ENHANCING THE LOCAL IMPACT OF COMMUNITY BANKS

PREPARED FOR:

PRESIDIO BANK

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**EXECUTIVE SUMMARY**

In the wake of the Great Recession, financial institutions have been uniformly pilloried by a spectrum of individual and institutional actors on the political right and left as being greedy risk-takers, responsible for the worst economic and financial downturn since the 1930s. Critics have made little distinction, however, between global financial institutions, which specialized in the exotic products most directly implicated in the crisis, and smaller-scale local banks.

In fact, most banks in the U.S. remain community-based institutions engaged in traditional consumer and small business depository and lending activities in their local markets. Blaming such institutions for the porcine speculation of a handful of the largest global financial institutions is akin to blaming utility companies for global warming. Like water, sewer, electricity and transportation, banks are a fundamental part of the infrastructure in any regional economy.

Despite the passage of some reform measures like the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, many “too big to fail” federal banking policies supporting some global financial institutions remain in force. In the absence of additional reforms, responsible, community-minded banks must be able to compete against these behemoths while also enhancing their local social impact and substantively distinguishing their business practices and operations.

Progressive banks are already engaging in such efforts, but they may be able to find additional ways to effectively leverage the power of their entire footprint—including both their traditional book of lending and depository businesses as well as their operational supply chain—to increase the positive contributions they make to their communities. The purpose of this study was to creatively explore this question: **In a competitive environment, how can small banks be a more positive force for local community development, wealth creation and wealth retention?**

To find answers, the MIT Wealth Creation Clinic partnered with one such progressive financial institution based in California’s San Francisco Bay Area. Presidio Bank, whose clients include medium-sized businesses and nonprofits, has since its genesis been interested in growing its impact on the communities of the Bay Area by further supporting active non-profits and community-serving businesses. As a small bank, however, Presidio’s annual
monetary donations and potential community resources are necessarily limited. Beyond continuing its lending and extensive community service practices that earned it a rare “outstanding” rating (top 8% of banks) from the Federal Reserve on its Community Reinvestment Act (CRA) exam, Presidio was also looking for new ways to work with non-profits and local businesses in its market area in a mutually beneficial manner by assisting them to achieve their economic development, housing, and employment goals, potentially fostering improved local wealth creation opportunities for all.

This study examines and documents a range of model activities at Presidio that other banks might emulate, while also offering recommendations for Presidio, other lenders, regulators, and banking associations.

**Key findings and recommendations are as follows:**

1. **Supply Chain:** Presidio is already engaging in a host of local wealth-enhancing practices in its supply chain, frequently using locally-owned and headquartered vendors for many of its procurement needs. In analyzing its footprint, MIT quantified the degree to which its supply chain is already local, and offers suggestions (see Findings Section II-A; Recommendations Section III-A) as to how the bank can do even more to leverage the power of its supply chain to benefit local communities. For example, by considering contracting opportunities with CRA-qualified businesses based in low-income/underserved census tracts, they can further enhance their impact on economic activity in neighborhoods where it is most needed.

2. **Donation, Lending and Investment:** Presidio works with Community Development Financial Institutions (CDFIs) and other non-profits to support lower-return community loan fund endeavors, microfinance entities, and other activities which benefit the underbanked and disadvantaged (See Findings Section II-B through II-F). MIT offers additional recommendations for external strategic partnerships and internal bank services/investments that can enhance Presidio’s social impact, and place it at the forefront of private-sector community development efforts (see Findings Section III-B). For example, by supporting organizations that document (in credit scores) the informal credit and social lending circle activities that are often more common among immigrant and low-income communities, they can enhance the representativeness and accuracy of their credit scores and improve market information about this segment of the population so that when these individuals do need formal banking services, they will face fewer barriers to approval.

3. **Strategic Operations and Processes:** As Presidio grows, it may need to more accurately quantify and prioritize its community development activities in order to maintain their quality and quantity while operating at a larger scale. MIT offers several tracking and organizational suggestions for Presidio in its internal processes: for example, by quantifying the dollar value of employee time spent volunteering in different capacities, the bank can better trace the impact of such efforts as well as increase the internal value and awareness allocated to such activities. See Section III-C for additional considerations and details.
4. Regulatory and Industry Association Implications: Bank regulators and independent banking associations may be able to do far more to formally credit and recognize the important role that community banks play in enhancing local economic activity and wealth generation. MIT offers a variety of suggestions—from leveraging the power of naming by creating a “locally made” branding badge for “locavesting” banks, to giving CRA credit for using qualified local suppliers and contractors, to better differentiating CRA ratings—in Section III-D.

I. BACKGROUND INFORMATION

A. ABOUT THE STUDY

1. ABOUT THE PARTICIPANTS

The Wealth Creation Clinic at MIT’s Department of Urban Studies and Planning (DUSP). The Ford Foundation-Sponsored MIT Wealth Creation Clinic, modeled after the transactional Community Economic Development Legal Clinics established by the Ford Foundation in the 1970s, provides a range of economic development and planning services to client partners. The “transactional” model provides community-based development practitioners (clients) with access to the skills and knowledge of economic development practitioners working in business and commercial settings within academia (faculty and students), and provides a venue for training future practitioners. The Clinic is based on a pragmatic approach that emphasizes skill development (of both the student and client) and service provision in support of wealth creation and livelihood generation activities.

The Clinic is housed in MIT’s Department of Urban Studies and Planning (DUSP). Since its founding 80 years ago, DUSP has consistently been rated the premier planning school in the world. Home to the largest urban planning faculty in the United States and enjoying the advantage of operating within the context of MIT’s culture of innovation and interdisciplinary knowledge creation, DUSP applies advanced analysis and design to understand and solve pressing urban and environmental problems. To this end, the department fosters a culture of learning by doing, while also supporting the development of influential theories in the areas of urban planning and design; housing, community and economic development; and environmental policymaking.

