FEDERAL RESERVE BANK OF DALLAS

BANKING & COMMUNITY

Perspectives

FIRST QUARTER 1999

Shell Community Banking Initiative

A 'Private-Private' Partnership

Houston business owner Carl Jackson (right) and Unity National Bank Executive Vice President Tommy Brooks discuss the success of AR Brake Complete Automotive Service Center.

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Consumer Advisory Council Appointment

When Carl Jackson, owner of AR Brake Complete Automotive Service Center in Houston, needed money to expand his growing business, his bank turned to an innovative new partnership to provide a $200,000 loan. The partnership is between Unity National Bank, a minority-owned bank in Houston's Third Ward, and Shell Community Financing Company of Texas, a subsidiary of Shell Oil Co. Both are participants in the Shell Community Banking Initiative, an unusual "private–private" partnership that Shell sees as a way to stimulate small-business development in its operating areas.

"Shell Oil has a continuing commitment to improve and strengthen its corporate performance in key minority business opportunity areas, including funds management, banking and in our supplier network," says Jack E. Little, the company's president and chief executive officer.

Shell designed the Community Banking Initiative to expand the lending capacity of selected community-based financial institutions and support the growing financial needs of traditionally underserved communities. Unity National Bank and Founders Bank of Compton, Calif., are the two institutions selected to participate in the local-bank pilot program.

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Unity National Bank Chairman Limus Jefferson (left) is joined by Susan Hodge, treasurer of Shell Oil Co., and Albert Myres, former manager of Corporate Banking and Business Support, Shell Oil Co.

"The community banking program, launched in early 1998, sets a new standard for corporate partnerships with minority-owned banks," says Little. "This initiative facilitates a Shell Oil Co. business objective to align closely with the financial health of the communities we serve and to make a difference in those communities."

Shell made a noncontrolling equity investment of $250,000 and deposited $1 million in demand deposits in each of the two banks (Unity National and Founders) involved in the local-bank pilot program. The company also makes up to $2.5 million per year available to each bank for small-business loans—like the one obtained by Carl Jackson's AR Brake—over the next three years.

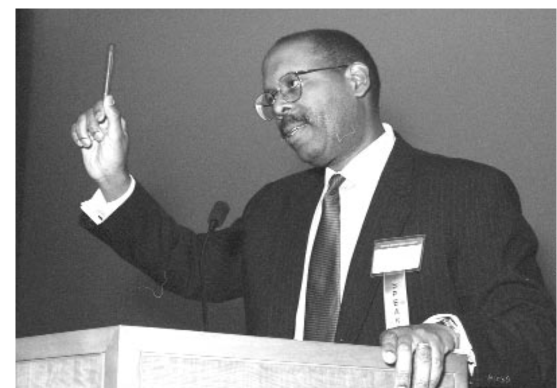
To initiate a loan to an individual business, Unity National screens applicants and performs a credit analysis before passing the application on to a review committee at Shell Community Financing. If Shell chooses to participate, the bank originates and services the loan. Shell Community Financing's involvement has augmented Unity National Bank's legal lending limit on an individual loan by approximately 40 percent, which has resulted in an additional $500,000 loaned to minority-owned businesses in Houston since March 1998.

"The historical dilemma for corporations wanting to invest in the inner city has been determining prime locations for businesses and finding talented people to run those businesses. That is our role," says Larry Hawkins, president of Unity National. "Since we are part of the inner-city community, we can help Shell in those areas. Shell's success depends on how well we fill that role."

Through their connections in the National Minority Bankers Association, Unity National and Founders have helped Shell fulfill its national commitment to increase the value of its certificates of deposit in minority- and women-owned banks from $2 million up to $5 million. To date, Shell has $100,000 certificates of deposit with approximately 50 member banks across the country. Forty association members have provided a $60 million unfunded line of credit to Shell, for which they will each receive a commitment fee.

If the pilot with Unity National and Founders proves successful, Shell plans to expand its program to municipalities nationwide, investing up to $45 million over a three-year period. The national

Larry Hawkins, president of Unity National Bank in Houston, explains the Shell Community Banking Initiative at the Dallas Fed's recent Community Development Conference.



Fast Facts

Shell Community Financing Company of Texas has formed a partnership with Unity National Bank in Houston and Founders Bank in Compton, Calif.—the Shell Community Banking Initiative—designed to stimulate small-business development in inner-city communities.

Objective

Support minority- and women-owned small-business development in areas where Shell Oil has a significant operating presence.

