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*Communities and Banking* seeks to further the practice of community and economic development by exploring effective ways for lenders to work with public, private, and nonprofit sector entities toward proactive compliance with the Community Reinvestment Act.

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## ***Insurance Industry Reinvestment: The Massachusetts Experience***

On August 10, 1998, a broad coalition of community groups witnessed the conclusion of an eight-year effort as the Governor of Massachusetts signed into law a bill directing the state's insurance industry to create two community development investment initiatives of approximately \$100 million each. The "Act Insuring Community Investment and the Equitable Taxation of Insurance Companies in Massachusetts" focuses on the potential to use insurance industry dollars for suitable investments in low- and moderate-income communities.

Under the law, state-based insurance companies must help capitalize the two investment initiatives in order to benefit from major new tax reform, a long-desired goal of the Massachusetts life insurance and property and casualty insurance companies. The law also provides tax incentives for out of state insurance companies to invest in the initiatives. As a result, as much as \$200 million will be invested in affordable housing, small and minority-owned businesses, job-creating projects, and community health centers. This legislative mandate is the first in the nation directing insurance companies to invest in low- and moderate-income communities; banks have been required to do so since the passage of the 1977 Community Reinvestment Act (CRA).

### **Why Insurance Companies?**

Since the passage of the federal CRA, banks have long been required to help meet the credit needs of low- and moderate-income neighborhoods within their communities. However, the CRA only applies to banks and not to other financial services providers, such as insurance companies.

The passage of the recent legislation in Massachusetts may be the beginning of a broader movement, reflecting the tremendous changes in the financial services industry. Already the financial services sector has begun to consolidate and the distinctions between the various providers have begun to blur. Many banks are now selling insurance; insurance companies are offering checking accounts and buying thrifts; families are using mutual funds as savings accounts; and so forth. Meanwhile, home buyers, real estate developers, and business owners are seeking capital from a vast array of often very sophisticated sources including, but not limited to, banks. Indeed, as banks have become more and more active in the community development arena, they have also become smaller players within the overall financial services industry. Simultaneously, non-bank financial services providers are becoming more involved with community development activity.



There are several rationales for increased insurer involvement in community reinvestment and economic development. First, there is genuine interest on the part of insurance companies to be better corporate citizens within the markets they serve. Second, insurance companies view the current situation as an opportunity to help influence the current policy debate and the course of legislative initiatives. At present there are a number of initiatives in Illinois, Texas, Washington, and other states which resemble the

Massachusetts insurance reinvestment legislation. In California, the insurance industry responded to a potential legislative mandate by joining a cooperative effort with both community advocates and state insurance regulators. The California Organized Investment Network (COIN) identifies investment opportunities focused on community development and seeks to match insurance companies with these investment opportunities through publications and committees. "The Massachusetts experience," notes Michael Gunning, Director of COIN, "placed a bookend on the issue. COIN is a more voluntary approach, while the Massachusetts initiative offers the industry a carrot, in this case tax relief."

Third, insurance companies benefit from seeking out profitable alternative investment opportunities. As large institutional investors, insurers have often overlooked the potential of community development investments. In general, the industry has claimed that community development investments were usually too small in scale, not rated, too risky, and failed to provide adequate returns. In addition, the insurance industry often observed that nationally adopted regulatory requirements effectively prohibited community development investments on the basis that they would not qualify as "admitted assets," and therefore would be counted against certain asset and reserve accounts which insurance companies must maintain for liquidity purposes.

As Sidney W. Johnson, Executive Director of the San Francisco-based Development Fund, states, "It would be fair to say that there have been and continues to be, genuine investment opportunities targeted to low- and moderate-income communities, that fall below the radar screen of insurance companies due to the perceived risk, perceived transaction size, and perceived or real transaction complexity." Many of the ongoing efforts across the nation, are attempting to erase some of the misperceptions surrounding these types of investments. Mr. Gunning of COIN states that most of these insurer reinvestment initiatives advocate industry involvement in this field, "strictly as an alternative investment approach," adding that "you can find many safe and sound opportunities among these investments."

## The Situation in Massachusetts and Subsequent Legislation

The situation in Massachusetts began to change in 1995. News reports of the failure of insurance companies to write homeowner's policies in certain urban neighborhoods placed pressure on the Massachusetts legislature. In 1996, a new bill passed, granting financial incentives to insurance companies for writing policies in under-served communities and penalties for failure to do so. The bill also required public disclosure of geographic identification (by zip code) of the locations served by the largest 25 companies. Shortly thereafter, the legislature's Joint Committee on Insurance began taking a serious look at where insurance companies were investing throughout Massachusetts.

In the fall of 1996, the Massachusetts Affordable Housing Alliance (MAHA) and the Massachusetts Association of Community Development Corporations (MACDC) released reports that highlighted the potential for the insurance industry to invest more in low- and moderate-income neighborhoods. The MAHA research found that low- and moderate-income households paid up to 40 percent of the statewide life insurance industry's annual premiums — totaling almost \$1 billion per year, while the MACDC report found that only 5 percent of the companies selling life insurance in Massachusetts had invested in any of the 12 major financial intermediaries used to fund community development within the Commonwealth. Even those larger community development projects that would meet the insurance industry's risk, return, and reserve requirements were being ignored. For example, statewide investments in affordable housing developments accounted for less than 0.1 percent of the life insurance industry's real estate portfolio. Instead, the industry was investing in Fortune 500 companies, condominiums, office complexes, and malls. Economic development projects were not being actively sought out by insurance companies.

In March of 1997, community organizations released another report that identified over \$620 million in investment opportunities through which insurance companies could finance community development efforts such as the development and purchase of affordable housing, small business and job creation, and commercial and industrial development. The report was careful to include only profitable investment opportunities that were appropriate for insurance companies. Indeed, enough insurance companies had already made these types of investments to demonstrate that it was possible for them to do so.

Simultaneously, the insurance industry decided to make a renewed push for major tax relief legislation that had also been pending before the Massachusetts legislature for several years. It quickly became apparent that these two bills would be combined by the legislature, and a legislative precedent allowed for such a link. In 1977, the life insurance industry had obtained sizable tax relief in exchange for creating and funding the Massachusetts Capital Resource Company (MCRC), whose mission it was (and continues to be) to finance mid-size companies in high-job-growth industries such as technology. At that time, nine of the largest life insurers agreed to capitalize MCRC with \$100 million in order to obtain tax relief for the industry that amounted to \$12 million per year (in 1977 dollars).

MACDC, MAHA and the Organization for a New Equality (ONE) engaged industry leaders in serious discussions around a possible insurance industry commitment to invest in low- and moderate-income neighborhoods. While these talks did not lead to complete agreement, they did enhance mutual understanding and respect, paving the way for groundbreaking legislation. After months of debate and negotiation, the Massachusetts legislature passed the Insurance Industry Community Investment Initiative, providing for new community investment dollars and industry tax relief. With broad and bipartisan leadership, the bill was signed by the Governor on August 10, 1998.

## How the Massachusetts Model Works

The final statute was called "An Act Insuring Community Investment and the Equitable Taxation of Insurance Companies in Massachusetts" (Act). Although the Act does not follow the CRA model used by bank regulators (see the table below), it does succeed in creating two new investments pools: the Massachusetts Life Insurance Community Investment Initiative (Life Initiative) and the Massachusetts Property & Casualty Community Investment Initiative (P&C Initiative). Both initiatives will be financed through the collection of 'proportionate shares' of funds deposited by each company wishing to benefit from certain state tax cuts that will be phased in over a five-year period. (Each company's proportionate share is based on its share of the tax cut included in the bill.) These tax cuts are expected to save the Massachusetts-based insurance companies approximately \$48 million per year. However, only those companies that invest in the investment pools will be able to receive the tax cut.

