MICRO CAPITAL TASK FORCE: MOVING MONEY TO MAIN STREET

The American dream is out of reach for millions of Main Street business owners who are not able to access capital or support on the path to capital for their businesses. Hard work alone will not solve the problem given the current path of financial institutions and other market players, even with strong support from a range of community-based institutions. Solving this problem requires the emergence of a new financial system for Main Street.

Recognizing this massive market failure, AEO, the national trade association for US microfinance and Main Street businesses, formed a private multi-stakeholder task force to present fact-based and practical recommendations to the Department of Treasury and other agencies, the White House, Congress and other stakeholders regarding access to capital in amounts of up to $250,000 for the smallest businesses. In parallel, AEO commissioned Ira Lieberman, one of the pioneers in scaling microfinance internationally, to draft a strategic plan to scale Main Street microfinance in the United States.

Lieberman's team[1] worked from October 2013 through March 2014 to establish a fact base from which to make recommendations for structural change. The team evaluated existing data and industry reports; performed groundbreaking analyses to provide insight into the economics of emerging technology-led for-profit micro lenders; and conducted more than 50 interviews with senior leaders in mission-focused organizations and venture-backed technology companies, established financial institutions, and government agencies. The complete findings of their work along with other supporting material for the MCTF are available at www.aeoworks.org.

This note represents a ***PRELIMINARY*** synthesis of the findings and recommendations for the Micro Capital Task Force. It is intended as a basis for dialogue and to support the MCTF working groups. Over the coming weeks, we will be engaged in continued discussions to further refine and advance the framework and recommendations. Then on May 7, we will be hosting a summit in New Orleans to discuss the findings and continue to align on a path forward. We look forward to seeing you then. Should you have any questions about the Micro Capital Task Force, please contact either of us or Tammy Halevy, SVP, New Initiatives at AEO (thalevy@aeoworks.org).

Thank you for your work to move money to Main Street!

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MICRO CAPITAL TASK FORCE: MOVING MONEY TO MAIN STREET

THE PROBLEM: THE SYSTEM TO FINANCE MAIN STREET IS BROKEN

The American dream is out of reach for millions of Main Street business owners. According to US Treasury Secretary Jacob Lew, each work day more than 8,000 businesses in communities across the country fail to qualify for a commercial bank loan. The capital gap to Main Street businesses represents $44 billion to $52 billion in unmet demand.[2] These requests for credit are declined because applications are too expensive for banks to evaluate and serve, not because all of the businesses are inherently too risky. In fact, AEO estimates that about one-third (30%) of these businesses are credit-worthy using underwriting methodologies currently available in the market. The remaining 70 percent of applicants will present manageable credit risks if and when proven solutions to serve them along the path to capital achieve financial sustainability and scale.

Closing the gap is possible. It will require collaboration, focused investments and tweaks to programs, policies and regulations so that 1) the costs and risks of bringing new products to market are minimized; 2) efficient and effective guidance on the path to capital is available; 3) the infrastructure of community development finance for Main Street is strengthened.

When Main Street businesses don't get what they need to succeed, the entire economy suffers.

Who is on Main Street and What Do They Need?

Main Street businesses represent the vast majority of the more than 25 million business establishments in the US. Main Street businesses include sole proprietors (e.g. solo); businesses with up to four employees (e.g. micro) and businesses with up to 50 employees (e.g. small). There are several ways to segment and characterize these businesses and their needs. In addition to the number of employees as a proxy for capacity, relevant dimensions include industry (e.g. broad range including construction, retail, services, etc.), age of business (e.g. less than one year to long established), growth aspirations of the owners and geography. Capital needs include equity and credit building products (especially to start a business); short term or long-term working capital; and financing for major investments (See Exhibit 1.) At present, there is a market gap for "Micro Capital" – loans less than $250,000 and equity for Main Street businesses to start (and grow). Businesses owned by women, African Americans, Latinos and others are affected disproportionately by this capital gap.[3] The likely causes of these gaps are complex. Solutions must include increasing the availability of suitable credit products and strengthening the underlying performance of these Main Street businesses.

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[2] "Micro and Small Business Finance in the USA: A Strategy for Structural and Policy Changes in the Sector," Ira Lieberman, Jose Ruisanchez, Paul DiLeo, Jenifer Mudd, Keith Catanzano and Alana Heath, (January 2014).

[3] For empirical analysis of the capital gap by race, see for example, Robert W. Fairlie and Alicia M. Robb, "Race and Entrepreneurial Success," (MIT Press, 2009). Surveys by a variety of organizations consistently demonstrate a capital gap to women-owned businesses as well. For a discussion of causality including the different capital structures of firms owned by women and minorities, see Alicia M. Robb, "Access to Capital among Young Firms, Minority-Owned Firms, Women-Owned Firms and High-tech Firms," (SBA Office of Advocacy, April 2013)

Today's System of Financing Main Street: Built for a Different Era

We don't have a financial infrastructure for Main Street because the system we have was designed and built for an era when business owners participating in the formal economy had far fewer choices: Finance for Main Street came primarily from the extensive branch network of commercial banks. Where that system failed, government stepped up to create obligations and incentives to support an infrastructure of mission-focused community lenders.

