

**THOUGHT LEADERSHIP**

LEGAL UPDATES

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# CFPB Pilot Study Finds Differential Treatment in Small Business Lending Markets

On November 13, the Consumer Financial Protection Bureau (CFPB) released a report on matched-pair testing in small business lending, highlighting potential racial discrimination. The study reveals that Black small business owners may face less favorable treatment compared to their white counterparts when seeking credit.

## Background

In 2023, the CFPB and the U.S. Department of Justice (DOJ) partnered to conduct matched-pair testing to analyze differential treatment between Black and white small business owners. The study involved recruiting 50 pairs of testers to visit 25 bank branches in Fairfax County, Virginia, and 25 in Nassau County, New York. Each pair of testers consisted of one Black and one white participant. In total, 100 visits were conducted.

Testers were instructed to approach each branch with a prepared small business profile and request information on available business financing options. Each interaction was audio recorded and testers completed a post-visit survey to document their experience, which provided the data analyzed in the report.

The test results examined four metrics: (1) encouragement or discouragement to apply for a loan; (2) information provided about requested loan products and potential steering to other products; (3) the overall quality of treatment or customer service; and (4) the amount of business and credit information requested.

## Statistical analysis and results

The study found that Black testers received less favorable treatment than paired white testers in two out of the four metrics analyzed. On both metrics, the differential treatment was statistically significant.

First, Black testers received less favorable treatment on measures of encouragement to apply for financing. Although testers tended to receive favorable levels of encouragement/discouragement regardless of their race, white testers purportedly received more favorable treatment than their Black counterparts. This pattern was consistent across both an objective index of potentially encouraging/discouraging behaviors and the testers' subjective rating of their experience.

Second, Black testers were purportedly more likely to be offered non-requested credit products, such as business credit cards or real estate-secured loans. While bank representatives were equally likely to discuss the credit products that testers requested as part of their inquiry, these bank representatives were more likely to discuss non-requested products with Black testers. In fact, according to the study, bank representatives discussed non-requested products with 59% of Black testers but only 39% of white testers.

### **Implications for financial institutions**

The Equal Credit Opportunity Act (ECOA) prohibits racial discrimination in both consumer and business-purpose credit transactions. Consequently, the CFPB recommends implementing several compliance management practices to mitigate the risk of an ECOA violation within a financial institution's small business lending program. These practices include: (1) active oversight by the board of directors and management of the institution's compliance management system framework; (2) comprehensive risk-focused policies and procedures for small business lending; (3) periodic reviews of existing policies and procedures to address the risk of an ECOA violation; and (4) small business lending monitoring programs and risk assessments.

Based on the limited nature of the study, the CFPB counsels against generalizing the report's findings to the total U.S. small business lending market or to any specific financial institution. However, the CFPB's report purports to reveal evidence of less favorable treatment of Black small business owners relative to white small business owners at large banks in two counties. As such, the CFPB's study may be used to provide a "framework" for detecting such differential treatment within other financial institutions.

### **What this means to you**

Business purpose lenders need to be vigilant about fair lending risk. Indeed, with the advent of data collection and reporting requirements for small business lenders under Section 1071 of the Dodd-Frank Act, regulators, plaintiffs, and the media will have access to the type of data that can be used to

make out *prima facie* disparate impact claims under the Equal Credit Opportunity Act. The CFPB's study, with its associated "framework" for detecting disparities in the lending marketplace, reads like an invitation for certain stakeholders to scrutinize data for actionable disparities.

**Contact us**

If you have any questions about this study or other consumer financial issues, contact Chris Friedman or your local Husch Blackwell attorney.