

**Testimony of Makada Henry-Nickie,  
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**Before the  
United States House Financial Services  
Consumer Protection and Financial Institutions Subcommittee**

**Hearing on  
“The Future of Banking: How Consolidation, Nonbank Competition, and Technology are  
Reshaping the Banking System”**

September 29, 2021

**Introduction**

Chairman Perlmutter, Ranking Member Luetkemeyer and distinguished Members of the Committee. I am pleased to join today's hearing on the Future of Banking. I am Makada Henry-Nickie, Fellow at The Brookings Institution. My comments today will focus on market trends, the rise of FinTechs as consequential market players, and the impact of these shifts on marginalized consumers. My comments on these issues today are my own and do not reflect an official position from The Brookings Institution.

The US is in the midst of a generational demographic change driven by communities of color. In the last decade, Asian and Hispanic Americans grew 35.5% and 23%<sup>1</sup>. However, the financial services sector has yet to respond to these representational changes. Within the consumer financial market, minority households systematically occupy status quo roles on the fringe, rather than sitting at the center of market models as growth drivers. According to FDIC's 2019 banking survey, 7.1 million households remain unbanked. Most of these households—64%--were from Black and Hispanic communities. Indigenous communities have an unenviable long-standing experience of systematic financial exclusion. Despite modest progress in promoting financial inclusion, 16.3% of Indigenous

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<sup>1</sup> Census Bureau Race and Ethnicity in the United States: 2010 Census and 2020 Census see: <https://www.census.gov/library/visualizations/interactive/race-and-ethnicity-in-the-united-state-2010-and-2020-census.html>

Americans are unbanked and disproportionately exposed to alternative financial services and products, such as predatory payday loans and title loans.<sup>2</sup>

The prosperity of our economy is stifled when future growth segments are excluded from fully participating in the US economy. The Biden-Harris administration has drawn on a comprehensive accountability model to orient the federal government's policy framework toward a racially inclusive economy. While President Biden's racial equity agenda marks a sea change moment, it is only a first step towards closing profound longstanding racial wealth gaps.<sup>3</sup> Financial intermediaries and regulators must do their part to ensure that the financial services ecosystem responds to the unmet needs of minority communities.

### **Reduced Banking Competition Creates Risks for Marginalized Communities**

The Great Recession dramatically changed the landscape of financial services. More than a decade after the subprime crisis, the banking infrastructure continues to contract. In the years since the housing bubble, the number of commercial banks has fallen sharply from 7,279 in 2007 to 4,375 in 2020, an astonishing 40% decline.<sup>4</sup> According to a 2017 FDIC study, the accelerated pace of mergers and acquisitions between community banks accounted for 91% of the consolidation trend.

Notably, acquired community banks were often less profitable than similarly sized institutions, often cited as problematic on the FDIC's watch list.<sup>5</sup> In addition to merger activity, enhanced regulatory oversight and market dynamics undermined de novo bank formation, increasing complexity in the post-crisis banking landscape.

### **Figure 1**

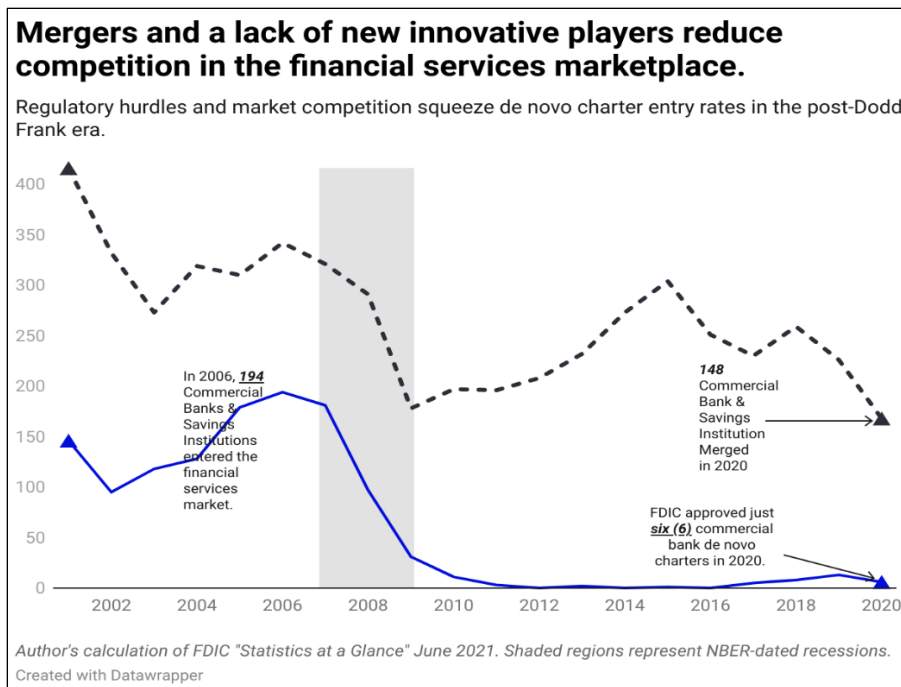
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<sup>2</sup> Federal Deposit Insurance Corporation (FDIC), *How America Banks: Household Use of Banking and Financial Services, 2019 FDIC Survey* (October, 2020).

