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STATEMENT OF

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on

PRESERVING AND EXPANDING MINORITY BANKS

before the

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

of the

FINANCIAL SERVICES COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

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Chairman Watt, Ranking Member Miller, and members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding the FDIC's role in preserving and expanding opportunities for minority depository institutions (MDIs). Historically, MDIs play a vital role in their communities. They serve as a key source of credit and other banking services essential to economic growth and business development in areas that are often underserved by traditional depository institutions.

My testimony will discuss the current financial condition of MDIs and the FDIC's efforts to implement the statutory mandate under section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) to preserve and encourage minority ownership of depository institutions. My testimony also will detail the FDIC's actions to respond to the recommendations in the October 2006 report by the Government Accountability Office (GAO) on MDIs.

The Condition of Minority Depository Institutions

As of June 30, 2007, there were 205 MDIs in the banking system, including 129 supervised by the FDIC. These MDIs ranged in size from $2 million to $25 billion in assets. However, over 63 percent of MDIs have $250 million in assets or less. The capital levels of MDIs are roughly comparable to that of the industry. More than 99 percent of MDIs meet or exceed the highest regulatory capital standards. In addition, minority-owned institutions are more likely to be headquartered in urban areas than other banks and thrifts, with almost 90 percent headquartered in metropolitan areas, compared to slightly more than 50 percent of all insured institutions.

A larger proportion of MDIs are new compared to the industry average. Almost 17 percent of minority-owned institutions are less than five years old compared to 8.5 percent of the overall industry. In fact, almost 12 percent of minority-owned institutions are less than two years old, compared to an industry average of 4.4 percent.

While most MDIs are profitable, the financial performance of MDIs, as a group, lags behind that of non-minority institutions. The average return on assets (ROA) for minority-owned institutions in the first half of 2007 was 0.69 percent, compared to an industry average of 1.21 percent. Less than one in three minority-owned institutions (30.5 percent) had an ROA of 1 percent or higher, while 47.3 percent of all insured institutions had ROAs of 1 percent or better. In addition, almost a quarter of minority-owned institutions (23.2 percent) were unprofitable for the first six months of this year, compared to 9.4 percent of all insured institutions.

MDIs also have much lower levels of noninterest income and higher levels of loan-loss provisions than the rest of the industry. Noninterest income represents only 19.5 percent of net operating revenue (net interest income plus total noninterest income) at minority institutions, compared to an industry average of 42.7 percent. Loan loss provisions represent 15.3 percent of net operating revenue for MDIs, versus an industry average of 6.7 percent.

In addition, asset-quality indicators are less favorable at MDIs than for the industry as a whole. For the first six months of 2007, the net charge-off rate for minority-owned institutions was 0.56 percent, compared to an industry average of 0.47 percent. For the same period, 2.03 percent of all loans at minority-owned institutions were noncurrent (90 days or more past due or in nonaccrual status), compared to 0.90 percent for all insured institutions.

The difference in profitability can result from many factors. MDIs, like most community banks, often must compete with larger financial institutions for both business and a talented work force. They also may find it difficult to diversify their geographical and credit risk exposures due to their commitment to serve local communities and ethnic populations. In addition, some minority institutions are challenged with operating in an economically depressed market area. The disparities in profitability and other key measures between MDIs and other financial institutions demonstrate the continuing importance of the FIRREA goals to encourage and preserve MDIs.

Statutory Requirements

FIRREA requires the Secretary of the Treasury to consult with the Director of the Office of Thrift Supervision and the Chairperson of the FDIC Board of Directors to determine the best methods for preserving and encouraging minority[1] ownership of depository institutions. Specifically, Section 308 of FIRREA sets the following goals:

[1] "Minority" as defined by Section 308 of FIRREA means any "Black American, Asian American, Hispanic American, or Native American."

- Preserve the number of minority depository institutions;
- Preserve the minority character in cases of merger or acquisition;
- Provide technical assistance to prevent insolvency of institutions not now insolvent;
- Promote and encourage the creation of new depository institutions; and
- Provide for training, technical assistance, and education programs.

