Speeches, Statements & Testimonies

FDIC Chairman Jelena McWilliams on “Creating a Financial System of Inclusion and Belonging”. Keynote Speech before The University of Chicago Law School and American Financial Exchange Webinar on “The Role of Minority Depository Institutions and Innovation in the Age of COVID-19”

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Good morning. Thank you, Richard, for that kind introduction and the opportunity to speak with you today.

The topics before us today are particularly timely. As the COVID-19 pandemic continues to disrupt the daily lives of all Americans, we are particularly mindful that minority communities have suffered disproportionately, from both a health and economic perspective.[1] As these challenges remain with us, over the past several months we have also witnessed a nationwide conversation about racial inequality and other social issues that pose difficult questions across a wide range of policy areas, including banking and financial services.

As the nation’s deposit insurer and primary supervisor of community banks, including minority depository institutions (MDIs), the FDIC plays an important role in helping these institutions meet the needs of their customers and communities – especially minority and low- or moderate-income (LMI) communities.[2]

Before I discuss the FDIC’s ongoing work in these areas, let me first offer a few words more generally about the necessity of creating a financial system of inclusion and belonging. This mission is not theoretical or merely academic to me; it is personal.

I was born on the wrong side of the Iron Curtain in the former Yugoslavia in the 1970s. While Yugoslavia practiced its own kind of communism as the only non-aligned country in the Eastern Bloc, I realized quickly that even in a system built upon presumed equality and fairness, not all were equal. For my family, that inequality was very real.

As I struggled to transcend my place in that society, I increasingly ached for an opportunity to be all that I could be, to realize my fullest potential and not be limited by my parents’ lack of wealth, education or connections. And from my vantage point back then, there was a faraway place that held the promise of freedom and prosperity.

I spent my 18th birthday on a plane *en route* to the United States, with $500 in my pocket that my parents borrowed. The very next day, I opened a checking account at a bank, and deposited all $500 in that account. I applied for a credit card, but with no credit history and no assets other than that meager $500, I was denied. Instead, I was offered the option to open a secured credit card and I jumped on it. But if you think about it, the entire concept did not make sense: I was essentially borrowing from myself while the bank held my money as collateral and collected the interest. Except that, for a new immigrant like me, it did: with each swipe of that credit card, I looked like others in the grocery store checkout line. I was still doing mental math to figure out if I had enough available funds to cover my purchase but if my accent made me stand out, the grocery purchase did not.

After 12 on-time monthly payments, the bank released my security deposit. With my newly established credit history, I was able to obtain an unsecured credit card, an auto loan, student loans, and, eventually, my first mortgage, which enabled me to become a homeowner. As a homeowner, you want clean streets, nice parks, good schools, a safe neighborhood. By becoming financially and emotionally invested in your neighborhood, you become invested in the broader community and its success … you start to "belong."

While it would be easy to look at me today through the lens of the office that I humbly hold and assume that I must "belong," I know what not belonging feels like in this society. I understand the perspective of those who cannot make ends meet despite holding multiple jobs, who cannot qualify for credit, who watch their checking account balance with daily trepidation, who ration heat in winter to lower utility bills. When you have to do all that and still barely survive, it is hard to feel that you "belong." You feel disenfranchised instead.

A significant part of my focus as FDIC Chairman has been bridging the gap between those that belong and those that do not. Because the FDIC is a bank regulatory agency, we have approached this issue from the perspective of financial services. We know that individuals from LMI communities are often the least likely to have the very banking and financial services they need most.[3] With respect to minority communities in particular, despite meaningful improvements in recent years, the rates for black and Hispanic households who do not have a checking or savings account at a bank remain substantially higher than the overall "unbanked" rate. Similarly, black and Hispanic households are less likely to have mainstream credit (i.e., credit products that are likely reported to credit bureaus) across all income levels.[4] And savings rates remain lower among these households,[5] which results in greater difficulty dealing with unexpected expenses.

These disparities pose challenges to regulators and other policymakers about how best to address them. While we recognize that there is no single solution, I would like to discuss the FDIC's recent and forthcoming initiatives to promote and preserve MDIs, as well as our efforts to encourage innovation at community banks more broadly.

