Detroit, Michigan, region was defined as Macomb, Oakland, and Wayne counties, and the Richmond, Virginia, region was defined as Chesterfield, Dinwiddie, Hanover, Henrico, and Prince George counties and Colonial Heights, Hopewell, Petersburg, and Richmond cities.

[32] Cowan, Spencer M., 2012. *Discredited: Disparate Access to Credit for Businesses in the Chicago Six County Region*. Woodstock Institute, August 2014. For that earlier report, the Chicago region was defined as Cook, DuPage, Kane, Lake, McHenry, and Will counties.

[33] Mills, Karen Gordon, and Brayden McCarthy, 2016. *The State of Small Business Lending: Innovation and Technology and the Implications for Regulation*. Downloaded November 30, 2016, from http://www.hbs.edu/faculty/Publication%20Files/17-042_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf. NFIB Research Foundation, 2012. See also *Small Business, Credit Access, and a Lingering Recession*. Downloaded March 25, 2014, from www.NFIB.com.

[34] Small loans to businesses are more commonly referred to as "small business loans." That terminology frequently causes confusion, however, because some people think that "small" modifies "business," and so they think that the term refers to loans made to businesses below a certain size. The adjective "small" modifies "loans," not "business," which means that the loans are in amounts of less than $1 million and may be made to any size business.

the Community Reinvestment Act (CRA).[35] The banks report on the number and dollar amount of loans they make, broken down by three loan amount ranges (less than $100,000, $100,000 to $249,999, and $250,000 to $1,000,000) and by the census tract in which the business is located. In addition, the banks report the number and dollar amount of small loans they make to businesses with gross revenue of under $1 million, also at the census tract level. [36] For purposes of reporting, banks generally aggregate any extension of credit, including traditional loans, lines of credit, and credit cards, in the amount reported as loans.[37] They also aggregate all extensions of credit to a single business in the reported loans, and so the number of loans is roughly equal to the number of businesses receiving loans.[38]

Longer-term Trends in CRA-reported Small Loans to Businesses, Nationally

After extraordinary growth in CRA-reported small business lending between 2001 and 2007, the total number and dollar amount of all CRA-reported small loans to businesses nationally dropped dramatically between 2007 and 2010, and then increased slowly through 2015 (Chart 1). The total number of loans increased by 123 percent between 2001 and 2007, decreased by 69 percent between 2007 and 2010, and then rebounded by about 39 percent between 2010 and 2015, leaving the total number of CRA-reported small loans down by over 56 percent overall from the peak in 2007 and down by three percent since 2001. The total dollar amount of CRA-reported small business loans increased by 48 percent between 2001 and 2007, decreased by 47 percent between 2007 and 2010, and then increased by 26 percent through 2015. Overall, the total dollar amount of CRA-reported small loans decreased by 33 percent between 2007 and 2015 and is still slightly less than the amount in 2001.

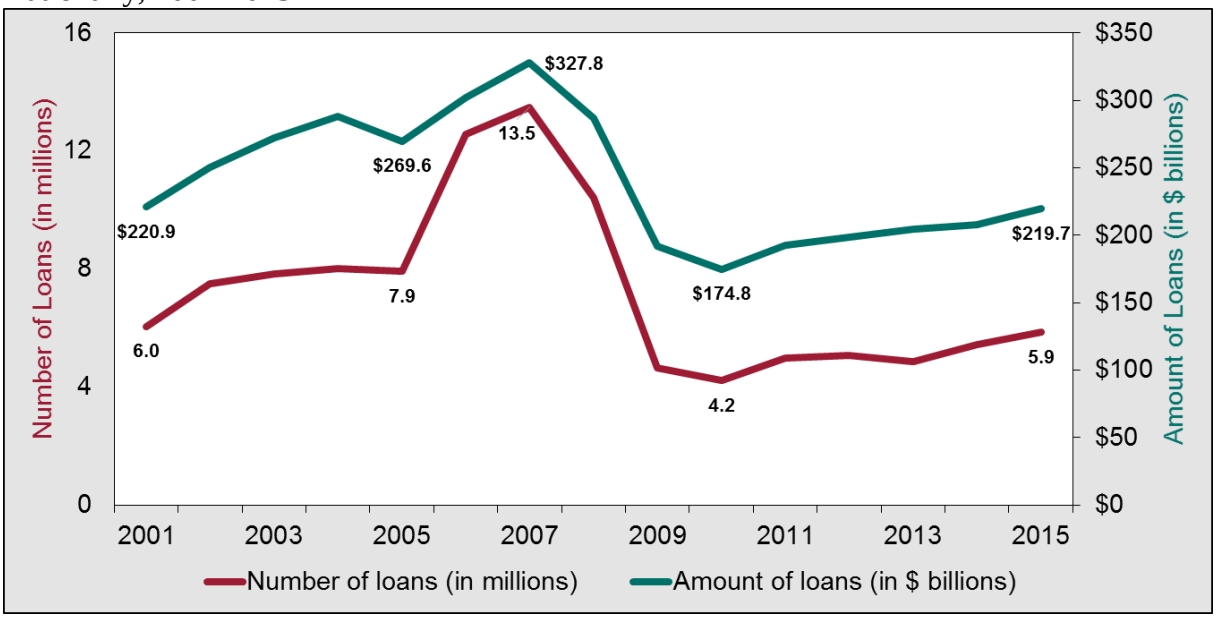
[35] While only large financial institutions are required to report to the FFIEC under the CRA, some smaller lenders report voluntarily. In 2014, a total of 603 commercial banks and 164 savings institutions reported, with 503 required to report and 264 voluntarily reporting. The threshold for reporting in 2014 was $1.202 billion in assets. Together, they provided 88.4 percent of the number and 69.3 percent of the amount of all small loans to businesses. Downloaded October 24, 2016, from *https://www.ffiec.gov/hmcrpr/cra15tables1-5.pdf#table1*. For simplicity, the reporting financial institutions will be referred to as "banks" regardless of their technical, legal status.

[36] Lenders are not required to collect revenue data for businesses to which they make loans, and so some loans to firms with revenue under $1 million are almost certainly not reported as such. For example, if a bank provides a business credit card to a small firm but does not collect revenue data from the firm, it may not report the loans as one to a firm with revenue of less than $1 million. The data on loans to small firms, therefore, is likely lower than the actual figure.

[37] The aggregation of different kinds of credit – credit cards, lines of credit, and term loans – obscures an important distinction among those different forms of credit. In general, credit cards can provide flexible access to short-term capital for small purchases and to manage cash flow, while term loans would be more appropriate for major capital expenditures, such as for purchasing new equipment, that may require a longer-term repayment option. Some advocates have expressed concerns that too many of the loans are in the form of credit cards and not enough as term loans which might better suit the borrowers' needs or the purposes for which the loans are intended.

[38] The number of loans and businesses receiving loans may not be exactly the same because some businesses may receive loans from more than one reporting bank, and, under some circumstances, banks may report multiple loans to one business without aggregating them.

Chart 1: Total Number and Dollar Amount of CRA-reported Small Loans to Businesses Nationally, 2001-2015

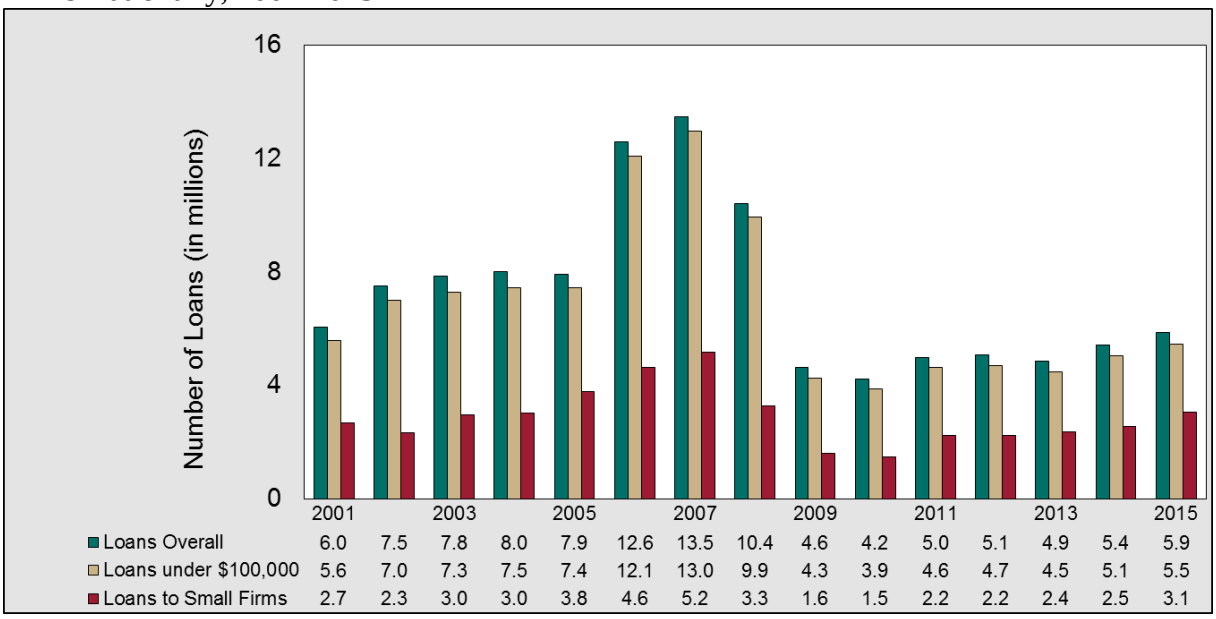


Source: FFIEC CRA Nationwide Summary Statistics, 2001-2014, Table 2, CRA National Aggregate Table 1, 2015.

Loans under $100,000, the amount of capital that the smallest businesses are most likely to seek, constitute the vast majority of the total number of loans reported under the CRA, consistently over 92 percent of all loans nationally (Chart 2). "The reality is that for most banks, lending to small businesses, especially below $100,000, is costly and risky. But it is these lower dollar loans that actually are most important to startups and small businesses that are critical to accelerating the current recovery."[39] The data for the number of CRA-reported loans in amounts under $100,000 nationally follow a pattern similar to that for CRA-reported small business loans overall, with an increase of 132 percent between 2001 and 2007, a rapid decrease of 70 percent between 2007 and 2010, followed by a modest, slow recovery of 41 percent through 2015. The number of loans under $100,000 that CRA-reporting banks originated in 2015 remained 58 percent lower than in 2007 and two percent lower than the number of loans under $100,000 originated by CRA-reporting banks in 2001. Because those banks aggregate extensions of credit to individual businesses, the decline in the number of reported loans indicates that fewer businesses received credit, especially in the form of small loans most critical for the smallest businesses, from the banks reporting under the CRA.

[39] Mills and McCarthy, 2014, p. 23.

Chart 2: Total Number of CRA-reported Loans, Loans under $100,000, and Loans to Small Firms Nationally, 2001-2015

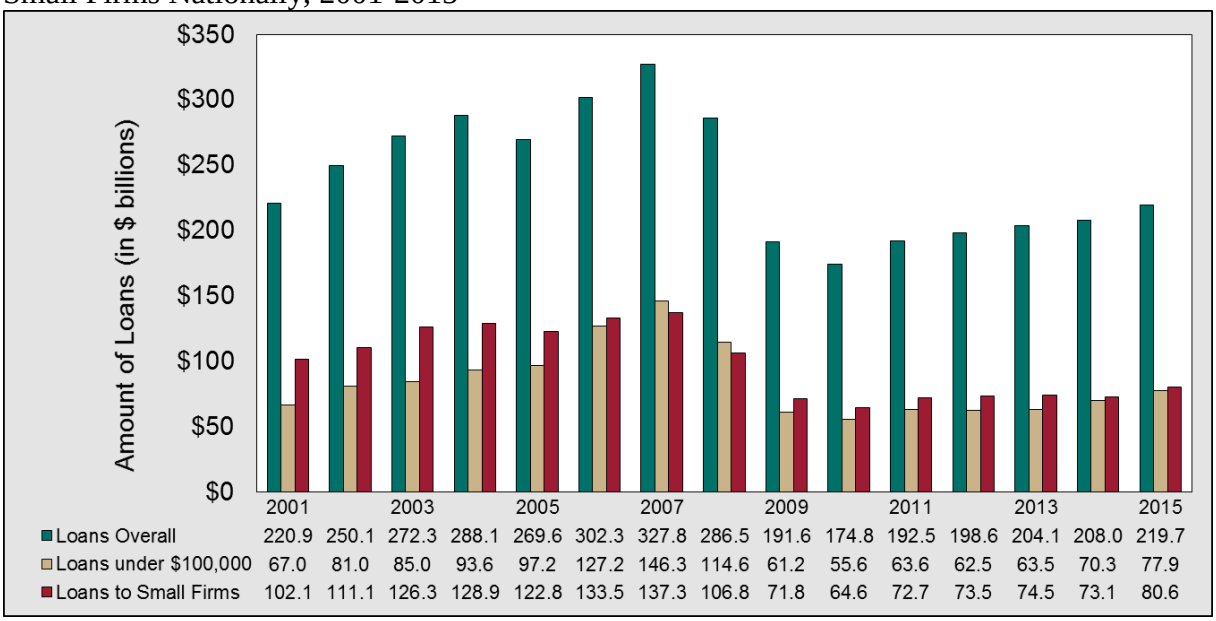


Source: FFIEC CRA Nationwide Summary Statistics, 2001-2014, Table 2, CRA National Aggregate Table 1, 2015.

The number of CRA-reported loans to small firms (those with gross revenues under $1 million) also followed the pattern of increasing rapidly between 2001 and 2007, up by 94 percent, followed by a collapse through 2010, and then recovery into 2015, although the recovery in the number of loans was somewhat stronger than for either loans overall or loans under $100,000. Between 2007 and 2010, the number of CRA-reported loans to small firms fell by over 71 percent, followed by an increase of over 105 percent in the number of loans through 2015. The number of loans to small firms was just over 15 percent higher in 2015 than in 2001, but still 41 percent lower than the peak in 2007.

The pattern for the total dollar amount of CRA-reported small loans to businesses overall was slightly different than the pattern for the total number of loans. The increase in the dollar amount of CRA-reported loans, from $220.9 billion in 2001 to $327.8 billion in 2007, or 48 percent, was not as dramatic as the 123 percent increase in the number of loans (Chart 3). The total dollar amount of CRA-reported loans then dropped by 47 percent between 2007 and 2010, followed by an increase of 26 percent through 2015. The total dollar amount of small loans to businesses from CRA-reporting banks is down 33 percent since 2007 and remains slightly below the amount in 2001.

Chart 3: Total Dollar Amount of CRA-reported Loans, Loans under $100,000, and Loans to Small Firms Nationally, 2001-2015



Source: FFIEC CRA Nationwide Summary Statistics, 2001-2014, Table 2, CRA National Aggregate Table 1, 2015.

The changes in the total dollar amount of CRA-reported loans under $100,000 more closely paralleled changes in the number of loans, increasing by 119 percent between 2001 and 2007, contracting by 62 percent between 2007 and 2010, and then increasing by 40 percent through 2015. The total dollar amount of CRA-reported loans under $100,000 decreased nearly 47 percent from its peak in 2007, but it is up by 16 percent, from $67.0 billion to $77.9 billion, since 2001.

