CONVERSATIONS WITH MIKE MILKEN

Emanuel J. Friedman
Co-CEO & Co-Chief Investment Officer, EJF Capital LLC

Neal Wilson
Co-CEO, EJF Capital LLC

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Mike Milken: We are fortunate today to have the co-CEOS of EJF Capital, Manny Friedman and Neal Wilson. Thank you both for joining me. We've talked a lot about food deserts, the fact that you can't get access to healthy food in many communities in America. But there are also financial deserts where you might not find a bank in a community and the lack of financial knowledge or financial literacy inhibits growth. We begin here thinking about 2020 with a crisis brought on by the COVID-19 pandemic that has hit hardest at small and medium businesses and minority communities, and a crisis brought on by underlining issues of social justice, equity, inequality. And in many ways, EJF Capital has to address these issues.

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>
> \- Manny Friedman

This interview has been lightly edited for clarity and readability.

There are many areas in finance people could invest in, but you have been unique and your knowledge of financial institutions, particularly small banking institutions and community organizations that provide capital. Manny, talk to us a little about your background growing up, going to Georgetown and what led to the founding of EJF Capital and its mission.

Manny Friedman: I grew up in a small town in the South Wilmington, North Carolina. My father was a rabbi there. We had a very strong sense of social justice. But I got very lucky when I was 15 years old, my father gave me $100 to invest in the market. I bought a few shares of a stock. I got up one o'clock at night to see how the stock had done, since in Wilmington, newspapers didn't have daily quotes and it was one o'clock at night in Norfolk, and I saw the stock was up 2⅝. And at that point, my heart began to beat. I thought I was struck by lightning and I knew exactly what I wanted to do in life, which is really a lucky break because we all stumble through life often. And the only thing I wanted to really do was invest in the market and work with financial solutions.

"Neal, what eventually led you to become co-CEO of EJF Capital?":

Neal Wilson: Well, my epiphany was much more mundane than Manny's. My parents are school teachers and three out of my four grandparents were school teachers. So I didn't know anything about the capital markets or the ability to buy a stock when I was 15. I had the good fortune of going to Columbia, went on to Penn Law and I got into the securities law space. The epiphany for me was really just understanding that capital markets are really not only an engine for the economy, but maybe similar to you Mike, you understand it also can be the engine for doing good. And it really is the key critical thing is getting capital married to opportunity. And then that can be for making a profit; it can also be for trying to facilitate positive momentum within a society. My other big break, frankly, was working on the IPO of Manny's prior firm Friedman Billings Ramsey. I was very lucky to have met Manny at that time, and he's been a proselytizer for the capital markets ever since. And I'm just, happy to be able to say I'm co-CEO with Manny.

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(MF): And to emphasize what Neal just said, I'll never forget my father came up to see me one year and at a firm that was already 400 or 500 people dealing a business in the market. He really didn't understand the market, and he thought all investing was just simply trading stocks back and forth. He took me aside and said, 'look, Manny, when are you going to start doing something useful with your life?' I'm not just trading stocks, I'm working with people like yourself to come up with real capital solutions to massive problems in society and solutions that will last one year, five years, 10 years, 20 years. And really that's what drives people is to come up with those kinds of solutions.

So as large money managers responsibility for the people whose money you manage, one of the things that has struck me is your unique understanding of these community banks and underserved communities, and the potential leverage that you not only invest in these companies, you're an active mentor to them. And for our listeners, by providing equity capital as a base for these community banks and minority banks and small banks and other financial institutions, they can multiply that tenfold. So $10 billion in capital going into these institutions results in the potential for $100 billion to go out into the community. Over the decades, the large banks have moved farther away from dealing with these communities. Between February and April, more than 3.3 million small businesses closed as a result of the COVID-19 pandemic; 41 percent of black-owned businesses were shuttered for good; 36 percent of immigrant-owned businesses closed; 32 percent of businesses led or owned by people of Latin American ancestry.

