

October 17, 2019

## Memorandum

**To:** Members, Committee on Financial Services

**From:** FSC Majority Staff

**Subject:** October 22, 2019, “An Examination of the Decline of Minority Depository Institutions and the Impact on Underserved Communities”

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The Subcommittee on Consumer Protection and Financial Institutions will hold a hearing entitled, “An Examination of the Decline of Minority Depository Institutions and the Impact on Underserved Communities,” at 2:00 p.m. on Tuesday, October 22, 2019, in room 2128 of the Rayburn House Office Building. This will be a single-panel hearing with the following witness:

### Witnesses

- **Kenneth Kelly**, Chairman and CEO, First Independence Bank, and Chair, National Bankers Association (NBA)
- **Jill Sung**, CEO, Abacus Federal Savings Bank, and Chair, Independent Community Bankers Association’s (ICBA) Minority Bank Council
- **Mara Falero**, Vice President of Marketing and Communication, Jetstream Federal Credit Union, representing the National Association of Federally-Insured Credit Unions (NAFCU)
- **Jeff Bowman**, President and CEO, Bay Bank
- **Aron Betru**, Managing Director, Center for Financial Markets, Milken Institute

### Overview

On February 13, 1865, a bill to incorporate a bank to serve freed slaves was introduced in Congress and "An Act to Incorporate the Freedman's Savings and Trust Company" was signed into law by President Abraham Lincoln on March 3, 1865.<sup>1</sup> MDIs have a long history in the United States. MDIs peaked in terms of number of institutions in 2008, at 215 institutions.<sup>2</sup> However, following the financial crisis and the disproportionate impact of the housing crisis and recession on minority communities, the number of MDIs fell 31% over the following decade, to 149 at year-end 2018. According to the Federal Deposit Insurance Corporation (FDIC), MDI banks were 2.5 times more likely to fail than all other banks, with most of the failures happening during the crisis,

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<sup>1</sup> Reginald Washington, "The Freedman's Savings and Trust Company and African American Genealogical Research," Prologue, 29: 2 (Summer 1997) available at <http://www.archives.gov/publications/prologue/1997/summer/freedmans-savings-and-trust.html>.

<sup>2</sup> FDIC, “2019 Minority Depository Institutions: Structure, Performance, and Social Impact”, 2019, available at <https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf>

or immediately thereafter.<sup>3</sup> Meanwhile, MDI credit unions have seen similar declines, with more than one-third of such institutions disappearing since June 2013.<sup>4</sup>

### **Minority-Owned Banks and Credit Unions**

Section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) requires that banking regulators: preserve the present number of minority depository institutions; preserve the minority character in cases of merger or acquisition; provide technical assistance to prevent insolvency of institutions not now insolvent; promote and encourage creation of new minority depository institutions; and provide for training, technical assistance, and educational programs.<sup>5</sup>

The FDIC Policy Statement defines MDIs as “any Federally insured depository institution where 51 percent or more of the voting stock is owned by minority individuals” or any such institution where “a majority of the Board of Directors is minority and the community that the institution serves is predominantly minority”.<sup>6</sup> The term “minority” means any “Black American, Asian American, Hispanic American, or Native American”.<sup>7</sup> The composition of MDIs has changed over the past 2 decades, with a notable near-disappearance of black MDIs over this period, and the rapid emergence of Asian MDIs, as illustrated in Figures 1 and 2 in the appendix below.

Today, MDIs represent 2.8% of FDIC insured banking charters, 1.3% of assets, and 1.7% of banking offices<sup>8</sup>. By comparison, MDI Credit unions represent a 10% of all federally insured credit unions, although they tend to be smaller than their peers, with 87% of MDI credit unions reporting total assets of \$100 million or less.<sup>9</sup> According to the National Credit Union Administration (NCUA), MDI credit unions “underperformed in all growth categories – including assets, membership, shares, loans, and net worth – compared to low-income credit unions, small credit unions, and federally insured credit unions overall.”<sup>10</sup>