Promoting and Preserving MDIs

Shaped by my personal experiences and guided by a commitment to increasing financial inclusion in traditionally underserved communities, one of my priorities as FDIC Chairman has been expanding our engagement and collaboration in support of MDIs. We define an MDI as a federal insured depository institution for which (1) 51 percent or more of the voting stock is owned by minority individuals, or (2) a majority of the board of directors is minority and the community that the institution serves is predominantly minority. Many of these institutions serve LMI communities with unique needs for accessing financial services, and the FDIC's oversight must reflect their critical role in our financial system.[7]

An MDI is often the financial lifeblood of the community it serves, enabling individuals and minority-owned small businesses to securely build savings and obtain credit.[8] Although the number of MDIs is comparatively small relative to the total number of FDIC-insured institutions, these banks have a substantial impact on their communities, including through mortgage lending and small business lending.

We have embraced our statutory responsibility to promote and preserve the health of MDIs by seeking new and innovative ways to engage with these institutions and better understand their needs. The FDIC frequently engages with MDIs in Washington and throughout our six regions with technical assistance, banker roundtables, and networking events to connect MDIs and non-MDIs for potential business partnerships (I refer to these events as "speed dating, FDIC-style" …this is not your grandmother's FDIC, for sure).

Last year, the FDIC published a comprehensive research study analyzing the demographics, structural change, geography, financial performance, and social impact of MDIs over a 17-year period ending December 31, 2018.[9] Although the study found improvements in MDIs' financial performance, it also observed that many MDIs face greater economic challenges than non-MDI community banks.

To address some of these challenges, the FDIC has:

- Tripled MDI representation on our Community Bank Advisory Committee (CBAC);[10]
- Established a new MDI subcommittee on the CBAC to highlight the work of MDIs in their communities and to provide a platform for MDIs to exchange best practices;[11]
- Enabled MDIs to review potential purchases of a failing MDI before non-MDI institutions are given this opportunity;
- Clarified that non-MDIs can receive Community Reinvestment Act credit for their collaboration with MDIs; and
- Facilitated commitments to support MDIs, including most notably a $100 million commitment by Microsoft.[12]

Notwithstanding these important steps, we recognize that we can do more, and "more" in this case will require us to think outside the box.

One of the options we are exploring to support MDIs and Community Development Financial Institutions (CDFIs) is a framework that would match these banks with investors interested in the particular challenges and opportunities facing those institutions and their communities. *(We may or may not have drawn inspiration from a successful television show whose name I am not supposed to mention in which entrepreneurs present their business ideas to a group of potential investors.[13])*

Although we are still developing the details, the idea would include a vehicle through which investors' funds would be channeled to make investments in or with MDIs and CDFIs, including direct equity, structured transactions, funding commitments to loan participations, or potential loss-share arrangements.

This initiative seeks to accomplish several objectives, including maximizing the benefits to MDIs and the communities they serve by providing capital preservation and growth, as well as providing a minimal return to investors. We expect to release more information in the near future, and we will continue to work with stakeholders on how best to proceed.

Encouraging Innovation to Support Financial Inclusion

As we consider additional ways to create a more inclusive banking system, we must recognize the tremendous benefits that financial innovation can deliver to consumers, including in the areas of payments and credit.[14] New technologies have the potential to bring more people into the banking system, provide access to new products and services, and lower the cost of credit.

Perhaps no issue is more consequential to the future of community banking than technological innovation, and regulators cannot simply stand on the sidelines and wring our hands.[15]

We can foster the development of new technologies that improve the way banks operate. We can engage with banks, fintechs, and other stakeholders to ensure that institutions are comfortable offering innovative products and services, consistent with safety and soundness principles and consumer protection laws. And, we can work to remove unnecessary barriers that create operational and regulatory uncertainty for institutions that want to innovate, but are reluctant to do so.

For community banks, including MDIs, the path to innovation may seem daunting. The cost to innovate is often prohibitively high. They may lack the expertise, information technology infrastructure, or research and development budgets to independently develop and deploy their own technology. That is why partnering with a fintech that has already developed, tested, and rolled out new technology is often critical for successful innovation. In this regard, fintechs can serve as great equalizers by allowing “little guys” to compete more effectively while satisfying consumer demand.

To help overcome these challenges, we established an office of innovation – FDiTech – in 2019, and began working on several initiatives to promote innovation and support financial inclusion.

To help facilitate greater access to credit using new technologies, the FDIC and our fellow regulators issued a statement encouraging the responsible use of alternative data in credit underwriting.[16] Alternative data is information not typically found in the consumer’s credit files of the nationwide consumer reporting agencies or customarily provided as part of applications for credit. Using alternative data can improve the speed and accuracy of credit decisions and help firms evaluate the creditworthiness of consumers who might not otherwise have access to credit in the mainstream credit system.

