



CALIFORNIA REINVESTMENT COALITION

February 19, 2019

Regional Director Kathy Moe
Assistant Regional Director Perissa Ali Clark
FDIC San Francisco Regional Office
25 Jessie Street at Ecker Square, San Francisco, California 94105

Via email: JHull@FDIC.gov and CHerman@FDIC.gov

Re: *Community Group Opposition to Square Application for ILC Charter*

Dear Regional Director Moe and Assistant Director Clark,

The undersigned community organizations write to oppose the application by Square to obtain an Industrial Loan Corporation charter. We do so primarily due to concerns about the application's circumvention of the Community Reinvestment Act, and specific concerns about the small business loan products offered by Square. Given that the application was filed over the holiday season, and that numerous issues have been raised but not addressed, we request an extension of the comment period and that the FDIC hold public hearings in San Francisco and Fresno California. The FDIC must not approve of this application without imposing substantial conditions on Square, or else the FDIC will risk becoming the agency of choice for questionable fintech firms that seek a pathway to the cheap funding source, preemption protection, and other benefits that a bank charter may provide.

This application will set an important precedent

This application is significant and will have strong precedential value. As fintech firms look to expand their business models, to seek certain benefits and protections of a bank charter, and to secure low cost funding via FDIC insured bank deposits, such firms are looking to see how the FDIC will respond to this application. We are also concerned about a regulatory race to the bottom as the Office of the Comptroller of the Currency (OCC) and the FDIC seek to offer fintech firms a pathway to banking. The bar must be set high, or companies with less than model practices will line up to enter the banking system via the ILC charter. Several industry participants,¹ as well as community groups, have expressed concern about the ILC charter. As such, we urge the FDIC to take great care in analyzing the application and reviewing Square's practices and policies before making a decision.

¹ Jim Daly, "Community Bankers Ask The FDIC To Deny Deposit Insurance For Square's Bank," Digital Transactions, October 10, 2017.



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Additionally, this application comes during a time when the OCC, having issued an Advanced Notice of Proposed Rulemaking, appears poised to alter CRA in a manner we fear will lead to significantly less reinvestment in communities. There are many issues of contention raised during this debate where community groups disagree strongly with the OCC and/or members of the financial services industry.²

Perhaps one exception is what we believe to be broader support for the idea that companies like Square should not be able to take deposits nationally, and reinvest them only around their lone headquarters city which is chosen apparently only because it offers certain corporate benefits. This application is a poster child for how CRA needs to be strengthened. Square is a California company based in the San Francisco Bay Area. Its customers are national, and many are located in California. A Square Bank should not be allowed to take deposits and loan profits out of California and other states, and reinvest them only around its Salt Lake City headquarters from where presumably few, if any, deposits, will originate. Essentially, money will be diverted from diverse small businesses and communities in California and elsewhere, to small businesses and communities only in Salt Lake City. This is an issue that should concern state and local jurisdictions, as well as communities, where Square is located, doing business, profiting, and expecting to take deposits, but not reinvesting.

Previous concerns remain

In 2017, Square filed its first application with the FDIC for an ILC charter. At that time, several of our organizations commented on the application, raising the following issues:

- Square's CRA Plan is inadequate and circumvents the goals of the Community Reinvestment Act, proposing to take significant deposits from California and other states, but making no meaningful and concrete plan to reinvest beyond the Salt Lake City area;
- Square does not disclose APR information to its loan applicants and customers, making it impossible for small businesses to comparison shop for the best loan product for their needs, including lower cost products;
- Square reports very high loan repayment rates, but does not report this information to credit bureaus, depriving its customers the ability to improve their credit scores and qualify for a broader array of financial products;
- Concerns have been raised about fintech lending and the use of algorithms generally, which can have a disparate impact on borrowers of color with regard to loan decisions and pricing;
- Privacy concerns have been raised about companies, such as Square, that rely on Big Data to make underwriting and other decisions.

² Rachel Witkowski and Kate Berry, "Cheat Sheet: Hopes and hang ups on CRA reform," American Banker, November 25, 2018.



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Square later withdrew its first application without addressing community concerns, and has recently refiled. Yet our concerns remain. As such, we are renewing our call for significant changes to Square's business practices before a bank charter is granted.