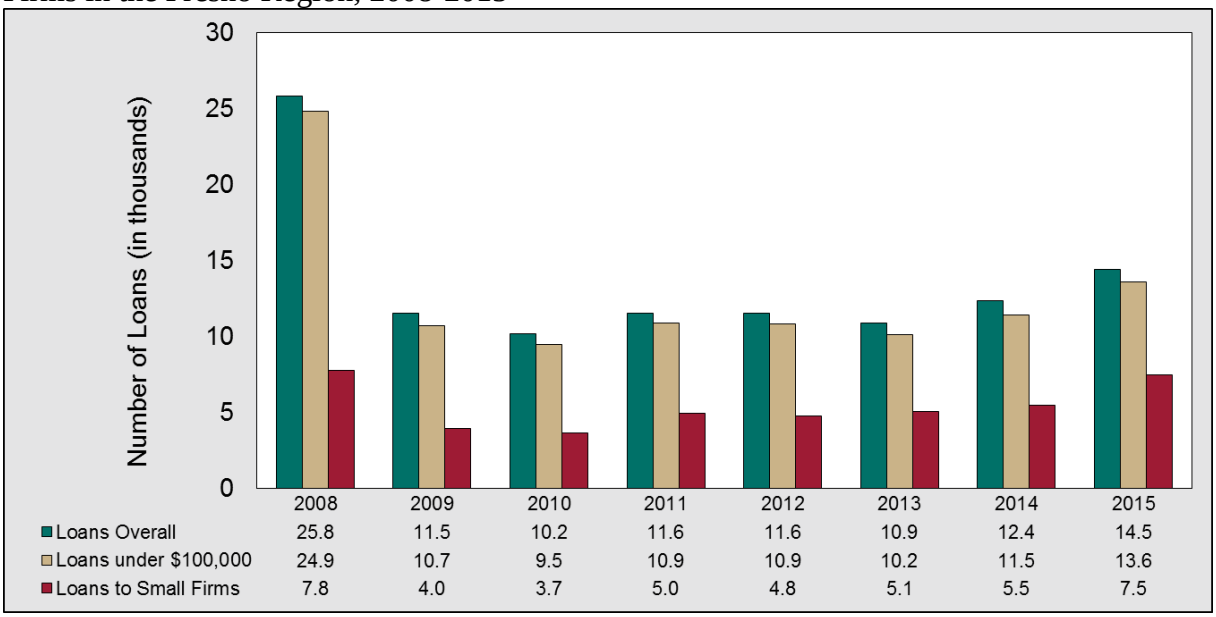
The total dollar amount of CRA-reported loans to small firms showed much more modest changes than either the amount of loans overall or loans under $100,000 between 2001 and 2007, increasing by only 34 percent. The decline in the amount of loans to small firms between 2007 and 2010, however, was similar in magnitude, 53 percent, to the decline in the amount of loans overall, and the recovery was weaker, with the amount up only 25 percent between 2010 and 2015. As a result, the total dollar amount of CRA-reported loans to small firms is down over 41 percent from the amount in 2007 and just over 21 percent since 2001.

Longer-term Trends in CRA-reported Small Loans to Businesses in the Fresno and Minneapolis-St. Paul Regions

Data on the number of CRA-reported small loans to businesses for the Fresno and Minneapolis-St. Paul regions for the period from 2008 to 2015 generally follow the national pattern, with a steep decline between 2008 and 2010, followed by varying degrees and patterns of recovery between 2010 and 2015 (Chart 4 for the Fresno region and Chart 5 for the Minneapolis-St. Paul region). In Fresno, the decrease and subsequent recovery in the number of loans overall matched the national pattern, down about 60 percent between 2008 and 2010, and then back up by about 40 percent between 2010 and 2015. The Minneapolis-St. Paul region experienced less of a decline between 2008 and 2010, down about 47 percent, and a much weaker recovery than the nation as a whole or the Fresno region. The number of loans overall in the Minneapolis-St. Paul

region was up by only 16 percent between 2010 and 2015 and actually declined slightly between 2011 and 2014. In the Fresno region, the number of loans to small firms saw a much stronger recovery than overall small business lending, increasing by over 100 percent between 2010 and 2015, compared with an increase of just under 50 percent in loans to small firms nationally.

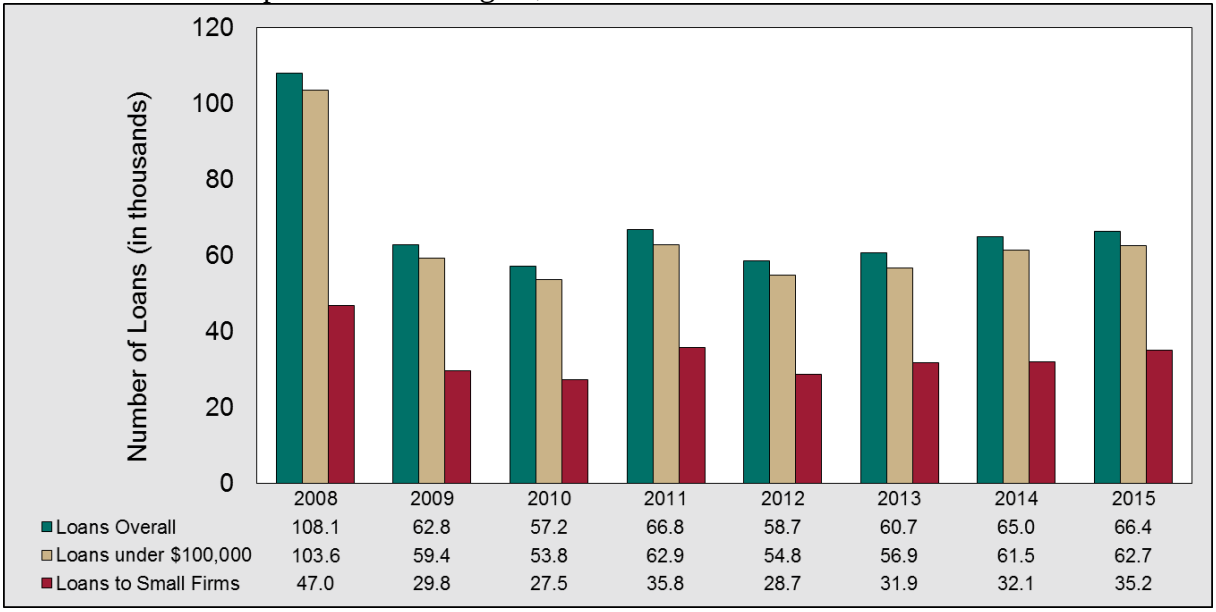
Chart 4: Total Number of CRA-reported Loans, Loans under $100,000, and Loans to Small Firms in the Fresno Region, 2008-2015



	2008	2009	2010	2011	2012	2013	2014	2015
Loans Overall	25.8	11.5	10.2	11.6	11.6	10.9	12.4	14.5
Loans under $100,000	24.9	10.7	9.5	10.9	10.9	10.2	11.5	13.6
Loans to Small Firms	7.8	4.0	3.7	5.0	4.8	5.1	5.5	7.5

Sources: FFIEC CRA data for Fresno County 2012-2015; Author's calculations.

Chart 5: Total Number of CRA-reported Loans, Loans under $100,000, and Loans to Small Firms in the Minneapolis-St. Paul Region, 2008-2015



	2008	2009	2010	2011	2012	2013	2014	2015
Loans Overall	108.1	62.8	57.2	66.8	58.7	60.7	65.0	66.4
Loans under $100,000	103.6	59.4	53.8	62.9	54.8	56.9	61.5	62.7
Loans to Small Firms	47.0	29.8	27.5	35.8	28.7	31.9	32.1	35.2

Sources: FFIEC CRA data for Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties, 2012-2015; Author's calculations.

The differences between the Fresno region and the national trends are relatively minor with respect to the decrease in the number of CRA-reported loans in all three categories for the period from 2008 to 2010 (Table 1). In all geographies, the total number of loans, loans under $100,000, and loans to small firms dropped by around 52 to 62 percent, with the largest declines in loans of under $100,000. The recovery between 2010 and 2015 in the Fresno region was also similar to the national data, with the strongest growth in the number of loans to small firms. In the Minneapolis-St. Paul region, the decrease in the number of loans between 2008 and 2010 was smaller than for the nation as a whole in all three categories of loans, followed by a much weaker recovery, especially in the number of loans to small firms. In fact, all of the recovery in the number of loans in the Minneapolis-St. Paul region occurred between 2010 and 2011, with the total number of loans in all three categories as of 2015 below the level achieved in 2011. Overall, the combination of a more moderate decline and weak recovery left the Minneapolis-St. Paul region with a smaller decrease in the number of loans and loans under $100,000, but with a greater decrease in lending to small firms between 2008 and 2015 than either the Fresno region or the nation.

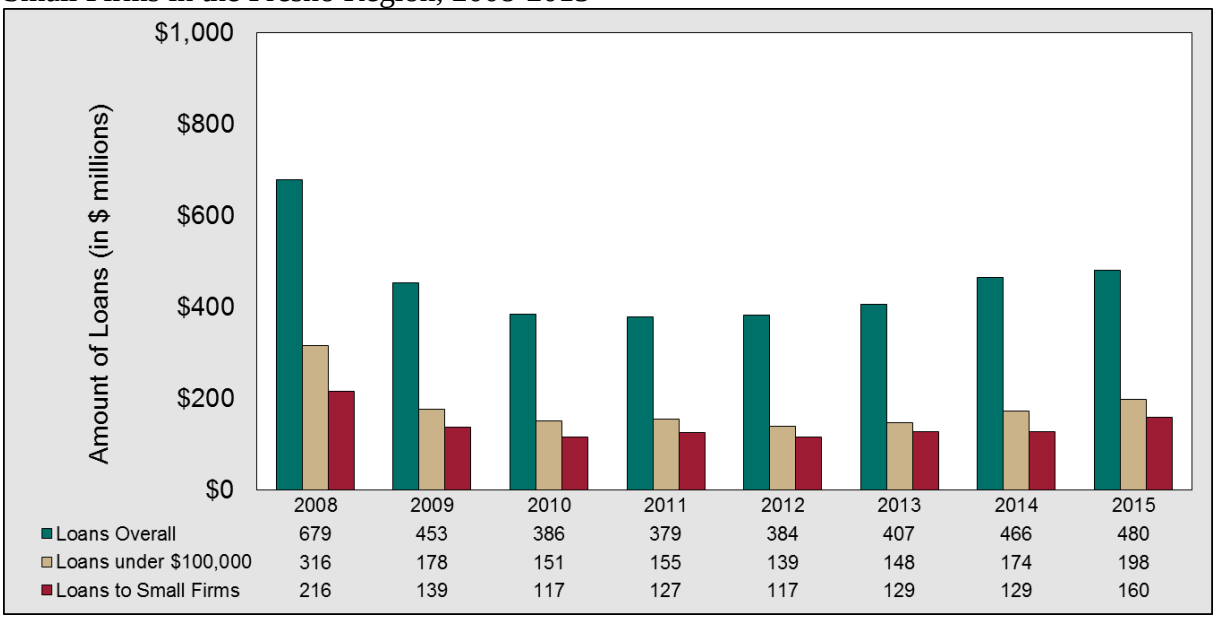
Table 1: Change in the Number of Small Loans to Businesses, Loans under $100,000, and Loans to Small Firms, Nationally and in the Fresno and Minneapolis-St. Paul Regions, 2008-2015

		2008-2010	2010-2015	2008-2015
Total Number of Loans	National	-59.5%	38.9%	-43.8%
	Fresno Region	-60.6%	41.8%	-44.1%
	Minneapolis Region	-47.1%	16.1%	-38.6%
Loans under $100,000	National	-60.9%	40.7%	-45.0%
	Fresno Region	-61.8%	43.1%	-45.3%
	Minneapolis Region	-48.1%	16.5%	-39.5%
Loans to Small Firms	National	-54.5%	105.6%	-6.4%
	Fresno Region	-52.8%	103.5%	-3.9%
	Minneapolis Region	-41.5%	28.3%	-25.0%

Sources: FFIEC CRA data for Fresno County for the Fresno region, and Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties for the Minneapolis-St. Paul region; Author's calculations.

Data on the total dollar amount of CRA-reported small loans to businesses for the Fresno and Minneapolis-St. Paul regions for the period from 2008 to 2015 show an overall pattern similar to the changes in the total number of loans in those two regions. The Fresno region generally tracked the national trends, while the Minneapolis-St. Paul region decreased less than the nation as a whole between 2008 and 2010, followed by a much weaker recovery between 2010 and 2015 (Chart 6 for the Fresno region and Chart 7 for the Minneapolis-St. Paul region). The weakness of the recovery in the Minneapolis-St. Paul region over that period obscures the difficulties facing businesses in the region because of the strong rebound in business lending in all three categories between 2010 and 2011. Taking 2011 as the baseline, lending to businesses in that region decreased between 2011 and 2015.

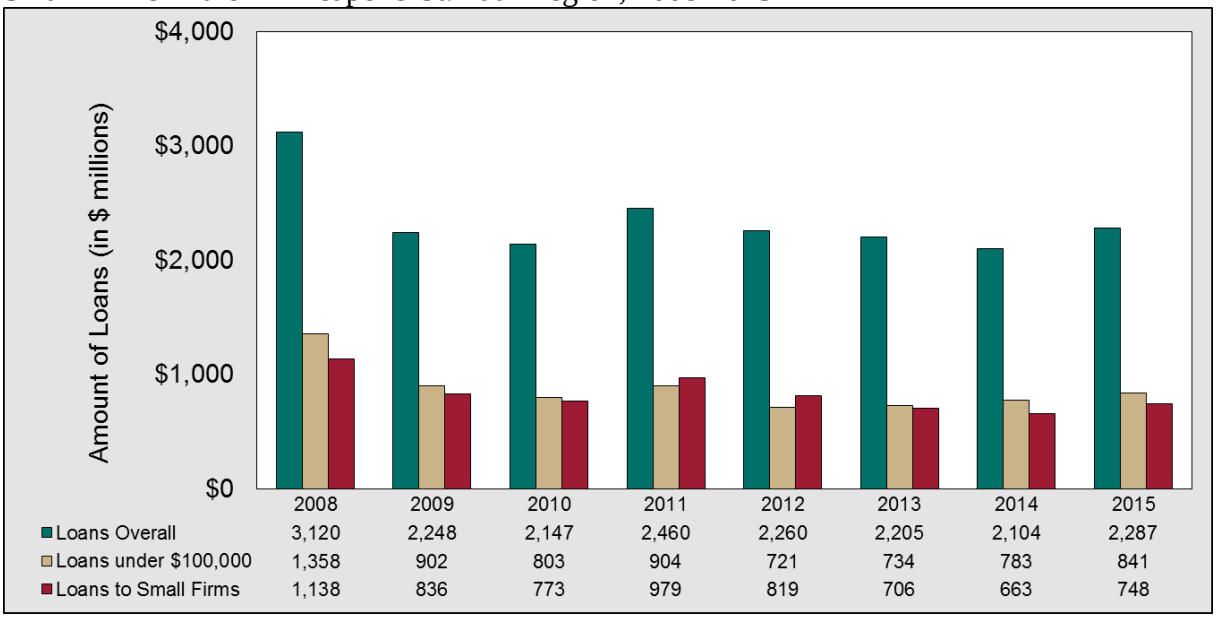
Chart 6: Total Dollar Amount of CRA-reported Loans, Loans under $100,000, and Loans to Small Firms in the Fresno Region, 2008-2015



	2008	2009	2010	2011	2012	2013	2014	2015
Loans Overall	679	453	386	379	384	407	466	480
Loans under $100,000	316	178	151	155	139	148	174	198
Loans to Small Firms	216	139	117	127	117	129	129	160

Sources: FFIEC CRA data for Fresno County 2008-2015; Author's calculations.

Chart 7: Total Dollar Amount of CRA-reported Loans, Loans under $100,000, and Loans to Small Firms in the Minneapolis-St. Paul Region, 2008-2015



	2008	2009	2010	2011	2012	2013	2014	2015
Loans Overall	3,120	2,248	2,147	2,460	2,260	2,205	2,104	2,287
Loans under $100,000	1,358	902	803	904	721	734	783	841
Loans to Small Firms	1,138	836	773	979	819	706	663	748

Sources: FFIEC CRA data for Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties for the Minneapolis-St. Paul region, 2008-2015; Author's calculations.

The decrease between 2008 and 2010 in the total dollar amount of CRA-reported loans in the Fresno and Minneapolis-St. Paul regions followed much the same pattern as the total number of loans (Table 2). The decrease was slightly larger in the Fresno region and smaller in the Minneapolis-St. Paul region than in the nation as a whole. The recovery in Fresno region was stronger with respect to loans to small firms but weaker for loans under $100,000. In all three

categories, the recovery in the Minneapolis-St. Paul region lagged, with the total dollar amount of loans to small firms actually declining between 2010 and 2015. The Minneapolis-St. Paul and Buffalo regions[40] were the only ones studied in this series to see continued declines in lending to small firms during the recovery period.

