TESTIMONY OF EVERETT K. SANDS, CEO OF LENDISTRY, TO THE HOUSE SMALL BUSINESS COMMITTEE'S SUBCOMMITTEE ON ECONOMIC GROWTH, TAX, AND CAPITAL ACCESS

"Examining the Role of Community Development Financial Institutions and Minority Depository Institutions in Small Business Lending"

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Committee Chairwoman Velázquez, Ranking Member Luetkemeyer, Subcommittee Chair Davids, Subcommittee Ranking Member Meuser, Vice Ranking Member Williams, and distinguished members of the Subcommittee, thank you calling a hearing on The Role of CDFIs and MDIs in Small Business Lending, and for your interest in my perspectives and insights on this topic.

My name is Everett K. Sands, and I have more than 20 years of experience in lending at Minority Depository Institutions, at one of the largest national banks, and at the only fintech Community Development Financial Institution, Lendistry. For the past five years, as founder and CEO of Lendistry, my focus has been on responsible lending to underserved small businesses, and particularly those owned by minorities, women, veterans, and people in rural areas. Since the onset of COVID-19 lockdowns and their related impacts, Lendistry has been the primary point of contact in connecting more than a quarter of a million affected small businesses with $3.25 billion in loans or grants.

My message today is that the single most effective way for Congress and the Federal Reserve to significantly expand capital access for small and underserved businesses is to focus on making significantly more capital available to CDFIs and MDIs. One unmistakable lesson of the determined economic relief efforts led by Congress over the past year in response to COVID is that small and underserved businesses are far and away more successful in accessing capital from CDFIs and MDIs than from other sources. Yet, paradoxically, CDFIs and MDIs face more barriers to gaining an adequate supply of capital to deploy than other federally-regulated and federally-certified financial institutions. In short, CDFIs and MDIs are essential, yet underutilized, pieces of the small business funding infrastructure.

The stakes in addressing this paradox are enormous. Disparity in access to capital on responsible terms is a critical hurdle for small businesses, both in powering the nation's economic and jobs recovery, and in narrowing the racial wealth gap.

To summarize the specific recommendations that I discuss in greater detail below:

1. *Leverage several key building blocks that already have been established by Congress and the Federal Reserve by establishing mechanisms that are exactly analogous to ones that already have proven to be effective in opening a flow of capital to CDFIs and MDIs.* My recommendations in this regard focus on:
    - Making greater use of the Paycheck Protection Program Liquidity Facility (PPPLF) and all three SBA 7(a) programs;
    - Expanding the Community Advantage program, in three dimensions – length, loan amount and geographic reach; and
    - Making greater use of the Federal Home Loan Banks (FHLB) and programs that guarantee loans, such as the recently renewed State Small Business Credit Initiative (SSBCI).

2. *Optimize the complementary nature of traditional banks, on one hand, and CDFIs and MDIs, on the other, for the benefit of small businesses.* My recommendations in this regard focus on enhancing the incentives for traditional banks (which have outstanding access to capital but poor connectivity with small businesses) to partner with CDFIs and MDIs (which have outstanding connectivity with small businesses but poor access to capital).

3. *Create an office within Small Business Administration dedicated to supporting the efforts of CDFIs and MDIs as small business lenders*.

I. Introduction

I have more than 20 years of experience in the banking and lending fields. Prior to starting Lendistry, I worked in both national and community banking. I have served as a Board Member and an Executive for two minority deposit institutions; as a sales team leader for a national bank on both the East and West coasts; as a member of committees focused on compliance, rate-risk, and commercial lending; and as a manager of credit and operations departments. I also currently serve as a Board Member of the University of Pennsylvania's Institute for Urban Research, and of Lendistry's nonprofit small business advisory and technical assistance affiliate, The Center for Strategic Economic Studies and Institutional Development ("The Center").

