CDFIs' Mission-Driven Orientation Is Critical to Making Financial Technology Work for Deep South Communities

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HOPE (Hope Enterprise Corporation/Hope Credit Union/Hope Policy Institute) takes a multifaceted approach to financial technology because not all financial technology is created equally—there are helpful and harmful elements. In the intersection between the mission-driven work of community development financial institutions (CDFIs), particularly those with a strong track record of serving communities of color, and the role of financial technology, the question is often framed as how technology can strengthen the work of CDFIs. In HOPE's experience, the question is typically the opposite: how can financial technology be improved by understanding the experiences of CDFIs serving historically underserved communities?

HOPE, a Black-led, women-owned CDFI credit union, loan fund, and policy organization in the Deep South, was established to ensure that all people—regardless of where they live, gender, race, or birthplace—have the opportunity to support their families and realize the American Dream. Since 1994, HOPE has generated over $3.1 billion in financing that has benefited nearly 2 million people throughout Alabama, Arkansas, Louisiana, Mississippi, and Tennessee.

Seventy-three percent of HOPE members have household incomes below $50,000, with 28 percent earning less than $19,000. Eight out of 10 members are people of color, and 60 percent are female. Our branches are located in areas often left behind by other types of investment, with 86 percent in counties where most residents are Black. One-third of our branches are located in counties that have endured deep poverty for more than three decades, and three branches are in small Delta towns with no other depository institution. Before opening an account with HOPE, 31 percent of members were unbanked, and 15 percent were underbanked.

CDFIs such as HOPE bring decades of experience in reaching the communities that financial technology companies seek to target. Although certain elements of technology improvements provide some strengths, there are elements of how CDFIs work that simply cannot be replaced and that inform how technology is deployed in places like the Deep South.

What We Mean by Financial Technology

As CDFIs consider the role of fintech in their work, it is critical to define what the technology is and does. In some cases, fintech means software that aids in processing manual functions, much like moving from typewriters to computers, or faxes to emails. But even these developments have not meant greater access for all. Many of the borrowers and communities that HOPE serves still lack Internet or computer access, and there is still a very hands-on, front-end approach. One example: HOPE worked with local governments in the Mississippi Delta and Alabama Black Belt to gain access to CARES Act dollars. One hurdle was getting local leaders access to fundamental technology, such as an email account or a scanner, to submit the documents necessary to receive funds that would aid their response to the COVID-19 pandemic. So, although software to ease internal paperwork duties is critical, it does not mean that it should drive the outward-facing design by which people can exclusively access financial services.

In other cases, fintech means automated decision-making, using algorithms to replace underwriting decisions. This use of financial technology brings a whole different layer of concerns. For example, one of HOPE's strengths in increasing access to mortgage loans for borrowers typically unable to reach them is its ability to know the whole person through a manual underwriting process. The history and stories of the members we serve are a beautiful tapestry of barriers, hardships, and moments of resiliency by the time they reach HOPE's doors. Their intricate stories demonstrate their ability to be successful homeowners and would very likely be lost in an automated, algorithmic decision-making machine that uses traditional data points to deny or approve (and price) someone for a home loan. This is especially true, given our region's long history of exclusionary and discriminatory policies that disproportionately harm people of color. This racially-discriminatory history produces racially-biased inputs, and in turn racially-disparate outcomes. Evidence of pricing discrimination by fintech mortgage lenders provides reason for concern. In one study, Latino and African American borrowers "pay 7.9 and 3.6 basis points more in interest for home-purchase and refinance mortgages, respectively, because of discrimination," resulting in an extra $765 million in annual interest payments.[1]

Finally, financial technology also refers to old practices in new forms, including predatory lenders that ensnare people into unaffordable loans. In our region, rent-a-bank arrangements—in which nonbank lenders partner with banks to make triple-digit interest rate loans[1]—are a particularly pernicious form of predatory lending with the fintech label. Rampant in the mid-1990s but relatively dormant since 2005 due to federal regulation, rent-a-bank arrangements have resurfaced amid recent rollbacks of federal rules. Another example of predatory lending includes payday loans in the form of high-cost, early-wage access apps, in which people pay excessive fees for a loan based on future earnings. The long-standing concerns about the predatory features of these products are not alleviated by the technology mechanisms facilitating them.

1 Robert Bartlett et al., "Consumer-Lending Discrimination in the FinTech Era" (Berkeley, CA: Haas School of Business, UC Berkeley, May 2019), p. 1, http://faculty.haas.berkeley.edu/morse/research/papers/discrim.pdf.

