# Charting a Path for Inclusion of the Country's Minority Depository Institutions: 2020 COVID-19 Legislative and Regulatory Agenda

June 4, 2020

The National Bankers Association (NBA) represents the country's Minority Depository Institutions (MDIs). Our institutions bank the communities that are most vulnerable to the coronavirus epidemic – both physically[1] and economically[2]. While the National Bankers Association commends Congress on its leadership to date in responding to the COVID-19 pandemic, we firmly believe much work remains to be done in supporting the MDI sector as we respond to the credit needs of the communities and small businesses that our member institutions serve that will disproportionately shoulder the burden of any economic downturn attributable to the COVID-19 pandemic. With these concerns in mind, the NBA offers the following nine (9) recommendations and a path forward for the Congress in administering the CARES Act as well as to Congress as you continue to develop additional economic relief measures in response to the COVID-19 pandemic:

(1). **MDIs should be afforded primary credit access to the Federal Reserve's discount window program at least through the duration of the Administration's national emergency declaration.** On the Federal Reserve's website regarding access to the discount window, the criteria for primary credit states that Federal Reserve banks with 1, 2 or 3 CAMELS ratings and well or adequately capitalized should receive primary credit treatment regarding access to the discount window.[3] r All MDIs and other mission-oriented lenders like CDFI banks should be afforded primary credit status to the discount window so long as the national emergency declaration remains in place.

(2). **The Small Business Administration should seek to proactively lower any administrative barriers to MDI participation across all SBA loan programs:** To the extent that there are any administrative barriers to participation that have historically limited MDI participation in SBA lending programs – such as the requirement for certain programs that lenders originate a minimum number of loans, for example – that do not require Congressional action, we would urge the Small Business Administration to proactively identify and eliminate those barriers to participation as soon as practicable. African-American borrowers as a share of all 7(a) and 504 program lending in 2016, for example, only accounted for 2% of the lending activity in flagship SBA programs with Latino borrowers only faring slightly better – this despite MDIs

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[1] *See,* Deborah Barfield Barry, "Health Issues for Blacks, Latinos, and Native Americans May Cause Coronavirus to Ravage Communities" (March 30, 2020). *USA Today*. Available at: https://www.usatoday.com/story/news/nation/2020/03/30/coronavirus-cases-could-soar-blacks-latinos-and-native-americans/2917493001/.

[2] *See,* Amelia Thomson-DeVeaux, "Which Workers Are Most Vulnerable to the Economic Costs of the Coronavirus" (March 18, 2020). *FiveThirtyEight*. Available at: https://fivethirtyeight.com/features/which-workers-are-most-vulnerable-to-the-economic-costs-of-the-coronavirus/.

[3] Federal Reserve, Discount Window, https://frbdiscountwindow.org/pages/general-information/primary-and-secondary-lending-programs. (Accessed April 1, 2020).

having an established track record of higher rates of small business and SBA lending to diverse entrepreneurs and a willingness to do larger SBA loans to diverse entrepreneurs relative to non-MDIs.[4] The best way to ensure that the SBA-related provisions of the CARES Act and any subsequent relief measures administrated through the SBA actually makes it way to diverse entrepreneurs, LMI communities, and the nonprofit institutions that serve LMI communities and communities of color is to take affirmatives steps to ensure that every MDI has the ability to fully participate in every SBA program. Affirmative steps would include goals for diverse entrepreneur participation in COVID-19 related SBA programs[5], targeted efforts to ensure that MDIs are delivery channels for diverse entrepreneurs such as creating an MDI Coordinator within the SBA's Office of Advocacy similar to federal banking regulators' MDI-specific liaisons, and adequately compensating lenders for program participation by establishing a reasonable rate floor, *supra*. Diverse entrepreneurs, nonprofit institutions that serve LMI communities and communities of color, and LMI communities are the most economically vulnerable during and in the aftermath of the COVID-19 pandemic. Accordingly, we believe that the SBA should proactively lower any administrative barriers to participation to ensure broad support of MDI participation in existing SBA programs as well as those established through the CARES Act and any subsequent COVID-19 relief measures that will help to ensure a robust and inclusive economic recovery.

(3). **The Small Business Committees should proactively seek to expand the SBA's lending capacity by incorporating MDIs and CDFIs into the SBA's direct lending programs and other programs that would expand the SBA's reach and capacity during the COVID-19 response:** Under normal circumstances, we understand that certain SBA programs like the Disaster Loan Program and even the SBA's Microloan Program are rightly limited to either the SBA directly or to a narrow universe of nonprofit lenders. But in a time of crisis where the pace at which relief is extended is paramount and the SBA could easily be overwhelmed, mission-oriented financial institutions like MDIs and CDFI banks should be force multipliers for the SBA in helping them expand their reach to diverse entrepreneurs and nonprofit institutions that service the credit needs of LMI communities and communities of color. We therefore ask that in the next COVID-19 related economic relief package, the House and Senate Small Business Committees proactively lower the barriers to participation and provide direct financial support to MDIs and CDFI banks for inclusion in SBA programs like the Disaster Loan and Microloan Programs that currently do not allow for direct participation from mission-oriented lenders.