"This legislation is a creative, thoughtful and strategic response to concerns raised by both community groups and the insurance industry," said Tom Callahan, Executive Director of the Massachusetts Affordable Housing Alliance. "It sets the stage for a significant infusion of capital into low- and moderate-income communities over the next several years."

### A COMPARISON

BANK CRA	MA INSURANCE INITIATIVE
<ul style="list-style-type: none"> <li>• Broad definition of investment obligation under the investment test.</li> <li>• Mandatory (affirmative obligation to invest in low- and moderate-income communities in assessment areas).</li> <li>• Decentralized. Each bank develops its own strategy.</li> <li>• Ongoing.</li> <li>• Rating system.</li> <li>• No dollar amount specified.</li> <li>• Covers lending, investments and service provision.</li> <li>• Public disclosure of each bank's activities upon examination.</li> <li>• CRA performance considered during regulatory applications.</li> </ul>	<ul style="list-style-type: none"> <li>• Specific list of "qualified investments."</li> <li>• Voluntary. Tax relief and tax credits are used as incentives.</li> <li>• Centralized. All companies participate in the same pool.</li> <li>• Money invested in pools for 5 years; funds remain for 24 years.</li> <li>• No rating system.</li> <li>• Specific investment thresholds are established for each company.</li> <li>• Applies only to investments and loans.</li> <li>• Public disclosure of each investment pool's activities.</li> <li>• No influence in regulatory applications.</li> </ul>

If every state-based company participates, each investment pool will receive \$100 million over five years (\$20 million per year). In addition, the Act establishes a 1.5 percent tax credit for each dollar invested by a company in the pool in excess of that company's proportionate share. This provides an incentive for companies to invest more than is otherwise required, and is a particularly important incentive for out-of-state companies (for example, Prudential, New York Life, Met Life, and others) which do not benefit from the state tax cut, but have a substantial market presence in the Commonwealth. If the additional tax credit is successful, it will increase the total of both investment pools beyond the \$200 million level. Both initiatives are to be implemented on a revolving basis, whereby returns on investments will be reallocated to new projects, and they are required to operate for at least 24 years.

The Act specifically requires the two initiatives to invest funds in such prudent and sound activities as the following:

- affordable housing development;
- small, minority, or women-owned businesses;
- job-generating community economic development projects; and
- community health centers.

The legislation also addresses industry concerns that un-rated investments would not count for the purposes of solvency tests administered by state insurance regulators. The Act requires all investments in the two initiatives to be considered "admitted assets" and thus duly countable. While investments can be made either directly to projects or indirectly through community development financial intermediaries, it is anticipated that most of the investments will be made through intermediaries in order to maximize efficiency and reduce possible underwriting challenges.

Each initiative is required to establish an "investment committee" to review, authorize, and act upon specific investments and to establish underwriting guidelines. Each committee must include at least two community representatives (a total of four) and must hold at least one public meeting each year in each of five regions across the state (Greater Boston and southeastern, northeastern, central, and western Massachusetts). Public disclosure is required on the investment activities, including a listing of all investments made showing the value, type, and recipient.

Although no specific timeline was set for implementing this Act, companies must deposit funds in the investment initiatives by December 31, 1999, in order to receive the tax cut for that year. Once the funds are placed in the initiatives, they must be invested in qualified investments within 12 months. In the meantime, both initiatives will establish their investment committees, select community representatives, establish underwriting guidelines, and adopt an application process.

## **Countdown to Investments in 1999**

Both the Life and P&C Initiatives are now being developed. The Massachusetts Capital Resource Company (MCRC), the company created in 1977 by nine life insurers in exchange for similar tax relief, will administer the Life Initiative. The management of MCRC and representatives of the life insurers are working to identify community representatives for the investment committee and soon will establish investment guidelines and procedures. The Life Initiative could start making investments as early as the summer of 1999.

"The life insurance industry is committed to making the new Life Insurance Community Investment Initiative as much of a success with similar impact in the affordable housing and community development arena as MCRC has had in the economic

development world," said Bill Torpey, President of MCRC. "We look forward to working closely with community groups and community intermediaries in this process, many of whom we have met over the past year."

So far, the P&C Initiative has made less progress. Unlike the life insurance industry whose nine largest companies have experience working together through MCRC, the P&C industry is composed of dozens of sizable, competing companies with no prior experience in working together on such a project. As a result, the P&C Initiative appears to be coming together more slowly.

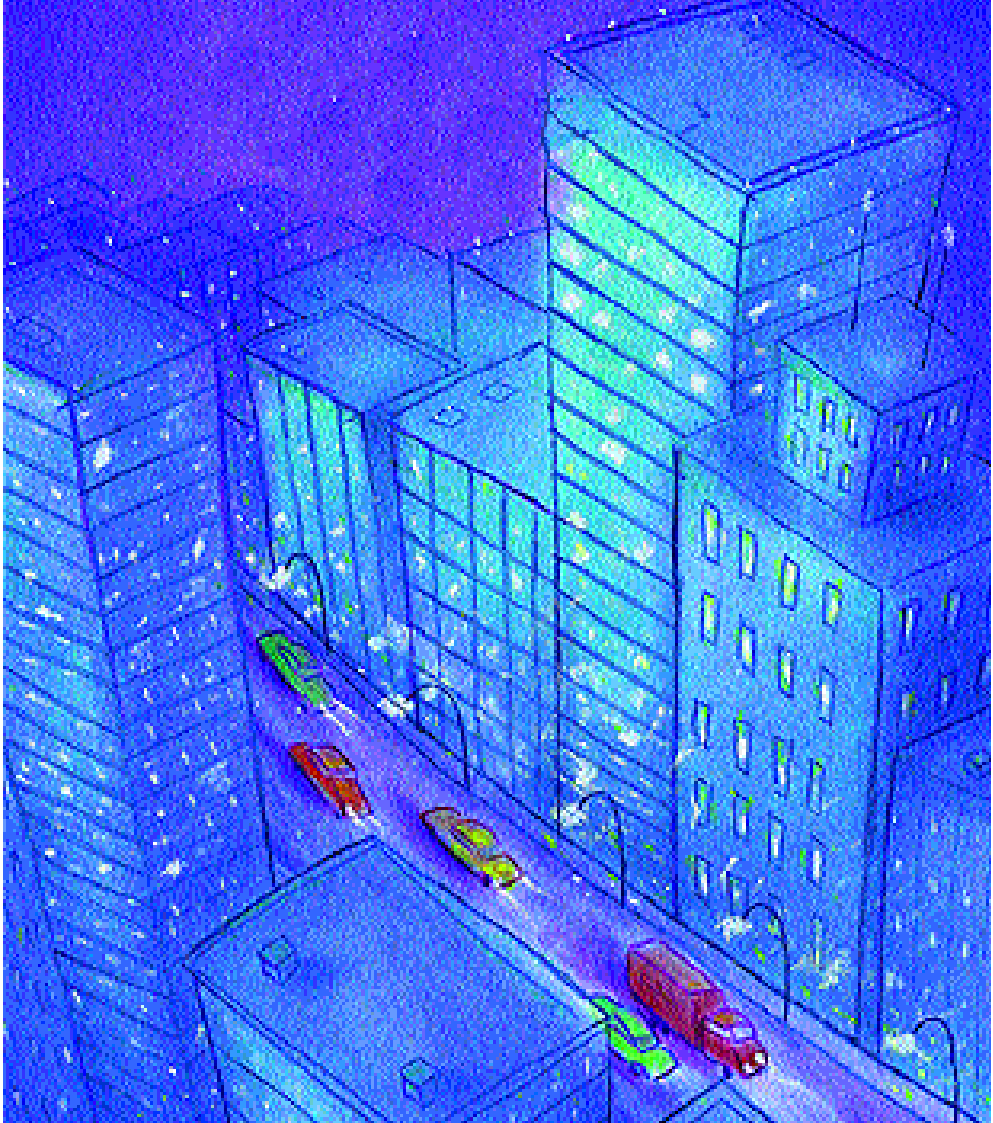
Still, it is expected that P&C insurers will follow a process similar to that of the life insurance companies and be ready to operate by the deadline.

