Minority Banks and the Economy

Remarks by

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Thank you for the opportunity to join you today. I am pleased to host this important event at the Federal Reserve Bank of Kansas City.

The Kansas City Fed is one of 12 regional Reserve Banks that, along with the government agency called the Federal Reserve Board in Washington, D.C., comprise the Federal Reserve System, our nation's central bank. The work of the Federal Reserve can be summarized in three primary mission areas: monetary policy, financial institution supervision and regulation, and payment services. And taken together, these activities are intended to maintain economic and financial stability as important conditions for the health of the U.S. economy and the prosperity of the American public. As a regional Federal Reserve president, I oversee the Kansas City Fed's work in these areas across a seven-state region with branch offices in Omaha, Denver and Oklahoma City.

In my remarks today, I will offer a brief perspective on the performance of the nation's economy and the current stance of the Federal Reserve's monetary policy. I'll also discuss the importance of access to credit in creating broadly shared economic growth, concluding with highlights of how these issues affect communities, including minority communities. Before continuing, I must tell you that the views I share are wholly my own.

The U.S. economy

The U.S. economy is in reasonably good shape, with growth reported to have increased 3.0 percent in the second quarter of 2017, a rebound from its weak first quarter pace. Consumers continue to be the main force behind this expansion, with consumption accounting for more than two-thirds of the nation's gross domestic product (GDP). We also have recently seen business investment pick up, experiencing the strongest growth rate since mid-2014. Looking forward, with accommodative financial conditions, elevated levels of consumer and business confidence, and a brighter global growth outlook, I expect the economy will continue to grow over the next few years with low unemployment and low inflation.

Labor markets have continued to strengthen with total employment increasing on net by 17 million workers, which is double the number of jobs lost in the last recession. As employment has steadily increased, the unemployment rate has fallen from 10 percent in 2009 to its current level of 4.4 percent. This level of unemployment is below nearly all estimates of the natural rate of unemployment, which is the level of unemployment that is estimated to prevail in the longer run in the absence of cyclical fluctuations.

At last week's Federal Open Market Committee (FOMC) meeting, the committee decided to maintain the current level of short-term interest rates, continuing an accommodative policy stance. Another important action was taken, however. The committee announced it would initiate the process of normalizing its balance sheet.

Based on my own economic outlook, further gradual rate adjustments will be needed to move the federal funds rate toward its longer-run level. With an economy growing at an above-trend rate and unemployment below most estimates of its long-run level, continuing to remove accommodation will be important for long-run sustainable growth and financial stability.

Access to credit

Appropriate monetary policy settings serve an important role in sustaining growth in the long run. But there are many other important factors that determine the nation's economic growth, including a healthy and productive labor market, innovation and access to capital. I would like to turn to the issue of the availability of credit and its implications for the economic prospects of households and businesses.

The banking system in the United States has long been an essential source of capital for the nation's economy. Here in the Tenth Federal Reserve District, we have a large number of community banks.

Having adapted over the years to significant economic and regulatory changes, as well as technology disruption, the community bank business model has retained its unique focus on relationship banking. These banks, their owners and the people who work for them are generally members of the communities they serve. The relationships are long-term and the incentives of the bank and the borrower are well aligned.

Whether the community is a small rural town or an urban neighborhood —this business model features local bankers who are immersed in their communities, understand the economic drivers of their communities and often serve as leaders in their communities. Those of you who are bankers here today recognize this critically important role, and your financial institutions have recognized that this requires diverse staff reflecting the communities they serve.

However, diverse talent in banks is just one aspect of serving a community from a base of understanding and personal engagement. Diverse ownership of banks is also important. Yet, there are very few minority-owned banks in the United States today and their numbers are declining. Over the 10-year span since 2006 to the end of 2016, the total number of FDIC-insured minority depository institutions has declined from 194 to 157.[1] Within this category, the number of institutions classified as Native American or Alaskan Native American has held

[1] Data Source: FDIC-Insured Minority Depository Institutions data, year-end totals. Accessible via: https://www.fdic.gov/regulations/resources/minority/mdi.html. Minority status is defined either by the concentration of ownership status among a certain minority group or the concentration of board membership by a minority group of an institution that serves primarily that minority group.

relatively steady, falling from 20 to 18, while the number of Hispanic American banks has dropped from 48 to 39. The sharpest decline has been in the number of African American banks, which has fallen by almost half to 24 institutions, according to FDIC data.

Community bank trends

These trends are not limited to minority banks, however. The number of banks in the United States has dropped considerably from a little more than14,000 in 1982, according to FDIC data, to around 5,000 today, and much of this decline has been in banks with less than $100 million in assets. How these consolidation trends affect access to credit is important to understand.

You have only to read today's news to recognize the value of a local bank. It was recently reported that Bank of America, the second largest lender in the United States, has closed nearly 1,600 branches since the financial crisis. These closures primarily impact rural areas. While some branches were sold to smaller lenders, others were simply closed with customers directed to offices dozens of miles away.[2] On the other hand, at about the same time this story was making headlines, another article highlighted efforts to save a community hospital in the Missouri boot heel region and the involvement of a community bank in providing its financing. As the banker explained: "We knew what would happen to this community if that hospital closed."[3]

[2] https://www.wsj.com/articles/how-bank-of-america-ditched-1-597-branches-across-the-u-s-1505646000
[3] http://kcur.org/post/how-one-missouri-town-saved-its-hospital-financial-collapse#stream/0

The historic role of minority-owned banks

Throughout the history of our financial system, the inability to access credit often spurred the establishment of a local bank. These banks often proved to be innovative lenders that considered the unique characteristics of local communities.