As a banker I typically served in a change agent capacity, being called in to turn around a unit of a bank, and as such, units I have led typically recorded annual growth rates of between 300% and 600%. I have closed more than $4 billion in transactions. During my career, businesses I have led have been regulated by the Federal Deposit Insurance Corporation, Federal Housing Administration, Federal Housing Finance Agency, Federal Home Loan Bank of San Francisco, Office of Comptroller of Currency, Office of Thrift Supervision, Small Business Administration, Veterans Administration, and various state regulators.

Lendistry is a minority-led fintech CDFI and Community Development Entity (CDE), and a member of the Federal Home Loan Bank of San Francisco. Women and minorities comprise a significant majority of Lendistry's management team. Our proprietary technology and online application portal enable a faster and more widely accessible lending process for small business borrowers. As a CDFI, Lendistry is dedicated to providing economic opportunities and progressive growth for underserved urban and rural small business borrowers and their communities. The Center also offers business coaching, financial education, and technical assistance. Lendistry is a proud signatory of the Small Business Borrowers' Bill of Rights, guidelines set by The Responsible Business Lending Coalition.

I recruited a team to start Lendistry with me because I saw that consolidation trends in the community banking and regional banking segments were leaving an expanding gap in the small business lending market. Small businesses that were ready to graduate beyond financing themselves through credit cards and home equity were finding far fewer community banks available to help them take the next step in their growth so that they eventually could become large enough for a large regional or national bank to serve them. (The dual trends of dwindling numbers of community banks and larger banks withdrawing from the smaller end of the small business market due to operational efficiency considerations has continued and become so pronounced that I believe the definition of “underserved small business borrower” should be expanded to include a loan size threshold, and loan size has become a larger and more significant barrier to capital access for small businesses than all other traditional criteria combined.) Into this credit vacuum for small businesses, unscrupulous lenders have proliferated and thrived.

This adverse capital availability environment for small businesses was, and continues to be, compounded for entrepreneurs with historically weaker ties to traditional banks, including women and minorities, as well as entrepreneurs based in rural areas with fewer banking options. I believed technology could play a significant role in the solution, and by approaching fintech from my banking background rather than from a technology background, I believed I could bring a somewhat differentiated lens to the market.

Since launching in 2015, Lendistry has sought to use fintech—and partnerships with financial institutions, non-profits, and government organizations—to help solve the problem of disparities in access to capital, to open doors that were previously closed to small businesses owned by minorities, women, and veterans, businesses located in rural areas, or businesses whose financing needs to take the next step in their development are just too small for traditional banks.

As a hybrid of a fintech lender and community bank, and with roots in traditional banking as mentioned above, Lendistry combines the best of fintech—efficiency, scalability, and seamless user experience—with the best of traditional lending—low cost of acquisition, low cost of funds, and strong risk management—and all with an unwavering commitment to responsible credit culture and expanding access to small business funding.

Today Lendistry ranks second nationwide in SBA Community Advantage lending, a pilot program spearheaded in 2011 to increase SBA-guaranteed loans to small businesses in underserved areas. Community Advantage loans range in size between $50,000 and $250,000, and it is the only category of SBA loan in which Black and Latinx borrowers, combined, account for more than 10% of annual loan volume. More than 60% of Lendistry’s outstanding principal loan balance is with minority and women-owned borrowers, more than 70% is to underserved small businesses, and 60% is with low- or moderate-income borrowers.

Lendistry also has a highly nuanced understanding of small business ecosystems. In the fourth quarter of 2020, Lendistry, Next Street Financial, Concerned Capital, and other local stakeholders, published a detailed examination of the current small business community and supporting ecosystem in Los Angeles County, with a focus on local businesses owned by people of color and the COVID-19 response and recovery.

Ecosystems and partnerships are fundamental to Lendistry's operating method and philosophy. Lendistry has partnerships in place with more than 50 organizations, including business associations, chambers of commerce, Community Development Financial Institutions, and mission-based organizations. These partners in turn have extensive networks, enabling Lendistry to reach underserved geographies and demographics, and provide services and support in more than 15 languages.

