Strategic Options

Private companies or philanthropic organizations can support the business needs of mission-driven banks by providing grants or making equity investments, supporting investment funds to inject capital or absorb problem loans, placing deposits, and providing technology support.

Capacity-Building Grants and Equity Investments

Private companies or philanthropic organizations could develop a grant program and invite mission-driven banks to submit proposals for building capacity and better serving their communities. Grants could increase lending or develop new products or services to benefit minority communities. Companies would develop a set of criteria to evaluate such proposals. These could include, for example, the number of jobs created from a new community development investment or the number or type of new loans generated from a new product offering.

Other types of grants could focus on improving operations, providing technical assistance, increasing development or community services, or providing more loans to consumers or small businesses. For example, companies could designate a series of grants and specify what types of lending or community investments the grants would be designed to support.

Grants would flow directly to capital, creating a multiplier effect on a bank's ability to lend to its customers. Every dollar increase to equity capital can increase lending by a multiplier of eight to ten times, depending on the bank's regulatory capital requirements. This is because federal supervisory agencies do not require banks to hold a dollar of capital for every dollar of lending. Generally, federal supervisory agencies base regulatory capital requirements on the risk of the bank's portfolio.

Companies could invite each individual MDI or CDFI bank to develop a plan for how it would use the funds, allowing the companies to evaluate each proposal based on their grant criteria and any outcome-oriented goals.

The board of the National Association of Chinese American Bankers, shown here with Betty Rudolph (center), FDIC's National Director, Minority and Community Development Banking.

Like grants, equity investments increase capital and have a significant multiplier effect on a bank's ability to lend. Generally, equity investments up to 5 percent do not trigger regulatory scrutiny. Passive non-voting equity investments are allowed in excess of 5 percent in many cases, without triggering regulatory scrutiny. Companies can combine equity investments with grants to provide even more capital to mission-driven banks. Each institution may view a proposed equity investment differently, and the company and the bank would need to consider any potential regulatory impact on a case-by-case basis.

In addition to increasing lending or building capacity, mission-driven banks could also use grants or equity investments to bolster loan loss reserves to help offset any losses due to nonperforming loans. Many mission-driven banks have restructured loans to customers affected by the COVID-19 pandemic. Depending on the speed and nature of the economic recovery, some institutions may experience significant losses on their loan portfolios.

A potential use of these grants or equity investments could be to bolster capital reserves to weather this turbulent point in the economic cycle. Equity investments or grants could help many mission-driven banks sustain their operations and provide additional lending to the LMI communities they support in the event of a protracted recession. In addition, grants could help many mission-driven banks sustain their operations and provide additional lending for their LMI customers and communities.

A grant or equity investment of $3 million to $5 million can make a big difference in an institution that is the median size of an MDI ($339 million). In addition, it is possible for companies or their MDI or CDFI bank partner to leverage the original company investment by finding a program that will match these funds. For example, the CDFI Fund requires a one-to-one match for its financial assistance awards, and reports that awardees, on average, leverage each dollar awarded with $10 of other investment. With an initial investment, mission-driven banks can leverage a company's original investment to obtain more funding through the CDFI Fund or from private investors, foundations, and others.

Creating a process to invite mission-driven banks to "pitch" their proposals is likely to be one of the most effective forms of assistance, but would inevitably take more time to implement than deposits. A company would need to create a framework for the application and evaluation process. The company would determine the complexity and depth of the application process, but a simple, streamlined process would encourage participation by limiting the burden and costs of proposal development for mission-driven banks. In addition, the company may want to hold "listening" sessions to better understand MDI and CDFI bank needs.

National Bankers Association Chairman Kenneth Kelly with FDIC Chairman Jelena McWilliams at the NBA Conference in 2019. Mr. Kelly is also Chairman and CEO of First Independence Bank in Detroit, Michigan.

Unibank

Lynnwood, Washington
Asian American MDI

UniBank's headquarters in Lynnwood, Washington.