Similarly, we worked with our fellow regulators earlier this year to issue principles encouraging financial institutions to offer responsible small-dollar loans to customers for both consumer and small business purposes.[17] We recognize the important role that such loans can play in helping customers meet their ongoing needs for credit due to temporary cash-flow imbalances, unexpected expenses, or income shortfalls, including during periods of economic stress, national emergencies, or disasters.

Small-dollar credit products and the use of alternative data in underwriting can create a powerful combination for LMI consumers. Our new guidance documents can help encourage FDIC-supervised institutions to offer products to existing and potential customers, consistent with safe and sound banking principles and consumer protection laws.

We are also working on numerous initiatives to facilitate partnerships between fintechs and banks. These partnerships are particularly important to financial inclusion, allowing banks to partner with fintechs that have already developed innovative products and underwriting methods that banks can quickly and safely adopt to support their customers.

To help encourage these partnerships, the FDIC issued earlier this year a guide for fintechs and other third parties looking to work with banks.[18] Using the guide, fintechs that may be new to bank partnerships can gain a better understanding of applicable risk management principles and the due diligence processes banks generally follow to meet them.

More recently, we asked stakeholders to comment on a groundbreaking approach to facilitate technology partnerships. Our request for information proposed a public/private standard-setting partnership and voluntary certification program that would help reduce the cost and uncertainty associated with the introduction of new technology at an institution.[19]

Risk management is an important component of third-party partnerships with banks. But the on-boarding and due diligence process can be costly and time consuming for both banks and their potential technology vendors. These challenges are often amplified at community banks with tight budgets and limited technology expertise. The costs are also high for technology firms. Each bank often has a somewhat different approach to due diligence, and the paperwork and review requirements for vendors are multiplied at each new institution.

The voluntary certification program we have proposed would create a standard setting organization (or “SSO”) to establish standards for due diligence of vendors and for the technologies they develop. The FDIC would participate with industry and other stakeholders in the development of these standards. Fintechs could then voluntarily submit their organization and technologies to an independent certifying organization to verify conformance to the applicable standards. In turn, banks could rely on this certification to on-board the vendor and integrate the technology into bank operations.

Standardizing the due diligence process and removing regulatory and operational uncertainty surrounding technologies could fundamentally change the way banks partner with technology firms. Public comments on the request for information are due next month, and we look forward to reviewing recommendations from interested parties as we consider next steps.

Additionally, we are working on amendments to our brokered deposits regulation that, once finalized, will remove regulatory hurdles to certain types of innovative partnerships between banks and fintechs.

These are only a few of the steps we are taking to facilitate the introduction of innovative technology into the banking industry. We expect these steps to make banks more efficient and to help introduce new products and services to the market that are safe, affordable, and accessible.

For our most vulnerable communities, these new products can be a lifeline in troubled times. But technology is not just about access to affordable credit. New technologies can also form the basis for an ongoing relationship with a bank and the financial system – a relationship that can open new doors to financial security and economic opportunity.

Conclusion

Looking back at my early days in the United States, the secured credit card I obtained in 1991was one of the pivotal first steps on my long journey to belong in this society. Over time, I learned how to make the financial system work for me, how to manage credit so that banks would seek me instead of me seeking them, and how to make credit decisions that would allow me to prosper in the long run.

I am profoundly grateful for those early experiences, not only because they shaped me in more ways than I can recognize, but because they have allowed me to look at our laws and public policy more holistically. I understand the critical role that banks play in enabling individuals – especially those from LMI communities – to build a better life for themselves and their families.

I believe that millions of unbanked Americans could benefit by becoming part of the banking system and learning how to make the system work for them. Our job as regulators is to ensure that banks do their part in making that feasible. In the long run, our society will be better off if these millions of Americans feel like they belong.

There is still much work to do to effectively tackle the problems and hardships many Americans face, and to address disparities in our society. Both as fellow Americans and regulators with power to shape public policy, we must harness innovation to bring more people into the fold. We need to ensure that our regulations and policies encourage financial institutions to think creatively about reaching out to unbanked consumers and providing products and services that will keep those consumers banked. Regulators need to ensure that the financial institutions at the forefront of those efforts – as MDIs have been for decades – can continue to do so. And that will require creativity and sustained effort that FDIC stands ready to provide.

Thank you again for the opportunity to be here today, and I look forward to a productive conversation.