Groups request for extension of the comment period

Consistent with 12 C.F.R. section 303.9, we request an extension of the comment period. We believe additional time is necessary to develop factual information that the FDIC would determine might materially affect the application. Square filed this application just before the holidays, and just after Square met with representatives of the California Reinvestment Coalition and the National Community Reinvestment Coalition. While Square representatives suggested at that time that the company would be refileing its application in the future, there was no indication that the application was going to be refiled days later. Square representatives did notify community groups that an application had been filed, after news reports appeared announcing this, but did not respond to our requests for the public portions of the application, presumably because of the holidays. If bank applicants are to be forgiven for not responding to emails during the holidays, community groups should not be expected to have time to receive, review, analyze and comment on bank applications during this time. Square never provided the application, though the FDIC did respond promptly. We understand from the FDIC that the application was amended in the last few days, and as such, we request additional time to review those changes.

As we believe that significant issues are raised by this charter application, and that the FDIC will want to fully vet concerns - such as those relating to CRA circumvention, small business loan costs, disclosure requirements, credit reporting, fair lending, privacy issues and Big Data, and problematic processing clients, as well as recently amended application materials - we believe that an extension of the comment period is warranted.

We are hopeful that Square will make recommended changes to its practices and application, and believe an extension of the comment period will facilitate dialogue and perhaps lead to a better resolution for California communities. When asked if it would agree to an extension of the comment period, Square deferred. As such, we feel we must register our opposition to the current application.

Square is commended for reaching out and for continuing dialogue

We again acknowledge and thank representatives from Square for reaching out to the California Reinvestment Coalition, CRC members and allies to discuss the company's ILC application and plans. Square answered initial questions, and provided information about the company's CRA Plans and small



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business loan products. Square recently met with representatives from a number of the undersigned organizations. Square has conveyed that it is open to and welcomes continuing dialogue. We remain encouraged by these outreach and transparency efforts, but look forward to these conversations translating into improved practices, products, and plans.

Square's CRA Plan is inadequate

Unfortunately, we must nevertheless oppose this application given Square's proposal to reinvest mainly in the Salt Lake City area, despite the fact that the vast majority of its presence, activity and customers will be outside of its proposed Salt Lake CRA assessment area. Similar concerns have been raised when other financial firms have sought to obtain and operate bank charters without a traditional retail deposit taking branch presence. We have likewise viewed such efforts as attempts to circumvent the CRA, and have called for greater and more detailed, reinvestment commitments.

Here, in Square's second attempt, it submits a CRA strategic plan which makes mention of "national" reinvestment activity. There are a few references in the Plan to meeting the needs within the assessment area and "the nation," "throughout the United States," "nationwide," or "broader nationwide small business community." But the key word in the Plan is "may."³ And there is no commitment by Square that it will engage in any particular kind of CRA activity in any particular geography outside of Salt Lake City. In fact, it is not clear that there is any commitment to reinvest beyond the limited assessment area at all, except in theory.

The bank should identify the top 10 to 20 Metropolitan Statistical Areas where it is engaged, by customers and loan activity, and designate these as CRA assessment areas. In prior years, the Office of Thrift Supervision had extended assessment areas and CRA reporting beyond non-bank bank headquarters.⁴ There the OTS maintained, "having repeatedly faced the question of how to evaluate the CRA performance of thrifts that deliver their products by non-branch systems on a national or regional basis, the Office of Thrift Supervision has taken the approach of looking at their performance throughout the markets where they do credit business, not just in the main office assessment area."

A similar approach was followed after Charles Schwab established a bank without branches, but retained national lending activity and its large non-bank presence in San Francisco. There, the OCC noted that, "given that the bank will have national operations, while it is only required under CRA

³ "Community Reinvestment Act Strategic Plan: Application to the Federal Deposit Insurance Corporation by Square, Inc.," December 18, 2018, p. 22.

⁴ "OTS, Looks Beyond Home Base to Assess CRA Performance of Non Branch Thrifts," The Community Banker: Bank Regulatory News, June 17, 1999.



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regulations to treat the Reno MSA as its assessment area, the OCC has an interest in the full scope of the bank's CRA related activities, and will be requiring the bank to provide additional information on CRA qualifying loans, investments and services provided by the bank outside of its assessment area. The bank will be required, annually, to provide the OCC with the number, type and amount of loans and investments made in LMI geographies outside its assessment area as discussed in the conditions below."⁵ This approach should be revived, enhanced and extended to Square. Once again, Square indicates a desire to serve broader areas beyond Salt Lake City, but does not take the necessary step of designating these areas as CRA assessment areas.

In its proposed CRA strategic plan, Square conducts an analysis of community credit needs in Salt Lake City. It should do so for the top 10 to 20 markets where it currently does business, and where it expects its depositors will reside. In its application, Square confirms that its small business products are marketed on a nationwide basis. Square should identify concrete and creative ways to support small business and economic development activity in all of these communities. The Bank should commit to invest in and make grants to Community Development Financial Institutions, Community Development Corporations, loan pools and other community institutions that provide capital and technical assistance to small businesses and further local economic development efforts. The Bank should explore referring its customers to such institutions for technical assistance and even for loan capital where local CDFIs and community lenders might offer better terms than Square products. As drafted, the CRA Plan will not help the Bank to sufficiently meet community credit needs.