And obviously we need to figure out how we can revive these job-creating businesses. It's important, the government in many ways – and you both are two of the leading experts in the world – has attempted to get capital out and has committed a great deal of money. But that money hasn't necessarily made it to where it was most needed. I know you've spent six months working on this area. How important are these community banks in ensuring that these businesses could be reborn and creating jobs.

> "The government, first of all, has done a remarkable job [on the economy]. However, they have left out an important part – the underserved part of the community, the rural part of the community, the inner-city part of the community. They haven't done it on purpose, because it's sometimes hard to reach that community. You need very small vehicles."
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(MF): Every time there's a crisis, it seems like something very new. But a couple of things: the government, first of all, has done a remarkable job – Democrats, Republicans, the Administration – in terms of trying to attack the problem. However, they have left out an important part of the community – the underserved part of the community, the rural part of the community, the inner-city part of the community. They haven't done it on purpose, because it's sometimes hard to reach that community through different vehicles. You need very small vehicles. You need hands-on vehicles. There are 5,000 small banks in the United States with their hands that touch all these communities. So there is a way to get a billion dollars, $10 billion, $50 billion of long-term loans at very low rates – 1-percent rates, let's say – into the hands of individuals, into the hands of small businesses, into the hands of this community.

Because everyone, all of us in this room, are here because of somebody else. And this is a very unusual time because normally you couldn't do this, but today interest rates in the United States are zero to 1 percent. Unbelievable. And we do have this terrible crisis. We do have this unbelievable inequality in the community, in the country, but because interest rates are zero or 1 percent for 30-year money, that means the U.S. government actually can put billions and billions and billions out, multiply that money. As you said, 10-to-1, and it doesn't cost them anything.

So everyone is in agreement: we want to do something. You've often said you've got to think big to solve problems, which is very, very, very true. You can get billions of dollars out and you can do it through some of the present bills that are being proposed and it will not cost the government money, yet it has the potential to solve the major inequality problem in the United States.

"There is an underlying desire on both parties to help the small banks. But now it has to be focused at the next level, which is the minority-owned banks, the community development banks. We can't get confused on the best way to do it. We have to mentor, and I think then the sustainability will go on and on."

- Neal Wilson

(NW): Mike, maybe I can put a finer point on that. Given the historically low rates, what we're saying is the government can be the catalyst for effecting long-term change. The issue is that you have a collision between one view of how to help these communities, and that's granting money or requiring the big banks to put deposits in these Minority Depository Institutions (MDI) or minority-owned businesses. The problem is, if I put a deposit or I grant money, it can only be lent out less than one time. Whereas if I can use, as Manny indicated, a facility with historically low financing, what that allows is letting outside money, private investors, risk takers, or impact investors to invest in the equity of the banks or to invest in debt issued by the banks. And then you can have a 10-times multiplier. So that's a common misconception that deposits are hugely helpful. What you really need is equity and you need debt. And the last thing I would say on this, as we looked at the last five years, how much equity for banks under $3 billion has been raised for minority-owned banks?

(MF): Zero.

(NW): Zero. How much sub-debt outside investors coming in? Two out of 153 banks that are minority owned. That's in the last five years. Meanwhile, this year in the first six months, we're seeing an explosion of sub debt issued by other banks. And that's a crying shame. So what we believe is that there's a way to use the public-private partnership concept with the historically low rates as a catalyst and really incentivize investors, whether they be private risk-takers, impact investors, ESG investors, or local community investors to have that huge multiplier effect that you referenced Mike.

(MF): Some of the big banks won't take a deposit because they can't earn any money on it. So deposits today are not needed. What is needed is capital, but once you have capital, you're protected: you're a strong institution; you're not afraid to make a loan; you're not looking over your shoulder if you make a mistake. And that capital is so cheap and is perpetual capital, it makes them strong forever. You're teaching a fisherman to fish and you're doing it for the next hundred years. But there are billions of dollars that we could put in to these institutions, and 1-percent perpetual capital, and the government will be paid back. It doesn't cost the government anything yet. And then that has this unbelievable multiplier impact.