<sup>3</sup> Exec. Order No. 13985, 86 Fed. Reg. 7009 (January 20, 2021).

<sup>4</sup> Federal Deposit Insurance Corporation (FDIC). *Statistics at a Glance: Historical Trends*. June 30, 2021.

<sup>5</sup> Breitenstein, Eric, and Nathan Hinton. "Community Bank Mergers Since The Financial Crisis: How Acquired Community Banks Compared With Their Peers." *FDIC Quarterly*, vol. 11, no. 5, 2017, pp. 41-52, [www.fdic.gov/analysis/quarterly-banking-profile/fdic-quarterly/2017-vol11-4/fdic-v11n4-3q2017-article2.pdf](http://www.fdic.gov/analysis/quarterly-banking-profile/fdic-quarterly/2017-vol11-4/fdic-v11n4-3q2017-article2.pdf).



In 2018, the FDIC Bank Application Actions database recorded 16 approved new bank applications at the end of the second quarter of 2021, only one de novo application was approved.<sup>6</sup> This extreme reduction in commercial banking has serious implications for minority and low-income communities that depend on the physical retail network to interact with the financial services system. Contrary to broader digital trends, select segments within underserved communities disproportionately rely on physical retail outlets to connect with mainstream banking. The FDIC's 2019 under-banked survey underscores the importance of bank branches to groups that visit branches more than ten (10) times a year: (1) older Americans; (2) people with disabilities; (3) people with regular income volatility; and (4) indigenous Americans.<sup>7</sup>

Correspondingly, the hollowing out of the retail bank footprint also impacts the small business community. Studies have documented the contractionary effects of branch closures on local lending for small businesses. These effects can linger in markets for many

<sup>6</sup> FDIC Banking Applications Actions database <https://www.fdic.gov/regulations/applications/actions.html>

<sup>7</sup> Federal Deposit Insurance Corporation (FDIC), *How America Banks: Household Use of Banking and Financial Services, 2019 FDIC Survey* (October, 2020).

years.<sup>8</sup> Other researchers have shown that lenders without branch anchors allocate less capital to small businesses than branch-tethered lenders, although these marginal effects have slightly attenuated since 2011.<sup>9</sup> Efficiency gains are the celebrated mantra of merging institutions, but low-income communities rarely realize economies of scale. Instead, mergers led to increased FHA loan denials and substantial increases in interest rate pricing on non-agency mortgage loans, particularly for subprime borrowers.<sup>10</sup>

### **FinTechs Response to Gaps**

Bank mergers have resulted in enormous credit gaps in low-income communities. Financial technology companies (FinTechs) have responded to the gap by providing innovative credit and savings products. Missteps with the Paycheck Protection Program (PPP) illustrated the remarkable ability of FinTech companies to rapidly direct critical credit flows to underserved consumers. According to the Federal Reserve Bank of New York, one in four black small business owners applied for and received PPP loans from fintech lenders, twice the rate of other ethnic and racial groups, including Hispanics.<sup>11</sup>

Lack of existing banking relationships was a key feature of Black PPP applicants. Historical barriers contextualized the PPP saga and limited the ability of banking institutions to respond in real time. For example, the SBA relaxed the identification rules for companies with established relationships. However, lenders were still expected to comply with strict Know Your Customer (KYC) identification regulations when processing applications for companies without conventional connections, which proved costly for minority-owned enterprises. Since the subprime crisis, fintechs have emerged as consequential players in

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<sup>8</sup>Nguyen, Hoai-Luu Q. 2019. "Are Credit Markets Still Local? Evidence from Bank Branch Closings." *American Economic Journal: Applied Economics*, 11 (1): 1-32.

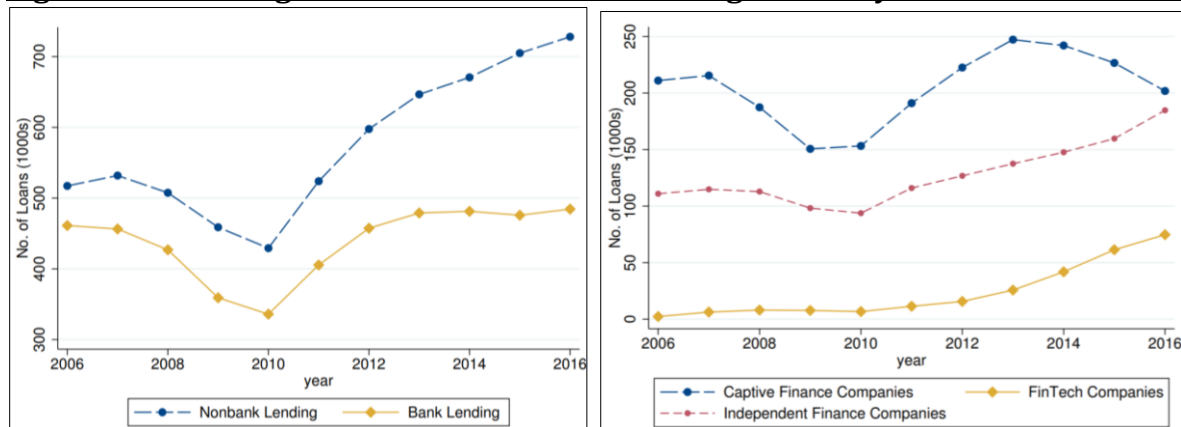
<sup>9</sup> Anenberg, Elliot, Andrew C. Chang, Serafin Grundl, Kevin B. Moore, and Richard Windle (2018). "The Branch Puzzle: Why Are there Still Bank Branches?," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, August 20, 2018, <https://doi.org/10.17016/2380-7172.2206>.