Additionally, Square should set its benchmark for overall CRA performance higher, as expressed as a percentage of assets or deposits so that as Square grows, its commitment to communities can grow along with it. We also renew our objection to a Bank designating what level of CRA activity will achieve an Outstanding rating, as such determinations should be subject to a more thorough review of the bank's performance in the context of any community comments.

The reality is that Square is profiting from minority owned businesses, and proposes to obtain deposits from such businesses and communities. We understand that Square makes a high percentage of its small business loans to business owners of color and female run businesses, which, depending on the pricing and terms of such loans, is to be commended. We remain concerned that Square's products sound like revenue based Merchant Cash Advance loans that can be costly and confusing to borrowers, and we seek more clarity here. We also understand that a significant portion of Square's business is in California, that a similar percentage of bank deposits can be expected to derive from California, and that California communities should be able expect that Square will reinvest these deposits back into these communities.

⁵ DECISION OF THE OFFICE OF THE COMPTROLLER OF THE CURRENCY ON THE APPLICATION TO CHARTER CHARLES SCHWAB BANK, NATIONAL ASSOCIATION, RENO, NEVADA, February 4, 2003, p. 9.



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The credit needs in the San Francisco Bay Area, parts of California, and wherever else Square expects its depositors to live, are most likely very different than the detailed Salt Lake City credit needs assessment that Square provides in its draft strategic plan. In California, we have critical needs for investments that counter displacement, create good-paying jobs, build affordable housing for homeless people, bring unbanked persons into the financial mainstream, support financial literacy and empowerment, and many other products and services that Square does not propose to provide, even though it will gladly take deposits from these communities. Square knows where it is likely to obtain Bank customers based on where its existing customers reside and do business. It will certainly know in the future where those small business and consumer deposits come from before it designates them as received in Salt Lake City. The FDIC charter and current CRA regulations may complicate this dynamic, but nothing prevents Square from making concrete commitments to these communities, which it fails to do.

If Square wants to reinvest in California communities where many of its customers conduct business, yet insists on regulatory certainty, a simple solution would be to establish deposit taking ATMs in its San Francisco location and/or to do so in Oakland, where Square plans to move some offices. Then Square could establish a multi-county CRA assessment area in the Bay Area where it can focus reinvestment activity. A similar result was achieved by Capital One Bank when Capital One converted existing non-bank retail locations in the Bay Area and Los Angeles into deposit taking facilities.⁶

Small business lending concerns

Again, CRC thanks Square for explaining its product offerings, and appreciates that Square's loan sizes are meeting a key market need and that default rates are reportedly low. It also must be noted, however, that Square's Merchant Cash Advance products from a few years ago, with more onerous loan terms, may not have well served the interests of all small business borrowers. We accept Square's statements that its newer Flex Loan Product is a better product for small businesses than prior products. And yet, we are not certain that the pricing on this product makes it favorable to small businesses in every instance. We seek clarity on the costs of these loans and think that should be part of the public record of this application. Greater transparency around pricing for the benefit of the public and small businesses, is important.

In fact, in a February meeting with Square, Square refused to provide any APR ranges for the loans it has originated. This was so even though Square submitted comments to the California Department of Business Oversight (DBO) proposing that DBO adopt a certain APR calculation as DBO develops rules to

⁶ See FEDERAL RESERVE SYSTEM, Capital One Financial Corporation McLean, Virginia: Order Approving the Acquisition of a Savings Association and Nonbanking Subsidiaries (where Federal Reserve Board approval order notes that Capital One expresses plans to convert non-bank cafes into deposit taking facilities that will trigger CRA responsibility).



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implement recently adopted state legislation requiring APR-like disclosures on small business loans. How can the FDIC approve a charter for a company that refuses to provide any APR information for its main, small business loan product? Square must provide information about the APRs on loans it has originated, calculated using the stated term of the loan, the historic repayment history of businesses, and any proprietary underwriting assumptions that Square uses. The Chair of the FDIC has recently spoken in favor of transparency.⁷ We hope that the FDIC will not become the regulator of choice for those refusing to provide transparency.

