

The spectre of a few gigantic banks striving to become even more colossal evokes resignation among some people. They see the banks as so powerful that resistance to them is futile. Much of the media's coverage has reinforced this sense of passivity by conveying a sense that the mergers are "done deals" waiting to be rubber-stamped by the Chrétien government.

Yet a growing number of Canadians and organizations, including many CED groups, are resisting a megabank future. Fightback strategies vary widely, however. Some argue that we should forget about the banks and focus on building up member-owned financial institutions - an argument which ignores the overwhelmingly dominant position of the banks in Canada's financial marketplace and the fact that it is our money - the deposits of over 20 million Canadians - which has made the banks as wealthy and powerful as they are today.

Others see widespread anger about the banks as a golden opportunity to move the debate beyond bank-bashing and towards viable, positive reforms which can bring about satisfaction for long-suffering Canadian bank customers, while advancing the community-based economy. This movement for better banks is led by the Canadian Community Reinvestment Coalition, made up of over 80 small business, labour, CED, and other groups across Canada.

Who decides on vital issues such as the mergers? "We want to ensure that decisions about the financial services industry in this country continue to be made by Canadians, for the benefit of Canadians," said Royal Bank CEO John Cleghorn in January as he announced his bank's plan to merge with the Bank of Montreal.

We couldn't agree more - except that Canadians require mechanisms to ensure there is no gap between this rhetoric and reality. What we lack are strong laws to ensure that banks and other financial institutions are meeting our needs, similar to the Community Reinvestment Act (CRA) in the United States.

COMMUNITY REINVESTMENT IN THE U.S.

Enacted in 1977, the CRA is a time-tested law that goes a long way to making U.S. banks

and other financial institutions serve the needs of all their customers, rich and poor alike. It also encourages community-based economic development, both through funding and by empowering community organizations.

The CRA grew out of the notorious practice in the 1960s of "redlining," in which bank branches drew a red line around certain low-income urban neighborhoods and told their loan officers not to lend to anyone living in those neighbourhoods.

Under the CRA, the U.S. government reviews the performance of banks and other financial institutions in meeting local needs for credit and deposit services in a manner "consistent with the safe and sound operation of the institutions." Bank performance in meeting needs is revealed by requiring them to disclose detailed data about their loans, investments, and services. A bank with a failing grade can be required to take corrective action, and any expansion, merger, or takeover of the institution can be denied.

Here are a couple of examples of the CRA in action. Before the Bank of Montreal could expand its subsidiary, Harris Bank of Chicago in 1994, Harris Bank had to correct its poor lending and service record, revealed under the CRA's detailed lending, investment, and service disclosure requirements. It did so by pledging \$327 million in credit and assistance over five years for small business loans, affordable housing, and other needs in Chicago.

These funds result from agreements

Legislated community investment works
in the U.S. It can work here too.

Community Reinvestment - Now Is The Time

Murray MacAdam & Duff Conacher

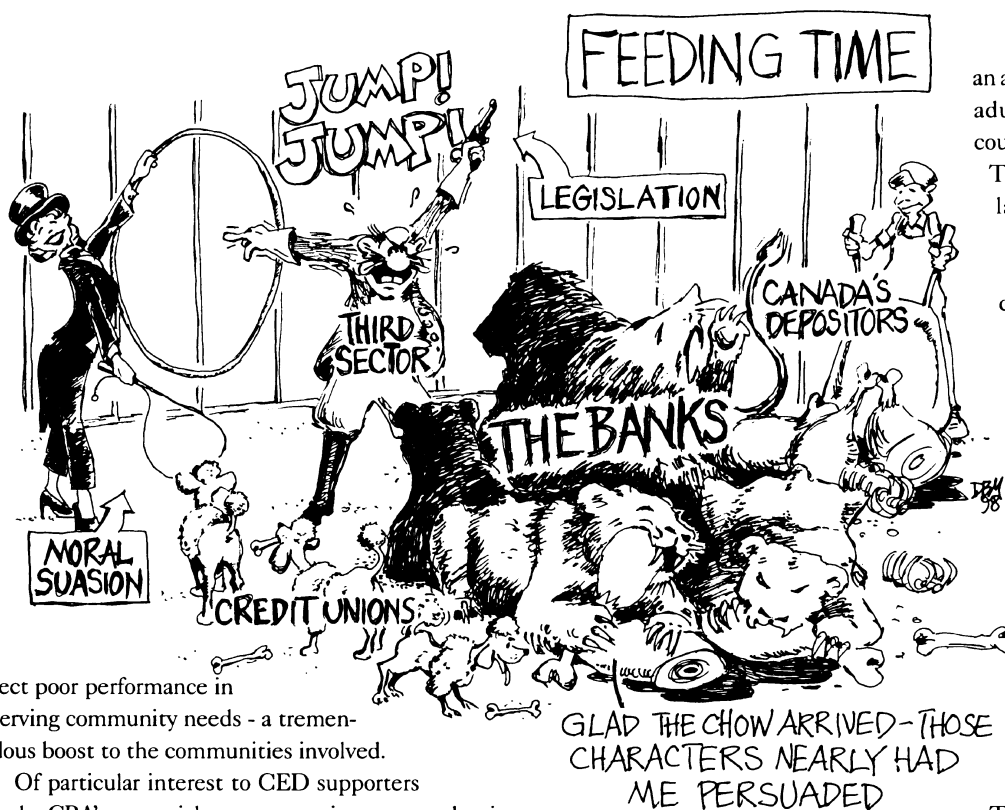
reached between the bank and community organizations such as the Chicago Association of Neighborhood Development Organizations (CANDO). Bank representatives meet quarterly with neighborhood representatives to discuss their progress and assess new opportunities.