Unibank is in the business of enabling the attainment of the "American Dream." Founded in 2006 in Lynnwood, Washington by a group of Korean American entrepreneurs who overcame cultural barriers and financial challenges, Unibank started with one goal in mind: to make it easier for other Korean immigrants and future generations to succeed in business and attain their "American Dreams."

Fourteen years later, Unibank has grown with the Korean American community in Washington. Through loan guarantee programs offered by the Small Business Administration (SBA) and the U.S. Department of Agriculture (USDA), Unibank can provide access to financing to potential borrowers, which would not have been possible through traditional commercial financing means. The bank continues to help many individuals who cannot access financing due to difficulties with language and financial understanding. Unibank makes an effort to find these individuals and then guides them every step of the way.

When the Covid-19 pandemic hit the Washington area, Unibank knew that they had to help their customers and community. Through the SBA's Paycheck Protection Program (PPP), Unibank jumped into action and started contacting small businesses that might need extra help during the pandemic. Working diligently, Unibank provided 391 loans through PPP totaling $41.4 million, with an average loan size of $106,000.

Over the years, Unibank has learned that the aspiration to succeed financially and leave a legacy for one's children is not unique to the Korean American immigration story. Unibank now has a customer base of people of other Asian descent, and those underserved in the mainstream market. In the past, the bank sought mainstream deposits to fund Korean American borrowers, and now Unibank uses funds from Korean American depositors to assist borrowers outside of this community.

Unibank is a $380 million Asian American MDI headquartered in Lynnwood, Washington. It is the only bank based in the Pacific Northwest that primarily serves the Asian American community. It provides commercial and retail banking services through its four branches in the Seattle-Tacoma-Bellevue metropolitan area.

Unibank provided the information used for this impact story.

Additional resources could include the FDIC's MDI advisory subcommittee, or MDI and CDFI bank trade groups (e.g., Community Development Bankers Association, National Bankers Association, National Association of Chinese American Bankers, and the Hispanic American Bankers Association).

Investment Funds

An economic downturn can have a significant impact on the asset quality and earnings of mission-driven banks. In the wake of the COVID-19 pandemic and the ensuing recession, many mission-driven banks are likely to experience a significant uptick in credit losses. Companies, philanthropic organizations, and larger banks could collaborate in creating an investment fund that could channel investors' funds through capital injections into mission-driven banks, to help the banks absorb losses during a period of economic turmoil, preserve capital, or support new lending. An investment fund also could provide other financial support for mission-driven banks, including participations in bank loans, purchase of nonperforming assets, structured transactions, or direct grants.

Companies, philanthropic organizations, and larger banks could capitalize the fund with their own performing assets, cash, or an equity stake. The fund's investment decisions could be managed by an investment committee made up of independent advisors, trustees, and investor representatives. An investment advisor could set up the fund to:

- Maximize the benefits to the mission-driven banks and the communities they serve by providing capital preservation and growth;
- Return principal to investors without harming mission-driven banks' capital positions;
- Provide investors a minimal return on investments;
- Maintain the passive nature of investments;
- Maintain the simplicity of the arrangements;
- Minimize setup and operational costs; and
- Focus on the mission-driven banks most in need of support.

Creating a Financial System of Inclusion and Belonging

"The FDIC has embraced our statutory responsibility to promote and preserve the health of MDIs by seeking new and innovative ways to engage with these institutions and better understand their needs. We do, however, recognize that we can do more, and 'more' in this case will require us to think outside the box.

"One of the options we are exploring to support MDIs and CDFI banks is a framework that would match these banks with investors interested in the particular challenges and opportunities facing those institutions and their communities.

"Although we are still developing the details, the idea would include a vehicle through which investors' funds would be channeled to make investments in or with MDIs and CDFIs, including direct equity, structured transactions, funding commitments to loan participations, or potential loss-share arrangements.

"This initiative seeks to accomplish several objectives, including maximizing the benefits to MDIs and the communities they serve by providing capital preservation and growth, as well as providing a minimal return to investors. We expect to release more information in the near future, and we will continue to work with stakeholders on how best to proceed."

