April 15, 2022
Minority Depository Institutions Advisory Committee
Office of the Comptroller of the Currency

Re: Ludwig Institute for Shared Economic Prosperity Statement on Ensuring the Continued Health and Viability of Minority Depository Institutions

At the moment the Great Recession hit in 2008, America boasted 215 minority-owned banks[1]. Now, only 143 minority depository institutions remain[2] as of the fourth quarter of 2021. This decline, a trend that might be termed "The Great Winnowing," began well before the housing market's crash. It is not just down to a broader shift toward consolidation within the world of finance, but also the result of the policies crafted by regulators in Washington.

For decades, regulators have embraced a set of rules that, when recessions arise, force the closure of struggling lenders that serve poorer and marginalized communities. In practice, this has the effect of allowing investors to purchase the closed lenders' assets (loans and properties) while they're devalued. This vicious cycle has steadily worsened inequality because those assets — now owned by outsiders — skyrocket in value when the market recovers. Unless policymakers shift their approach, the Great Winnowing is almost certain to continue the next time the economy takes a dip.

Part of the problem is that not everyone views the survival of banks intent on serving poor and minority communities as desirable. Some in finance and government quietly would just as soon let these lenders be subsumed into much bigger banks or other financial behemoths, many of which have only the most superficial understanding of how to parse loan applications in marginalized communities.

The Ludwig Institute for Shared Economic Prosperity believes providing financial services to people who live in more modest and minority communities requires both the savvy to understand which applications are truly viable and, perhaps more important, a deep-seated commitment to a given locality that neither behemoth banks nor federal bureaucrats can realistically hope to develop.

The OCC should work with Congress to set up a permanent backstop for MDIs when economic conditions deteriorate. Also, MDIs who provide loans to low-moderate income and minority communities should not be forced to devalue and sell off their assets during economic downturns. These are assets whose value will rebound once a recovery is underway. And the current regulatory landscape puts MDIs at a disadvantage compared to larger financial institutions. More must be done to correct the regulatory imbalance between large and small financial institutions.

The Great Winnowing's effects have largely been hidden from more prosperous communities — but they're very real, and often tragic. For example, ShoreBank, the community development financial institution founded in the early 1970s to serve Chicago's South Side. For decades, ShoreBank was lauded

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[1] Federal Deposit Insurance Corporation. Minority Depository Institutions Structure, Performance, and Social Impact, 2019. https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf
[2] Federal Deposit Insurance Corporation, Minority Depository Institutions List – Fourth Quarter 2021. https://www.fdic.gov/regulations/resources/minority/mdi.html

as a national icon that helped finance working-class borrowers looking to climb into the middle class. But when the Great Recession hit, its customers were among the first to be laid off, and a number of its loans were among the first to go into default.

ShoreBank itself wasn't culpable. But as the Great Recession took hold, regulators worried that a failure to crack down on certain banks holding too many delinquent loans would signal to other institutions that they could be more profligate in their lending — concerns often overcome when larger institutions are at risk. To its great credit, the Federal Deposit Insurance Corporation attempted to save ShoreBank by trying to secure funds from the Troubled Asset Relief Program. But when other voices inside the White House and agencies vetoed that proposal, Washington essentially forced the bank out of business[3].

At the same time that the government was using TARP funding to save larger financial institutions deemed "systemically important," regulators were tightening the screws on the very mission-driven lenders who were serving the communities suffering most wretchedly amid a global crisis. After ShoreBank's assets were gobbled up for a cut-rate price, the struggling remnants of the ShoreBank franchise were left to stagger forward. And the South Side communities in Chicago that had once depended on ShoreBank were left to beg other lenders — often larger banks headquartered outside their communities — to set up shop in ShoreBank's now glaring absence.

The narrative — in which a minority depository institution helps poor and minority communities accrue wealth in good times and is then shunted aside when the economy goes south — has prevailed for decades. Washington can and should put a stop to it. There needs to be a safety net explicitly designed to buoy MDIs caught in the grips of crises that are not of their making. Recent congressional funding boosts in these institutions are a good start. But to end the vicious cycle, Washington must be much more aggressive given the inevitable dips in the economy.

To begin, we need a Federal Community Banking Reserve that can be deployed to buttress small struggling lenders at the moment that economic conditions deteriorate. The FCBR should be modeled, in spirit, on the Strategic Petroleum Reserve established to protect against the specter of another oil crisis — and in this case would be available during a broader recession. Minority-owned banks and mission-driven lenders are the victims of circumstance during financial crises. Particularly because they are lifelines for those they serve, they deserve a reprieve from such an approach.

Second, MDIs who underwrite mortgages in marginalized communities should not be forced to sell off assets at the moment the broader market craters. Too often, lenders are compelled to value their assets using "mark to market," equating their balance sheet with what the assets would sell for on any given day. That rule puts minority and community-focused institutions at a drastic disadvantage against bigger institutions that can move assets from one set of investments to another. We should not make it easy for Wall Street firms to hoover up temporarily devalued assets that are sure to bounce back in the recovery.

Also, policymakers should provide relief to these smaller lending institutions by remolding the regulatory mandates that put them at a disadvantage. The current regulatory regime perversely benefits the big banks vis-à-vis the small banks, as the big ones are best equipped to hire and invest in the additional staff and technology required to comply. Attempts to right the regulatory balance between large banks and smaller ones hasn't been aggressive enough. Absent a carve out for MDIs making more marginal loans to

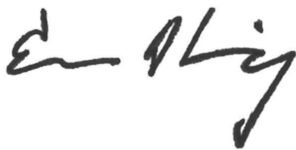
[3] Federal Deposit Insurance Corporation. Failed Bank Information for ShoreBank, Chicago, IL. https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/shorebank.html

Americans with lower incomes, the rules too often force them to reject worthy applications for fear of failing to clear a seemingly endless series of regulatory hoops. If MDIs do not get the benefit of being considered “systemically important” they should not be forced to meet this unreasonable regulatory burden.

The primary challenge for policymakers worried about the Great Winnowing should not simply be to protect the unwitting public from financial crises. Washington needs to give greater priority to protecting the underlying institutions born to serve underprivileged communities. When minority-owned and community-centered lenders are forced out of business, the businesses and families they are best-equipped to serve eventually pay the price. To protect the provision of financial services to low-moderate income and minority communities, Washington should prepare to extend them a real lifeline ahead of the next inevitable recession.

LISEP would be pleased to work with the OCC and the MDIAC to come up with additional steps that the agency can take to support the continued health and viability of MDIs.

Sincerely,



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