With our reach, technology, and operational and capital capacity, Lendistry has both the ability and interest to serve a much larger geographic footprint and broader market than we do today and fill the lending gaps left by mainstream finance for the benefit of small businesses, and particularly those owned by minorities, women, veterans, and those in rural areas.

II. Lendistry and COVID-19 Small Business Recovery Effort

Lendistry's focus on small and minority owned businesses, and our ability to efficiently process high volumes of applications, have enabled us to make an impact during this period of urgent need.

Over the past 13 months, Lendistry has deployed, or has firm commitments to deploy, $3.25 billion to more than 250,000 small businesses in PPP loans and government COVID relief grants, and we project that "capital deployed" figure to grow to at least $5 billion by year-end. In addition to providing PPP loans nationwide, including in at least one county represented by every member of this subcommittee, Lendistry has served as the administrator for COVID relief grant programs offered by the states of Pennsylvania and California, which have provided small businesses in every county of those states with critically needed equity capital.

New business formation, and small businesses in general, are engines of job creation in economic recoveries. Small business ownership remains the most effective path available to minorities to narrow the racial wealth gap. Therefore, this subcommittee's purview of <u>capital access</u> for small business is vitally important, both to the health of the national economy and to our national aspiration as a bastion of economic opportunity for all.

III. The Capital Access Landscape for Small Business Today

The capital access landscape many small businesses must traverse as they try to grow resembles a desert, where the lifeblood of responsibly-priced capital is scarce. Worse, it is a desert that is made almost impossibly steep, by the prevalence of predatory lenders that have filled a void left by two decades of bank consolidation. The small businesses that tend to be most affected by these arduous conditions are those owned by minorities, women, and veterans; those located in rural areas; and those which, regardless of their ownership demographics, have capital requirements that are simply too small to be profitably served by traditional banks, whose median asset size ballooned by more than 500% between 2000 and 2019.[1]

All of the types of small businesses I just cited can be considered "underserved small businesses." And the economic relief efforts in response to COVID over the past year have provided ample evidence that dramatic actions to increase the availability of capital will only benefit these underserved small businesses if the capital is connected to effective conduits that are willing and able to reach them. While traditional banks are very effective in deploying very large amounts of capital, their operational incentive is to do so through as few separate underwritings as are prudent from a risk management perspective, resulting in very large average loan size. This logic also bears out in Federal Reserve survey data regarding the businesses that traditional banks tend to establish relationships with. Minority-owned businesses – which are disproportionately small businesses – are much less likely than other businesses to have a banking relationship[2]. Thus, well-intended measures that push more capital to traditional banks can have the effect of incentivizing banks to make larger loans, as we saw with the original version of PPP, or can result in vast amounts of available capital simply going untapped, as we saw occur with the original version of the Main Street Lending Program.

IV. A Year of COVID Relief Contains Clear Lessons for Action and Reason for Hope

The good news is that the small business COVID relief effort also has validated that CDFIs and MDIs are effective conduits for deploying capital to small businesses, and that when capital is made available to CDFIs and MDIs, the accessibility of responsibly-priced capital improves for small businesses generally, and for underserved small business especially.[3] Moreover, as a signatory to the Small Business Borrower's Bill of Rights, we at Lendistry see that the lessons of the past year also contain a market-oriented solution to the predatory lending problem, with the potential for responsibly-priced capital to drive out predatory capital. Because high-interest

[1] Most banks simply are too large to efficiently make small loans. Twenty years of bank consolidation has cut the number of FDIC-chartered banks in the U.S. by 45%. According to FDIC data, there were 8,315 FDIC-insured banks in 2000, compared to 4,519 in 2019, with just 32 new FDIC-insured bank charters issued since 2010. As a result, the median asset size of remaining banks has grown by more than 500%, from $751 million in 2000 to $3.9 billion in 2019.

