BETTER MARKETS

RACIAL ECONOMIC INEQUALITY REPORT

# Addressing Racial Economic Inequality Through the Banking System

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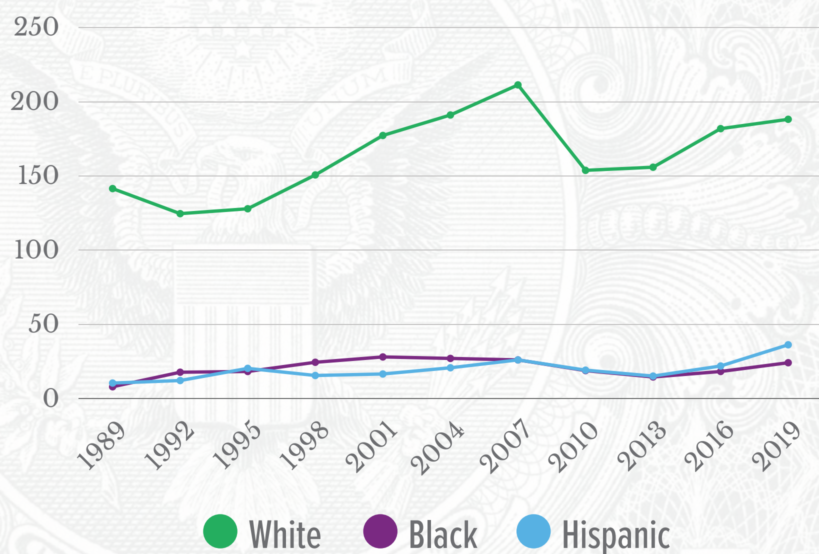
*December 2, 2021*

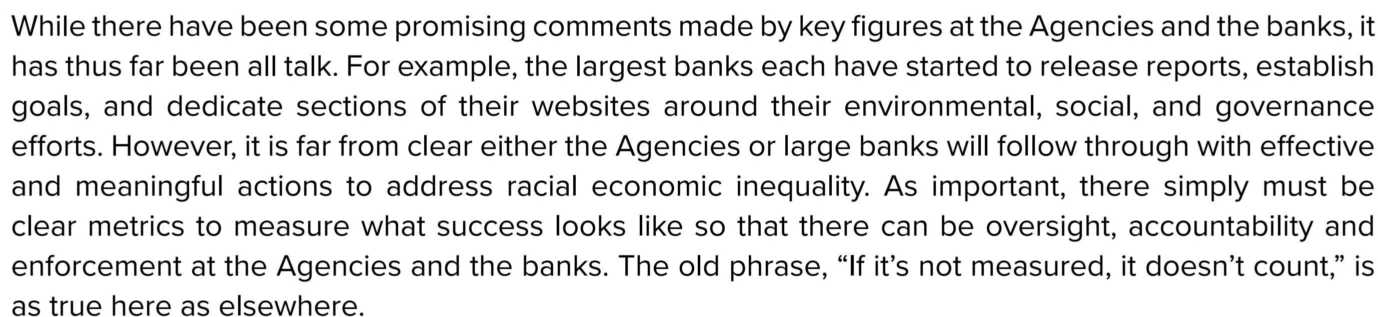
Generations of discrimination and mistreatment informed by racist beliefs, narratives, laws, policies, and practices have contributed to deeply entrenched structural inequities within the financial services sector that continue to profoundly undermine the economic status of people of color. This will not be easily undone, even if the federal banking regulatory agencies and the banks they supervise and regulate commit to more meaningful engagement and actions. Nonetheless, such a concerted commitment is badly needed and long overdue. If the banking regulatory agencies and the banks undertake concerted, concrete action, they could play a very significant role in moving toward a more just and equitable society.

Racial economic inequality has not only led to limiting economic opportunities and the wellbeing of many people of color, it also has put in place a structurally regressive financial system that has resulted in tremendous and growing economic inequality in the United States. Both continue to hold our economy back from achieving its full potential, ultimately hurting every American. [A report from Citigroup] estimated that if four key "racial gaps" between Black and white Americans—in wages, education, housing, and investment—"had been closed 20 years ago, $16 trillion could have been added to the U.S. economy. And if the gaps are closed today, $5 trillion can be added to U.S. GDP over the next five years." Of course, dollars cannot capture the human toll those racial gaps inflict on tens of millions of Americans of color who deserve better.




The federal banking regulatory agencies—the Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, collectively referred to herein as the "Agencies"—play a number of roles that relate both directly and less directly (but no less importantly) to the challenges created by the long history of racial economic inequality in the U.S. Collectively, they can use their authorities to influence the actions of the banking system to, for example, provide increased access to lending and financial services to communities of color. Each can also act individually. For example, the Fed can use monetary policy and financial stability to lead to improvements.

Additionally, banks can take actions on their own that can benefit economically marginalized communities of color, including making a strong commitment to directing larger amounts of funding to specific communities and increasing the availability of financial services. They can also reduce or remove fees they charge on financial services that disproportionately affect communities of color and work to eliminate [discrimination in their everyday processes].



While there have been some promising comments made by key figures at the Agencies and the banks, it has thus far been all talk. For example, the largest banks each have started to release reports, establish goals, and dedicate sections of their websites around their environmental, social, and governance efforts. However, it is far from clear either the Agencies or large banks will follow through with effective and meaningful actions to address racial economic inequality. As important, there simply must be clear metrics to measure what success looks like so that there can be oversight, accountability and enforcement at the Agencies and the banks. The old phrase, "If it's not measured, it doesn't count," is as true here as elsewhere.

In this report, we discuss the following actions the Agencies should take:

- Propose and finalize meaningful reforms to the Community Reinvestment Act rules and enforcement including:
  - Making the assessment process less subjective;
  - Utilizing quantitative metrics that assess the extent to which a bank's activities are contributing to the economic wellbeing of the communities they serve;
  - Changing the final scoring to directly reflect the extent to which a bank's activities are contributing to the economic wellbeing of the communities they serve;
  - Incorporating race as a factor into the assessments;
  - Updating the application approvals process to include minimum CRA examination scores for approvals; and
  - Modifying the assessment area parameters to better align the assessment areas with sources of funding.
- Improve efforts to promote minority depository institutions;
- Require disclosure of noncompliance with consumer protection laws by banks and their branches;
- Study and promote the usage of alternative sources of data and methodologies to determine creditworthiness/ability to repay, particularly at smaller, community-focused banks;
- Collect necessary data and study the costs and fees associated with banking products and services, including by race, and work with the Consumer Financial Protection Bureau to design rules that make banking fairer;
- Increase diversity among leadership and staff; and
- Specifically for the Fed, continue to pursue the new monetary policy approach of prioritizing employment over inflation and defining employment to be "broad and inclusive."

