You may be flattered when a nominating committee calls you about being elected or appointed to a board of directors. Sure, you’ve been on many boards. But are you a good board member? Have you truly contributed to the mission of the nonprofit(s) on whose boards you’ve served? Or, are you a nightmare for board chairs and chief staff executives?

Here are a few tips to help you be an effective board participant. Some of these can be found in handbooks about boards. And some are the unwritten lessons gleaned from my work with nonprofit CEOs and board chairs over the last 20 years -- the tips they want to tell you but don’t. Following these can keep you from being the kind of board member that keeps nonprofit leaders up at night. Hopefully, these tips can help you provide the critical leadership most needed by our non-profits and communities.

What To Do

1. Understand the responsibilities of a nonprofit governing board. Board service is more than the old saw about “wealth, wisdom, or work.”

2. Ask questions before you agree to serve on the board. What are the major issues the organization is facing? How can you help? Why are they interested in you? What is expected of the board as a whole and of each board member? What are the strengths and weaknesses of the board when dealing with tough issues and working with staff? How and
how often does the board evaluate its own performance, the chief executive’s performance, and the organization’s impact? In what stage is the nonprofit in its own development? Do the roles and responsibilities of the board fit what it should be doing at this stage in the nonprofit’s life cycle?

3. **Before you agree to serve, communicate clearly what you can and cannot offer the organization.** If you can’t give and raise financial support for the group, say so. (You should probably decline to serve if you aren’t willing to do both of these, at least at modest levels.)

4. **If you decide to serve, attend the orientation and read the materials.** As former Raleigh Mayor Smedes York says, “Half of leadership is just showing up. The other half is reading the minutes.”

5. **Ask questions at board meetings.** The only dumb question is the one you wanted to ask but didn’t. As the board makes decisions, be sure you understand the history and context of an issue enough to exercise good judgment. If you don’t understand the financial information, say so. Be sure you know the differences between for-profit and nonprofit accounting.

6. **If you don’t see the board evaluating itself, the organization’s outcomes, and the chief executive at least annually, volunteer to help establish and implement good practices for all three of these key board responsibilities.**

7. **Know the salary ranges for staff and the policies for setting them.** You’ll probably only directly review the actual salary for the chief staff executive. Be sure all salary ranges reflect the education, experience, and responsibility levels required in the positions. Be sure both the salaries and benefits package are adequate for adults who may have families to support and mortgages and college tuition to pay. Inadequately compensated employees often can’t afford to stay long, and high turnover is more expensive than low pay. It is unwise--if not unethical--if a nonprofit doesn’t pay its own staff enough to support
their families. Just like businesses, nonprofits must do their part to be responsible employers in the community.

8. **Be ready to describe the nonprofit’s mission in the check-out line at the grocery store.**

9. **Do what you say you’ll do.** I hear regularly from nonprofit executives who resent spending their valuable time contacting (or cleaning up behind) their own board members who don’t follow through.

10. **Say something kind to staff on a regular basis.** Too many board members treat staff like faceless, menial workers and begin most of their sentences with “You should . . .”

11. **Use your senses of humor and celebration.** Nonprofit work is serious business, but putting the fun in activities like fundraising is a gift. Celebrate the accomplishments and milestones in the nonprofit’s development.

**What Not To Do**

1. **Don’t join a board because it looks good on your resumé or just because you’re interested in the issue.** While commitment to the mission is a prerequisite for board service, a governing board deals mostly with organizational issues--goals, budgets, planning, etc.--rather than the direct content of the nonprofit’s work. If you’re interested in working directly with children, be a service volunteer rather than a board member.

2. **Don’t confuse your roles.** If you also serve as a volunteer in the group’s programs, remember this is different from your board hat. As a service volunteer, you’re directly accountable to a staff member or another volunteer.

3. **Don’t try to manage the organization.** One of board members’ greatest sins is going beyond their governance and policy role-- meddling in management responsibilities. The board of a new group or one without paid staff often does some administrative work as well, but remember you’re wearing a volunteer hat--not a board hat--in this case.
4. *Don’t get involved in personnel matters regarding staff other than the chief staff executive unless you do so as a member of a formal grievance committee of the board --and then only if the grievance committee has followed all required procedures.*

5. *Don’t assume that leading or managing a nonprofit is the same as managing a for-profit corporation, a government agency, or a college program.* Non-profits are significantly different in many issues related to their stake-holders, clients or constituents, accounting, law, communications, marketing, governance, accountability, resources, and bottom line. For example, nonprofit stake-holders typically are a complex matrix of the people served, volunteers, staff, board members, individual donors, foundation and corporate funders, elected officials, government agency regulators (local, state, and federal), the local community, the media, and all taxpayers (because of the tax-exempt status).

6. *Don’t assume you’re an expert your first year on the board. Listen and learn first.*

7. *Don’t stay on the board if you can’t attend most meetings.* The days of “name only” boards are over. A non-profit dealing with critical social issues cannot afford someone taking up a board seat who’s not giving thought, commitment, and time.

8. *Don’t serve on more boards than you can handle responsibly.* If you’re on more than 3-5 governing boards, you’re either a full-time volunteer or you need to resign from some. The standard of “due diligence” for board members means you show up, do your homework, and focus your energy on that organization. In addition to potential legal liability from poor attendance or inattention to the board’s financial responsibilities and others, you risk losing two of your most important assets--the respect you have for yourself and the respect others have for you.
Serving effectively on a nonprofit board can be one of the biggest challenges to your leadership skills. Serving wisely is a fine art and a true privilege. Being a board member or trustee means you hold the trust of an organization and the public in your hands. Hold them with awe and care.