For decades, the network of bank branches and infrastructure of mission-focused community lenders served Main Street reasonably well. Yet now this system is under extreme pressure. Absent a systematic and coordinated effort to respond to these pressures, capital and necessary supports along the path to capital will not flow to the businesses whose growth will revitalize Main Streets and cross-streets in every community throughout the country.

Pressures Mounting in Every Quarter

1. Frustration on Main Street

Main Street business owners feel burned. As one indicator, the polling organization Gallup reported that between 2007 and 2012 confidence in banks fell by half. In June 2013, Gallup reported that 28% of respondents expressed very little or no confidence in banks.[4] Trust – or the lack thereof – in financial institutions is another indicator of frustration. Banks ranked near the bottom for the second year in a row among 15 industries in the 2014 Edelman Trust Barometer, an annual global survey[5]. In part as a consequence of these sentiments, business owners are avoiding banks and looking for alternatives.

The alternative market of nonbank lenders is only showing signs of growth and proliferation. Loan originations by online lenders, merchant cash advance providers and other alternatives have grown a reported 64% since 2010.[6] Estimates of CDFI lending to Main Street vary, but the CDFI Fund reported that awardees originated ~$360m in 2011[7] and in a 2013 survey of CDFI loan funds, more than one quarter (26%) reported constraints on capital available to lend[8], one sign of unmet demand and the potential for growth. It is worth noting that both of these alternatives are relatively trusted: "Technology" was ranked highest among industries and nonprofits and their

[4] Denis Jacobe, "Americans' Confidence in Banks Up for First Time in Years," June 14, 2013. http://www.gallup.com/poll/163073/americans-confidence-banks-first-time-years.aspx

[5] "2014 Edelman Trust Barometer Financial Services Industry Results" accessed on March 28, 2014 at http://www.edelman.com/insights/intellectual-property/2014-edelman-trust-barometer/trust-in-business/trust-in-financial-services/

[6] Susanna Tisa, "Regulators are Encouraging Shadow Bankers," *The American Banker* (15 January 2014)

[7] CDFI Fund, "CDFI Fund Year in Review 2012"

[8] Lolita Sereleas, Ruth Barber, Moira Warnement, "Deployment Strategies for CDFI Small Business Lenders" (January 2014)

representatives were generally seen as credible voices by both individuals who trust financial services and those who do not.[9]

2. *Unintended Consequences of the High Costs of Compliance*

The near-collapse of the US economy highlights the need for a thoughtful and carefully architected financial system. Yet, as regulators have pressed hard on traditional banks in the wake of the financial crisis, demand has migrated elsewhere. The *Wall Street Journal* estimated that some 24 nonbank technology-led lenders loaned about $3 billion to small businesses in 2013.[10] Businesses have turned to these lightly regulated alternatives, usually at much higher cost, as regulated mainstream banks are discouraged from lending to anyone but the most creditworthy and mission-focused lending today does not present credible alternatives at scale.

Debate over the tradeoffs between the need for regulatory controls and the costs of compliance – especially for smaller institutions – is ongoing and lively.[11] Some argue that costs for each organization to establish a compliant reporting infrastructure can be prohibitive. Others argue that strict reporting requirements permit regulators to enforce rules against bad actors. Greater transparency should enable the right mix of "carrots and sticks" as socially-minded or market-motivated private actors could respond to market gaps at the same time that regulators and the courts enforce compliance.

Passage of the 2010 the Dodd-Frank Wall Street Reform and Consumer Protection Act included a mandate to collect and disclose data on small business lending.[12] These rules are yet to be promulgated, but represent an opportunity to harmonize requirements and create a Main Street shared utility to access data reported across government agencies. Loan level reporting as envisioned by Dodd-Frank would ensure a shared understanding of where, to whom and at what price capital is flowing and where it is not. Expanded institution level reporting would make it clear where capital is coming from. At present, some of this data is collected and shared in private consortia.[13] Other elements are reported today as part of obligations under the Community Reinvestment Act or as part of participation various programs such as SBA 7(a) lending or CDFI Fund grant awards. Harmonized and robust data standards related to capital access on Main Street would support compliance and create incentives for collaboration and innovation.