Meanwhile, community development practitioners and financial intermediaries are beginning to develop ideas for how the funds could be invested. Some of the possibilities include:

- mortgage-backed securities backed by mortgages from the state's Soft Second program, which provides home-ownership opportunities to low- and moderate-income communities;
- low-income housing tax credits that help to finance affordable rental properties;
- equity investments to fund the redevelopment of blighted commercial properties;
- community development finance institutions that provide debt and equity financing for low-income, minority and women-owned businesses; and
- capital improvements for community health centers.

## Lessons and Challenges

While neither the insurance industry nor the community groups consider the Act to be perfect, both sides appear to be supportive. Community groups had to give up their goals of establishing an affirmative obligation to invest and a public rating system. In exchange, they won a simpler, faster process that provides significant investment capital right away. While industry leaders had hoped to pass a tax relief bill with no investment strings attached, they are pleased that the investment initiative is voluntary, focused on prudent investments rather than philanthropy, and limited in terms of time and size. Indeed, during the final days of the past legislative session, with passage of the bill in doubt, community groups and industry leaders were able to reach a agreement



on most of the key issues. These agreements eased the task of legislators and eventually paved the way for passage of a bill that everyone could accept.

The experiences in both Massachusetts and California highlight the economic development challenges brought on by the fast-paced consolidation of the financial services industry, as banks continue to lose their dominance through disintermediation. "If the CRA is not protected and eventually extended to other segments of the financial services industry, then community reinvestment and fair lending regulation will become less and less helpful to both low-income and minority communities," notes Marc Draisen, President and CEO of MACDC. This challenge is made more difficult by the fact that insurance companies are currently regulated solely at the state level. While states have the authority to regulate, most use guidelines written by the National Association of Insurance Commissioners (NAIC), which has no federal regulatory power and is therefore not accountable or accessible to the public. Conversely, most insurance companies operate on a national basis. This makes it very difficult for any one state to adopt regulations that are inconsistent with the NAIC framework, which tends to discourage community-based investments because they are usually small and not rated.

Despite the obstacles, other state legislatures are moving to address this issue. And the insurance industry is also becoming more proactive in this regard. Recently, insurance industry leaders in California formed IMPACT Community Capital LLC, which is owned and operated by participating insurers. IMPACT will act as a secondary market intermediary for community development investments. Given the proliferation of insurance reinvestment legislation in state legislatures across the country, it's likely that more programs similar to those in Massachusetts and California may be on the horizon.

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***\* Luxman Nathan, Federal Reserve Bank of Boston, contributed to this story.\****

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# PRODUCTIVE PARTNERSHIPS

## *Town Meets Gown: The Massachusetts University-Community Partnership*

Ivory towers. Academic islands. These are stereotypical phrases used to describe the perceived isolation and detachment of some higher education institutions in relation to their surrounding communities. While a local college or university may provide jobs and increased retail traffic for host communities, the unfortunate reality is that often-times campus boundaries separate students and faculty from neighborhood residents.

In response, some institutions have begun to seriously look at increasing their participation in community development and reinvestment. The experiences of New England colleges and universities in this field are highly varied. Some institutions have been very active in partnering with local organizations in order to address issues of mutual concern, such as crime prevention, blight removal, or affordable housing development. Other institutions have not been very successful at this type of endeavor, resulting in poor working relationships between academic and community leaders.

Until recently, there was no major initiative to help interested Massachusetts colleges and universities work with their host communities in solving common problems, harnessing mutual resources, or learning from the examples of others. However, at a statewide conference hosted by Boston College on January, 21, 1998, the Massachusetts University-Community Partnership (MUCP) was launched in response to this programmatic vacuum.



MUCP is a consortium of universities and colleges in Massachusetts convened by U.S. Senator Edward M. Kennedy in order to discuss the methods through which higher education institutions can enhance the lives of youth and families who reside in nearby communities. The conference brought together university and college presidents from throughout the state to discuss potential contributions in the areas of economic impact, neighborhood revitalization, K-12 education, health and human services, and academic outreach or outreach scholarship.

Following the January 21 meeting, the presidents of six Massachusetts universities and colleges — Boston College, Clark University, Fitchburg State College, Northeastern University, Springfield College, and University of Massachusetts-Dartmouth — agreed to serve on the steering committee of MUCP. Their representatives, together with representatives from the Federal Reserve Bank of Boston, Greater Boston YMCA, and 1 to 1: The Mass Mentoring Partnership, are working with Senator Kennedy's office to further the objectives of MUCP. In particular, the MUCP hopes to create a mechanism through which member institutions can provide technical assistance to other Massachusetts colleges and universities that would like to develop stronger community assistance programs.

## **The Value of Partnerships: The Experience of Clark University**

"The MUCP came up as an idea in Senator Kennedy's office mostly based on the example of Clark University and its connection with the community in Worcester," explains Marianna Pierce, Chief Education Counsel to Kennedy. "We started wondering what other partnerships — big and small — existed with Massachusetts colleges. As we explored, we found that many colleges have local partnerships and that MUCP could help new ones to be formed more easily."

Responding to the continued decline of the neighborhood surrounding Clark's campus, and with the hope of forging a strong relationship between the university and the local community, Clark University joined community members in the 1980s to form the University Park Neighborhood Restoration Partnership. This partnership focused on making the neighborhood a safer, more desirable place to live and work, thereby benefiting both the university and the residents of the surrounding area.

What started with attempts to improve parking and noise control has resulted in innovative programs like the University Park Campus School, a small school open only to residents of the local community. Students at the University Park Campus School benefit from the program's small size and their close interaction with teachers both in the classroom and through after-school programs. In turn, Clark education students who staff the school gain invaluable practical experience. "The partnership that we have developed with our neighbors is a good example of a true collaborative effort, where no partner dominates the relationship and everyone brings something to the table," says Jack Foley, Executive Assistant to the President at Clark.

Clark has also sponsored a number of other programs, including after-school programs, adult education, music lessons, and summer camps. They have offered a number of home-ownership incentives to get local residents to stay in the campus neighborhood and to get Clark employees to move there.

### **A Diversity of Approaches**

Aside from Clark, other members of MUCP have been developing their own community partnership programs, often focusing on educational initiatives. They welcome the creation of the MUCP as a means to help disseminate information about their approaches to community involvement and on best practices. "Our efforts to sustain and increase our college and community partnerships would be greatly enhanced by the support of MUCP," says Dale Lucy-Allen, Director of the Office of Student Volunteer Programs at Springfield College. "The statewide infrastructure, regional training, and technical assistance will increase the sharing of successful practices and enable other institutions to avoid recreating the wheel when starting their own efforts."

Springfield College's community education initiatives have already garnered much attention. One such program is the Partners Program, a nationally recognized tutoring/mentoring program that pairs students from three colleges with youth from three urban neighborhood schools for academic, social, and recreational activities. It is an example of a student-led program that works in partnership with the teachers, administrators, and families from the local public schools, as well as the Springfield Public Schools central office.