Responsibilities of the Board as a Whole

- Determine the mission and goals.
- Select the chief staff executive, support the executive, and evaluate his or her performance annually.
- Ensure effective organizational planning.
- Ensure adequate resources to accomplish the organization’s mission and goals.
- Ensure effective management of resources.
- Monitor the quality of the organization’s public image.

Responsibilities of Each Board Member

- Attend all board meetings.
- Make a personal contribution. The fact that each board member gives is more important than the amount.
• In coordination with the staff and board, help with fundraising contacts with foundations, corporations, individual donors, and other funding sources
• In coordination with the chief executive, represent the organization to your constituencies and in your community.
• If the organization has members, recruit new members.

This article is reprinted with permission from *Common Ground*, a publication of the N.C. Center for Nonprofits. It was commissioned originally by the W.K. Kellogg Foundation for its Focus publication.

**About the Author**

![Jane Kendall](image)

**Jane Kendall** is president of the N.C. Center for Nonprofits in Raleigh, North Carolina and is a trustee of three nonprofits. She served previously as executive director of the National Society for Experiential Education.
When you think of the secondary mortgage market, it is likely Freddie Mac and Fannie Mae come to mind. As two of the largest sources of home mortgage funds in the nation, Freddie Mac and Fannie Mae purchase mortgages from lenders, package them into securities, and sell them to investors. In doing so, they replenish the pool of funds available for new mortgages. Chartered by Congress to increase the supply of capital for housing, Freddie Mac and Fannie Mae provide continuous, low-cost funds for our nation’s homebuyers and renters.

With credit scoring here to stay, many wonder how it will affect the flow of capital for our nation’s housing. This article addresses how the secondary mortgage market is handling credit scoring. In a series of questions posed by Community Investments, experts Henry Cassidy from Freddie Mac and Robert Engelstad from Fannie Mae discuss how credit scored loans are treated, highlighting policies and practices for loan buy-backs and loan pricing. They also address common perceptions and misperceptions about the processing and purchasing of credit scored loans. Sharing the lessons they have learned about credit scoring, Mr. Cassidy and Mr. Engelstad offer suggestions on how new underwriting services and credit scoring
instruments can help lenders find good loans and increase the flow of low-cost capital for our nation’s housing needs.

**Loan Purchases and Buy-Back Policies**

To what extent does a credit score affect the purchase of a loan and the possibility of a buy-back?

**Fannie Mae** - Fannie Mae’s quality control underwriting reviews include an assessment of the borrower’s credit history and score in the very same manner that we advise lenders—as just one part of a comprehensive analysis of the mortgage application. The evaluation of a borrower’s management of credit—whether this evaluation includes a credit score or not—is only one factor in a mortgage underwriting decision. Fannie Mae’s underwriting review also considers the loan terms, the borrower’s ability to repay the loan, the value of the property and other factors to determine whether or not the loan meets Fannie Mae guidelines.

Loan repurchases are rare; last year we had approximately one repurchase for every one thousand mortgages that Fannie Mae purchased. Also, we do not require repurchases of mortgages for underwriting reasons as long as the mortgage is not delinquent.

**Freddie Mac** - Freddie Mac maintains standards for our mortgage purchases through our published underwriting guidelines and Seller/Servicer contracts. These standards typically are the same whether or not credit scores are used in underwriting.

We require our lenders to represent that every loan sold to Freddie Mac using traditional, “manual” under-writing techniques meets the standards set forth in the underwriting guidelines we agree to in our purchase contracts. To ensure the accuracy of these representations, Freddie Mac conducts a post-purchase quality control review of a sample of the loans sold to us. The
sample is drawn from a number of mortgage purchase categories, including loans randomly drawn from total purchases, loans with high-risk attributes, and loans sold by lenders whose recent performance is poor. Among the many tools we use to define “high-risk” are credit bureau scores indicating extremely poor credit histories.

We’re taking steps that hold the promise of largely eliminating the risk of repurchase requests for the vast majority of loans. When lenders sell us mortgages using Loan Prospector, our automated underwriting service, Freddie Mac typically waives most representations and warranties associated with a borrower’s credit worthiness, thus largely eliminating the prospect of a loan buy-back in these cases. Freddie Mac is currently launching pilot initiatives that will permit lenders to sell us more loans under these favorable conditions.

What quality control mechanisms should lenders use to avoid repurchases of credit-scored loans?

**Fannie Mae** - The quality control efforts that work best do so regardless of the use of credit scores. They include: the commitment of senior management, accountability of all employees, clear and measurable standards of quality, ongoing assessment against the standards, and constant feedback to eliminate the causes of errors to improve the performance.

Credit scoring can help an underwriter perform a more consistent, objective and accurate evaluation of credit report information but it should *never* be used in isolation for making underwriting decisions. Credit scores should be used *as part* of a comprehensive analysis of the unique characteristics of each individual mortgage application and should complement an underwriter’s judgement, not replace it. Fannie Mae sees credit scoring as
another tool that helps the industry make more mortgages, not as an excuse to do less.