Table 2: Change in the Dollar Amount of Small Loans to Businesses, Loans under $100,000, and Loans to Small Firms, Nationally and in the Fresno and Minneapolis-St. Paul Regions, 2008-2015

		2008-2010	2010-2015	2008-2015
Total Dollar Amount of Loans	National	-39.0%	25.7%	-23.3%
	Fresno Region	-43.2%	24.6%	-29.2%
	Minneapolis Region	-31.2%	6.5%	-26.7%
Loans under $100,000	National	-51.4%	40.1%	-32.0%
	Fresno Region	-52.3%	31.5%	-37.2%
	Minneapolis Region	-40.8%	4.7%	-38.1%
Loans to Small Firms	National	-39.5%	24.8%	-24.5%
	Fresno Region	-45.6%	36.2%	-25.9%
	Minneapolis Region	-32.1%	-3.2%	-34.3%

Sources: FFIEC CRA data for Fresno County for the Fresno region, and Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties for the Minneapolis-St. Paul region, 2008-2015; Author's calculations.

The average loan amount that businesses receive has changed between 2008 and 2015 (Table 3). The pattern for the average loan amount for all three geographies was the opposite of the patterns with respect to the number and total dollar amount of loans. Between 2008 and 2010, the average loan amount for all three categories of loans increased, followed by a decrease between 2010 and 2015. The average loan amount for all CRA-reported loans in 2015 was higher than it was in 2008, although the increase was lower in the Fresno and Minneapolis-St. Paul regions than nationally. The same is true for loans under $100,000, although the changes were less dramatic than for loans overall, except in the Minneapolis-St. Paul region. The situation was less favorable for small firms. The average loan amount to small firms did increase between 2008 and 2010, but considerably less than the average for loans overall. The average loan to small firms then decreased substantially more than the average for loans overall between 2010 and 2015. The result is that the average loan amount for small firms is between 12 and 23 percent less in 2015 than it was in 2008.[41]

[40] Cowan, 2017B. The Buffalo region saw continued decreases in the total dollar amount of small business lending across all three categories.

[41] Not only was the average loan size for small firms down, they also appeared to be more highly dependent on credit cards as the principal form for the loans they received than businesses generally For example, in 2015 American Express, FSB, which essentially provides only credit cards for business customers, accounted for 34.6 percent of loans to small firms in the Fresno region and 24.6 percent of loans to small firms in the Minneapolis-St. Paul region, compared with 29.3 percent of all loans in the Fresno region and 20.9 percent of all loans in the Minneapolis-St. Paul region. Those percentages represent a lower limit on the extent to which businesses are receiving loans in the form of credit cards because other banks, such as Bank of America, Chase, Citibank, and Wells Fargo, also offer credit cards in addition to traditional term loans. While many businesses may want and need loans for the purposes for which credit cards are well-suited, such as short-term cash flow management or for routine expenditures, others may have needs, such as major equipment purchases, better met by more conventional term loans.

Table 3: Change in the Average Loan Amount for Small Loans to Businesses, Loans under $100,000, and Loans to Small Firms, Nationally and in the Fresno and Minneapolis-St. Paul Regions, 2008-2015

		2008-2010	2010-2015	2008-2015
Total Dollar Amount of Loans	National	50.8%	-9.5%	36.5%
	Fresno Region	44.0%	-12.1%	26.5%
	Minneapolis Region	30.0%	-8.3%	19.3%
Loans under $100,000	National	24.3%	-0.4%	23.7%
	Fresno Region	24.9%	-8.1%	14.8%
	Minneapolis Region	13.9%	-10.1%	2.3%
Loans to Small Firms	National	32.8%	-39.3%	-19.4%
	Fresno Region	15.2%	-33.1%	-22.9%
	Minneapolis Region	16.1%	-24.5%	-12.4%

Sources: FFIEC CRA data for Fresno County for the Fresno region, and Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties for the Minneapolis-St. Paul region, 2008-2015; Author's calculations.

The trend in the average loan amount between 2008 and 2015 nationally, both with respect to loans overall and loans to small businesses, reflects the longer-term reduction in the average loan amount shown in the data reported under the CRA since 1996, as shown in Bostic and Lee (2017).[42] The average loan amount overall was $93,700 in 1996, dropping to $48,700 by 2000. The average slowly decreased to $46,400 by 2004, and then dropped to $28,300 by 2007. The upward trend in the average loan amount overall between 2008 and 2015, therefore, is attributable, in part, to the relatively low baseline in 2008 from which the change is measured. Between 2000 and 2015, the average loan amount overall dropped from $48,700 in 2000 to $38,200 in 2015, or about 21.6 percent overall.

The same longer-term trends are at play with respect to loans to small firms. The average loan to small firms peaked in 1997 at $77,900, dropping to $54,400 in 2000. That level held through 2004 and then dropped to an average of $30,900 by 2007. Although the average loan to small firms rebounded from $36,800 in 2008 to a new high of $50,800 in 2009, the average then dropped dramatically in 2011, to $34,700 and continued to decline through 2015, to an historic low of $26,600. Between 2000 and 2015, the average loan amount to small firms dropped from $54,400 to $26,600, or about 51.2 percent overall.

Methodology for Analysis of Lending Patterns by Income, Race, and Ethnicity

This report focuses on the segment of CRA-reported lending by banks that is most crucial for neighborhood businesses, loans under $100,000. They constitute over 92 percent of all CRA-reported small business loans, and 70 percent of small employer firms that sought financing applied for less than $100,000.[43] As noted earlier, those are the loans that are "most important to

[42] Bostic, Raphael W., and Hyojung Lee, 2017. *Small Business Lending Under the Community Reinvestment Act*, in *Cityscape*, Washington, DC: U.S. Department of Housing and Urban Development, Office of Policy Development and Research, 19(2) 63-84. The authors of this report restricted the data used to tracts in metropolitan statistical areas and metropolitan divisions, which omits some rural and sparsely populated areas.

[43] *2016 Small Business Credit Survey: Report on Employer Firms*.

startups and small businesses" and are also the bulk of loans that the rapidly growing fintech lenders are providing. For example, the average loan size that online lenders responding to the California Department of Business Oversight survey reported for 2014 was $12,236.[44]

In order to analyze the extent to which financial institutions reporting under the CRA requirements are meeting the credit needs of businesses in low- and moderate-income census tracts and in communities of color, the CRA-reported data provide only one part of the necessary information. The CRA reports include only loans that the reporting banks made, with no data on the numbers of applications or amount of loans applied for; they do not, therefore, have data on the level of demand for bank loans from businesses.

Data on aggregate demand for business loans suggest that many businesses rely on banks for their financing but, at the same time, have difficulty in accessing capital from banks. A 2012 survey of businesses found that 85 percent relied on either a major bank or a regional or community bank as their main financial partner.[45]

> Based on regional survey data from the Federal Reserve Bank of New York, about 37 percent of all small businesses applied for credit in the fall of 2013. About 45 percent did not apply, presumably because they did not need credit, but about 20 percent did not apply because they were discouraged from doing so, either because they felt that they would not qualify or because they thought the process would be too arduous to justify the time commitment. Of businesses that did apply, over 40 percent either received no capital at all or received less than the amount that they requested.[46]

While the data aggregated for the nation as a whole present one type of estimate for demand, the national averages do not necessarily reflect what is happening within any given metropolitan area or at the neighborhood or census tract level.[47] The Department of Housing and Urban Development (HUD) aggregates United States Postal Service (USPS) census tract address data (HUD/USPS Vacancy Data), including the total number of business addresses and the number of vacant business addresses, and the difference represents the number of active business addresses for each census tract. The number of active business addresses can serve as a proxy for the level of demand for business loans assuming that the demand for loans is roughly proportional to the number of businesses.

The CRA-reported data show the number and dollar amount of small loans to businesses; the HUD/USPS Vacancy Data provide a proxy measure for the level of business loan demand, and

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[44] *Survey of Online Consumer and Small Business Financing Companies – 01/01/2010 through 06/30/2015: Summary Report of Aggregate Transaction Data*.

[45] NFIB Research Foundation, 2012.

[46] Mills and McCarthy, 2014, p. 23.

[47] The lack of data on the demand for small business loans was addressed in Section 1071 of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, which gave the Consumer Financial Protection Bureau (CFPB) the authority to require lenders to collect and report business loan application data, including the type and purpose of the credit applied for, the race and gender of the principal owners of the business, and the gross annual revenue of the business. The CFPB has not yet promulgated the rules for collection of those data; it is in the pre-rule phase as of November of 2017.

census data from the FFIEC has the income level of each census tract relative to the median family income of the metropolitan area of which it is a part and the percentage of the census tract population that are minorities. By combining the three datasets, it is possible to compare the relative level of access to business capital from banks reporting under CRA requirements for businesses in census tracts with different income or population demographics.[48]

For purposes of analyzing the data by income level, this report uses the standard definitions of low-, moderate-, middle-, and upper-income that the FFIEC uses:

- A low-income census tract has a median family income less than 50 percent of the Area Median Family Income;
- A moderate-income census tract has a median family income from 50 percent to less than 80 percent of the Area Median Family Income;
- A middle-income census tract has a median family income from 80 to less than 120 percent of the Area Median Family Income; and
- An upper-income census tract has a median family income 120 percent or more of the Area Median Family Income.

Findings by the Income Level of the Census Tract

Businesses in low- and moderate-income census tracts receive a smaller percentage of CRA-reported bank loans under $100,000, both by the number of loans and the total dollar amount of those loans, than their respective shares of active business addresses nationally and in both the Fresno and Minneapolis-St. Paul regions. Nationally, businesses in low-income census tracts comprised an average of 9.2 percent of all businesses for the period 2012-2015,[49] but they received only 4.7 percent of loans and only 4.9 percent of the total dollar amount of loans (Chart 8).[50] Those businesses received 51.1 percent of the number of loans, and 53.5 percent of the

[48] This report examines lending to businesses in census tracts with different demographic characteristics, which is not the same ownership of the business. Businesses in predominantly Hispanic census tracts, for example, could have a non-Hispanic owner. One consistent source of data on access to loans by the race or ethnicity of the business owner is from the SBA, which provides a relatively small percentage of business loans overall. Fisher, Alan, 2013. *Small Business Access to Credit: The Little Engine that Could: If Banks Helped*. Downloaded January 5, 2017, from http://www.calreinvest.org/publications/california-reinvestment-coalition-research, published by the California Reinvestment Coalition, is a study of small business lending using SBA data to examine disparities in access to loans by minority- or Hispanic/Latino-owned businesses. It found that the number of SBA loans by the five leading banks in California declined by 58.8 percent between 2007 and 2013, while the number of those loans to African American-owned businesses declined by 93 percent and the number of SBA loans to Hispanic/Latino-owned businesses declined by 73 percent.

Bates, Timothy, and Alicia Robb, 2016, "Impacts of Owner Race and Geographic Context on Access to Small-Business Financing" in *Economic Development Quarterly*, 30(2) 159-170, used data from the Kauffman Firm Survey and found that minority-owned businesses are heavily concentrated in minority neighborhoods, that firms with an African American owner were significantly less likely to apply for loans, and that they received smaller loans, than firms with owners who were not African American.

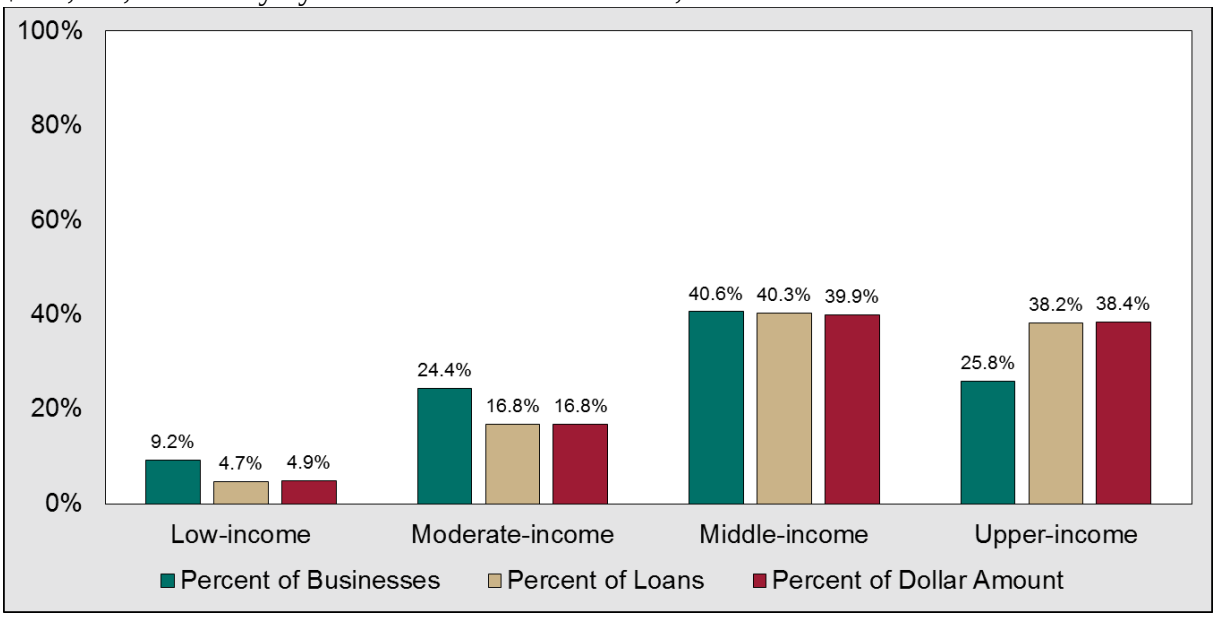
[49] For CRA reporting purposes, the census tract boundaries changed from the 2000 Decennial Census boundaries to the 2010 Decennial Census boundaries in 2012. The decision to analyze the census tract level data for the period between 2012 and 2015 was to keep the census tract geographies consistent for the entire period.

[50] The calculated percentages for the total number and total dollar amount of loans under $100,000 in low- and moderate-income census tracts nationally are consistent with, but slightly lower than, the percentages for all loans in Bostic and Lee (2017), which may reflect the differences in the geographic areas and types of loans included in the data analyzed. Their data show that those percentages have remained consistent since 1996, across periods of economic growth and recession.

dollar amount of loans, that their share of businesses represents. If businesses in low-income census tracts had received CRA-reported loans under $100,000 in proportion to their share of business addresses overall, they would have received an average of almost 221,000 more loans per year, totaling an average of over $2.9 billion annually. For the period between 2012 and 2015, they would have received a total of over 883,000 more loans, nearly $11.6 billion dollars more in loans, than they actually received.

Businesses in moderate-income census tracts comprised an average of 24.4 percent of all businesses, but they received only 16.8 percent of CRA-reported bank loans under $100,000, and 16.8 percent of the total dollar amount of those loans, nationally between 2012 and 2015. They received 68.8 percent of the number, and 69.0 percent of the total dollar amount, of loans under $100,000 that their share of businesses represents. If businesses in moderate-income census tracts had received CRA-reported loans under $100,000 in proportion to their share of business addresses overall, they would have received an average of almost 373,000 more loans per year, totaling an average of over $5.2 billion annually. For the period between 2012 and 2015, they would have received a total of over 1,493,000 more loans, totaling nearly $20.6 billion dollars more in loans, than they actually received.