Presidio Bank. Presidio Bank is a small locally-owned and operated institution based in San Francisco, California with four additional regional offices in the Bay Area. With a total asset base of roughly $450MM, Presidio primarily targets small and medium-sized businesses and non-profits. Presidio provides the personalized time and attention of a neighborhood bank but possesses many of the resources of a regional institution. Employees and board members actively participate in the community by financially supporting and volunteering with local organizations. Presidio’s efforts have earned the bank a reputation for strong community involvement, in part reflected by their recent Community Reinvestment Act (CRA) rating of “Outstanding”, the highest possible rating in the four-tiered system that the FDIC utilizes to evaluate compliance for most financial institutions.
Bank History. Presidio was founded in 2006 and its initial capital raise was vastly oversubscribed, with more than $60MM in equity commitments for only $40MM of bank equity sold. Based on archival research, as well as interviews with employees and clients, this oversubscription reflected a number of factors: (a) generally flush capital markets were prevalent during the time period (b) Presidio’s assembled founding directors included a number of well-respected citizens and highly-regarded business and civic leaders in the Bay Area, and (c) the Bay Area had lost many local banks during the 20+ years of banking deregulation and associated mergers that had prevailed throughout the U.S. financial markets, resulting in unmet demand by small and mid-sized businesses for local, personalized banking services.

Bank Strategy & Business Model. Presidio’s founders made the explicit decision not to focus on the technology sector, which is a leading industry and source of value-add/exports in the Bay Area. This decision reflected their view that the technology sector, with its strong ties to highly competitive venture capital sources and a wide range of associated national and local specialist banking partners, was a saturated, very competitive, and extremely challenging market to successfully penetrate as a start-up bank unless it focused most, if not all, of its strategic resources on the sector. Instead, Presidio established its mission to provide banking services to local businesses operating throughout the Bay Area, including but not limited to legal/professional services firms, local real estate developers/owners, small and mid-sized businesses, and non-profit organizations. After opening its first branch in San Francisco, additional branches followed in San Rafael (Marin County – North Bay), Santa Rosa (Sonoma County – Wine Country/North Bay), Walnut Creek (East Bay), and Palo Alto (Mid-Peninsula).

The bank also made an explicit decision to position itself as a business bank rather than a consumer bank, specializing in C&I (commercial and industrial) loans and commercial real estate lending. None of its branches have any teller windows, nor is there a “retail” banking presence of any kind. While the bank does offer some personal banking services to the owners of the small businesses it serves, consumer banking per se is not its focus. In conjunction with this, the bank made an intentional decision not to enter the residential real estate mortgage market as a stand-alone business. This strategy necessarily limits the potential range of community engagement initiatives that Presidio might target.

Community Engagement Approach. The bank’s current approach to community donations, investments and services has largely been what multiple employees characterized as an organic “friends and family” approach – that is, a bottom-up or reactive strategy, in which notable community development or donation opportunities emerge organically through employees’ outside activities or through their relationships with clients; the bank considers these opportunities on a one-off, case-by-case basis. While there is a Corporate Responsibility Committee, previously called the CRA Committee but renamed to reflect a broader community engagement focus, there does not appear to be a top-down strategy or process defining and guiding the types of community efforts Presidio might proactively consider seeking out to sponsor.
2. About the Study: Purpose, Approach and Methodology

Purpose. The purpose of the project partnership between Presidio Bank and the MIT Wealth Creation Clinic was twofold:

- **Document and Measure Existing Practices.** So that other institutions might learn from Presidio’s community-centric model, MIT documented Presidio’s current community engagement practices, while also reviewing their impact on local economic development and wealth creation and retention by examining effects across the supply chain. MIT was also to recommend additional ways to define and measure its philanthropic, volunteer, and other community-related lending book/product activities.

- **Consider and Propose New Practices.** MIT was also asked to research and analyze potential new avenues by which Presidio Bank can enhance its business and its community apart from direct monetary donations, with a focus on serving non-profits and small businesses, and make recommendations for initiatives the Bank could consider.

The results of the two-part study not only provide Presidio Bank with alternatives to effectively increase the scope of their community efforts, but also provide a guide to expand the local impact of other community banks based on Presidio’s example.

Approach and Methodology. A key element in increasing the impact of community engagement is measurement. Presidio Bank should be able to track its community efforts, not only to evaluate and strategically enhance its local role but also to determine the benefits of local involvement for both the community and the bank in order to encourage the diffusion of Presidio’s practices to other community banks. The Bank’s measurement strategies have captured some of its impact, but bank officers are seeking creative criteria to track less obvious elements of its community contribution.

The MIT Wealth Creation Clinic used a mix of quantitative and qualitative techniques to trace the indirect network, supply chain, and multiplier effects of Presidio’s activities that would not be captured by analysis of its direct lending activities and other financial services.

The Clinic conducted remote and on-site interviews with key internal stakeholders at Presidio, with key CRA-activity philanthropic beneficiaries, and with other community stakeholders including several of Presidio’s non-profit clients. Concurrently, the Clinic collected and reviewed documentation and statistics related to Presidio’s monetary giving, volunteer efforts, and other modes of community engagement.

Tracking the indirect impact of Presidio Bank’s community involvement required documenting and measuring activities that are located upstream, downstream and horizontally across the supply chain:
• **Stakeholder Analysis.** The MIT Wealth Creation Clinic interviewed a wide range of bank employees, clients, beneficiaries and other stakeholders, including a federal regulator, local government agency, and unaffiliated community groups. These stakeholders were geographically disbursed throughout the region, including entities in the East Bay, North Bay, Peninsula, and San Francisco, and were also distributed across entity types, including non-profit organizations, tax-exempt foundations, for-profit entities, and public sector agencies. Interview questions were tailored as appropriate, given the nature and scope of the interviewee’s range of activities and purpose. Representative interviewees included:

  Glide Economic Development Corporation

  Marin Community Foundation

  California Reinvestment Coalition

  Mission Asset Fund

  City of San Francisco – Office of Economic and Workforce Development

  Federal Reserve Bank of San Francisco

  East Bay Housing Organizations (EBHO)

  Oakland Peace Center

  Working Solutions

• **Supply Chain Analysis.** The MIT Wealth Creation Clinic worked with bank employees to gather qualitative and quantitative information on the bank’s internal operations, reviewing data on its contractors, suppliers, borrower and depositor clients, and donors/recipients in order to fully analyze the interstitial spaces of its supply chain.