<sup>10</sup> Ratnadiwakara, Dimuthu and Yerramilli, Vijay, Effect of Bank Mergers on the Price and Availability of Mortgage Credit (September 1, 2020). Available at SSRN: <https://ssrn.com/abstract=3695662> or <http://dx.doi.org/10.2139/ssrn.3695662>

<sup>11</sup> Jessica Battisto, Nathan Godin, Claire Kramer Mills, and Asani Sarkar, "Who Received PPP Loans by Fintech Lenders?," Federal Reserve Bank of New York *Liberty Street Economics*, May 27, 2021, <https://libertystreeteconomics.newyorkfed.org/2021/05/who-received-ppp-loans-by-fintech-lenders.html>.

the financial services sector. According to a recent New York University study, fintechs and nonbank finance companies steadily grew their share of the small business lending market (Figure 2).<sup>12</sup>

**Figure 2: UCC Filings U.S. Small Business Loan Origination by Banks and Non-Banks**



Source: Adapted from *The Rise of Finance Companies and FinTech Lenders in Small Business Lending*. Manasa Gopal and Philipp Schnabl. May, 2020.

Crucially, the NYU study found that fintech-oriented small business loans have emerged as near perfect substitutes for missing bank loans. While early evidence suggests that the benefits of fintech-enhanced competition inure to low-income communities, it is important to emphasize that this imbalance applies equally to downside risks. A controversial University of Texas Austin report linked some fintechs to higher rates of fraudulent PPP loans, implying that these companies generated significant fee-based revenues while facilitating costly waste at taxpayers' expense.<sup>13</sup>

The evidence of fintech lenders' track record is mixed. A groundbreaking Berkely study showed that fintech lenders reduced loan denial disparities but continued to perpetuate pricing disparities that disadvantaged Black and Hispanic borrowers, though to a lesser extent than traditional banks.<sup>14</sup> However, findings of a recent matched-pair paper

<sup>12</sup> Gopal, Manasa and Schnabl, Philipp, *The Rise of Finance Companies and FinTech Lenders in Small Business Lending* (May 13, 2020). NYU Stern School of Business, Available at SSRN: <https://ssrn.com/abstract=3600068> or <http://dx.doi.org/10.2139/ssrn.3600068>

<sup>13</sup> Griffin, John M. and Kruger, Samuel and Mahajan, Prateek, *Did FinTech Lenders Facilitate PPP Fraud?* (August 17, 2021). Available at SSRN: <https://ssrn.com/abstract=3906395> or <http://dx.doi.org/10.2139/ssrn.3906395>

<sup>14</sup> Bartlett, Robert, et al. "Consumer-Lending Discrimination in the FinTech Era." *National Bureau of Economic Research*, 2019. *Crossref*, doi:10.3386/w25943.

contradict the Berkley report, showing virtually no lending discrimination between whites and borrowers of color among fintech-oriented mortgage loans.<sup>15</sup> Despite mixed signals, fintechs have clearly added value to the consumer financial market. As with their bank counterparts, fintech companies need robust oversight to ensure that marginalized consumers have access to a fairer, more transparent market.

### **Leveling the Playing Field**

Increased competition is vital to an innovative market that increasingly offers marginalized consumers a pathway to a transparent financial market that meets their individual needs. Fintech companies play an essential role in shaping an inclusive banking culture that responds to the needs of low-income and minority consumers.

Innovation is a dynamic process in which banks and fintechs actively experiment with a wide range of services and products and try to find the right balance in the composition of market players. Congress has a duty to create a framework to ensure that consumers remain protected in the course of this dynamic process. Congress can take clear steps to protect consumers and restore their ability to hold innovators and abdicators responsible for their decisions.

This subcommittee should examine how to extend the authority of the CFPB to include oversight of the Community Reinvestment Act (CRA). Compliance with CRA is a crucial regulatory tool that allows regulators to hold lenders accountable while deepening lending in low-income communities. CFPB should not be a passive bystander in the CRA review process while managing the real effects of banking consolidation in affected communities. CFPB has unique insights into the consumer-centric lending practices of banking institutions, which should be considered in the review process for merger applications.

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<sup>15</sup> Shoag, Daniel, The Impact of FinTech on Discrimination in Mortgage Lending (May 2021). Available at SSRN: <https://ssrn.com/abstract=3840529> or <http://dx.doi.org/10.2139/ssrn.3840529>