Core Components

Local-Bank Pilot Programs

- Place additional deposits in participating banks
- Purchase a noncontrolling equity interest of up to $250,000 per bank
- Make available up to $2.5 million annually for each bank's participation in small-business loans over the next three years

National Program

- Increase the value of Shell Oil certificates of deposit with minority- and women-owned banks from $2 million up to $5 million
- Provide Shell with a commitment for a $60 million line of credit (unfunded) from minority- and women-owned banks for which the banks earn a fee

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component of the Community Banking Initiative could have a major impact on small-business lending if it is fully implemented. When combined with the capital resources of Shell's partner institutions, new loans could total more than $110 million nationwide.

Shell has approached Unity National and Founders about developing a program to teach new entrepreneurs the basics of running a successful business and starting a mentoring program for people with entrepreneurial potential.

In the case of Carl Jackson, this private–private partnership has created new business opportunities for all three participants—Shell Oil, Unity National and AR Brake. According to Jackson, "Thanks to Shell's partnership with Unity National Bank, I was able to get the loan for my business. Because of that loan, my business is more stable. It has had a domino effect by making it possible for me to provide more secure jobs for my employees and make a contribution to the economic stability of our neighborhood and community."

Did You Know...?

Garcia Named to Consumer Advisory Council

The Board of Governors of the Federal Reserve System has appointed Rose M. Garcia to its Consumer Advisory Council. Garcia is executive director of the El Paso Collaborative for Community and Economic Development. She also serves as president of the Texas Association of Community Development Corporations and is a leader in the development of affordable housing in Texas and New Mexico.

The Consumer Advisory Council consists of 30 members who represent consumers, lending institutions and other sectors. Members are appointed for three-year terms and meet three times annually to advise the Board of Governors on consumer concerns.

Fair Lending Examination Procedures Available

On January 5, the Federal Financial Institutions Examination Council announced the release of the Interagency Fair Lending Examination Procedures. The core procedures, adopted by each of the member agencies of the FFIEC, provide a basic and flexible framework for the majority of fair lending examinations. The procedures are available on the FFIEC's web site at www.ffiec.gov/fairlend.pdf.

CRA-Qualified Investments

Two New Instruments

In 1998 both Fannie Mae and Access Capital Fund—a closed-end mutual fund—developed innovative instruments to help banks make investments in their communities that also fulfill requirements of the Community Reinvestment Act (CRA). Backed by mortgages meeting CRA requirements for low- and moderate-income lending in targeted areas, these instruments—called mortgage-backed securities—provide community investment opportunities and increase the availability and flow of capital into targeted areas.

Fannie Mae's Special Instrument

Fannie Mae's mortgage-backed securities (MBSs) are custom-tailored to the targeted areas of individual financial institutions. When an institution contacts Fannie Mae about investing in an MBS, the agency begins the process by approaching mortgage lenders in the targeted area about CRA-qualified loans the lenders would consider selling.

Before guaranteeing the loans submitted by interested lenders, Fannie Mae reviews them to ensure they meet underwriting standards and CRA requirements. The loans are then pooled into an MBS and sold to the investor institution. As the mortgages in the security are paid down, the investor receives the payments. If the institution decides to sell an MBS, it must be sold back to Fannie Mae.

The Access Capital Instruments

Access Capital Strategies LLC, which manages the Access Capital Strategies Community Investment Fund, was established through funding from Fannie Mae and provides an innovative approach to making investments in Fannie Mae CRA-targeted MBSs.

A financial institution interested in investing in an MBS commits to purchase shares of Access Capital Fund and designates a target geographic area for its investment. Access Capital identifies and pools qualified loans from the target area. The loans are put into a AAA credit-enhanced MBS that Access Capital Fund purchases and maintains. As the loans are repaid, shareholders receive pro rata dividends from all the MBSs in the fund. Access Capital Fund invests in Fannie Mae and Freddie Mac MBSs, as well as securities backed by the government-guaranteed portion of student loans and community development loans that are enhanced by the Federal Home Loan Bank. The fund may also actively trade these securities, creating additional income for investors.

"Our goal with this fund is to enhance the liquidity of community development loans and provide investors with CRA investment credit at appropriate risk-weighted returns," says Ronald A. Homer, chief executive officer of Access Capital. "We are accomplishing this goal by converting these loans into investments guaranteed by Fannie Mae and other agencies. Investments in our fund are revolving and therefore can be leveraged many times."