Section 308 defines an MDI as any federally insured depository institution where 51 percent or more of the voting stock is owned by minority individuals. In addition to the statutory ownership test, the FDIC considers an institution an MDI if a majority of the Board of Directors are minority individuals and the community that the institution serves is predominantly minority. This expanded definition is based on the public comments received by the FDIC when we revised our MDI Policy Statement in 2002.

FDIC's Minority Deposit Institution Program

In order to achieve the goals of section 308, the FDIC first adopted a specific policy statement[2] regarding minority ownership of financial institutions in 1990. This policy statement was updated in 2002. The 2002 Policy Statement[3] has six main components designed to preserve and encourage minority ownership of depository institutions. First, it clarifies the definition of MDIs for inclusion in the FDIC's program. Second, it establishes the organizational structure for the MDI program and the resources the FDIC will dedicate to the program. Third, it describes the technical assistance the

[2] The FDIC adopted the *Policy Statement on Encouragement and Preservation of Minority Ownership of Financial Institutions* on April 3, 1990.
[3] The FDIC adopted the *Policy Statement Regarding Minority Depository Institutions* on April 9, 2002.

FDIC will make available to MDIs. Fourth, it describes the training and educational programs that the FDIC will make available. Fifth, it describes how the FDIC will address failing minority institutions during the resolution process. Finally, the policy statement describes how the FDIC will report on the activities and results of the MDI program.

Identification of Minority Depository Institutions

To ensure that all MDIs are able to take advantage of the benefits of the FDIC's voluntary MDI program, we maintain a list of federally insured MDIs. Because an institution can be an MDI based on the composition of its Board of Directors and the community served, not just its ownership, institutions that are not already identified as MDIs can request to be designated as such by certifying that they meet the FDIC's definition. During the examination process, FDIC examiners review the appropriateness of an institution's inclusion on the list. In addition, FDIC regional offices monitor changes to the list while processing deposit insurance applications, merger applications, change of control notices, or failures of MDIs. The FDIC works closely with other federal regulatory agencies to ensure that institutions not directly supervised by the FDIC also are accurately captured on the list. In addition to routinely posting the most recent quarterly list of MDI's on our public website, FDIC staff periodically provides the list to relevant trade associations and seek input regarding its accuracy.

Organizational Structure

The FDIC devotes considerable resources to our MDI program. As described in the 2002 Policy Statement, the MDI program is staffed by a national coordinator in Washington, D.C., and coordinators in the FDIC's six regional and two area offices. The national coordinator regularly contacts minority bank trade associations about participation in events and other issues, coordinates with other agencies, maintains FDIC's list of all insured banks that are considered to be minority under the FDIC definition, and compiles quarterly reports for the FDIC Chairman. The FDIC regional MDI coordinators are responsible for arranging annual regional MDI outreach events and serving as the primary contact for MDI matters within their region. The efforts of these key MDI coordinators are supplemented by the active participation of employees across the FDIC. For example, employees are detailed as needed to assist with the development of specific MDI programs and conferences.

In addition, hundreds of examiners interact with MDIs and receive specialized training each year. The FDIC has specific programs in place to educate bank examiners and sensitize them to the unique issues often found in MDIs. Since many minority depository institutions were established to serve an otherwise under-served market, certain measures, such as high profitability, may not be as essential to the organizers and shareholders of the institution. Instead, community development and improving consumer services may drive many of the organization's decisions. While the level of an institution's earnings is important, the FDIC has issued guidance to its examiners that the evaluation of earnings performance should also consider the trend and stability of earnings, the ability to provide for adequate capital, the quality and sources of earnings, and the adequacy of budgeting systems. FDIC examiners also have been advised not to place undue emphasis on peer analysis when evaluating minority depository institutions due to their unique characteristics. However, examiners can create custom peer groups to possibly provide a more meaningful comparison of similarly situated institutions.