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[9] "2014 Edelman Trust Barometer Financial Services Industry Results"

[10] Ianthe Jeanne Dugan and Ruth Simon, "Alternative Lenders Peddle Pricey Commercial Loans," Wall Street Journal, January 7, 2014,

[11] See, for example, hearings in the US House of Representatives on 4 December 2013, "Examining Regulatory Relief Proposals for Community Financial Institutions,"

[12] Pub.L. 111–203, H.R. 4173; commonly referred to as Dodd Frank

[13] Industry consortia exist such as Paynet

3. *Performance Expectations from All Capital Sources: Private, Public, Philanthropic & "Impact"*

Banks – especially community banks -- are under competing pressures to meet capital adequacy and risk management requirements under Basel 3 while also stepping up their CRA activities. Community banks represent a critical source of capital for Main Street: Nearly one-third (31%) of the total value of small business lending by FDIC-ensured institutions was originated by community banks in 2012[14] and not surprisingly, these institutions have higher rates of loan approvals than their larger peers.[15] Within the universe of community banks, 83 are certified by the US Treasury as Community Development Financial Institutions (CDFIs). In the Q1 2013, these banks had $1.46 billion in outstanding loans of less than $250,000 to small businesses, with an average loan size in this segment of just under $52,000.[16]

The Basel 3 capital conservation buffers risk creating disincentives for capitalizing these entities, which in turn could constrain their Main Street lending. Minimum regulatory capital requirements will increase from the current 4% to 6% (phased in by 2015). In addition to this minimum, banks with less than an additional 2.5% buffer (phased in by 2015 also) above and beyond the minimum 6% will be restricted from declaring any capital distributions. Restricting dividends would likely discourage current shareholders from contributing more capital and create disincentives for outside investors to contribute capital. Community financial institutions do not have access to the credit markets that large banks do. Most equity is raised through private equity in closed offerings.

Public financing for the community infrastructure built over the last forty years is no longer assured – both because of politics and because of fiscal realities. As one example, the President's FY2015 budget request included an 8% reduction in Community Development Block Grants over the prior year. This reduction reflects continued downward trend over the prior four years. And while support for the Department of Treasury's CDFI Fund remains steady for the last few years at around $200 million, the largest CDFI Fund programs are not designed at present to support lending to Main Street.[17]

At same time that constraints on private investment and public financing are emerging, trends in philanthropy and social investing call for higher standards of productivity, and impact – including measurement. Some analysts estimate the value of private capital waiting on the sidelines to be

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[14] Analysis of FDIC data cited in "Small Business Lending in the United States 2012", Office of Advocacy, US Small Business Administration (July 2013). Definitions of community banks differ: FDIC uses asset size of <$1B but according to NCIF, CDFI banks generally fall into asset class of <$2B.

[15] Biz2Credit, a privately-held small business lending marketplace, reports that in February 2014, small banks (e.g. less than $10 billion in assets) approved 51.4% of loan applications compared to 19.1% for large banks (e.g. >$10 billion in assets). This estimate is based on analysis of 1,000 monthly loan applications packaged by the company.

[16] "Small Business Lending: A Quick Take on the CDFI Banking Industry," National Community Investment Fund (September 2013)

[17] Neither New Markets Tax Credits nor the Bond Guarantee program are be used to finance lending to Main Street. See "CDFI Bond Guarantee Program: Issues & Recommendations," Association for Enterprise Opportunity (August 2013)

as high as $2 billion.[18] The failure of this potential capital flow to finance Main Street businesses is a consequence of many complex factors. Many are structural. On the demand side, few if any of the mission-focused microfinance institutions in the United States present the scale or capacity to absorb this capital. Balance sheets of individual microfinance institutions are typically too small to support the type and size of investment presented by philanthropic or impact investors. On the supply side, the seemingly insurmountable transaction costs and implicit competition versus other investment opportunities has failed to attract systematic interest from these sources of capital. As a result, investment does not flow to Main Street.

4. *Technology enables explosive growth in product offers; new investment models and radically improved productivity for greater market reach*

Technology is making it possible to introduce new products, services and delivery models to Main Street. At the same time, the internet and new modes of communication are driving change in capital markets. Automated credit decisions that aggregate and analyze a wide array of contextual data as well as peer-to-peer lending and its corollary, crowd-funding are fast becoming the norm. In addition to product innovation, technology enables radical productivity improvements and cost structures that create the potential for scale. Credit decisions that once required weeks to prepare and review can be packaged in hours and evaluated in days. Time spent performing routine tasks can be re-allocated to higher value activities. In response, investments in Main Street focused financial technology companies are growing. Global investment in financial technology ventures has grown more than three-fold in the last five years, with more than $2 billion invested in US companies in 2013 alone.[19]

Product development for credit models is unique in technology application development. Several features characterize the creation of new credit products and warrant highlighting:

- Industry-specific dynamics, borrower size and borrower circumstances create the need for specific credit models to meet specific business owner needs and business use cases. The growing availability of large pools of contextual data, coupled with advances in computing power and insights of data scientists makes it possible to serve more businesses – and remove bias from the underwriting process. At the same time, this same data can be used to assess gaps in business performance relative to credit models in order to uncover "technical assistance" needs efficiently and effectively.
- Intellectual property (IP) in the form of data about borrowers, loan performance and other variables that yield predictive insights for credit decisions is "trapped" in many organizations including government, CDFIs, banks, payment processors, property managers, utilities, and other places. Often, the "owners" of this data don't have incentives

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19 "The Boom in Global FinTech Investment: A New Growth Opportunity for London." Accenture Consulting (March 2014)

to make use of it. Sometimes, the skills and capabilities required to model the data are not resident in the organizations that collect the data.