This report also discusses the many self-described efforts and "commitments" being made by Wall Street's biggest banks to address and promote racial equity and inclusion. While some banks have announced some positive steps, many of these stated commitments are dubious, unlikely to materialize effectively, or are normal, profit-producing activities that should have been undertaken anyway without special commitments. Without transparent, consistent disclosures from the banks, it is impossible to truly hold them to account for any of these commitments.

The pervasiveness and systemic nature of racial economic inequality in the U.S. can at times make it difficult to distinguish among key drivers. Rather than an exhaustive attempt to identify all issues, this report highlights the major issues as they relate to the roles of both the Agencies that supervise and regulate the banking sector and the large banks within it. We outline the relevant mandates of the Agencies as well as the powers and authorities they have available to specifically address issues of racial economic inequality, and we review and assess the types of commitments that have been made by large banks.

## Access to Affordable Credit, Capital, and Other Financial Services Must Be Improved in Economically Marginalized Communities of Color

The main way the banking system and the Agencies can play a role in helping to close wealth and standard-of-living gaps for marginalized communities of color is through increasing access to banking products and services. Although it remains an open question just how effective these can be in countering the structural causes of racial economic inequality, affordable credit, capital, and basic financial services can make a significant difference to households and small businesses in managing their day-to-day financial situation and, combined with other factors, in achieving long-term financial goals.[1]

People of color have for generations faced huge race-based obstacles when seeking the credit and services that are critical to building wealth over time, prominently including both home mortgages and small business lending, but also basic services such as affordable bank accounts for checking and other services. For example, the Federal Reserve reports that 40% of Black and 30% of Hispanic Americans are unbanked or underbanked, compared to just 12% of whites. This leads to a significant reliance on alternative—and far more costly—sources of credit and other financial services (*e.g.*, check cashing outlets and payday lenders) by those who can least afford them.

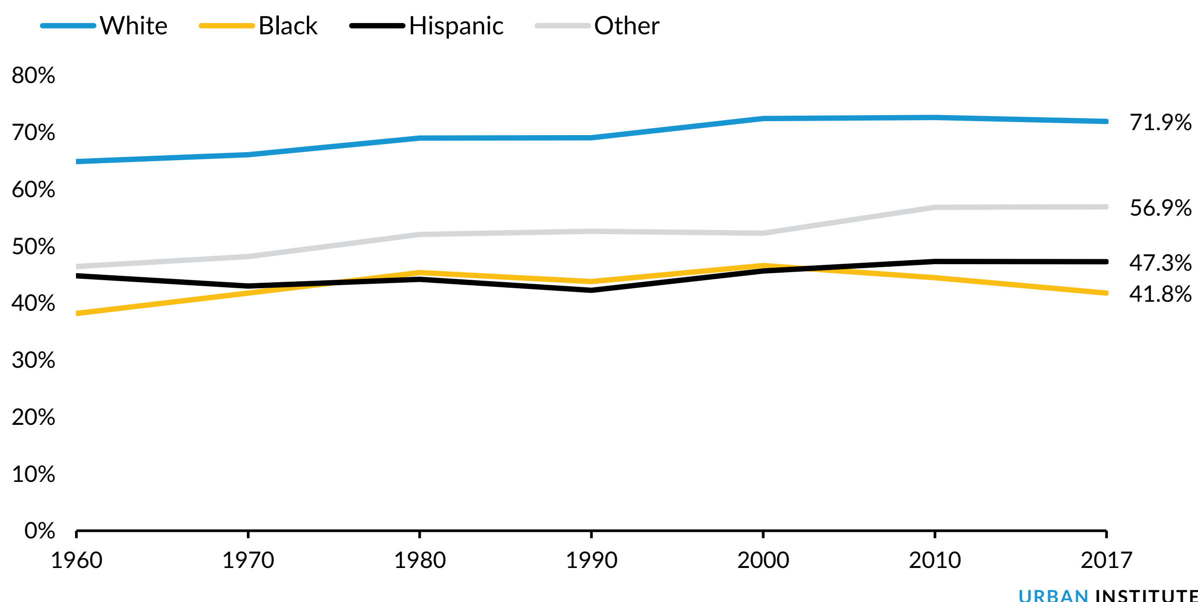
| Race/ Ethnicity | Unbanked | Underbanked | Fully Banked |
|---|---|---|---|
| White | 3 | 9 | 88 |
| Black | 13 | 27 | 59 |
| Hispanic | 9 | 21 | 70 |

Source: Board of Governors of the Federal Reserve System (May 2021), Economic Well-Being of U.S. Households in 2020

The long, sordid and outrageous history of explicitly racist practices in financial services is well known, such as mortgage and home ownership "redlining." This must not be forgotten as they are major factors in today's racial disparities and wealth gap, especially since attempts to undo the effects of such racist practices have largely failed and communities of color can still find themselves in a state of being redlined.

[1] Of course, many of the critical policy issues related to racial economic inequality cannot be addressed by the Agencies, which have no direct role to play with respect to – among other things – education, health care and minimum wage levels.

The Fair Housing Act, Equal Credit Opportunity Act, and the CRA were enacted in the 1960s-70s to ensure equal access to credit for all Americans. However, the rate of home ownership among Black Americans is no greater today than in 1960s-70s, with other minority communities faring only slightly better. Clearly, these existing laws alone have not been enough to make a difference with the problems they were designed to address, and these laws alone do not represent a key that can unlock the solution to racial economic inequality. However, strengthening enforcement efforts around them is something useful the Agencies can and should do.




