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**Written Testimony of**

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

“Open for Business: The Impact of the CFPB on Small Business”

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## **Witness Background Statement**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

<sup>3</sup> 15 U.S.C. § 1642.

<sup>4</sup> 15 U.S.C. § 1645.

<sup>5</sup> 15 U.S.C. § 1691 *et seq.*

<sup>6</sup> Pub. L. 111-203, § 1071, 124 Stat. 1376, 2056-2057, July 21, 2010.

<sup>7</sup> Pub. L. 111-203, § 1071, 124 Stat. 1376, 2056-2057, July 21, 2010.

<sup>8</sup> Pub. L. 111-203, §§ 1002(12), 1061, 124 Stat. 1376, 1957, 2035-2039, July 21, 2010.

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

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

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

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

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

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

<sup>11</sup> Pub. L. 111-203, §§ 1025, 1026(d)(1), 124 Stat. 1376, 1990-1994, July 21, 2010.

<sup>12</sup> Pub. L. 111-203, §1021(b)(3), 124 Stat. 1376, 1980, July 21, 2010.

<sup>13</sup> Pub. L. 111-203, §1024(b)(2)-(3), 124 Stat. 1376, 1987-1988, July 21, 2010.

<sup>14</sup> Pub. L. 111-203, §1022(b)(2)(B), 124 Stat. 1376, 1981, July 21, 2010.

<sup>15</sup> Pub. L. 111-203, §1022(b)(2)(C), 124 Stat. 1376, 1981, July 21, 2010.

<sup>16</sup> Pub. L. 111-203, §1100G, 124 Stat. 1376, 2112-2113, July 21, 2010.

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

<sup>18</sup> P.L. 111-203, § 1100G, 124 Stat. 1376, 2112, July 21, 2010.

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

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

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

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

### III. The CFPB Can Help Small Businesses

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

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

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<sup>19</sup> P.L. 111-203, § 1022(d), 124 Stat. 1376, 1984-1985, July 21, 2010.

<sup>20</sup> P.L. 111-203, § 1023, 124 Stat. 1376, 1985-1987, July 21, 2010.

<sup>21</sup> P.L. 111-203, § 1022(b)(3)(A), 124 Stat. 1376, 1981, July 21, 2010.

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

<sup>23</sup> NSBA Issue Brief, *Credit Card Reform*, at [http://nsba.biz/docs/2011/Credit\\_Card\\_Reform.pdf](http://nsba.biz/docs/2011/Credit_Card_Reform.pdf).

<sup>24</sup> *Id.*

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

#### **IV. Conclusion**

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