(4). **Key provisions of the House-sponsored "Take Responsibility for Workers and Families Act" expanding the capacity of MDIs and CDFIs must be a part of the next COVID-19 economic relief package:** Sections 206 (a $1 billion supplemental appropriation for the Community Development Financial Institutions Fund), 207 (expanding key MDI sector support provisions like the Minority Bank Deposit Program), and 208 (zero-interest loans to CDFIs and MDIs with < $1B in assets to expand their capacity to meet the emergency financing needs of diverse and LMI customers, nonprofit institutions, and small businesses) of the "Take Responsibility for Workers and Families Act" make the kind of investments in the CDFI Fund and in MDIs that are necessary to expand our institutions' capacity to lend and respond to the

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[4] *See*, The Milken Institute, "The Partnership for Lending in Underserved Markets: Increasing Minority Entrepreneurs'' Access to Capital" at 9. Available at: https://milkeninstitute.org/sites/default/files/reports-pdf/PLUM-Capstone-Report.pdf. *See also*, Federal Deposit Insurance Corporation, "Minority Depository Institutions: Structure, Performance, and Social Impact" at 64-67. Available at: https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf.

[5] Entrepreneurs of color constitute 15% of all U.S. businesses, so the SBA should make best efforts to ensure that 15% of funds dispersed as a part of the economic response to the COVID-19 epidemic. *See*, Minority Business Development Agency, "State of Minority Business Enterprise" (December 8, 2019). Available at: https://www.mbda.gov/page/state-minority-business-enterprise-smobe-data-state.

In light of the SBA's track record with diverse entrepreneurs and MDIs long-standing commitment to diverse entrepreneurs, the SBA should proactively seek opportunities to work with MDIs as delivery channels for lending to diverse entrepreneurs and nonprofits.

growing needs of our small business, nonprofit, and consumer banking clients during the COVID-19 pandemic. We know that the Administration and Congress seek both a robust and inclusive economic recovery; the provisions in Sections 206, 207, and 208 will help to ensure that it is. MDIs and CDFIs have been a historically underutilized delivery channel for getting capital to LMI communities and diverse entrepreneurs and nonprofit institutions, and these three sections of the "Take Responsibility for Workers and Families Act" could go a long way in rectifying this historic oversight precisely at a time when the communities our institutions serve need help the most.

(5). **The next iteration of COVID-19 economic relief measures should include H.R. 5322, the "Ensuring Diversity in Community Banking Act of 2019 Act"** The Act includes a number of important provisions that the NBA has advocated on for some time. The NBA has long sought to codify and enhance federal agency participation in Treasury's Minority Bank Deposit Program (MBDP). The Act brings about much-needed reforms to the MBDP – a program which has unfortunately gone underutilized by federal agencies. The NBA has similarly raised concerns with prudential regulators that bank examiners do not come to our institutions with an understanding of the unique operating environments associated with the economically distressed communities our institutions disproportionately serve. The Act seeks to rectify this by taking historic steps to diversify our federal bank examiner corps and to introduce best practices across federal banking regulators regarding culturally-competent training and best practices to ensure that examiners have a full appreciation of our institutions' unique operational challenges. The NBA has long viewed Treasury's Financial Agent Mentor-Protégé Program (Program) as an underutilized vehicle for MDI-majority bank partnerships, and the Act expands the Program's reach to include more MDI-majority partnerships in administering programs through the Bureau of the Fiscal Service.

(6). **The next iteration of COVID-19 economic relief measures should include modernizing Section 29 of the Federal Deposit Insurance Act such that well-capitalized community banks can diversify their deposit bases.** Section 29 of the Federal Deposit Insurance Act's (FDIA) regulation of brokered deposits significantly impairs community banks' ability to compete with larger insured depository institutions in attracting deposits outside of their traditional branch and service networks – this despite mounting evidence that so-called brokered deposits do not contribute to bank failures and otherwise behave like core deposits.[6] These restrictions are particularly significant for MDIs whose deposit bases draw almost entirely from LMI communities that are the most economically vulnerable as a result of the COVID-19 pandemic.[7] Well-capitalized MDIs should be able to work with third parties to attract core deposits outside of their current branch networks without concern that it would attract unwarranted regulatory scrutiny or higher deposit insurance premiums, especially when the deposits do not pose significant risks to the institutions' safety and soundness or to the Deposit Insurance Fund. Our depositors will be the hardest hit by the economic downturn, and outdated restrictions on third-party assistance in securing core deposits that are stable sources of funding should be modernized to reflect how consumers bank and the particular impacts that we anticipate on our banks' deposit bases due to the COVID-19 pandemic. We believe that Congress should be seeking to encourage the long-term safety and soundness of MDIs which should include supporting efforts for MDIs to diversify their deposit bases – particularly during an economic emergency where massive job losses in LMI communities and communities of color are expected – through modernizing Section 29 of the FDIA.