We continue to urge Square to:

- Commit to transparent and clear APR and related disclosures to small business loan customers, so they understand precisely the terms of the loan they are getting and how that relates to most other products in the market, and
- Develop a plan to report positive loan repayment history to credit reporting agencies so that small business customers can improve their credit and perhaps graduate to other, potentially more beneficial products with Square or other lenders, or to develop other strategies to create pathways for small business owners to graduate to more and better products. For the few borrowers that find themselves in default on their loans, Square should connect such borrowers to appropriate financial counseling resources.

Since its first application was withdrawn, we were disappointed to see that not only did Square refuse to provide APR disclosures, it also reportedly lobbied against statewide efforts to require APR disclosures for small business loans, first in California, now in New Jersey.

We found little comfort in Square assertions that it would comply with applicable state law when it still refused to provide APR disclosures, and fought against these very laws. We have also been concerned that it will take time for the California Department of Business Oversight to fully develop implementing regulations, and where Square and other lenders will have the opportunity to weaken the regulatory rule. Square has the opportunity to be a leader, to embrace the new requirements, and to immediately begin disclosing APRs.

But much more concerning now is Square's hesitancy when asked recently if it will in fact comply with California state law if it obtains a bank charter. Without a commitment that the Bank will comply with California's APR disclosure law, Square will not only itself undermine California's policy mandate that all small business owners should be able to understand and compare the costs of loan products, but Square will inspire the worst fintech lenders to evade state law by seeking an FDIC ILC charter. This in itself is a reason to oppose this application.

⁷ Press release, "FDIC Chairman McWilliams Announces Transparency and Accountability Initiative," October 3, 2018.



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In a previous meeting we asked Square to commit to, at the very least, disclosing APR and an estimated monthly payment (two very common disclosures) so that small business owners could compare their Square loan to other products. The letter Square submitted to the CA Department of Business Oversight during the recent comment period on transparent business lending regulations seemed to be moving in the right direction, though we retained a few misgivings around how Square proposed to estimate a term. Square now seems poised to take several significant steps backward with the exemption that would be granted to them through this industrial loan charter. We are now unsure if they will commit to any of the transparency metrics we put forward.

We have also urged Square to consider ways to report credit to enhance the credit profiles of its borrowers so that these businesses are not relegated to Square products, but can become more attractive to mainstream and lower cost credit providers. If Square is truly concerned about the success of its customers and small businesses generally, it should be able to commit to such an outcome. A further argument for reporting positive credit repayment to credit bureaus is so that CDFI, community and other lenders can easily see the total debts owed by prospective loan applicants and thereby make better underwriting decisions of their own. If credit reporting is logistically challenging as Square maintains, then Square should commit to otherwise assist its small business borrowers to graduate to more and better options and products.

Public reporting, fair lending, big data and privacy concerns

Additionally, we are concerned by Square's statement in its Plan that "the Bank does not require the small businesses to report their revenue levels, nor does it use this metric in underwriting the loan."⁸ It is one thing if Square chooses not to use small business revenue in its underwriting decisions. But the public relies on CRA small business data reporting to understand whether small business credit needs are being met, and revenue size of the business is a key data point. It is unclear if this means that Square will not be reporting revenue data as part of its public CRA and other reporting. Square should be required to or commit to collect and report such data.

Next, fintech algorithms and data collection present continuing fair lending and privacy concerns. Fintech presents the opportunity for quicker and more thoughtful underwriting, as it relies on a plethora of data points. But fintech also presents the threat of fair lending violations as underwriting and algorithms are opaque, without a long track record subject to regulatory scrutiny, and can lead to

⁸ "Community Reinvestment Act Strategic Plan: Application to the Federal Deposit Insurance Corporation by Square, Inc.," December 18, 2018, p. 20.



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disparate underwriting and pricing results.⁹ Thus far, Square has not responded nor demonstrated how they are addressing fair lending concerns to show that its underwriting, marketing and lending activities are not leading to problematic outcomes. We strongly believe that Square should do more to address these concerns and to demonstrate that its underwriting, marketing and other loan related activities do not run afoul of fair lending laws before any charter is granted.

We urge Square to subject its operations to an independent fair lending audit which should be made publicly available.¹⁰ Square customers and other stakeholders have a right to know whether its loan underwriting models and targeted advertising consider factors prohibited under fair lending laws (such as race and ethnicity), or proxies for those prohibited classes, in making its decisions. We believe that Square should commit to offering all current and future Square customers the best priced product for which they qualify, regardless of which Square product or channel the customer first engages. We further urge the FDIC to refrain from approving this and other bank charter applications until the FDIC is completely clear and comfortable that underwriting and related practices are compliant with all fair housing and fair lending laws.