### **Community Development Financial Institutions**

The Community Development Financial Institutions (CDFI) Fund is an agency of the U.S. Treasury Department, and was established by the Riegle Community Development and Regulatory Improvement Act of 1994.<sup>11</sup> The mission of the CDFI Fund is “to expand economic opportunity for underserved people and communities by supporting the growth and capacity of a national network of community development lenders, investors, and financial service providers.”<sup>12</sup> A

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<sup>3</sup> *Id*

<sup>4</sup> As of December 2018, there were 529 MDI credit unions, which compares to 805 such firms as of June 2013. See NCUA, Minority Depository Institutions Annual Report to Congress, [2013](#) and [2018](#).

<sup>5</sup> FDIC, Policy Statement Regarding Minority Depository Institutions, available at <https://www.fdic.gov/regulations/laws/rules/5000-2600.html#fdic5000policys>

<sup>6</sup> FDIC, “2019 Minority Depository Institutions: Structure, Performance, and Social Impact”, 2019, available at <https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf>

<sup>7</sup> *Id*

<sup>8</sup> *Id*

<sup>9</sup> NCUA, “2018 Minority Depository Institutions Annual Report to Congress” available at <https://www.ncua.gov/files/publications/2018-mdi-congressional-report.pdf>

<sup>10</sup> *Id*

<sup>11</sup> PL 103-325

<sup>12</sup> CDFI Fund website, available at <https://www.cdfifund.gov/about/Pages/default.aspx>

CDFI is a “specialized financial institutions serving low-income communities,”<sup>13</sup> and a CDE is “a domestic corporation or partnership that is an intermediary vehicle for the provision of loans, investments, or financial counseling in low-income communities.”<sup>14</sup> The CDFI Fund certifies CDFIs and Community Development Entities (CDE).<sup>15</sup> Becoming a certified CDFI or CDE allows organizations to participate in various CDFI Fund programs as follows:

1. Bank Enterprise Award (BEA Program):<sup>16</sup> provides FDIC-insured depository institutions awards for a demonstrated increase in lending and investments in distressed communities and CDFIs.
2. CDFI Program: provides Financial and Technical Assistance awards to CDFIs to invest in, and build their capacity, including product development and loan loss reserves.<sup>17</sup>
3. Native American CDFI Assistance Program (NACA Program): provides CDFIs and Sponsoring Entities Financial and Technical Assistance awards to increase lending and grow the number, and helps build capacity of Native CDFIs.<sup>18</sup>
4. New Market Tax Credit: tax credits for making equity investments in CDEs that stimulate capital investments in low-income communities.<sup>19</sup>
5. Capital Magnet Fund: awards to CDFIs and non-profit affordable housing organizations to finance affordable housing solutions and related economic development activities.<sup>20</sup>
6. Bond Guarantee Program (BGP): a source of long-term, patient capital for CDFIs to expand lending and investment capacity for community and economic development purposes.<sup>21</sup>

Since its founding, the CDFI Fund has awarded over \$3.3 billion to CDFIs and CDEs, allocated \$54 billion in tax credits, and \$1.51 billion in bond guarantees.<sup>22</sup> According to the CDFI Fund, some programs attract as much as \$10 in private capital for every \$1 invested by the CDFI Fund.<sup>23</sup>

### **Treasury Department programs supporting MDIs**

There are several U.S. Department of the Treasury programs that are designed to support MDIs. The Minority Bank Deposit Program (MBDP) is a voluntary program which encourages minority-owned banks, women-owned banks, and credit unions that serve low-income communities to become depositories and financial agents. The MBDP was created in 1969 in response to Executive Order 11458,<sup>24</sup> which established a national program supporting minority business enterprise. It was expanded under Executive Orders 11625<sup>25</sup> and 12138.<sup>26</sup> The

<sup>13</sup> *Id*

<sup>14</sup> *Id*

<sup>15</sup> See Figure 3 in the appendix for types of certified CDFIs. Also see Figure 9 in the appendix, which shows for the decade preceding the financial crisis, CDFIs, followed closely by MDIs, were more likely to locate and provide mortgages to low-income communities as compared to all other banks.

