Remarks by

John P. LaWare

Member, Board of Governors of the

Federal Reserve System

at the

1991 Annual Community Reinvestment Forum

of the

Federal Reserve Bank of Cleveland

Cleveland, Ohio

September 20, 1991

Good morning, ladies and gentlemen. I am delighted to be with you today under the auspices of the Federal Reserve Bank of Cleveland to discuss the relationship between community reinvestment by banks and the stability, economic vitality, and development of the community. The relationship is strong and direct, and no matter how onerous compliance may be to bankers, I would argue that it is good business which will serve well the best interests of shareholders as well as depositors.

The Community Reinvestment Act was chiefly sponsored in the Congress by Senator William Proxmire of Wisconsin. The Senator's principal concern was inner-city housing and the desirability of making home ownership a realizable dream for minorities and low-income groups. To this end the Act requires banks to define the community which they serve, determine the credit needs of the community, describe the services they are prepared to offer in the community, and market those services actively. The rationale

for the legislation is that banks which enjoy the special status and privileges granted them by government and which derive a portion of their deposit base from a definable community have a moral responsibility to that community to try to meet its legitimate credit needs.

While the original thrust of CRA was aimed at making mortgage credit more available to minorities and low-income groups, it soon became apparent that credit, broadly defined, is a key ingredient in making a viable economy for any community. Mortgage loans, consumer installment loans for all purposes, small business loans, and even industrial loans all play a role in stabilizing a community, and the logical source of these credits is the banking industry which draws at least part of its deposit resources from that community. Community Re investment, then, is the re-deployment of deposits by the banks back into the community from which they are drawn in the form of loans of all kinds.

CRA is not about charity. A bank which attempts to comply with CRA requirements with a generous charitable contributions budget will be in for a rude surprise when they are graded "needs to improve" or "substantially not in compliance." Nor is CRA about making bad loans.

CRA is about using the basic business of banking -- that is, making loans -- to address the legitimate credit needs of a community. To do it right a bank must be prepared to put in

place the necessary talent to analyze the market and design the products which will satisfy market needs. Sounds familiar, doesn't it, because that is what banks do all the time. But, this effort is more focused and needs special skills. The community banker, or "street banker" as he is referred to in the inner city, is like the postman or the cop on the beat. He knows his territory intimately. He makes a point of knowing the people and their organizations. He knows what their needs are and what their capacities are. Most important of all, he knows how to adapt the capabilities of his bank to the needs of his customers.

Organizing for this kind of an effort is crucial. It must be organized from the top down. To be successful a bank's community reinvestment program must have the support and commitment of the board of directors and the chief executive officer. And not token support either. The board must approve the allocation of resources and monitor management performance in executing their commitment. The CEO has to lead the charge by personal involvement in community affairs and by communicating his and the board's commitment and expectations to the lending officers who must make it all happen.

Board involvement is a year-around proposition, not a once-a-year event. Many banks have assured continuous involvement by forming a committee of the board for community affairs. Ideally, directors chosen for such an assignment should be enthusiastic about the program and involved themselves in community affairs.

Whether or not a board committee is formed, the board should receive regular full reports on how the CRA program is going. And not just the success stories, either. Mistakes in these programs can often be valuable experiences leading to successes in the future.

My own experience at Chemical Bank in New York 24 years ago -- ten years before CRA -- is a case worth reviewing briefly.

In the late 1960's, we at Chemical had an ever-growing charitable contributions budget dispersed to a vast number of worthy agencies which left us all with a warm feeling, but no way to really measure to our satisfaction what we were doing to attack the multitude of problems which faced the city. We reasoned that if the community could not be stabilized it would continue to deteriorate and the health of the community was important to the health and prosperity of the bank which depended on it. We decided that credit extension was the most powerful weapon we had to fight decay and despondency. But we didn't know where to start. Our buttoned-down white-collar bankers had no experience in Harlem, or Hell's Kitchen, the Bowery, or Bedford-Stuyvesant. They were more comfortable in corporate executive suites or with the merchants and residents along Fifth Avenue and Fifty-Seventh Street.

However, circumstances offered an opportunity. At that time in the late Sixties, we were recruiting management trainees from colleges and graduate schools who had a highly developed sense of

social responsibility and were anxious to make a personal commitment to any program of the bank that addressed social issues. We gave them the opportunity to be street bankers for a couple of years and, as it turned out, we had more applicants than jobs available. We sent these young men and women to search out responsible community organizations and projects where we could use our lending power prudently to finance legitimate needs.

As a first step, we decided to adopt a rifle approach to our program rather than scatter shots all over the city. Our first target was East Harlem -- that area of Manhattan between 96th Street and 125th Street and Park Avenue and the East River. Our street bankers literally walked the streets getting the feel of conditions, taking inventory of businesses and housing and analyzing the ethnic mix of the community. Then they systematically called on and got to know the agencies and informal community groups who were trying to deal with community problems. They compared notes, examined projects, and eventually developed a list of agencies and community groups whom they felt we could work with with confidence. Many of these agencies and community groups were living hand-to-mouth existences because, like all grant-supported groups, their cash flow was very uneven. Our street bankers worked with these groups to develop budgets based on expected cash flows and then provided direct assistance by lending to them on a monthly drawdown basis against an assignment of grant proceeds. This helped to stabilize the agency functions and enabled them to plan ahead more effectively.