These iterations of financial technology directly and indirectly affect HOPE and its members. HOPE's relationship to technology is rooted in the unique strengths of CDFIs and whether technology contributes to the goals of closing the racial wealth gaps exacerbated by the financial system. CDFI strengths include deep relationships with members and communities, supporting people along their journey toward financial security. They also continue to make those who are underserved by other lenders aware of the availability of HOPE and similar institutions. Incorporation or expansion of the use of technology must amplify these strengths, not replace them. Finally, no matter the form, financial technology—and deregulation under the guise of expanding financial technology—should not be used to perpetuate existing patterns of inequality and disenfranchisement.

HOPE's Use of Financial Technology in the Paycheck Protection Program

HOPE seeks to close the racial wealth gap in the Deep South primarily through serving small business owners and entrepreneurs, particularly minority-owned businesses. Nationally, the racial wealth gap between Black and white households is 10 to 1—for every $1 of wealth held by white households, Black households hold one dime.[2] For households with children, this ratio skyrockets to 100 to 1—for every $1 of wealth held by white households with children, similar Black households hold one penny.[2] A clearly demonstrated pathway for closing this gap is small business ownership. Among small business owners, the wealth gap shrinks to 3 to 1.[3] Entrepreneurship and small business ownership is critical to our region's economic survival and overall economic vitality.

Between 2017 and 2019, 72 percent of HOPE's commercial loans were under $1 million. In 2019, over 60 percent of our commercial loans were to minority- and women-owned businesses. In March 2020, HOPE launched a new small business loan product up to $250,000 to meet the demands and needs in our region. HOPE is both a certified Community Advantage Lender and a participant in the SBA Paycheck Protection Program (PPP). Prior to PPP, HOPE originated about 50 business loans in a typical year, the majority of which went to businesses owned or led by women or people of color.

Thus, by the onset of COVID-19, HOPE had the expertise and some initial infrastructure to meet the needs of small businesses in our region. However, this alone was not enough to overcome the structural inequities baked into the PPP, particularly in the first round of $350 billion, which was depleted in 14 days.[3] Larger financial institutions had more resources to invest in in-house technology software to process applications quickly.[4] Their customer base consists of larger, more resourced businesses with pre-existing banking relationships. As such, they were able to access the bulk of the PPP funds before most, if any, community-based lenders even were able to submit an

2 Kriston McIntosh et al., "Examining the Black-White Wealth Gap" (Washington, DC: Brookings Institution, February 27, 2020), https://www.brookings.edu/blog/up-front/2020/02/27/examining-the-black-white-wealth-gap/.

3 Association for Enterprise Opportunity, "Tapestry of Black Business Ownership in America" (Washington, DC: Association for Enterprise Opportunity, February 16, 2017), https://aeoworks.org/images/uploads/fact_sheets/AEO_Black_Owned_Business_Report_02_16_17_FOR_WEB.pdf

4 Small Business Administration (SBA) Inspector General, "SBA's Implementation of the Paycheck Protection Program" (Washington, DC: SBA Inspector General, January 14, 2021), https://www.sba.gov/sites/default/files/2021-01/SBA%20OIG%20Report-21-07.pdf. (Finding: "The top 15 lenders in round one approved an average loan amount of $526,576 in the first 7 days of the program. By comparison, all the other PPP lenders approved an average of $238,083 in the same period.")

application.[4] Accessing SBA's portal was a key barrier—which, for HOPE, took over seven days and a call to our Congress member. HOPE was able to get only 45 PPP loans funded by the SBA before the $350 billion was depleted seven days later.

As is well-documented now, and was viscerally felt in March and April of 2020, small businesses urgently needed support at the start of the pandemic. This was particularly true for Black- and Latino-owned businesses, which were disproportionately in industries affected by public health safety measures; yet, they also had the smallest cushion to withstand an economic shock due to a long history of discrimination by the financial system now charged with throwing them a lifeline.[5] The PPP's shortcomings unfolded against a backdrop in which, from February through April of 2020, the number of Black business owners declined by 41 percent and Latino business owners declined by 32 percent, compared with a 17 percent decline for white business owners.[5] The disparities in access to PPP funds and COVID-induced business closures will affect the growth and health of businesses owned by people of color for years to come.