- Development of credit models is a dynamic and evolutionary process. As credit models develop and mature, increasingly granular tiers of expected performance and segments of borrowers can be identified. Early stage credit intellectual property results in minimal loss segmentation contributing to higher price due to cost of losses. As models mature, costs come down as predictive risk-based pricing can better reflect actual risks of loss and other cost drivers recede with scale. (Exhibit 2)

We find ourselves with a broken system. This massive market failure and the associated missed opportunities for growth and employment have consequences that warrant attention from policymakers, business leaders, philanthropists, CDFI leaders, and others.

THE SOLUTION: MAIN STREET FINANCIAL SYSTEM 2.0

We are at an inflection point. That change is coming is inevitable. What is less clear absent a systematic and coordinated national effort is how the existing infrastructure of banks and mission-focused community lenders will interact with the growing set of alternative lenders to move money to Main Street in every community.

In order to bring more clarity and a shared fact-base to these issues, AEO launched the Micro Capital Task Force, a year-long process of inquiry, analysis and engagement including an expert team led by Ira Lieberman, one of the pioneers in scaling microfinance internationally; a multi-stakeholder survey of leaders in mission-focused lending, credit technology companies, investors and other industry participants; and working groups of senior practitioners and experts.

The Micro Capital Task Force set two goals:

1. Identify solutions for the problem of ***availability*** by resolving the market failure that results in 8,000 bank declines every business day

2. Identify solutions for the problem of ***access*** by ensuring that mission-focused lending is capitalized for the impact necessary and possible

Through this work three critical observations came into focus:

1. Banks are retreating and mission-focused lenders are struggling. At the same time, technology has unleashed the potential of new business models and sources of value including data aggregation to form credit intellectual property; automation in servicing and online origination as well as new approaches to balance sheet formation.

These changes present the opportunity to lay the groundwork for a new financial system for Main Street that does everything possible to:

- Reduce the operating costs of lending associated with originating, servicing, and collecting
- Accelerate development of new products and services through data access, data sharing and targeted investment
- Finance the development and delivery of proven business development support services on the path to capital (e.g. targeted "technical assistance" to support applicants prepare their businesses for capital)
- Reduce the time and expense of raising balance sheet capital and the cost of funds as methodically and quickly as possible for each promising new offer and for a select set of microfinance institutions
- Create mechanisms to absorb higher than expected costs in the early days of bringing new products to market (or accept higher market pricing)

2. With a new financial system, Main Street would start to look like every other consumer-facing industry. Business owners would be presented with a plethora of choices to meet their needs. Scarce but critical resources could then be deployed in a targeted manner to best meet needs in underserved communities.

3. At present, banks, community lenders, business service providers, credit technology players, philanthropists, Wall Street, and the government operate in relative isolation as if in silos to solve the challenges of moving money to Main Street. Each silo prioritizes different variables to guide its direction and resource allocation. Each is making some progress in moving money to Main Street, however, none has cracked the code. Each group has complementary strengths and weaknesses. (See Exhibit 3.) Addressing the needs of Main Street on a national scale will require incentives, encouragement and support to collaborate, combine their strengths, and compensate for weaknesses.

FINANCIAL SYSTEM 2.0: PATH FORWARD

The good news is the components of Financial System 2.0 exist today (Exhibit 4). Moving money to Main Street in every community does not require radical change. This new financial system for Main Street will require investments in critical support infrastructure along with a policy and regulatory environment that aligns incentives for all stakeholders with the right balance between carrot and stick.

Our current infrastructure of banks and CDFIs represents a starting point from which to engage with emerging technologies. Financial System 2.0 requires a shared vision of the opportunity at hand that can guide collaboration, focused investments, new standards and tweaks to programs, policy and regulation.

Financial System 2.0: Vision for Main Street

Treasury Secretary Lew defined the goal: solve for the 8,000 applications for credit that are declined each business day. Ira Lieberman's team then sized that gap at $44B - $52B. Closing the gap will require collaboration, focused investments and tweaks to programs, policies and regulations so that the costs and risks of bringing new products to market are minimized; efficient and effective guidance for business owners on the path to capital is available; and the infrastructure of community development finance for Main Street is strengthened.