*If credit report errors or discrepancies surface when re-scoring loans, how will these errors affect the purchase price of the loan and the possibility of a buy-back?*

**Fannie Mae** - For some cases, we obtain a new credit report and independent verifications of income and assets during our underwriting review. If the new credit report contains information that is different from the report obtained by the lender—which would not be unusual—we consider whether or not the additional information would warrant a different underwriting decision. We also consider whether or not the information would have been available to the lender at the time the underwriting decision was made.

Standard “score migration” would have no effect on the purchase price of a mortgage or its eligibility for sale to Fannie Mae. Fannie Mae understands that it is not unusual for a borrower’s credit score to change from the time when the lender underwrites the application to the time when the mortgage is sold to Fannie Mae. This is one reason we offer lenders the option of providing us with the credit score they used as part of their underwriting decision.

**Freddie Mac** - If a lender concludes that a credit score is based on significantly inaccurate information, the lender is free to ignore the credit score and sell us the mortgage based on the lender’s documentation of the borrower’s overall credit history. This policy ensures that borrowers obtain an “A” rate when there is inaccurate information in their credit reports. In terms of re-scored loans being subject to the possibility of a buy-back, there is no difference in the way Freddie Mac treats these loans from any other loans we purchase.
What types of credit errors are significant to warrant a possible score override?

**Fannie Mae** - Whenever an underwriter has reason to believe that the credit score may be compromised by inaccurate information, the underwriter should disregard the credit score associated with the repository file that had the inaccurate information. This is particularly important when significant items of credit information are involved -- such as any reported accounts that do not belong to the applicant and any derogatory information that is reported in error.

**Freddie Mac** - Freddie Mac’s experience indicates that minor discrepancies in the balances owed or payment amounts on open accounts belonging to the borrower are typically not significant to the predictiveness of the credit score. The following inaccurate information, however, may significantly undermine the usefulness of a credit score:

- Public records information on a bankruptcy, foreclosure, judgment or collection that does not belong to the borrower;
- Delinquencies that are reported in error; and,
- One or more tradelines that do not belong to the borrower.

How do you respond to the notion that score thresholds (e.g., 620) exist in practice, and that the threat of buy-backs dissuades some lenders from conducting more time-consuming, manual reviews of marginal or low-scoring loan applications?

**Fannie Mae** - Fannie Mae constantly and consistently communicates to our lenders that we will purchase mortgages with credit scores below 620. We make this clear through our underwriting policies, our underwriting training, our meetings with lenders, and most important--through the way we
conduct business. We do purchase loans with lower credit scores. We do not prevent lenders from delivering these loans to us, nor do we ask for repurchases simply based on lower scores.

**Freddie Mac** - Freddie Mac has repeatedly advised lenders that a credit score of 620 should not be viewed as an absolute threshold. Second, the fact that a loan has a score below 620 or, for that matter, any other number does not make a loan subject to repurchase. Our advice on using credit scores is that they can be used to quickly process the vast majority of borrowers, freeing up resources and time for lenders to focus on the more difficult loan files.

*What products and services do you offer that encourage lending to borrowers with all levels of credit scores?*

**Fannie Mae** - Fannie Mae’s Desktop Underwriter underwrites and approves loans with credit scores below 620. In our letters to lenders about credit scoring, we provide specific examples of situations in which it would be acceptable to sell us loans with lower credit scores. We are currently piloting and developing new products for Desktop Underwriter designed to provide even more approval options for lower-scoring, higher risk loans.

**Freddie Mac** - Traditionally, mortgages purchased by Freddie Mac have been characterized as “A” quality loans. Loans deemed to be higher risk often were originated in the subprime market—a higher-cost source of mortgage financing. Most subprime borrowers have a variety of past credit problems—some minor and others serious. Borrowers who need to consolidate debt or refinance often turn to the subprime market when they cannot qualify for conventional financing.

Freddie Mac currently has a series of pilot initiatives that will bring former subprime borrowers into the lower-cost prime market. Most notably, Freddie
Mac has expanded the loans it will purchase to include “A-minus” loans. “A-minus” loans have risk attributes that place them close to “A” quality standards. Borrowers usually fall into this category rather than “A” category because of a few additional blemishes on their credit records.

Additionally, by more accurately measuring risk, Freddie Mac’s Loan Prospector can identify borrowers who should be in the prime market already, but are unnecessarily relegated to the more expensive subprime market. This enables them to benefit from the lower-cost financing available from lenders selling loans to Freddie Mac - in other words, taking advantage of current products. Freddie Mac estimates indicate that 10 to 30 percent of borrowers who obtained mortgages in the subprime market could have qualified for a conventional loan through Loan Prospector.¹

Access to developing and current products, through the use of better statistical tools promises to benefit minority and low-income families. The subprime portion of the mortgage market finances a significantly higher percentage of minority borrowers, particularly African-American households. It also finances a significantly higher percentage of low-income borrowers and a higher share of borrowers living in underserved areas.²

**Pricing and Fees**

*Do you base the price of loan purchases on credit scores? If so, how?*

**Fannie Mae** - We have always based the prices we charge for credit risk on the mortgage characteristics most strongly correlated to default risk, such as product type, mortgage term, and loan-to-value (LTV) ratio. Credit scoring represents a more efficient and accurate way to reflect borrower credit risk in our pricing and provides additional insight about relationships between risk factors such as a credit score and LTV on defaults. We have incorporated this credit scoring information into our pricing system. Although credit scores
are now used in our loan pricing, they are not used alone or as the sole factor in the pricing of any mortgage.

