TESTIMONY OF EVERETT K. SANDS, CEO OF LENDISTRY, TO THE HOUSE COMMITTEE ON FINANCIAL

"An Unprecedented Investment for Historic Results: How Federal Support for MDIs and CDFIs Have Launched a New Era for Disadvantaged Communities"

February 16, 2022

lendistry

I. Introduction

Committee Chairwoman Waters, Ranking Member McHenry, Vice Chair Auchincloss, Vice Ranking Member Wagner, and distinguished members of the Committee, thank you for calling this hearing to examine the critical role minority depository institutions (MDIs) and community development financial institutions (CDFIs) play in providing capital access to underserved and underbanked communities, and communities of color; and to explore additional steps that should be considered to enable Congress's significant work over the past 18 months in strengthening and empowering MDIs and CDFIs to achieve maximum potential.

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 six 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.

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 commend Congress for hearing and acting upon the learning, made clear by COVID's initial phase, that small and underserved businesses are far and away more successful in accessing capital from CDFIs and MDIs than from other sources. In response, Congress, with leadership from this committee and the Small Business Committee, took decisive action to allocate significantly more capital to CDFIs and MDIs, as detailed in the Hearing Memo. Thanks to your actions, a powerful freight train of capital access is supplied and on the move.

The urgent work that now remains for Congress is to enact a set of surgical repairs and enhancements to the track network, so that the freight train of capital access can move at the speeds that underserved and minority communities require. At stake in Congress finishing the job is nothing less than the opportunity to narrow the racial wealth gap. That's because when capital is available within communities on responsible terms, it naturally displaces predatory loans that disproportionately impact wealth, jobs and productive economic activity in communities of color. And because the economic model of predatory lending requires a high volume of loans, displacing even a moderate portion of the demand for predatory loans can be profoundly effective in making those businesses economically unattractive for their investors.

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

1. *Permit the Federal Home Loan Bank (FHLB) to accept federally guaranteed small business loans as collateral from CDFIs*
2. *Require the FHLB to assign CDFIs the same credit ratings as banks and/or create a loan credit enhancement fund*
3. *Lower the CDFI Bond Guarantee from $100 million to $25 million*
4. *Exempt CDFIs from state licensing requirements*
5. *Allow CDFIs to access the Federal Reserve discount window*
6. *Develop a reporting system for Treasury capital deployment programs that are geared to Socially and Economically Disadvantaged Individuals*
7. *Create a federal office dedicated to supporting the efforts of MLIs*

II. About Lendistry

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 leader 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 $10 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.

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 is one of the top SBA Community Advantage lenders, 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 are the only type 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 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.[1] Based on the learnings from that study, Lendistry's nonprofit affiliate last year launched the Los Angeles County Small Business Resiliency Program.[2]

Ecosystems and partnerships are fundamental to Lendistry's operating method and philosophy. Lendistry has partnerships in place with more than 100 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

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. 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.

---

[1] https://nextstreet.com/portfolio/la-county-small-business-ecosystem-assessment/

[2] https://www.newswire.com/news/the-center-by-lendistry-launches-small-business-resiliency-program-for-21410424

Over the past 22 months, Lendistry has deployed approximately $8.4 billion in government COVID relief grants and PPP loans to more than 570,000 small businesses, 94% of which employ fewer than 10 employees. We project that "capital deployed" figure to grow to more than $10 billion by year-end. In addition to providing PPP loans nationwide, Lendistry has served as the administrator for COVID relief grant programs offered by the states of California, New York and Pennsylvania, as well as New York City.

III. Bottlenecks in the Capital Access Landscape for Small Business Today, and Recommended Actions

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.[3]

All of the types of small businesses I just cited can be considered "underserved small businesses." Congress heard and acting upon the learning, made clear by COVID's initial phase, that small and underserved businesses are far and away more successful in accessing capital from CDFIs and MDIs than from other sources. In response, Congress, with leadership from this committee and the Small Business Committee, took decisive action to make significantly more capital available to CDFIs and MDIs.. Thanks to your actions, a powerful freight train of capital access is supplied and on the move.

However, a number of gaps and weaknesses combine to prevent the allocated capital from reaching its intended end-users quickly enough, with a large enough multiplier effect, and through enough distribution points.

The urgent work that now remains for Congress is to enact a handful of surgical repairs and enhancements to the track network, so that the freight train of capital access can move at the speeds that underserved and minority communities require.

[3] 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.

Following are the most common and negatively impactful bottlenecks in the capital access landscape today, and proposals for actions to alleviate them:

1) Bottleneck: Regulations prevent federally guaranteed small business loan programs, like the Small Business Administration (SBA) and the State Small Business Credit Initiative (SSBCI), from reaching their full potential and making the much more significant impact they're capable of making.