**Sources:** Decennial Census and the American Community Survey.

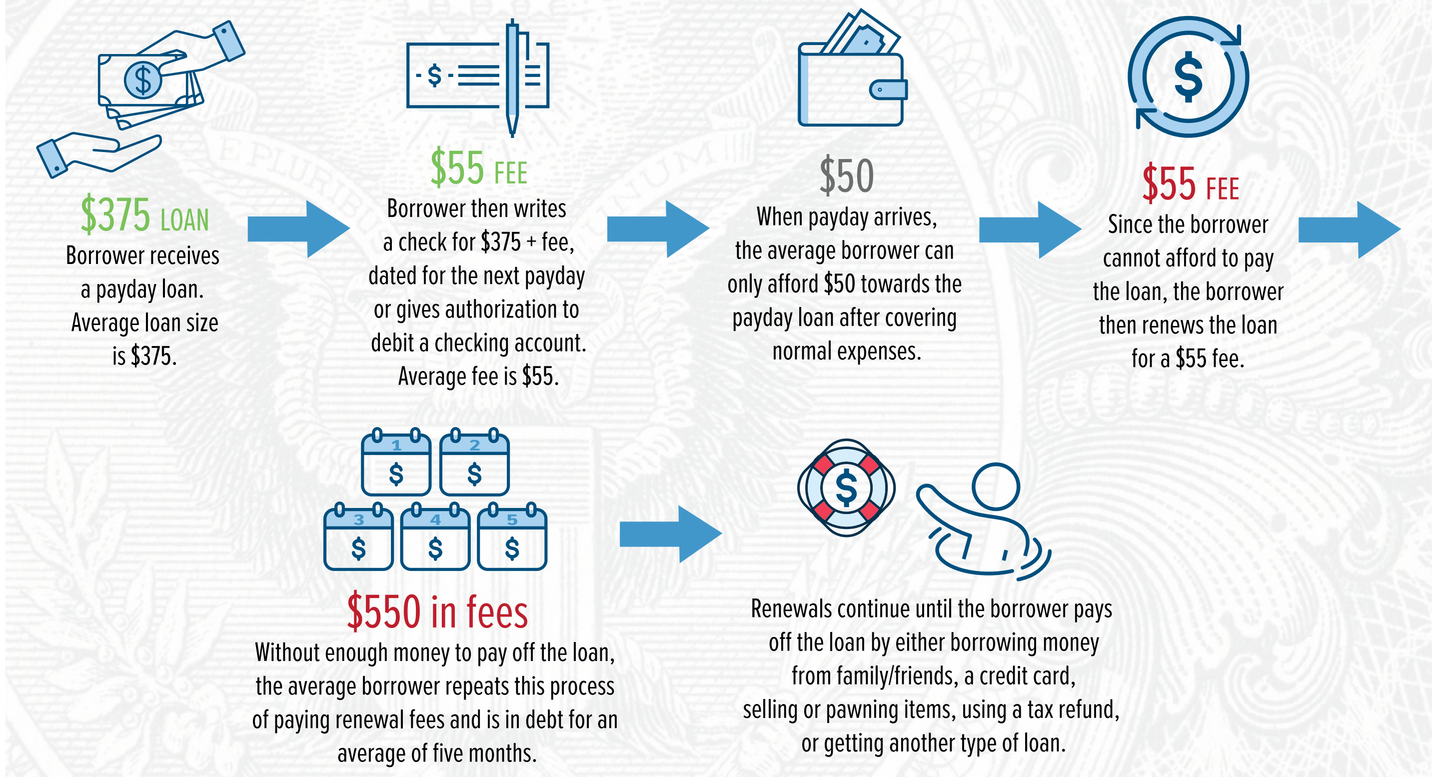
Reprinted from *Explaining the Black-White Homeownership Gap*,
Jung Hyun Choi, Alanna McCargo, Michael Neal, Laurie Goodman, Caitlin Young (October 2019), URBAN INSTITUTE. Copyright 2019 Urban Institute.

These laws have failed in part because even though they "promote" lending to underserved communities—*e.g.*, low-income and communities of color—they do not require such lending. This allows banks to cite the classic "chicken-or-egg" issue with lending in such communities—*i.e.*, banks will claim loans are appropriately made based on creditworthiness, but creditworthiness is difficult to build without the ability to take out a loan in the first place. Lest we forget, the structural racism embedded by federal government redlining in the early 20th century was rationalized through the baseless assertion that members of communities of color were, by definition, not creditworthy. In the absence of greater access to and provision of credit, there are simply fewer avenues to build wealth for individuals through asset purchases, such as home ownership, or for the community as a whole through developing sustainable, local businesses.

### *The Consequences of Lack of Bank Credit and Services are High and Regulation of Alternative Financial Services is Overly Complicated and Inefficient*

As noted above, being unbanked or underbanked leads to a heavier reliance on nonbank alternative financial services such as check cashing and payday loans. These services come at punitive costs that perpetuate the inability to open a bank account or develop a robust credit history that facilitates the ability to obtain a bank loan. In 2019 the FDIC reported that only 53% of Black households and 59% of Hispanic households used some form of bank credit, compared with 79% of white households.

The lack of banking relationships among Black and Hispanic communities directly leads to the use of alternative financial services. In the same report the FDIC showed that Black and Hispanic households utilized nonbank credit at more than twice the rate of white households and utilized money orders and check cashing services about three to six times more frequently. The costs of using alternative financial services add up. Check cashing incurs a fee for each check instead of paying fixed monthly or annual fees on a checking account (or in the case of those that can meet minimum balances—no fees), which could save an estimated $40,000 over the course of a career. Fees on payday loans are exorbitant, averaging around 400% annualized. Importantly, while such loans are purportedly meant to be very short-term borrowings, in fact on average a borrower has a payday loan out for five months per year, mostly from repeated loan renewal. This results in a total amount of fees that is 10 times higher than the fee on the original loan if it had been able to be paid on time.




Note: Calculations are based on average loan amount, average fee amount, and average time loans are held as reported in Payday Lending in America: Who Borrows, Where They Borrow, and Why, Nick Bourke, Alex Horowitz, Tara Roche (July 2012), The Pew Charitable Trusts

These fees and usurious interest rates are able to exist in part because the nonbank institutions that offer alternative financial services do not face the same regulatory requirements and supervisory scrutiny as banks. There is a web of laws, regulations, and agencies that govern alternative financial services, but they often fail to protect financial consumers.

For example, at the national level, the CFPB has authority to act against predatory or deceptive practices and, importantly, to enact and implement regulations. That led the CFPB to enact a rule in 2017 requiring payday lenders to verify the ability of borrowers to repay their loans as of the time the loan was made as well as other protections. First, it's hard to imagine that even years after the global financial crisis the CFPB had to enact a rule requiring a lender to ensure that a borrower could repay a loan. Second, and most importantly, the rule was never even implemented before it was repealed under the Trump Administration, due to industry lobbying and the Trump CFPB's dereliction of duty. The result is that it is perfectly legal for a payday lender to give a loan to someone who at the time of getting the loan is known to not have the ability to repay the loan. This guarantees an inevitable loan rollover with all the fees and costs associated with a perpetual debt trap.

The Federal Trade Commission can also take enforcement actions against payday lenders for deceptive and unfair lending. Additionally, many states have laws that set limits on the levels of interest that can be charged on any loan or the fees charged on services such as check cashing and money orders.
However, even where laws and regulations that seek to protect consumers of alternative financial services products do exist, nonbank financial institutions have been finding ways to get around them. Notably, nonbank lenders have been avoiding state-imposed interest rate caps through the so-called rent-a-bank scheme, where nonbanks make pre-arranged purchases of loans "originated" by national banks to leverage the banks' national preemption over state laws. This practice has been hindered by a Congressional repeal of an OCC rule that shamefully protected the practice, but it has by no means been eliminated.