We work with our lenders on a variety of pricing structures. The variations reflect an individual customer’s preferences related to operational capability, changing market conditions, and changing profiles or risk characteristics. We typically base our credit risk pricing on the expected risk profiles of future loan sales to Fannie Mae. Some lenders prefer to have their pricing reflect the risk profile of actual deliveries.

**Freddie Mac** - Credit scores are only one of several factors we use to assess credit quality and are one element in pricing for all customers.

In the past, conforming mortgages in the market were priced based on the average price of a group of loans, such as 30-year mortgages. While this type of pricing was useful, it limited the number of high-risk mortgages that the conforming market could bear or it would increase the pricing on the mortgage pool with higher percentages of riskier loans, represented in part by low credit scores.

With the advent of new technology and increased credit expertise, the mortgage market is moving to risk-based pricing, which prices each loan according to its specific risk attributes. In response to these developments in the mortgage market, we have begun to provide lenders with the option to price mortgages on a loan-level basis using risk-based pricing. In a number of these limited pricing initiatives, we use credit bureau scores as one of the elements used to establish a loan-level price. Our effort to set loan-level prices for mortgages or packages of mortgages up-front is in a pilot stage, but we expect it to become the predominant method for almost all lenders to establish their mortgage rates. Risk-based pricing is a tool that Freddie Mac will use to provide the lowest-cost mortgage financing available today to as many borrowers as possible.
The Bottom Line

*In terms of loan performance, have the predictive factors of the credit scores proven to be accurate?*

**Fannie Mae** - Yes. The research we have done indicates that, holding all other risk factors constant including the amount of the downpayment, a borrower with a lower credit score, below 620, is 2 1/2 times more likely to default than someone with a credit score between 660 and 699. The actual default rate for loans in the score range between 660 and 699 is similar to the average default rate for all Fannie Mae loans.

Our credit scoring research has also taught us an important lesson about the predictive factors of a borrower’s income. It is just as likely for a low-income homebuyer to have a high credit score as a high-income homebuyer. A borrower’s management of credit, as measured by credit score, has little correlation with the borrower’s income.

Our analysis has also provided us with a more dynamic view of the relationship between credit risk, as measured by credit scores, and downpayment. For example, a borrower who makes only a 5% downpayment but has a high credit score (e.g., over 740) would be less likely to default than a borrower who put 30% down but had a weak credit profile (e.g., a credit score under 620). If we only looked at downpayment as the primary risk factor for default, we would overstate the real risk of many homebuyers.

These lessons learned from our research on credit scoring should help lenders use credit scoring to find more good loans. They should also improve access to credit for low-income borrowers. For example, a low-income homebuyer who might not have been able to save a downpayment could still
get a mortgage, with a strong credit profile compensating for the lack of a downpayment from the borrower’s own funds.

**Freddie Mac** - In 1996, we became the first (and, we believe, to date, the only) industry participant to publish evidence that the custom mortgage scoring model we use in Loan Prospector is validated against important borrower population groups, including minority and low-income borrowers. In a report to Senator Carol Moseley-Braun, we reported that, based on a statistical review of one-unit, newly originated mortgages purchased by Freddie Mac during 1994 (totaling over a million loans), measuring incidence of foreclosure through April 1996, Loan Prospector’s risk classifications predicted likelihood of foreclosure in a statistically significant and powerful manner. We also reported that Loan Prospector’s risk classifications provided a comparable and statistically significant prediction of the likelihood of foreclosure for the group of African-American, Hispanic and non-minority borrowers in the sample of mortgages reviewed.

Additionally, the U.S. Department of Housing and Urban Development (HUD) recently approved Freddie Mac’s Loan Prospector as the first automated underwriting system for FHA loans. HUD adopted Loan Prospector after a 18 month pilot (with 15,000 loans) which validated our long-standing findings that Loan Prospector is a fair and objective tool for evaluating borrowers and expands homeownership opportunities for America’s families, including minorities.

The use of credit bureau scores must be kept in perspective. Technological advances such as credit scores, automated underwriting and risk-based pricing are merely tools, not ends in themselves. Freddie Mac believes that these tools will enable us to finance homes for borrowers who were clearly on the fringe of the conventional conforming market in the past. Freddie Mac’s vision is to make the lowest cost of mortgage financing available to as many Americans as possible. We are working diligently to achieve that vision.
and to keep concerns about fairness foremost in our thinking. We welcome the opportunity to engage in dialogue about ways to improve the world’s best housing finance system.

For more information about the products and services of Freddie Mac and Fannie Mae, please visit their Web sites at: www.fanniemae.com or www.freddiemac.com.

Credit Scoring: Tool for Secondary Market Small Business Loans
Selling mortgage loans in the secondary market is now common practice and credit scoring is one of the tools that has helped sales to top $1.7 trillion. Although less common, there is growth in the securitization of business loans, which in the last two years reached $34 billion. This growth has occurred as financial institutions are seeking to increase non-interest income while retaining relationships with their small business borrowers. The Riegle Community Development and Regulatory Act (1994) paved the way by reducing capital requirements to apply only to the unsold portion of a securitized small business loan. As with selling mortgage loans, securitization can help to reduce exposure to interest rate fluctuations and concentration risk. Securitizing a loan portfolio requires standardized underwriting, loan documentation and monitoring. To ensure consistent underwriting, when pooling small business loans with similar risk profiles, some banks are looking to credit scoring. Fair, Isaac and Company, Inc. pioneered the use of credit scoring to assess the risk of small business credit applicants. By using their Small Business Scoring Service℠ (SBSS) banks can standardize their small business loan application process to both increase efficiency and facilitate potential future sales.