In the first round, technology and program design were barriers to accessing PPP. Non-employer businesses were unable to access the program for the first seven days, and there were unnecessarily restrictive barriers to justice-involved borrowers. This had a tremendous impact on the reach of PPP in our region, as 96 percent of Black- and Latino-owned businesses and 84 percent of white-owned businesses in the Deep South are non-employers.[6] Additionally, HOPE's five-state footprint consists of four of the five top states in the country in terms of incarceration rates.[6] These barriers are in addition to the first-come, first-served nature of the program rollout, which exacerbated long-standing racial disparities in access to financial institutions. For example, fewer than 25 percent of Black-owned employer firms have a recent borrowing relationship with a bank.[7] This number drops to 10 percent among Black non-employer firms, compared with 25 percent for white-owned non-employers.[7] These gaps in financial relationships exist even among healthy firms. According to the Federal Reserve Bank of New York's August 2020 report ("Double Jeopardy"), 73 percent of healthy or stable white employers have an existing banking relationship, compared with 42 percent of healthy or stable Black employers.

That said, although technology was one of the barriers in PPP deployment, it was one of several barriers that HOPE sought to overcome between the first and second rounds. It was critical for HOPE to examine how it would meet growing demand for relief to small businesses as the public health and economic impacts of COVID-19 cut deeper into our region. Between the first and second rounds of PPP, HOPE took two steps to overcome the challenges that were also borne of disinvestment patterns in the Deep South and minority-led CDFIs. The first was to invest in software processing technology by contracting with a third party, StreetShares. Many larger financial institutions already have this type of technology in-house.

5 Claire Kramer Mills and Jessica Battisto, "Double Jeopardy: COVID-19's Concentrated Health and Wealth Effects in Black Communities" (New York: Federal Reserve Bank of New York, August 2020), p. 6, https://www.newyorkfed.org/medialibrary/media/smallbusiness/DoubleJeopardy_COVID19andBlackOwnedBusinesses.

6 Kiyadh Burt and Diane Standaert, "Deep South Economic Mobility Forecast" (Jackson, MS: Hope Policy Institute, February 24, 2021), https://hopecu.org/manage/media/HOPE-Deep-South-Economic-Mobility-Forecast-Presentation.pdf. (The report provides analysis of statistics for non-employer firms by industry, sex, ethnicity, race, and veteran status for the United States, states, and metro areas [2017, Annual Business Survey Program]).

7 Kiyadh Burt, "Analyzing the CDFI Asset Gap: Examining Racial Disparities in CDFI Fund Awardees from 2003 to 2017" (Jackson, MS: Hope Policy Institute, November 5, 2020), http://hopepolicy.org/manage/wp-content/uploads/CDFI-Fund-Time-Series-Analysis-brief-edited.pdf.

HOPE also partnered with Goldman Sachs to receive an $80 million injection of liquidity to expand our lending potential. Credit unions' and other financial institutions' lending capacity is limited by their asset size. HOPE has documented historic racial disparities in asset gaps among minority- and white-led CDFIs, showing that over a 15-year period among CDFI Fund awardees, white-led CDFIs had a median asset size 2.5 times larger than minority-led CDFIs.[8] Thus, going into the pandemic, white-led CDFIs had a leg up in their lending capacity, even though minority-led CDFIs typically have a stronger track record in serving the communities hit hardest by COVID-19. To achieve scale in this type of lending in some of the hardest-to-reach communities during a global pandemic and economic crisis was no small undertaking. For example, at peak, nearly half of HOPE's staff were dedicated to PPP lending, with a significant amount providing technical assistance to small borrowers. Both investment of technology and capital resources were critical to ensure that HOPE's strengths and lending expertise could be fully deployed during this crisis.

HOPE's Use of Fintech for PPP Processing

As HOPE readied for the second round of PPP, it simultaneously engaged in advocacy to address some of the structural barriers of the first round. It sought to obtain a dedicated pool of PPP funds to be deployed by CDFIs and MDIs in order to alleviate the inequities embedded in the first-come, first-served deployment of funds. At the same time, HOPE strengthened its internal systems by contracting with a software processing company, StreetShares, due to the lack of preparedness of other vendors with whom it was already working. This is one lesson learned in retrospect: HOPE recognized the need to have ongoing conversations with its technology providers about their ability to enact urgent technology upgrades, as well as to anticipate members' needs and develop products for them.

StreetShares is a software platform that allowed us to put PPP loans into an operating system securely and quickly. This significantly enhanced HOPE's ability to process numerous loans with swiftness and with ease, as we moved through the underwriting process and sent them to SBA for approval. StreetShares listened to the HOPE's unique needs and partnered with us throughout the process. The StreetShares application allowed HOPE to leverage its deep relationship with underserved communities (such as communities of color in the Deep South) and our expertise in providing assistance to small businesses to meet the overwhelming demand for small business relief as a result of the pandemic. The technology was critical given the overwhelming volume of demand and the speed at which the funds were being deployed.

