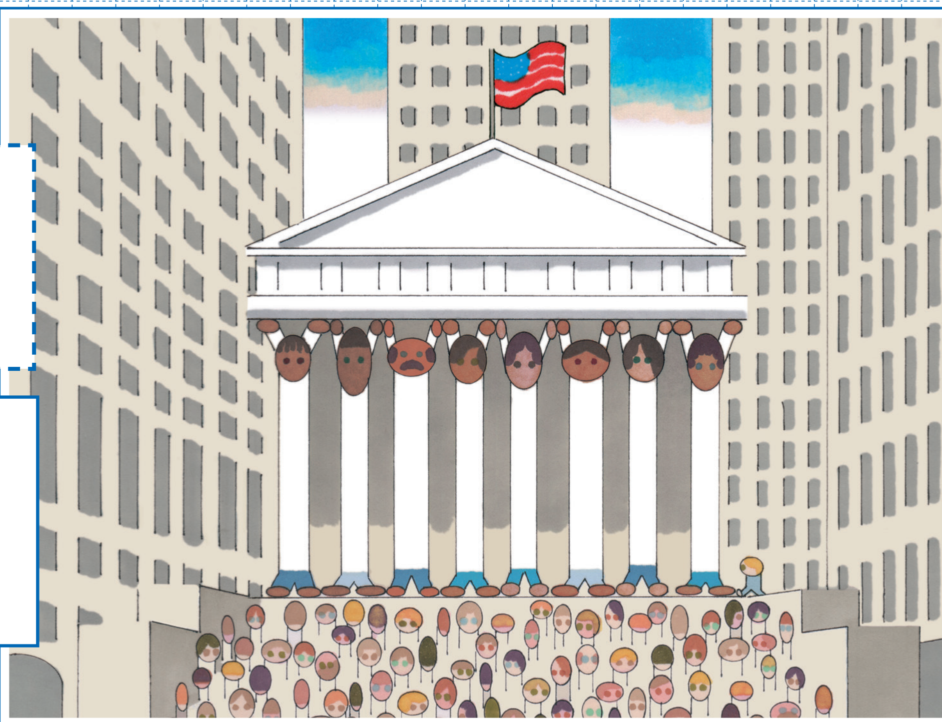
Bloomberg Businessweek

March 21, 2022 | bloomberg.com

So You Want to Start a Nonracist Bank



A Wall Street lifer's quixotic quest to build a truly inclusive finance company

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It hit him before the pandemic and before the summer of protests. Alex Ehrlich, a 40-year veteran of some of the world's biggest banks, would leave his executive position at Morgan Stanley to build a financial institution that looked much different than the ones where he'd spent his career.

Anyone who's been on Wall Street that long knows something is wrong there. Things had improved since the early days of Ehrlich's career, when women and Black people were all but shut out of executive suites, but much of the industry's money and power remain in the same hands today. Black people and women talk about it, and so do some rich, White, well-connected, middle-aged executives.

Ehrlich is one of the latter. He worked at Goldman Sachs Group Inc. for decades, was a managing director at UBS AG, and was helping run the prime brokerage business at Morgan Stanley, servicing hedge funds and chairing the investment bank's diversity council, when his epiphany hit. "We'll start a bank, and we'll get it right from the beginning," he told *Bloomberg Businessweek* soon after stepping down from Morgan Stanley in January 2020. "The single most important conclusion I came to personally was that banks are really, really challenged simply by their history and their size."

Pretty much every big U.S. financial institution says it's hard at work on inclusion and its attendant network of pipelines, mentorship programs, and retention initiatives. But the way Ehrlich saw it, banks with thousands of workers are too big to remake their cultures in any reasonable time frame, even if they really want to. His imagined company would be unencumbered by its size. It would be, to the best extent possible, inclusive and nonracist in its practices and impact, even as he couldn't guarantee that he wouldn't fail or unwittingly exacerbate the problems he'd set out to solve.

Ehrlich was offering a pair of reporters a chance to see what it looked like when a finance executive starts with a blank slate and tries to leverage the privilege his position affords him to build an institution that embodies those ideals. He agreed to keep speaking to us about the challenges, as long as it didn't reveal company secrets and we didn't publish our interviews until he'd raised money. Since he set forth, things he couldn't have foreseen have happened to Wall Street, to his startup, and to him. His digital financial-services company, Percapita Group LLC, has found opportunity and crisis and has won backing from big-time investors. As its planned launch early next year draws closer, the kind of inclusion that Ehrlich and his colleagues have in mind has shifted. It's not just about culture change anymore. It's about how to bring people who've been left out of the financial system into the fold—and make some money from them in the process.