### *The Agencies Must Use Their Existing Authorities to Increase Access to Affordable Credit and Other Financial Services, Especially Through Modernizing the Rules Implementing the Community Reinvestment Act and Supporting Minority Depository Institutions*

Under their supervision and regulation (S&R) authorities, the Agencies have responsibility for promoting greater access to credit and other financial services by assessing whether banks are complying with all applicable laws and regulations. The two laws that give the Agencies the most direct authority in this regard are the CRA and—to a lesser extent—the Financial Institutions Reform, Recovery, and Enforcement Act's provision of support for minority depository institutions, or MDIs, as amended under the Dodd-Frank Act.

While some laws focus on the fairness of banking practices, the CRA focuses on the *availability and provision of* lending and other banking services. Under the CRA, each of the agencies is responsible for ensuring that the depository institutions they supervise are helping to meet the credit and other needs of the low-to-moderate income communities in which they do business. The Agencies are responsible for designing the rule they use to implement the CRA, and they have discretion over the severity of the consequences. Therefore, the CRA provides them with a potentially very strong method to promote increased access to credit and other services in low-to-moderate income communities.

The Agencies conduct regular examinations to assess the amount and breadth of lending, investment, and services provided to individuals and small businesses within low- to moderate-income communities. The examinations result in a final assessment rating and accompanying publicly available report. Banks that are below a satisfactory rating could face the consequence of being subject to restrictions on actions that require an application, such as mergers and acquisitions, opening and closing branches, and implementing or terminating banking activities.[2]

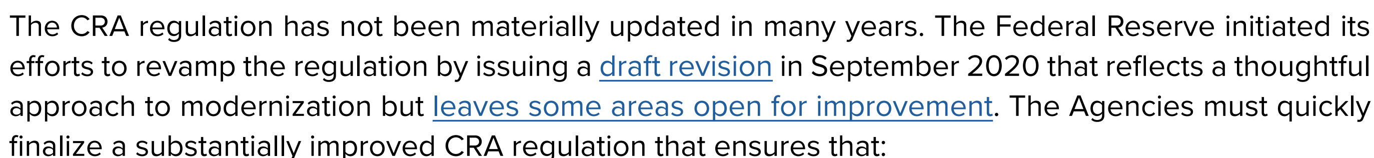
However, according to CRA data, banks rarely seem to have assessments below "Satisfactory", with recent data showing such "failing" assessments only occur in about 2% of exams. The current interagency regulation allows significant supervisory discretion in coming up with the final rating, which can result in potential "grade inflation," preventing any possibility of meaningful consequences. Indeed, around 98% of exams result in a rating of "Outstanding" or "Satisfactory," the latter being minimum rating that is considered "passing." Even if more banks had ratings below "Satisfactory", none of the application approvals processes include required minimum CRA ratings as a condition for approval.

| Year | Outstanding | Satisfactory | Needs to Improve | Substantial Noncompliance |
|---|---|---|---|---|
| 2016 | 8.8% | 89.6% | 1.6% | 0.1% |
| 2017 | 10.3% | 87.7% | 1.8% | 0.3% |
| 2018 | 9.8% | 88.7% | 1.4% | 0.1% |
| 2019 | 9.9% | 88.7% | 1.4% | 0.0% |

Source: Josh Silver and Jason Richardson, *Do CRA Ratings Reflect Differences In Performance: An Examination Using Federal Reserve Data*, National Community Reinvestment Coalition (May 27, 2020)

A 98% pass rate is clear evidence that the test is worthless, or worse, counterproductive and misleading. Additionally, with the rise of online banking and its use of centralized deposits, there is a disconnect under the current rule between the communities that are assessed as part of the examination (where the banks put the deposits) and the actual sources of funding (where the people who provided the deposits live).

[2] It is important to note that the CRA applies directly to the banks and not their holding companies. Therefore, the OCC conducts most of the CRA examinations, particularly for the largest banks, since nearly all the largest banks as well as a significant proportion of all other banks hold national charters with the OCC. However, in many cases for larger banks, the ultimate consequences lie with the Federal Reserve, who will assess the merger and acquisition applications of the holding companies that own the larger banks. For a detailed overview, see *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework.*



The CRA regulation has not been materially updated in many years. The Federal Reserve initiated its efforts to revamp the regulation by issuing a draft revision in September 2020 that reflects a thoughtful approach to modernization but leaves some areas open for improvement. The Agencies must quickly finalize a substantially improved CRA regulation that ensures that:

1) the final assessment ratings are more meaningful;
2) a bank's deficiencies in meeting the needs of the communities it serves are captured; and
3) the associated penalties with meaningful consequences to motivate compliance are in place.

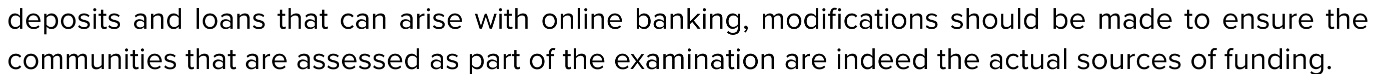
The assessment process must be less subjective and more holistic in assessing not only whether needs are being met but also if the efforts are improving communities and the wellbeing of their residents over time. The CRA is not only about lending. It also evaluates the amount of investments made that have a community development purpose as well as the level of provision of both retail and community development services. Each piece is critical.

If there were increased capital investments, lending, and provision of financial services in marginalized communities of color, then their economic wellbeing should at least be improving over time and not remaining stagnant or declining as is the case for many of these communities. It could even lead to economic wellbeing generally keeping pace with economic progress at a national level, especially when combined with other actions that would require legislation. Material contribution to a community's economic wellbeing as assessed through quantitative metrics should be the basis for and description of the final rating rather than the current ratings such as "Satisfactory" or "Outstanding."

Application approvals processes should be updated to have explicit thresholds based on CRA assessments and ratings that can result in automatic rejection of applications. Ratings more closely tied to actual, concrete efforts to affect community improvement would be helpful for setting a minimum requirement for application approvals. For example, the Fed and other Agencies could require that a bank's CRA efforts are shown at least to be contributing positively to the economic wellbeing of the low-to-moderate income communities in which they do business.

Requirements and explicit consequences that impact a bank's business activities or its ability to engage in mergers and acquisitions must be in place to incentivize behavior that furthers the goals of the CRA. Otherwise, the CRA will continue to lack effective direct enforcement. The agencies already have the discretion to include such requirements. For example, the Bank Merger Act states that the Agencies must "take into consideration . . . the convenience and needs of the community to be served," leaving it open to the discretion of the Agencies as to how that factor should be considered in the merger and acquisition approval process.