At the same time, in working with HOPE, StreetShares strengthened its own capacity in processing PPP loans. Its goal was for its platform to reach businesses in communities hardest hit by the crisis; thus, it required a partnership with an entity (such as HOPE) that already had a strong relationship with businesses in the region. An important element of the use of this technology is that it did not replace HOPE's strengths, but worked to enhance them by streamlining the paperwork

8 Kiyadh Burt, "Analyzing the CDFI Asset Gap: Examining Racial Disparities in CDFI Fund Awardees from 2003 to 2017" (Jackson, MS: Hope Policy Institute, November 5, 2020), http://hopepolicy.org/manage/wp-content/uploads/CDFI-Fund-Time-Series-Analysis-brief-edited.pdf.

and organizational elements of processing thousands of PPP loans. The technology did not replace the things which are most unique to HOPE's ability to meet its mission, such as the relationships HOPE team members have in communities hardest hit by the pandemic and the expertise of walking along side distressed businesses who may be both new to the lending process while navigating the urgency of the pandemic.

PPP is just one of many SBA lending programs, several of which aim specifically to reach underserved borrowers. The data from these other programs show pre-existing gaps in SBA's reach. For example, between 2015 and 2020, 28 percent of approved 7(a) loans went to minority-owned businesses. However, when looking at Black businesses alone, just 2.5 percent of approved SBA 7(a) loans went to Black borrowers ($3.7 billion out of $144 billion). As we emerge from COVID-19 and PPP comes to a close, SBA and participating lenders should address the disparities within the PPP program and not repeat them in future SBA programs. Community-based lenders, technology providers, and SBA must work collectively to deepen SBA's lending resources in communities of color. Developing software that interacts smoothly across multiple SBA programs—and increasing its access among minority-led and minority-serving CDFIs—may further help SBA address the gaps in its own lending to communities of color.[8]

Borrowers' Experiences

In fall of 2020, HOPE partnered with 60decibels, an impact evaluation firm, to survey a representative sample of HOPE's PPP borrowers to understand their experiences. These results show both the limitations and benefits of technology, while also affirming the strengths of mission-driven lenders, like HOPE. First, even with the use of technology to aid the processing of completed applications, businesses still needed significant help in preparing the application materials. For many HOPE borrowers, this additional assistance was critical. Many of the businesses HOPE serves are most often ones where the owner is both the chief cook and bottle washer, doing the work of running the business while also in charge of running the business. This is in stark contrast to larger, more resourced businesses that may have specialized legal or accounting staff on hand, either internally or on contract. In addition, many of the businesses in communities HOPE serves are those historically overlooked by other mainstream financial institutions, meaning they are typically less likely to have capital reserves to withstand the shock of economic downturn.

HOPE's survey of PPP borrowers showed that most (64 percent) were not prepared for a crisis such as COVID-19. However, this varied widely by race: 71 percent of Black PPP borrowers reported being "unprepared" or "very unprepared," compared with 47 percent of white borrowers. This level of preparedness before the pandemic had a strong correlation to the amount of assistance that borrowers needed to complete the PPP application, which HOPE was able to provide with one-on-one technical assistance. Businesses that felt "very unprepared" or "unprepared" for the challenges brought on by COVID-19 spent more time with a HOPE associate on the PPP application. Those who said "very unprepared" spent an average of two hours, and those who answered "unprepared" spent an average of 48 minutes with an associate. Conversely, those who said "somewhat prepared" spent an average of 37 minutes. As such, technology alone could not have met these borrowers' needs, but the use of technology to enhance other functions ensured that HOPE team members could spend time with the borrowers who needed support along the way.

Additionally, HOPE asked about borrowers' experiences with other lenders, such as online lenders. About 18 percent of those who applied to HOPE for PPP with another lender did so through an online lender. The majority said their experience was either "better" or "much better" with HOPE; hence, borrowers actually received their loan from HOPE rather than the PPP lender. In the words of one member, "HOPE was easier because I was actually speaking with someone in person, and [the other lender] was online and I actually didn't get to speak with somebody."

HOPE borrowers also expressed frustration with service by larger banks. Black-owned businesses approached mainstream financial institutions offering PPP loans only to learn that they would not be served. For example, a Black dentist was not funded by a large bank, and the bank never called to check on the application. The dentist applied with HOPE, and we approved her $12,000 loan request. HOPE approved a $7,200 loan for a Black-owned, 27-year-old barbershop in New Orleans after the owner received no help from the bank, one of the largest in the country and with major CRA obligations. These stories were a constant narrative during our PPP lending process, an extension of a banking system that has historically failed to serve communities of color and low-income communities with the same attention as others.