Successful Wall Street executives tend to be brash and intense. Ehrlich, who's 63, bearded, and balding, comes across as professorial and avuncular. His mom was an immigrant from Eastern Europe who occasionally spoke Yiddish in their Long Island home, and he seems to have an almost quaint commitment to the idea of the American dream. He's designed a pyramid-shaped hierarchy of leadership values, and he'll sometimes ask people to draw it out so they'll remember it.

At Morgan Stanley, Ehrlich befriended a young analyst named Drisana Hughes, whose father had once been a lawyer for the bank. The way she saw it, he really cared about her career. They stayed in touch even after she left Morgan Stanley in 2017 to work in politics. And when Ehrlich left, too, and told her about his idea to start something different, she joined him as a founding partner. "A blank sheet of paper is amazing," she told us.

Ehrlich was funding the operation, planning to spend millions of dollars of his Wall Street fortune at first. In early 2020, he outlined his vision for the company he was tentatively calling Inclusion Development Corp. For starters, it would seek to hire hardworking, creative, and self-aware people who look like the rest of the country. "If a third of our leadership is White and male, that's fine," he said—that proportion generally tracks with the U.S. population. He thought he could hire Wall Street veterans excited enough by the prospect of creating a new corporate model for finance that they'd "walk away from multimillion-dollar jobs" to try.

Their target customers would be low-paid and nonunion American workers with hourly jobs inside corporations, a niche chosen in part for moral reasons: The financial system has been known to ignore or even punish working-class Americans. But there was a practical consideration, too. Reaching people through big employers would give Ehrlich access to and information about thousands of people at once, letting him avoid huge marketing outlays. The resulting savings could help him keep fees low and avoid harsh terms. Ehrlich thought corporations and their human resources departments might give his company opportunities to offer workers a suite of services—not so they could get a cut of the profits, but because their employees might consider it a perk.

As for business lines, he and Hughes were considering Wall Street staples such as a wealth management unit, an arm for selling exchange-traded funds, and even a corporate advisory unit that did investment banking. But services like these typically cater more to rich people. To meet workers where they are, the startup decided to focus instead on consumer finance.

By May 2020, Ehrlich and Hughes had more colleagues. Maripat Alpuche had been a partner at white-shoe law firm Simpson Thacher & Bartlett, specializing in huge bank mergers and co-chairing its women's committee. She'd been preparing to retire to a life at the beach when she met Ehrlich.

Alex Brunson was barely three years out of college, a hip and artistic classically trained singer. He'd dreamed of playing basketball for Duke University but stopped growing at 5-foot-6. He went to Duke anyway, majoring in economics, then worked for Chick-fil-A and American Eagle before getting hired by Morgan Stanley. Brunson was responsible for the name Percapita, tossing it out on an internal call.

The team began homing in on a concrete product, a credit card that charged two interest rates: a tiny one for necessities and a higher one for inessentials. ▶

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◀ "Groceries are a necessity; restaurants are not. Child care is a necessity; leisure travel is not," Ehrlich said. The idea had an informal quality. "None of us are credit card people," he went on. "Will people partner with us? Will consumers want this? Can we manage the data properly? And can we manage the risk properly? And can we fund it?"

They were also thinking about getting into a trillion-dollar sector riven with racial inequities: "We particularly think the student loan market is ripe for being able to do good and make money," Ehrlich said. He seemed to see the trillion-dollar pile of student loans not as a trap but a business opportunity, especially if his team could widen access to debt refinancing.

The pandemic had been wreaking havoc in the U.S. for two months. Hughes was in New York. She seemed shaken as she watched fellow twentysomethings who were carrying heavy student debt burdens lose their jobs. "To see this happen in real time has been so heartbreaking," she said. "People have no money. What are they supposed to do?"

Three days later, on May 25, police in Minneapolis murdered George Floyd.

"We have spent as a team so much more time talking about antiracism, what that means in finance, what that means for our business, what that means for raising money," Hughes said on a call a few weeks later.

"Now, instead of being ahead of the curve, we're surfing a wave," Ehrlich said. "Everybody wants to talk about it and see change." He wasn't referring only to protesters; he meant investors chasing businesses like his. "There's a wave of capital out there looking for something to do."