   Recommendation: The guarantees provided by SBA loans and by the newly re-established 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, Federal Home Loan Banks do not currently allow CDFIs to pledge small business loans as collateral, even if they are substantially guaranteed by programs such as SBA and SSBCI. The opportunity cost for CDFIs resulting from this capital inefficiency is enormous, because when capital is used to fund loans backed by guarantees, the capital can be 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 FHLBs' 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 SBA, SSBCI and similar programs offering guarantees. This gap is ripe for Congress to close, and Congressman's Torres's bill would be a positive step in that regard.

2) Bottleneck: Even though the FHLB does not experience defaults from member institutions, it assigns CDFIs a lower credit score than banks, which increases CDFIs' collateral requirements when borrowing from the FHLB and reduces their advance rates, as compared with banks. In other words, the FHLBs' policies for CDFIs prevents CDFIs from maximizing the impact that their capital can deliver.

   Recommendation: Require the FHLBs to assign CDFIs the same credit rating as banks, and/or create a loan credit enhancement fund that can be drawn down to provide the incremental collateral associated with CDFI borrowing.

3) Bottleneck: High minimum borrowing thresholds for the CDFI Bond Guarantee program are out of step with the CDFI landscape, where the median asset size in 2020 for all categories of CDFIs was $28.2 million, and for CDFI Loan Fund – which accounts for more than half of all CDFIs - was just $9.5 million.[4] The effect is to severely limit the

[4] Community Development Financial Institutions Fund, 2020 Annual Certification Report, October 6, 2021, p. 33. https://www.cdfifund.gov/sites/cdfi/files/2021-10/ACR_Public_Report_Final_10062021_508Compliant_v2.pdf

number of CDFIs that can take advantage of the CDFI Bond Guarantee program, which in turn limits the availability of capital for the communities that CDFIs serve.

Recommendation: By lowering the CDFI Bond Guarantee from $100 million to $25 million, as proposed by Chairwoman Waters and Congressman Cleaver, smaller CDFIs will gain greater access to capital.

4) Bottleneck: The anachronistic state-by-state licensing requirement for CDFIs not only limits how quickly capital can be distributed but also how effective the CDFI designation can be as a force for displacing predatory lenders with responsible lenders.

   Recommendation: CDFIs should be exempted from state-by-state licensing requirements, thereby bringing about three clear benefits: i) CDFIs can move much faster to deploy capital where it's needed, ii) CDFIs can more easily attain the risk management benefits of geographic diversification, and iii) many more lenders would be motivated to attain CDFI designation, which would have the effect of significantly increasing the supply of capital provided on responsible terms and, through market forces, make predatory lending businesses less economically viable.

5) Bottleneck: No contingency has been made to ensure that, the next time there is an acute crisis facing small businesses, CDFIs will have rapid access to capital to support the disproportionately minority-owned small businesses that do not have traditional banking relationships.

   Recommendation: In order to respond with agility in the next crisis for small businesses, and especially for those that are underserved by traditional banks, CDFIs must have direct access to the Federal Reserve discount window, as proposed by Chairwoman Waters, rather than be dependent on other banks for capital. A further advantage of establishing Fed access for CDFIs would be that banks seeking to gain CRA credit would be incentivized to provide something else of value to CDFIs beyond capital, while allowing for flexibility and creativity in bank-CDFI relationships (e.g., one CDFI might want a partnership for customer acquisition to help keep costs down, another may want access to a technology, etc.).

6) Bottleneck: There does not currently exist a system for measuring and reporting on the progress of Treasury programs geared to Socially and Economically Disadvantaged Individuals (SEDIs) in deploying allocated capital to institutions in accordance with those programs' missions.

   Recommendation: Treasury programs that are geared to SEDIs should have accountability to ensure that deployers of capital report their performance so that progress in fulfillment of their missions can be measured, with the expectation of annual performance improvement.

7) Bottleneck: There is not a single federal point of coordination for minority lending institutions to maximize their impact.

   Recommendation: Congress has taken multiple actions to support the CDFI and MDI ecosystem. It would be transformational for there to be a dedicated office, as proposed by Chairwoman Waters, focused on the following: 1) Supporting the growth of MLIs; 2) Helping with both policy and regulatory matters for current and new MLIs; and 3) Collaborations between MLIs and technology partners.

IV. Conclusion

Congress has allocated significant capital to be available to CDFIs and MDIs to help address the capital availability disparity for underserved communities. Through further focused action, Congress can act to ensure allocated capital reaches its intended end-users more quickly, with a larger multiplier effect, and through more distribution points. At stake is nothing less than the opportunity to narrow the racial wealth gap and harness market forces to replace predatory loans with responsible capital. We believe that our proposed solutions are common-sense ways to address real-world challenges, and hope that they garner bipartisan support. We look forward to working with you and members of Congress on both sides of the aisle on these critical challenges in the weeks and months ahead.