Chart 8: Percent of Businesses, Loans, and Dollar Amounts for CRA-reported Bank Loans under $100,000, Nationally by Census Tract Income Level, 2012-2015



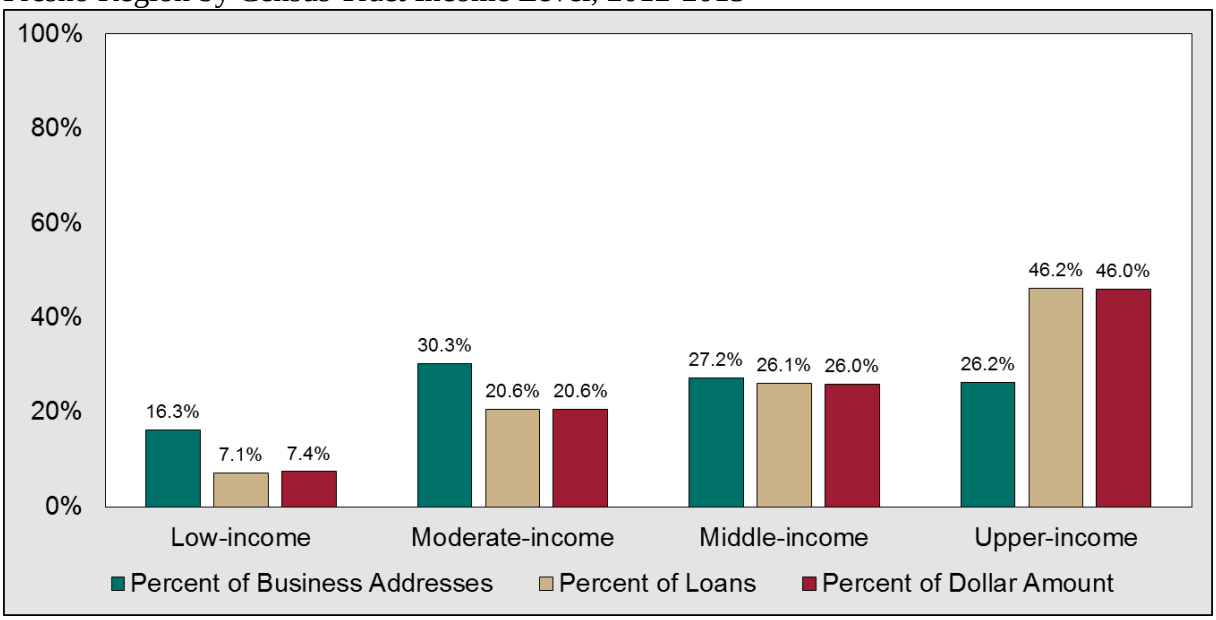
Sources: FFIEC CRA Nationwide Summary Statistics, Tables 4.1 and 4.2; FFIEC Median Family Income Percent data 2014; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

Similar patterns are evident in the Fresno and Minneapolis-St. Paul regions. Businesses in low- and moderate-income census tracts received fewer CRA-reported bank loans under $100,000 and less in total loan amounts than their respective share of businesses represents. For example, businesses in low-income census tracts in the Fresno region comprised an average of 16.3 percent of all businesses in the region, but they received only 7.1 percent of the total number, and only 7.4 percent of the total dollar amount, of those loans between 2012 and 2015 (Chart 9). That is, those businesses received 43.5 percent of the number, and 45.6 percent of the total dollar

amount, of loans under $100,000 that their share of businesses represents. If businesses in low-income census tracts in the Fresno region had received CRA-reported bank loans under $100,000 in proportion to their share of all businesses in the region, they would have received an average of over 1,000 more loans per year, totaling an average of over $14 million annually. For the period between 2012 and 2015, they would have received a total of over 4,100 more loans, nearly $56 million dollars more in loans, than they actually received.

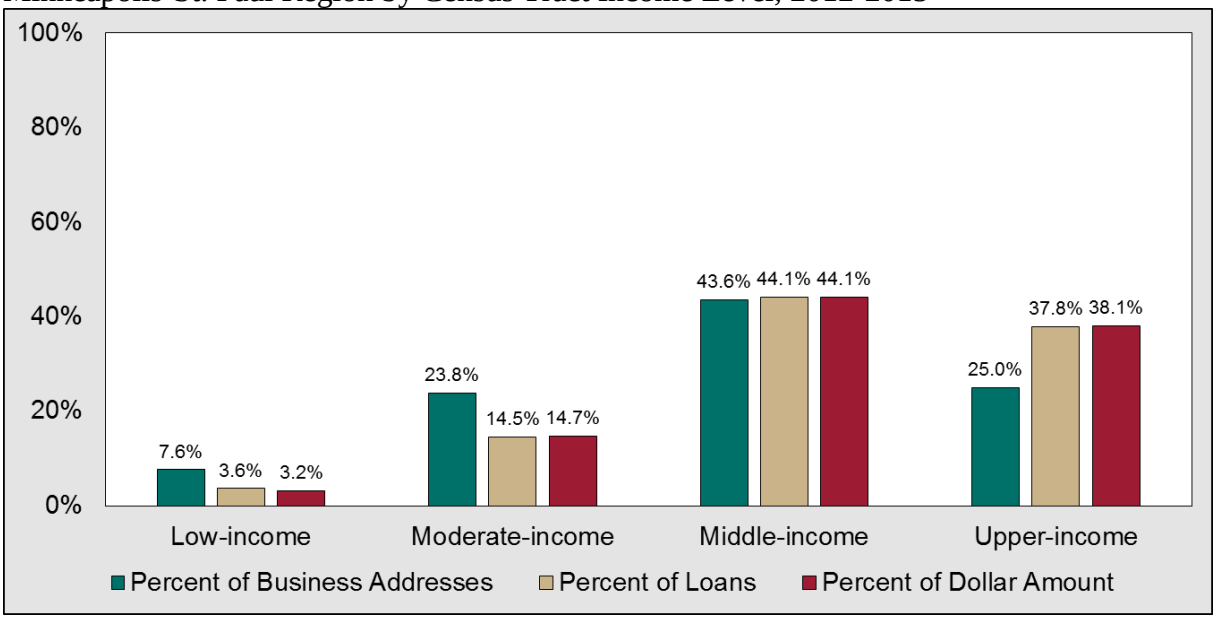
For businesses in low-income census tracts in the Minneapolis-St. Paul region, the disparity between the percentage of businesses they represent and the percentage of the number and dollar amount of CRA-reported bank loans under $100,000 they received is as severe as the disparity in the Fresno region. Businesses in low-income census tracts in the Minneapolis-St. Paul region comprised an average of 7.6 percent of all businesses in the region, but they received only 3.6 percent of CRA-reported bank loans under $100,000, and 3.2 percent of the total dollar amount of those loans, between 2012 and 2015 (Chart 10). That is, those businesses received about 47.5 percent of the number, and 42.3 percent of the total dollar amount, of CRA-reported banks loans under $100,000 that their share of businesses represents. If businesses in low-income census tracts in the Minneapolis-St. Paul region had received CRA-reported bank loans under $100,000 in proportion to their share of all businesses in the region, they would have received an average of over 2,300 more loans per year, totaling an average of over $32 million annually. For the period between 2012 and 2015, they would have received a total of over 9,200 loans, over $130 million dollars more in loans, than they actually received.

Chart 9: Percent of Businesses, Loans, and Dollar Amount for Loans under $100,000 in the Fresno Region by Census Tract Income Level, 2012-2015



Sources: FFIEC CRA data for Fresno County, 2012-2015; FFIEC Median Family Income Percent data 2014; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

Chart 10: Percent of Businesses, Loans, and Dollar Amount for Loans under $100,000 in the Minneapolis-St. Paul Region by Census Tract Income Level, 2012-2015



Sources: FFIEC CRA data for Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties, 2012-2015; FFIEC Median Family Income Percent data 2014; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

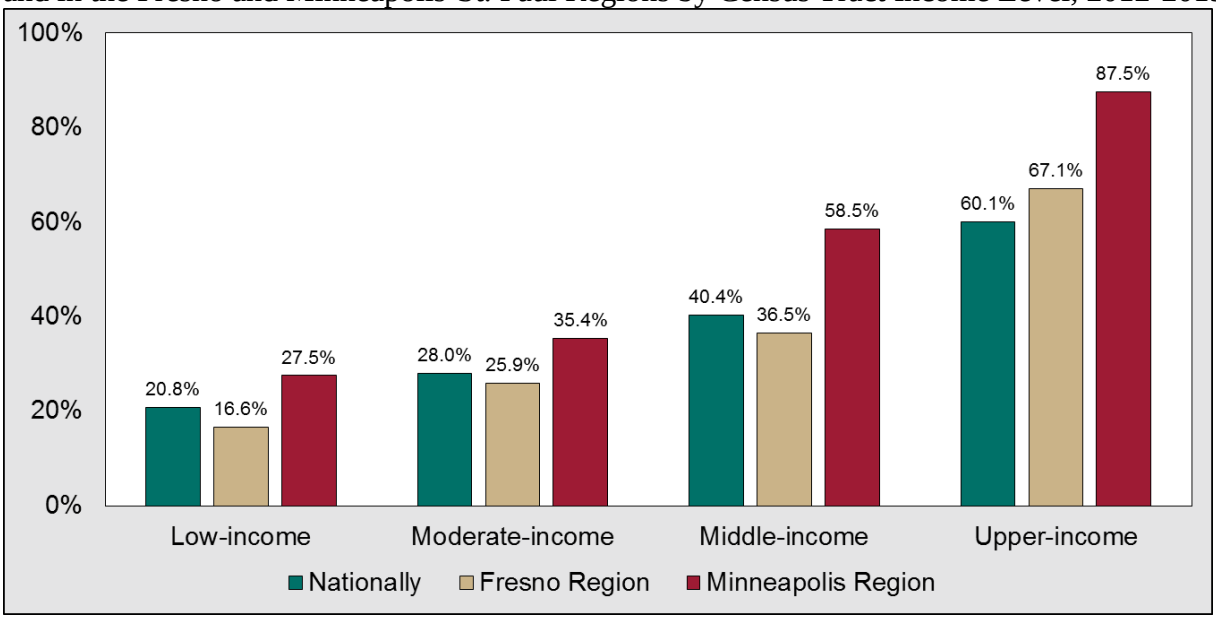
Businesses in moderate-income census tracts in both the Fresno and Minneapolis-St. Paul regions also received a smaller percentage of CRA-reported bank loans under $100,000, both with respect to the number and total dollar amount of loans, than their overall share of businesses. Businesses in moderate-income census tracts in the Fresno region received 68.1 percent of the number, and 68.1 percent of the total dollar amount, of loans under $100,000 that their share of businesses represents. If businesses in moderate-income census tracts in the Fresno region had received CRA-reported bank loans in proportion to their share of business addresses overall, they would have received over 4,300 more loans totaling over $61 million more than they actually received in the period from 2012 to 2015.

Businesses in moderate-income census tracts in the Minneapolis-St. Paul region had larger disparities with respect to the number and dollar amount of loans than their counterparts in the Fresno region. In the Minneapolis-St. Paul region, businesses in moderate-income census tracts received 61.1 percent of the number, and 61.7 percent of the dollar amount, of CRA-reported bank loans under $100,000 that their share of businesses represents. If businesses in moderate-income census tracts in the Minneapolis-St. Paul region had received CRA-reported bank loans under $100,000 in proportion to their share of businesses overall, they would have received over 21,000 more loans totaling just over $270 million more than they actually received in the period from 2012 to 2015.

Nationally and in both the Fresno and Minneapolis-St. Paul regions, businesses in lower-income census tracts were less likely to have received CRA-reported bank loans between 2012 and 2015 than businesses in higher-income census tracts (Chart 11). An average of one in five businesses (20.8 percent) in a low-income census tract received a loan under $100,000 during that period

nationally, compared with more than three out of five businesses (60.1 percent) in upper-income census tracts. That means that businesses in upper-income census tracts were 2.9 times as likely to have received loans as businesses in low-income census tracts. In the Fresno region, the degree of disparity was even worse than in the nation as a whole. One business in six (16.6 percent) in low-income census tracts received CRA-reported bank loans under $100,000, compared with over two-thirds of businesses (67.1 percent) in upper-income census tracts. In other words, businesses in upper-income census tracts in the Fresno region were over four times as likely to have received loans as businesses in low-income census tracts. In the Minneapolis-St. Paul region, a similar pattern of disparity is evident, although the percentages of businesses receiving loans in both low- and upper-income census tracts are higher than nationally or in the Fresno region. In the Minneapolis-St. Paul region, just over one business in four in a low-income census tract received a loan, compared with seven out of eight in upper-income tracts. In other words, businesses in upper-income census tracts in the Minneapolis-St. Paul regions were more than three times as likely to have received loans as businesses in lower-income tracts.

Chart 11: Average Percent of Businesses Receiving Loans under $100,000 Annually Nationally and in the Fresno and Minneapolis-St. Paul Regions by Census Tract Income Level, 2012-2015

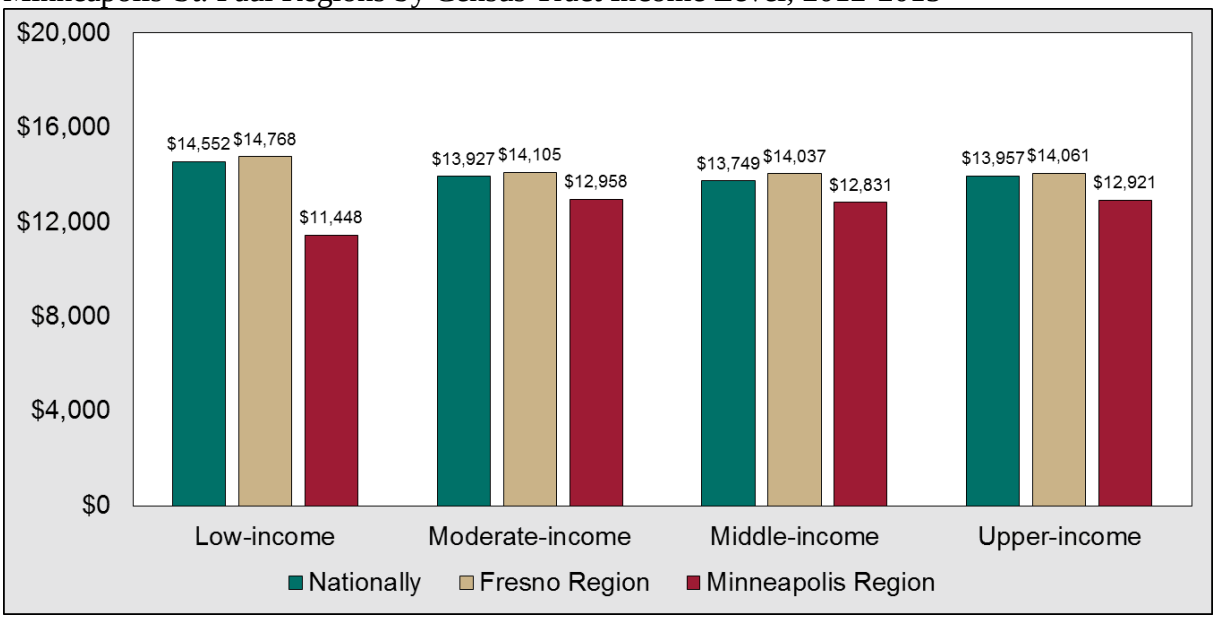


Sources: FFIEC CRA data for Fresno County for the Fresno region, and Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties for the Minneapolis-St. Paul region, 2012-2015; FFIEC Median Family Income Percent data 2014; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

While the probability of a business receiving a CRA-reported loan under $100,000 increases as the income level of the census tract increases, nationally and in both the Fresno and Minneapolis-St. Paul regions, the average loan amount for loans under $100,000 does not (Chart 12). The average loan amount for loans under $100,000 was actually 4.3 percent, or $595, higher in low-income census tracts nationally than in upper-income census tracts. In the Fresno region, the average loan amount was $707 higher (or 4.8 percent) in low-income census tracts than in upper-income census tracts. In the Minneapolis-St. Paul region, the average loan amount was $1,473 lower (or 12.9 percent) in low-income census tracts than in upper-income census tracts, but the average loan amount in moderate-income tracts was higher than the average loan amount in

either middle- or upper-income census tracts in the region. While businesses in low- and moderate-income census tracts are less likely to receive CRA-reported loans under $100,000 than businesses in upper-income tracts, the loans they do receive are generally larger than those received by businesses in upper-income tracts, with some exceptions.

