SPECIAL ISSUE

BANKING & COMMUNITY

Perspectives

FEDERAL RESERVE BANK OF DALLAS JULY 1995

Positive Partnerships

In a speech given at the Social Compact Awards luncheon in Washington, D.C., on May 17, 1995, Federal Reserve Chairman Alan Greenspan discussed successful community and economic development partnerships between community-based organizations and financial institutions. We wanted to share with you these remarks, which also highlight the new CRA regulation and underscore the need to strive continuously to eliminate lending discrimination.

I am very pleased to be here today as part of your honoring some of the people who have had the courage and determination to make a difference in our country's neighborhoods. These changes were made in the spirit of partnership—that is, partnerships between community-based nonprofit organizations, local entrepreneurs and financial institutions. But something more fundamental was behind these successes.

The people here today have demonstrated unusual vision and creativity. In neighborhoods where most people saw blight and decay, they saw opportunities. They brought together the resources necessary to make things happen—often in nontraditional ways. These entrepreneurs had to seek out the capital to make their vision a reality. Like any venture capitalist, they had to sell their investors on their vision. They had to overcome the bureaucratic hurdles that federal, state and local governments threw in their paths. And finally, and often the most difficult task, they had to sell their customers on their product. They had to convince people who had abandoned hope for the neighborhoods they called home that things could get better.

Having this vision to recognize gaps in the market and then fill them is what makes new products possible. And it is the emergence of new products to fill unmet needs that has so

enriched lives in so many communities. In Rancho Vista, for example, the entrepreneurial vision of our honorees led to a new way of financing prenatal care. As a result, low- and moderate-income people who lacked health insurance coverage can now obtain prenatal care that they could not otherwise afford.

On the other side of the country, in New Jersey, barrier-free housing for the disabled and those with special needs filled a unique market niche at substantially lower cost than the public sector has been able to attain through traditional care facilities. We are all better off for these efforts, whether we are

(continued on page 2)

Speech

(continued from page 1)

the direct consumers of them or the taxpayers who would otherwise shoulder the costs.

I would particularly like to commend the partners from the financial services industry who are here today. They are, of course, a crucial player in community revitalization. To put forward their resources and their energy to the extent they have, they must share the vision of the entrepreneurs with whom they are working. They are taking risks, but they recognize that as part of their mission.

The history of financial involvement in increasing homeownership in America is one of taking risks—of designing new instruments and financial products to make financial resources prudently available so that more people can realize the goal of homeownership. Taking prudent risks in lending so that others may attain an objective is the essential role of a financial intermediary.

Our New York honorees give an idea of the extent of partnership that is possible and the complexity of the mission they are undertaking. While today the Social Compact is honoring the particular efforts of one financial institution—Nat West—the Neighborhood Housing Services of New York has managed to partner with no fewer than 180 financial institutions. In Rochester, the partnership between First Federal and the North East Block Club has successfully combined the best of what each has to offer into one deal: community skills, financial resources and vision.

"It is a natural part of the enlightened self-interest of any organization to be concerned with the community in which it has invested and for it to want to improve the quality of life its employees live."

The institutions represented here today are most active in the communities in which they do business, and they know that helping in the rehabilitation effort also preserves their own environment. One can easily see the River Bend area of Des Moines from the Principal Financial Group's building downtown. The historic sections of Savannah now being rehabilitated are only a short walk from Wachovia's downtown office. It is a natural part of the enlightened self-interest of any organization to be concerned with the community in which it has invested and for it to want to improve the quality of life its employees live.

We have long recognized the importance of self-interest in promoting the well-being of all. Most of the parks, libraries and institutions of higher education in America's cities were founded by local businesspersons wanting to improve the local quality of life. Many of the gifts that started these institutions were given long before charitable giving received a tax deduction—in fact, long before there even was an income tax. While there may be no obvious short-term profit motive involved in these gifts, maximizing the long-term franchise values of business enterprise requires an institution to recognize that it is a part of the community in which it operates. Having a high quality of life in that community may allow the firm to attract employees from other areas or maintain the morale of current employees.

Edmund Burke noted the "little brigades" of individuals who banded together in voluntary association to provide the basic social infrastructure that allows society to operate. So, today we are celebrating the achievements of partnerships of people who made things happen in their communities. We are celebrating the increase in material opportunity and the capacity for families of modest means to take their first step on the ladder of economic opportunity. Let us bear in mind and pay tribute to the virtues of a system that made today possible—partnership, vision and enlightened self-interest.

“CRA has helped financial institutions to discover new markets that may have been underserved before.”

CRA Reform

These same three factors have been in regulators’ minds during the recent regulatory reform process for the Community Reinvestment Act. Preparing the new regulation has been a very difficult task. Various facets had to be carefully weighed and balanced. First was the president’s request that the agencies produce a more objective system that would include less process and paperwork burden for the financial industry and produce greater results for the community. There was the community’s increased need for access to credit in all areas, including low- and moderate-income neighborhoods, and the needs of the financial industry to make safe, sound and profitable loans.