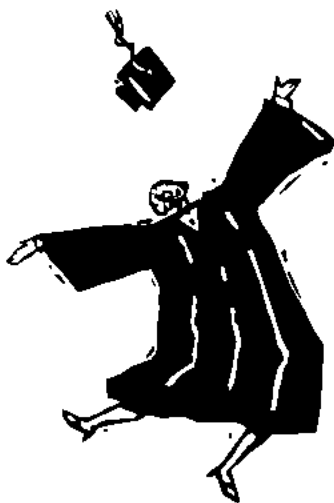
Other programs at Springfield College include the Summer Enrichment Program and America Reads. The Summer Enrichment Program, a collaborative between the Springfield Parks and Recreation Department, Springfield College, and many other com-

munity-based organizations, provides educational, cultural, recreational, and social activities to inner-city youth and families during the summer. In the America Reads project, college students utilize work-study funding to staff and provide reading assistance at neighborhood homework centers and after-school sites.

At Boston College, a number of university-community collaborations, including the Gardner Extended Services School Project (GESS) and the projects of the Center for Child, Family, and Community Partnerships (CCFCP), exemplify many of the initiatives undertaken by MUCP. CCFCP's mission is to integrate Boston College with the community in a working partnership to promote the positive development of children, youth, and families. It acts, in part, to advance faculty outreach scholarship, undergraduate and graduate training, and opportunities for service-learning by students.

GESS, an interdisciplinary and multi-agency initiative to transform the Gardner Elementary School in Boston into an extended services school, offers programs in educational enrichment for students and adults, recreation, and family services and referrals. "We have been working on this partnership for a number of years and have broad-based community support," says Mary Walsh, a professor at BC's School of Education.

"It is our goal that future projects will fit into multiple categories," says Richard M. Lerner, Director of CCFCP. "To illustrate, the Gardner Project speaks not only to K-12 education, but also to neighborhood revitalization, health and human development, and outreach." A main feature of GESS is the after-school program, which specifically integrates academic instruction with opportunities for enrichment, career exploration, youth development, and family support services.

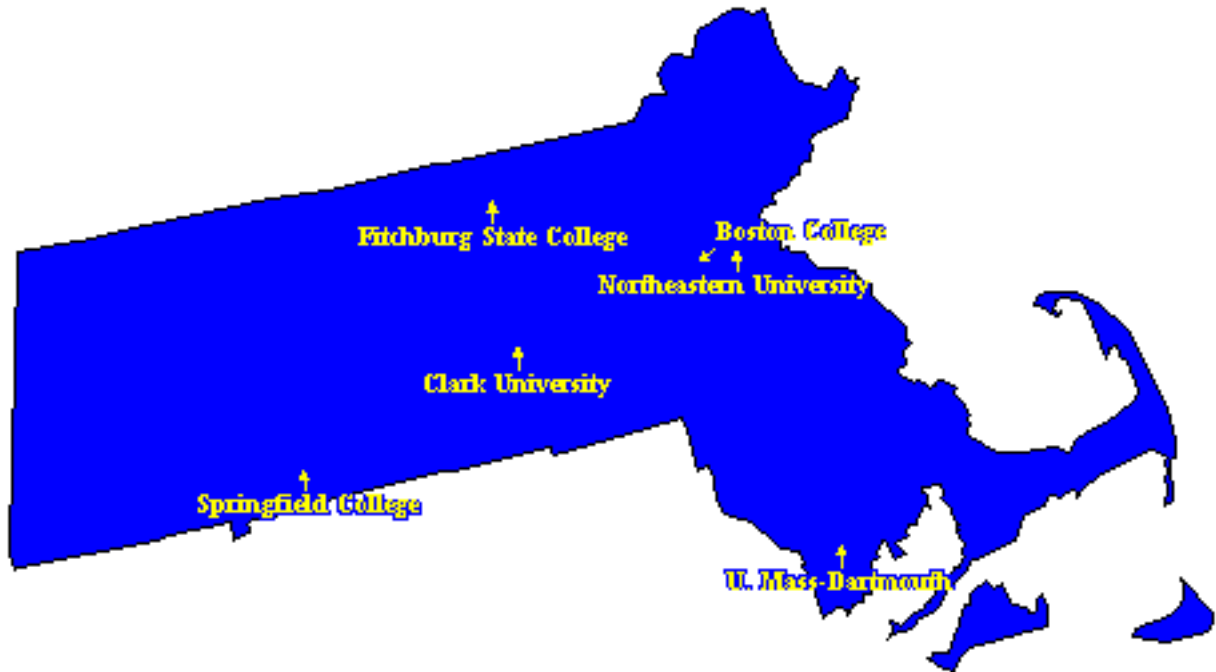


The Center for Applied Child Development at Tufts University has established collaborative projects with many public and private schools throughout the New England region. The vast majority of these projects focus on how best to include all children, including children with special needs, in productive learning experiences using differentiated instruction and sophisticated school and classroom management techniques.

According to Dr. Donald Wertlieb, Professor at the Eliot-Pearson Department of Child Development at Tufts, "These partnerships are especially gratifying, not only in that they meet the needs of teachers and administrators committed to quality education, but also [because] through these partnerships we work with hundreds of teachers, get a better grasp on their concerns to help improve our own research and, most important, together we help make a difference in the lives of many, many children."

"It is important that institutions are here for the long haul," says Tom Keady, Northeastern University's Director of Government Relations and Community Affairs. Northeastern is currently engaged in three economic development efforts. The Davenport Commons, a housing development, will have 125 units of student housing, 75 units of affordable housing, and a retail component. Student rent will help subsidize the affordable housing, with the groundbreaking expected in September 1999.

In addition, Northeastern recently acquired through auction a foreclosed property near the university's Boston campus. Now renamed Renaissance Park and undergoing renovation, the building will house tenants such as a health center and a local pharmacist, both of whom will benefit from below-market rents. A third part of Northeastern's efforts is the Merchants Academy, an entrepreneurial development institute run by Dr. Joseph Warren. Started last fall, the Academy offers classes to individuals who have the



### **MUCP Steering Committee Member Institutions**

vision and initiative to start their own businesses but lack the basic entrepreneurial training needed to get their businesses off the ground.

### **Plans for the Future**

As the above-described programs demonstrate, a number of Massachusetts universities and colleges are involved in developing and sustaining community partnerships. "But," says Lerner, " [the effort] is not coordinated across the state and as such we are missing opportunities to create economies of scale and to co-learn about best practice in such areas as dissemination or technical assistance." The goal of MUCP is to synthesize these individual experiences into a model for collaboration — the first of its kind in the nation — that could be reproduced in other states.

The MUCP steering committee, in conjunction with Senator Kennedy's office, is currently planning a new conference for Spring 1999. The conference will attempt to:

- continue to support existing university-community partnerships;
- develop a model for such support that could be reproduced regionally as well as nationally; and
- garner additional support for the ongoing activities of MUCP as they relate to technical assistance, faculty and student training (including undergraduate service learning), regional response to community issues, and enhancing knowledge about best practices.

At the same time, many of the MUCP member institutions are already beginning to provide informal technical assistance and support services to other colleges and universities interested in broadening their community participation and involvement. This work includes grantsmanship services, program evaluation methods, and network development. These and other efforts are definitely part of a growing trend among universities and colleges to become more involved in the day-to-day lives of their surrounding communities. "There certainly is an interest at the national level in colleges being partners with entities in their communities," comments Pierce. Hopefully, the MUCP will serve as a model for similar initiatives across the country.

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# ENTERPRISING

## ***Adopting Commercial Codes: Overcoming Lending Barriers on Reservations***

Imagine that you are a policy maker in a small, impoverished country, with no access to financial institutions and little available capital. You are surrounded by communities which, though not necessarily affluent, have a wide range of financial services at their disposal. Your citizens must travel to these communities in order to tap into the ever-deepening international capital markets, perhaps to obtain a small loan for home improvements or to start up a business. However, more often than not, your citizens are turned away from these outside institutions because they reside in your country. What do you do?