Additionally, many minority depository institutions may have difficulty raising deposits from their local market. These institutions may use Federal Home Loan Bank borrowings and other wholesale funding sources to offset the shortage of local deposits. In addition, minority depository institutions sometimes attract large, out-of-area deposits from institutional investors. There are potential risks associated with the use of such "noncore" funds, and examiners are advised to continue to review every institution's program for identifying, measuring, monitoring, and controlling those risks. These funds can be volatile, but when prudently managed can be beneficial to banks. In addition, many of the "noncore" funds obtained by minority depository institutions may actually be rather stable due to the investor's desire to advance the institution's objectives.

To ensure examiners remain knowledgeable of the unique challenges faced by MDIs and the appropriate examination treatment, representatives from the MDI community are invited to participate in all FDIC regional training conferences. MDI bankers are invited to speak to the audience of examiners on their experiences and their institutions' unique operating environments.

The benefits of facilitating communication and maintaining a dialog with MDIs, as well as actively engaging in partnerships with trade groups and associations serving MDIs, was evident in the aftermath of Hurricane Katrina. In cooperation with the National Community Investment Fund, the National Bankers Association and ShoreBank Corporation, FDIC staff provided support for three African-American owned institutions in the New Orleans area. The FDIC and its co-sponsors actively provided assistance for these MDIs, which had been severely affected by the storm, via grants, capital injections, emergency staffing and other assistance. As part of this effort, a group of non-minority institutions provided $22 million in deposit pledges and $120,000 in direct cash donations to assist these MDIs in meeting the housing and other needs of their employees. Our various support measures enabled the MDIs in the hurricane ravaged area to play a crucial role in helping the recovery efforts in their communities.

Technical Assistance

Under the MDI program, the FDIC actively reaches out to minority banks to offer technical assistance available beyond the normal examination and supervisory process. The FDIC requires its regional coordinators to ensure that examination case managers contact minority banks 90 to 120 days after an examination to offer technical assistance and a follow up visit by FDIC examiners to assist in addressing any problem areas that were identified during the examination. The purpose of these offers of technical assistance are solely to assist MDI management in understanding and implementing recommendations from the prior examination, not to identify additional problems. In addition, MDIs are strongly encouraged to contact the FDIC for any assistance needed regarding bank regulations, FDIC policies, and examination procedures, even if there are no specific issues arising from the examination process.

The FDIC routinely provides guidance or clarification on matters arising from the application process, as well as other guidance in technical areas such as compliance with the various consumer protection laws, financial reporting, and accounting. Further, FDIC regional staff contact the minority banks they supervise at least once a year, or more frequently if appropriate, to offer to have a member of our regional management meet with banks' board of directors and to familiarize the institutions with the FDIC's initiatives.

In addition to working with individual banks, the FDIC is exploring ways to increase usage of technical assistance by groups of MDIs. For example, in the next few weeks, the FDIC, in partnership with the Puerto Rico Bankers Association, will host the First Annual Puerto Rico Bankers Association/FDIC Compliance School. The program will cover a vast range of complex compliance issues, including Bank Secrecy Act/Anti-Money Laundering compliance, and how these issues directly impact Puerto Rico's banking industry.

Training and Educational Programs

The 2002 Policy Statement also outlines the training and assistance programs available under the MDI program. The FDIC sponsors and hosts events in support of minority banks in coordination the other federal and state bank regulators. These events include national conferences, regional forums and conferences, and Minority Bankers Roundtables.

For example, this past summer, the FDIC and the other federal banking agencies sponsored the second annual "Minority Depository Institutions National Conference" in Miami, Florida. This three day conference was attended by 170 people, including minority bankers, members of MDI-related trade organizations, representatives from the GAO, congressional staff, and regulatory personnel. This annual conference is devoted to topics relevant to MDIs, as well as specific issues identified by MDIs as important to their business success.

The topics at the conference were selected based on feedback obtained during last year's national conference and from direct input from the MDI community and trade associations. The sessions addressed some of the most significant issues facing MIDs today, including exploring methods to promote economic inclusion by expanding access to the financial mainstream, strategies for reaching underserved communities by advancing sustainable homeownership, mitigating losses on Community Development Financial Institutions (CDFI) Fund programs, and on ways for raising deposits and debt and equity capital at the holding company level. The break-out sessions covered technical matters in the areas of information technology, BSA, compliance and CRA, and accounting issues associated with assessing the adequacy of the loan loss reserve. The post-conference surveys indicated that the participants found the sessions relevant and beneficial.