Additionally, some modifications should be made to help ensure the banking products and services are being allocated effectively. To promote financial services specifically in marginalized communities of color, the Agencies should consider incorporating the race of those in the community served into their CRA assessments, which could, for example, ensure that the financial needs of predominantly non-white low- to moderate-income communities are being met to the same degree as predominantly white low- to moderate-income communities. Also, to address the geographical disconnect between



deposits and loans that can arise with online banking, modifications should be made to ensure the communities that are assessed as part of the examination are indeed the actual sources of funding.

Another important requirement for the Agencies is to support the preservation of MDIs under Section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act, as amended under the Dodd-Frank Act. This requires the Agencies to consult with each other on the best methods for preserving the number and character of MDIs, provide technical assistance to encourage practices that support financial strength, promote the creation of new MDIs, and provide training and education.

MDIs play a critical role in supporting and improving the communities they serve and indeed have been shown to be better at providing credit in communities of color. A 2019 report from the FDIC showed that MDIs tend to support communities in which a higher proportion of residents are people of color and provide a higher proportion of lending in areas with more low- and moderate-income residents as compared to other banks.

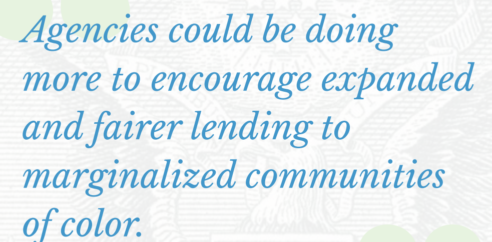
The Agencies have a decidedly mixed record in support of MDIs. In the first years of the 2000s, prior to the financial crisis, there was significant growth in the number of MDIs. That trend sharply reversed because of the 2008 financial crash: MDI charters fell by 31% after the crisis, and MDIs were two-and-a-half times more likely to fail than all other banks. In 2020, the Agencies each stated their commitment to supporting MDIs. In a creative use of its mandate, the FDIC recently launched its Mission-Driven Bank Fund initiative, which puts the FDIC's brand and position as a regulatory agency of MDIs and Community Development Financial Institutions behind a private fund that raises capital for these institutions. Whether or not this particular initiative is successful, the Agencies should be pursuing efforts that can truly make a difference in supporting MDIs.

Other related laws focus on ensuring there is fairness in lending as well as adequate consumer protections. Within their supervisory activities, the Agencies assess compliance with all applicable consumer protection laws, such as: Equal Credit Opportunity Act; Fair Housing Act; Fair Debt Collection Practices Act; Truth in Savings Act; Truth in Lending Act; prohibitions on unfair or deceptive acts or practices under the Federal Trade Commission Act; Real Estate Settlement Procedures Act; Home Ownership and Equity Protection Act; and the Secure and Fair Enforcement for Mortgage Licensing Act.

Noncompliance with these laws can negatively affect a bank's formal supervisory assessments and rating, which can inform determinations to restrict banks' activities, or result in direct enforcement actions, such as fines or an agency requiring a bank to make monetary adjustments to consumer accounts. However, since bank assessments remain confidential, it is difficult to know whether supervisory assessments related to these laws have in fact led to meaningful negative consequences for any banks with significant deficiencies in compliance. The Agencies should be required to disclose noncompliance for specific banks and their branches, especially highlighting noncompliance in low-income communities and communities of color.

### *The Agencies Should Encourage the Use of Alternative Sources of Data and Methodologies to Determine Borrower Ability to Repay, Particularly at Smaller Banks That Are More Community-Focused*

Outside of these specific laws, the Agencies could be doing more to encourage expanded and fairer lending to marginalized communities of color. While the usage of alternative sources of data and assessment methodologies in the determination of creditworthiness has yet to have a long history, the Agencies should be promoting their usage by banks at least in benchmarking their "traditional" approaches to loan underwriting. Creating benchmarks that challenge the structure and assumptions of models and processes that are in place is an important part of model risk management, and an obvious area where the Agencies can encourage banks to be using such alternatives through their supervisory activities. Benchmark usage would help to expose any potential deficiencies or biases in banks' current practices and would offer a means to determine creditworthiness for those that lack robust traditional credit histories.



*Agencies could be doing more to encourage expanded and fairer lending to marginalized communities of color.*

The Agencies released a statement regarding the use of alternative data in credit underwriting, acknowledging its potential benefits. However, the Agencies must go further and strongly encourage banks to use such alternatives, in accordance with proper risk management. Since the methodologies that incorporate alternative data sources are relatively new, it may take some time for the Agencies to assess—through their supervisory activities—that the methodologies indeed are improvements and do not pose similar or new consumer protection or financial stability concerns. They could start by encouraging the direct usage for loans to low-income borrowers that may have insufficient traditional credit histories, but it should quickly move from there to be utilized more broadly.

This is an effort that should not be left only to the banks to pursue. The agencies also should be using their expertise and staff to independently research the ways in which alternative data can be used as well as determine and assess industry "best practices." These actions would inform their supervisory assessments of bank practices and help to promote the usage of such data and methods.

The use of alternative sources of data to assess a borrower's ability to repay in the underwriting process would be especially important for MDIs, community banks, community development banks, and banks that partner with community development financial institutions. Smaller, community-focused banks empirically already have been shown to be better at providing credit to lower-income households, communities of color, and small businesses.

Also, these banks take a different approach to lending as compared to larger banks, focusing more on "relationship" banking and holding loans for their full life, whereas larger banks rely more on strict formulas or procedures and will sell loans as part of their business management. In other words, smaller, community-focused banks have it as their mission to provide lending and financial services to their communities, by definition, but large banks will potentially limit their lending to low-income

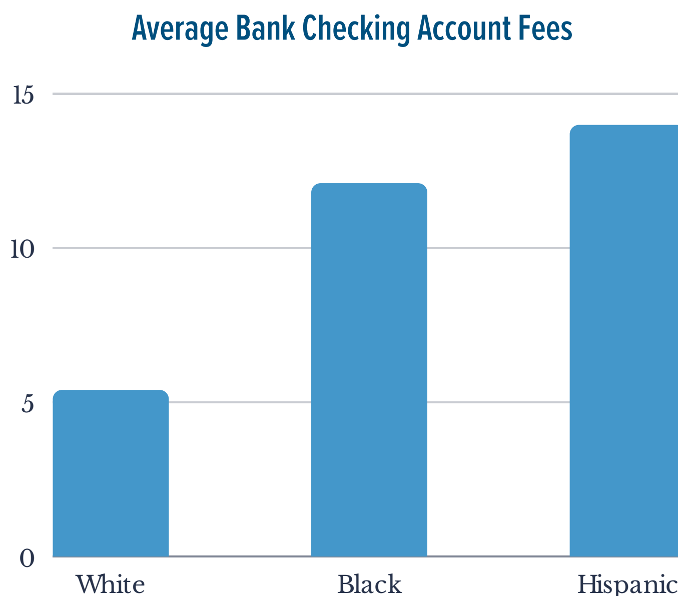
communities in order to meet certain internal metrics or manage their capital requirements. Therefore, increasing the means of smaller, community-focused banks to determine borrowers' ability to repay will only further their effectiveness in providing credit in economically marginalized communities of color.