These imperatives represent the basis for the three strategic pillars of the Micro Capital Task Force: 1) Make every Main Street Investible; 2) Meet Main Street Businesses on their Paths to Capital with a Robust Product and Service Marketplace; 3) Turn "Decline" into "Delight"

Below are the elements of a Financial System 2.0 framework and recommendations:

1. Make Every Main Street Investible

Fragmentation characterizes every aspect of Main Street: millions of business owners who are distributed geographically compete in diverse and dynamic sectors. One consequence of this fragmentation is that billions of dollars of private, public, and philanthropic capital are stuck on the sidelines because the costs of any single transaction are prohibitive. Making Main Street investible requires solutions that strike the right balance among specific and unique needs, local control and the benefits of scale. The Task Force has identified (x) priority opportunities to make Main Street Investible:

- **a.** Create a Main Street window in the CDFI Fund to provide capital and targeted capacity building to a select set of high-impact/high-potential institutions including networks
- **b.** Mobilize and pool capital from financial institutions and other corporations, impact investors and philanthropy
- **c.** Ensure transparency, harmonization and access to government data related to demand, funds flows and performance of institutions
- **d.** Organize a multi-state pilot to test the customization of SBA and other Federal guarantees
- **e.** Enable the crowd to meet the mission: Create regulatory carve-outs and securities law exemptions for certified CDFIs that seek to co-invest in Main Street businesses
- f. Streamline rules surrounding peer-to-peer lending and exempt certain nonbank lenders (e.g. certified CDFIs and qualified peer to peer lending platforms) from state by state licensing requirements so that these lenders can export rates nationally.

2. Unleash a Robust Product and Service Marketplace: Path to Capital & Pricing

In tandem with addressing barriers to investment flows, we must ensure that there are products and services to meet the unique needs of Main Street and each segment of business owner. Unfortunately, the status quo includes disincentives and constraints on product development, market testing and scale: Banks fear bringing new programs and products to their regulators. Emerging technology companies pass along the costs and risks of early stage product development and infrastructure building to Main Street borrowers resulting in higher prices compared to banks or CDFIs. CDFIs deploy scarce subsidy but don't have access to growth capital to invest in product development for the niche markets where they focus or for a scalable origination infrastructure. Additionally, business development services – frequently described as "technical assistance" when provided by CDFIs and other nonprofits – is all over the map.[20] Yet the provision of targeted support to fill gaps in experience or capacity along the path to capital can have material and measurable results on the performance of the business and several proven solutions exist.[21]

Fortunately, these constraints can be addressed and incentives for collaboration, data access, data sharing and investment can solve for them. The Micro Capital Task Force has identified three priorities to unleash a robust product and service marketplace:

a. Establish a fund to incubate and scale products, services and delivery models ranging from niche market credit products to business development services along the "Path to Capital"
b. Define a framework and clarify goals, targets and metrics of business development services (aka "Technical Assistance")
c. Establish Safe Harbors for regulated financial institutions to test new products without ramifications back to the portfolio review by regulators. This could take the form of a process analogous to pharmaceutical clinical trials including standard regulatory pre-screening and market testing standards.

In addition to creating incentives for the development, distribution and scale of new products and services, we must create a new culture around pricing. Price is among the most emotional and political issues for mission-focused lending and market lending. We must shift the debate from judgment about intent to one that best serves the needs and interests of Main Street. At the same time, well-intentioned price caps on government lending programs place undue constraints on the financial viability of mission-focused program participants.

[20] "Micro and Small Business Finance in the USA: A Strategy for Structural and Policy Changes in the Sector," Ira Lieberman, Jose Ruisanchez, Paul DiLeo, Jenifer Mudd, Keith Catanzano and Alana Heath, (January 2014).
[21] See for example, Association for Enterprise Opportunity, "The Power of One Business," (May 2012).

The Micro Capital Task Force has identified three priorities related to changing the culture of pricing:

a. Create transparency with regard to cost structures, losses, margins and subsidy through a data exchange that will permit "apples to apples" benchmarks and comparisons of products and institutions in addition to complete pricing transparency for borrowers.
b. Permit each qualified program participant in government backed direct loan programs to set pricing in line with specific borrower profiles and market based conditions in its operating area
c. Pool capital from philanthropy, CRA obligations and government supports into a pay for performance fund to target subsidy directly to individual applicants for specific proven products and services.

3. Turn "Decline" into "Delight"

Even when we solve for investment flows and the availability of products and services, the problem of support on the path to capital will persist. We must acknowledge value of "technical assistance" and invest in both proving innovative solutions and scaling proven solutions as noted above. The current model for delivering guidance along the path to capital is broken at every point. No stakeholder is well-served by the status quo. The business owners described by the Treasury Secretary whose applications for credit are not approved generally experience "decline and drop" as banks have few incentives and limited ability to provide guidance or counseling directly to these unqualified applicants. In some cases, business owners need CFO-like services to improve their financial management. In other cases, applicants do not have realistic expectations and require coaching. Many applicants experience challenges related to business or personal credit. A network of CDFIs and nonprofits relying on available proven solutions and innovating to fill the gaps should present the ideal solution to this problem. Certainly there are examples of referral networks today but they are all subscale and both bank partners and CDFIs identify constraints on current approaches. In order to systematically solve for the 8,000 declines each business day cited by the Secretary of the Treasury, we must[22]:

a. Enable Main Street business loan applicants to opt in to an automated referral network of approved lenders and service providers
b. Ensure approved networks rely on highest levels of privacy and data protection standards
c. Provide safe harbor from violations of privacy rules to participants in approved networks