2 Federal Reserve Banks, 2019 Small Business Credit Survey and 2020 Report on Employer Firms. Fewer than 1 in 4 Black owned businesses with employees and fewer than 1 in 3 Latinx-owned businesses with employees had received funding from a bank in the prior five years, compared with nearly half of white-owned firms with employees. Moreover, just 1 in 10 Back-owned sole proprietorships or independent contractors – which comprise a disproportionate share of all Black-owned businesses – had a recent borrowing relationship with a bank, compared with 1 in 4 white-owned non-employer businesses.

[3] For example, using PPP loan size as a rough indicator for the relative size of businesses, according to the most recent SBA data for the 2021 PPP program, the overall average loan size was $45,000, the average size of loans originated by banks was $62,000, and the average size of loans originated by CDFIs was less than $27,000. Likewise, according to SBA data for the 2020 PPP program, the overall average loan size was $101,000, the average size of loans originated by banks was $141,000, and the average size of loans originated by CDFIs and MDIs together was about $74,000.

lenders have high funding costs, they can only remain viable if they have robust demand. If more capital is made available to CDFIs and MDIs, small businesses will have greater access to capital on responsible terms, in turn reducing demand for loans offered on predatory terms and, ultimately, making the predatory lending business less attractive to the investors that supply its capital.

Returning to the metaphor of the capital access landscape, the past year has provided clear and compelling evidence that measures making significantly more capital available to CDFIs and MDIs will transform the steep desert that small businesses must cross on their path to growth into a more fertile and flatter playing field.

V. CDFIs and MDIs: Paradoxically Underutilized and Undercapitalized

According to the most recent Annual Report by the CDFI Fund, as of year-end 2019, CDFIs as a group had just $93 billion in capital available for lending and equity investments. Moreover, the uneven distribution of capital across CDFIs meant that the median total financing capital for CDFIs was only $9 million.

Among MDIs, Black-owned MDIs in particular exhibit the paradox of being both highly effective and undercapitalized, with small business loans representing 21% of total assets vs. 18.6% for all FDIC-insured banks, yet their Tier 1 Capital was just 9.4% of total assets vs. 11.7% for all FDIC-insured banks, according to 2017 FDIC data.

VI. Recommended Actions

Congress and the Federal Reserve already have put in place key building blocks for addressing the problem of CDFIs and MDIs lacking the capital necessary to be significantly more impactful for small businesses. The work that is left to do is relatively straightforward and has three components. First, leverage the existing building blocks by establishing mechanisms that are exactly analogous to ones that already have proven to be effective in opening a flow of capital to CDFIs and MDIs. Second, optimize the complementary nature of traditional banks, on one hand, and CDFIs and MDIs, on the other, for the benefit of small businesses. Third, create an office within the Small Business Administration to lead the efforts geared towards maximizing the impact that CDFIs and MDIs can deliver.

1. Starting with leveraging existing methods and vehicles, Congress and the Federal Reserve should seize multiple opportunities:

    a. The Paycheck Protection Program Liquidity Facility, or PPPLF, is the facility that funds PPP loans. Based on reports, the facility is working and has created a tremendous multiplier effect for CDFIs and MDIs. The Federal Reserve should authorize the same facility as a funding source for all SBA 7(a) products – Express, Community Advantage and regular – and all CDFIs and MDIs should lendistry

retain access to the PPPLF while being empowered to make all types of SBA 7(a) loans.

b. Expand the Community Advantage program, in three dimensions – length, loan amount and geographic reach.
    i. First and most important, as the only category of SBA loan in which Black and Latinx borrowers, combined, account for more than 10% of annual loan volume, CA has earned a longer statutory runway than 30 months, with us already approaching the midway point. It is strongly in the interest of the CA program's objectives and effectiveness for the program to encourage more participants and supporters, and to have the best opportunity to do so, it must enable potential participants to have a sound basis to include CA in their long-term planning.
    ii. Second, there needs to be an increase in the loan amount offered. Currently CA ranges from $50,000 to $250,000. The range must extend to, at minimum, $350,000.
    iii. Third, just as MDIs have no geographic restrictions in their SBA loan activity, prudent risk management strongly argues that CDFIs likewise should be unrestricted in their geographic diversification.