<sup>16</sup> Riegle Community Development and Regulatory Improvement Act of 1994 (P.L. 103-325)

<sup>17</sup> *Id*

<sup>18</sup> *Id*

<sup>19</sup> Community Renewal Tax Relief Act of 2000 (P.L. 106-554)

<sup>20</sup> Housing and Economic Recovery Act of 2008 (P.L. 110-289)

<sup>21</sup> Small Business Jobs Act of 2010 (P.L. 111-240)

<sup>22</sup> CDFI Fund, “An Introduction to the CDFI Fund”, 2019.

<sup>23</sup> [https://www.cdfifund.gov/Documents/CDFI\\_infogrphic\\_v03Aaf.pdf](https://www.cdfifund.gov/Documents/CDFI_infogrphic_v03Aaf.pdf)

<sup>24</sup> <https://www.mbdp.gov/page/executive-order-11458>

<sup>25</sup> Signed October 13, 1971. See <https://www.archives.gov/federal-register/codification/executive-order/11625.html>

<sup>26</sup> Signed May 18, 1979. See <https://www.archives.gov/federal-register/codification/executive-order/12138.html>

Competitive Equality Banking Act of 1987<sup>27</sup> and the Financial Institutions Reform, Recovery and Enforcement Act of 1989<sup>28</sup> include provisions supporting the intent of the MBDP. In testimony before the Committee in April 2019, Doyle Mitchell, President and CEO of Industrial Bank, stated that, “Historically, Treasury’s Minority Bank Deposit Program has been a reliable source of deposits for NBA member banks, but the federal government’s utilization of the program has decreased dramatically in recent years.... [we] urge the relevant oversight subcommittees for this program to identify the particular causes of the program’s decline and the affirmative steps Treasury will be taking to increase participation in the program.”<sup>29</sup>

In addition, Treasury runs a Mentor-Protégé Program, which is designed to motivate and encourage firms to assist small businesses in enhancing their capabilities. The program is also designed to perform Department of the Treasury contracts and subcontracts, foster the establishment of long-term business relationships between these entities and Treasury prime contractors, and increase the overall number of these entities that receive Treasury contract and subcontract awards.<sup>30</sup> Some have suggested institutions that serve as Treasury’s financial agents be required to participate in the Mentor-Protégé Program and partner with small MDIs as part of the program.<sup>31</sup>

### **MDIs and the Communities they Serve**

MDIs face several challenges, including the ability to raise capital despite overall strong financial performance, and challenges experienced as result of serving communities that are often the first and hardest hit in economic downturns.<sup>32</sup> Despite regulators having a shared mission to preserve and promote MDIs, these firms have shrunk in numbers, including especially African American MDIs, which is contributing to growing banking deserts in minority communities.<sup>33</sup>

Furthermore, research confirms continued patterns of discrimination in banking. Indeed, a report by the Center for Investigative Reporting found persistent discrimination in mortgage lending, and that “black applicants were turned away at significantly higher rates than whites in 48 cities, Latinos in 25, Asians in nine and Native Americans in three.”<sup>34</sup> Similarly, mystery shopper research studies found that loan officers from non-minority banks systematically

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<sup>27</sup> P.L. 100-86

<sup>28</sup> P.L. 101-73

<sup>29</sup> <https://financialservices.house.gov/uploadedfiles/hhrg-116-ba15-wstate-mitchelljrb-20190409.pdf>

<sup>30</sup> <https://www.treasury.gov/resource-center/sb-programs/Pages/dcfo-osdbu-mentor-protege-01-scope.aspx>

<sup>31</sup> Testimony of Jeff Smith President and CEO, Unity National Bank, and representing the National Bankers Association before the House Financial Services Oversight and Investigations Subcommittee hearing, “Examining Discrimination and Other Barriers to Consumer Credit, Homeownership, and Financial Inclusion in Texas,” September 4, 2019, <https://financialservices.house.gov/uploadedfiles/hhrg-116-ba09-wstate-smithj-20190904.pdf>.