• **Industry Practices Review.** The MIT Wealth Creation Clinic also interviewed representatives of other banks, including two large “bulge-bracket” Wall Street-based banks and a large multi-state regional bank based in the Midwest, to establish a guide against which to compare some of Presidio’s community engagement activities.
B. NATIONAL AND REGIONAL ECONOMIC AND BANKING MARKET OVERVIEW

1. NATIONAL AND REGIONAL BANKING MARKETS IN CONTEXT

In the wake of the Great Recession, financial institutions have been harshly painted with a broad brush. The Occupy (Wall Street) movement, for example, has targeted large global banking entities like the top four U.S. bank holding companies by asset size—JPMorgan Chase, Bank of America, Citigroup and Wells Fargo—as responsible for greedy, risky lending practices that fueled a speculative asset bubble which, upon bursting, brought about the worst U.S. and global economic downturn since the Great Depression. Similarly, from the other end of the political spectrum, Tea Party organizations and others suspicious of centralized financial and government power have called for banking reform, with some backing Senator Warren’s call to reinstate The Glass-Steagall Act (which separated investment banking, commercial banking, and insurance) to break up megabanks.

Making matters more confusing, the large investment banks (e.g. Goldman Sachs and Morgan Stanley), which had long been categorized separately from commercial banks and which had specialized in the riskiest financial products, were strongly encouraged to convert to “bank holding companies” (i.e. commercial banks) during the most recent crisis so that they could receive access to Federal Reserve backing and liquidity measures. This blurring may have diminished the public’s ability to distinguish between a local community bank and Goldman Sachs, leading to a widespread questioning of the efficacy of the banking system as a whole.

| Presidio Bank, Community Banks, and Megabanks: Loan and Investment Profile Snapshot |
|---------------------------------|-----------------|-----------------|-----------------|-----------------|
| % of Bank Assets, 3/31/13:      | Presidio Bank  | Community Banks | Megabank (Assets $100B+) | All Banks      |
| Small Business Loans            | 15.0%          | 16.8%           | 1.9%                | 4.5%           |
| Domestic Private and Foreign Securities | 1.5%          | 1.0%           | 7.3%                | 5.6%           |
| Non-Government Private Domestic Securities (Mortgage-Backed Securities, Asset-Backed Securities, Structured Financial Products) | 1.5%          | 0.9%           | 4.2%                | 3.6%           |
| Foreign Securities              | 0.0%           | 0.1%           | 3.1%                | 2.0%           |

Source: MIT analysis of Federal Financial Institutions Examination Council, FDIC, Federal Reserve data

In fact, the exotic mortgage products, derivatives, and credit default swaps implicated in the pre-2008 asset bubble were not uniformly distributed among all banks. Smaller, local banks rarely participated in such practices. Indeed, most banks in the U.S. remain small, community-based institutions, engaged in basic consumer and small business depository and lending activities. They are less likely to securitize debt and mortgages they originate, keeping them on their own balance sheets. The chart above summarizes some key differences between small and large banks in regards to such activities, and also shows how Presidio matches the profile of small banks.
Like water, sewer, electricity and transportation, banks are part of the requisite infrastructure in any regional economy. Just as these utilities may voluntarily adjust their operations to be effective in changing times, and just as some of the needed adjustments may require regulatory action, so too with banking. But broadly demonizing financial activity is at best, myopic, and at worst, harmful and counterproductive to economic development, which can improve the well-being of society’s most vulnerable populations.

Accordingly, we will first contextualize this study’s findings and establish a framework for its recommendations by reviewing some key aspects of national and regional banking and financial services markets. Since the structure of banking markets changes across place and time, the current state of the U.S. and Bay Area banking markets not only bounds the range of possible community impact maximization strategies for Presidio and other commercial banks, but also influences the perceived usefulness and attractiveness of these strategies.

- **Banks Play an Essential Role in the Generation and Retention of Wealth in Advanced Economies, Across All Types of Economies and Organizations.** Banks and financial institutions, be they commercial banks, central banks, thrifts, credit unions, or investment houses, are an integral part of any system of

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**Supply Chain & Community Wealth**

![Diagram](https://example.com/diagram.png)

*Source: MIT Wealth Creation Clinic Process Rendering*
economic production and provide money to fund the infrastructure of the regional economies in which they operate. *When organizations pay their workers, when workers purchase goods, and when the manufacturers of those goods make capital expenditures to acquire equipment, all of these activities typically involve banking transactions. This is even true for non-profits.* Banks, in addition to providing these financial services, contract for a host of services (from potential clients) in their local economy across industries—for space, equipment, furniture, supplies, food, marketing materials, accounting/audit services, legal services, advertising, and so forth. This circulation process, and banks’ central role in it, is critical to the creation and retention of local wealth (see diagram).

- **Banks Make Choices Which Influence How They Help Retain or Create Local Wealth.** While banks provide the financial infrastructure critical to the healthy operation of any regional economy, they do not necessarily do so in ways which are equally advantageous to their host regions. Banks can choose how they operate: some banks may make choices that export wealth out of the region—to out-of-market headquarters staff, investors and suppliers—while others may maintain a local focus, with locally-owned suppliers, locally-based branch landlords, local clients, and local investors. As such, the bank’s total footprint—including not just its loans to area small businesses, but also its supply chain—provides a critical source of opportunities to boost local circulation of money, and local wealth creation opportunities (see diagram).

In a 2010 literature review for an exhaustive study on Wal-Mart’s potential impact on New York City’s local businesses, Bill De Blasio, The Public Advocate for the City of New York and current mayoral candidate, and the team led by Dr. Tom Angotti at CUNY Hunter College’s Center for Community Planning and Development, succinctly and eloquently made the case for local businesses’ effects on wealth creation and retention:

“Locally owned businesses are crucial to the vitality of our economy because they keep a higher percentage of their resources in the local economy by procuring their goods and services from the local area. Locally owned businesses recirculate dollars in the neighborhood while chain stores send revenues to corporate headquarters. A 2004 study found that for every $100 spent in locally owned businesses, $68 stayed in the local economy while chain stores only left $43 to recirculate locally. The local owners tend to live in the community, spend more on labor, are twice as likely to use local supply networks, and contribute more to local charities.29 Small businesses are the engines of local economic development, leaders in innovation and change, and are more productive than large chains.30 In New York City, small retail businesses are a particularly important means of economic and social advancement for immigrant families….Our observations about the critical importance of locally-owned businesses are widely shared among those who have studied urban economies in depth. According to economists at Winthrop University, states with a higher percentage of very small businesses, those with 20 employees or less, have a more productive workforce and higher levels of GDP growth than states with lower levels of very small businesses. Furthermore, states that are rich in very small businesses have lower rates of unemployment.31” (page 9, De Blasio, Angotti et al., 2010)
By choosing to use locally-owned suppliers in their operations, and by choosing to lend and conduct banking transactions for locally-owned businesses, community banks serve a critical role in sustaining these small businesses which in turn tend to spur local economic development and innovation.

