Statement of

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on

An Examination of Regulators' Efforts to Preserve and Promote Minority Depository Institutions

before the

Subcommittee on Consumer Protection and Financial Institutions

of the

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Chairman Meeks, Ranking Member Luetkemeyer, and members of the Subcommittee, the Federal Deposit Insurance Corporation (FDIC) appreciates the opportunity to testify today on the state of minority depository institutions (MDIs), the FDIC's efforts to preserve and promote MDIs, as well as actions that the agency will be taking to help reverse the decline in these institutions.

I serve as the FDIC's National Director for Minority and Community Development Banking. In this capacity, I ensure that the FDIC's MDI program is integrated throughout the agency's supervision, consumer compliance, and resolution functions.

Minority Banker Engagement with the FDIC Board

In the FDIC's *2018 Annual Report*, Chairman McWilliams noted in her introductory message that the FDIC would increase its engagement with MDIs.[1] As part of that commitment, in 2018 the FDIC appointed additional minority bankers to the FDIC Board's Advisory Committee on Community Banking (CBAC).[2] We believe that this will be an important way to help facilitate greater engagement and information sharing between MDIs and non-MDIs.

This year, the FDIC announced several new initiatives to increase engagement with MDIs, including the formation of a new MDI Subcommittee to the CBAC to highlight MDIs' efforts in their communities and to provide a platform for MDIs to exchange best practices.[3] The new subcommittee will focus on the issues, tools, and resources that are unique to MDIs, and the

[1] *See* FDIC, *2018 Annual Report*, Message From the Chairman, available at https://www.fdic.gov/about/strategic/report/2018annualreport/ar18chairman.pdf.
[2] *See* "FDIC Announces New Members for the Advisory Committee on Community Banking," PR18073 (October 10, 2018), available at https://www.fdic.gov/news/news/press/2018/pr18073.html.
[3] *See* "FDIC Hosts Interagency Conference Focusing on Minority Depository Institutions, Announces New MDI Initiatives and Publishes Results of New MDI Study," PR19054 (June 25, 2019), available at https://www.fdic.gov/news/news/press/2019/pr19054.html.

FDIC hopes that the subcommittee will help us identify additional opportunities to tailor regulatory requirements and supervisory expectations for MDIs with less complex balance sheets while maintaining overall safety and soundness. The inaugural meeting for this subcommittee will be in early December.

<u>FDIC Research on Size, Demographics, Financial Performance, and Social Impact of MDIs</u>

In June, the FDIC published a comprehensive research study, *Minority Depository Institutions: Structure, Performance, and Social Impact*,[4] that explores structural changes among FDIC-insured MDIs, their role in the financial services industry, and their impact on the communities they serve. Compared with the total of more than 5,400 insured financial institutions, the number of MDIs is small. From 2001 up to the 2008 financial crisis, the number of MDIs increased from 164 to 215 before declining to 149 as of the end of 2018. The number of African American MDIs declined by more than half during this period, from 48 (30% of MDIs) in 2001 to 23 (15% of all MDIs) at the end of 2018. In 2019, one African American MDI merged with a non-MDI and one recently failed, reducing the number of African American MDIs to 21 (14% of all MDIs). However, the number of Native American, Hispanic, and Asian MDIs increased during the same period. Overall, MDIs declined more modestly relative to the consolidation trend experienced by most of the banking industry.

Over this period, MDIs were about two and a half times more likely to fail than non-MDI banks. Most of the MDI failures occurred during the 2008 crisis or shortly thereafter. They were generally smaller institutions, and many served communities that faced economic challenges even before the crisis. Voluntary mergers were the greatest contributing factor to the

[4] *See* FDIC, *Minority Depository Institutions: Structure, Performance, and Social Impact*, available at https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf.

consolidation of MDIs. However, most of the assets of the 118 MDIs acquired through mergers or failures were acquired by other MDIs.

MDI financial performance has improved over the past five years, particularly in terms of loan performance. While MDIs tend to outperform non-MDI community banks in revenue generation, they have much higher expenses, particularly among smaller MDIs. As a result, MDIs have long underperformed other community and non-community banks when measured by the cost to bring in a dollar of revenue. However, that disadvantage has narrowed in recent years.