The FDIC also hosts facilitated group discussion sessions throughout the country. The intent of these sessions is to provide a regular forum in which MDIs can meet with other MDIs and their regulatory agencies to discuss issues facing the industry. The sessions serve as an opportunity to identify issues of interest that impact the minority banking community, and recommended avenues that would make the MDI outreach efforts more effective. In 2007, the FDIC will have hosted five of these regional events.

Since 2004, the FDIC has conducted a Minority Bankers Roundtable Series as part of our annual regional outreach program. These events provide another opportunity for the MDI community to voice views and concerns on current regulatory and supervisory issues. Additionally, at these roundtables, FDIC regional personnel seek feedback as to how the FDIC can be more effective in expanding its minority banker outreach initiatives, including seeking suggestions on ways to better market our technical assistance resources. We also investigate possible collaborative projects between the FDIC and the minority banking community.

Additional training events available to MDIs have included the FDIC's Director's College Program, the FDIC's Money Smart Program, a Non-banked/Under-banked Summit, and the Alliance for Economic Inclusion. The Alliance for Economic Inclusion was started in 2006 to establish broad-based coalitions of financial institutions, community-based organizations and other partners in nine markets across the country to bring all unbanked and underserved populations into the financial mainstream. The FDIC also formed a partnership with the CDFI Fund to promote a new outreach effort to help more insured institutions, particularly MDIs, apply for various CDFI programs.

Failing Institutions

The 2002 Policy Statement also addresses the circumstances surrounding the failure and resolution of an MDI. The FDIC has developed policies for failing banks that are consistent with FIRREA's requirement that the agency work to preserve the minority character of minority banks in cases of mergers and acquisitions. The FDIC maintains a list of qualified minority banks or minority investors that are invited to bid on the assets of troubled minority banks that are expected to fail. From April 1998 to June, 2002, there were six minority-owned institutions that failed, four of which were acquired by other minority-owned institutions, thus preserving the minority ownership. None have failed since 2002.

Reporting

The regional MDI coordinators provide quarterly reports regarding their activities to the national coordinator. These reports address outreach activities, including training and technical assistance provided during the quarter, as well as significant outreach and training events planned in the future. The national coordinator compiles the results of the regional offices' reports and submits a quarterly summary to the FDIC's Chairman. The FDIC's *Annual Report* also highlights our efforts to preserve and promote minority ownership of depository institutions (see Appendix).

The FDIC also maintains a website to promote the MDI program. The website, located at http://www.fdic.gov/regulations/resources/minority/index.html, describes the FDIC's MDI program and current initiatives. It provides contact information for each of the regional coordinators, a list of MDIs, training and conference information, and useful resources for MDIs, such as links to deposit insurance coverage and assessment calculators. The website also prompts users to submit comments or suggestions regarding ways to improve the MDI program.

The FDIC activities detailed above are designed to implement the elements of the 2002 Policy Statement and achieve the goals of Section 308 of FIRREA. The program is extensive and seeks to provide MDIs with information and assistance that is relevant and useful. As part of every program, the FDIC invites feedback from MDI participants on ways to improve existing programs or needs for new programs. The Committee's invitation letter asks whether the FDIC will commit to issuing an annual report to Congress on our efforts to implement section 308. Currently, the FDIC includes a report on our efforts in our overall *Annual Report*. The FDIC is proud of our many activities in this area and would welcome an opportunity to provide Congress with a separate annual report on our actions.

<u>The October 2006 GAO Report</u>

In October 2006, the GAO issued a report entitled, *Minority Banks: Regulators Need to Better Assess Effectiveness of Support Efforts*. Although the report noted that the FDIC "currently has the most comprehensive program to support minority banks and leads an interagency group that coordinates such efforts," it recommended improvements that could be made by all of the agencies to assess the effectiveness of their programs and ensure results. While the GAO noted that "banks regulated by the FDIC, which had the most extensive program and outreach efforts were more positive about their agency's efforts than banks regulated by other agencies," we were concerned to learn that only about half of our institutions rated our efforts as good or very good and that only about a third of the institutions took advantage of the technical assistance we provide.

