AMERICAN BANKER

DIVERSITY AND EQUALITY

Does Fed already have the power to tackle racial inequality?

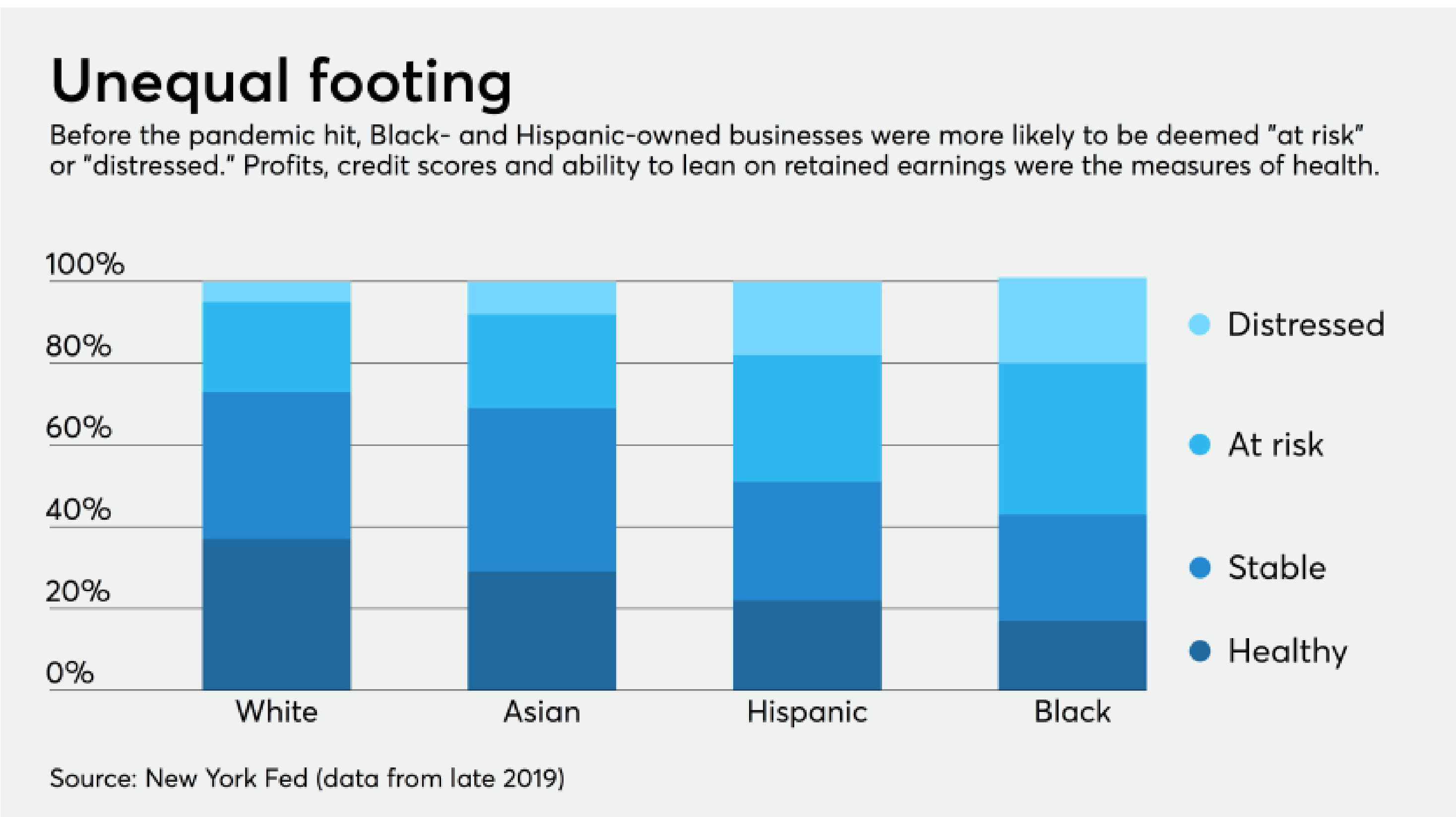
By Neil Haggerty August 23, 2020, 9:00 p.m. EDT 7 Min Read

WASHINGTON — Democrats in Congress have been calling for legislation to require the Federal Reserve to address racial inequality, but observers say that the central bank already has several regulatory tools at its disposal to tackle the issue.

The focus on the Fed's potential role in helping right societal wrongs coincides with concerns about the coronavirus pandemic's devastating impact on minority communities, which have struggled to get access to government rescue programs.

“It’s abundantly clear that the economic damage inflicted by financial crises disproportionately harms communities of color,” said Gregg Gelzinis, senior policy analyst at the Center for American Progress. “To the extent the Fed uses its regulatory authority to mitigate the chances of future financial crises through stress testing, capital requirements, liquidity rules … and the body of the post-crisis prudential rules, the benefits of that will disproportionately flow to communities of color through a reduced exposure to financial crises.”

Even before the pandemic, minority-owned businesses were much more likely to be deemed stressed, according to a Federal Reserve Bank of New York report published in April. More than 20% of Black-owned businesses were considered distressed in late 2019, compared with 5% of white-owned businesses. That classification applied to businesses that weren't profitable, had low credit scores and relied more on external financing than retained earnings to fund operations.