The agreements and Harris Bank's commitment to the community "wouldn't exist without the Community Reinvestment Act," says CANDO executive director Ted Wysocki. Harris Bank also maintains a healthy profit while meeting community needs, earning \$64 million in the first quarter of 1998, up from \$55 million last year.

Some U.S. banks with excellent CRA performance evaluations use those ratings in their advertising to show that they are serving the community well. Imagine if our banks did that!

Our second example of the CRA's benefits takes us to Texas - not usually known as a bastion of social progress. After a CRA-mandated review revealed a poor lending record by the Texas Commerce Bank, an agreement was reached with local organizations which led the bank to provide financing for 411 new homes in a section of Dallas where no new housing had been built in over 25 years.

These scenes of positive bank-community partnerships are played out in communities across the U.S. Hundreds of bank-community agreements and \$435 billion for local investments have resulted since the CRA was enacted, as banks have been required to cor-



rect poor performance in serving community needs - a tremendous boost to the communities involved.

Of particular interest to CED supporters is the CRA's potential as a community organizing tool. U.S. activists have found that once people have been mobilized to work together around their banking needs, they often feel empowered enough to take on other issues affecting them.

Admittedly, the U.S. banking system is far from perfect. Merger mania has also struck there, and as U.S. banks gobble each other up, fears are growing about negative impacts on jobs, service fees, and small business loans. But at least American consumers and community groups have the CRA and other laws as tools for fighting back - and are using those tools to mount an energetic campaign against proposed bank mergers.

What a sharp contrast to Canada, where we lack effective measures for holding banks accountable to community interests and where small businesses have consistently ranked access to capital as a Top Ten problem in surveys over the past decade.

In fact, a recent analysis of bank lending statistics by the CCRC, using figures supplied by the banks, found that the big banks are still putting the credit squeeze on small businesses. They've been getting a smaller share of total available bank credit, while big businesses get the lion's share.

Of the nearly \$100 billion increase in total

business

credit from 1995 to 1997, 81.3% was loaned out in amounts of more than \$5 million. Meanwhile, the number of customers with more than \$5 million borrowed dropped by almost 14%. In essence, a smaller number of big borrowers are getting more of the money loaned out. At the same time, small businesses are receiving only 6.5% (at most) of total business credit extended by the banks, - less than in 1995. During the same period small business lending dropped as a percentage of total lending in Québec, northern and eastern Ontario, Manitoba, Saskatchewan, Alberta, and Toronto.

DEVELOPING A CANADIAN COMMUNITY REINVESTMENT ACT

Canadian banking representatives remain hostile to proposals for enacting CRA-style legislation in Canada. They argue that low-income neighbourhoods are not subject to the blatant discrimination of "redlining," so we don't need tough CRA-style disclosure mechanisms to protect consumers here.

Yet low-income Canadian neighbourhoods have borne the brunt of bank branch closures in recent years. Those closures, coupled with stiff ID requirements for opening

an account, mean that at least 400,000 adult Canadians have no bank account.

The banks also claim that CRA-type laws would force them to meet lending quotas. Canada's banks mistakenly interpret the "meet community needs" requirement under the CRA as a quota system.

In fact, under the CRA, the demand for lending, investment, and service are tracked, as is each bank's record in meeting that demand, taking into account the risk of lending, local conditions and the institution's financial health. A bank must take steps to correct its record only if it is unfairly turning away loan applicants or depositors who could be served without putting the institution at risk. No quota is involved.

