



**TESTIMONY OF EVERETT K. SANDS TO THE
HOUSE FINANCIAL SERVICES COMMITTEE'S TASK FORCE ON
FINANCIAL TECHNOLOGY**

**License to Bank: Examining the Legal Framework Governing Who Can
Lend and Process Payments in the Fintech Age**

September 29, 2020



Task Force Chair Lynch, Task Force Ranking Member Emmer, Chairwoman Waters, Ranking Member McHenry, and distinguished members of the Task Force, it is an honor for me to appear before you today. My name is Everett Sands, and I appreciate the Committee's interest in financial technology, and this opportunity to provide insights and information from my perspective of more than 20 years in lending, including the past five years focusing on responsible lending to underserved small businesses by leveraging financial technology.

My testimony will address several of the Task Force's areas of interest, with a focus on lending generally and on small business lending, though many of my comments are also applicable to other areas of lending, as they are closely tied in terms of the credit parameters from a consumer perspective and origination activity from financial technology ("Fintech") lenders. The single, unifying perspective that ties together my testimony is this: in lending, there are good and responsible actors and there are bad and unscrupulous actors, and it is my belief and experience that the best protection against bad actors is to take actions designed to incentivize more good actors to come into the field, making their offerings more available and crowding out the bad actors. Fintechs can have a constructive role in lending if their rates and product offerings are responsible.

And as my testimony concludes, the stakes for expanding responsible lending are enormous and the urgent need for action in this regard cannot be overstated. Small businesses and consequently the United States, are in crisis. Every day is a fight to remain open and continue doing their parts for their owners, their employees, their communities and the economy. That makes it all the more vital that there is financing available and accessible to business owners with ideas for how to pivot and for entrepreneurs with vision for new businesses for this new environment. Now more than ever, grit, plans and dreams need capital.

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. 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 \$3 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-owned and technology-enabled Community Development Financial Institution (CDFI). In fact, Lendistry is the only fintech CDFI. 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. Lendistry also offers business coaching, financial education, and technical assistance through its nonprofit partner organization, The Center. 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, predatory 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.

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.

As the only fintech CDFI, we believe we have a unique perspective on the ways in which fintech can expand access to underserved small businesses, and the regulatory actions that would make the greatest positive impact on bridging the substantial funding gap for small businesses, and particularly those owned by minorities, women, veterans and those in rural areas.

II. Lendistry and COVID-19 Small Business Recovery Effort

In response to the COVID-19 crisis, Lendistry has stepped up to provide desperately needed capital to small businesses struggling amid the pandemic, both as a lender and as an administrator of state and local grant programs made possible by the Coronavirus Relief Fund under the CARES Act.

The urgent need among small businesses—and particularly very small businesses and those owned by historically disadvantaged people, which data show have minimal reserve resources to withstand a prolonged downturn—has been a challenge that we at Lendistry believed from the beginning we were built to take on. The business owners we are mission-bound to serve have been suffering a crisis of financial liquidity, and we knew we possessed the relationships to



connect with them, the technology to serve them, the experience to meet them where they are, and the technical assistance to help guide them.

What we never had before, however, were access to a very large amount of capital to deploy, and access to geographic territories outside of California. Once Lendistry was selected by Goldman Sachs' 10,000 Small Businesses Initiative to have access to \$175 million in capital to deploy for PPP loans, and was granted authorization by the SBA to expand our footprint – not to all states, unfortunately, but to 12 states with large populations, diverse populations, and significant rural areas - the true power of our platform and our organization was unleashed.

During the four-month span of our PPP offering, Lendistry originated, processed and approved more than \$180 million in PPP loans to more than 3,500 small businesses – which was nearly twice the loan dollar volume we funded during the preceding four years since our founding.

The major learning of PPP for Lendistry, and we believe for policymakers, is that lack of access to capital and territory were significant limiting factors to the impact that Lendistry had been able to make prior to PPP – despite the fact that Lendistry is a CDFI, a CDE and a member of the Federal Home Loan Bank of San Francisco.

Lendistry's contribution to the small business recovery effort amid the COVID-19 pandemic has not been limited to PPP, however. Another feature of the CARES Act that has gotten much less attention than PPP is the \$150 billion Coronavirus Relief Fund, which allocated funds to states and large counties to deploy on a discretionary basis with certain broad parameters. Many states and counties have elected to use a portion of their allotments of Coronavirus Relief Fund dollars for small business grant programs. Because administering such a program-including designing the grant application, building an engine to process a high volume of applications according to criteria specified by the state or local authority, processing the applications, verifying information, complying with applicable federal requirements, reporting on the status, and ultimately funding the businesses approved for grants-requires very similar capabilities as were demanded of lenders by the PPP program, and because Lendistry is a CDFI and excels in partnering, the state of Pennsylvania and its network of 17 local CDFIs selected Lendistry as their administrative and technology partner for their \$190 million small business grant program. Lendistry processed more than 50,000 grant applications in two weeks and will fund approximately 10,000 applicants. Through Lendistry's work with Pennsylvania's statewide small business grant program, we also were chosen as the administrative partner to four additional county programs in the state.