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[1] *See*, e.g., Rajashri Chakrabarti and William Nober, "Distribution of COVID-19 Incidence by Geography, Race, and Income," Federal Reserve Bank of *New York Liberty Street Economics* (June15, 2020), available at https://libertystreeteconomics.newyorkfed.org/2020/06/distribution-of-covid-19-incidence-by-geography-race-and-income.html; *see also* Sharon Cornelissen and Alexander Hermann, "A Triple Pandemic? The Economic Impacts of COVID-19

Disproportionately Affect Black and Hispanic Households," Joint Center for Housing Studies of Harvard University (July 7, 2020), available at https://www.jchs.harvard.edu/blog/a-triple-pandemic-the-economic-impacts-of-covid-19-disproportionately-affect-black-and-hispanic-households.

[2]Section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) sets forth several statutory goals for the FDIC and other financial regulators, including:(1) preserve the number of MDIs, (2) preserve the minority character in cases involving merger or acquisition of an MDI; (3) provide technical assistance to prevent insolvency of institutions not now insolvent; (4) promote and encourage creation of new MDIs; and (5) provide for training, technical assistance, and educational programs.

[3]*See* 2017 FDIC National Survey of Unbanked and Underbanked Households, available at https://www.fdic.gov/householdsurvey/2017/2017report.pdf. In 2017, 6.5 percent of U.S. households were "unbanked," meaning that no one in the household had a checking or savings account. By comparison, 16.9 percent of black households were unbanked and 14 percent of Hispanic households were unbanked.

[4]*See id*. at 10. While 19.7 percent of U.S. households in 2017 had no mainstream credit in the past 12 months, 36 percent of black households and 31.5 percent of Hispanic households had no mainstream credit.

[5]*See id.* at 44.

[6]*See* Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2019, Featuring Supplemental Data from April 2020* (May 2020), available at https://www.federalreserve.gov/publications/files/2019-report-economic-well-being-us-households-202005.pdf.

[7]*See* FDIC, *Minority Depository Institutions: Structure, Performance, and Social Impact*, available at https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf.

[8]*See*, *e.g.*, James Barth, Aron Betru, Matthew Brigida, and Christopher Lee, *Minority-Owned Depository Institutions: A Market Overview*, Milken Institute (July 2018), available at https://milkeninstitute.org/sites/default/files/reports-pdf/MDIs-A-Market-Overview.2018.FINAL.pdf.

[9]*See* FDIC, *Minority Depository Institutions: Structure, Performance, and Social Impact*, available at https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf.

[10]*See* FDIC Advisory Committee on Community Banking, available at https://www.fdic.gov/communitybanking.

[11]*See* MDI Subcommittee to FDIC's Advisory Committee on Community Banking, available at https://www.fdic.gov/regulations/resources/minority/subcommittee/index.html

[12]*See* Microsoft, "Addressing racial injustice" (June 23, 2020), available at https://blogs.microsoft.com/blog/2020/06/23/addressing-racial-injustice/.

[13]Our lawyers successfully persuaded me not to use the show's name for fear of a copyright and trademark infringement.

[14]*See*, e.g., Bank for International Settlements, "How fintech can promote financial inclusion – anew report on the opportunities and challenges" (April 14, 2020), available at https://www.bis.org/press/p200414.htm; *see also* Ratna Sahay et al., "The Promise of Fintech: Financial Inclusion in the Post COVID-19 Era," International Monetary Fund, available at https://www.imf.org/~/media/Files/Publications/DP/2020/English/PFFIEA.ashx.

[15]*See* FDIC Chairman Jelena McWilliams, "The Future of Banking," speech before the Federal Reserve Bank of St. Louis (Oct. 1, 2019), available at https://www.fdic.gov/news/news/speeches/spoct0119.html.

[16]*See* Federal Regulators issue joint statement on the use of alternative data in credit underwriting (Dec. 3, 2019), available at https://www.fdic.gov/news/news/press/2019/pr19117.html.

[17]*See* Federal Agencies Share Principles for Offering Responsible Small-Dollar Loans (May 20, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20061.html.

[18]*See* FDIC, *Conducting Business with Banks: A Guide For Fintechs And Third Parties* (February 2020), available at https://www.fdic.gov/fditech/guide.pdf.

[19]See Request for Information on Standard Setting and Voluntary Certification for Models and Third-Party Providers of Technology and Other Services, 85 Fed. Reg. 44890 (July 24, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-07-24/pdf/2020-16058.pdf.