Exhibit 1: Main Street Businesses Have a Range of Capital Needs

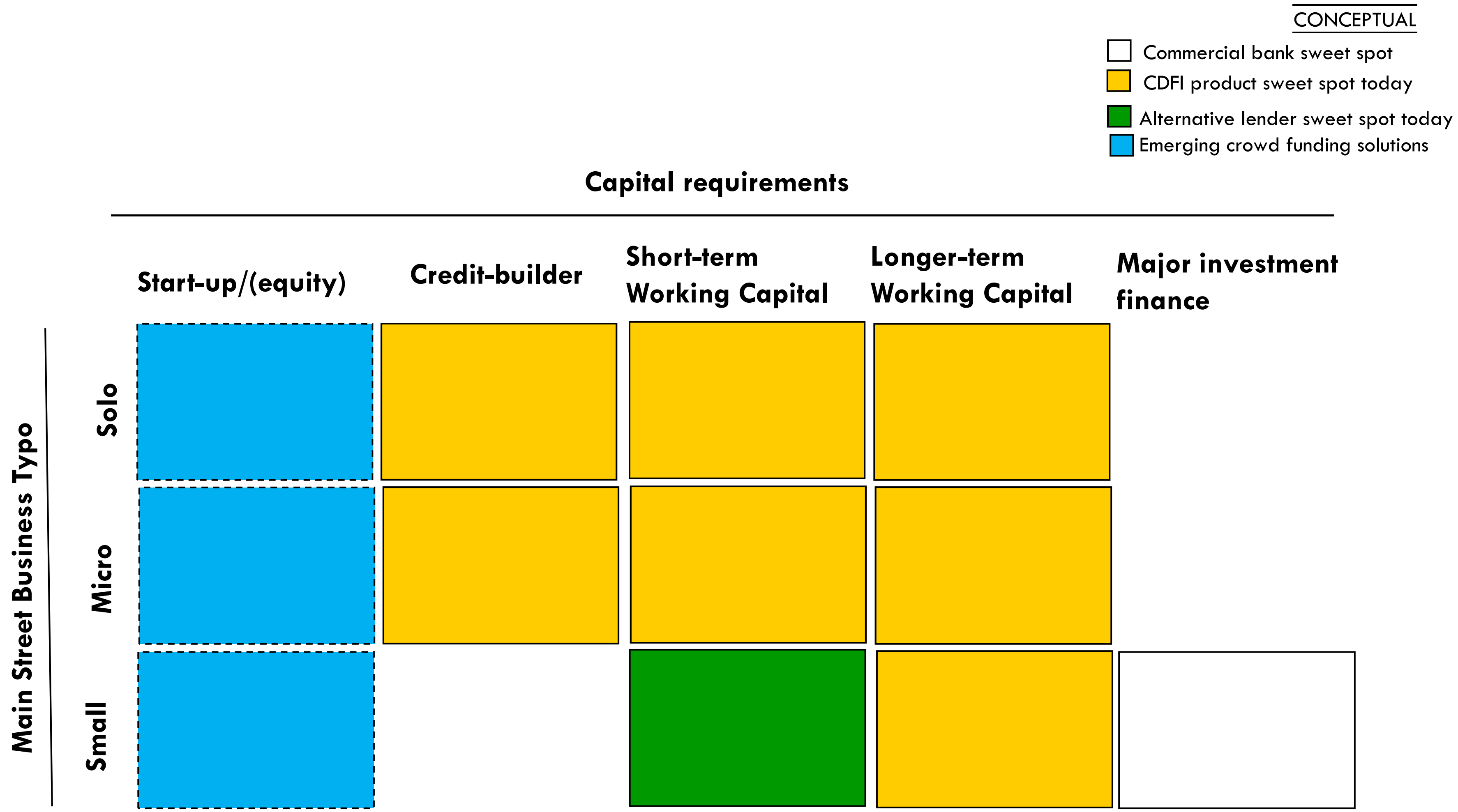
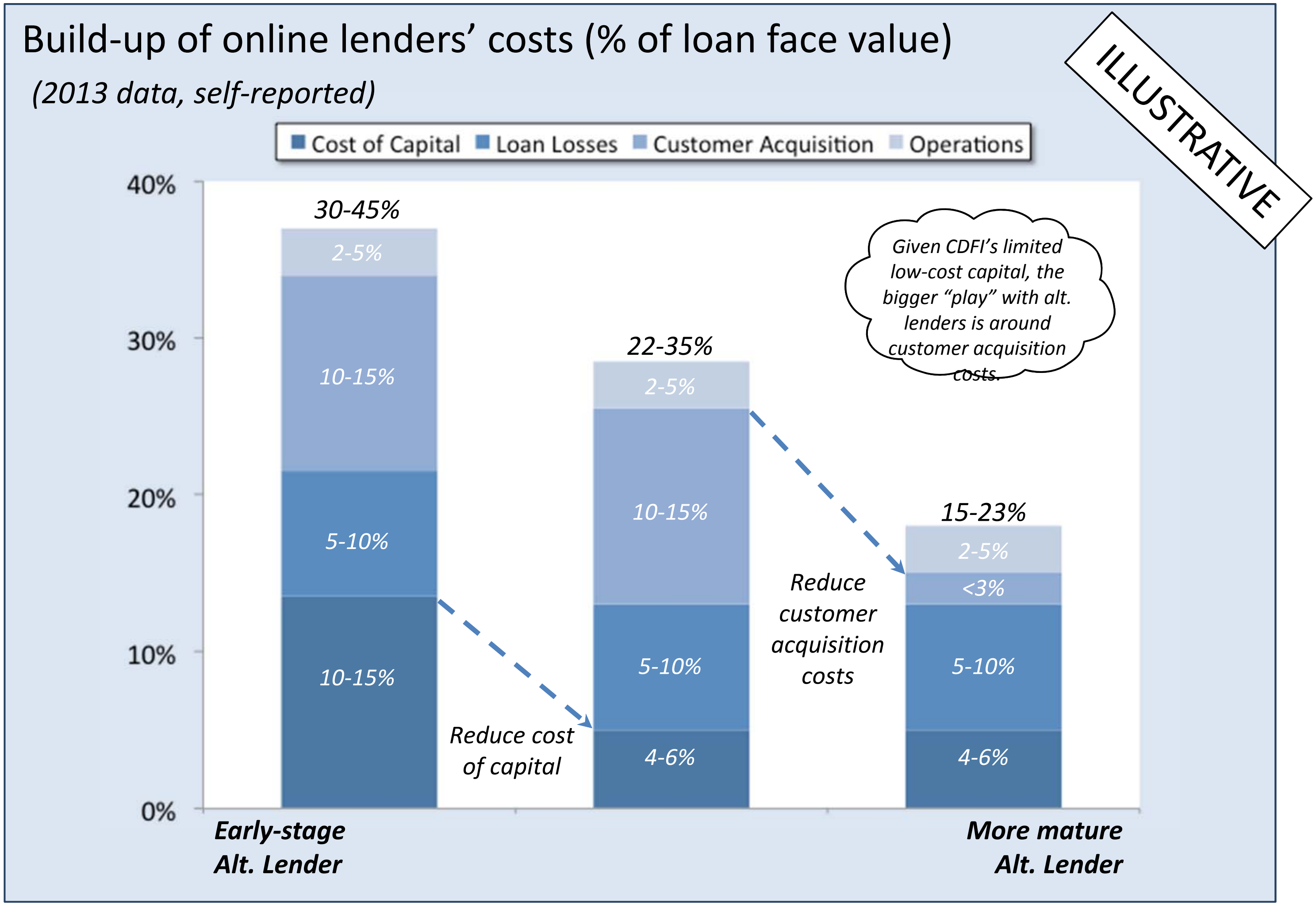