The GAO recommended that the FDIC, along with the other banking regulators should regularly review the effectiveness of our minority bank support efforts and related regulatory activities and, as appropriate, assess the need to make changes necessary to better serve such institutions. Specifically, the GAO recommended periodic surveys of such institutions to determine how they view our minority support efforts and related activities and the development of outcome-oriented performance measures to assess the progress of our efforts in relation to our program goals.

Feedback from MDIs is important in implementing programs that most effectively meet the needs of this segment of the industry. To implement this GAO recommendation, the FDIC has developed an annual survey that will be sent to all MDIs starting at the end of 2007. All MDIs, including those not supervised by the FDIC, will be able to rate the effectiveness of the FDIC-sponsored conferences and roundtables. In addition, FDIC-supervised institutions will be able to provide feedback on the FDIC's outreach efforts and technical and general assistance. The FDIC will use the overall findings of this survey to assess our effectiveness in reaching out to the MDI community and to make improvements, where necessary. Further, the survey results and comments will be helpful in developing the agenda for the 2008 Interagency National Minority Depository Institutions Conference.

The GAO also recommended that the FDIC and other banking agencies establish specific outcome oriented performance measures for their MDI programs. For 2007, the FDIC developed nine performance measures that are specifically tracked quarterly by senior management of the FDIC. The successful achievement of the objectives is factored into executive management compensation each year.

The specific outcomes related to these performance measures include continuing or improving past programs such as the National MDI conference and improving the utility and access of the MDI website. In addition, the performance measures include the development of new programs, such as the FDIC's "University Partnerships" program. This pilot program provides an opportunity for the FDIC to forge partnerships with colleges, universities, and MDIs to jointly promote financial literacy at the college level and be a resource to the academic community, particularly historically black colleges and universities (HBCUs) or schools that have a significant minority population. The FDIC also meets annually with the Deans of all HBCU Business Schools to, among other things, make them aware of the FDIC's efforts at improving financial literacy at the college level.

In addition to the specific performance measures, the FDIC will continue to adhere to a number of core strategies, including the following:

- Take a more pro-active approach in following up with minority banks that utilize the FDIC's technical assistance program to see if our assistance contributed to the desired result;
- Undertake a review of our technical assistance program to ascertain ways to achieve a higher minority bank usage rate;
- Improve our efforts to educate examiners on minority bank characteristics and issues;
- Develop informative and effective outreach programs to the minority bank community; and
- Continue to look for new ways to partner with and promote the financial health of the minority institutions and the communities they serve.

Conclusion

In summary, minority institutions face many challenges. They must compete with larger financial institutions for both business and a talented work force. They may find it difficult to diversify their geographical and credit risk exposures due to their commitment to serve local communities and ethnic populations. Some minority institutions are also challenged with operating in an economically depressed market area. Despite these challenges, minority institutions are demonstrating their commitment to providing entrepreneurial capital, promoting economic revitalization, and creating jobs.

The FDIC recognizes the vital role that minority institutions play in the economic development of communities throughout the United States and is dedicated to the goals of preserving, promoting, and encouraging the creation of minority depository institutions.

This concludes my statement. I will be happy to answer questions.

Appendix

2006 Annual Report (page 21-22)

Minority Depository Institutions

The FDIC has long recognized the importance of minority depository institutions in promoting the economic viability of minority and underserved communities. As a reflection of the FDIC's commitment to minority depository institutions, the FDIC issued a "Policy Statement Regarding Minority Depository Institutions" on April 9, 2002. The policy statement implements an outreach program designed to preserve and encourage minority ownership of financial institutions.

Since the adoption of that policy statement, the FDIC has maintained contact with various minority depository institution trade associations; met periodically with the other federal banking regulators to discuss initiatives underway at the FDIC and identify opportunities for the federal banking agencies to work together to assist minority institutions; held regional outreach meetings And five Minority Bankers Roundtables; and extended offers to each FDIC-supervised minority depository institution to meet and discuss issues of interest.