This is the dilemma currently facing many policy makers in Indian Country. Today, despite years of anti-poverty and social service programs, Native American reservations are still islands of poverty amidst a sea of generally more affluent rural and urban communities in the United States. In the 1990 census, 1.9 million Americans identified themselves as American Indian, Eskimo, or Aleut; One-half of this population lives on federally recognized reservations and in Aleut/Inuit communities. According to the 1990 census, unemployment among Native Americans was roughly 29.5 percent for working-age men and 21.1 percent for working-age women, compared to only 6.4 percent and 6.2 percent, respectively, for all other races in the United States. The vast majority of households live below the poverty level and approximately 32 percent of reservation residents receive some form of public assistance, compared to 7.7 percent for all U.S. residents. A major factor in explaining the persistence of poverty and joblessness on most reservations is that tribal members and tribal governments lack access to investment and loan capital for use in small business and infrastructure development.

### **Barriers to Providing Banking Services on the Reservations**

For many reservation inhabitants, acquiring even the most fundamental of banking services is a time-consuming and frustrating task. Mistrust of off-reservation financial institutions, past discrimination, and geographic remoteness are obstacles that hinder many Native Americans from accessing financial services. Those who manage to overcome these barriers and establish accounts at local banking facilities often underutilize the services provided. For a variety of reasons, they usually rely on banks only for savings accounts and check-cashing services.

For financial institutions trying to do business with these populations, frustrations can also run high. Simply arranging collateral for a loan is an insurmountable task in certain situations. Jurisdictional boundaries that impede or prohibit foreclosure, as well as the unique status of most tribal lands (see box on page 14), can exasperate even the most diligent bankers. According to the Office of the Comptroller of the Currency, "Banks ... would like to increase the volume of mortgage and other lending, to Native Americans living in Indian country. However, perfecting a security interest in a loan's underlying collateral and access to the collateral in the event of default can prove difficult." The situation has deteriorated to the point that personal family vehicles are the only potential collateral owned by much of the reservation population.

The economic and social conditions observed on reservations throughout the United States suggest a parallel to the world's transitional economies. The poverty, lack of educational opportunities, and unemployment one encounters in Indian Country support this claim. The assertion also holds when considered from a lending perspective. According to the World Bank:

[P]rivate lenders in most transition economies are reluctant to make loans when the only collateral offered is movable property held by the borrower — tractors, livestock, inventory, machinery, or, in extreme cases, cars and trucks... This difficulty in using movable property as collateral results in much presumably desirable investment going unfinanced. Capital formation is slowed, resulting in lower output and growth.

Native American reservations are "sovereign dependent" nations. As such, tribal governments are not necessarily bound by all of the same legal codes that govern the different states, including banking laws. In particular, many reservations lack the legal codes that would afford protection to banks and other financial intermediaries in tribal courts.

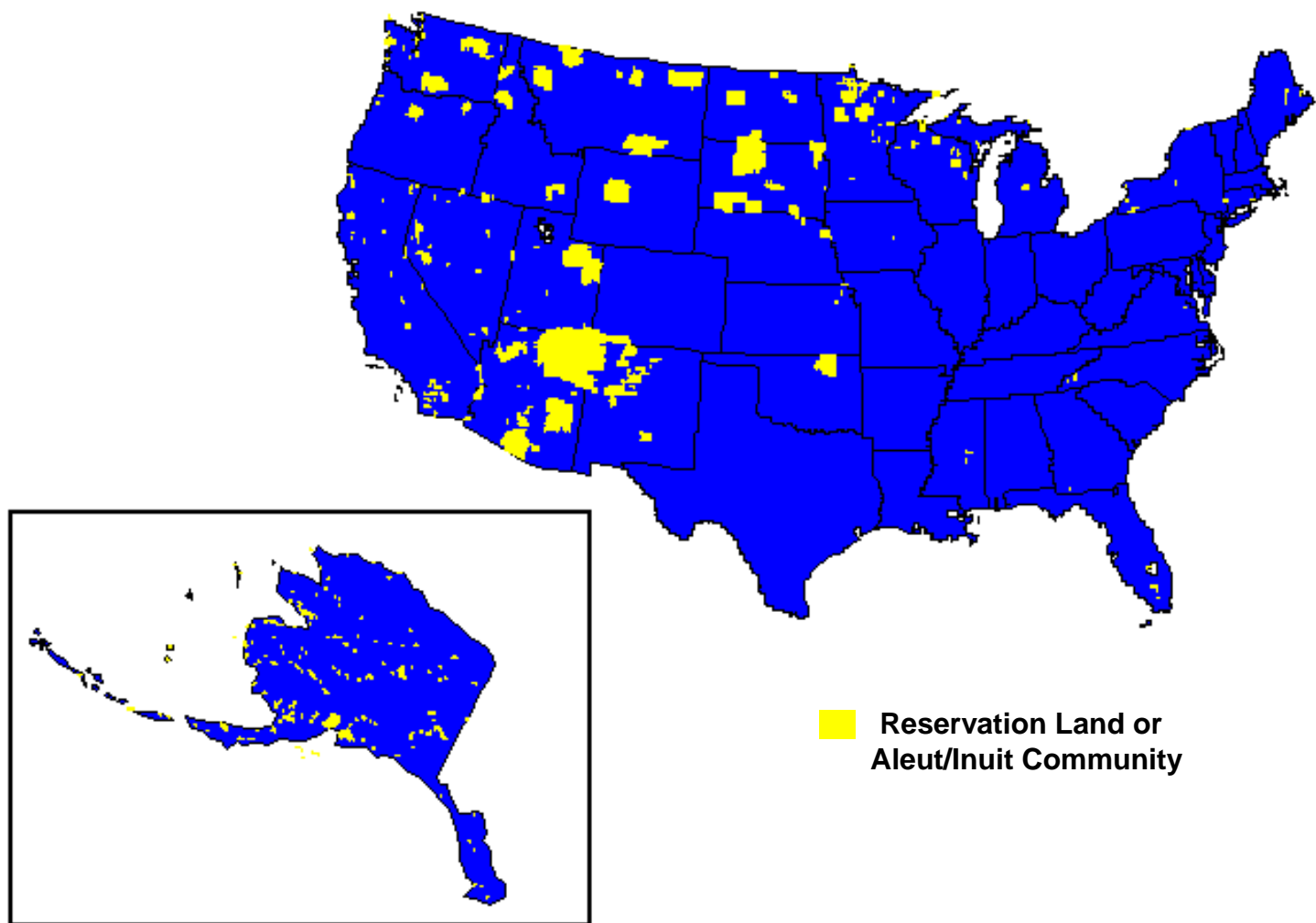
## What Are Commercial Codes?

In the United States this set of laws is known as the Uniform Commercial Code (UCC). The UCC, consisting of nine articles, was adopted in 1951 by the federal government and was subsequently adopted by forty-nine of the fifty states. (Louisiana adopted all the articles of the UCC except for Article II and Article VI.) Prior to this, each state had its own legal practices regarding commercial law. Since all the states honor similar sets of commercial law, businesses are able to conduct transactions across state borders efficiently and without concern over the enforceability of contracts or agreements.

In general, commercial codes help to standardize dispute resolution concerning secured transactions — such as lending — through provisions detailing the rights and obligations of both creditor and debtor parties, the method through which liens are executed and prioritized, and the correct procedures to be undertaken in case of default. (For a summary of the articles of the U.S. Uniform Commercial Code, please see the box on page 16.)