For more information contact Fair, Isaac at 1-800-999-2955.
The benefits of our tools are described in more detail in Freddie Mac’s report, Automated Under-writing: Making Mortgage Lending Simpler and Fairer for America’s Families (available at Freddie Mac’s Web site: http://www.freddiemac.com).

Based on an analysis of home-purchase borrowers in the primary market versus the subprime market done by researchers in the U.S. Department of Housing and Urban Development’s (HUD) Office of Policy Development and Research, 5.3 percent of primary market borrowers were African-American borrowers, compared to 13.5 percent in the subprime market, and 6.2 percent of primary market borrowers were Hispanic borrowers compared to 9.2 percent in the subprime market; 10 percent of borrowers in the primary market had incomes at or below 60 percent of area median income, compared to 14 percent in the subprime market; 23 percent of borrowers in the primary market had incomes at or below 80 percent area median income compared to 29.5 percent in the subprime market; and 24 percent of borrowers in the primary market were living in “Underserved Areas” (as defined by HUD) compared to 36 percent of borrowers in the subprime market. See HUD’s Office of Policy Development and Research, Working Paper No. HF-001, Table B-1 (12/96).

About the Authors

Henry Cassidy is the senior vice president of single-family risk management for Freddie Mac. Having served in this role since January 1996, he is responsible for promulgating mortgage underwriting
policies, the quantitative development of automated underwriting and collateral evaluation systems and their associated policies, and for quality control. He acts as secretary to the Credit Policy Committee.

Previously, Mr. Cassidy served as vice president of mortgage credit policy from February 1990 to 1996. Prior to joining Freddie Mac, he was director of the General Research Division at Federal Home Loan Bank Board from 1971-1984. Mr. Cassidy holds a Ph.D. in Economics and a M.A. in Mathematical Statistics from the University of Illinois, and a B.S. from Carroll College in economics and mathematics.

Robert J. Engelstad is the senior vice president for credit policy at Fannie Mae. In this position, he is responsible for the policies relating to loan underwriting, performing loan servicing, and counter-party risk. Since joining Fannie Mae in 1984, Mr. Engelstad has also served as manager of appraisal standards and assistant director of real estate sales. Prior to coming to Fannie Mae, he worked in the Office of Single-Family Housing at HUD/FHA and with the Ginnie Mae Mortgage Backed Security Program. Mr. Engelstad is a graduate of the School of Public and International Affairs at George Washington University in Washington, D.C.
“Welfare to Work” Does Work

Author(s): Ardis D. Jerome, Senior Director of Marketing and Planning, Goodwill Industries of San Francisco, San Mateo and Marin Counties, Inc.
Summer 1998

Undoubtedly you know about Goodwill Industries . . . the closet is too full, you finally clean it out and drop off the bags stuffed full of slightly out-of-style clothes. But did you know that Goodwill Industries pioneered the concept of “welfare to work” long before it was a political buzzword or an official government program? This article highlights how Goodwill Industries, in partnership with financial institutions, is making “welfare to work” work for our communities.

Founded in 1902 by a Methodist minister in Boston, Goodwill Industries employed poverty-stricken immigrants who worked for goods donated by Dr. Edgar J. Helm’s affluent parishioners. Soon, there were more clothes and household items than the immigrants needed and the first Goodwill Industries store opened. It was here in Boston that Dr. Helm launched the very first “welfare to work” program by employing the impoverished immigrants at the Goodwill Industries store. Today, almost a century later, nearly 1,500 Goodwill Industries retail stores operate in the United States and Canada. These stores generate employment opportunities and revenue which funds other Goodwill Industries’ skills training programs. Goodwill Industries has earned a strong reputation for providing employment and training to people with disabilities and other barriers to employment.
In 1997, Goodwill Industries’ retail sales were an astounding $598.7 million, total revenue exceeded $1.2 billion, and 204,235 people received employment and training services. Goodwill Industries has shown that “welfare to work” programs can work. Last year, over 32,000 people became employed, becoming taxpayers not tax users.

In 1996, “welfare to work” programs like Goodwill Industries gained national attention as Congress passed the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (welfare reform) that required adults who receive public assistance to find jobs in two years or lose their benefits. To transition from welfare to work, people need employment and training programs like those Goodwill Industries offers.

Currently, Goodwill Industries holds 70 welfare-to-work contracts in the U.S. mostly with state or local governments. More than 20,000 “workfare” participants have already been served through partnerships with government and private industries.

Unfortunately, while Goodwill Industries is largely self-funded through its retail sales, the demand for employment and its ancillary services is far greater than resources, physical space and money available. Private funds to build training centers, retail stores, equipment training rooms and ancillary support systems are crucial to the success of Goodwill Industries’ “welfare-to-work” programs.