### *Wealth-Extracting Fees Affect Communities of Color Disproportionately and Need to Be Fairer to Consumers*

In addition to improving access to financial services, the Agencies should be studying the potential negative impacts of banking services that are actively being utilized. Fees charged by banks for various financial services and other factors that prevent ready access to financial services, such as required charges when a customer fails to maintain minimum deposits levels for checking accounts, have been shown to affect low-income households and communities of color disproportionately.

Bank fees add up just as fees do with nonbanks. For example, there were $31 billion in total overdraft fees across large and small banks in 2020. And the costs in Black and Hispanic communities to open and maintain checking accounts are higher. For example, as reported by BankRate, Black and Hispanic banking customers pay more than double the monthly checking account fees as white customers.

**Average Bank Checking Account Fees**




Source: Bankrate survey, December 2-4, 2020, as cited in
*Survey: Those hit financially by COVID-19 paying 4 times more in bank fees*, James Royal (January 13, 2021), BANKRATE

The Agencies should investigate such wealth-extracting practices and determine whether they are the result of legitimate business needs that are supported by objective and ample data. Regardless of the outcome of that investigation, the Agencies should work with the CFPB to design rules that make banking fairer and accessible to all Americans.

***Commitments Made by the Largest Banks for Increasing Access to Credit and Other Financial Services Fall Short of Being Meaningful and Are Unable to Be Assessed by the Public***

Each of the largest banks have made public commitments to increasing access to credit, capital, and financial services in low-income communities and communities of color. Some of these commitments are indeed philanthropic support, while others only appear to be so. In either case, the picture is complicated by a history of direct and indirect discrimination, un- and under-served communities, certain wealth-extracting banking activities, and fair and helpful banking activities and services that should already exist without the need for "special" programs.

Most of the "commitments" that target marginalized communities of color are in the form of investments. While increasing investments can be very helpful, it is still important to note that distinction and be clear that in making such commitments banks are not making sacrifices in the interest of the public good. They expect to make a profitable return on these investments.

Many of the committed investments are in affordable housing developments, small minority-owned businesses, and mortgages to low- to moderate-income individuals or individuals of color. Like all of their operations, each of these activities is intended to increase bank profits. Affordable housing investments provide tax incentives. Loans of course charge interest, and loans made in low- to moderate-income communities and communities of color typically carry higher interest rates because borrowers may lack robust credit histories or have fewer assets to support the loan. Banks should not need to set up special programs to be making such investments. These are communities in which they already have a presence and so one would expect these committed activities would be part of their normal course of business.

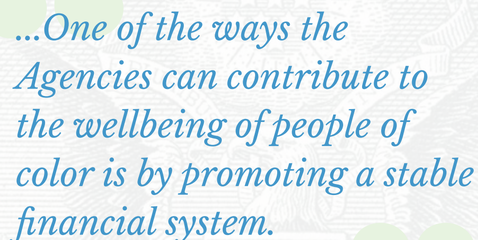
Some of the commitments are indeed philanthropic but are generally of insufficient size to make a material difference. Banks are providing grants, donations, and philanthropic capital to a variety of activities from skills training to community birth centers. Of course, these types of commitments are just a small fraction of the banks' overall investment commitments.

For example, Goldman Sachs' One Million Black Women initiative aims to provide—among other things—$100 million in philanthropic support over 10 years, the equivalent of 0.05% of 10 years' worth of recent earnings (which will undoubtedly go up over the next 10 years, making the commitment even less). Furthermore, these direct philanthropic commitments should be set against the direct wealth-extracting, high-margin bank fees that are more prominent in low-income communities and communities of color.

Outside of investments and donations, some banks are starting to work to expand banking services to more un- and under-banked individuals. Wells Fargo recently launched their Banking Inclusion Initiative, a 10-year initiative to provide accounts and banking services to more individuals. However, this is a strange effort for a bank that is having ongoing trouble in servicing and protecting the customers it already has. In the last five years it has been fined billions of dollars as well as had its size limited by the Fed and other business restrictions for, among other issues, creating fake accounts without customers'

knowledge to boost revenues and failing to protect and provide support for mortgage and auto loan borrowers. It also recently attempted to shut down its program of personal lines of credit.

To expand banking services to more people, other banks are exploring the use of data and technology to create alternative evaluations of creditworthiness or reach more consumers to increase access to credit. Banks should have been investing in these efforts years ago and are in large part driven by growing competition from financial technology companies that are offering cheaper and more easily accessible credit and services to low-income communities. To keep up with the competition, banks are developing their own technology and are purchasing or partnering with financial technology companies. If done right, technology can expand the availability of banking products and services and can potentially reduce biases in lending or other financial services. However, they must be carefully monitored and regulated to ensure that they don't replicate or exacerbate the biases and blind spots of the current system.



*...One of the ways the Agencies can contribute to the wellbeing of people of color is by promoting a stable financial system.*

## Employment-Focused Monetary Policy, Overall Financial Stability, and a Strong Banking System Combined Can Promote Increased Employment, Wages and Wealth as well as Reduce the Chance of Financial and Economic Crises That Hurt Low-Income Communities the Most

Although not often made as explicit as it should be, one of the ways the Agencies can contribute to the wellbeing of people of color is by promoting a stable financial system—the foundation of which is a safe and sound banking system. When a financial system is less stable and a banking system less resilient, financial and economic crises are more likely to occur and to be deeper and longer, just as with the 2008 financial crisis. Communities with lower wealth and income suffer the most in times of financial crises, leading to longer periods of recovery for them after crises relative to others. If the probability of such crises is materially reduced and the severity of crises, if they occur, could be limited this is good for everyone, especially lower-income communities.

The promotion of financial stability includes two key elements:

1) ensuring that funds continue to be transferred from savers and investors to borrowers who need funds at the lowest possible cost; and

2) keeping large financial institutions resilient to stress and markets functioning.