### Land Designation: Trust vs. Fee Land

Reservation Land is usually divided into Trust and Fee property. *Trust land* is land held in trust by the federal government, which holds the legal title, for the benefit of a tribe or an individual tribal member. Restrictions are often placed on the ability to mortgage trust land. In the event of foreclosure there are also restrictions on the transfer of title, especially to individuals who are not members of the tribe. Transactions involving trust land must be approved by the Bureau of Indian Affairs (BIA), which presents an added difficulty for lenders trying to arrange collateral for loans. In contrast, *fee land* is privately owned by either tribal members or non-members, and as such can be more readily used as collateral in the lending process.



## Federally Recognized Native American Reservations & Aleut/Inuit Communities in the Continental United States & Alaska

Thus, the UCC plays at least two roles crucial to the banking industry. First, it outlines the terms for secured transactions — those where collateral is used to help assure repayment. As such, a commercial code spells out the rights and responsibilities of lenders and borrowers who either reside in or operate firms within the designated area of a code’s jurisdiction.

In addition, the presence of formal, accepted rules reassures both creditors and debtors that the transactions they enter into are legally binding. This benefits both parties simultaneously. Creditors enjoy a reduced risk of non-payment and have legal recourse in the event of default, while debtors are protected from arbitrary or unfair collection actions.

As "sovereign dependent" nations, Native American reservations often do not have commercial codes or formal agreements to adjudicate commercial cases under the United States’ Uniform Commercial Code (US UCC). Without a formal commercial code or legal provisions to honor a federal or state UCC, reservation lending involves a tremendous amount of default risk. This deters most off-reservation banking institutions from entering reservation banking markets, and often from originating loans to Indians who reside or operate firms on reservation lands.

### Previous Development Efforts

Until recently, most tribal governments have not been concerned with adopting commercial codes. Many tribal economic development strategies have focused on the creation of large public enterprises rather than seeding an indigenous private sector through small business development. This strategy was attractive to tribal governments primarily as a means to generate jobs for unemployed and underemployed tribal mem-

## **Article I – General Provisions**

Explains the general purpose of the code, how it fits within the general body of existing laws, the jurisdictional reach of the code, and any limitations on its use or applicability. Also, terms used within the code are defined in this article.

## **Article II – Sales**

Defines and delineates the obligations of parties involved in any sales transaction, including the express provision through which a sales agreement can be terminated or cancelled, and the recourse available to parties in case of breach of the sales contract. "Sales" is defined as any transaction involving a transfer of goods.

## **Article IIa – Leases**

Details the rights and protections afforded to parties in a lease contract for either the purchase or rental of goods and services.

## **Article III – Negotiable Instruments**

Deals with all transactions carried out with a promise to pay a fixed amount of money, with or without interest or other charges described in the transaction agreement.

## **Article IV – Bank Deposits & Collections**

Regulates the relationships between banking institutions and their clients. Outlines the duties and obligations of the banking institution towards its depositors and borrowers, including provisions governing collection proceedings.

## **Article IVa – Funds Transfers**

Deals with similar issues as Article IV but with regard to electronic payments and transfer of funds.

## **Article V – Letters of Credit**

Outlines procedures for establishing letters of credit as well as remedies available to both parties involved in case of breach.

## **Article VI – Bulk Transfers & Bulk Sales**

Deals with sales and transfers that are not related to the normal business of the seller, including sales by auction, or a sale or series of sales conducted by a liquidator on the seller's behalf.

## **Article VII – Warehouse Receipts, Bills of Lading & Other Documents of Title**

Seeks to structure the rules governing the shipping and storage of goods in the normal course of business. The article outlines provisions that protect the interests of those who own the goods, those involved in the actual movement of the goods, and those to whom the goods will be delivered.

## **Article VIII – Investment Securities**

Defines the rights and obligations of those who engage in the ownership and transfer of investment securities, including provisions for tracking and registration of ownership of securities.

## **Article IX – Secured Transactions; Sales of Accounts & Chattel Paper**

Chattel paper is a document that outlines monetary obligations and security interests in a lease of specific goods. Liens are a form of chattel paper. This article specifies how governing bodies are to execute and honor such documents. Specifically, Article IX delineates the validity of secured agreements and the rights of third parties, while establishing the order of claims to collateral, procedures for filing, and mechanisms to deal with defaults.

*For the complete text of the United States Uniform Commercial Code (US UCC), please visit the website of the Legal Information Institute, Cornell School of Law at <http://www.cornell.edu/ucc/ucc.table.html>*

bers. Some tribes have been rather successful at this, most notably the Mississippi Choctaw. The Choctaw are renowned for their large, tribally owned joint ventures with companies such as Ford, AT&T and Boeing. In fact, the Mississippi Choctaw tribe is frequently cited as one the largest employers in the state of Mississippi, and the tribe often transports hundreds of non-Indian workers onto their reservation from neighboring communities.

But for the most part, large-scale tribal enterprises have not generated the revenues needed to maintain wages, invest in physical plant, and expand operations. Because of their job-creation focus, these public enterprises — which include manufacturing, resource extraction, timber, or agribusiness ventures — are usually not competitive with similar non-tribal firms. Furthermore, plant and equipment are often not maintained, owing to a lack of resources available for investment in and improvement of physical capital. For all of these reasons, tribal government-run businesses have not been viewed by off-reservation lenders as sufficient sources of collateral, diminishing the ability of tribal governments to obtain loan capital from regional banking institutions.



The focus on large tribal enterprises has also kept small business development strategies from getting the attention they deserve on many reservations. The resulting environment exhibits a dearth of revolving loan funds, technical assistance projects, and other resources to help reservation entrepreneurs. In addition, ignoring small businesses makes it difficult to attract off-reservation entrepreneurs onto the reservation.

## **Changing Economic Tides and Commercial Codes in Indian Country**

This economic situation is gradually changing, and with these changes has come increased interest in commercial codes. First, the explosion of gaming on Indian reservations has led to an increase in funds for once desperately cash-strapped tribal governments. As of December 1996, the General Accounting Office found that 184 tribes operated some 281 gaming facilities across Indian country. These facilities range from the gigantic Foxwoods Casino operated by the Mashantucket Pequot Tribe of Connecticut (located in the busy Boston-New York corridor), to modest establishments run by tribes throughout the sparsely populated western United States. These profits are increasingly used to improve roads, water and power delivery systems, and other physical infrastructure as tribes begin to seek outside investment. They are also being used to help capitalize small business and housing development loan funds.

Second, indigenous small business development is also on the rise. The numbers are modest but encouraging: The Department of Commerce estimates that Native Americans still have the lowest per capita business ownership rate of any ethnic group in the United States. Yet more and more Native American-owned businesses are being created on reservations. These new businesses benefit not only from gaming profits, but also from increased efforts by the U.S. Small Business Administration to serve reservation communities. In addition, several regional banks located near reservations have been seeking to increase their lending, investment, and service activity in once-eschewed reservation markets, in order to better comply with the Community Reinvestment Act.

While these developments seem to bode well for reservation-based economic development in general, the lack of commercial codes and other institutional infrastructure serves as a potent barrier to continued progress. Though several Indian Tribes have adopted their own commercial codes, and the number is growing, by no means do all reservations operate under independent commercial laws. Some of the most successful tribes have fashioned agreements and Memoranda of Understanding with relevant state officials to honor state UCCs and related commercial legislation. For example, the highly successful Mississippi Choctaw defer to the State of Mississippi's UCC in the



*"... there is an inherent mistrust that the White Man's laws are not meeting the needs of the Indian people. There is often a fear of the White Man's law."  
-- Gail Small,  
Director  
Native Action*

event of any commercial dispute on their reservation.