<sup>32</sup> James Barth, Aron Betru, Christopher Lee, and Matthew Brigida, “Minority-Owned Depository Institutions – A Market Overview,” Milken Institute (July 15, 2019), <http://milkeninstitute.org/reports/minority-owned-depository-institutions-market-overview>; Carolyn Karo Schulman, “Partnership for Lending in Underserved Markets – Phase II Summary: Lessons Learned for Advancing Minority Small Business Capital Access,” (May 1, 2018), <https://milkeninstitute.org/reports/plum-phase-ii-summary-lessons-learned-advancing-minority-small-business-capital-access>; and House Financial Services Oversight and Investigations Subcommittee hearing, “Examining Examining Discrimination and Other Barriers to Consumer Credit, Homeownership, and Financial Inclusion in Texas,” (Sep. 4, 2019), <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=404229>.

<sup>33</sup> *Id.*

<sup>34</sup> Aaron Glantz and Emmanuel Martinez, February 15, 2018, “Kept Out: For people of color, banks are shutting the door to homeownership”, The Center for Investigative Reporting.

discriminate against minority small businesses. For example, minority-testers were less likely to be provided product information on loan fees (26% of the time versus 59% for white-testers), and more frequently asked to provide information like financial statements (83% vs. 50%), personal savings and investments (61% vs. 22%), and credit card debt (43% vs. 13%). In addition, minorities were less frequently offered help to complete a loan application (18% vs. 59%), offered a business card (43% vs. 82%), or offered help with future banking needs (43% vs. 68%).<sup>35</sup>

Additional research confirms that MDIs and CDFIs play an active role in addressing persistent discrimination, as they are far more likely to serve underbanked communities of color and low and moderate income (LMI) communities than both large banks, and non-minority owned community banks, as confirmed by loan data. According to the Federal Deposit Insurance Corporation (FDIC), the median share of the estimated service area population living in LMI census tracts is 69% for African American MDIs, 45% for Asian American MDIs, and 30% for Hispanic American MDIs, compared to 26% for non-minority owned noncommunity banks, and 21% for non-minority owned, metro-area community banks.<sup>36</sup> Similarly, looking at Home Mortgage Data Act (HMDA) reported mortgage origination data, MDIs serve a substantially higher share of minority home mortgage borrowers compared with non-MDI metro-area community banks, as shown in Figures 5, 6 and 7 for African-American, Hispanic, and Asian-American MDIs, respectively, in the appendix.<sup>37</sup> Similar patterns exist for small business lending, as MDIs made a greater share of their loans to small business borrowers located in LMI census tracts than non-MDI banks, as shown in Figure 8 in the appendix.<sup>38</sup>

### **Legislative Proposals**

- **Ensuring Diversity in Community Banking Act (Meeks).** The discussion draft would:
  - Establish and codify MDI Advisory Committees for all prudential regulators;
  - Encourage Federal Government-held deposits in MDIs;
  - Require diversity reports and best practices from prudential regulators' OMWIs on the bank examiner corps;
  - Modify the Bank Holding Company Act to encourage investments in small MDIs;
  - Require participation in Treasury's mentor-protégé program for big banks that are a financial agent of the Treasury Department;
  - Incorporate information sharing for CDFI certification, when appropriate, as part of FDIC's *de novo* bank application process;
  - Streamline and simplify CRA exams for eligible MDIs that are also CDFIs;
  - Create a Small Business Administration task force focused on MDIs and CDFIs;
  - Allow investments in CDFIs that operate in opportunity zones; and,
  - Sense of Congress to fund the Loan-Loss Reserve Fund for Small Dollar Loans.
- **Discussion Draft regarding Treasury's Mentor-Protégé Program (Beatty).** The discussion draft would codify the Department of the Treasury's mentor-protégé program to encourage collaboration between MDIs and institutions that are financial agents for the Treasury Department.

<sup>35</sup> Bone, S., Christensen, G., and Williams, J., 2014, "Rejected, Shackled, and Alone: The Impact of Systemic Restricted Choice on Minority Consumers' Construction of Self," *Journal of Consumer Research*, 41: 451-474.