Chart 12: Average Dollar Amount for Loans under $100,000 Nationally and in the Fresno and Minneapolis-St. Paul Regions by Census Tract Income Level, 2012-2015



Sources: FFIEC CRA data for Fresno County for the Fresno region, and Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties for the Minneapolis-St. Paul region, 2012-2015; FFIEC Median Family Income Percent data 2014; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

Findings by the Percent Minority[51] or Hispanic/Latino Population

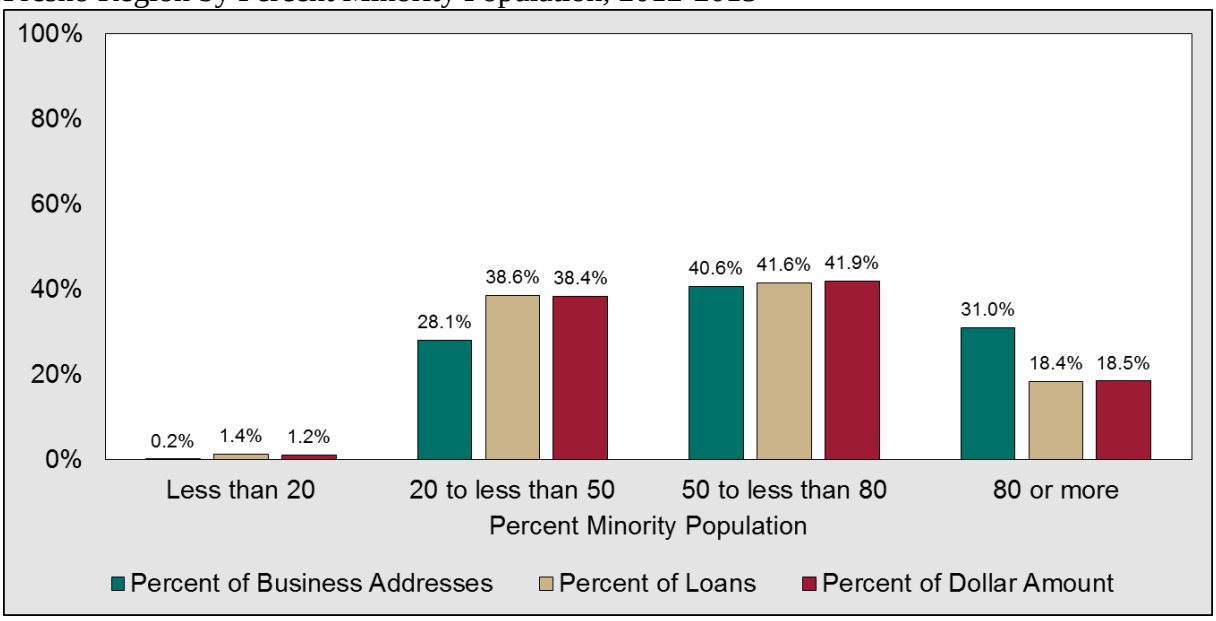
Percent Minority Population

Businesses in predominantly[52] minority census tracts in the Fresno region received a smaller percentage of CRA-reported loans under $100,000, both by the number and total dollar amount of loans, than their respective share of businesses in the region. They constituted an average of 31.0 percent of businesses, but they received only 18.4 percent of the number of loans and only 18.5 percent of the total dollar amount of such loans (Chart 13). That is, they received 59.2 percent of the number, and 59.5 percent of the dollar amount, of CRA-reported loans under $100,000 that their share of businesses represents. If businesses in predominantly minority census tracts in the Fresno region had received CRA-reported loans under $100,000 in proportion to their share of businesses overall, they would have received just under 5,700 additional loans, an average of over 1,400 loans annually, totaling nearly $79 million, or just under $20 million annually, more than they actually received between 2012 and 2015.

[51] "Minority" includes all of the non-white population in the census tract, based on the FFIEC census data.

[52] For simplicity and ease of reading, this report will use the following terminology: census tracts that were 20 percent or less minority or Hispanic/Latino will be "predominantly white" or "predominantly non-Hispanic;" census tracts that were 20 to less than 50 percent minority or Hispanic/Latino will be "majority white" or "majority non-Hispanic;" census tracts that were 50 to less than 80 percent minority or Hispanic/Latino will be "majority minority" or "majority Hispanic," and census tracts that were 80 percent or more minority or Hispanic/Latino will be "predominantly minority" or "predominantly Hispanic."

Chart 13: Percent of Businesses, Loans, and Dollar Amount for Loans under $100,000 in the Fresno Region by Percent Minority Population, 2012-2015



Sources: FFIEC CRA data for Fresno County, 2012-2015; FFIEC Percent Minority Population data 2012-2015; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

Businesses in majority minority census tracts in the Fresno region received slightly more than their proportionate share of loans under $100,000, both in terms of the total number of loans and the total dollar amount of those loans. They comprised 40.6 percent of businesses in the region, and they received 41.6 percent of CRA-reported loans under $100,000, and 41.9 percent of the total dollar amount of those loans. Of the eight regions studied in this series of reports, Fresno is the only one in which businesses in any of the disadvantaged categories[53] of census tracts received a greater share of loans than its percentage of businesses. Fresno is also the only one of the eight regions in which over 70 percent of census tracts were majority or predominantly minority and it also had the highest percentage minority population of the eight regions.

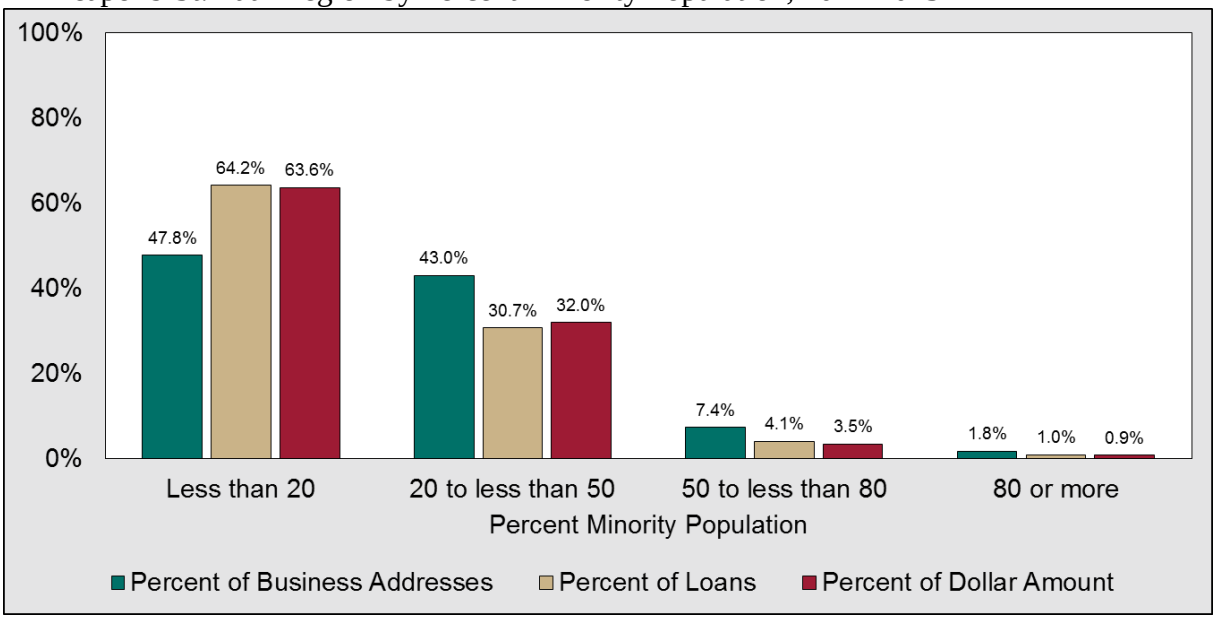
The disparities with respect to the number and total dollar amount of CRA-reported loans under $100,000 for businesses in predominantly minority census tracts in the Minneapolis-St. Paul region show a degree of disparity consistent with the disparities in the other seven regions studied. Those results, however, must be interpreted with caution because of the very low percentage of census tracts in the region that are predominantly minority.

Census tracts that were either predominantly or majority minority in the Minneapolis-St. Paul region comprise 13.3 percent of all census tracts in the region. The data show that businesses in that combined set of census tracts constitute 9.1 percent of businesses in the region, but they received only 5.1 percent of the total number of loans under $100,000 and 4.3 percent of the total dollar amount of those loans. That is, businesses in census tracts that were either predominantly or majority minority received 56.0 percent of the total number of loans, and 47.3 percent of the

[53] The disadvantaged categories are: low- or moderate-income, predominantly or majority minority, and predominantly or majority Hispanic.

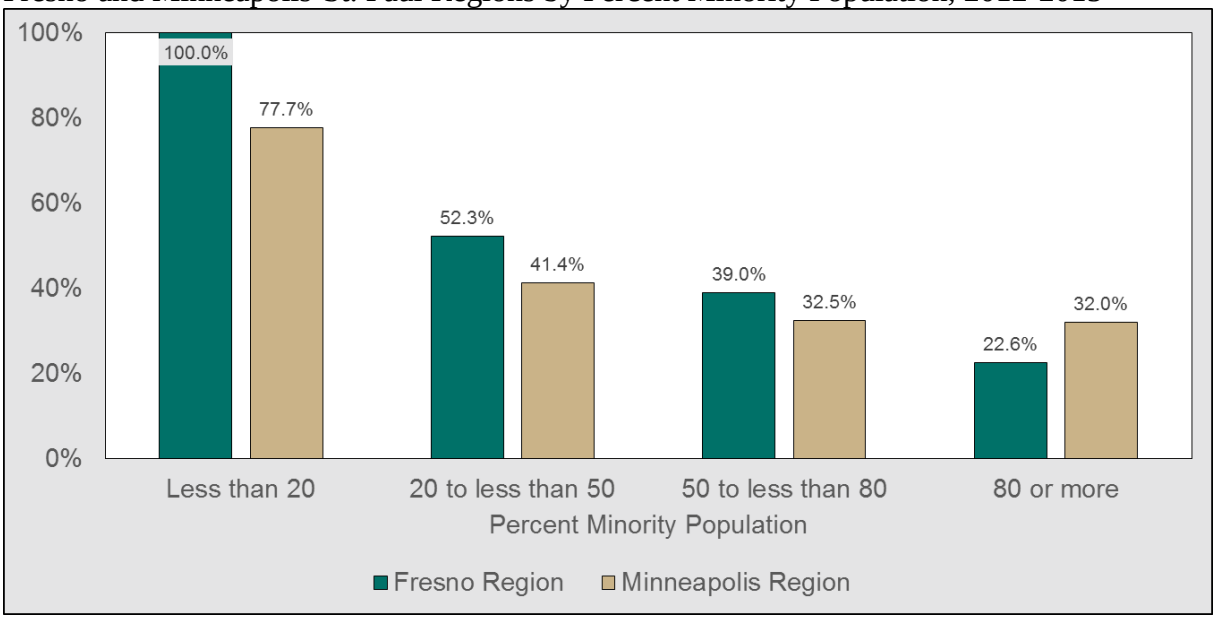
total dollar amount of loans, that their share of businesses represent. If businesses in predominantly or majority minority census tracts in the Minneapolis-St. Paul region had received CRA-reported loans under $100,000 in proportion to their share of businesses overall, they would have received more than 2,300 additional loans annually, over 9,300 loans between 2012 and 2015, totaling nearly $36 million annually, or over $143 million more than they actually received between 2012 and 2015.

Chart 14: Percent of Businesses, Loans, and Dollar Amount for Loans under $100,000 in the Minneapolis-St. Paul Region by Percent Minority Population, 2012-2015



Sources: FFIEC CRA data for Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties, 2012-2015, 2012-2014; FFIEC Percent Minority Population data 2012-2015; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

Chart 15: Average Percent of Businesses Receiving Loans under $100,000 Annually in the Fresno and Minneapolis-St. Paul Regions by Percent Minority Population, 2012-2015



Sources: FFIEC CRA data for Fresno County for the Fresno region, and Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties for the Minneapolis-St. Paul region, 2012-2015; FFIEC Percent Minority Population data 2012-2015; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

The pattern of disparities in access to CRA-reported loans under $100,000 in the Fresno and Minneapolis-St. Paul regions are consistent with the pattern of disparities in the six other regions studied in this series. Overall, the higher the percentage of minority population in the census tract in either region, the lower the percentage of businesses that received loans (Chart 15). In both regions, however, comparing the percentages requires some caution because of the low percentage of census tracts in the predominantly white or minority categories. In the Fresno region, only 1.0 percent of tracts were predominantly white, while only 3.1 percent were predominantly minority in the Minneapolis-St. Paul region. With such small numbers of tracts and businesses in those tracts, the data would be very sensitive to even small changes in the number or amounts of loans made during the study period in those tracts.[54] The results do show that businesses in tracts where the population was 50 percent or more minority (predominantly or majority minority) were less likely to have received loans than businesses in census tracts where the population was more than 50 percent white (predominantly or majority white).

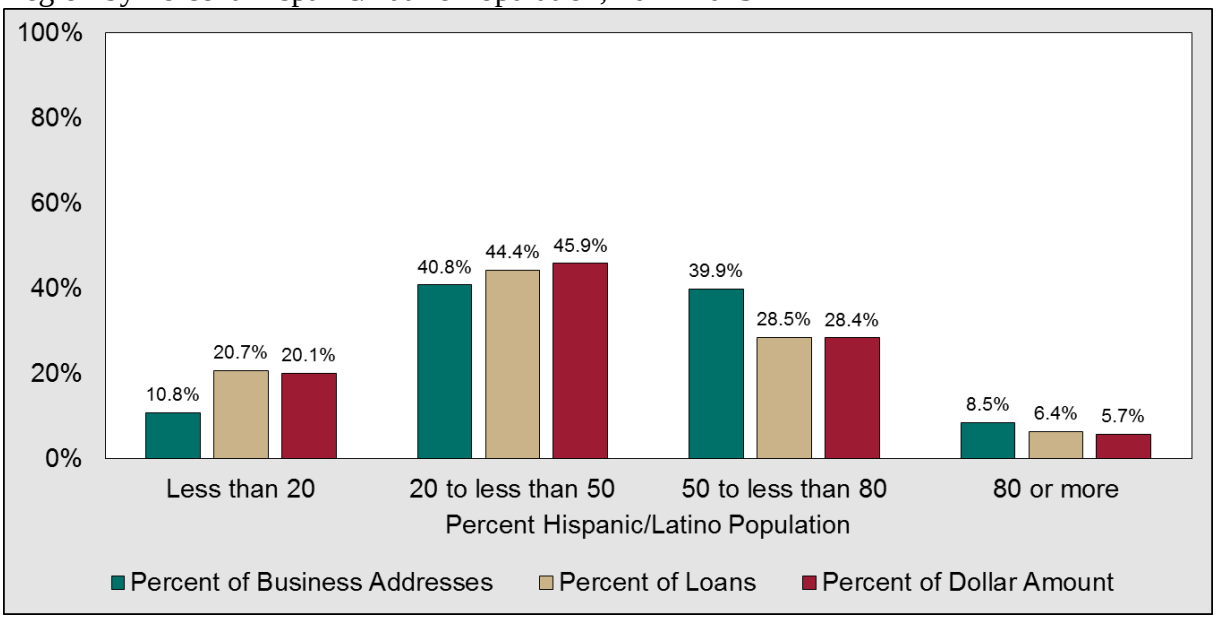
Percent Hispanic/Latino Population

As with the analysis of the distribution of CRA-reported loans under $100,000 by the racial composition of census tracts, analysis by the percentage Hispanic/Latino population shows that the higher the percentage of Hispanic population, the lower the probability that a business receives a loan. In the Fresno region, businesses in predominantly Hispanic neighborhoods constituted 8.5 percent of all businesses, but the received only 6.4 percent of CRA-reported loans under $100,000, about 75.6 percent of the number they would receive based on their proportion

[54] In the Fresno region, there were more loans to businesses than businesses in predominantly white census tracts. That result could be from undercounting the number of businesses or from the possibility that some businesses received loans from more than one reporting financial institution.

of businesses (Chart 16). Those businesses received only 5.7 percent of the total amount of loans, or about 71.2 percent of the amount they would receive based on their share of all businesses. If businesses in predominantly Hispanic census tracts received CRA-reported loans under $100,000 in proportion to their share of businesses in the Fresno region, they would have received about 930 more loans totaling over $17.6 million than they actually received between 2012 and 2015.