- **But Banks' Choices May Be Limited By Competitive, Regulatory and Civil Society Constraints: “Too Big to Fail” On One Side vs. Anti-Banking Sentiment On the Other.** While the United States is a capitalist economy with strong competitive pressures, since the 1980s its banking policies have produced a highly concentrated market for financial services, as thousands of locally owned, managed and controlled banks have been merged into or acquired by a handful of global financial institutions (see diagram in Appendix, Section IV). Nonetheless, small banks remain the lifeblood of most U.S. metropolitan areas’ business infrastructure, accounting for 95% of all financial institutions in the U.S., down from 97% since the 1980s.

When viewed by total deposits, however, the picture looks markedly different: the largest banks (specifically, those with assets over $10B), saw their share of deposits grow from 27% to over 80% of the total market between 1984 and 2011 (see chart above). In California, the trend has mirrored the nation: the number of banks in the state peaked in 1986-1987 before the full weight of the S&L (Savings & Loan) crisis had unfolded, and there are now less than half as many banking institutions operating statewide. To summarize, in California as in the US overall, small banks remain large in number, but are dwarfed in scale by a handful of megabanks that now dominate the market.

These megabanks benefit from market perception, based on actions prior to and during the Great Recession, that the government will not allow them to fail. This industry-wide assumption creates a moral hazard in which investors demand less of a risk premium (on the basis of an implicit government bailout) and banks are encouraged to engage in riskier behavior (again as a bailout is presumed).
As small banks face the risk of large-bank acquisition or failure, they must simultaneously contend with the widespread backlash against banking in general, as embodied in its most extreme form by the Occupy movement. Arguably, this anti-bank sentiment is historically similar to the anti-trust and anti-monopoly protests of previous eras in U.S. history, used to call for splitting up giant railroads, oil companies, telephones, and “natural monopoly” utility functions. In fact, today’s suspicion of banks might be understood to be the latest incarnation of a deeply entrenched, long-running anti-monopolism sentiment in the United States, with “too big to fail” banks—supported by TARP and a host of special/emergency Federal Reserve programs to enhance liquidity—as the new target (see Appendix, Section IV).

The alternative to mainstream banking, put forward by the most radical elements of the reform movement, has been to promote public banks (like the State Bank of North Dakota) or limited-scope, depositor-owned institutions (such as credit unions). While credit unions are appealing alternatives for many consumers, they have traditionally not been favored by businesses and organizations that may need a fuller range of advanced financial products requiring sophisticated structuring techniques and large up-front capital outlays. It is unclear whether their needs can be effectively met by credit unions in lieu of community banks.

Against this backdrop, community banks face a challenging market. Larger banks are benefiting both from aforementioned federal policies and technological advances in bank document processing that have enhanced the role of economies of scale in the industry. As a result, those smaller community banks which cannot compete with these larger entities wind up failing or closing, while those that succeed face merger and acquisition takeover attempts by their larger rivals. At the same time, there is more than a kernel of truth in various individual and institutional actors’ characterization of large financial institutions as anti-competitive monopoly-seeking enterprises, and community banks experience significant competitive pressure in the wake of large banks’ growth. Growing public distrust of the private banking system may hurt small banks, especially consumer banks, as some clients may take their business to alternative entities (e.g. credit unions).

- Caught in the Middle, Community Banks as a Category Remain Weakly Defined, Creating Challenges. The lack of a distinct legal definition and status for small community banks becomes troublesome as they struggle to distinguish themselves from their larger, riskier and poorly-viewed counterparts: unlike many other financial institutional forms—credit unions, registered securities broker-dealers, savings and loan associations—“community banks” are not formally defined under law or regulations. According to new working “research definition” of the FDIC, they are typically, but not always, less than $1B in asset size, operate only within the state or metropolitan area of their headquarters and/or adjoining states in select instances, and are focused more on multivalent and holistic “relationship” banking with their clients, rather than simply on “transactional” services (see Appendix, Section IV, for more details).
• **Community Reinvestment in the Era of the CRA.** Some community banks are actively seeking to increase their local impact, but most are obligated to make some level of contribution to their neighborhoods or regions because of the Community Reinvestment Act (CRA) of 1977.

  ➢ **CRA Review.** The CRA requires that banking institutions meet certain lending, investment and services tests to ensure that they are adequately providing credit to all parts of their assessment area, including low and moderate-income census tracts and small businesses. Compliance is determined by comparing banks’ performance to that of their peers (as measured by scale and scope) in the region, and by comparing banks’ distributions of loans by borrower type and census tract income level to the overall distribution of such borrowers and census tracts in their region. Banks which fail to comply with CRA face regulatory denials of applications to expand to new market areas, open additional branches, or merge with other banks.

  ➢ **A Negative Perception of CRA Casts a Shadow over Banks’ Community Development Efforts.** Though CRA has been criticized as having encouraged subprime and other high-risk lending practices that exacerbated the most recent financial crisis (Agarwal et al., 2012), such claims have largely been refuted (Reid et al., 2013). Interviewees from Presidio and other financial institutions actually referred to some CRA-qualified loans and investments as being “low return” (e.g. below market rate investments in community development loan funds) as opposed to being high-cost/high-return and high-risk investments. Consistent with this, some studies have concluded that very few of the riskiest residential mortgages of the last cycle were CRA-qualified loans: according to a Federal Reserve study cited by the National Community Reinvestment Coalition, just 6% of the “high-cost” loans (a category which typically encompassed most subprime mortgages) were CRA-related, reflecting the fact that many of the risky loans were either (a) not CRA-qualified, or (b) made by institutions not regulated by the CRA, including independent mortgage companies, credit unions, mortgage affiliates of banks, securities firms, and insurance companies.