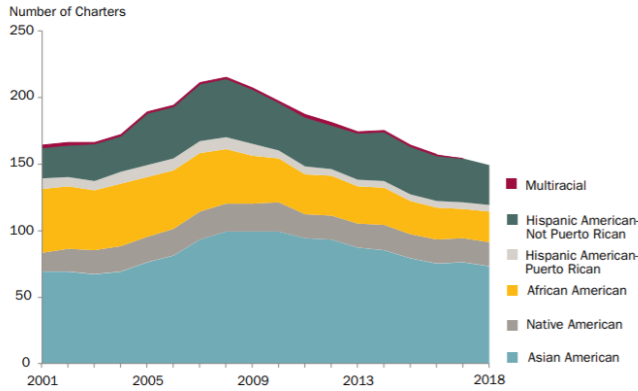
<sup>36</sup> *Id.* Also see Figure 4 in the appendix.

<sup>37</sup> FDIC, "2019 Minority Depository Institutions: Structure, Performance, and Social Impact" available at <https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf>.

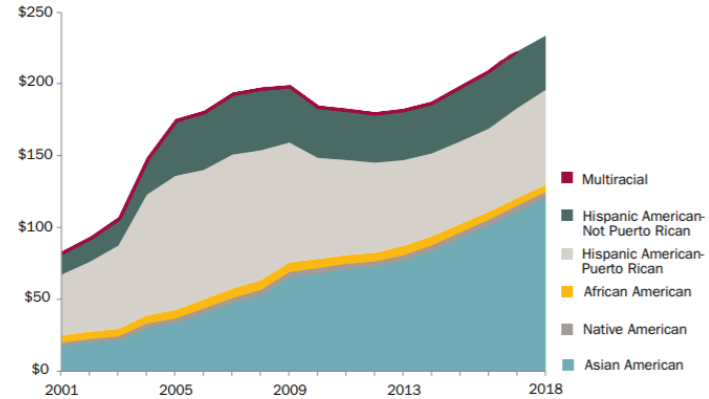
<sup>38</sup> *Id.*

Appendix

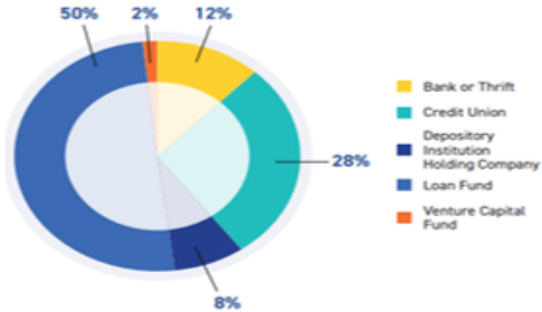
**Figure 1. Number of MDI Bank Charters – 2001 to 2018<sup>39</sup>**