Many financial institutions choose to work with Goodwill Industries because it is considered a well-run organization that understands the business community. These transactions can also mean potential Community Reinvestment Act (CRA)-related opportunities for a bank. For example, Exchange Bank recently financed a new Goodwill Industries plant in Santa Rosa. According to Patrick Kilkenny, president and CEO of the National Bank of the Redwoods, who serves on the finance committee for Goodwill Indus-
tries in Santa Rosa, “Goodwill Industries will leverage this money to expand employment and training programs. It was the first time Exchange Bank had made a loan to a nonprofit. They were very comfortable with Goodwill Industries’ ability to generate cash flow.”

When making this type of loan, financial institutions help people transition from welfare to work and at the same time, may also earn lending consideration under the CRA. In addition, bankers like Kilkenny who choose to serve on Goodwill Industries’ board of directors may receive credit under the CRA’s service test. The benefits to banks of partnering with Goodwill Industries, however, do not stop there.

By working with Goodwill Industries, banks help develop and gain access to a well-trained workforce. For example, challenged by a dwindling workforce intensified by a 3% unemployment rate, Seafirst Bank, a division of Bank of America, NT&SA, approached the Seattle Goodwill Industries in search of skilled and trained workers. According to Goodwill Industries’ Director of Training and Employment Janetta Narte, the visit gave rise to a four-week proof operator training program.

Seafirst provided five on-site proof machines, supplies and 25 ten-key calculators. Its staff provided input into the training curriculum and assisted with classroom instruction. The pilot program, launched in February, consisted of 15 participants. Since then 14 people have been hired into Seafirst’s proof and ATM department. Based on positive results from the pilot program, the Seattle Goodwill Industries now offers two classes, one for proof operators and one for ATM processors. The second class, which began in June, had 50 applicants for its 15 seats.

According to Resa Peay-Wainwright, Bank of America Global Learning Services, and board member of the San Francisco Goodwill Industries, “It
certainly makes sense to work with Goodwill Industries for the opportunity to increase our pool of viable job candidates and to help our own communities at the same time.”

As welfare reform takes hold in our communities, financial institutions can play a significant role in making "welfare to work” work for everyone involved. Banks can support programs like Goodwill Industries which have made “welfare to work” a reality for thousands of people since 1902. At the same time, banks earn CRA consideration and tap into a pool of skilled workers who help them improve services and their bottom line.

Further information about local programs and opportunities is available by calling 1-800-741-0186, your local Goodwill Industries, or visiting Goodwill Industries’ Web site at www.goodwill.org.

About the Author

Ardis D. Jerome is senior director of marketing and planning at Goodwill Industries of San Francisco, San Mateo and Marin Counties, Inc. She began her Goodwill career in Spokane, Washington in 1977, where she was a forerunner in upgrading Goodwill’s retail image.

Since 1985, Ms. Jerome has served in many capacities with the San Francisco operation, earning marketing awards, developing a new corporate
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Qualified Investments: How to Make Investing in Your Communities Really Count!

Author(s): Cynthia Burnett, Community Investment Specialist, Federal Reserve Bank of San Francisco
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Editor’s Note: Since the implementation of the new Community Reinvestment Act (CRA) regulation, bankers have expressed concern about their ability to find qualified investments. Beyond finding them, bankers worry that examiners won’t recognize their investment as qualified under the new CRA. For some banks, the issue of defining qualified investments remains elusive and has too many gray areas. For others who have a firm grasp on the regulatory definition, many still face the problem of finding deals in which their banks want to invest. Several savvy bankers have resorted to creating their own investment initiatives which address the unique needs of their communities and ensure strong performance under the investment test (some of which will be highlighted in future issues in Community Investments). Community Affairs staff often recommend that banks read CRA public evaluations of similarly situated financial institutions to understand what other banks are doing to comply with the CRA. Specifically for qualified investments, the public evaluations provide insight into what banks are investing in and what level of CRA consideration they are receiving. Recently, Community Affairs staff reviewed a total of 45 public evaluations and strategic plans from the 12th District from the four regulatory agencies and compiled a list of the types of investments banks are making. To keep things in context, the list also includes asset size, investment test rating and overall CRA rating. The document was first
distributed at the American Bankers Association’s National Compliance Conference in San Diego in May 1998. Since then, many bankers and community groups who reviewed the document have called with technical questions about what qualifies as an investment under the CRA. The following article sets out to answer these questions by reiterating the regulatory definition of qualified investments and highlighting the process that examiners use to determine whether an investment will receive CRA consideration.

Investing in disenfranchised communities can infuse life back into decaying neighborhoods. Through redevelopment bonds, loan pool certificates, equity investments in local community banks, and grants to local nonprofits, bank investors can reap social benefits, earn returns on their investments, and meet their CRA goals. But meeting CRA goals implies an understanding of what qualifies as an investment. To gain that understanding, consider the background information examiners use to identify and rate qualified investments.

Identifying Qualified Investments
When determining investments, examiners look at four broad categories of investments including lawful investments, membership shares, deposits, and grants. Within these categories, investments are evaluated by considering their purpose and geography.

Purpose
Qualified investments must have community development as their primary purpose, which means invested funds must be used for any one of the following:

- Affordable housing for low- and moderate-income (LMI) persons;
- Community services targeted to LMI persons;
Promoting economic development\(^1\) by financing small businesses or farms,\(^2\) or,
- Revitalizing or stabilizing LMI areas.\(^3\)

If a majority of the dollars or beneficiaries of an investment falls into one of the above categories, then the “express purpose” of an investment is considered to be community development. If there is no clear majority, examiners determine if an investment meets any one of the following criteria:

- The express “bona fide” intent of the investment is for community development;
- The investment is specifically structured to achieve the express community development purpose; or,
- It is reasonably certain that the investment will accomplish the stated community development purpose.