Chart 16: Percent of Businesses, Loans, and Amount for Loans under $100,000 in the Fresno Region by Percent Hispanic/Latino Population, 2012-2015



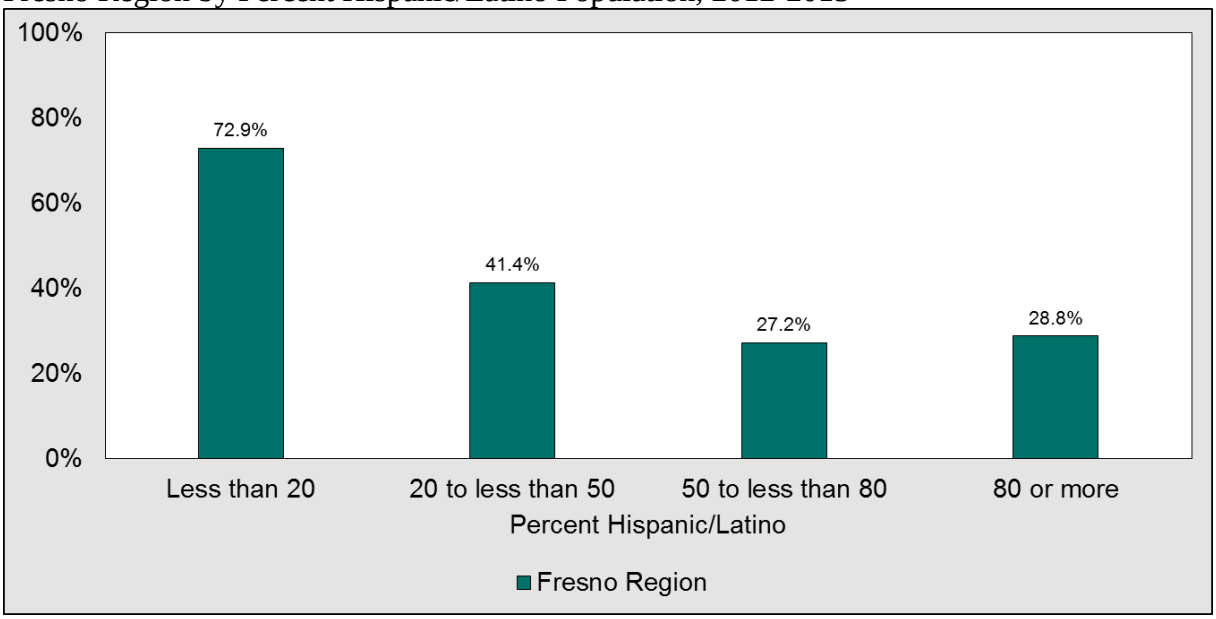
Sources: FFIEC CRA data for Fresno County, 2012-2015; FFIEC Hispanic/Latino Population and Population data 2012-2015; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

For businesses in majority Hispanic census tracts in the Fresno region, the situation was similar. They comprised 39.9 percent of businesses in the region, but they received just 28.5 percent of CRA-reported loans under $100,000, and 28.4 percent of the total dollar amount of those loans. In other words, they received 71.5 percent of the total number of loans and 71.2 percent of the total dollar amount of loans that their share of total businesses represents. If businesses in majority Hispanic census tracts had received loans in proportion to their share of businesses, they would have received over 5,000 more loans, totaling just under $73 million, than they actually received between 2012 and 2015.

The Minneapolis-St. Paul region has no census tracts that are either predominantly or majority Hispanic/Latino.

As with the analysis by the racial composition of the census tract, the data show that businesses in predominantly or majority Hispanic census tracts are less likely to have received loans between 2012 and 2015 than businesses in predominantly or majority non-Hispanic census tracts (Chart 17). Businesses in predominantly non-Hispanic census tracts are about 2.5 times as likely to have received loans than businesses in either predominantly or majority Hispanic census tracts.

Chart 17: Average Percent of Businesses Receiving Loans under $100,000 Annually in the Fresno Region by Percent Hispanic/Latino Population, 2012-2015



Sources: FFIEC CRA data for Fresno County, 2012-2015; FFIEC Hispanic Population and Population data 2012-2015; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

Regional Comparison

Analysis of CRA-reported business loan data for loans under $100,000 in the Fresno and Minneapolis-St. Paul regions between 2012 and 2015 shows clear disparities in the rate of loan origination to businesses by the income level and racial or ethnic composition of the census tract. Earlier research on lending in the Chicago and Los Angeles-San Diego regions,[55] the Buffalo and New Brunswick regions,[56] and the Detroit and Richmond[57] regions showed similar patterns in metropolitan areas in different parts of the country, with different economic trajectories, and with different demographic characteristics. In this and the three earlier studies, businesses in low-income census tracts received roughly half the number and total dollar amount of CRA-reported loans under $100,000 that their share of businesses represents (Table 4). For example, businesses in low-income census tracts in the Fresno region represent an average of 16.3 percent of all businesses in the region, but they received only 7.1 percent of the number of loans under $100,000 and only 7.4 percent of the total dollar amount of those loans (Chart 9). Therefore, the ratio of the percent of businesses to loans is 43.5 percent, that is, businesses in low-income census tracts received 43.5[58] percent of their proportionate share of the number of loans. Businesses in moderate-income census tracts in the Minneapolis-St. Paul region were an average of 23.8 percent of businesses in the region, but they received only 14.5 percent of the number of loans under $100,000, and 14.7 percent of the total dollar amount of those loans (Chart 10). The ratios of businesses to loans, 61.1 percent, and business to the amount of loans, 61,7 percent, are both the lowest of the eight regions studied.

[55] Cowan, 2017A.
[56] Cowan, 2017B.
[57] Cowan, 2017C.
[58] The difference between the calculated ratio and the result of dividing the percentage of loans by the percentage of businesses is due to rounding.

Table 4: Ratio of the Percentage of the Number and Total Dollar Amount of CRA-reported Loans under $100,000 to the Percentage of Businesses by the Income Level of the Census Tract

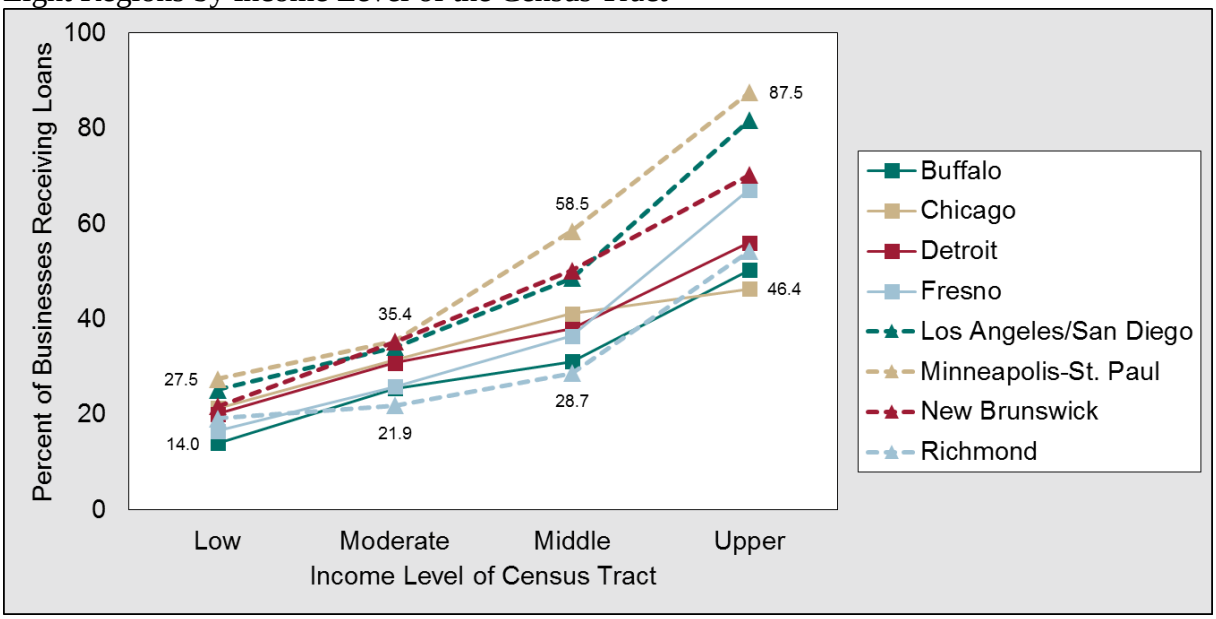
	Low-income		Moderate-income	
Region	Number	Amount	Number	Amount
Buffalo	42.8%	42.9%	77.9%	82.0%
Chicago	53.0%	46.0%	77.8%	72.4%
Detroit	49.8%	54.3%	76.9%	79.6%
Fresno	43.5%	45.6%	68.1%	68.1%
Los Angeles/San Diego	47.9%	51.3%	64.8%	65.4%
Minneapolis-St. Paul	47.5%	42.3%	61.1%	61.7%
New Brunswick	40.7%	38.7%	66.1%	64.4%
Richmond	57.7%	66.8%	65.7%	63.3%

Data sources: Cowan, 2017A; Cowan, 2017B; Cowan, 2017C; FFIEC CRA data for Fresno County for the Fresno region, and Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties for the Minneapolis-St. Paul region, 2012-2015; FFIEC Median Family Income Percent data 2014; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

The disparity in access to CRA-reported loans under $100,000 is also apparent in the percentage of businesses in low- and moderate-income census tracts that receive loans, not only in the Fresno and Minneapolis-St. Paul regions, but in the Buffalo, Chicago, Detroit, Los Angeles-San Diego, New Brunswick, and Richmond regions as well (Chart 18). In all eight regions, the higher the income level of the census tract, the higher the percentage of businesses receiving loans, with dramatic increases for the percentage of businesses receiving loans in upper-income census tracts in five of the eight regions – Buffalo, Detroit, Fresno, Los Angeles-San Diego, and Richmond.

In low-income census tracts, between 14.0 and 27.5 percent of businesses received loans in the eight regions. That means that between 86.0 percent (about six out of seven) and 72.5 percent (nearly three out of four) did not receive a loan. Considering that loans include term loans, lines of credit, and credit cards, the fact that so many businesses in low-income census tracts did not receive loans points to a significant lack of access to capital and the tools that businesses need to manage expenses and cash flow fluctuations. Even in moderate-income census tracts, somewhere between 78.1 percent (about four out of five) and 64.6 percent (about two out of three) businesses lack access to even a business credit card or line of credit.

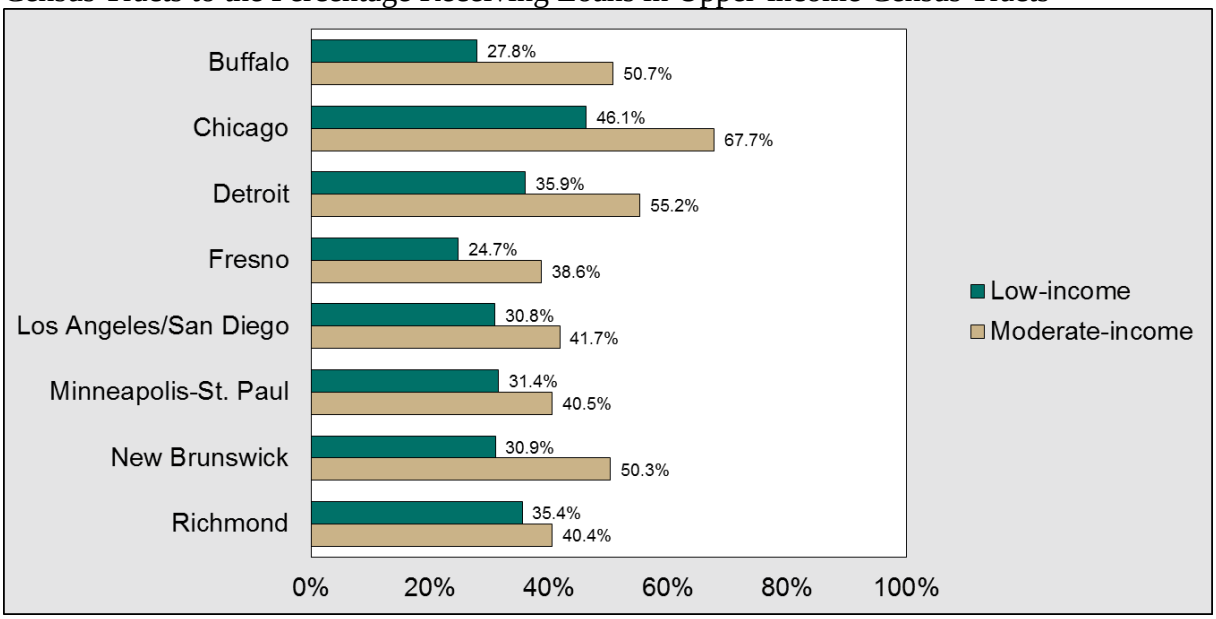
Chart 18: Average Percentage of Businesses Receiving CRA-reported Loans Under $100,000 in Eight Regions by Income Level of the Census Tract



Data sources: Cowan, 2017A; Cowan, 2017B; Cowan, 2017C; FFIEC CRA data for Fresno County for the Fresno region, and Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties for the Minneapolis-St. Paul region, 2012-2015; FFIEC Median Family Income Percent data 2014; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

The extent of the disparity in access to CRA-reported loans under $100,000 for businesses in lower-income census tracts is also shown in the ratio of the average percentage of businesses that receive such loans in low- or moderate-income census tracts to the percentage that received those loans in upper-income census tracts (Chart 19). For example, businesses in low-income census tracts in the Fresno region were only about 25 percent as likely to have received loans as businesses in upper-income tracts in the region, the lowest ratio of the eight regions studied. Overall, the ratios of the average percentage receiving loans under $100,000 in low-income census tracts to the percentage receiving loans in upper-income census tracts range from a low of 24.7 percent in Fresno to a high of 46.1 in the Chicago region. The disparity in access is somewhat less for businesses in moderate-income tracts, but it is still substantial. In the Fresno region, businesses in moderate-income census tracts were under 39 percent as likely to have received loans as businesses in upper-income tracts, also the lowest ratio of the eight regions. While the socio-economic conditions and sizes of the eight regions studied – Buffalo, Chicago, Detroit, Fresno, Los Angeles-San Diego, Minneapolis-St. Paul, New Brunswick, and Richmond – vary considerably, the disparities in access to capital are relatively consistent, although the Chicago region appears to have a slightly lower level of disparity with respect to the income level of the census tract than the seven other regions.

Chart 19: Ratio of the Percentage of Businesses Receiving Loans in Low- and Moderate-income Census Tracts to the Percentage Receiving Loans in Upper-income Census Tracts



Data sources: Cowan, 2017A; Cowan, 2017B; Cowan, 2017C; FFIEC CRA data for Fresno County for the Fresno region, and Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties for the Minneapolis-St. Paul region, 2012-2015; FFIEC Median Family Income Percent data 2014; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

Analysis of CRA-reported lending data for loans of under $100,000 also showed disparities in access with respect to the racial composition of the census tract, especially for businesses in predominantly minority census tracts. Except in the Los Angeles-San Diego, Fresno, and Richmond regions, businesses in predominantly minority census tracts received between 50 and 56 percent of the number and total dollar amount of CRA-reported loans under $100,000 that their share of businesses represents in their respective regions (Table 5). In the Los Angeles-San Diego region, businesses in predominantly minority census tracts received about two-thirds as many loans as their share of businesses represents, and they received about 60 percent as many loans as their share of businesses in the Fresno region. Those two regions were the only ones that were majority minority, with more than half of the population identifying as non-white, of the eight regions studied. In the Richmond region, businesses in predominantly minority census tracts received only 42 percent as many loans as their percent of businesses in the region.