BankBoston's Investment in Access Capital Fund

BankBoston was one of the first to endorse the Access Capital Fund. Using the institution's $25 million investment, Access Capital purchased a BankBoston portfolio of 226 adjustable-rate mortgages to create an MBS. The fund currently provides a 5.17 percent yield to shareholders.

"BankBoston is very active in originating affordable housing loans," says John Wells, director of portfolio management, Global Treasury, at BankBoston. "And we are always looking for new ways to achieve our investment credits. Participating in the Access Capital Fund gave us the opportunity to meet those credit needs as well as the investment credit test under the CRA. And it gave us the opportunity to help smaller banks with

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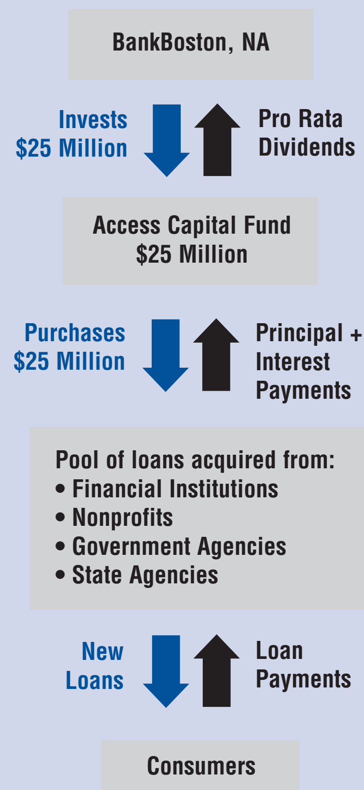

The pool of loans meets the requirements for consideration under the CRA. The pool may include mortgage loans guaranteed by Fannie Mae, the guaranteed portion of SBA loans, and community development loans that have been enhanced by the Federal Home Loan Bank.

TIB–
The Independent BankersBank
Forms Small Business Investment Company

TIB is partnering with Service Asset Management Co. (SAMCO) and Conrad/Collins Inc. to establish the first small-business investment company owned by small to midsize community banks. From left are Gayle Earls, president and CEO of TIB, James Gardner of SAMCO, Barry Conrad of Conrad/Collins, and Michael O'Rourke and Kevin Drew of TIB.

TIB–The Independent BankersBank in Irving, Texas, has taken the lead in establishing the Independent Bankers Capital Fund, the first small business investment company (SBIC) owned by small to midsize community banks. TIB supplies correspondent banking services to 670 independent community banks in Texas and surrounding states. TIB, which acts as a bankers' bank, created the fund to offer member banks a way to provide equity financing to growing businesses in their communities.

The SBIC program is a unique partnership of public and private funds in which the U.S. Small Business Administration (SBA) supplements the private capital invested in the SBIC. The ratio of SBA to SBIC funds could be as high as 3-to-1.

SBICs are privately owned and managed, profit-motivated investment firms licensed and regulated by the SBA. Many SBICs are owned by large commercial banks. "It's usually larger financial institutions that have the resources to fund a bank-owned SBIC," says Kevin Drew, senior vice president of correspondent banking for TIB. "By pooling our member-bank resources to form the Independent Bankers Capital Fund, we can extend this source of funding to smaller communities."

Congress created the SBIC program in 1958 after a Federal Reserve Bank study identified a major gap in capital markets for long-term financing of small growth-oriented businesses. To support their growth, these emerging companies require equity or equity-type capital that often exceeds what traditional, asset-based credit would provide. The SBIC program was created to address this need, particularly for businesses requiring financing in the $300,000 to $5 million range.

SBICs provide equity capital, long-term loans, debt-equity investments and management assistance to small businesses—generally those with annual income of less than $6 million and net worth of less than $18 million.

"Over the past 40 years, SBICs have provided more than $21 billion in financing to approximately 84,000 businesses, and those businesses have created hundreds of thousands of new jobs," says Don Christensen, SBA associate administrator for investment. Federal Express, Apple Computer, Compaq Computer and Outback Steakhouse are a few of the companies that received SBIC financing in their early stages.

TIB finances the Independent Bankers Capital Fund by obtaining commitments from small and midsize banks willing to invest a minimum of $200,000. By law, banks may invest up to 5 percent of their capital and surplus in an SBIC, money that may be eligible for credit under the investment test of the CRA. The fund has raised $8 million in commitments so far and will apply for an SBA license to operate as an SBIC as soon as the fund reaches $10 million. The fund manager expects to begin providing financing for small businesses in July.

The fund's strategy will be to target manufacturing, distribution and service companies with established, proven market positions and a history of profitable and growing operations. Companies must have been in business at least five years. The fund will finance operations, growth, modernization and expansion for amounts between $500,000 and $3 million.