Keep in mind that it is each institution’s responsibility to demonstrate that an investment is a lawful investment, deposit, membership share, or grant that has community development as its primary purpose.

Once the primary purpose is established, examiners assess the degree of innovation and complexity of investments. To do this, examiners rely on qualitative information, such as comparing qualified investments to typical investments in an institution’s portfolio and to types of investments made by an institution’s peers. Most importantly, examiners look at what types of investments are most common in a bank’s assessment area.

**Geography**

When evaluating potential qualified investments, examiners also determine if an institution’s assessment area benefits from these investments. A qualified investment must benefit an institution’s assessment area(s) or a broader
statewide or regional area inclusive of the assessment area. According to the CRA, “the fundamental determination that an examiner must make in regard to an investment is the extent to which it contributes to a bank’s overall record of helping to meet the credit needs in its assessment area.”

To ensure that an investment meets the geographic criterion, examiners consider the following:

- Who benefits from the investment;
- Whether the investment responds to credit and community development needs; and,
- Whether private investors routinely provide this type of investment, and if there are any other unmet investment needs in an assessment area.

**Rating Qualified Investments**

Examiners assess total qualified investment level in comparison to an institution’s total investment portfolio; percentage ratios of previous examinations are often compared to ratios for current examinations to assess percentage increases or decreases over time.

Banks must receive at least a “low satisfactory” on the lending test to achieve a “satisfactory” or better composite rating. Institutions with “high satisfactory” ratings in the lending test can effectively raise their assigned composite CRA rating to “outstanding” with a “high satisfactory” or “outstanding” rating in the investment test, depending on the service test score.

Institutions may receive favorable CRA credit under both the lending and investment test for a single qualified investment. For example, institutions that make qualified investments in third party community development organizations that, in turn, use the investments to make community
development loans can receive favorable consideration under both the investment and lending tests for their pro-rata share of the loans made by the third party.

**Conclusion**

This article offers some basic information on identifying and developing qualified investments. A successful strategy should address the credit needs in an institution’s assessment area in a manner that is integrated with and integral to the institution’s overarching investment plan.

Ten Most Common Qualified Investments

July ’97 - March ’98

This list of qualified investments is presented in the order of frequency from the most (1) to the least (10) frequently reported investments for which institutions have received CRA consideration.

1. Grants to nonprofit organizations providing services to low-and moderate-income people and communities
2. Grants to nonprofit affordable housing developers
3. Donations to charitable organizations, specifically involved in education, health care, nutrition, and welfare-to-work programs for low-and moderate-income people and communities
4. Purchases of housing finance bonds targeted to low-and moderate-income communities
5. Purchases of low-income housing tax credits
6. Purchases of certificates of deposit and equity investments in community development banks and community development credit unions
7. Investments in community development corporations
8. Purchases of municipal redevelopment bonds targeted to low-and moderate-income communities
9. Investments in other community development financial institutions
10. Purchases of multifamily affordable housing revenue bonds

Community Affairs staff prepared a list of all qualified investments that had received CRA consideration from July 1, 1997 through March 15, 1998. Data was gathered from completed performance valuations from all four regulatory agencies. These performance valuations were based on data from large financial institutions, small financial institutions that had opted to have investments reviewed, and limited purpose and wholesale banks, all located within the Federal Reserve’s Twelfth District. All strategic plans were also included.

1 Economic development is promoted if the activity supports permanent job creation, retention, and/or improvement for persons who are currently LMI, or in LMI geographies targeted for redevelopment by the federal, state, local, or tribal government.

2 The CRA regulation defines small businesses and farms as those with gross annual revenues of $1 million or less. The regulation also recognizes the Small Business Administration’s and Small Business Investment Company program’s definition of small businesses as legitimate, although different, for the purpose of determining CRA credit. See publication, Federal Register/Vol. 62, No. 193/October 6, 1997.

3 Community development activities that revitalize or stabilize LMI areas include community or tribal-based child care, educational, health, or social services targeted to LMI persons.

About the Author

Cynthia Burnett is a community affairs specialist at the Federal Reserve Bank of San Francisco, which she joined in 1997. Her work focuses on issues of welfare reform, specifically, welfare-to-work and regional job creation initiatives related to the Community Reinvestment Act. She is currently researching local and national asset accumulation models for low-income families. Prior to joining the Bank, Ms. Burnett served ten years in the management of nonprofit affordable housing, and health and human service organizations in Sacramento and the San Francisco Bay Area.
Financial education in primary and secondary schools is an increasingly sought after element of school curriculum development. Educators, businesses, community groups and parents realize that instruction in the fundamentals of banking and finance can help children grow up to be responsible adults. Recognizing the rewards of educating and empowering students with the tools of financial literacy, the financial community is becoming an active and growing force in the education sector.

**What are the Rewards?**

Banks can benefit from involvement in financial education by receiving credit under the service test of the Community Reinvestment Act (CRA), provided bank activities are directed to low-and moderate-income people.