Among those tribes which have adopted commercial codes, the Blackfeet Tribe of Montana provides an interesting case study. The Blackfeet instituted a UCC specifically to assist in the establishment of a tribally owned financial institution. Their commercial code was then instrumental in helping the tribe found The Browning Bank of Browning, Montana, the first nationally-chartered financial institution owned and operated by a Native American tribe. In addition to allowing the tribe to obtain a national charter through the Office of the Comptroller of the Currency, their commercial code has become a useful tool in running the day-to-day business of the bank. The UCC aids both borrowers and bank staff by guiding management decisions and protecting the bank's customers from arbitrary legal action in cases of default.

Banks located near reservations have become increasingly active in advocating that tribes adopt commercial codes. As they attempt to enter potentially lucrative reservation banking markets, some banks and their affiliated bank foundations are working with regional law schools, Native American community groups, and the relevant state officials to better inform tribal authorities on the necessity of standardizing commercial regulation on reservations. Foremost among them is the First Interstate Bank of Montana Foundation, led by Gerald Sherman, himself a member of the Oglala Lakota Nation. Working with the Indian Law Clinic at the University of Montana (Missoula), several tribal governments, and regional banks, The First Interstate Bank Foundation has sponsored the development of commercial codes on reservations throughout that state.

Apart from their own legal counsel, tribes have other resources to aid them as they consider adopting commercial codes. The Indian Law Clinic at the University of Montana School of Law is a good example of the kinds of resources available to tribes. The Indian Law Clinic recently finished drafting the *Model Tribal Code, Secured Transactions*. By tailoring Article IX of the Uniform Commercial Code to meet the needs of reservation economies, the Indian Law Clinic hopes to "[E]ncourage the business and lending communities to invest in Indian Country and foster economic development."

Maylenn E. Smith, Director of the Indian Law Clinic, estimates that roughly 40 percent of all Native American tribes in the United States have some form of commercial law governing their reservations, ranging from specific clauses dealing with foreclosure on reservation property to complete commercial codes. She adds that the right course for a tribe with regard to code development depends greatly on how the tribe views economic development.

Drafting the language contained in commercial codes can be a difficult task. Mr. Sherman notes that most model tribal commercial codes focus on Articles I and IX of the US UCC. "These articles are more pertinent to the goal of increasing banking services to reservations because they deal with banking transactions and the perfection of liens and collateral." Though it is possible to simply co-opt commercial code statutes from the various state codes or even from the US UCC, there is no *a priori* reason to believe that this is the appropriate step for reservation economies. The Indian Law Clinic, according to Ms. Smith, was careful to "retain provisions that tribes had already enacted as legislation" in its drafting process.

By utilizing informed legal counsel that is interested in the unique business environment within a given reservation, a tribe can ensure that the specific language and statutes are tailored to fit its needs. At the same time, the code must balance the competing interests of outside parties and tribal members. This involves acquainting the average tribal member with the nature of a commercial code and its potential benefits.

Gail Small, Director of Native Action, a nonprofit organization located on the Northern Cheyenne Reservation in Montana, recalls that it took approximately three years to develop their tribe's recently enacted commercial code. Native Action placed great emphasis on making drafts both accessible and comprehensible to the general Indian populace. "Looking at code development with Indian tribes, there is an inherent mistrust that the White Man's laws are not meeting the needs of the Indian people. There is often a fear of the White Man's law," notes Ms. Small. Thus, public education campaigns and debate may be critical to obtaining the necessary input and support for code development from all sectors.

The potential benefits of commercial codes are clear. First, they can outline the tribes' regulatory jurisdiction over financial and commercial transactions involving tribal members. Second, commercial codes explicitly detail the applicable rules in adjudicating disputes involving secured transactions, giving tribal courts the legal resources to settle commercial disputes. As Ms. Smith explains, commercial codes add "an element of predictability" to business transactions and "make it easier for the tribal court to address problems as they arise. [Tribal] judges can also look to the commercial code as a blueprint of the necessary steps to follow." Finally, litigation can be dealt with much more efficiently if the proper venue for cases is spelled out in the jurisdictional boundaries specified in the tribal codes. All of this removes the uncertainty and risk that have kept most banks from lending to reservation residents and firms, or establishing branches on reservations.

## **The Importance of Fair and Consistent Implementation**

Both the Mississippi Choctaw and the Blackfeet of Montana enjoy successful commercial oversight. As illustrated by the Mississippi Choctaw, successful commercial oversight does not necessarily stem from the existence of a commercial code. Even more important than the presence of a ratified commercial code is the existence of the underlying political and institutional infrastructure to ensure its enforcement. Far too often, laws are passed on reservations without the necessary preparation to ensure successful implementation and enforcement. Traffic ordinances, zoning rules, and other regulatory codes are often passed by tribal legislatures, put on a shelf in the tribal court building, and seldom looked at again. The likelihood of this happening is increased when the rules are as esoteric and intangible as those spelled out in commercial codes.

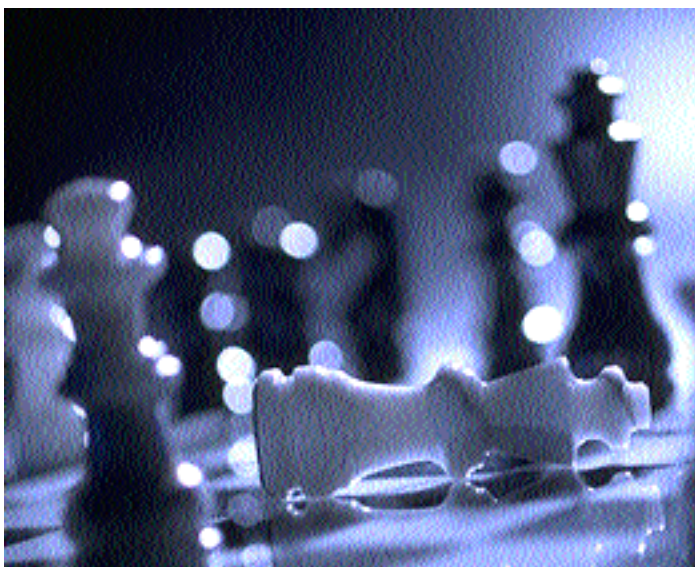
Banks and other outside financial institutions need to be comfortable working within the bounds of tribal institutions. This would include comfort in dealing with the tribal court system that operates in a desired reservation banking market. While most tribes have clauses and articles within their constitutions establishing judicial independence from executive and legislative branches, such independence is not always evident in practice. This leads to an environment where commercial codes may not be consistently enforced in cases involving outside financial or commercial interests, eroding the potential for developing beneficial relationships with outside banking institutions.

Implementation is a complex matter in itself. In order to successfully implement a commercial code, a tribe would need to create a system



for filing and perfecting liens that can be accessed by both tribal and non-tribal parties and is harmonized with existing state and county filing systems. Ms. Smith explains that "the cost of developing a filing system that will be accessible is fairly significant."

Implementation also involves coordination among tribal courts, tribal police, and outside authorities in the event of a foreclosure. The Northern Cheyenne tribe, according to Native Action's Ms. Small, actively involved the tribe's law enforcement officials in the code development process. Their involvement resulted in the creation of an impoundment facility, which will aid tribal authorities in the event they need to repossess autos or other collateral as they enforce the commercial code.



### **Commercial Codes: Part of a Larger Development Strategy**

The existence of commercial codes on Native American reservations is not a panacea for tribal economies, individual reservation residents, or banking institutions that conduct business in Indian Country. As Gail Small of Native Action notes, "It's simply a civil procedure law that will assist in making bankers feel more secure as they lend on reservations." Thus, a commercial code, while important in

helping remove barriers to accessing financial resources, will not alleviate the other factors that plague reservation economic development, including geographic remoteness and poor infrastructure.