"Funding small businesses with strong growth potential is vital to the health of our economy," says Christensen. "The 23 million small businesses located in the United States employ more than 50 percent of the private workforce, generate more than half of the nation's gross domestic product and are the nation's principal source of new jobs."

For more information, contact Kevin Drew with TIB at (800) 288-4842.

Bank Consolidation

and Community Development Lending

What effect will increased bank consolidation have on low- and moderate-income neighborhoods and rural communities? What steps can banks take to meet credit needs in consolidated markets? What kind of relationship will large banks and community development organizations have in the future?

To address these questions, we have sought out the perspectives of three experts—a banker, an executive director of a community-based organization and the chairman of a large community development intermediary.

Karen Alnes

Director of Privacy and Information Sharing, Wells Fargo Bank, and Former Manager of the Community Affairs Program for Norwest Bank

Last year's megamergers prompted many community members to voice their concerns—sometimes quite loudly—that the resulting large banks would pay less attention to meeting the needs of their low- and moderate-income communities. Community groups of all sizes fear that, as banks grow, they will cease to care about community development, or will seek to dispense their obligations by writing large checks to fund only the largest community development intermediaries.

I would argue, however, that the reality has been quite different. The CRA is alive and well and working hard to ensure that the lines of communication between banks and communities remain open, and that large banks continue to address the needs for community development in all their markets.

CRA was born, in part, out of the concern that banks would abandon their neighborhoods or hometowns for higher yielding, safer investments elsewhere. The increase in bank consolidations has triggered new fears that the needs of low- and moderate-income communities will be overlooked in the industry's efforts to grow in order to survive. The growth of large community development organizations has brought fresh anxiety that relationships with smaller, more local nonprofits will be swept aside in the interest of efficiency.

As a political process, CRA is almost unparalleled in its ability to bring together grassroots community efforts and industry. In 1998, the process of public comment and bank response prior to mergers was exercised at a level greater than ever before. The Federal Reserve extended many public-comment periods, and record numbers of public meetings were held to allow anyone so inclined to step forward and offer comment. In the course of just four mergers, more than 2,500 individuals, groups and organizations expressed their comments—some favorable, some critical—regarding the banks' performance in community reinvestment. The Federal Reserve's Approval Orders for all of the transactions illustrate the extensive attention given to each bank's CRA performance and to the concerns of those who took the time to file comments. Few other industries can boast such a strong level of community involvement.

Few other industries can boast such a strong level of community involvement.
Karen Alnes

CRA Effectiveness

There are many indications that CRA has been effective. In the past few years, record numbers of dollars have been invested in or committed to community development. Some of these dollars funded projects that would not have been possible between a community bank and a small nonprofit. Large community development intermediaries have grown and evolved to address very specific needs across broad geographies. They have aided numerous smaller partners in creating the capacity for many types of community development projects. In a smaller community, the presence of a successful community development project (which may or may not have been funded by a large intermediary) often provides encouragement and support for development of additional projects by smaller local organizations. Large banks may elect to invest significant community

development dollars in the large intermediaries, but the process almost always includes many smaller local partners in every project.

Large community development intermediaries would probably be among the first to herald the importance of smaller nonprofits. Community-based nonprofits often serve as the key partner for the large intermediaries. After a merger or acquisition, banks of all sizes are wise to continue to work closely with local nonprofits, especially those with which they have had successful partnerships in the past. It is through partnerships with local organizations that the larger community development organizations are able to focus their efforts and identify the needs and the best opportunities in each market. Banks are in a unique position to enhance those partnerships to bring greater resources to the community through directing their investment dollars in the larger funds.

Not all large, consolidated banks have abandoned local marketplaces. As Norwest (now Wells Fargo) has grown, the banks have remained community-based, with many located in towns of fewer than 50,000 people. Each local "store" manager is responsible for understanding the needs of the local community and knowing the significant players in the community, including the local nonprofits or others who might be interested in community development. The manager is also responsible for the success and profitability of that store, which is directly related to the economic health of the community. However, unlike the community bank manager of the past, this manager has at his or her disposal an array of community development products, services and expertise through the parent organization. The local bank is able to deliver "big-bank" services with small-bank accessibility.

The strategy seems to work best when banks communicate regularly with their communities and listen carefully to the response, whether or not an application for acquisition is under consideration. The bank that maintains strong contacts with local government and community groups—in short, a bank that acts like a community bank—will find continued opportunities, and greater opportunities, for successful community development projects that benefit the community as well as the bank.