Since banking services are often scarce or non-existent in underserved communities, many adults, also deprived of financial education, are not in a position to educate their youth. Fortunately, there are programs designed to address these needs and some are described here. You might want to consider joining one of these programs, seeking similar programs in your area, or even creating your own program.
Finance on Friday
Among the largest and best known programs offering financial education is Junior Achievement (JA). Founded in 1919, JA reaches nearly 2.7 million U.S. students across the nation. The organization aims to educate and inspire young people to value free enterprise, understand business and economics, and become work-force ready.

Using a structured financial education program with “school-to-career” transition programming and age-appropriate curricula (K-12), JA was developed and is implemented by classroom volunteers from the business community both in the U.S. and in approximately 100 countries world-wide.

Corporate support is essential to the success of JA’s programs. An example of how local business has supported JA is “Finance on Friday,” a financial education event sponsored and underwritten by Visa International (Visa) through a community affairs grant in coordination with the Bay Area Urban Bankers Association. The activity involved over 1,500 economically disadvantaged students at two elementary schools in Oakland, California. Approximately 55 volunteers from Visa and the banking community participated in the event, which featured personal finance, community development, entrepreneurial skills, goal planning, and personal achievement.

Banking on the Future
In southern California, a local non-profit, Operation Hope (OH), has implemented its own program known as “Banking on the Future” (BOTF). OH works in partnership with various organizations and individuals including banks, schools, public service agencies and corporations to bring BOTF to inner-city classrooms. Youth learn the fundamentals of opening and maintaining bank accounts, budgeting, and the importance of credit.
International Bank of California Vice President and CRA Officer Richard Oladapo appreciates that BOTF focuses on low- and moderate-income communities. Apart from tangible CRA benefits, the BOTF program helps foster the growth of fiscally responsible adults. Therefore, Oladapo believes that inner cities are an ideal location for the BTOF program because they have an abundance of children and adults with the potential to develop and grow successful business ventures.

**Kids Own Bank**

Banker Don Cohen, a community real estate lender for the Associated Bank of Milwaukee (AB), works with an educational program facilitated by the Milwaukee Education Trust named “Kids Own Bank” (KOB). After the successful launch of the first elementary school KOB, Cohen asked the University of Wisconsin, Milwaukee to develop an expanded KOB education program in partnership with his bank.

KOB is a school savings program that utilizes a comprehensive, ten-lesson financial education curriculum. It requires active participation by students in the actual operation of their own bank. The program relies on a series of comic books published by the Federal Reserve Bank of New York and on other free publications available from the Federal Reserve System. AB, one of the program sponsors, provides deposit and withdrawal slips and “passbooks” for participating students. When each student’s account reaches nine dollars, AB, or in some cases another corporate sponsor, agrees to provide the last dollar. When each account reaches ten dollars, it is transferred to AB and converted into a conventional savings account.

The KOB program is directed at schools in low- and moderate-income areas. Cohen identifies qualified schools based on the percentage of each school’s enrollment that is in government-sponsored school lunch programs.
In just four years, 39 schools throughout the state have implemented the program and other states want to replicate it. “Just as rewarding,” Cohen says, “is knowing that the program serves a dual purpose: educating parents as well as children in the fundamentals of financial education.”

**Bank At School**
Although classroom instruction and the experience of saving money are important, exposure to financial institutions is also useful. Illinois’ “The Bank At School” program provides this exposure. It was developed and sponsored by the Illinois State Treasurer’s Office as a joint effort with elementary schools and financial institutions. The program consists of two sections, classroom instruction and “bank day”. During “bank day” students take a field trip to their sponsor-bank and are exposed to bank operations through practical student-teller training. They also are given the opportunity to open a personal savings account.

To date, the program has enjoyed the successful participation of approximately 108,000 students, 675 school districts, and 400 partnering financial institutions. To ensure the program is accessible to youth of different backgrounds and ethnicities, the teacher’s manual has been translated into six foreign languages.

**Conclusion**
With numerous programs available and seemingly limitless resources and possibilities, becoming a player in the financial education arena could not be easier. Banks can provide services such as classroom-instruction and technical assistance or can participate on the boards of organizations that further financial education.

In any case, bank involvement in financial education in schools is a “win-win” situation. Banks can further their CRA goals and at the same time
promote and foster the development of a generation of financially educated adults.

For more information on “Banking on the Future” contact Operation Hope’s Lashan Epperson, Program Manager, Banking on the Future & Entrepreneurial Training at (213) 891-2909.

For more information on “Kids Own Bank” contact Don Cohen, Associated Bank, Milwaukee at (414) 283-2284 or Paul Haussman, University of Wisconsin-Milwaukee at (414) 227-3265. For more information on “The Bank at School” program contact Illinois State Treasurer Judy Baar Topinka’s Office at (217) 782-6540. Also look for the JumpStart Coalition for Personal Financial Literacy, a non-profit organization based in Washington D.C. that consists of a wide range of organizations including federal agencies, universities and nonprofit associations. Banks interested in learning more about the organization, and opportunities for participation in the program should contact Dara Duguay, Executive Director, at (202) 466-8610.

**About the Author**

Jessica Hebert is a portfolio manager and senior examiner at the Federal Reserve Bank of San Francisco, where she has spent the past seven years in positions of increasing responsibility. In her current assignment with the Community Affairs Unit, she assists financial institutions in boosting their CRA performance. Prior to her career at the Federal Reserve Bank, Ms. Hebert worked for Bank of America, where she completed its Preferred Banking Commercial Lending program, and worked in Retail
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