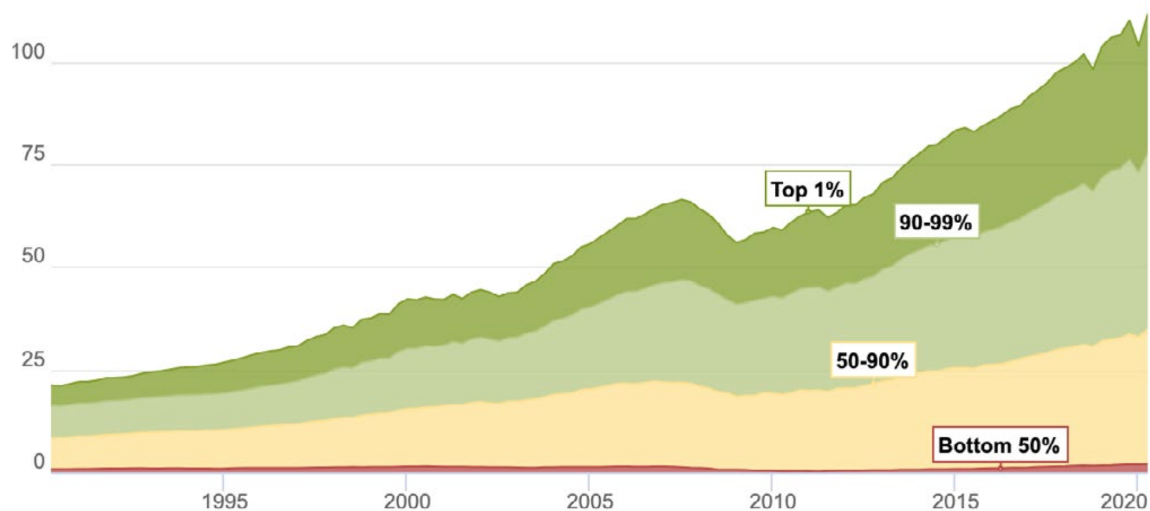
The banking system largely serves as the intermediary between savers/investors and borrowers in the real economy, and so a strong, well-managed banking system is critical, and especially important in reducing the probability and severity of financial crises. The Agencies, of course, are collectively responsible for promoting the safety and soundness of the entire U.S. banking system through their authorities stemming from their roles of supervising and regulating the banking system.

Distinct from the other agencies, the Fed separately plays a critical role in our economy and in the promotion of financial stability as the country's central bank. The Fed's actions with its "normal course" monetary policy operations—targeting short-term interest rates—and special actions taken in response to financial and economic crises—*e.g.*, buying government-backed securities and special lending and liquidity programs—can significantly affect the wellbeing of all Americans, including economically marginalized communities of color.

The Fed's special actions in response to the pandemic-caused financial and economic stress prevented a significantly more severe economic collapse from occurring, but also contributed to a material increase in the already-huge wealth gap. Special actions the Fed takes in response to crises are intended to provide "easy money" to corporations, investors, and consumers to support the economy. This can contribute to increasing asset prices and exacerbate the wealth gap between white households and households of color, since the latter hold less in wealth-building assets.

Indeed, the average Black family had less than 15% of the wealth of the average white family heading into the pandemic. Between the market collapse in March 2020 and the first quarter of 2021, net worth for the top 10% of Americans grew by $18.8 trillion compared to around $5.7 trillion for the other 90% of Americans (~$5 trillion for the 50 to 90% group and only $700 billion for the bottom 50%).

**Distribution of Wealth in the United States ($ Trillions)**



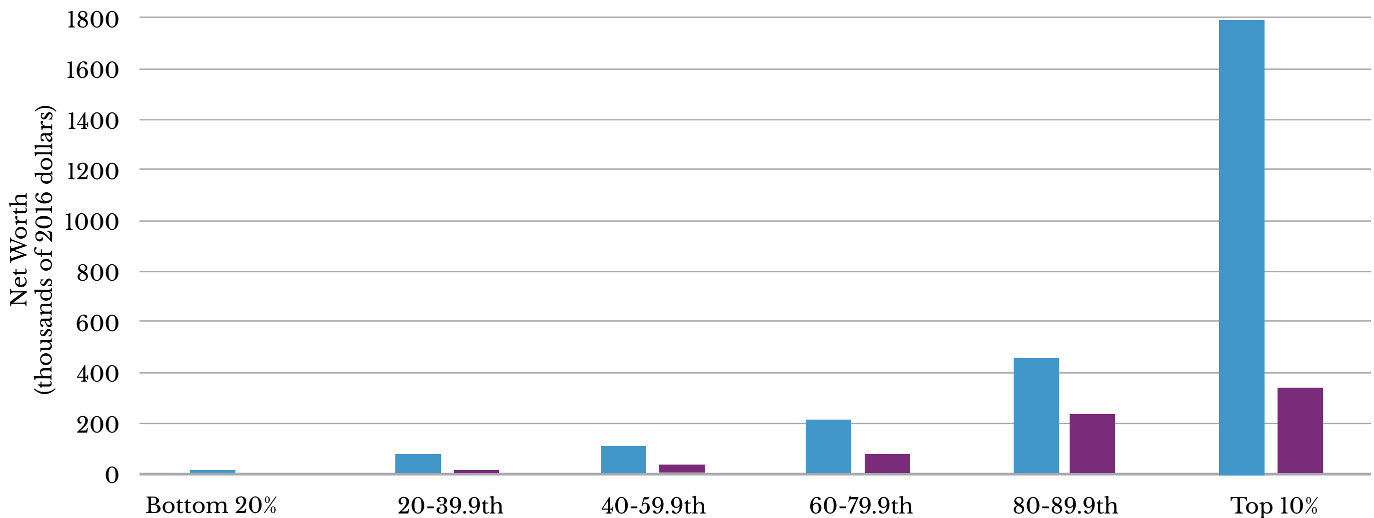

Source: Board of Governors of the Federal Reserve System statistical release Z.1

On the other hand, the Fed's "normal course" actions that are supportive of employment over the long run can lead to more equitable labor markets and may eventually contribute to reducing the wealth gap. By pursuing accommodative monetary policy for an extended period of time prior to the pandemic, the Fed was able to significantly contribute to achieving the lowest Black unemployment rate on record in 2019 without precipitating an inappropriate level of inflation. This was the case-in-point precursor to a new monetary policy framework that was officially started in 2020.

Monetary policies up to that point focused more on low inflation rather than maximum employment. The updated policy puts greater focus on maximum employment levels and a "broad and inclusive" conception of employment by shifting the focus from maintaining low inflation to maximizing employment as much as possible without letting inflation become a serious issue. This allows inflation to run above the Fed's target to make further gains in employment than it would with the previous use of stricter inflation targeting.

The new monetary policy framework may help to close employment gaps, which in turn could support upward movement of incomes across the population and reduce the income gap. Combined with increased access to credit, people from more segments of the population, including economically marginalized communities of color, may eventually be better able to purchase wealth-generating assets, such as houses and financial assets, potentially helping to close the wealth gap in the long run.