III. Lending Responsibly as a Fintech: How Lendistry Does It

Lendistry takes a straightforward path to lending responsibly, consisting of four key components.

First, we set a maximum interest rate. No loan we originate can have an APR exceeding 18%, and in many of our products the maximum rate is considerably lower. If a loan has a risk profile such that we would need to charge a higher rate in order to be compensated for taking the risk, it's a loan we should not or will not make, and in all likelihood it's not a loan that the borrower should be taking on, for their own sake.

Second, we manage our costs, and we do that in three ways: with low cost of funds, with strong risk management, and by keeping our customer acquisition costs far lower than most fintechs. Lendistry's access to government programs-SBA, Federal Home Loan Bank, and others-are critical to our ability to keep our costs of funds low, and they also contribute to our strong risk management by providing guarantees to a very high percentage of our loan portfolio. Lendistry's loss rate is less than 1% versus an acceptable industry standard of 5%.



The third component of our approach to responsible lending is the technical support we make sure our borrowers have access to, whether provided directly by Lendistry or by our non-profit affiliate, The Center for Strategic Economic Studies and Institutional Development. The support our borrowers receive helps make them smarter users of credit, helps them be more effective in operating and developing their businesses, and helps them manage their loan so that it remains in good standing and so that they remain in a strong position to modify or replace their loan as their needs and market conditions warrant.

The final component of Lendistry's responsible lending approach is our ongoing efforts to partner with other financial institutions. Our partnerships can take many forms, but among the most powerful is with larger banking institutions that recognize that there are segments of their footprint that they are not serving or that they are underserving, and that the most efficient way for them to bridge that gap is by partnering with Lendistry, enabling us to use their capital to do what we do best. Alternatively, Lendistry can effectively operate a portion of a bank's lending business on a white-label basis.

IV. Acting to Incentivize and Expand Responsible Lending is the Best Protection Against Predatory Lending

The federal government already possesses systems and authorities that can and should be both empowered and harnessed to create compelling incentives for fintechs to choose to operate within a regulated framework and conduct lending activities in a responsible manner. By increasing borrowers' access to responsible sources of financing, the competitive environment for unscrupulous lenders will become more difficult, which in turn would be expected to make them less attractive vehicles for the investors who capitalize them.

Compare the incentives of the lender who is federally regulated with the ability to borrow from, for example, the Federal Reserve and obtain capital equal to many times the amount of its equity, with those of the unregulated lender who, with the same amount of equity, can only borrow a far smaller amount from a private funder. For the purposes of this comparison, assume each lender begins with \$10 million in equity, and the federally regulated entity able to leverage its equity into \$100 million in capital while the unregulated entity's \$10 million only can be leveraged to \$40 million.

With a much larger amount of capital available, the regulated lender can operate on a volume model, pricing its loans to be highly attractive to generate a high volume of originations. By contrast, the unregulated lender with less capital available due to less leverage must price its loans many multiples higher, on average, in order to achieve the same return on the initial \$10 million in equity, because the unregulated lender's pricing not only must compensate for the lower amount available to lend but also must compensate for the higher default rate it can expect to incur by lending to borrowers unable to obtain loans at lower rates from the regulated entity.

Possible solution: CDFI Fund in an Empowered Gatekeeper and Oversight Role

Non-depository fintech lenders are by now a fixture within the financial services landscape, and while some may elect to pursue charters enabling them to accept deposits, it is important for the protection of borrowers and for the availability of financing on a responsible basis that due consideration be given to using existing systems more effectively with respect to fintech lenders. An incentives-oriented mindset is important for promoting innovation while tilting the competitive landscape against unscrupulous participants.