**Figure 2. MDI Bank Assets (\$billion) – 2001 to 2018<sup>40</sup>**

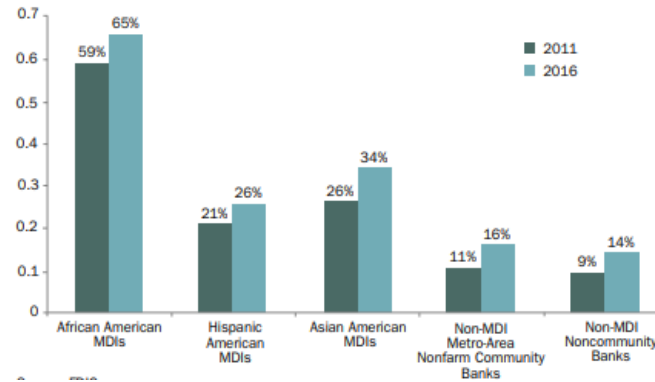


**Figure 3. Types of Certified CDFIs**  
Types of Certified CDFIs (of 1,112 CDFIs as of September 30, 2018)



Source: FY 2018 CDFI Fund Year in Review

**Figure 4. Median Share of HMDA Mortgage Originations for Properties in LMI Census Tracts<sup>41</sup>**

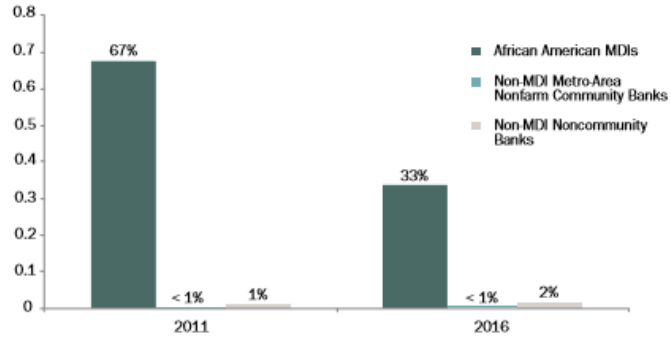


<sup>39</sup> *Id*

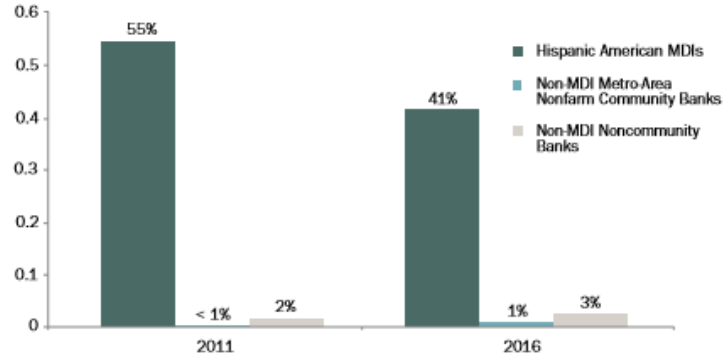
<sup>40</sup> *Id*

<sup>41</sup> FDIC, “2019 Minority Depository Institutions: Structure, Performance, and Social Impact” available at <https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf>

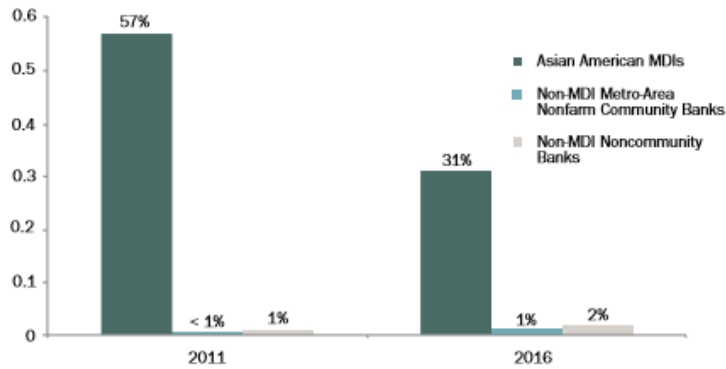
**Figure 5. Median Share of HMDA-Reported Mortgage Originations to African American Borrowers Is Higher for African Americans MDIs<sup>42</sup>**



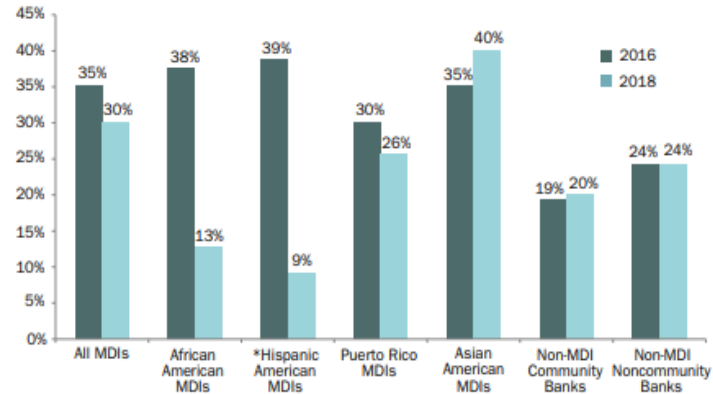
**Figure 6. Median Share of HMDA-Reported Mortgage Originations to Hispanic Borrowers Is Higher for Hispanic MDIs<sup>43</sup>**