But at least one colleague was hesitant to move quickly. "I'm definitely Team Wait," Hughes said. "Everyone feels pressure to say now, all of a sudden, that they care about Black people."

Pledges to make profound changes were whizzing around the industry. Goldman Sachs created a $10 million Fund for Racial Equity. Morgan Stanley named two Black women to top management groups and added an inclusion commitment to a public list of the bank's core values. At Percapita, Hughes and Brunson were thinking about credit scoring, which has long been blamed for putting Black borrowers at a disadvantage. Recent research from the Brookings Institution, for example, has shown that Black people are likelier to get excluded from mainstream finance based on credit scoring.

Anyone who wants to overcome such shortcomings while issuing credit or making loans faces a conundrum. "We don't just want to use a standard model that's subject to elements of racism," Ehrlich said. "And on the other hand, to the extent we veer any distance from the standard models, it makes it really hard for us to operate."

Just as Wall Street bundles home loans into mortgage-backed securities, credit card companies lump together debts from different borrowers into bonds that they then sell to investors. Those buyers use credit scores to gauge the risk. If Percapita avoided standard ratings, the bond buyers are "just going to say we can't tap the public markets," Ehrlich said. "If we're going to invent a new model and we're going to claim it's a superior model and base our business off of that, and it turns out we're wrong, and it blows up on the people we sell the notes to, that's not a good outcome either."

"My view is we've got to try," Hughes responded. She'd been reading Mehrsa Baradaran's books on race and finance, *The Color of Money* and *How the Other Half Banks*, which call for profound shifts to the unequal credit system. "If we do this right, it could really change people's lives."

Brunson, who was giving deep thought to his Black identity, told colleagues he wanted to read Ibram X. Kendi's bestselling *How to Be an Antiracist*, which argues that policy has to produce or sustain racial equity to deserve that mantle. The company bought copies for everyone. Soon after, they read the book and discussed what it meant for them and the firm they were building.

Percapita had been founded before antiracism had entered the corporate lexicon. Alpuche didn't see how it could legitimately start using the phrase. "When you actually say, 'I'm an antiracist organization,' that just wasn't what we had set out to build," she said.

Ehrlich agreed. "Kendi talks about judging racism on the factual results of a process rather than on the intentions," he said. "If you're trying to build an organization from scratch, and you're trying to be antiracist, it imposes upon you certain standards that are really, really hard to live up to." They decided not to get hung up on adopting the label. Instead, they recommitted to the practical and capitalistic idea of reducing the cost of access to the financial system. That was how they thought they could make banking more equal, whether they called the company inclusive or antiracist or not. To them, the decision wasn't a cop-out or a moral compromise. It represented a business proposition.

In July, a few months after joining, Hughes decided to leave Percapita. "Not that I think his work isn't impactful, but I had to do more right now," she said. By the end of the month, she was working for Joe Biden's campaign. (She continues to work in politics.)

Later that year, Ehrlich got more discouraging news when he met with potential corporate partners for the credit card. "Nice idea, but you guys are off base," he said representatives from four companies told him. "Some of our employees don't have bank accounts. Some of our employees literally pick up a paycheck and go to a check-cashing store. And you want to give them a credit card?"

Percapita tabled the two-rate card idea and began asking more basic questions about how the unbanked, underbanked, and badly banked live—how workers get their money and what they do with it, how they cash their checks and send funds to family or borrow against their upcoming pay. There are already lucrative businesses built on those processes, but they've also been known to extract enormous sums from poor people.

"We can do payday loans for a couple percent," Ehrlich said, referring to the margin over the company's capital costs. This could be a substantial improvement in a sector where annual interest rates can top 600% in some states. It wouldn't forge any new paradigms, but it could help customers keep more of their paychecks and generate modest returns. "We're not working for free," he said. "This is not a not-for-profit."

Ehrlich got his first solid lead near the end of 2020, when an owner and operator of McDonald's franchises in California agreed to give the Percapita team access to the kinds of workers who could become their customers. With serious market research about to get under way, the company hired Keith Mestrich, former head of Amalgamated Bank, founded for union members a century ago, and Daniela Peluso, an anthropologist who's studied Indigenous communities in the Amazon. They joined an earlier hire, Eni Asebiomo, a former SpaceX engineer.