In HOPE's survey of its PPP borrowers, 36 percent decided to take a PPP loan with HOPE because they lacked another option or were declined by another bank. As one member described it, "I'm a member [of a bank], and initially they weren't gonna do it and then my account management app said they gave me PPP. Then they changed their mind. HOPE was the only community institution that really embraced PPP. I attempted, but [the bank] is the fourth-largest bank in the world, so that didn't fit their corporate mission." Another member said, "We tried to get it through other avenues and other banks, but they didn't give us the time of day. HOPE was the only one to assist us with the matter. I didn't even know how to fill it out; they just had an online form, and I uploaded the tax form and then we just winged it, but HOPE called after and fixed it."

Although both fintech firms and larger financial institutions have greater access to technology, they do not have the strengths of mission-driven lenders to reach the businesses that need it most. Beyond the experiences of HOPE's members, these patterns are also evident in the aggregate. For example, a recent study of whether the first round of PPP relief reached communities hardest hit by the pandemic found that fintech lenders alone did not compensate for banks' underperformance in hardest-hit communities.[9] Additionally, even though 19 fintech lenders here in Mississippi were participating PPP lenders as of May 2020, only five made any loans at all in the state in 2020. Even for loans made by CDFIs under $150,000, CDFIs collectively outperformed all PPP loans made by fintech lenders in Mississippi in terms of number of loans, loan volume, and jobs saved (see Table 1).

9 João Granja et al., "Did the Paycheck Protection Program Hit the Target?" Working Paper 27095 (Cambridge, MA: National Bureau of Economic Research, 2020), http://www.nber.org/papers/w27095, https://www.nber.org/system/files/working_papers/w27095/w27095.pdf

Table 1
2020 PPP Lending in Mississippi, by Lender Type[10]

Lender Type	Total Loan Volume	Total Jobs	Total Loans
Fintechs Total	$40,206,463	4,828	2,100
CDFI PPP Loans under <$150K	$609,710,383	108,607	22,817

Conclusion

As of September 15, 2020, HOPE funded 2,587 loans totaling $81 million, supporting more than 10,200 jobs in the Deep South. The majority of HOPE's PPP borrowers are businesses owned or led by people of color and women, and most are located in communities of color. The vast majority of HOPE's PPP loans are to small businesses, independent contractors, and sole proprietorships. Others include rural hospitals, HBCUs, and nonprofit service providers. Nearly 40 percent of HOPE's PPP loan dollars reached communities with poverty rates that exceeded 20 percent for more than three decades in a row. HOPE's median amount of roughly $11,000 is substantially lower than loans originated by most PPP lenders and most other CDFIs. Ninety-seven percent of HOPE's PPP loans in rural areas are under $150,000. In 2021, in the third round of PPP, HOPE funded an over 2,500 additional loans, bringing the total to 17,734 jobs saved and over $140 million in PPP funds deployed throughout the South.

The PPP served as a lifeline for many of HOPE's PPP borrowers, with 50 percent saying they would have "closed down" without assistance and another 13 percent saying they would have had to lay off employees. The severity of minority-owned businesses' being unserved by the banking system cannot be overstated. One borrower predicted what might have happened if he had not received a PPP loan: "Probably would be put out of business, would not have been able to catch up with rent. I would probably be homeless as well."

HOPE's ability to reach the depth of need amid the pandemic is due to its 25 years of expertise in meeting the needs of historically underserved businesses and communities. The scale of the COVID-19 pandemic sent shock waves through our entire region, both at the onset and even a year later. Even with HOPE's experience and dedication, rising to the challenge of the massive economic losses caused by COVID-19 also meant overcoming a series of structural barriers—many historically rooted for minority-owned businesses and minority financial institutions, and others unique to the nature of this particular crisis. Technology, and the ability to have access to it, was one of those barriers. Access to improved technology systems was critical in responding to the scale of the pandemic. However, technology alone would not have been enough, especially in light of other systemic challenges, such as capitalization limits and design flaws within the PPP program, that also

10 Analysis of SBA Paycheck Protection Program Loan Level Data for PPP loans originated in 2020, accessed June 7, 2021, https://www.pandemicoversight.gov/.

needed to be overcome. And, as evidenced by our members' experiences, technology alone would not have provided the one-on-one support many of the hardest-hit businesses needed to access relief.

HOPE has come to understand the importance of continually working with existing technology providers to ensure they are adapting to the needs of our members and to underscore the need for software systems that can build capacity across all SBA programs. HOPE and CDFIs play a critical role in ensuring the benefits of technology actually reach and work for the communities we serve. HOPE's experience with PPP is another example of the organization's long history of rooting its response—whether it be to a disaster or new financial technology—in understanding what is necessary to close the racial wealth gap in the Deep South.

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