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(NW): And Mike, the Public Private Investment Program that the Treasury had in 2009 is a perfect pattern because they put out $18 billion. They got it paid all back in five years, plus a $4 billion return on the interest that was charged. And yet, they fixed the commercial mortgage-back market and the residential mortgage-back market in the process. So if we could apply that concept to the banks that are underserved by capital, we think there could be a great marrying of the government and private capital.

So let me see if I can paraphrase a little bit here. We have a number of things that have the potential to create a virtuous circle. The first element is the low level of interest rates; we're not talking about the government giving up anything. We're talking about the government being able to borrow at the same rates they're affording capital. The second element is the amount of money that's been given with Democrats, Republicans, the Administration – trillions of dollars to shore up the economy. But what we're talking about is a small fraction of that that needs to go in as equity capital; subordinated long-term debt into minority institutions. Manny, I know you've been a leader working with the Milken Institute Center for Financial Markets and our effort and research in this area, but for our listeners, there's only 21 of those 5,000 banks that are African-American owned and in many of these community banks.

So the question is if we as a country and you've talked about it, Manny, have the will that we want to support these small businesses. We recognize they create more than 50 percent of the jobs. You shut down 3.3 million small businesses, even if they each only had four employees, that's 12 million people. And so we've been trying to figure out how do we get capital to these businesses? And the large money center banks cannot do it. And so the key is how do we get these into these community organizations? And that is not only capital, but mentoring. You have been actively involved in helping these small and medium businesses. Talk to us a little bit about the mentoring part of that relationship.

(MF): Part of mentoring a bank or mentoring a financial institution is making sure they're well capitalized; they're overly capitalized. Once they're strong, they have access to everybody. They have access to the best software, they have access to the best minds. So, I mean, we're 80, 90 people. We're not going to be able to solve this problem. This problem is going to be solved by making sure that these banks have billions of dollars of permanent capital they don't have right now. And there is a solution Mike, right now. And that's the amazing part is there are bills in Congress by Republicans and Democrats, by Senators and Representatives, that have pieces of this solution all put together. It just has to be all tied together, made much, much bigger, have the complete cooperation of the Fed and Treasury and be executed.

"People that get that capital get even stronger and grow stronger and are more efficient. If you can't make that first breakthrough, that takes you out of the game, period. We've got to get all these institutions to a certain level where it's an even playing field."

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That solution is sitting there and it'll go away if we don't do it in the next five or six months. And that solution is basically to make sure this money goes into the banks, first of all, at very low rates, 1 percent perpetual preferred. And it goes out to the underserved communities and at the $50,000 rate, $100,000, $200,000 and be long term 1-percent money. So there is a solution sitting there in our face, and that's the frustration. It's very rare in life that everything come together, maybe five or six times in anybody's life, but here it is, a solution to this major, major problem in United States. We don't seem to be able to come together on.

(NW): Let me talk about the mentoring part and how that works. If you have this government and private investor combination, when we invest money on behalf of our clients, whether they be impact investors, private risk-taking investors, ESG investors, they need a return. They want a return. And so we're aligned with the bank being successful and making sure that they are integrated in, as Manny said at the outset of this podcast, the network. We've all gotten to where we are today by other people lifting us up and helping us. You need that network. And as Manny said, if you teach a person to fish, they will not need you long term, but they'll be a positive feedback loop because then the investors will want to keep investing. They'll still want to help the communities, but also transform those communities and get a return in the process. And I think that's better than, 'Hey, put a deposit in this bank.' Then it's a drive-by; you're on to the next thing; you put your deposit there. If you are an investor, whether it be debt or equity, you are aligned and you are wedded together in terms of your future. How that bank does is our future, and I think that's the alignment that's so critical here.

During a period of five years of substantial economic growth, substantial hiring, why did we not strengthen these financial institutions? Why did we not help raise capital during this period of time? Five years ago, four years ago, three years ago before COVID 19 crisis hit us?

(NW): I think you needed the catalyst of the pandemic to change the culture of investing in the banks that we're talking about. Those banks that need capital, they've been used to getting money granted and deposits being essentially forced by the big banks through some of their requirements, regulatorily, to deposit money, as opposed to thinking about the capital markets like Manny thought about it when he was 15. So investors can't just invest in the equity of a minority-owned bank, any other small bank; it can't be too high price. It's gotta be the right price.