Since the recession, credit quality has improved greatly across the banking industry. For MDIs, loan performance has improved sharply, providing the most significant boost to post-recession MDI earnings. In 2019, the number of profitable MDIs increased to its highest level since before the crisis, but the percentage of unprofitable MDIs is significantly higher compared to the broader banking industry. Unprofitable MDIs are generally smaller and located in urban areas that experienced significant distress during the crisis or smaller rural markets with ongoing economic challenges.

Our research study also highlighted information that further demonstrates the essential role that MDIs play in serving low- and moderate-income (LMI) customers and minority customers. For example, 69 percent of the median African American MDI's customers live in LMI areas; 45 percent of the median Asian MDI's customers reside in LMI areas; and 30 percent of the median Hispanic MDI's customers live in LMI areas. Non-MDIs do not have the same reach into these communities. For the median non-MDI community bank, 21 percent of customers live in LMI areas.

MDIs originate a greater percentage of home mortgages to borrowers in LMI census tracts. They also originate a greater share of Small Business Administration loans in census tracts with larger shares of minority populations than non-MDIs. MDIs are vital service providers for minority populations, which have higher percentages of unbanked households than other groups.

The FDIC's *2017 National Survey of Unbanked and Underbanked Households*[5] shows that nearly 17 percent of African American households and 14 percent of Hispanic households are unbanked, meaning they do not have an insured bank account. MDIs that serve these communities are well positioned to address the issue of underbanked and unbanked consumers.

<u>FDIC's Initiatives to Preserve and Promote MDIs</u>

Section 308 of FIRREA[6] established five goals for the FDIC and other banking regulators: preserve the number of MDIs; preserve the minority character of an MDI in cases involving merger or acquisition of the MDI; provide technical assistance to help prevent insolvency of MDIs; promote and encourage creation of new MDIs; and provide training, technical assistance, and educational programs for MDIs. The FDIC Board of Directors adopted a *Policy Statement Regarding Minority Depository Institutions*[7] to guide the agency's efforts to support MDIs and meet these statutory goals in 1990 and revised the policy in 2002.

We are working on proposed changes to our MDI policy statement to emphasize current examiner instructions related to MDI supervision. For example, examiners are instructed to take

[5] *See* FDIC, *2017 National Survey of Unbanked and Underbanked Households*, available at https://www.fdic.gov/householdsurvey/.
[6] Pub. L. 101-73, 103 Stat. 183, 353 (August 9, 1989).
[7] *See* FDIC, *Policy Statement Regarding Minority Depository Institutions*, available at https://www.fdic.gov/regulations/laws/rules/5000-2600.html#fdic5000policyso.

into account an MDI's unique characteristics and core objectives – in addition to the risk it poses to the Deposit Insurance Fund – when evaluating the institution's financial condition and risk management practices. Once we have a completed draft revised policy statement, we will issue it for public notice and comment before the FDIC Board of Directors takes a final vote on an updated policy.

Outreach, Technical Assistance, Training and Education

The FDIC carries out an active program of regular outreach, technical assistance, and training and education to provide MDIs with the tools and resources to be profitable and serve their communities. In 2018, we provided technical assistance 149 times upon request by an MDI. In 2019, we conducted six roundtables and hosted the banking agencies' biennial MDI/Community Development Financial Institution (CDFI) Conference. We have had strong participation in the roundtables and the conference, which was attended by 200 minority bankers, trade group representatives and others. These events included presentations on important topics such as the new current expected credit losses accounting methodology, Bank Secrecy Act compliance, cyber security and innovation. Minority bankers have given us very positive feedback about the roundtables and the conference.

Partnerships between MDIs and Other Banks

The FDIC's 2019 initiatives focus on building capacity in MDIs by promoting collaboration with the broader banking industry and sharing best practices. In June, the FDIC welcomed 10 large banks and seven MDIs to Washington for a roundtable to discuss potential partnerships. Each participant had outlined in advance the types of partnerships it was seeking and, during the roundtable, MDIs and larger banks met one-on-one to explore collaboration opportunities. Following the roundtable, several large banks expressed appreciation for the opportunity to find mutually beneficial partnerships and eagerness to begin working with MDIs to help them have a greater impact on their communities. One of the large banks drafted a proposal to expand its partnerships beyond the seven MDIs at the roundtable. One of the MDIs reported that it had partnered with three larger banks from the event on a variety of technical assistance efforts. Based on the success of the June event, the FDIC held similar roundtables in Atlanta and Chicago this year and plans to host additional events in the Midwest and on the West Coast next year.