The CCRC proposes a bank accountability system for Canada, based on the U.S. system with its strong community development focus. It's also worth noting that, as outlined below, the criteria are not about penalizing the banks - unless they deserve it. Incentives for improving performance are also included. And as community-minded U.S. banks have done, Canadian banks that could show that they are serving their customers and local communities well could use that information in their marketing. (The CCRC's proposals cover all deposit-taking institutions, e.g., credit unions as well as banks. For purposes of simplicity, we generally use the term "bank" rather than "financial institution.")

HOW THE SYSTEM WOULD WORK

Definition of Community

Banks would be required to provide data on their overall activities broken down by census tract. Each branch would have to define the "community" it purports to serve. The data would also be correlated by federal parliamentary riding, so that MPs can assess each bank's performance in their riding.

Data Disclosure Requirements

Each chartered bank would be required by

law to report to the federal government annually the following information for each branch's lending and investments to businesses and community developments, such as co-op housing, worker buy-outs, and microcredit funds:

- the number of applicants in each category.
- the number of applicants the bank accepts and rejects in each category.
- the default and loss rate for each category.
- the number of loans or investments in each category called by the bank.
- all of the above categorized by size of loan or investment (under \$5,000; \$5,000-\$25,000; \$25,000-\$50,000; \$50,000-\$100,000; \$100,000-\$250,000; \$250,000-\$500,000; \$500,000-\$1 million; \$1-\$5 million; over \$5 million).
- all of the above would also be categorized by size, type, and location of the business, and also by the gender of the business owner.
- in addition, banks would be required to provide reasons for application rejections. Service would also be assessed by requiring banks to disclose:
 - the bank's pattern of opening and closing branches, especially in low- and moderate-income neighbourhoods and communities.
 - whether an independent audit reveals that the bank has lowered barriers to access to services, as promised by the banks to the federal government in February 1997.
 - the number of complaints received by each branch, and the rate of resolving complaints, as well as the number of lawsuits involving customers and the institution, and their outcomes.
 - overall, whether the range of services provided meets the distinct needs of each community (e.g., by providing extended hours or financial planning services).

Performance Standards

Evaluations would be based on lending, investment, and service tests, as in the U.S. If review of the data revealed a pattern of rejecting certain categories of loan applicants (for example, by size of business, gender of the business owner, or location of business), and the loan default and loss rates were similar for these applicants as for other appli-

cants, then the bank would receive a lower grade than if all borrowers of similar risk were treated equally.

For investment, banks would be judged on the number of applicants, approvals, and rejections, along with flexibility of investment practices, particularly as they relate to meeting the needs of low- and moderate-income individuals trying to start businesses, small businesses, and community development borrowers.

Community Participation

The CCRC proposes that the Department of Finance be in charge of examining and evaluating the data, with a final decision concerning rating and penalties made by the Minister of Finance. Individuals, community groups, small businesses, and others would have an opportunity to comment on the performance of bank branches as part of the regulatory review, and to appeal to the Minister the grade given to any bank.

Incentives to Improve Performance

A range of penalties and incentives, would encourage banks to improve their performance:

- As Ontario has done, federal and provincial governments should consider imposing a surtax on banks, combined with a tax credit that could be applied to the surtax based on the bank's performance in meeting community needs.
- As Ontario has done, governments should not contract out business to banks that fail to meet community needs.
- As in the U.S., the federal government should deny applications to expand or merge by banks with an overall failing grade.
- If a bank branch has a failing grade, a bank executive and board member should be required to attend a public meeting in that community. At the meeting the bank's representatives should be required to accept community submissions about the bank's performance, and to explain how the bank plans to obtain a passing grade in the future.
- Existing fines in financial institution laws would apply.

What would be the impact of these measures? Given that bank lending statistics reveal that the banks are not supporting the

job-creating small business sector with the credit it needs, it's clear that a Canadian CRA would result in billions of dollars in new credit for small businesses, leading to thousands of new jobs. The enormous potential is obvious when you consider that small businesses create over 35% of Canada's gross domestic product, yet only receive at most 6.5% of total business credit extended by the banks.

Less tangible, but no less important, are the spin-offs that could be expected in terms of low-income communities being revitalized and community organizations being able to obtain the funding they need for local initiatives.

The community reinvestment proposals outlined above and the 20-year U.S. experience with the CRA make it clear that we can do much more to ensure that our banks meet the needs of individual Canadians, small business owners, and communities across the country. After reviewing the U.S. system, the Liberals, Conservatives, NDP, and Bloc Québécois have all included CRA-like proposals in their party policies or election platforms over the past two years.

It's about time that the Liberal government responded to the broad-based support for laws requiring banks and other financial institutions to disclose detailed information about their lending, investment, and service to customers, along with the right to evaluate these data and grade each financial institution, as in the U.S.²⁰

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