Likewise, the mistrust of banking institutions among reservation populations will not be erased overnight through ratification and implementation of a commercial code. Much of the animosity between off-reservation banks and reservation inhabitants has been built up over generations, and it is not without foundation. Lack of communication, misperceptions, outright discrimination, and a dearth of enforceable transaction law have eroded the critical relationships and trust necessary for effective banking. Commercial codes lay a foundation for overcoming this difficulty, by establishing the rules that must be followed by all parties, including off-reservation lenders and reservation inhabitants.

Adoption of a code is also a means to an end, not an end in itself. It is part of the process of establishing mutually beneficial business transactions. As such, commercial code development and enactment become a mechanism through which tribes can reassert their sovereignty. First Interstate's Gerald Sherman notes that when tribes do not have commercial codes governing their reservations, "any time a dispute arises, the tribal court defers to what the state law says. They [the tribe] go to someone else's law." Through standardizing commercial practices and dispute resolution systems, commercial code enactment can be viewed as a proactive development that will help strengthen reservation economies. Gail Small of Native Action states that "Every time you assert jurisdiction over an area, you are asserting your sovereignty." As such, Ms. Small and others look at commercial codes as a means for tribes to harness their sovereignty to foster economic development, helping to "build a self-sustaining economy for our people."

*--by Eric Henson*

*The Economics Resource Group, Inc.*

*&*

*Luxman Nathan*

*Public & Community Affairs*

*Federal Reserve Bank of Boston*

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# CONSUMER FOCUS

## *The Perils of Identity Fraud*



Identity fraud — the acquisition of credit in someone else's name — has been receiving a lot of attention as of late. By some estimates, it is the fastest-growing financial crime in the country. In most cases, the victim never learns how an identity thief accessed his or her personal financial information in order to open new accounts or obtain credit. Some identity thieves use driver's license numbers, Social Security numbers, or bank and credit account numbers to obtain other vital information such as a victim's address or place of employment. Once they get this information, the identity thieves can open new credit accounts and checking accounts, obtain cellular phones, or lease apartments and automobiles, all in the name of the hapless victim.

The identity fraud victim does not usually learn of the problem until after the thieves have incurred large amounts of debt and stopped making payments. Oftentimes, victims discover that they've had their identity stolen when they receive a phone call from a collector regarding a large amount of outstanding debt. In other instances, they find out about the problem when their legitimate credit application is denied. These events cause many victims to start looking for problems, but by then most of the damage is done.

While a victim is usually not responsible for more than \$50 of any fraudulently incurred debt (and in many cases, this amount is waived), it is still a difficult experience to endure. One identity fraud victim, who spoke on condition of anonymity, described the six months she spent trying to correct her credit status. She has filed a criminal report, submitted records, obtained notarized copies of her signature along with letters of explanation to creditors and credit reporting agencies, but has yet to clear her name. "Even though I am the innocent victim, I am assumed to be guilty and must prove my innocence repeatedly. I still cannot get a mortgage, credit card, or even a cell phone. It is extremely difficult to prove who I am and requires an amazing amount of time. The ease with which this can happen to someone is staggering."

There is no specific profile of a typical identity fraud victim, since the prevalence of bank and credit account data makes it difficult to determine a single source. Some information has been obtained by stealing mail and wallets or by rummaging through discarded financial information from a victim's trash can. With increasing amounts of personal data being stored electronically, thieves are able to obtain vital information from third parties. Recently in Boston a high-profile case of identity fraud led investigators to the accounting office of a local college, where an employee sold the account and Social Security numbers of students who had paid bills with credit cards, to a ring of identity thieves.

### **Industry and Legislative Response**

Since the victim of identity fraud is not responsible for the debt incurred, the financial services industry bears the financial cost from this type of crime. Most creditors and the credit reporting agencies have established fraud units to handle the

issue, including training on fraud patterns and new twists on old methods. Employees are trained to look for patterns, such as the change of address of several different individuals' accounts to one location, in an effort to catch large criminal rings.

According to Dave Gilmore, Director of Fraud Control for Experian, a credit reporting agency, "The bad guys can respond very quickly. They don't have to play by the rules. All of us must be educated about the credit systems and protect ourselves. Experian has dedicated resources to fighting the problem. We work with groups such as the International Credit Association to educate consumers about identity theft and support legislation to make identity theft a criminal activity."

In fact, identity theft was only recently made a crime when the federal government and the states of Arizona, California, and Massachusetts passed legislation that makes the use of another person's identity a criminal act. On October 30, 1998 identity theft became a federal crime when President Clinton signed HR 4151. Under this legislation, it is illegal to knowingly transfer or use someone else's personal identifying information, such as a Social Security number, with the intent of committing a federal crime or state felony. Other states are also in the process of passing legislation to criminalize identity fraud.

The key, according to Gilmore, is "to make the statutes broad enough to include patterns which are not already known." Each time the industry establishes safety mechanisms to prevent one type of identity theft, new methods are developed. For the financial services industry and concerned consumer advocates, the most important thing is to develop the capacity to monitor patterns and react quickly.

*--by Julia D. Stewart  
Public & Community Affairs  
Federal Reserve Bank of Boston*

## **What Can You Do to Protect Yourself?**

Experts suggest doing the following:

- Keep your personal data secret and limit access as much as possible.
- Make sure receipts, credit offers and applications, insurance forms, bank checks and statements, and tax forms are kept in a safe place or disposed of properly.
- Minimize the identification information you have and carry around. Do not carry Social Security numbers or all your credit cards in a wallet or purse.
- Protect your Social Security number. Ask to use other types of identifiers if possible.
- Pay attention to your billing cycles. Follow up with creditors if bills do not arrive on time.
- Carefully review your credit card statements and phone bills each month. Immediately report any discrepancies to the companies.
- Before revealing personal identifying information, find out how it will be used and if it will be shared with others.
- Be aware of others when using a phone card or ATM. Shield the key pad when entering a PIN (personal identification number).
- Never give out credit card or bank account information over the phone unless you are familiar with the business and have initiated the call.
- Order a copy of your credit report each year. Make sure it's accurate and includes only those activities you've authorized. The three main credit reporting agencies are:

Equifax: (800) 685-1111 or <http://www.equifax.com>

TransUnion: (800) 916-8800 or <http://www.tuc.com>

Experian: (800) 682-7654 or <http://www.experian.com>



## **INFORMATION EXCHANGE:**

### **BUSINESS ACCESS TO CAPITAL & CREDIT: A FEDERAL RESERVE SYSTEM RESEARCH CONFERENCE**

The Federal Reserve System is sponsoring a research conference entitled *Business Access to Capital & Credit*, March 8 and 9, 1999, in Arlington, Virginia. The conference will feature 17 research papers, followed by discussants' responses and a general discussion. Papers selected for presentation offer new insights into a variety of topics including, but not limited to, the effects of financial industry consolidation on lending; credit scoring and securitization for small business loans; access to credit for minority-owned businesses; and microlending. Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, is scheduled to speak at the conference on Tuesday, March 9.

Representatives from academia, financial institutions, nonprofit organizations, foundations, government, and various regulatory agencies are invited to attend.

The conference will be held at the Sheraton National Hotel, located at 900 S. Orme Street in Arlington, Virginia. The registration fee is \$295. For registration information, please contact Lori Carrington, Division of Consumer and Community Affairs at the Board of Governors at (202) 452-3378, or Mia Worlds, Community Affairs at the Federal Reserve Bank of Dallas at either (800) 333-4460, ext.5377 or (214) 922-5253.

*Members of the media are invited to attend the conference free of charge. Please indicate your plans to attend by contacting Allison Cline at (214) 922-5253.*