Minority-owned banks emerged for the same fundamental reason, and their history tells an important story about access to the financial system, and understanding history is so important to understanding how to solve the challenges we face today.

In the Tenth Federal Reserve District, Centinel Bank of Taos, N.M., is a great example. Centinel is generally believed to be the first mainland U.S.-based Hispanic bank. If you were here last year, you remember one of our speakers was Centinel's chair and CEO, Rebeca Romero Rainey. In 1959, Rebeca's grandfather, who had served in the military and then earned a law degree, was denied a $50 loan to purchase office furniture. At that point, he vowed to create a bank that would provide equal access to credit for everyone. After gathering support from about 300 investors, the bank opened for business in 1969.

More recently, the first bank owned or controlled by a Native American tribe was created in 1987 when the Blackfeet Tribe of northwestern Montana took over a failed bank in the city of Browning, Mont. Blackfeet National Bank later became Native America Bank, NA.

With some of the earliest African American banks, loans were primarily to mutual aid societies and entrepreneurs.[4] The number of African American-owned banks increased substantially after 1900 and, between 1900 and 1914, the number of African American business enterprises doubled, with more substantial increases in some business segments, particularly

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[4] Ammons, Lia. "The Evolution of Black-Owned Banks in the United States Between the 1880s and the 1990s." Journal of Black Studies, Vol. 26, No. 4 (Mar. 1996).

retail merchants.[5] This was a notable expansion of opportunity compared to the late 1800s when the primary occupations held by African Americans were blacksmith, tailor, barber and similar jobs.[6]

The first banks with African American ownership opened during the Reconstruction period in our country. The first to receive a charter was The Savings Bank of the Grand Fountain of the United Order of True Reformers. In 1890, the bank's founder, William Washington Browne, explained his goal: "The True Reformers sounds like reformers of character, but we are hunting for people who are already reformed. The church …has the other kind of reformation in hand; mine is financial reform. I want to go forward reforming our people financially. We are throwing away money enough to buy this country."

Browne's bank, and the others that soon followed his model, sought to provide services to customers who had suffered in many ways, including being exploited financially. Prior to that bank's creation, the government had established the Freedman's Bank in 1865 specifically to serve the nation's African American population. Although the intentions were honorable and branches were opened in several states in an attempt to connect to local populations, the bank's leadership was not aligned with the needs of its communities. Instead, corruption and high-risk investments made with bank deposits resulted in its failure (despite the best efforts of Frederick Douglass, who had fought to save the institution after the damage had been done). In this era before deposit insurance, the collapse took with it the life savings of 61,000 savers who were struggling to become established in the United States.

Browne's life story is itself very much about the ability to overcome challenges and is as inspirational as any in American history. At age of 13, he escaped slavery and eventually joined

[5] Meier, August. "Negro Class Structure and Ideology in the Age of Booker T. Washington." Phylon. Clark Atlanta University. Vol. 23, No. 3. (Q3, 1962).
[6] Ibid.

the Union Army. After gaining an education in Wisconsin, he returned to the south as a teacher and served as a minister. Influenced by his experiences, Browne established the Grand Fountain of the United Order of True Reformers, a fraternal organization with the stated goals of taking care of the sick, burying the dead and providing other assistance.

Browne had not necessarily sought to establish a bank to achieve personal goals. Instead the bank was created in response to the needs of his organization, which reflected the needs of the community. A Virginia chapter had been unable to organize because of difficulties safely storing its treasury of about $100. Denied access to a traditional banking institution, the group had to instead rely on the safe of a local storekeeper, which had proven problematic. The chapter was ready to give up, but Browne encouraged them forward. Creating a bank provided a degree of security for the organization by meeting a very fundamental financial services need—in this case, the bank was literally a response to the need for a safe place to store funds—but Browne knew, as we know today, that banks also foster opportunities. It was to be an economic win/win—a place to pool the resources of savers to meet the needs of borrowers.

In the words of one of Browne's associates: "We mean to encourage … people to get homes and means upon which they may independently subsist."

Browne kept his word. Throughout the panic of 1893, which saw nearly 600 banks nationwide either fail or suspend operations, it is recorded that Browne's bank was the only bank in the entire state of Virginia that continued paying out all checks. During the crisis, at least one local public school was able to obtain the funds necessary for paying salaries from Browne's bank after being denied by other financial institutions. Similarly, the bank loaned money to the City of Richmond in the early 1900s when the city was also unable to obtain funds from other sources. This is the story of community banks—saving the local hospital in Missouri today, funding Hispanic customers in 1969, and saving the city of Richmond in the early 1900s. An institution that is local enough to understand and meet the credit needs of a community determines whether that community thrives or withers.

Conclusion

This history is a reminder of the importance of access to credit and the role it plays in the prosperity of households and the vitality of businesses. In the words of one of Browne's contemporaries, "Banks are the life blood of trade and progress, whenever they may be established."[7] It is as true today as it was in 1890. And the health and diversity of our banking system remains key to the promise of delivering broad-based economic gains for thousands of communities and for the millions of households and businesses that they serve.

[7] Burrell, William Patrick and Johnson, D.E. Sr., "Twenty-Five Years History of the Grand Fountain of the United Order of True Reformers 1881-1905." Grand Fountain, United Order of True Reformers. Richmond, Va., 1909.