Peluso prepped Asebiomo and Brunson for a trip to San Jose, where they would spend three weeks embedded inside McDonald's restaurants. Their mission: learn more about why some people are unbanked or dissatisfied with their bank, and about how one might gain their trust. When they arrived in March 2021, they alternated between tasks like taking drive-thru orders or making coffee and surveying workers about their experiences with money. "People aren't mad at some abstract system and debating the merits of capitalism," Brunson said afterward. "That's not really happening. People are like, 'I'm trying to be a good mom. I'm trying to make rent.' It's that simple."

Ehrlich made his own trip to San Jose in May. Driving around from one fast-food spot to another, he saw workers treating his colleagues as family. He became convinced that if his company could reach communities like this, Percapita would win customers, change the way they bank, save them from steep fees, and build a sustainable business. It just needed to figure out how to earn the trust of workers who might be coming from countries where savings had been wiped out by hyperinflation, or were undocumented, or simply suspected that banks take advantage of people who look like them.

In the past few years, when the biggest finance companies have attempted to reach the unbanked, they've tried things like pledging money to community groups and underrepresented borrowers, partnering with Black-owned banks, promoting low-cost accounts, cutting overdraft fees, and opening branches in financial deserts. Some have tried financial technology to reach more people faster. It's not clear how successful those efforts will be at overcoming distrust. Percapita's view was that they had anthropology on their side—a way of seeing the problem as social as well as financial, which would help them connect with would-be customers who've ignored banks or been ignored by them.

Ehrlich was getting impatient to put this approach to the test, but he needed to bring in some outside money. Starting a financial firm is expensive, he pointed out. He wanted to raise at least $15 million, preferably twice that, by August 2021. He started with calls to a few people he knew from hedge funds. "That has evolved into a couple of offers for funding," he told us. "I believe we're going to raise money. The signs are good."

He and his colleagues were now touting a business plan and a suite of products that looked different ▶

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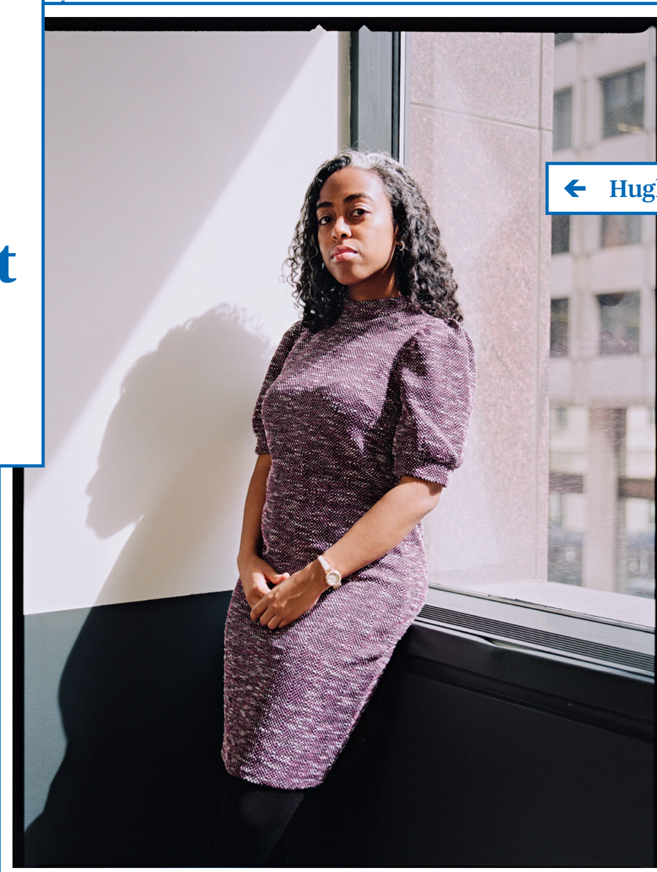

← Hughes

Alpuche, Ehrlich, Brunson, and Greene

◀ from their options from a year earlier, emphasizing services such as checking accounts, savings accounts, debit cards, credit cards, cross-border remittances. The key to Ehrlich's pitch was cheap access to a lot of customers through corporate employers, combined with an anthropological, empathetic bent that could push him and his colleagues over the barrier of consumer suspicion. They'd have to find investors who believed they could pull it off and didn't mind that they weren't driven to wring as much money as possible from poor people.

When Ehrlich spoke on a video call toward the end of July, a few days before his self-imposed deadline, his beard was longer than usual. His mouth was turned down, and he fell into pauses. "I'm telling you it's harder, that it's been hard," he said. "We're trying to do something really ambitious, and that requires a lot of investment." He was staring into space and wiggling in his chair. "Confidence that it is a good investment requires a certain leap of faith from people, because we're not copying anybody else's business model."