  ➢ **CRA Compliance and Evaluation Has Become Perfunctory.** An unintended consequence of the CRA, according to interviewees at Presidio, other banks, and regulatory agencies, has been the emergence of a “check the box” culture in which banks complete a minimum, perfunctory level of CRA-qualified activities to avoid receiving a “substantial non-compliance” rating in a regulatory examination. Such a culture may have unwittingly been aided by regulators’ application of CRA: while banks may receive a less-than-satisfactory rating in any one of the individual subcategories under CRA, most receive a satisfactory overall rating. Though various agencies responsible for CRA examinations (FDIC, Federal Reserve, OTS, OCC) have issued materials documenting what receives CRA credit and providing guidance on examination expectations, the specific quantitative hurdles and targets used for the evaluation criteria, if they exist, remain undisclosed.
Since 2010, over 5,000 bank examinations have been performed by the various regulatory agencies, and nearly 90% have resulted in a “satisfactory” rating. Less than 3% of banks received either a “needs to improve” or a “substantial noncompliance”, while roughly 8% received an “outstanding”. This is only a slightly less centralized distribution of ratings than before the financial crisis: from 2004 to 2008, 92% of banks received a satisfactory rating (see diagram). Coupled with the lack of transparency regarding the actual scoring methodology, this distribution of results fuels the “regulatory capture” claims of Federal Reserve critics (i.e. that the regulators are soft on the banks because they treat them as clients and as potential future employers). (Bloomberg News, 1/28/10)

- **Implications for Community Banks.** Viewed in its industry context, the benefits of Presidio’s business model and strategy—focusing on locally-owned, small-to-medium sized businesses as clients—are clear. Competing with the scaling cost advantage that large banks have in offering “commodity-like” or “vanilla” consumer products, and competing with credit unions for patronage from values-conscious consumers who prefer an explicitly co-operatively owned and local financial institution, Presidio has targeted a market space potentially less buffeted by these competitive pressures.
Not all banks can be business banks, however. Many consumers and businesses are looking for the personalized service that comes from a local bank, where the loan officers and other decision-makers possess a deeper understanding of the nature of the microeconomy and funding decisions do not require oversight or approval from an out-of-market executive who may not understand the nuances of the particular community. Small community banks may be able to compete more effectively by offering highly personalized business and consumer services and conducting operations in a community-embracing manner. By more explicitly branding their local nature, successful small banks might also discourage acquisition, since merging with a large bank would inherently destroy the local appeal of the community bank to its clients and ultimately result in asset losses.

But banks must balance the costs and benefits of pursuing local “embeddedness” with maintaining the stability of their business. Against federal policy-supported “too big to fail” institutions, privately-owned banks face competitive constraints and investor expectations that necessarily limit the scale of their resources for philanthropy, community reinvestment, and community development. The findings and recommendations sections (which follow) illustrate some ways in which community banks, given competitive pressures, can act as positive catalysts and agents for community development while sustaining their own business. Our findings and recommendations suggest that small banks are able to use their local knowledge and the strength of their community ties to not only enhance the quality of their local communities and regional economies, but to compete with large, out-of-market banks.

2. SAN FRANCISCO BAY AREA ECONOMY AND LOCAL BANKING MARKET OVERVIEW

- Intraregional Variance in Economic Structure Impacts Community Challenges by Micromarket. The Bay Area, like most regional economies, is not a monolith. The counties within it—including the primary counties in which Presidio operates—vary significantly in their economic structure and their most pressing community development challenges.

For example, housing in both San Francisco proper and in the South Bay (i.e. Santa Clara County) is extremely expensive, reflecting perennially low vacancy rates resulting from a mix of natural and regulatory constraints on new residential development. While rents and housing prices are lower elsewhere, such as the East Bay and parts of the North Bay/Wine Country, they are by no means “cheap”: while the median gross rent paid by residents in the City of Oakland is roughly 25% lower than the median rent in San Francisco, the figure is still higher than that of 90% of heavily-populated counties in the United States, based on MIT’s analysis of the Census’ 2011 American Community Survey.
Meanwhile, unemployment in Oakland is almost double that in San Francisco, and the ratio of the number of jobs in Alameda County (where Oakland is located) to the number of residents is far lower than in San Francisco.

Key Bay Area Metrics: Different Submarkets, Different Challenges

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<tbody>
<tr>
<td>San Francisco</td>
<td>5.70%</td>
<td>585,267</td>
<td>444,494</td>
<td>825,863</td>
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<td>Alameda</td>
<td>7.40%</td>
<td>648,707</td>
<td>706,494</td>
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<tr>
<td>Oakland (City)</td>
<td>11.30%</td>
<td>177,986</td>
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<tr>
<td>Santa Clara</td>
<td>6.80%</td>
<td>892,800</td>
<td>832,471</td>
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<td>Sonoma</td>
<td>6.70%</td>
<td>175,179</td>
<td>236,761</td>
<td>491,829</td>
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Housing & Income

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</thead>
<tbody>
<tr>
<td>San Francisco</td>
<td>376,924</td>
<td>1.6</td>
<td>63.90%</td>
<td>$69,894</td>
<td>13.80%</td>
<td>$1,407</td>
<td>$719,800</td>
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<tr>
<td>Alameda</td>
<td>583,593</td>
<td>1.1</td>
<td>47.00%</td>
<td>$67,558</td>
<td>13.10%</td>
<td>$1,244</td>
<td>$480,700</td>
<td>7.12</td>
</tr>
<tr>
<td>Oakland (City)</td>
<td>175,054</td>
<td>–</td>
<td>59.90%</td>
<td>$50,500</td>
<td>21.00%</td>
<td>$1,049</td>
<td>$419,200</td>
<td>8.30</td>
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<tr>
<td>Santa Clara</td>
<td>636,291</td>
<td>1.4</td>
<td>43.30%</td>
<td>$84,895</td>
<td>10.60%</td>
<td>$1,462</td>
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<td>7.39</td>
</tr>
<tr>
<td>Sonoma</td>
<td>204,777</td>
<td>0.9</td>
<td>40.50%</td>
<td>$61,020</td>
<td>12.20%</td>
<td>$1,189</td>
<td>$398,900</td>
<td>6.54</td>
</tr>
</tbody>
</table>


As a result of these disparities, community advocates operating within the Bay Area have different views on the most pressing problems within their micromarkets. In the East Bay, for example, the community groups we spoke with felt that housing costs per se were less at the forefront of the housing affordability challenge than were housing safety and quality, stemming from the lack of income, investment and well-paying jobs. Compared to neighboring areas, the East Bay’s home prices and rents are significantly lower, even when viewed in comparison to the lower levels of income, and its vacancy rates are higher. The challenge with housing was less one of total supply, but of the quality and maintenance of supply: is housing safe and well-maintained? The loss of owner-occupied stock to investors (often out-of-market, resulting in a loss of wealth to the region overall) via foreclosure, as struggling homeowners have lost their jobs, was also a concern, again reflecting how the weaker East Bay economy impacts community challenges.
In contrast, in San Francisco and Marin where housing costs are exorbitant (for the reasons discussed, supra), expanding the supply of affordable housing was frequently listed as among the most pressing challenges city-wide. Though certain districts remain economic deserts and are being targeted by the city for reinvestment, economic development was less frequently mentioned as the most critical issue in San Francisco as compared to the production of affordable housing. These disparities among the views of community stakeholders are consistent with and reflect the picture created by the quantitative evidence, as shown in the accompanying chart (above).