In August 2006, the FDIC hosted the first "National Minority Depository Institution Conference" in Miami, FL, with attendance from more than 100 bankers; representatives from the Office of the Comptroller of the Currency, the Federal Reserve and the Office of Thrift Supervision; and several private-sector and industry trade group representatives. The conference addressed topics of interest to the minority banking community, with particular emphasis on a shared commitment to expanding financial services available to minority and underserved communities; developing coalitions to improve minority community infrastructures by partnering with organizations such as NeighborWorks® America; and fostering a better understanding by the regulatory community of the unique challenges minority depository institutions face. A second national conference is planned for 2007.

During 2006, an FDIC task force also assisted three minority institutions headquartered in New Orleans, LA, and severely impacted by Hurricane Katrina in improving their liquidity by securing $22 million in deposit pledges from Utah-based ILCs. The ILCs also provided $123,000 in direct cash donations to assist these institutions in meeting the housing and other needs of their employees.

2005 Annual Report (page15)

Minority-Depository Institutions

The FDIC has long recognized the importance of minority depository institutions and their importance in promoting the economic viability of minority and under-served communities. As a reflection of the FDIC's commitment to minority depository institutions, on April 9, 2002, the FDIC issued a Policy Statement Regarding Minority Depository Institutions. The policy, which can be found at www.fdic.gov/ regulations/resources/index.html, implements an outreach program designed to preserve and encourage minority ownership of financial institutions.

Since the adoption of the policy by the FDIC Board of Directors, the program's National Coordinator has maintained contact with various minority depository institution trade associations, and has met periodically with the other Federal banking regulators to discuss the initiatives underway at the FDIC, and to identify opportunities where the agencies might work together to assist minority institutions. All of the FDIC's six DSC Regions have held annual Minority Depository Institution Outreach Programs, made annual contact with each FDIC-supervised minority depository institution, and offered to make return visits to these institutions following the examination process.

During 2004, the FDIC created the Minority Bankers' Roundtable series, a forum designed primarily to explore partnerships between the minority depository institutions community and the FDIC. During 2005, there were six sessions held in: Nashville, Tennessee; New York, New York; Houston, Texas; Santa Monica, California; Atlanta, Georgia; and San Juan, Puerto Rico. The Minority Banker Roundtable and annual regional outreach events will continue in 2006.

In 2005, the FDIC also provided technical assistance, training and educational programs and held interagency forums to address the unique challenges faced by minority depository institutions. Training and educational programs for minority depository institutions included the FDIC's Director's College Program and the FDIC's Money Smart Program. The FDIC co-hosted Regional Forums with the America's Community Bankers Association and the National Bankers Association in 2005. FDIC also participated in and/or co- sponsored conferences with America's Community Bankers, National Bankers Association, National Association of Chinese American Bankers, Western Independent Bankers, and Puerto Rico Bankers Association.

FDIC also supported the preservation of minority depository institutions in its response to Hurricane Katrina. The FDIC Task Force on Minority Community Banking and Non-Branch Banking met with representatives from the Utah industrial loan company industry to facilitate their assistance to minority depository institutions in the Gulf Coast region affected by Hurricane Katrina. The result has been that as of year-end 2005, the Utah industrial loans companies have pledged more than $18 million in deposits and over $120,000 in direct grants to this effort. Efforts similar to these made by this FDIC task force will continue in 2006.

FDIC will continue its minority depository institution programs in 2006.

2004 Annual Report

No specific citations.

2003 Annual Report

No specific citations.

2002 Annual Report (page 14)

Minority Depository Institutions

The FDIC has historically taken steps to preserve and encourage minority ownership of insured financial institutions. On April 9, 2002, the FDIC Board adopted a new policy statement related to minority depository institutions. The new policy statement reflects changes in certain regulations and expands the FDIC's Minority Depository Institutions Program. Enhancements to the program include increased communication with minority depository institutions, better coordination with trade associations that represent minority depository institutions, better defined roles for a national program coordinator and regional coordinators, and more opportunities for institutions to request technical assistance.