Table 5: Ratio of the Percentage of the Number and Total Dollar Amount of CRA-reported Loans under $100,000 to the Percentage of Businesses by the Racial Composition of the Census Tract

	50 to Less than 80 Percent Minority Population		80 Percent or More Minority Population	
Region	Number	Amount	Number	Amount
Buffalo	55.1%	58.8%	50.1%	45.7%
Chicago	98.2%	95.2%	53.8%	44.3%
Detroit	61.4%	61.3%	53.8%	44.3%
Fresno	102.4%	103.2%	59.2%	59.5%
Los Angeles/San Diego	84.9%	85.8%	67.6%	64.8%
Minneapolis-St. Paul	56.1%	47.1%	55.2%	47.8%
New Brunswick	91.6%	92.6%	55.9%	52.8%
Richmond	51.5%	51.2%	42.5%	35.5%

Data sources: Cowan, 2017A; Cowan, 2017B;, 2012-2015; Cowan, 2017C; FFIEC CRA data for Fresno County for the Fresno region, and Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties for the Minneapolis-St. Paul region, FFIEC Percent Minority Population data 2012-2015; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

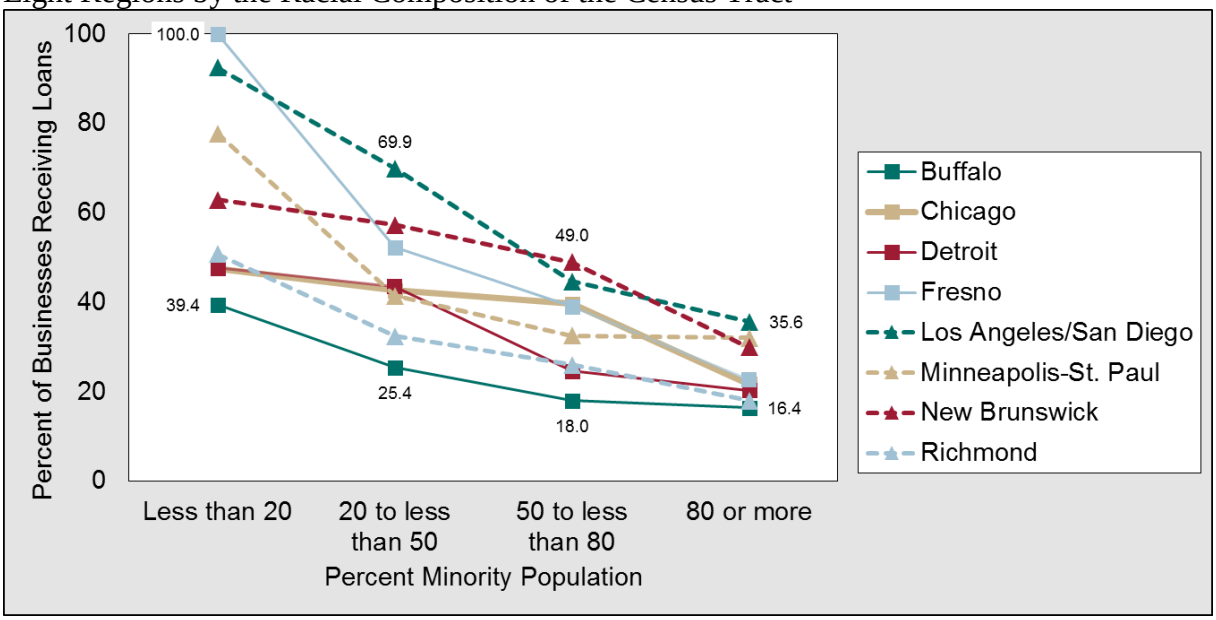
For businesses in majority minority census tracts, the analysis shows a different result. In the Fresno region, businesses in majority minority census tracts actually received a higher percentage of loans than their share of businesses. In four of the other seven regions, Buffalo, Detroit, Minneapolis-St. Paul, and Richmond, businesses in majority minority census tracts received between 51.5 and 61.4 percent of CRA-reported loans under $100,000 that their share of businesses represents. In the three other regions, Chicago, Los Angeles-San Diego, and New Brunswick, businesses in majority minority census tracts received closer to their proportionate share of loans, between 84.9 and 98.2 percent.

The average percentage of businesses that received loans in census tracts with different racial composition also show some regional differences in access to CRA-reported loans under $100,000 (Chart 20). For example, the average percentage of businesses receiving loans dropped sharply when the population of the census tracts became majority minority, as compared to majority white, in the Detroit region. In the Chicago and New Brunswick regions, the sharpest drop came for loans to businesses in census tracts that were predominantly minority. In the Buffalo, Minneapolis-St. Paul, and Richmond regions, the sharpest decline in the average percentage of businesses receiving loans was in census tracts that were 20 percent or more minority.[59] The Los Angeles-San Diego regions showed about equal levels of decrease in the average percentage of businesses receiving loans for both majority white and majority minority census tracts compared to businesses in predominantly white census tracts. Overall, the findings in this report with respect lending to businesses in minority neighborhoods in the Fresno and Minneapolis-St. Paul regions, as well as the six other regions covered in the three earlier reports,[60] are consistent with studies of lending to minority-owned businesses, which tend to be

[59] The sharp drop between the percentage of businesses receiving loans in predominantly white and majority white census tracts in the Fresno region is likely attributable, at least in part, to the relatively small number of census tracts that are predominantly white in the region, as noted earlier.
[60] Cowan, 2017A; Cowan, 2017B; Cowan 2017C.

located in minority neighborhoods, that have shown that minority business owners have less access to credit and are more likely than equally credit-worthy white owners to have their loan applications rejected.[61]

Chart 20: Average Percentage of Businesses Receiving CRA-reported Loans Under $100,000 in Eight Regions by the Racial Composition of the Census Tract

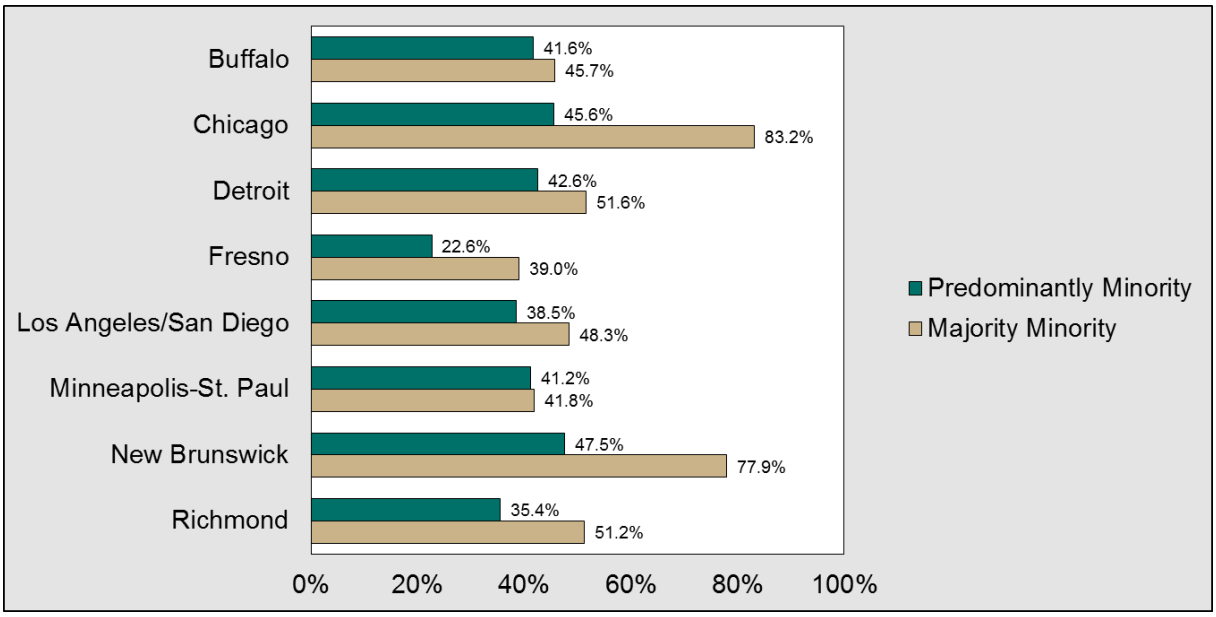


Data sources: Cowan, 2017A; Cowan, 2017B; Cowan, 2017C; FFIEC CRA data for Fresno County for the Fresno region, and Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties for the Minneapolis-St. Paul region, 2012-2015; FFIEC Percent Minority Population data 2012-2015; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

The extent of the disparity in access to CRA-reported loans under $100,000 for businesses in majority minority and predominantly minority census tracts is also shown in the ratio of the average percentage of businesses that receive such loans in majority or predominantly minority census tracts to the percentage that received those loans in predominantly white census tracts (Chart 21). Businesses in predominantly minority census tracts were less than half as likely to have received loans as businesses in predominantly white census tracts in all eight regions. Businesses in majority minority census tracts were about half as likely to have received loans as businesses in predominantly white census tracts, with the exception of the Chicago and New Brunswick regions. For example, businesses in majority minority census tracts in both the Detroit and Richmond regions were about 51 percent as likely to have received loans as businesses in predominantly white tracts in those regions. As with the analysis by the income level of the census tract, the analysis of lending shows consistent patterns of disparities despite the differences in the size, socio-economic characteristics, or geographic location of the regions studied.

[61] Bates and Robb, 2016; See also Klein, 2017, Fisher, 2013.

Chart 21: Ratio of the Percentage of Businesses Receiving Loans in Majority and Predominantly Minority Census Tracts to the Percentage Receiving Loans in Predominantly White Census Tracts



Data sources: Cowan, 2017A; Cowan, 2017B; Cowan, 2017C; FFIEC CRA data for Fresno County for the Fresno region, and Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Sherburne, Washington, and Wright counties for the Minneapolis-St. Paul region, 2012-2015; FFIEC Percent Minority Population data 2012-2015; HUD/USPS Vacancy Data, Q1-4, 2012-2015; Author's calculations.

Policy Implications

The term "loan" includes lines of credit and business credit cards as well as traditional term loans, and so the disparities across all eight regions studied in this and the three earlier reports show the extent to which businesses in lower-income or higher minority census tracts lack access to the capital and cash-flow management tools that businesses need to succeed. Roughly speaking, four out of five businesses in low-income census tracts, and three out of four in predominantly minority census tracts, do not even have a business credit card from any of the major providers, such as Capital One or American Express. Businesses in both low-income and predominantly minority census tracts are less than half as likely to have received a CRA-reported loan under $100,000 as businesses in upper-income or predominantly white census tracts.

The consistency of the findings across such different regions suggests that CRA-reporting financial institutions are not doing a good job of meeting the credit needs of businesses in lower-income neighborhoods and communities of color. Businesses need access to capital to survive and grow, and the success of local businesses is essential for the health of neighborhoods.[62] The lack of access to loans from larger financial institutions that report under the CRA has at least three potentially damaging impacts on businesses in those neighborhoods, with negative spillover effects on residents. First, without access to capital, businesses are less able to expand, retain their existing workforce[63] or hire additional workers, reducing the level of services and

[62] Bostic and Lee, 2017.

[63] National Small Business Association, *2016 Year-End Economic Report*, downloaded from http://www.nsba.biz/wp-content/uploads/2017/02/Year-End-Economic-Report-2016.pdf on May 9, 2017.

economic opportunity in the neighborhood. Second, without credit, businesses are less able to finance inventory and manage cash flow, making them more likely to fail than businesses that have that basic financial tool available. Third, business owners needing loans may have to use alternative lenders, such as InAdvance or Merchant Funding Services, which provide high-cost loans with interest rates as high as 367 percent.[64] The extraordinarily rapid expansion of fintech and other alternative lenders, increasing over 1,700 percent in the number and about 630 percent in the total dollar amount of loans between 2010 and 2014 according to one study,[65] suggests that non-bank lenders are filling the vacuum left by mainstream financial institutions.

The reliance on alternative lenders may be even greater for entrepreneurs from lower-income neighborhoods than for those from higher-income neighborhoods because they are less likely to be able to get loans from banks or to have significant equity in personal assets, such as a house, or personal credit cards with high available credit limits to use as a substitute for business loans.[66] For a quarter of small employer firms, personal funds are the primary source of capital.[67] The high cost of alternative loans drains capital from the business, reduces growth, and can lead to the same cycle of debt that consumers can be trapped in with payday loans.

The findings are particularly troublesome in an environment in which deregulation of the financial services sector appears increasingly likely. The disparities in access revealed in the data analysis have occurred within the current regulatory environment, one that provides some incentive under the CRA for banks to invest in low- and moderate-income census tracts within their service areas. Reducing regulatory incentives for banks to lend and invest in low- and moderate-income areas may exacerbate the problems that businesses in lower-income and predominantly minority or Hispanic census tracts have getting loans from banks, leading to even greater reliance on the unregulated, sometimes predatory, non-bank fintech and alternative business lenders. The existing data on the products and practices of virtually unregulated fintech lenders suggest some of the perils that small businesses in a less regulated financial services environment could face.

One element of the current trend toward less regulation of the financial services sector is the effort to limit the power and effectiveness of the CFPB. While its jurisdiction over business lending is somewhat limited, the Bureau has achieved a noteworthy measure of success in protecting consumers of financial services from unfair and abusive products and practices. The data it can collect under Section 1071 of the Dodd-Frank Act, for example, could provide valuable insight into business lending patterns and practices, much as the data available under the Home Mortgage Disclosure Act reporting requirements has done for mortgage lending. The CFPB or Department of Justice (DOJ) could then use those data to ensure that business lenders are complying with applicable fair lending requirements.

[64] Woodstock Institute analysis of 15 alternative loans showed effective annual interest rates from 26.3 percent to 367.7 percent. All of the loans analyzed with repayment periods of less than nine months had effective annual interest rates of over 100 percent.
[65] *Survey of Online Consumer and Small Business Financing Companies – 01/01/2010 through 06/30/2015: Summary Report of Aggregate Transaction Data*.
[66] Robb, 2013. Fairlie and Robb, 2010.
[67] *2016 Small Business Credit Survey: Report on Employer Firms.*

In May 2017, the CFPB issued a "request for information," seeking comments on small business lending data collection.[68] This data collection is intended, at least in part, to identify the financing needs of small businesses, with a focus on women- and minority-owned businesses. Also in May 2017, the CFPB published a white paper[69] detailing the existing state of data available to document small business lending, noting the numerous gaps in those data, as well as inconsistencies in the definition of "small business" among the various organizations collecting the data. For example, the FFIEC defines small firms for CRA reporting requirements as those with revenues of under $1,000,000, while the SBA defines small businesses as those with 500 or fewer employees. Under the FFIEC/CRA definition, 94.9 percent of all firms are small; under the SBA definition, 99.94 percent are small businesses. As the report states, "with the current data it is not possible to confidently answer basic questions regarding the state of small business lending. For example, it is difficult to determine the extent to which there has been a net decline in small business lending as opposed to a shift from lending from banks to alternative lenders during the recession or simply a decrease in credit extended." Without more accurate data about the demand for and supply of credit, identifying needs and implementing policies to address those needs is more difficult and less precise, resulting in inefficiency and missed opportunities to promote economic prosperity more broadly.

Recommendations for Policymakers:

- **Require all small business lenders (bank and non-bank) to report race and gender of loan applicants and other relevant data.** The Consumer Financial Protection Bureau (CFPB) should develop rules under Section 1071 of the Dodd-Frank Act to require small business lenders to report loan data. As the CFPB noted in its white paper, currently available small business loan data are so inadequate and inconsistent that they can't reliably be used to support evidence-based policymaking or advocacy to promote economic development or assess potential fair lending issues in the market. In the rules, the CFPB should require small business lenders, including fintech lenders, to report the type of lender, the loan amount requested, the type of loan requested (e.g., term loan, credit card, or merchant cash advance), the action taken on the application, the amount loaned, the Annual Percentage Rate on the loan, whether the loan is payable by ACH debit, and the lender's default rates, in addition to any borrower demographics and business attributes necessary for fair lending analysis. The data reporting to CFPB should be in addition to any reporting to the prudential regulators by fintech lenders operating under a federal charter.

Currently, the CRA requires only lenders with assets of over approximately $1 billion to report small loans to businesses. While CRA-reporting lenders do make the majority of business loans, non-reporting institutions still make about a third of all loans by dollar volume.[70] The CFPB should include small lenders in its database to allow a more comprehensive analysis of how well regulated financial institutions are meeting the credit needs of businesses in low- and moderate-income neighborhoods and communities of color.

[68] The comment period closed on September 14, 2017.

[69] Consumer Financial Protection Bureau, *Key Dimensions of the Small Business Lending Landscape*, May 2017, downloaded from https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201705_cfpb_Key-Dimensions-Small-Business-Lending-Landscape.pdf on May 9, 2017.