**Banking Consolidation and Concentration Impacts “Money Centers” Like San Francisco.** In the era of banking consolidation that commenced with the S&L deregulation in the early 1980s and continued through the repeal of Glass-Steagall at the turn of the 21st century, the acquisition of small banks resulted in a loss of banking headquarters around the country. Nationally, the three most prominent products of M&A—Wells Fargo, Bank of America, and J.P. Morgan Chase—are actually the result of the merger of 109 different banks since 1983 (see Appendix, Section IV). While Wells Fargo remains headquartered in San Francisco and is the largest U.S. bank based there, these and other mergers resulted in the loss of locally-based banks such as Bank of America (now headquartered in Charlotte).

San Francisco, notably, despite its status as a “money center” banking hub, lost a number of regional and local banks in the 1980s, 1990s, and early 2000s, as larger banks gobbled up smaller ones: Wells Fargo and Bank of America, once “local” Bay Area banks, each bought a host of local and out-of-market banks to become significant multi-market and national financial services firms.

The net effect of these mergers is readily apparent when reviewing FDIC data on deposit market share by MSA. For the Bay Area, we analyzed FDIC deposit market share data for the San Francisco-Oakland-Fremont MSA, San Jose-Sunnyvale-Santa Clara MSA, Napa MSA and Santa Rosa-Petaluma MSA combined. These two banks, with over 61% of local deposits, effectively control more than half the FDIC-insured depository market in these four Bay Area MSAs combined. Adding the shares of the third and fourth-ranked banks in the region, out-of-market national players J.P. Morgan Chase and Citigroup, the top four banks in the region control 72% of deposits. In 1994, in contrast, one would have had to include the top seven banks to surpass the share of the top two today, and one would have had to include the top 12 banks to surpass the share of the top four today. Put another way, the San Francisco Bay Area’s banking market in 1994, before a wave of consolidations, was as concentrated as the market in New York City MSA is today (see chart). In fact, we reviewed the market share data of the 15 largest MSAs in the United States, and no other large region’s banking market is so dominated by so few institutions (see table below). Only Phoenix, where the top three account for nearly 70% of the market, comes close, making the Bay Area arguably the most concentrated banking market in the United States.
Notably, under current bank merger policies, if two institutions attempting to merge were anywhere near the (combined) deposit market share of Bank of America in the Bay Area, it would likely be forced to divest of a significant share of its branches to a competitor due to concerns about anti-competitive/monopolistic behavior.

### San Francisco Bay Area is the Most Concentrated Banking Market Among Large Metro Areas

<table>
<thead>
<tr>
<th>Deposit Market Share of FDIC-Insured Banks:</th>
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<tbody>
<tr>
<td>Market Area</td>
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<tr>
<td></td>
</tr>
<tr>
<td>San Francisco Bay Area</td>
</tr>
<tr>
<td>San Francisco–Oakland–Fremont MSA</td>
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<tr>
<td>San Jose–Santa Clara–Sunnyvale MSA</td>
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<td>Napa MSA</td>
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<td>Santa Rosa–Petaluma MSA</td>
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<td>Houston MSA</td>
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<td>Phoenix MSA</td>
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<td>Dallas MSA</td>
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<td>New York MSA</td>
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<td>Philadelphia MSA</td>
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<td>Seattle MSA</td>
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<tr>
<td>Riverside–San Bernardino MSA</td>
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<td>Chicago MSA</td>
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<td>Los Angeles MSA</td>
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<tr>
<td>Miami MSA</td>
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<tr>
<td>Washington DC MSA</td>
</tr>
<tr>
<td>Large Markets Straight-Line Average</td>
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<tr>
<td>United States – Total</td>
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</tbody>
</table>

Source: MIT Analysis of FDIC data as of 6/30/12

While, as stated above, Wells Fargo and Bank of America dominate the Bay Area banking market (as measured by deposits), there are a number of other extremely large “local” banks who cast a long shadow within the Bay Area financial services market. Bank of the West, for example, is the seventh-largest ranked by Bay Area-market share and is still ostensibly a “local” bank in that its US operations remain based in San Francisco (it has been a wholly-owned subsidiary of the French BNP Paribas since 1979). But as it has acquired many other community banks in the Bay Area and beyond, with over $60B in assets and 700 locations in 19 states it would hardly now qualify as a community bank.
Banking Concentration has Implications For Local Philanthropy and Community Development. As noted earlier, local businesses contribute more to their local economies than chains/non-local businesses. One critical way is through corporate philanthropy, and academics have documented how the loss of business headquarters reduces donations and investment in a region. Harvard Business School Professor Rosabeth Moss Kanter’s student, Allison Hughes, in her study (1994) of local businesses’ philanthropic ties to its host region, documented how a change from local to out-of-market ownership via merger, acquisition or other headquarters relocation reduced area businesses’ donations and other network ties to a region. The decrease in the local presence of company senior executives meant that there were fewer decision-makers with first-hand knowledge of the region able to vouch for the importance of reinvesting company profits in specific, local communities and causes. Card, Hallock and Moretti (2010) updated and more rigorously quantified this result, specifying the impact of gaining a publicly-traded company’s headquarters as adding between $3MM and $10MM per year in contributions to local non-profits.

These findings would imply that the concentration and consolidation in the banking industry, resulting in the existence of fewer banks with fewer headquarters distributed across fewer regions, hurts the level of business reinvestment and donation activity in the metropolitan areas that are losing banking headquarters.

II. FINDINGS

Presidio Bank was, as initially suspected, doing more than it was aware of to enhance local wealth creation and retention opportunities in its communities. In this section, we review a host of community value creation practices observed in Presidio’s operations during our fieldwork and interviews on site.

A. LEVERAGING ITS SUPPLY CHAIN TO ENHANCE LOCAL WEALTH CREATION.

Although Presidio does not deploy an explicit “local procurement only” policy to favor locally headquartered and owned firms as service providers, much of its “sourceable spend” is already targeted and focused on such contractors. This practice ensures that the dollars spent in its supply chain are being recirculated locally to benefit in-market economic activity.