Additionally, Square obtains large amounts of data from its customers that it uses in making offers of credit. Square has yet to share the steps they take to protect this data, or to inform customers on the uses of their data. Bank customers must be fully informed as to how their information will be used, and Square must commit to not using customer data improperly. We are concerned that Square collects too much data on its customers and shares this data too widely with third parties.

⁹ FinTech lenders charge Latinx/African-American borrowers 6-9 basis points higher interest rates, consistent with the extraction of monopoly rents in weaker competitive environments and from profiling borrowers on shopping behavior. In aggregate, Latinx/African-American pay \$250-\$500M per year in extra mortgage interest. See Bartlett, Robert, et al. "Consumer-Lending Discrimination in the Era of FinTech." *Working Paper, University of California, Berkeley* (2018), available at: <https://faculty.haas.berkeley.edu/morse/research/papers/discrim.pdf>

¹⁰ This assessment should include a study evaluating Square's automated decision systems and the automated decision systems' development process, including the design and training data of the automated decision system, for impacts on accuracy, fairness, bias, discrimination, privacy, and security that includes, at a minimum— (A) a detailed description of the automated decision system, its design, its training, data, and its purpose; (B) an assessment of the relative benefits and costs of the automated decision system in light of its purpose, taking into account relevant factors, (C) an assessment of the risks posed by the automated decision system to the privacy or security of personal information of consumers and the risks that the automated decision system may result in or contribute to inaccurate, unfair, biased, or discriminatory decisions impacting consumers; and (D) the measures the Square will employ to minimize the risks described in above, including technological and physical safeguards.



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Square processing and other service concerns, including reportedly processing for neo-Nazi groups

Concerns have been raised about other Square services which we have not had the opportunity to discuss with Square. Specifically, there are questions about how much Square captures in float or otherwise when Square works with small businesses and their payroll tax deposits (which can represent 15% of base salaries). How long does Square hold those small business funds? Does Square keep the interest earned while holding on to those funds? Is any benefit derived from such a practice reverted back to the small business in the form of interest returned or reduced rate on a small business loan? We have not fully raised this issue with Square, and we would benefit from further discussion of these issues.

More concerning are recent reports that Square is providing processing services for Neo-Nazi and/or white supremacist organizations. One report notes that "Square processes payments for National Vanguard; a neo-Nazi group; Barnes Review, a Holocaust denial website; and Occidental Quarterly, a racist journal."¹¹

These are explosive allegations. We have not had the opportunity to discuss this with Square to hear their response. Regardless, this raises serious questions about whether Square has any policies in place to conduct due diligence on customers and vendors, and to screen out problematic actors.

Conclusion

For the above reasons, we object to this application and urge the FDIC to reject it unless CRA and other due diligence enhancements are put in place. We will also continue to check with our networks to determine if small business owners, CDFIs, community lenders, technical assistance providers, and others have experience with Square that they wish to share to inform the deliberations around this application.

In the meantime, we call on the FDIC to extend the comment period, conduct public hearings in San Francisco and Fresno, and reject this application unless substantial conditions are imposed to address the above concerns.

Should you have any questions about this letter, or wish to discuss our position further, please feel free to contact Kevin Stein of the California Reinvestment Coalition at (415) 864-3980.

¹¹ Jessica Schulberg, "Tech Companies Promised to Stop Helping Neo-Nazis Raise Money. They Haven't," Huffington Post, August 13, 2018, available at: https://www.huffingtonpost.com/entry/tech-companies-white-supremacists-stripe-paypal-square-anedot_us_5b71fd68e4b0ae32af9ae20e



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Very Truly Yours,

Access Plus Capital
Asian Business Association
Asian, Inc.
Bankers Small Business CDC of CA
Black Business Association
Business Resource Group
California Capital FDC
California Reinvestment Coalition
California Resources and Training
Causa Justa Just Cause
CDC Small Business Finance
City of Commerce American GI Forum
City of Livingston
Consumer Action
Domar Companies, LLC
Empire Justice Center
Greenling Institute
Inland Empire Latino COALITION
Los Angeles Local Development Corporation
Main Street Alliance
Main Street Launch
Mission Economic Development Agency (MEDA)
National Federation of Filipino American Associations
Nor-Cal FDC
One Million NIU
Opportunity Fund
Pacific Asian Consortium in Employment (PACE)
Pacific Coast Regional Small Business Development Corporation
Pacoima Development Federal Credit Union
Renaissance Entrepreneurship Center
SF African American Chamber of Commerce (SFAACC)
Small Business Majority
Southeast Asian Community Center (SEACC)
Southern California Black Chamber of Commerce
The Central Valley Urban Institute
Woodstock Institute
Women's Economic Ventures



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