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[6] *See*, James R. Barth and Yanfei Sun, "Bank Funding Sources: A New Look at Brokered Deposits" at 37 (January 2018) (noting that ". . . most of the empirical studies, either those focusing on bank failures or on bank failure costs, don't provide justification for the current regulatory treatment of brokered deposits . . . Moreover, none of the studies provide direct evidence that brokered deposits are a causal factor with respect to bank failures, failure costs, or banking instability."). Utah Center for Financial Services. Available at: https://lassonde.utah.edu/wp/wp-content/uploads/2018/05/UCFS_Barth_Brokered_Deposit-2018.pdf.

[7] *See*, Note 2.

(7). **The next iteration of COVID-19 economic relief measures should include a temporary regulatory reprieve from FDIC, Federal Reserve, and OCC regulatory standards to allow banks (less than 5 billion USD in assets) that target LMI communities more flexibility–such as a wider range within key ratios they must maintain (i.e., liquidity, capital adequacy, and leverage)–to not only be in good standing, but also continue to provide capital as needed.** Past research has shown most small businesses only have a few short weeks of cash on hand. A significant number of small businesses in affected neighborhoods will suffer substantial reductions in income, and therefore, require even more access to capital. Banks that may be willing to support these businesses are not going to be able to if it exceeds their regulatory thresholds. Banks with less than $5 billion in assets represent 96 percent of all banks, but only 14 percent of all assets. Given the smaller scale of these banks and limited risk to the broader financial system, adjusting key capital ratios thresholds is an acceptable risk to reduce the effect of the current economic shock.

(8). **The next iteration of COVID-19 economic relief measures should include federal resources to enhance the Tier 1 Capital of banks that support underserved communities (e.g., MDIs and CDFIs) by fully capitalizing and leveraging Treasury's CDFI Fund Program.** A critical component of the resilience of the banking sector is the amount of Tier 1 Capital it has. Without sufficient Tier 1 Capital, not only are banks limited in the amount of deposits they can take in, but it also hampers their ability to weather loan losses. In this unprecedented economic shock, many financial institutions, especially those in underserved communities, will have increased delinquent loans. Although federal government efforts to stand up new loan loss reserves are important, standing up a new federal program with significant red tape will create a bottleneck when speed is necessary. A more sustainable effort would be to fully capitalize and leverage Treasury's CDFI Fund Program to provide direct Tier 1 capital support to banks that support LMI communities without triggering the Bank Holding Company's limitations.

(9). **The Small Business Administration should revisit the allowable interest rates under the Paycheck Protection Program, and any extensions of the Program should ensure that interest rates strike the appropriate balance between encouraging lender participation and ensuring access to affordable credit for small businesses.** While guidance from the Small Business Administration suggests that interest rates for the Paycheck Protection Program (PPP) should not exceed 4%, the current iteration of the PPP does not allow interest rates to exceed 1.0%. While the NBA understands and appreciates extending small business credit at rates small businesses can afford, very few banks – and particularly small, mission-oriented lenders like MDIs that already have well-documented challenges raising capital – have a cost of capital anywhere close to 1.0%, and the proposed fee schedule does not adequately make up for the cost of underwriting and the cost of capital our member institutions would incur for each loan they would make under the Program. Further, at 1.0% there will be no secondary market for these loans, so our member institutions will have to hold these loans on their balance sheets further limiting their attractiveness to smaller financial institutions. Absent interventions that allow for lowers costs of capital for our member institutions (like accessing the Federal Reserve's discount window at the prime credit rate, *supra*) or higher origination fees, we would urge the SBA to revisit the current 1.0% rate cap and Congress to ensure that future extensions of the Program statutorily provide a rate floor of at least 2.75% -- a rate still well below the current rates across virtually all SBA program and other small business lending. Otherwise, most MDIs will be priced out of the Program significantly impairing the Program's impact and reach and the inclusiveness of any economic recovery.

We have an opportunity to avert an economic collapse if Congress and the Administration takes the necessary steps now to provide diverse small businesses, nonprofits, and LMI communities the emergency relief they need now. The steps taken through the previous three relief measures were welcomed and necessary as we anticipate a series of additional actions that will need to be taken by Congress and the Trump Administration to ensure that we not only contain the spread of COVID-19 but also limit the potential economic carnage to LMI communities and communities of color that stand to be the hardest hit both by the pandemic itself as well as the economic consequences associated with our response to the pandemic.  Providing relief to the nation's MDIs and CDFIs is vital if our efforts are to ensure that every community in the country can take part in our nation's post COVID-19 economic recovery.  We appreciate the opportunity to submit our recommendations for the administration of the CARES Act and future iterations of COVID-19 economic relief measures, and look forward to being a resource to Congress in ensuring both a robust and inclusive response to and recovery from the COVID-19 pandemic.

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