Rose Garcia

Executive Director, El Paso Collaborative for Community and Economic Development, and President, Texas Association of Community Development Corporations

The Texas Association of Community Development Corporations (TACDC) is a nonprofit statewide membership association of community development corporations (CDCs) and related nonprofit, government and for-profit entities. Our members are engaged in producing affordable housing and community economic development. The mission of TACDC is to enhance community development throughout Texas. We have 198 members, including 74 voting CDC members. TACDC is governed by a volunteer board of 15 directors elected by the members. The TACDC Roundtable, which discusses and suggests policy for the board's consideration, includes the board members and 11 representatives of national financial intermediaries and private lending institutions. The Roundtable supports TACDC's work with their financial and staff resources.

The current megamergers between large banking institutions are the result of many years of mergers between small and medium-sized banks. The result has been the obvious centralization of capital and private sector leadership. Local communities witness the drastic reduction in the number of access points to this capital and leadership. While these larger institutions are making an admirable commitment to community development activities, the fact remains that, at the local level, continued bank consolidation means a growing loss of private sector leadership, local authority and the ability to respond locally to problems and priorities. It means that local communities have fewer lending institutions with which to build strategic partnerships for addressing critical community development needs, such as affordable housing and small-business formation.

Local Voices

These megabanks must acknowledge that by becoming "the only game in town" they are also centralizing responsibility for private sector investment in rural and low-income communities. There simply are not as many banks around to "share the burden," and the responsibility of individual banks for community investment has grown. Building a great America means having local access to capital for business formation and housing development. A local voice is important in policies that guide the flow of this capital. If banks are centralizing capital through continued mergers, then banks must make a strong commitment to local investment in communities. Think of it as the price of a healthy society, as corporate stewardship and as rebuilding local markets so that traditional banking activities can flourish.

Great institutions should have great visions for this country. That requires

Building a great America means having local access to capital for business formation and housing development.
Rose Garcia

Institutions, encouraged by changes in CRA regulations, have gone from pledging large commitments to significant, market-driven lending and from boutique investments to standard, affordable product lines and services.

Bart Harvey

in these communities.

In this era of devolution, when states are becoming critical players in the housing and economic development policy arena, nonprofit intermediaries, state associations and CDCs are vital links between large national and multistate banks and local communities. These organizations can provide necessary and effective conduits to ensure that financial and leadership support from national and multistate banks actually reaches the local level.

human and financial leadership on the part of these lending institutions. Bank consolidation brings with it tremendous forces toward centralization of capital, leadership and location of lending institutions, as the doors of local banks close in the name of cost-efficiency and economies of scale. However, there are ways banks can ensure that the credit needs of low- and moderate-income neighborhoods and rural communities are met:

- Support CDCs by offering below-market interest rate loans and strong local leadership to increase business development and rebuild local economies.
- Identify appropriate avenues—such as national financial intermediaries and state associations or CDCs—for providing financial resources and building leadership and professional capacity.
- Make a leadership and financial commitment to state associations around the country, since these statewide policy and advocacy groups are becoming so critical to the community development industry in the current environment of devolutions.
- Support the establishment of, and make a financial commitment to, a national investment fund for community development so that centralized capital has a mechanism for reaching the local level.
- Recognize the special market needs of many rural and low- and moderate-income communities by providing staff that reflects ethnic markets and by keeping smaller branches open to maintain a local presence and local access to capital

TACDC serves as a central think tank for the Texas community development industry to identify strategies and resources necessary to advance the productivity of community development in the state. Nowhere else in Texas do CDCs, financial intermediaries, lending institutions and related nonprofit and government entities meet together to develop capacity and leadership for sustainable and productive community development. Private lending institutions are well represented in TACDC's membership and have provided outstanding leadership and financial support through the TACDC Roundtable. We do not want to lose this in the merger process.

Bart Harvey

Chairman and CEO, The Enterprise Foundation

A Revolution in Our Time

If ever the impact of technological change and global competition were evident, it is in the financial services industry. An ever quickening pace of financial institution consolidation is evidenced each day in *The Wall Street Journal* by a game of "top this merger": Deutsche

Bank and Bankers Trust, NationsBank and Bank of America, Bank One and First Chicago, Wells Fargo and Norwest, First Union and CoreStates. These mergers are creating not only great regional franchises but truly national banks of immense size and scope.