Overall, of the 830 vendors with whom the bank has a record of having done business during its history (based on data provided by the bank from its accounts payable system), inclusive of vendors for whom the bank does not have a selection choice, more than 700 suppliers/contractors (87% of the total) are located within the bank’s “assessment area,” roughly equal to the Bay Area as defined by the Federal Reserve. Another 4% were located elsewhere within California, largely in the Sacramento (e.g. membership/fees to the California Banker’s Association, not a “sourceable spend” item) or Los Angeles metropolitan areas. Just 9% of the total vendors were located out of state.
Location within the Bay Area, however, does not mean headquartered in the Bay Area. We created a random sample of 10% of the 700+ Bay Area suppliers/vendors in the bank’s database, and audited their ownership and headquarters. Of that sample, more than 95% was headquartered in the Bay Area and/or locally owned.

Not all vendors/suppliers, however, are conducting business with the bank at the same volume. MIT analyzed the bank’s actual vendor expenses year-to-date through mid-July 2013, and found that some of the largest expenses were incurred to what appeared to be non-local vendors. Understanding the limits of relying solely on address information to establish provenance of ownership and location and aware of the complexity of the supply chain, MIT further analyzed the largest expenses and found that several which appeared to be out-of-market were in fact local expenditures with an in-state but out-of-market (mostly Southern California) P.O. Box expense processing address for an operation actually based in the Bay Area.

Once these vendors were adjusted for, just under two-thirds of the bank’s year-to-date expenses (a multi-million dollar amount, unpublished here due to disclosure limitations) were accounted for by Bay Area-based and located vendors. Of the remaining third, another one-third (effectively 10 percent of the total pool of expenses) appeared to involve vendors for which the bank might have a choice to deploy a locally headquartered, rather than out-of-market, supplier (see recommendations section for details). The single largest expense, accounting for one-third of all out-of-market expenses (again, 10% of total spend) was for a banking software/infrastructure system for which the bank does not have a local alternative.

Two examples of the local supply chain in action are worth reviewing in depth:

1. Wine Procurement

At client and shareholder events, Presidio serves wine procured from Napa and Sonoma wineries, all of whom are clients or shareholders of the bank. While this might not appear significant—after all, if Napa and Sonoma are part of its geographic footprint, we might expect them to use wine locally sourced from these regions—Presidio nonetheless faces a choice to use wine from other nearby high-quality wine regions, such as the Central Coast of California, Oregon or Washington State, which might be able to better compete on price at a given level of quality. Instead, Presidio has chosen to use local wine, produced by either client or shareholder members of the “bank family.” When interviewed about this practice, clients and the bank leaders expressed great pride in the commitment to local wineries.

This example also provides a contrast to the activities of larger banks: an employee of one “bulge-bracket” investment bank interviewed for this project noted, when asked about the bank’s use of local suppliers, the “ironic” localism of the firm’s private cafeteria: one day a week, the cafeteria has a selection of “locally-sourced” foods. But the foods, staffing and operations are nonetheless all handled by a global, out-of-market food services vendor. The employee was unsure how much of the cost of the good was going to this out-of-market food services company for its role in the process.
One might think that practices like Presidio’s wine procurement might only be possible for regionally famous local goods—after all, how can local banks in places like Virginia and Michigan be expected to use local wine for their client events? Napa and Sonoma Counties, the heart of wine country and part of Presidio’s operational area, have a comparative advantage in wine production. But actually, as recently featured in The New York Times, local wine production is now successfully and profitably occurring at significant levels in all of the lower 48 states. Fifty years ago, half these states had zero or one working winery; today they all have at least five, with Colorado boasting 128 wineries, and Virginia hosting 275. As detailed in the Times’ account, the patient capital, public-private partnerships, and intentional regional marketing and cluster-building efforts of these wineries fly in the face of the oft-cited economic development theory of comparative advantage. As this theory has it, each region should specialize in those industries that they are “naturally” better at and export that product; given that grape production and wineries are highly sensitive to natural variations in weather and soil conditions, one might think natural comparative advantage would limit regional production beyond a handful of states. This example shows how intentional, branded localization can stoke its own demand and be a positive force in economic development in unexpected industries. This concept is well-demonstrated locally by the SFMADE campaign, a public-private partnership that promotes manufacturing and locally-made brand awareness regionally in San Francisco, and nationally in the revived “Made in America” campaign.

**A Nation of Wineries**

Wine regions have been developing across the country, as diverse landscapes and weather patterns allow states to grow a variety of grapes. Related Article →

![Map of wineries in the United States](image)

Source: The New York Times
The implications for Presidio and other banks? Local sourcing might be possible across a broader range of materials and products than first imagined, in varying industries that one might not associate with one’s home region. These same industries may prove to be fertile ground for new banks to recruit borrower/lender clients. This idea suggests that Presidio’s practice of using local (and client) wines and functions can be replicated elsewhere as wineries around the US take hold. Evidently, banks can and do participate in the “made in the USA” and “locally made” movements, from explicit public-private programs to enhance an industry’s production and competitiveness in a region (like SFMADE, which Presidio supported) to simply banking a region’s homegrown industries.

2. Office Space

Similarly, while Presidio had not explicitly considered that its leasing of office space for branches is also part of its supply chain footprint, its five offices are nonetheless all located in buildings that are locally owned by in-market investors and therefore the profit earned on the rent payment is not being “exported” out of the region. In one case, the landlord is a client of the bank: in effect, the landlord is depositing the rent checks Presidio writes back into their account with the bank. The client, who also engages in real estate development, has also built affordable housing in a redevelopment corridor near the bank’s office. This scenario is an excellent example of the bank’s indirect impact, as the bank’s services can support client activities that enhance community development.

To be sure, in some cases as Presidio seeks to expand or renew long-term leases, it may not be possible to lease from a local landlord. Real estate is not a fungible commodity, and in tight, low-vacancy commercial real estate markets such as those in the Bay Area, Presidio’s choices are constrained by what is available. With average commercial real estate occupancy rates typically in excess of 85-90%, the only availabilities with the floor plate size, configuration, building amenities, access to transportation, and other location/structural amenities that meet Presidio’s operating needs may not be linked to local landlords.

Further, commercial real estate leases are typically multi-year agreements, often between five and 15 years in length. Presidio’s local landlord may sell or syndicate all or part of the equity of the building to an out-of-market investor over the course of its tenancy, something over which tenants have no control.