Exhibit 2: Costs Decline Over Time for Technology-Led Lenders



Source: Lieberman et al "Micro & Small Business Finance in the USA: A Strategy for Structural & Policy Changes in the Sector " (March 2014)

EXHIBIT 3: STRENGTHS AND WEAKNESS OF THE SILOS

Component	Strengths	Weaknesses
Banks	• Balance sheet: Banks are this nation's solution for balance sheet for lending. Access to deposits and the Fed window make banks the most effective • Origination: With ~90,000 branches and 1.2 billion pieces of direct mail sent annually banks are unequivocally the largest "front end" of the financial system • Access to data: As scaled entities, banks pay some of the lowest fees for access to critical services such as credit bureau and credit score information, portfolios of merchant processing data, bank account data and general account information. • Efficient decline system: Counterintuitively, one of the great strengths of the banking system as it relates to Financial System 2.0 is already efficient systems for declining Main Street businesses	• Overhead too expensive to serve small loans • They are the "Big Box" stores of lending…do not engage in customer handholding for loan process • Highly inflexible, primarily FICO-based "boxes" for commercial lending. • Product innovation not a core competency • Culturally slow to adopt to introduce new products • Regulatory environment prevents product innovation • Market value disincentive to invest in innovation: Banks are valued as a multiple of book value. Innovation requires millions of dollars of losses for several years before generating a profit. Every dollar of loss is multiplied by the banks multiple. Ironically, the more successful the bank the higher the book multiple the more disincentive it has to lose significant money to innovate. • Community Reinvestment Act exists to ensure baseline of small business lending
Community Lenders	• Exist to fill gaps in lending on Main Street • Provide hands-on support to complete loan applications • Very high touch, flexible underwriting criteria – go the "extra mile" to find a way to	• Sub-scale • Highly fragmented geographically • Uneven coverage ("Swiss Cheese" coverage) • Inefficient processes, limited use of technology • Significant time spent raising capital • Limited origination capital