One such incentives-oriented solution for expanding responsible lending (and thereby narrowing the market opportunity for predatory lenders and, in turn, reducing the incentive for investors to capitalize them) begins with **the CDFI Fund**:

1. Create compelling incentives to be a CDFI, including all of the following:
 - Automatic approval to offer all SBA products



- Pathway/clear criteria for gaining nationwide territory approval
 - Benefit from new requirement placed on the SBA for a certain percentage of SBA loans to be made to underserved borrowers (thereby incentivizing the SBA to approve CDFIs to lend nationwide)
 - Member of Federal Reserve
 - Pathway/clear criteria for directly accessing its borrowing facilities
 - Benefit from new requirement placed on Federal Reserve for a certain percentage of funds borrowed from it to be deployed to underserved borrowers (thereby incentivizing the Federal Reserve to approve CDFIs to have access to its facilities)
 - Ability to lend nationally
 - Benefit from new incentives to be provided to banks (e.g., triple CRA credit, additional Tier 1 capital credit) for providing capital to CDFIs
 - For CDFIs not yet approved by Federal Reserve to access its facilities, this incentive to banks would create a valuable source of capital
 - For CDFIs that become approved by the Federal Reserve to access its facilities, banks effectively would be in competition with the Federal Reserve as providers of capital meaning, in effect, banks would need to provide something else of value to CDFIs beyond capital (allows for flexibility, e.g., one CDFI might want a partnership for customer acquisition to help keep costs down, another may want access to a technology, etc.)
2. Raise the bar for qualifying to be a CDFI, so that in addition to at least 60% of loan volume going to low- and moderate-income people, designated investment areas or other targeted populations (historically disadvantaged people), additional requirements would include:
- An interest rate ceiling of 36% APR
 - Collect no more than two payments per month
 - Standardized payment cycles
 - Additional disclosure (including allowing interest rate monitoring, detailed demographic reporting on loan recipients, organizational DEI)
 - Accountability (board of directors and executive leadership)
3. Empower and fund the CDFI Fund to monitor compliance with #2 above

Based on widely published average loan size data for fintech lenders as a group and for several of larger fintech lenders individually, we believe that most major fintech lenders already serve a significant percentage of underserved borrowers, making it readily achievable for them to meet the CDFI 60% requirement.

Madden vs. Midland Funding LLC and related pending rule-making

In a similar way as described above, a positive, incentive-based approach to expanding responsible consumer lending could function to blunt the potential adverse effects stemming from the possible adoption of the OCC/FDIC rules crafted in response to the Second Circuit's *Madden vs. Midland Funding LLC* decision.

OCC Special Charters

Though we believe an enhanced role for the CDFI Fund in a more highly incentivized CDFI designation, as discussed above, is a preferable solution, it could be adapted for the OCC if the OCC prevails in its appeal of the district court's decision in favor of NYDFS with regard to whether non-depository lenders can be granted special charters. OCC's historical capabilities in overseeing payments and transfer activity are less applicable and relevant to the lending context, in our view. We also believe lending and payments each require a significant adjustment in regulation, and we



would suggest the OCC focus on payments first as new technology entrants like bitcoin, blockchain and cryptocurrency gain traction.

Industrial Loan Charters

While it is clear that ILCs can be a threat to the banking system if the unregulated parent company has a financial misfortune, history has shown that the mixing of banking and commerce have not had a negative impact on the consumer and the deposit insurance fund. Likewise, the decisions being examined and considered by this committee and your Task Force today are quite similar to those that came before Congress when the ILC was instituted in the early 1900s. We think ILCs are a viable solution for granting access into the deposit insurance fund; however, in our view the parent company should be subject to the Bank Holding Company Act. We also believe ILCs represent an opportunity for the banking system to benefit from capitalization by non-financial corporate businesses, which we believe would be an important benefit as we enter the COVID-19 recovery.

Annual Oversight

In the context of either the CDFI Fund proposal, the OCC Special Charter or Industrial Loan Charter path, the evolution and speed of the fintech industry demands that the regulatory authority be empowered and mandated to conduct an annual review of the requirements, in order to ensure accountability and transparency. Currently, although the CDFI Fund conducts such reviews on an annual basis, OCC's reviews are conducted only once every three years, which is not an appropriate frequency for the pace of change within financial technology.

V. Partnerships between Banks and Non-Banks/Fintechs

Though I recognize the Task Force's intent in raising this topic is to examine the issue of so-called "rent-a-charters" (and to that point I again refer to the discussion above in section IV), I believe it's important for the Task Force to be aware of the many positive forms of partnership that can and do take place between banks and fintechs.

Lendistry's technology and processing capability, combined with our familiarity with small business borrowers, are seen by many banks as an operational efficiency solution for them. Partnerships between banks and fintechs also are effective in delivering the benefit of specialized expertise – such as cybersecurity and mobile payments – in an affordable way; this is especially beneficial for areas that undergo rapid development and enhancement, enabling banks to remain state-of-the-art.