[70] See footnote 24.

In addition to expanding the number of banks reporting, the CFPB needs to expand the scope of data that banks report. Currently, CRA business lending reports do not include some key data that would allow for a more precise estimate of how well, or poorly, the large financial institutions are meeting the goals of the Act, which is to meet the credit needs of the community. The CRA-reported data cover only loans that are actually made, for example, but do not include business loan applications that did not lead to a loan being made. The data, therefore, do not show how many businesses sought credit, but were denied. Nor does the CRA dataset include the amount of the loan applied for, which shows the level of demand for business loans. The CRA data aggregate loans originated into three categories, $100,000 or less, $101,000 to $250,000, and $250,000 to $1,000,000, but do not report the actual amount of the loan to allow analysis of the difference between the level of demand and the dollar amount of loans originated. Those additional data fields, including all loan applications, the amount requested, action on the application, and the amount originated, would much more accurately show the level of demand and how well banks are meeting the demand. In addition, the CFPB should require banks to report the type of loan applied for, whether it is a term loan, line of credit, or credit card, to show whether lenders are providing the types of credit businesses are seeking.

● **Investigate potential discrimination.** The CFPB and the Department of Justice (DOJ) should investigate potential violations of fair lending statutes by business lenders, and, if violations are evident, take appropriate remedial action. The Equal Credit Opportunity Act (ECOA) applies to business lending. The disparities revealed in this report, in the earlier reports on business lending in the Chicago, Los Angeles-San Diego, Buffalo, New Brunswick, Detroit, and Richmond regions, and other research on business lending,[71] found that businesses in census tracts with higher percentages of minority residents or with minority owners are less likely to receive business loans than businesses in census tracts with lower percentages of minority residents or with white owners. Over 90 percent of small business organizations responding to the CRC Small Business Lending Survey reported that discrimination against small businesses owned by women, people of color or other protected groups "often" (57.1 percent) or "sometimes" (33.3 percent) occurred.[72] Regarding fintechs, Congressman Emanuel Cleaver launched an investigation into fintech lending to small businesses. The initial findings support the need for further investigation.[73] For example, only some lenders reported taking steps to guard against algorithmic bias against minorities and other protected classes. These findings suggest the need for further investigation to determine whether business lenders are complying with ECOA and providing credit on a non-discriminatory basis to applicants. If further analysis shows violations, both the CFPB and DOJ should act to remedy those violations.

● **Strengthen enforcement of existing laws on community investments by banks.** One way to improve the performance of CRA-reporting financial institutions in making small loans to businesses in low- and moderate-income census tracts is for CRA examiners to place more emphasis on the business lending part of the exam than they currently do in determining CRA ratings. The change, however, should not be a zero-sum approach, placing more weight on

[71] Bates and Robb, 2016. See also Cowan, 2012.
[72] CRC Small Business Survey at 12.
[73] *Congressman Cleaver Announces Initial Findings* of *Small Business Fintech Investigation* (Oct. 17, 2017). https://cleaver.house.gov/media-center/press-releases/congressman-cleaver-announces-initial-findings-of-small-business-fintech.

business lending and diminishing the importance of the other types of lending, such as mortgages, in the lending component of the exam. Instead, examiners need to be more stringent in the scoring of performance with respect to all types of lending.

Examiners also need to consider the type of small business loans banks are offering, rather than aggregating term loans, lines of credit, and credit cards, into a single category. Those different types of loan serve very different purposes and should not be considered fungible in determining whether banks are meeting the credit needs of businesses. The distinction among loan types would not apply to all lenders because some, such as American Express, FSB, offer only credit cards. Other banks, including Bank of America and Wells Fargo, offer both term loans and credit cards, and CRA examiners should consider the mix of loan types in their assessment of CRA performance. For example, examiners could compare separately for each loan type the percentage of small business loans in low- and moderate-income census tracts with the percentage of each loan type in all census tracts within the bank's service areas.

Examiners could also look at the extent to which banks that are not lending proportionately to businesses in low- and moderate-income census tracts are financing fintech lenders that are making high-cost loans to businesses in those areas. Small business owners in San Diego at a recent roundtable hosted by the FDIC reported that they had resorted to high-cost fintech loans in part because they had been unable to secure capital from banks.

In addition to the lending test, regulators need to be more critical in enforcement of the CRA investment and service tests. On the investment test, regulators should prioritize investments in CDFIs and community lenders over other activities, such as investment in mobile banking services. Under the service test, regulators should provide more incentive for banks to maintain brick-and-mortar branches in low- and moderate-income neighborhoods. Bank branches are essential for many low- and moderate-income customers and businesses in low- and moderate-income neighborhoods. Branches provide services that may not be available through Automatic Teller Machines (ATMs), such as help completing loan applications or sending remittances. Some customers, particularly the elderly, may not be comfortable with ATMs or mobile technology and prefer to bank in person, as they always have. For neighborhood businesses, the local branch is a key source of credit and business loans. Research has shown that local bank branch closings resulted in a 13 percent decline in small business lending that lasts for several years, that the decline is concentrated in low-income and predominantly minority neighborhoods, and that the decline is not affected by the opening of new branches following the closings.[74] Given the importance of maintaining existing branches in low- and moderate-income neighborhoods to preserve small business access to bank loans, regulators should exercise their authority to require banks to obtain non-objection letters from their regulator whenever seeking to close branches in low- and moderate-income neighborhoods.[75]

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[74] Nguyen, Hoai-Luu Q., 2014. *Do Bank Branches Still Matter? The Effect of Closings on Local Economic Outcomes*. Downloaded from *http://economics.mit.edu/files/10143* on November 30, 2016. A later version of this study was published in October, 2015, by the University of California at Berkeley.

[75] According to an article in the Wall Street Journal, September 17, 2017, by Rachel Louise Ensign and Coulter Jones, Bank of America has closed 1,597 branches, mostly in rural areas, since the start of the financial crisis. The bank has pulled out of 253 counties entirely, reducing its presence from 725 counties to 472 counties nationwide. Of the counties Bank of America has exited, 95 percent are outside of metropolitan areas with populations of 1 million or more. Over the same period, the bank has opened branches in more populated cities.

According to one analyst, over 96 percent of banks receive a satisfactory CRA rating or better.[76] When only one business out of five in low-income tracts, and one of four in moderate-income tracts, has a loan, line of credit, or credit card from a large financial institution, rating the performance of 96 percent of financial institutions as satisfactory seems to set very low expectations. The significance of more stringent CRA examinations is evident in the recent $30 billion Community Benefits Agreement (CBA) plan that Fifth Third Bank agreed to with the National Community Reinvestment Coalition to address its "Needs to Improve" CRA rating, without any merger or acquisition pending.[77]

While the drafting of this report was in its final stages, the OCC took steps to make CRA examinations easier for financial institutions – precisely the opposite direction than the one recommended by this report. Under PPM 5000-43, issued on October 12, 2017, the OCC declared that unlawful discrimination would not negatively impact an institution's CRA evaluation unless the discrimination was tied to the institution's CRA-lending activities.[78] The practical implications of this new policy remain to be seen. Congresswoman Maxine Waters, Ranking Member of the House Financial Services Committee, said that the OCC's action "has weakened CRA enforcement by easing the consequences for banks that violate fair lending laws and harm consumers."[79]

- **Require non-bank lenders to serve and invest in their communities.** Regulators should incorporate the equivalent of CRA requirements for investment in low- and moderate-income census tracts, fair lending, consumer protection, and safety and soundness oversight similar to those for banks in any federal charter for fintech lenders; also, the charter should not preempt state laws conferring greater protection on business borrowers. Fintech lenders are filling the vacuum left by the failure of mainstream banks to make small business loans, and they may serve a valuable role in helping small businesses succeed, but only if the loans they make are beneficial for the businesses. Just as predatory consumer loans can trap borrowers in a cycle of debt and lead to financial ruin, predatory business loans can drain capital from businesses and lead to failures.

The Office of the Comptroller of the Currency (OCC) has proposed a federal charter for fintech lenders.[80] In its paper on innovation in banking,[81] the OCC recognized the role of fintech lenders and addressed some of the concerns it saw with banks working with or adopting the methods of the fintech lenders. The OCC's first guiding principle of understanding and evaluating new

[76] Thomas, Kenneth H., *Comptroller Curry: How About Some Real CRA Reform?,* in *American Banker,* April 9, 2014.
[77] A one-page summary of the CBA plan can be found at https://www.53.com/about/in-the-community/53-commitment-plan-summary.pdf.
[78] Office of the Comptroller of the Currency, *Policy & Procedures Manual (PPM 5000-43)* , Oct. 12, 2017, https://www.ots.treas.gov/publications/publications-by-type/other-publications-reports/ppms/ppm-5000-43.pdf
[79] *Waters Statement on the OCC's Weakening of CRA Enforcement* (Oct. 18, 2017), https://democrats-financialservices.house.gov/news/documentsingle.aspx?DocumentID=400864.
[80] Former Comptroller Curry made the announcement on December 2, 2016. See https://www.occ.gov/news-issuances/news-releases/2016/nr-occ-2016-152.html for a summary of his remarks and links to more information.
[81] Office of the Comptroller of the Currency, 2016. *Supporting Responsible Innovation in the Federal Banking System.* Downloaded from *https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-responsible-innovation-banking-system-occ-perspective.pdf* on November 30, 2016.

offerings was to support responsible innovation. It defined responsible innovation to mean "the use of new or improved financial products, services, or processes . . . in a manner that is consistent with sound risk management and is aligned with the bank's overall business strategy."[82] That definition completely fails to address the potential for innovative products to have an adverse impact on customers and borrowers.

Because many fintech lenders have provided access to capital with terms and conditions that are predatory and harmful to the borrower, advocates have expressed concerns over any federal charter for fintech lenders. Those concerns include the possibility that the charter will preempt state laws protecting business borrowers as has happened with national banks in consumer lending. For example, nationally chartered banks are allowed to charge the maximum interest rate on consumer loans permitted in the state in which they are incorporated, even if that rate exceeds the maximum allowed in the borrower's state of residence, effectively gutting state usury laws. The OCC special purpose charter should clearly limit any potential for preemption of more protective state laws.

A federal charter will provide significant benefits to the emerging fintech industry, and, in exchange for those benefits, federal charters for fintech lenders must include strong protections to reduce the chances that lenders can make predatory loans and must provide the same level of oversight for fintech lenders as for the banks with which they compete or partner. Fintech lenders who receive a federal charter should also be required to report the same data as lenders reporting data to the CFPB under Section 1071 of the Dodd-Frank Act.

As the OCC observed in its paper, not all innovations are beneficial, and the charter should ensure that the innovations it encourages do not do more harm than good. For example, the charter should include requirements to ensure transparency in loan terms, with disclosures similar to those for consumer loans under the Truth in Lending Act. Most businesses are sole proprietorships and do not have attorneys and financiers to explain complex loan documents and terms.[83]

- **Support and increase funding for government programs that support lending to underserved communities.** Community Develop Financial Institutions (CDFIs) are financial institutions with a mission to serve communities that are traditionally distressed or underserved by mainstream financial institutions. The New Markets Tax Credit (NMTC) provides private-sector investors a credit against federal income taxes for investments in Community Development Enterprises (CDEs), corporations with a primary mission to serve or provide investment capital in low-income communities.[84] Both CDFIs and CDEs are important sources of business capital in lower-income neighborhoods and communities of color, but they can serve only a small fraction of the need. Community organizations and advocates need to work to support and increase funding for CDFIs and the NMTC Program to enable CDFIs and CDEs to expand the level of investment they bring to their service areas. Recent federal government

[82] Office of the Comptroller of the Currency, 2016, p. 5.
[83] Mills and McCarthy, 2016.
[84] For more information about CDFIs and the NMTC program, see https://www.cdfifund.gov/programs-training/Programs/new-markets-tax-credit/Pages/default.aspx.

budget proposals would eliminate or cut funding for the CDFI Fund, which is the Treasury Department source for funds to support CDFIs.

● **Pass local laws to reward banks that lend to businesses in low- and moderate-income neighborhoods and communities of color.** Local governments should use responsible banking ordinances that link government bank deposits to community reinvestment performance to encourage financial institutions to make more small loans to businesses in low- and moderate-income neighborhoods and communities of color. As part of a revitalization strategy, for example, lenders that do the most to provide credit to businesses in neighborhoods targeted for revitalization could receive preference for municipal deposits and other banking services that the municipality needs. The effect would be to use the deposits and other services to make private capital available to support economic development in the neighborhood. Any responsible banking ordinance, however, must be carefully crafted as an incentive, not a mandate, to avoid having a court rule that it is preempted by federal and state bank regulations, as one court has done. Despite that ruling, other municipal responsible banking ordinances remain in effect.

● **Require banks seeking to merge or acquire other banks to commit to increased investment in low- and moderate-income communities.** Regulators should require strong community benefit agreement (CBA) plans with community input and enforceable goals for approval of mergers and acquisitions. As the recovery of the financial services sector has proceeded, the number of mergers and acquisitions has increased. These activities present one of the rare opportunities for the prudential regulators to use their authority under the CRA to require banks to fully meet their obligations to invest in low- and moderate-income census tracts. Advocates and community groups have secured negotiated CBAs with banks seeking regulatory approval for mergers or acquisitions, and regulators should use those agreements as performance models for the future, both as to the process through which the agreements are reached and the substantive requirements that the agreements contain. For example, Huntington Bank agreed to $16.1 billion in a CBA as part of the approval process for its acquisition of FirstMerit Bank, and City National Bank agreed to commit a minimum of $11 billion in CRA-qualified investments, including $4.2 billion in small business loans, over a five-year period in connection with its merger with the Royal Bank of Canada. Other banks seeking approvals for mergers and acquisitions should be required to make a similar commitment as a condition of the approval.

● **Extend consumer protection to small business loans.** Business borrowers, many of whom assume personal liability for repayment of loans to their businesses, [85] should receive the same types of protections for small business loans as they would receive were the loans for personal use. Lenders should be required to disclose the loan terms clearly, in a way that enables the borrower to understand the cost of the loan and repayment terms; to determine the borrower's ability to repay the loan without additional borrowing; and be prohibited from engaging in abusive collection practices. Not only should the protections be the same for small business loans as for consumer loans, but the CFPB should have authority over small business loans as it does over consumer loans, especially for the smallest loans and those for which the business owner assumes personal liability.

[85] According to the Census Bureau, http://www.census.gov/econ/nonemployer/, the majority of all business establishments in the United States are nonemployers, that is, self-employed individuals operating unincorporated businesses (known as sole proprietorships). See also Mills and McCarthy, 2016.

Recommendations for Banks:

- **Ensure equal treatment of loan applicants.** Banks should require compliance and fair lending teams to actively take steps to ensure consistency in the delivery of small business products and services. The disparities in lending to borrowers in communities of color identified in this series of reports, and the evidence of small business loan officer discrimination against and discouragement of small business loan applicants from protected classes highlighted in other research reports, raise serious fair lending concerns. Bank training of small business loan officers should emphasize consistent and fair treatment of all loan applicants including, for example, how loan officers offer business cards and assistance or make referrals. Banks should also ensure that their loan officers understand the culture of the neighborhoods they serve and can relate to the small business owners and entrepreneurs in their communities. Banks should also conduct periodic internal mystery shopping using testers of various backgrounds and protected classes, such as race, ethnicity, national origin, gender, and marital status, to ensure that applicants of different backgrounds receive the same levels of products, services, and assistance. Considering the extent to which lending and banking continues to become more automated, banks should also test their systems to guard against algorithmic bias or other processes that might have a disparate impact on protected classes.

- **Support nonprofit organizations that conduct fair lending and testing, or fair lending research and advocacy.** The disparities in lending to borrowers in low- and moderate-income communities identified in this series of reports raise concerns about the extent to which banks are meeting their obligations under the CRA to serve the credit needs of low- and moderate-income people and communities, consistent with safety and soundness. Banks should consider supporting nonprofit organizations that conduct fair lending training and testing, or fair lending research and advocacy. To the extent that bank grants or investments in fair lending training, testing, research, and advocacy primarily benefit low- and moderate-income persons and communities, banks can receive favorable consideration under the CRA investment or community development tests.