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On Behalf of both First Independence Bank and the National Bankers Association

Before the House Financial Services Subcommittee on Consumer Protection and Financial Institutions

"An Examination of the Decline of Minority Depository Institutions and the Impact on Underserved Communities."

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Chairman Meeks, Ranking Member Luetkemeyer, Chairwoman Waters, Ranking Member McHenry, and members of the Subcommittee, good afternoon and thank you for this opportunity to testify on the causes of the decline of Minority Depository Institutions or "MDIs" and its impact on underserved communities and the consumers and small businesses that depend on our institutions.

I am Kenneth Kelly, and I serve as the Chairman and Chief Executive Officer of First Independence Bank ("First Independence"). First Independence opened its doors in May 1970, and is now a $272-million bank. We are one of only two banks headquarted in Detroit, Michigan, and we are the only African American-owned bank in Michigan. First Independence is also a Community Development Financial Institution or "CDFI", where a significant amount of our activity takes place in LMI communities throughout metro Detroit. While our designation as an MDI and a CDFI affirms our mission-driven focus on LMI communities throughout metro Detroit, in acting as a bank of first and last resort for Detroiters and Michganders, our bank faces a number of challenges unique to institutions like ours that intentionally bank communities that many financial institutions choose not to.

We are a relatively small institution, so we are particularly sensitive to any regulatory changes in Washington because we have to cover additional compliance costs across a smaller asset base. We are a mission-driven financial institution, so we intentionally bank in lower and moderate-income communities and the businesses and the institutions that serve them which is often costlier. Because of the communities we serve, we're often at odds with examiners who don't always understand our banks. We also have to navigate an investor community that doesn't always see the value of our institutions.[1] These are all challenges in addition to the normal marketplace challenges that every financial institution faces, and yet, First Independence remains – like so many MDIs – the bank of first and last resort for the communities we serve.

Many of our MDIs are in crisis. The number of minority-owned banks has declined dramatically in recent years. In 2008, there were approximately 215 MDIs; ten years after the crisis, there were 149 – a 30% decrease.[2] For African-American owned banks, the decline was much worse going from 42 banks during the same time period to 26.[3] Spotty profitability, higher compliance costs, a constantly evolving regulatory environment, low interest rates, and less-than-optimal loan demand have created an operating environment for many MDIs that make operating profitably incredibly difficult. All of these circumstances notwithstanding, we believe that Congress can be a partner in helping to provide targeted relief and support that can help our institutions better meet the credit needs of the communities we serve.

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[1] *See generally*, Robin Newberger, "Capital-raising among minority-owned banks before and after the financial crisis." (2018). Available at: https://www.chicagofed.org/publications/profitwise-news-and-views/2018/capital-raising-among-minority-owned-banks-before-and-after-the-financial-crisis.
[2] *Id. See also*, the Independent Community Bankers Association, "Minority Banks", https://www.icba.org/advocacy/industry-issues/minority-banks (Accessed October 21, 2019).
[3] *Id.*

<u>There is broad diversity within the MDI sector with African-American-owned banks encountering the most difficulty.</u>

Like every other segment of the banking community, there is broad diversity *within* the MDI sector – in terms of business models, market service areas, size, profitability, and performance with clear patterns across and within each of the five ethnic groups used by federal banking regulators to classify MDI ownership (African American, Asian, Hispanic, Native American, and other). Understanding the heterogeneity within the MDI sector and the drivers of MDI performance are important in helping Congress develop policy interventions that are comprehensive and responsive to diverse needs of MDIs.

- **<u>The post-crisis decline of MDIs was significant across ethnic groups:</u>** According to the Federal Reserve Bank of Chicago, the average failure rate of MDIs from 2008 to 2015 was 2.4 percent compared with less than 1 percent for nonminority banks. The average annual failure rate for African American, Hispanic, and Asian-owned banks were 4.5%, 2.7%, and 1.9%, respectively in the seven-year period following the financial crisis.[4]

- **<u>MDI earnings have been underwhelming since the financial crisis:</u>** Hispanic-owned banks posted notable losses from 2008 to 2010 (ranging between 2 percent and 3 percent of risk-weighted assets) with African-American owned banks posting losses of about 1% of assets, and between 0.5% and 1% for Asian-owned banks. Native American-owned banks had slight profits in 2008 and 2010. Since 2010, on average, African American-owned banks have posted losses in *every year* after 2010. Hispanic- and Asian-owned banks did, fortunately, report positive earnings in each year between 2011 and 2016.[5]

- **<u>Capital-raising activity has taken a similar pattern within the MDI sector:</u>** Retained earnings at Asian-owned banks contributed to a larger share of new equity than all community banks, and Asian-owned banks were disproportionately represented in the sale of common stock post-crisis. African American-owned banks as a group retained no income every year from 2007 to 2016. Hispanic-owned banks were far less active in capital markets transactions relative to other MDIs during the same study period further underscoring the diversity of the MDI sector.[6]

The reasons for the divergences in performance, profitability and capital-raising activity run the gamut, but the key takeaway for Congress and federal regulators is that any efforts to support MDIs must be comprehensive and reflect the sector's diversity and the unique challenges facing many of our institutions – particularly African-American owned banks that have fared worse relative to other MDIs since the financial crisis and have had a more difficult time recovering post-crisis.