c. The guarantees provided by the newly re-established State Small Business Credit Initiative (SSBCI) are a powerful feature that cry out to be paired with low-cost sources of funds. The Federal Home Loan Bank is a source of very low-cost capital, and it already funds small business loans made by banks. However, currently Federal Home Loan Banks do not allow CDFIs to pledge small business loans as collateral, even if they are substantially guaranteed by programs such as SSBCI. Now consider that when capital is used to fund loans backed by guarantees, the capital can get multiplied and recycled on a more than 5-to-1 basis – meaning 1 million of capital can support about 5 million in guaranteed loans – and that ratio grows far higher when assuming loan repayment.

   It is clear that restrictions like the FHLB's not only represent an enormous lost opportunity for CDFIs to gain access to low-cost capital, but also amount to a significant underutilization of the power of the SSBCI and similar programs offering guarantees. This gap is ripe for Congress to close.

2. Turning to the second component of remaining work that I referenced, there is a clear opportunity to optimize the complementary nature of traditional banks, on one hand, and CDFIs and MDIs, on the other, for the benefit of small businesses.

   In the context of capital access for small businesses, the strengths of traditional banks in accessing and deploying low-cost capital in fewer, high-dollar transaction are highly complementary to the strengths of CDFIs and MDIs in deploying a high volume of responsibly-priced capital in relatively small amounts to small businesses that are less connected to financial ecosystems. The Community Reinvestment Act acknowledges this complementarity by providing incentives for non-minority-owned banks to partner with CDFIs and MDIs, yet even though traditional banks are awash in capital, the current incentives clearly are insufficient to motivate enough partnership activity on the part of banks. We therefore recommend two ways to enhance incentives aimed at this goal:

a. Within the CRA, both the amount and the certainty of CRA credit that non-minority banks can receive should be increased. This could mean banks receiving double or triple CRA credit for amounts they make available to CDFIs and MDIs, while gaining certainty that such activity "will", rather than "may", benefit their CRA examination.

b. And going beyond the CRA as a mechanism to incentivize action, non-minority banks should receive a tax credit, such as an investment tax credit, for providing capital to CDFIs and MDIs, whether through investments or other means.

3. Congress has taken multiple actions to support the CDFI and MDI ecosystem. It would be transformational for there to be an office within the Small Business Administration with a team that focuses on the following: 1) Supporting the growth of CDFIs and MDIs as SBA lenders; 2) Helping with both policy and regulatory matters for current and new members; and 3) Collaborations between SBA lenders and technology partners.

VII. Conclusion

Disparity in access to capital on responsible terms is a critical hurdle for small businesses, both in powering the nation's economic and jobs recovery and in narrowing the racial wealth gap. The intensive efforts to support small business through COVID made clear that in order for capital to benefit small businesses, and particularly underserved small businesses, it must be connected to the conduits that are highly effective in reaching them, which are CDFIs and MDIs. There is an exciting and clear opportunity for Congress and the Federal Reserve to make a major positive impact on the capital access landscape for small businesses. By establishing mechanisms that are exactly analogous to ones that already have proven to be effective in opening a flow of capital to CDFIs and MDIs, by recognizing and optimizing the complementary strengths and roles of traditional banks and CDFIs/MDIs in service of small businesses, and by establishing a dedicated office to support the CDFI and MDI ecosystem, Congress and the Federal Reserve can unleash positive forces that will deliver a multiplier effect on the capital that CDFIs and MDIs can deploy to small, underserved businesses, and make predatory lenders less economically viable through market forces.