Several bills have been introduced to address persistent economic inequality. House Financial Services Committee Chairwoman Maxine Waters, D-Calif., and Sens. Elizabeth Warren, D-Mass., and Kirsten Gillibrand, D-N.Y., [introduced legislation](#) earlier this month that would require the Fed to promote equality in employment, income and access to affordable credit when setting monetary

Ron Feldman, first vice president at the Federal Reserve Bank of Minneapolis, said that racial inequality should be a priority at the central bank and all of the banking regulators.

“Are there things around credit, through the allocation of credit that are critical in ensuring that, in fact, there is more racial equality going forward than there are today? I do think that is a very important area to look. I don’t think that is a tenth order type of issue,” Feldman said. “I think it’s a first or second order type of issue.”

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Karen Petrou, managing partner at Federal Financial Analytics, said there are a lot of moves that the Fed can make that are “possible under current law.” She suggested that the Fed consider easing its risk-based capital rule, which is aimed at maintaining a capital cushion at banks that engage in substantial trading activities.

“I think we need to relook at the risk-based capital rules, which unintentionally but significantly penalize lending to lower-income households and small businesses,” Petrou said.

While the Fed could tweak some of its capital requirements to ensure that communities of color and minority-owned businesses have better access to credit, Feldman said it's important that capital requirements aren’t weakened, because banks with less capital are less likely to lend.

really, really critical to make sure that those institutions are in fact actually lending in a fair and equitable way, particularly to people of color, both household and firms. If those banks are not well capitalized and are not strong, they are not going to be able to do that."

Petrou said the Fed can also do more to help establish new kinds of financial institutions that support diverse communities and minority-owned businesses.

"New charters for equality-focused banks I think would be a very important contribution," Petrou said. "We are seeing the value" of community development financial institutions, "but CDFIs are limited and I think equality banks would be a very good addition to the chartering landscape."

The support for banks in lower-income and minority communities goes hand in hand with a possible stricter merger approval process, according to some observers. Mehrsa Baradaran, a professor at the University of California, Irvine School of Law and the author of "How the Other Half Banks," said the Fed could more thoroughly scrutinize the impact of proposed bank mergers. For example, the merger in December of BB&T and SunTrust Banks into Truist Financial could reduce access to branches in the long run as the company seeks to streamline costs, she said.

"How many communities in the Southeast, predominantly black, predominantly poor communities lost their bank to that merger?" Baradaran said. "I think just asking those questions in a more probing way could get you there."

Aaron Klein, policy director of the Center on Regulation and Markets at the Brookings Institution, said the Fed could address issues of racial inequality by implementing its proposed real-time payments system more quickly. The thinking is that faster payments could reduce the risk of overdrafts and perhaps provide other benefits.

"The Fed has strong tools to reduce racial inequality that they are not using in payments regulation," Klein said. "Increasing pressure from Congress for the Fed to use these tools is important and overdue, especially as the Fed's monetary policy actively increases inequality."

to consumers who are currently unbanked would also address racial inequality. He noted that when Congress passed the coronavirus relief bill and stimulus payments were sent individuals and families, unbanked families ended up paying a price to access the funds they were entitled to.

“The poorest of the poor, the people who had no banking relationship and hadn’t paid taxes, they got their economic impact payment on a debit card,” Mierzwinski said. “And was their debit card from the government totally free? No. The government contracted some banks, and the banks charged fees to use the ATM machine.”

Rep. Joyce Beatty, D-Ohio, who chairs a House subcommittee on diversity and inclusion, pointed to the Community Reinvestment Act as an area where the Fed can better address disparities in access to credit.

She said the Fed should take a different approach than the Office of the Comptroller of the Currency's rule issued in May. It allows banks to receive CRA credit for investments in more low- to moderate-income areas than in the past, includes a list of activities that are normally approved for CRA credit and changes how CRA ratings are determined. However, consumer advocates have said the OCC's revamp waters down banks' obligations because it focuses too much on dollar values to the exclusion of noncash investments such as credit counseling and small-business advice.

“I believe that we need a modernized Community Reinvestment Act, and the rule that was recently issued by the OCC takes us backwards, something that banks and civil rights organizations largely agree,” Beatty told American Banker. “I think that the Federal Reserve has an opportunity to strengthen the CRA with their own rule, and it could help spur private investment in minority communities and minority-owned businesses.”

While the Fed may be able to utilize a number of policy tools to address racial inequality without Congress's passing new legislation, Ed Mills, a policy analyst at Raymond James, said that the Federal Reserve usually doesn’t act without legal directives.

would argue is out there."

Beatty touted her legislation, introduced along with the now-Democratic vice presidential nominee Sen. Kamala Harris, D-Calif., that would mandate at least one gender-diverse candidate and one racially or ethnically diverse candidate be interviewed when there is a vacancy at the head of one of the Fed's regional banks, as one way to make the Fed more responsive to the broader public's needs.

"We need to see more minority representation when we talk about those reserve banks, " Beatty said. " ... It makes a difference of what you look at for research, how you look at what regulations should be changed, [and] how you look at the CRA — which I believe needs an overhauling — if you had people who are affected by it serving on those boards and [as] CEOs or on the governing board."

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