**Figure 7. Median Share of HMDA-Reported Mortgage Originations to Asian American Borrowers Is Higher for Asian Americans MDIs<sup>45</sup>**



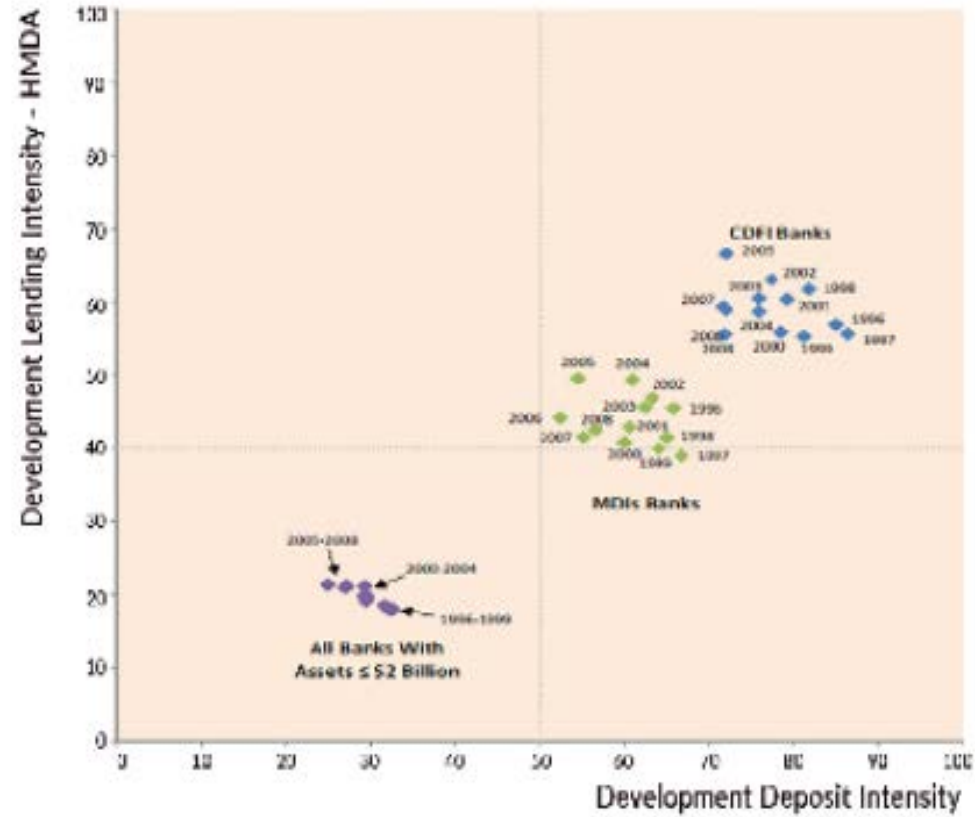
**Figure 8. Median Share of SBA 7(a) Loans in LMI Census Tracts<sup>44</sup>**



Sources: FDIC, U.S. Census Bureau, SBA  
 \*MDIs headquartered in Puerto Rico were disaggregated from the Hispanic American MDI category.

<sup>42</sup> *Id*  
<sup>43</sup> *Id*  
<sup>44</sup> *Id*  
<sup>45</sup> *Id*

**Figure 9. National Community Investment Fund Social Performance Metrics Comparison Across Banks<sup>46</sup>**



Source: National Community Investment Fund, Social Performance Metrics.

<sup>46</sup> James R. Barth, Aron Betru, Christopher Lee, Matthew Brigida, "Minority-Owned Depository Institutions: A Market Overview", 2019, The Milken Institute, available at <https://www.milkeninstitute.org/sites/default/files/reports-pdf/Minority-Owned%20Depository%20Institutions%20-%20A%20Market%20Overview%20FINAL.pdf>