**Median Net Worth, by Household Income Percentile**




Source: Board of Governors of the Federal Reserve System, Survey of Consumer Finances data as updated in 2016.
Reprinted from Examining the Black-white wealth gap, Kriston McIntosh, Emily Moss, Ryan Nunn, and Jay Shambaugh,
THE BROOKINGS INSTITUTION (February 27, 2020). Copyright 2020 The Brookings Institution.

It should not be forgotten, however, that monetary policy affects the entire economy and is not targeted to specific communities. The potential benefits of the new policy to economically marginalized communities of color are still largely theoretical and could be limited by numerous factors. There are specific measures that only Congress could impose that would have a more direct and immediate impact, for example increasing the national minimum wage, addressing widespread disparities in health care and education quality, and strengthening workforce programs and employment opportunities.

## Diversity and Inclusion is Necessary at the Agencies and Throughout the Banking System

It is critical to note the well-documented, yet often ignored importance of diversity and inclusiveness in the organizations that comprise the U.S. financial system. This applies to both private sector firms and the Agencies that regulate and oversee them, both groups of which have dreadful records in this regard.

Inclusiveness is about more than the issue of fairness. Multiple studies have found that more diverse leadership teams lead to better outcomes. When designing policy or targeting investments, it is important to bring to bear the perspectives of the broader population that will be affected by those actions. A more diverse leadership team means that decisions will be better informed, including about how policy proposals and implementation may practically effect and potentially benefit a diverse population. Moreover, there is much to be gained in promoting innovation and effective programs from having a variety of differing viewpoints and perspectives that challenge others to think more broadly.

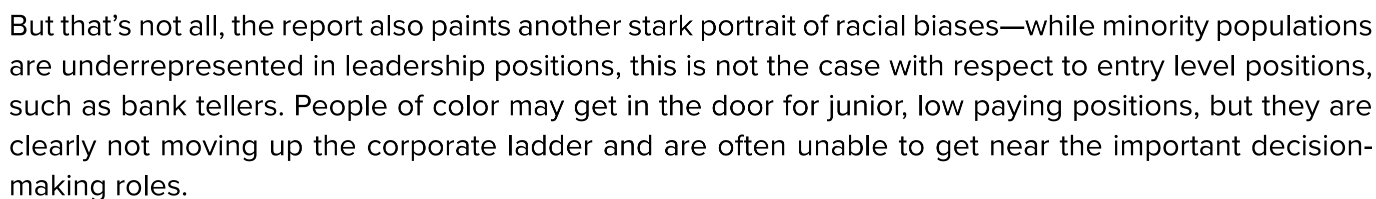
### *Diversity and Inclusion at the Agencies Is Seriously Deficient and Must Be Improved*

The Agencies have a poor record on diversity. As reported by the New York Times, across the Federal Reserve System there are 820 Ph.D. economists, of which only 11 are Black. There are no representatives of minority communities on the Federal Reserve Board and only two presidents of a Federal Reserve Regional Bank who are not white. At the FDIC a full 80% of executive managers are non-minorities while just 3.9% are Hispanic or Latino. Only at the OCC does the percentage of Black Americans in senior leadership reflect the population at large at 13%, though only 5.6% of leadership positions are held by Hispanic or Latino Americans.

The Dodd-Frank Act attempted to address diversity at the Agencies by requiring the creation of Offices of Women and Minority Inclusion, which are tasked with promoting diversity within the Agencies and collecting data on workforce demographics. However, they were not granted the authority needed to achieve their goals. They cannot enforce civil rights laws, require specific actions, or issue fines or any kind of penalties when the Agencies fail to meet diversity goals. While many of the programs run by the OWMIs are well intended, it has been over 10 years since the Dodd-Frank Act and the continued underrepresentation of people of color at the Agencies shows that more must be done to address racial equity in the agencies' personnel practices.

### *Large Banks Show a Significant Lack of Diversity and Inclusion at More Senior Levels*

The exclusion of minorities from senior leadership positions of course extends to the private sector as well. According to a report by the consulting firm McKinsey, across the U.S. financial services industry, approximately 90% of executive management level positions—the so-called "C-suite" level—are held by whites, a tremendous overrepresentation given that roughly 40% of the U.S. population are people of color.



But that's not all, the report also paints another stark portrait of racial biases—while minority populations are underrepresented in leadership positions, this is not the case with respect to entry level positions, such as bank tellers. People of color may get in the door for junior, low paying positions, but they are clearly not moving up the corporate ladder and are often unable to get near the important decision-making roles.

The largest banks have started publishing statistics on their employees by ethnicity and position type in various reports, but so far these only serve to show how far they need to improve their diversity, particularly at the senior management level. Additionally, calling into question any commitment on their parts, many banks are fighting efforts by their shareholders to get them to carry out formal, internal reviews to address the issue.

Some banks have set hiring and diversity goals. For example, Goldman Sachs has committed that by 2025 they will double the number of analysts hired from historically Black colleges and universities and that their population of vice president-level employees will be at least 7% Black and 9% Hispanic or Latino. While such goals are a move in the right direction, it is unclear how many analysts they are actually hiring from HBCUs, and their goals for vice presidents fall well short of being representative of the overall population. Others, like JP Morgan, have not set explicit goals but rather showcase the internal programs they have and cite the improvement in their statistics year over year.

The Agencies have limited authority to promote or ensure more diversity at banks, and so it is up to the banks themselves to promote and report on their diversity efforts. While all of the largest banks are voluntarily following some reporting standards—such as those laid out by the U.S. Equal Employment Opportunity Commission—without transparent and consistent disclosures of information across banks, public oversight and accountability is impossible.

## Conclusion

Despite laws and mandates that have existed for decades, the financial and economic racial disparities in the U.S. remain as a serious and shameful reality that is continually holding back communities of color from equal opportunity and financial inclusion. In fact, the wealth gap between white, Black and Hispanic households has grown since the start of this century. Black Americans, Hispanic Americans, and other Americans of color are more likely to have lower-income jobs, more likely to be unemployed, less likely to have significant savings, more likely to be underbanked or unbanked overall, less likely to own a home (a significant driver of the racial wealth gap), and more likely to use more expensive and predatory financial products.

This is because these issues are not a matter of circumstance, but rather the result of an inter-generational accumulation of past and present effects of racist practices throughout the history of this country. Existing laws and mandates in the banking system may have the right intentions, but they do not explicitly and effectively target the issues through strict requirements or truly meaningful consequences when banks fail to meet current requirements. The regulatory Agencies must and can do more under their existing authorities, and the banks themselves can take concrete action to reverse the effects of structural racism embedded in the banking system due, in part, to their past practices.

Better Banks | Better Businesses
Better Jobs | Better Economic Growth
Better Lives | Better Communities

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