Additionally, the regulators had to walk that fine line between trying to ensure credit availability without falling into the trap of credit allocation. In essence, there was a partnership of interest in accommodating all these goals in the revised rules.

The new CRA regulation is surely not perfect, but it probably is the best that we could do given all the competing considerations. When conducted properly by banks that are knowledgeable about their local markets, that use this knowledge to develop suitable products and have adequately promoted those products to the low- and moderate-income segments of the community, CRA can be a safe, sound and profitable business. This seems to have been proven over the years of our experience since the law was enacted in 1977. CRA has helped financial institutions to discover new markets that may have been underserved before.

But what about the question of whether loans to low- and moderate-income borrowers have caused safety and soundness problems? To date there is very little hard data. A few studies suggest that the delinquency experience is not materially different. Beyond that, anecdotal information seems to suggest that loans to low- and moderate-income people perform with respect to repayment as well as, and in some cases better than, loans to others, though default rates of some mortgage loans may be higher. Aside from the issue of repayment, there is the issue of profitability. The more successful programs involve credit counseling and other activities that add to cost, and whether they are fully recovered is unclear. But on the broader question, there is little or no evidence that banks’ safety and soundness have been compromised, and often bankers report sound business opportunities.

We at the Federal Reserve have stressed this market aspect of CRA in the past and will continue to do so in the implementation of the new regulation. I think this is crucial. If CRA is perceived by banks as a tax or credit allocation, it will fail in the long run.

Activities developed by banks to meet credit needs in low- and moderate-income neighborhoods should be well planned and thoughtfully implemented within banks’ overall business plan. Banks should not try to throw money at a problem or “just write the check”: that’s not to anyone’s advantage. The latter type of activity will not be sustainable over the long haul. Banks are not philanthropic institutions. They are for-profit entities with obligations to their stockholders, who require competitive rates of return, and are subject to a regulatory apparatus that protects their depositors from losses owing to unsound practices.

“There is little or no evidence that banks’ safety and soundness have been compromised, and often bankers report sound business opportunities.”

(continued on page 4)

(continued from page 3)

This is surely evident to everyone, and I apologize for emphasizing what may seem to be obvious. But I think it bears repeating, for CRA must meet the test of the market if it is to provide the long-term benefits of revitalization that we all desire. It's worth reminding all of us—community groups, policymakers and even bankers—of this fact from time to time, since it's sometimes tempting to emphasize short-term benefits at the expense of long-term commitments.

CRA has had a unique strength in that it has not been a bureaucratic, Washington-driven program that substitutes "inside the Beltway" decision-making by nonelected officials for the give and take of local community control. Yet in recent years, it has seemed clear that some greater direction from the regulators was needed, and we have tried to provide that guidance in the new regulation. But in doing so, we must be vigilant to avoid turning a flexible, locally determined program into a "one size fits all" approach.

This was one of the most difficult issues that we tackled in the revision process—trying to maintain some flexibility, yet further quantifying what is required for good performance. Centrally directed credit allocation by administrative agencies would interfere with the flow of credit and runs the great risk of misallocating funds and underserving some of the unique and critical needs of localities. I don't think you'll find any argument on this point from any of the agencies, but it will be important for all of us, in implementing the new regulation, to remain alert to the risk of de facto credit allocation that is not sanctioned by Congress, at the same time we are disavowing any such intention.

"To be sure, much discrimination, perhaps most, in today's society is subconscious, the result of habit and culture. But whether it is deliberate or not, the consequence is the same."

This brings me to the issue of implementation of the new regulation. In a sense the work is just beginning. There will be difficult steps in developing training for the agencies, lenders and community groups and in successfully implementing the new rules. We are committed to do this on an interagency basis to ensure maximum consistency both within and among the various regulatory agencies in the examination process. Since much of this will be new to everyone, we will be looking for, and paying close attention to, feedback from the lenders, community organizations and other interested parties on our progress. With everyone working together, we think that this will continue to be important to sound community development.

Discrimination

Before closing, I would like to turn briefly to a matter of serious concern to us all that is distinct from community development, but not unrelated. That is racial discrimination, whose specter has been at the roots of much effort at enhanced community development.

To be sure, much discrimination, perhaps most, in today's society is subconscious, the result of habit and culture. But whether it is deliberate or not, the consequence is the same. Free market capitalistic systems, rooted in individual freedom, cannot and should not abide such unjust behavior. To the extent that individual contributions to the marketplace are judged and rewarded on any basis other than economic values, the system suffers and the nation's standard of living is impaired. We may never reach perfection in this regard, but we should never cease to persevere in this important matter.

It has been a great pleasure to be with you today. I am sure that as long as organizations such as yours exist, there will be imaginative, creative and worthwhile projects that contribute to making our neighborhoods safer and better places to live. ▼

Perspectives
Federal Reserve Bank of Dallas
Community Affairs Office
P.O. Box 655906
Dallas, Texas 75265-5906