EXHIBIT 3: STRENGTHS AND WEAKNESS OF THE SILOS

	get an approval • Already the recipient of substantial bank, government, and philanthropic support • Growing recognition of the need to increase reach, impact and sustainability in order to maintain financial support	• Requires unsustainable levels of subsidy (e.g. $.42/dollar loaned per Aspen FIELD) • No common set of products, processes or standards • Each entity must raise its own capital base for each new product • Limited current path to scale constrains path to sustainability and/or growth
Credit technology companies	• Scalable, high growth products • Scalable, high growth operating platforms • Cultures of innovation • Skill base for data-driven product development • Enterprise market valuation places high premium on investing capital for disruption	• Expensive infrastructure contributes to high price • Expensive balance sheet access: Must form capital from private sources at exceedingly high cost compared to depository capital • No access to philanthropic, government or CRA support during early phases of product development • High origination costs: Cost to reach businesses coupled with monoline nature of product set translates to very high cost of acquisition. • Data access and peripheral services expensive (e.g. credit bureau, credit scores, background checks, ACH and processing services, collections). "Commodity" resources must be acquired and built to scale at high cost. • Must acquire access to proprietary data sources such as bank data and customer information slowly – a high friction and expensive process
Philanthropy	• Aggregated capital to support the capacity and balance sheet of small commercial lenders • Willingness to subsidize small loans that provide social value	• Provide capital to community lenders independent of their efficiency relative to alternatives • Provide capital regionally or geographically

EXHIBIT 3: STRENGTHS AND WEAKNESS OF THE SILOS

	(e.g. community development) • Willingness to support operations pre scale	
Wall Street	• Price to market • Scale	• Do not support "pre proven" credit IP • No social consideration
Government	• Mechanism to distribute taxpayer money to support lending through balance sheet, credit loss support, operating capacity • Regulatory influence • Bully pulpit influence	• Supporting outdated lending models • Congressional deadlock prohibits new legislation
Technical Assistance Service Providers	• Provide general business coaching • Support capital raising efforts of business • Raise philanthropic capital to support business coaching at very low or no cost to business • Operate locally in communities	• General business coaching not focused on loan approval, too broad a mission to be effective given resources • Geographically dispersed • No standardization of practices • Minimal data reporting on effectiveness • Limited use of e-learning and other scalable approaches to technical assistance
Lead generation services	• Aggregate small businesses	• Inefficiently connected to loan products • Minimal value add – don't often collect significant enough data to direct leads correctly • False promises to borrower
Business service providers (e.g. data providers, payment processors, social platforms, accounting services, etc.)	• Significant source of rich data that can accelerate credit IP development and reduce operating costs	• Limited senior level management engagement in the role of their platforms in enabling Main Street business lending. Therefore, low priority • Long business development cycles and high friction to access their data platforms in the absence of senior level mandate

Exhibit 4: Roles of Ecosystem Players in Financial System 2.0

FINANCIAL SYSTEM 2.0

BANKS

- Connect declined customers to service providers that can prepare applicant for long-term banking services
- Pool CRA funding
- Safe harbor to try new products and will connect credit technology products into their already scaled operating platforms

COMMUNITY LENDERS (CDFIs)

- Commit to principles and practices for impact, performance and sustainability
- Use data from "high touch" loan underwriting to enable to product development
- Develop and/or adopt standard but customizable solutions for declined applicants

PRIVATE INVESTORS

- Focus capital availability on scalable products, lowest cost originations and data exchange
- Benefits from financial & social returns of scale

PHILANTHROPY

- Commit to support for Main Street ecosystem as strategy for inclusive economic development
- Focus giving and investment on financial products and services with potential for scale / replication

CREDIT TECHNOLOGY COMPANIES

- Connect their products into community lenders and banks
- Connect to philanthropic and enhancement capital to lower costs during early stages of product development
- Connect to and contribute to common data platform to increase the use of broad sets of data in product innovation

BUSINESS SERVICES PROVIDERS

- Develop and/or adopt standard but customizable solutions for declined applicants
- Commit to "pay for performance" models to support the Main Street business on the path to capital (e.g. 3-9 months from decline)

GOVERNMENT

- Use power to convene and regulate to ensure a suitable framework for Main Street

Exhibit 5: Coordinated Action Required for Financial System 2.0

	Banks	Community Lenders	Nonprofit Service Providers	Technology Companies	Philanthropy	Private Investors	Dept. of Treasury	SBA	Dept. of Agriculture	SEC	OCC	OMB	The White House	Congress
1. Make Every Main Street Investible	×	×			×	×	×	×		×		×	×	×
2. Unleash a Robust Product & Service Marketplace	×	×	×	×	×	×	×	×			×		×	
3. Turn Decline into Delight	×	×	×	×	×	×							×	×