> **"Often in a democracy you need a crisis to get a focus, but we have the focus right now. We also have a lucky break of zero interest rates. We must enact this legislation, which will allow these institutions long-term capital that can't go away so that they can affect these communities."**
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And that's why the catalyst of the pandemic. And now this coalescing of both parties and the will of society is that if you can use historically low interest rates, you can make that be the catalyst so people can – both on the investor side, on the bank side and the local community side, every perspective – they can say, look, 'this is viable, this makes sense, this is important.' And I think if you have all those together, then you can have success. Prior to that, the mindset was, 'well, the big-money center bank is going to put a deposit because they have to under regulations. They must give me a deposit.' Well, we need equity and we need sub debt and we need it priced in a way that makes sense, and the government can be that catalyst. I don't know if Manny, if you see it a different way.

(MF): Often in a democracy you need a crisis to get a focus, but we have the focus right now. We also have a lucky break of zero interest rates. So this is the first time ever, certainly in my lifetime, where these institutions could get billions of dollars of 1-percent money, perpetual money, and become strong institutions and become big institutions. And hopefully, put Bank of America and JP Morgan to the wall; that's the real goal, to have a super-competitive system. But to do that, we must enact this legislation, which will allow these 5,000 institutions with long-term capital that can't go away so that they can affect these communities.

(NW): You had zero interest rates after the last financial crisis, but that was in part a crisis of the banking system. This, by contrast, the banking system is now viewed appropriately and properly as the transmission mechanism by which the Fed, the Treasury, Congress can infuse capital. So this is the right mixture; with the crisis, the pandemic, banks are not viewed as the problem, they're viewed as the answer part of the solution. That's why this is the perfect kind of scenario to make and effect that change.

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In April of this year, our Center for Financial Markets was very involved with a report called "Good Money After Bad," that compared efficiency of minority depository institutions, MDIs. What we saw in this report was [MDIs] performed with equivalent efficiency with non-market, non-minority institutions in terms of rate of return on assets. That Black and Hispanic banks had a higher efficiency compared to non-minority. And if they have the same resources from the outset, Hispanic-, Native American-, African American-dominated ownership institutions would perform as well or better than non-minority banks. And so the challenge is really to get capital to them. And I think the dual crisis that we've seen here, as you've both pointed out, if we're going to really focus on financial opportunity, freedom, access to capital for people throughout this country, there are bills in Congress that you've just discussed, Manny, in August of 2020, which could put us on the road to reduce inequality and create opportunity. We have talked about achieving the American Dream and what it means for decades, but part of that American Dream is access to capital.

What do you see happening if we get this capital? Take us five years forward from today. Yes, you will be successful for your clients and investors in your investments. But Manny, as an activist, what will you see happen in society if we can get this capital into these small and medium financial institutions?

(MF): If we can get this permanent capital at very low rates, which are market rates, really, it will have this massive multiplier impact. You're going to make millions and millions of Americans feel they're part of the system that they're part of the dream; they'll have access to money; they'll have access to loans. I mean, the sickening part of this bill is that they had to put in a clause that said that you can't charge more than 36 percent interest because many of many of these communities are getting their loans at very, very high rates; not from banks, but from other places. But what it will do long term, it will be one major step towards bringing society together to make everyone feel they have an interest in society, and that they're not left out. If someone has a business, someone has a home, someone has the opportunity to go forward, they look at life differently. If you're struggling every hour to put food on the table, then you can't think straight.

There's a report that comes out every year produced by a financial firm called Credit Suisse. And in that report every year, they give you a lot of information about net worth by countries around the world. And then when it comes to the number of people, percentage of the population that are millionaires for countries over 20 million in population, the United States and Australia are the highest at over 6 percent; over 6 percent of the people in the United States are millionaires in net worth and in Australia.