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[4] Maude Toussaint-Comeau, Robin Newberger, "Minority-Owned Banks and Their Primary Local Market Areas." (2017). Available at: https://www.chicagofed.org/publications/economic-perspectives/2017/4.
[5] Robin Newberger, "Capital-raising among minority-owned banks before and after the financial crisis." (2018). Available at: https://www.chicagofed.org/publications/profitwise-news-and-views/2018/capital-raising-among-minority-owned-banks-before-and-after-the-financial-crisis
[6] *Id.*

<u>Raising capital remains the most difficult challenge for MDIs, and meaningful support for MDIs must prioritize helping MDIs raise capital.</u>

The lifeblood of every financial institution is their ability to raise capital, and in the view of many of our member institutions, the difficulty that we encounter in the marketplace with investors directly contributes to our restricted ability to meet the credit needs of the communities we serve.

As we noted in previous testimony before the Oversight and Investigations Subcommittee this Congress, Congress should strongly consider a mix of capital-access or capital-injection programs, expanding the technical financial assistance available to our institutions through agencies like the Community Development Financial Institutions Fund, and bolster public deposit programs.

With respect to capital infusions, we view the Community Reinvestment Act and the Investing in Opportunity Act as potential opportunities that Congress should consider now to encourage equity investments in our institutions.

- **<u>The Community Reinvestment Act:</u>** While various forms of majority depository institution investments in MDIs are already generally CRA-qualified, the types of investments that our institutions need – preferred and non-voting common stock purchases – receive the same treatment as other types of MDI investments like loan participations despite having far less significant impact on MDIs. **Congress should amend Section 2903(b) of the Community Reinvestment Act such that majority institutions automatically receive positive CRA consideration for equity investments in MDIs. Congress should also instruct federal regulators to consider a "tiered" approach to CRA credit awarding enhanced CRA credit for equity investments in MDIs relative to other forms of CRA-motivated engagement between MDIs and non-MDIs. Doing so sends a clear signal to CRA officers at both MDIs and majority depository institutions that regulators are seeking to prioritize equity investments over other forms of CRA activity and gives MDIs a compelling and familiar tool to bring to bank investors in addition to traditional metrics that banks use to make investment decisions.**

- **<u>The Investing in Opportunity Act:</u>** While we understand that the Investing in Opportunity Act is outside the Financial Services Committee's jurisdiction, we believe that the Investing in Opportunity Act provides an opportunity to help alleviate the capital-raising challenges of MDIs. MDIs are already doing the kind of lending activity in LMI communities and communities that have been designated as "Opportunity Zones" pursuant to the Investing in Opportunity Act. Unfortunately, in an oversight during the drafting of the Investing in Opportunity Act, MDIs and CDFIs were lumped in with all other financial institutions and excluded from being designated as Qualified Opportunity Zone Businesses. Several MDIs have branches in Opportunity Zones and long-standing -- and often extensive -- relationships and experience lending in Opportunity Zone communities. We believe that the impact of the Opportunity Zones program could be amplified if eligible equity investments are allowed into MDIs and/or CDFIs. Nearly 60% of the activity of CDFIs takes place in LMI census tracts, so leveraging the Investing in Opportunity Act to push more equity investments into our CDFIs and/or MDIs better ensures that Opportunity Zone investments actually benefit the communities the law was originally intended to benefit. **Congress should amend Section 1400Z-2 of the Investing in Opportunity Act such that MDI-CDFIs are eligible for equity investments from Qualified Opportunity Funds.**

<u>There are a number of other steps Congress can take now to support MDIs.</u>

In addition to better leveraging the Community Reinvestment Act and the Investing in Opportunity Act to encourage equity investments in MDIs, Congress can also take a number of additional steps to support MDIs, including:

- Lowering the barriers to participation in the Minority Bank Deposit Program and encouraging more agency participation in the Program;

- Requiring that financial institutions acting as Financial Agents to the Treasury Department participate in Treasury's Financial Agent Mentor Protégé Program and partner with MDIs with assets under $1 billion;

- Expanding the annual appropriations to the CDFI Fund to support funding for programs like the Bank Enterprise Award and Technical Assistance programs;

- Reforming the New Markets Tax Credits programs allocation process so that Community Development Entities affiliated with MDIs have a fairer opportunity for securing allocations;

- Modernizing the Federal Deposit Insurance Act's approach toward brokered deposits making it easier for smaller MDIs to have access to a more diverse base of stable deposits;

- Urging the CFPB's reporting pursuant to the Improving Access to Traditional Banking Act to include the creation of a fund within Treasury for MDIs for financial literary and the development of alternatives to predatory, high-cost lending products;

- Exempting MDIs and CDFIs under $3 billion from the Bank Holding Company Act's change-of-control provisions which will allow for encouraging a larger pool of investors in our institutions;

- Creating an investment tax credit for acquiring preferred shares or non-voting common shares in MDIs;

- Further simplifying capital ratios for community banks;

- Streamlining BSA and AML reporting and call form reporting for institutions below $1 billion; and,

- Amending Section 308 of FIRREA requiring that regulators conduct impact analysis of any significant regulatory developments on MDIs.

CONCLUSION

We applaud Chairman Meeks and the leadership of this Subcommittee for this hearing. On behalf of the National Bankers Association, we are appreciative of Chairman Meeks' original sponsorship of the draft discussion that contains many of the recommendations above, and his long-standing advocacy on behalf of the country's MDIs.

While the trends regarding many of our MDIs are concerning, we firmly believe that policy interventions that represent the right mix of access to business opportunities at the federal level, incentives for equity investments in our banks, and targeted regulatory relief present a historic opportunity for Congress to provide support to the country's MDIs.

I look forward to answering any questions.