Progress of Minority Depository Institutions*

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The FDIC recently released a report on the structure, performance and social impact of minority depository institutions, focusing mainly on the last 13 years.[1] This follows a study and report of community banking that resulted in a greater understanding of the evolution of community banking during the previous 25 years.[2] As a result of that study, the FDIC hosted roundtable discussions across the country, undertook a review of its examination, rulemaking and guidance programs, and developed a technical assistance video program for bank directors, officers, and employees. While most minority depository institutions are community banks and may avail themselves of these tools, the FDIC may conclude that additional programs are desirable to support the minority depository institutions in the country.

Conclusions of the report

Geography

Minority depository institutions, or "MDIs,"[3] comprise a small portion of the total depository institutions in the country, representing only about 2.6% of all depository institutions. Their total assets are about $181 billion, and of that amount, five MDIs account for almost $60 billion,[4] leaving about $120 billion in total assets for the remaining 169 MDIs.

They are located primarily in metropolitan regions of the country, since that is where the heaviest concentration of minority customers lives. Nearly half of all MDIs are headquartered in five MSAs, with Los Angeles having by far the largest concentration of MDIs; NYC, Miami, Chicago, and Atlanta being other cities with large concentrations. In only a few metro areas does the share of deposits of MDIs amount to a significant share of total deposits. For example, in Los Angeles County, MDIs hold 10% of the deposits and in Miami-Dade County, they hold nearly 9% of the deposits.

Within the community of MDIs, most of the charters and most of the assets are held by Asian-American

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[1] "Early Release for the Upcoming FDIC Quarterly, 2014, Volume 8, No. 13.

[2] The MDI study only covers 13 years.

[3] A minority depository institution is one in which 51% or more of the stock of the institution is owned by one or more socially and economically disadvantaged individuals in which a majority of the Board of Directors is minority individuals and the community it primarily serves is predominantly minority.

[4] Five Hispanic-American MDIs located in Puerto Rico.

MDIs, with Hispanic-Americans owning most of the assets. While African-Americans hold nearly 30% of the charters, those institutions only hold about 3% of the assets.

Structural Change

Over the 13 year period covered, the number of charters has increased from 164 to 174, reaching a peak during this period in the turbulent immediate pre-recession period of 2007 when there were about 215 charters outstanding.[5] Most of that growth is traceable to the choices of some preexisting institutions to re-designate themselves as MDIs. There were 44 new charters granted during this period and 81 redesignations (there were also 33 failures and 57 mergers). Absent the redesignations, the number of charters would have dropped from 164 to 83.

If there is any single description of the structural changes that occurred during this period, volatility would probably be as good as any. Asian-American charters have dramatically increased as have Hispanic-American charters, while African-American charters have decreased significantly both in absolute numbers and in percentage of total MDIs.

Failure rates for MDIs were considerably higher than those of community banks as a whole — MDIs were three times more likely to fail. In part, that is because the communities served by the MDIs produce higher risk loans.[6] In most of the cases of failures, the failed institutions or its assets were acquired by other MDIs; such acquisitions are favored by statute and regulations.

Financial Performance

During this period, the pretax return on assets of MDIs was 0.69%; of community banks 1.02%; and for noncommunity banks, 1.34%. This, of course, was the highly volatile period from 2001 through 2013. During the first five years of this period, the performance of MDIs and community banks was about the same, but thereafter they deviated sharply. Loan loss provisions were twice as high at MDIs as at community banks, and efficiency ratios at MDIs are higher than at community banks. Interesting, overhead expenses have been substantially higher at African-American and Native-American banks than at Hispanic-American or Asian-American institutions.

Social Impact

MDIs tend to be located in parts of urban areas in which there is a higher share of the population living in LMI census tracts and with a higher share of minority population.[7] Loans are made with collateral from those areas and bank accounts are opened there.

For example, with respect to home purchase mortgages, the median share of home purchase mortgages made by African-American institutions was 78% compared with less than 1% for non-MDI community banks. Comparable figures exist for Hispanic-American and Asian-American institutions.

The report summarizes the social impact section by saying:

[5] For historical reference, there were 11 African-American chartered banks in 1943, 57 in 1979, and 91 in 1987. In 1962, the first Asian-American bank was chartered, in 1969 the first mainland-based Asian-American bank, in 1971 the first Native American bank, and in 1975 the first Women's bank. "***History***," National Bankers Association.

[6] There, of course, are often other reasons. See "***Failed Dreams — The Collapse of a Harlem Bank: Freedom Bank's Demise: A Trail of Risky Loans and Fast Growth***," December 3, 1990.

[7] For African-American institutions, 66% of the population served lived in LMI tracts, or nearly 4 times as many as in the average community bank. For Hispanic-American institutions, it is 34%, and for Asian-American banks, it is 45%. The minority population in service areas for African-American institutions was 60% and for the average community bank 9%.

"On the basis of [comparisons between the MDIs and other community banks] MDIs appear to be highly successful in carrying out their mission of serving low- and moderate-income as well as minority households."

Summary

Minority institutions have been in existence in one form or another in the U.S. since 1888 when Capital Savings Bank was formed in Washington D.C. and the True Reformers Savings Bank was opened in Richmond.[8] At various times since then, they have received special legislative or regulatory treatment.

In addition, there have been times when they received special supervisory treatment. For example, in 1971, soon after the Martin Luther King assassination riots, an African-American owned bank in Boston would have failed but for the use by the FDIC of the Open Bank Assistance program, a program that had been placed in the statutes in 1950 for quite different reasons.[9] This was the first use of that open bank assistance and was used primarily because the institution was a minority owned institution serving a minority customer base in a time of racial unrest in the country. In 1975, the FDIC established a Deposit Insurance National Bank in Kansas City to assume the insured deposits of the Swope Park National Bank, a minority owned institution that served a predominantly African-American population in Kansas City. That program had also not been used for decades although it had been established in 1933 and was designed to provide a slow payout of insured deposits in situations in which no other banks wanted to assume those deposits.[10]

It is probably no surprise that the profitability of MDIs is less than other community banks, since in many cases they serve a population that is not as wealthy and often not as integrated into the economic system as that served by the other community banks. Management might also be a problem for such institutions since job opportunities at non-MDIs are greater than they were when the government established programs designed to encourage the development of such institutions, so competition for good managers is more intense. Promotion opportunities are probably less in such institutions.

These and other societal reasons may account for the failure of MDIs to increase significantly either in number or in assets. Similarly, it was not the purpose of the study to determine if the customers of the MDIs would have been served by other non-MDIs, though the imposition of stringent CRA examinations and enforcement of Fair Lending and ECOA laws suggest that non-MDIs would have been interested in providing credit to those customers.

It will be interesting to see what conclusions the Board or the FDIC draws from this study and what recommendations they might make for legislative or regulatory changes as a result of the report.

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[8] Douglas Price of the Cleveland Federal Reserve Bank says that one was operating in 1866 but does not identify that institution. "Minority-owned Banks: History and Trends, Economic Commentary, Federal Reserve Bank of Cleveland, July, 1990. The first African-American woman owned institution was the St. Luke Penny Savings Bank in Richmond in 1903.

[9] The Board made the required finding of essentiality on the basis of the service being provided to the largely African-American community by the bank. It was the first time that authority had been used since Congress gave the FDIC authority in 1950 over the objection of the Federal Reserve. The FDIC argued that the Federal Reserve had been reluctant to provide lender of last resort assistance to the failing banks.

[10] That section was used at least one other time but has not been used for decades.