But when you look at the percentage of the population that has a net worth under $10,000, the United States has the highest of all developed countries. And this is prior to the coronavirus. Almost 30 percent of Americans have a net worth under $10,000 and are one medical emergency away from bankruptcy. But if we don't find a way in a democracy to get capital that people feel at least they have a chance, then we're really not going to achieve the American Dream today.

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And I would say to you, Manny and Neal, you've pointed out your role as partners, as investors here and bringing institutional capital to these organizations and the opportunity to do it. Have we ever had this opportunity before? Was there a time when you believe both political parties, the Administration, the Federal Reserve, Treasury, would have ever been united on this issue, as you think back over the decades?

(MF): Never certainly in my lifetime – and I'm a little older than Neal – that we've ever had this consensus. And that's very, very unusual. And this consensus is coming right at a point of zero interest rates. And it's coming right at the point where, where all the parties agree we have to do something. In a sense, Rome is burning and we have the opportunity to put out the fire. We have the tools and we have to just use them.

(**NW):** Mike, I think this is the ultimate opportunity to have sustainable change. And the good news is that in 2018, there was a slight recalibration in the favor of the small banks that was bipartisan. And so now that we have the catalyst, there is an underlying desire on both parties to help the small banks. But now it has to be focused at the next level, which is the minority-owned banks, the community development banks. There is an underlying desire to do well. The issue is, we can't get confused on the best way to do it. We have to mentor, and I think then the sustainability will go on and on.

And I think that even the debt, the debt can be access to capital markets. Good begets good. You can then securitize it. Then suddenly it becomes part of the fabric of our capital markets, that small banks have access to capital markets, not just because the government provided a program, it would be self-sustaining. And I think that is the promise, and that is the hope behind what we've proposed.

What we're talking about here is not cheap capital. We're talking about market capital; market rates today. We're not talking about subsidizing, we're talking, once again, just where the market is today. And when we talk about double digits, interest rates or charges to people in the lowest social economic groups, we're talking about a potential to bring fairness to them in what rates they're being charged today. I think what you're advocating here is the democratization of capital, and the fact that we have hundreds or thousands of institutions, if we empowered them, could solve that problem. Do we have the talent or can they recruit the talent to those organizations if they were to grow substantially?

(MF): Of course they can grow the same way you grew and way I grew. If you have access to money, if you have capital, you can grow. You can find great people, good people, the people who care. So, the issue isn't the ability to grow. The issue isn't the ability to fish. The key is to have the tools; there's only one tool and that's capital. It's not, as Neal said, it's not the silly deposits that people think is going to be the solution to the problem. It's true capital.

(NW): If you can take a son of a rabbi and son of a teacher with law degrees and make us business people, you can absolutely. Talent is talent. And people have talent and they have the tools As Manny said, if they have support and the network and the capital, then of course they can be successful.

(MF): Well, we know we're a tribal society. We know human beings have tribal values. The key is to try to get beyond those tribal values. This is a great opportunity for this country to go to that next level for the first time.

With thousands of banks out there – and maybe you're invested in 200 of them – when you make a decision to invest in one financial community bank versus another, what are you looking for?

(MF): Obviously the key in any business is the people, the person, the culture, especially in banking where trust is so important. But this is very much a self-reinforcing mechanism, and that is the people who have capital, get capital. People that get that capital get even stronger and grow stronger and are more efficient. It's the fact that you're cut off, that you can't make that first breakthrough, that takes you out of the game, period. We're not running around to invest in banks that have, 2-percent capital, that if they make a loan and they're going under. We've got to get all these institutions to a certain level where it's an even playing field.

(NW): Yeah, I would agree. I mean, quantitative and demographic factors always factor in, but it's really the management teams and it's the qualitative components of that. So the problem is that they need to have all the tools at their disposal and that's what we're advocating for.

(MF): And we all know how quick the systems are changing, and that means you have to have the money to adjust to these changes in the systems by being able to buy the systems, period.

(NW): The technology.

(MF): The technology.

Manny and Neal. I want to thank you for joining us today on this podcast. I want to thank you for building a firm that not only does well, but its basis is to build our country. All the best. Thank you.