VI. The Crisis for Underserved Small Businesses and the Urgency to Expand Capital Access

As my testimony declared from the beginning, the stakes for expanding responsible lending are enormous and the urgent need for action in this regard cannot be overstated. It is critical that incentives are created and barriers are removed to increase the supply of responsible capital resources and offerings available to empower and fund not only small businesses trying to stay open or re-open, but also those seeking to launch or grow. The challenge in front of us today will require every responsible lender possible to help with the restoration and repair of our small businesses nationwide.

Data collected, assembled and analyzed by Harvard University Economics Professor and American Economic Association Clark Medal winner Raj Chetty and his team at Opportunity Insights show that the employment rate among workers who had been making below \$27,000 per year as of January 2020 was still **16.1%** below January levels as of the end of July.¹

¹ <https://tracktherecovery.org/>



As of September 13, 2020, the number of small businesses open **decreased by 23.6%** compared to January 2020, and total small business revenue had **decreased by 20.6%** over the same period.²

Not surprisingly, the economic devastation has only widened historic disparities by disproportionately impacting minorities, and particularly Black and Latinx people and communities. The underbanked small business owners and their communities we serve already were in a financially precarious position before the start of COVID-19. The state of African American and Latino-owned business is in month six of an all-out crisis, as these horrific statistics reveal:

- As of May, over 41% of African American small businesses and 32% of Hispanic/Latino small businesses had stopped operating, according to an analysis of government data by Stanford Institute for Economic Policy Research leveraging University of California, Santa Cruz professor Robert Fairlie's research³.
- Moreover, research by the New York Federal Reserve⁴ found that in the eight states with the largest numbers of Black business owners, despite a leveling off in closure rates in May data, all but two of these eight states experienced a net decline in Black business ownership between February and June, with the net numbers of business closures most acute in Ohio (-59.3%) and New York (-56.0%).
- The same Stanford/U of California study found the number of working business owners plummeted from 15.0 million in February to 11.7 million in April, the largest drop ever.
- The devastating impact on these businesses is mirrored in African American and Latinx unemployment rates. Whereas overall unemployment was 8.4% in August, African American unemployment was 13.0% (vs. 6.7% for March) and Latinx unemployment was 10.5% (vs. 6.0% in March). Moreover, African American employment recovery is lagging behind the national average, with the gap between African American and white unemployment widening in August for the fourth straight month.
- On a market-by-market basis, small businesses in major cities like Boston, Chicago, Dallas, Houston, Miami, Los Angeles, San Francisco are suffering⁵. And in "majority minority" cities of Atlanta, Baltimore, Detroit and Philadelphia the conditions are worse.

Data says small business lender resources during the crisis have been insufficient for the need; projections say the need for capital will grow enormously.

- A report last month by the New York Federal Reserve⁶ found that "racial disparities in bank relationships prior to COVID-19...raise structural questions about the presence of banks and access to credit in communities of color, questions that have heightened significance when banks are relied on to administer federal, taxpayer-supported relief programs, as is the case with PPP." While 54% of healthy or stable white employers report having an existing banking relationship over the five-year period prior to COVID-19, just 33% of healthy or stable Black employers do.

² <https://tracktherecovery.org/>

³ <https://siepr.stanford.edu/sites/default/files/publications/20-022.pdf>

⁴ https://www.newyorkfed.org/medialibrary/media/smallbusiness/DoubleJeopardy_COVID19andBlackOwnedBusinesses

⁵ <https://www.nytimes.com/interactive/2020/06/18/us/coronavirus-black-owned-small-business.html>

⁶ https://www.newyorkfed.org/medialibrary/media/smallbusiness/DoubleJeopardy_COVID19andBlackOwnedBusinesses



- There also is the issue, discovered in Washington, D.C., but presumably applicable broadly, of unequal treatment by banks based on race and gender, as experienced by comparably-qualified applicants at 13 out of 17 branches of banks tested, ranging from community banks to large institutions.⁷

We know that in neighborhoods and communities comprised disproportionately of African Americans and Latinx, with the loss of locally-owned employers and independent businesspeople, who provide jobs both directly and indirectly, come compounding negative effects. Reversing these dynamics only becomes more difficult the longer their cause persists.

Lendistry's team, technology and partners equip us to make a positive and rapid impact, and we are prepared to do as much as we are permitted. We believe every responsible and willing lender is needed urgently at this critical juncture, and that it must be a priority for policymakers to take actions to incentivize, and remove barriers that delay, that outcome.

Thank you for the opportunity to testify.

⁷ <https://ncrc.org/despite-gaping-holes-in-government-data-tests-show-ppp-borrowers-faced-discrimination/>