At our roundtables and in discussions with large bank Community Reinvestment Act (CRA) officers, we are emphasizing the potential credit for which large banks can be considered under the CRA when they partner with MDIs. We are also promoting the *Resource Guide for Collaboration with Minority Depository Institutions* that we published in 2017.[8] We plan to engage our network of community affairs specialists around the country to discuss these benefits at other outreach events. Because we understand that partnerships with MDIs can be a useful strategy in serving the convenience and needs of their communities under CRA, we have always considered such partnerships in the CRA evaluation. To help ensure that examiners are appropriately providing banks with CRA consideration of partnerships with MDIs, we have recently updated our CRA examiner instructions and training to ensure examiners document this CRA consideration in the banks' CRA Performance Evaluation in a consistent manner.

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8 Available at https://www.fdic.gov/regulations/resources/minority/collaboration/resource-guide.pdf.

Preserving the Minority Character of Failing MDIs

One of the FDIC's statutory goals is to preserve the minority character of an MDI in the event of failure. Our research study showed that, over the 17-year period from 2001 to 2018, most of the assets of merged and failed MDIs have been acquired by other MDIs. Of the nearly $23 billion in failed bank assets during this period, 86 percent were acquired by another MDI. While this is a positive result, the FDIC continues to explore new ways to meet our statutory goal.

One of the requests the FDIC received from our outreach with MDIs was to conduct additional training on our franchise marketing process for failing MDIs. Since October 2018, the FDIC has held workshops at four annual regional MDI roundtables, a Native American MDI meeting, and an interagency MDI conference. We also held two webinars for MDIs across the country and a dedicated webinar for an MDI trade group. Our goal in providing these sessions is to help MDIs become more competitive in the bidding process. In addition, we provide one-on-one technical assistance to bidders before, during, and after the bidding process. During a recent transaction, we provided in-person technical assistance to five MDI prospective bidders at their request.

One area we identified for modification is our process for marketing failing MDIs. At the start of a new marketing initiative, we now provide a two-week window exclusively for MDIs to review bid information before other banks. At the expiration of the two-week window, all other qualified institutions on the bid list are given access to bid information, and later bids are received from all qualified institutions (MDI and non-MDI) wishing to submit bids. We believe this initiative will help us preserve the minority character of a failing MDI and successfully used this approach for the most recent MDI failure earlier this month.

Opportunity Zones

Another FDIC initiative is to provide tools and resources to facilitate MDI participation in economic revitalization in the Opportunity Zones created pursuant to the 2017 tax law. Nearly 31 percent of MDI branches are located in designated zones, compared to 14.6 percent for non-MDI community banks. While MDIs may not qualify for tax incentives or invest in a Qualified Opportunity Fund (QOF) unless they have capital gains, we believe that MDIs are well-suited to partner with other participants in the zones. For example, MDIs may offer debt financing to complement revitalization projects and local businesses that receive equity from QOFs. MDIs know these communities and can act as brokers, bringing projects to QOFs and helping to structure transactions.

To highlight the role that MDIs can play, the FDIC recently developed a website to serve as a clearinghouse of useful information for banks, investors, and opportunity fund managers. The website includes interactive maps showing the location of FDIC-insured MDIs overlaid on the zones, as well as links to comprehensive information on investment funds and state and local initiatives to complement and support economic revitalization in these communities. We plan to launch the site in the next 60 days. In addition, we developed a paper showing the roles that MDIs and other banks can play in opportunity zones.

Conclusion

Many MDIs, like the community banking sector overall, face challenges from the evolving financial services landscape. The boards and management of institutions must successfully navigate economic, technological, competitive, and regulatory circumstances to be profitable and serve their communities. For many MDIs, these challenges can be amplified if they serve economically distressed communities that do not fully recover during economic growth cycles. As the supervisor of nearly 100, or two-thirds of all MDIs nationwide, the FDIC is committed to promoting and sustaining the vibrant role these banks play in their communities. Increasing our engagement with MDIs enables us to understand their unique needs and provide tools and resources so they can help create jobs, grow small business, and build wealth in their communities. Thank you for the opportunity to testify today. I look forward to answering your questions.