FDIC Chairman Jelena McWilliams
The University of Chicago Law School and American Financial Exchange Webinar
August 26, 2020

Direct investments, such as through non-voting preferred stock, have the benefit of increasing capital and permitting banks to increase lending or preserve capital.

Purchasing troubled assets from mission-driven banks at a discount and managing them, structuring transactions, or liquidating troubled assets over time can help mission-driven banks move assets off their books, reduce losses they might otherwise experience, and redeploy the proceeds into new earning assets. Carrying troubled assets on the balance sheet results in additional expenses. In addition, earnings decline with additional provisions to the allowance for loan and lease losses that are needed to absorb estimated credit losses for the troubled assets. For example, legal costs often accompany foreclosing on real estate property. Institutions must maintain and protect this real estate to maximize potential recovery values. Managing this real estate brings about additional costs such as maintenance, tax, insurance, and other miscellaneous expenses, further reducing earnings. The investment fund could provide additional time to work assets and sell them to maximize their economic value and yield a profit for the investors.

Loan participations enable mission-driven banks to diversify their balance sheets and offer an opportunity for bank investors in the investment fund to expand their support for underserved communities. Direct grants, while not offering a return, can enable investors to target a particular need or area of interest, and could be funded by reinvestments of profits from other fund investments.

Bank investors can also potentially earn credit under the Community Reinvestment Act (CRA)[2] for activities related to an investment fund.

Deposits

Private companies, philanthropic organizations, or other banks can place deposits into mission-driven banks fairly quickly, providing an immediate benefit to the recipient institution. Corporations or philanthropic organizations can also place deposits through a service to spread a large amount of deposits automatically in increments of $250,000 per institution to ensure FDIC deposit insurance coverage. Deposits placed in insured financial institutions also provide some return based on rates set by each institution.

Mission-driven banks benefit from a stable deposit base, and longer-term deposits enable institutions to match lending opportunities based on deposit maturities. Mission-driven banks have different business models and strategic plans, however, and not all of these institutions are necessarily seeking deposits. A large influx of deposits can increase a bank's assets, resulting in the need to seek additional capital or to reduce lending to comply with regulatory capital requirements.

[2]The Community Reinvestment Act is a federal law enacted in 1977 to encourage depository institutions to meet the credit needs of LMI neighborhoods. The CRA requires federal supervisory agencies to assess how well each bank fulfills its obligations to these LMI communities. This information is used to evaluate applications for future approval of bank mergers, acquisitions, charters, branch openings, and deposit facilities.

Companies also could consider making larger deposits, although they might want to consult with individual MDIs and CDFI banks on amounts, as some institutions may not desire additional deposits if they would have a material effect on capital.

Technology Support

Many mission-driven banks would welcome a collaborative effort to bring together resources and capacity to consider innovative technology solutions, such as developing cutting-edge tools to manage their operations or more easily reach existing or new customers. This could be as simple as sharing technology to support mortgage origination, servicing, or support, or sharing compliance systems to support anti-money laundering activities. Another way to collaborate with mission-driven banks could be to partner on the development of customer-facing tools for online account openings and other applications to facilitate safe, affordable, and accessible banking.

This strategic option would require greater resources and time commitments to determine common needs and to agree on requirements that could support multiple institutions with varying needs. This support could also be provided to MDIs or CDFI banks that successfully compete for a company's grant or equity investment.

Other Partnership Opportunities

Many additional opportunities exist for larger banks, private companies, or philanthropic organizations to partner with mission-driven banks. These opportunities may be driven by the underlying business of the partnering company. For example, merchant services providers, including larger banks, could offer "white-label" products[3] such as credit and debit cards and other payment mechanisms. Mission-driven banks can benefit by rebranding such products for their own customers, and the providers can benefit by expanding their volume. Technology companies offering hardware, software, or other products and services could partner with mission-driven banks and their communities to support local businesses or institutions such as schools. The range of possibilities for these types of partnerships is considerable.

[3]White-label products are sold by companies or financial institutions with their own branding and logo, but the products themselves are manufactured by a third party.