And it was one of the first uses of credit extension to help stabilize the community.

Once these new relationships were established a sweat-equity rehab program was initiated. The agencies we worked with pre-screened loan applications and helped us to find borrowers who had the characteristics to stay with the program. The agencies became our partners in assuring the quality of the loans we made and to my recollection our losses in those programs were nominal.

This pattern of thoroughly studying the community and its needs and then moving in partnership with community agencies was used repeatedly and with good results. In combination with a MESBIC which supplied venture equity, we provided working capital to a minority owned and operated fast food store at the corner of 2nd Avenue and 96th Street. The loan was paid, although it had to be restructured, and the last time I drove down the FDR Drive it was still there. It provided a commercial dimension to that area of the city that had been lacking before.

A more ambitious project began to take shape in the Bedford-Stuyvesant section of Brooklyn. A community activist group had become interested in an abandoned Sheffield Farms Creamery. It was an extremely well built building, still in reasonably good repair. The concept was to convert it to retail and office space in the hope of reviving commercial activity in the heart of an area of the city that then resembled Berlin in 1945. A key element in the plan was the idea of attracting a bank to the

project. Not just to finance it, but to put a branch in the building. Our initial reaction was that that was a bit much. But, we sent out our street bankers to canvass the neighborhood and we found out that there wasn't a bank within a mile of the location and many individuals and storekeepers were very anxious to have a bank nearby.

The agencies and community groups we worked with felt this project could succeed with the right backing -- so we held our breath and took the plunge. The results were remarkable. Retailers, encouraged by the backing and presence of a major bank, signed up for space in the building and some of the office space was also rented by opening day.

And that opening day was something we didn't expect. We had a line around the block waiting to open accounts. The branch was profitable almost from the first day and it served as the origination point for sweat-equity financing for neighborhood rehabs and small business loans to merchants. The final chapter in that success story was written by a Fortune 500 manufacturer whom we persuaded to take over a warehouse nearby and start a sub-assembly operation to create some jobs for semi-skilled workers. Those were the first new jobs in that part of town in years and the operation was so successful that the company expanded it several times.

I am convinced that our success with these programs at Chemical, long before any federal mandate, was due to the

specific and conspicuous support of the chief executive officer and the board of directors. Early on a public affairs committee of the board was formed and several directors who themselves were community activists were named to the committee. Their support and encouragement kept moving us forward and their wise counsel kept us from more than one mistake.

It is important to remember that none of what I described was heavy lifting. In large part, it was plain-vanilla lending, often with good collateral. But, it was specialized because you had to find loan prospects in a different way. They weren't listed in Dun & Bradstreet and very often they didn't have a balance sheet when we started out. But careful research and investigation and cultivation of partnerships with agencies and community groups enabled us to make good loans and chip away in a material sense at some of New York's most stubborn problems.

In a slightly different mode, Community Development Corporations offer an attractive medium for bank involvement. Special statutory authorization enables banks to establish CDCs as wholly owned subsidiaries and they can engage in activities otherwise forbidden to banks because they are channels for community reinvestment. Such activities include real estate ownership, development, and management. Obviously, this is not intended as a loophole in the banking laws and the public benefits in such activities must be clearly demonstrable. Particularly desirable benefits would be low- and moderate-income

housing, small business development, and projects which would create new jobs for low- and moderate-income persons.

CDCs have access to government and foundation funding which act as enhancements to make banks' participation feasible. Banc One in Columbus has a for profit CDC for use as a vehicle by all of Banc One's bank subsidiaries. It has very successfully financed and made equity investments in housing projects in Ohio, Indiana, and Wisconsin.

But, CDCs are not restricted to urban activities. The McCreary County Community Development Corporation -- established by McCreary Bancshares, Inc. in Whitly City, Kentucky -- was founded to promote industrial development in McCreary County which is in an economically distressed area. The goal is job creation and economic development in a rural area rather than the inner city.

Another proven approach is the creation of lending consortia where several banks jointly develop financing typically for affordable housing or small business loans. In this way, community knowledge and experience of several institutions can be combined for mutual advantage.

I hope these remarks this morning have persuaded you that community reinvestment can make a difference and that it can be very good business. It is not high tech, but it is highly specialized. And to earn good marks from the compliance

examiners every step in the process must be carefully documented including the involvement of the CEO and the board.

CRA is here to stay and so is public disclosure of CRA ratings. Disclosure was a worry because many banks thought ratings would be confused with safety and soundness. For the most part, disclosure has gone smoothly and anxiety has diminished as results show that banks are largely in compliance. The Federal Reserve has completed compliance exams on 666 state-chartered member banks to date. 10.2 percent have been rated outstanding and 80.8 percent are rated satisfactory. 8 percent received a needs-to-improve rating and only one percent were graded as being substantially not in compliance. I think that rating distribution is about what I would expect because I believe making loans back into the community from which bankers draw deposits is a natural phenomenon and good business. Close attention to the process and proper documentation are the key to satisfactory or better ratings.

Thank you for letting me share my views and some experiences which I think support the view that community reinvestment is important to community stability and development.