By autumn, Ehrlich had lost some of his steam, if not his sense of mission. There were reasons to keep on. Percapita had landed deals with another sizable restaurant chain and a small New York manufacturer, which would provide it with access to their employees and permission to contact them. He'd hired Aliah Greene, a soft-spoken Morgan Stanley veteran from Harlem who had herself once relied on check-cashing places, to be Percapita's new chief risk officer and ultimately its chief operating officer. "Within a system that is what it is, individuals are finding the solutions that work for them, based off of what's available," she told us. "Our work here is to try to make something better available to them." Ehrlich mostly stayed offscreen on this Zoom call, his face replaced by a photo of an owl perched on a tree. He'd been working out of his country house near the Rhode Island shore, in a windowed woodshop dug into the side of a hill.

Around that time, he had a call with a billionaire that went badly. The potential investor said, nicely enough, that Ehrlich was doing it all wrong, and that he wouldn't touch Percapita because Ehrlich had said so many things that scared him—for example that,

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instead of focusing on technological solutions, the company was hiring expensive human beings, and anthropologists to boot. The billionaire instead talked up a different company that was selling what's called earned wage access, which gives workers paychecks when they want them, not every two weeks. Ehrlich clicked to that company's website. It was covered with the language of social justice, but it seemed to be charging people exorbitant rates to get access to their wages sooner—old-school payday lending by another name.

Not long after, Ehrlich concluded that he'd indeed been fundraising wrong, but not for the reasons the billionaire had said. He started thinking more like a banker than a founder. Rather than selling risky ownership stakes in his unproven company, he decided to issue convertible notes—debt that could be transformed later into an ownership stake. This approach would provide early investors with some protection, because they'd have a shot at getting paid back and also the eventual reward of equity on sweetened terms. "All of a sudden it started going well, and it kept going well," Ehrlich said.

His good mood held up. Hours before New Year's, Percapita closed its seed round. Ehrlich wouldn't say how much he'd raised, only that he was "delighted." The backers included S. Donald Sussman, founder of the hedge fund Paloma Partners and one of the top Democratic donors in the U.S., who described his investment to us as "significant." He and Ehrlich had bonded years earlier because of their similar values and Sussman's admiration for the system Ehrlich had helped oversee for clients who do high-frequency trading. "He himself is not a technology guy, he's not a computer scientist," Sussman said. Instead, he's "a guy who understands how this stuff needs to be done and who to hire to make it happen. Which is what he's doing again now."

"Confidence that it is a good investment requires a certain leap of faith"

Sussman is planning for Percapita to succeed, even as he doubts it will become his most lucrative investment. He noted that Walmart Inc. has a new financial technology venture, which just bought two companies as part of its plans to help customers and more than 1.5 million of its own employees manage their money. "It's a proof of concept, but it's also a competitor," Sussman said.

Percapita's other investors include an affiliate of Susquehanna International Group LLP, a key options trader and one of the biggest players in the exchange-traded fund market, and William Heard, who manages about $1 billion at Chicago-based Heard Capital. Ehrlich, Heard told us, "has the discipline of capitalism behind him."

In the more than two years since Ehrlich left Morgan Stanley, the language of diversity has become so prevalent across corporate America that it can lose meaning. Some executives who are trying to go beyond rhetoric and make comprehensive change have come to realize, especially in the wake of Floyd's murder, that being genuinely inclusive doesn't just mean diversifying offices. It means working to bring people who've been left out of the system inside it, in part by remaking the system for them.

Corporate America and Wall Street have made some progress on the first part of the vision. To take one example, Morgan Stanley named the most diverse class of managing directors in its history this January, with a U.S. group that was one-tenth Black. But the Percapita team thinks they can do better. They now have a business model that treats low-income Americans as viable customers, not people to ignore or exploit. "We will have fees," Mestrich, the former Amalgamated executive, said. "But they will pale in comparison to costs that have been extracted from them by other players." Other startups are taking similarly expansive approaches. They include CapWay, a debit card company founded by app developer Sheena Allen, and MoCaFi, a mobile bank service run by Wall Street veteran Wole Coaxum.

The work is triage, not revolution.

"Yes, the systemic things are there, and they are the cause of the issues," Greene said. "And in the meantime, someone's trying to figure out how to stretch their check."

Did Ehrlich have anything to add to that? "No, no, no, no, no, no, I don't have anything," he said. "We're trying to do what we can." B