Simultaneously, other kinds of financial consolidations are occurring, including a trespass on the traditional separation of certain kinds of financial services as set up by the Glass–Steagall Act and other regulations: Citicorp and Travelers, Bankers Trust and Alex Brown, NationsBank and Montgomery Securities.

The forces behind these major mergers and cross-product combinations include competitive position, efficiencies of scale, new credit products, technological cost and service efficiencies, increasing globalization of markets and capital leverage. In essence, the financial services market is adapting new technologies, competitive scale and new products to force efficiencies in a generally fragmented market, and to combine services regulated by CRA with nonregulated, fee-oriented products and services (investment banking, mutual fund management, insurance and other products) in search of greater profitability.

The force of this change seems inevitable. The issue is whether it is good for low-income people and communities, and what might be done to make sure it is responsive to the credit and consumer needs of all citizens.

There is no argument, even among bankers in the community development field, that CRA has played a significant role in focusing banks on lending into low-income neighborhoods and to minority borrowers.

As one indication of the extent of community reinvestment, Federal Reserve 1996 CRA data show that 32,677 community development loans totaling $17.7 billion were made. Eighty-one percent of the community development loans by dollars came from large (over $1 billion in assets) institutions. These numbers are consistent with the development by the larger financial institutions of highly focused, competent community reinvestment departments overseeing the flow of credit and lending into low-income areas and products targeted at minority borrowers. These departments and their institutions, encouraged by changes in CRA regulations, have gone from pledging large commitments to significant, market-driven lending and from boutique investments to standard, affordable product lines and services.

Does Bank Size Matter?

There certainly has been nothing in the evolution of the CRA that indicates bank size has been detrimental to the level of credit and services provided to low-income communities. In fact, I would postulate that many of the larger banks have been leaders in the field. However, there still is little quantitative data analyzing the relative (to asset size) contribution of large and small banks.

It is also evident that reduced transaction costs, specialized product research and experimentation by Fannie Mae and Freddie Mac, and increased emphasis on targeted areas and borrowers by large financial institutions have made the lending process more open and more cost-effective, and have highlighted the barriers that must be overcome to further reach the underserved.

Some Areas of Exploration

While the past impact of consolidation on community reinvestment is encouraging, the rapidity and extent of change in the financial services industry lead me to a cautionary note. All the positive steps that have been taken so far could be quickly wiped away without solid administration and congressional support for strengthening the role of community reinvestment in the midst of financial consolidation and deregulation.

Nonregulated deposits are already growing at a far more rapid rate than

Bank Consolidation

Continued

regulated deposits, and aspects of the proposed financial deregulation bill leave large loopholes that potentially could diminish the importance of CRA. Unless there is a proactive commitment to continuing the progress we have seen so far, these large mergers could further distance low-income communities and people from mainstream financial services.

With size comes the importance of effective regulation, measurement and remedies. Evenness of service, products and outreach over an entire market area (particularly away from larger markets) is essential. The best-rated institutions should be that way consistently, not just because of superior service in selected market areas. The effectiveness of the regulatory system is essential to any meaningful enforcement of current regulations.

Finally, we do not know how well technological advances—like credit scoring and automated underwriting—will aid low-income communities. The potential for positive or negative change remains wholly in the application and economics of these changes. While credit scoring and automated underwriting may make the lending process easier and fairer, the question is whether institutions using these tools will go the extra mile to eliminate disparate impact on low-income and minority groups. Will the potential to bring new resources and problem solving to riskier credits be realized?

Clearly the jury is out. The Enterprise Foundation is working hard with major merger partners to assist in the delivery of special products and services to low-income areas. It is also joining with others in the field to advocate policies that encourage fair treatment of low-income people and neighborhoods, a system of regulation that adapts to the new realities, and creative partnerships to utilize technological change for further progress in the community reinvestment process.

CRA-Qualified Investments

Continued from page 4

limited CRA investment opportunities in their assessment areas to meet their investment needs.

"Low- and moderate-income borrowers tend to keep their properties longer than the average homeowner, and they do not refinance as often as conventional borrowers when interest rates drop," Wells continues. "So these loans prepay slower than conventional mortgages. As a result, our investments in Access Capital provide attractive returns as well as CRA credit."

According to Homer, because a diversified loan portfolio is inherently less risky than an individual loan, MBSs reduce investor risk. And because fixed transaction expenses are distributed over the entire loan pool rather than charged to a single loan, MBSs reduce expenses associated with investing in affordable housing.

For more information about innovative investments of this type, contact Access Capital at (617) 576-5858 or Fannie Mae at (800) 752-0257.

Perspectives
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