Nevertheless, in both of these examples of wine and offices—in which some of the contractors were also bank clients and/or agents of community development—local procurement choices directly put money back into the local economy (when it otherwise might not be retained as it is exported out of the region), and also directly benefitted the bank, through its clients.
**B. Enhancing the Credit and Job Creation Capacity of Local Businesses.**

MIT analyzed Presidio’s loan portfolio, but the number of employees and/or overall annual revenues produced by its borrowers is not currently fully tracked. Without such data, it is difficult for the bank to assess the number of local jobs, revenue, and economic impact it has on the regional economy.

Nonetheless, an initial review of a client/borrower list indicated that more than 90% of Presidio’s clients and book are locally based and headquartered firms. (see Recommendations, Section III)

**C. Donating Banking Services and Products at Above/Below Market Rates.**

Presidio is already tracking and quantifying some of its banking product-related donations: for example, it pays slightly above-market interest rates on IOLTA (Interest on Lawyers’ Trust Accounts), a special type of deposit account in which the interest pays for legal services for indigent persons. The above-market portion of the donation is treated as a donation by the bank to the non-profit legal entity that oversees such services.

But through interviews and conversations with clients and stakeholders, MIT learned that Presidio was engaged in similar measures on other untracked fronts—for example, sometimes waiving fees for select, strong-performing non-profit and/or CRA-qualified bank clients, or sometimes offering below-market rate loans and products to such borrowers.

**D. “Reversing” Product Placement to Promote Community Development.**

In addition to using local suppliers and serving local clients, the bank promotes the interests of its non-profit and community-oriented clients through a form of “reverse” product placement. In traditional product placement, a for-profit product or good is featured as a form of paid but subliminal advertising and “commercial speech” in a media or entertainment setting that is not primarily a vehicle for “commercial speech.” For example, a well-known soft drink might be slipped into a blockbuster movie or fictional TV show.

Presidio has stood this approach on its head: in a reverse form of product placement, non-profit clients are being featured at no charge in explicitly “commercial speech”, i.e. in Presidio’s advertising series in the San Francisco Business Times. Further, Presidio features non-profit clients far more than would be expected based on non-profits’ pro rata share of the business. The Bank had not systematically tracked this practice, however, and as a result, did not have a sense of how much value it might be generating for its clients. MIT worked with its marketing officer to develop a method to measure this value to the non-profits it banks.

**E. Aligning Interests with Clients Using Inventive Products.**

Presidio’s innovative Community Values Certificate of Deposit (CD) product is a nod to bottom-up decision making and economic democracy, whereby clients direct part of the bank’s profits. For clients who commit to a long-term Community Values CD, Presidio donates the equivalent of 25 basis points (bp) or 0.25% of the principal balance, to qualified Bay Area Non-Profit organizations. While Presidio reserves the right to
approve/deny the named organizations, this program has resulted in thousands of dollars being donated to clients’ suggested local Bay Area non-profits. Not unlike the burgeoning donor-advised fund concept increasingly used among foundations, this CD enables the bank to align its community development program with interests expressed by its clients, and through its clients’ suggestions, makes it aware of previously unknown (to the bank) organizations to consider for CRA-qualified service, investment and donation opportunities.

F. WORKING WITH LOCAL WEALTH-BUILDING NON-PROFITS IN STRATEGIC OR INVENTIVE WAYS TO REACH THE UNDERSERVED BEYOND THE BANK’S CORE BUSINESS.

As a business bank, Presidio does limited lending in certain functional areas: for example, it issues very few consumer mortgages for single-family homes (the few such loans that it makes involve properties linked to primary business accounts held with the bank), and makes few loans to very small businesses: even its “small business clients” are still likely to be at or near the $250,000 per annum threshold in revenues, if not at or above $1MM.

But just because the bank is not currently built-out with the staff or organizational infrastructure to profitably lend in these arenas does not mean that they cannot have a social impact. While it may not do so using a local wealth creation motive, the Bank works with myriad local organizations serving market niches which are beyond Presidio’s chosen business scope, but nonetheless are still local wealth-enhancing organizations.

The Bank used an inventive structure—an affordable housing community development mortgage securities instrument—as a way to invest in several Habitat for Humanity homes without holding residential mortgages. The bank proposed the idea to the local operation of Habitat for Humanity, and that organization has since replicated this structure elsewhere for use in similar situations. This is an innovative, noteworthy example of how a banking industry product structure that was vilified in the housing market downturn—the securitization of residential mortgages and resale to out-of-market investors—can be redeployed to better serve communities’ needs.

Working Solutions, a microcredit finance provider in the Bay Area, offers a range of products for small enterprises, whose credit needs often go unmet by traditional banks. The higher per loan transaction costs (administration cost is spread over a smaller principal amount) make microfinance an arena that has historically been of little interest to banks, resulting in a gap in the market. Working Solutions fills this void. The institution provides a range of products, from their Kiva partnership, which lends very small amounts, to larger loans. Credit comes with a business plan strategy, counseling, and other support services.
Further, the bank also supports and donates to its client, Working Solutions, a non-profit organization which has a range of microcredit and microfinance products for small businesses which may not be large enough or have a strong enough credit history for a loan from Presidio. Working Solutions works with Kiva to provide loans to the smallest microenterprises. It also has other loan products, which come with business plan counseling and other incubator/developer resources included, to serve businesses as they grow to the larger end of the microfinance category. Again, the financed entities are by definition local businesses, empowering workers to start their own restaurant or shop rather than work for a large, out-of-market-based chain.

In a similar fashion, Presidio also invests with and/or donates to the Northern California Community Loan Fund, a Community Development Financial Institution operating a community revolving loan fund which reaches a range of financially underserved market niches, and the Marin Community Foundation, which runs a range of North Bay community development funds and directs the proceeds to a range of efforts from energy efficiency retrofit investments to affordable housing developments.

III. RECOMMENDATIONS AND CONCLUSIONS

While Presidio’s existing practices are exceptional in many regards, MIT repeatedly heard in its interviews that many of these practices were not “intentional”, “strategic” or “top down”, but rather occurred “organically” and “naturally” as a matter of course in its operations, through suggestions from investors, clients, and employees. As a result, its community engagement efforts do not feel “artificial” or “forced”, which is why employees believe that Presidio has avoided the “check the box” culture they so often saw at their other places of employment.

As the bank continues to grow to a larger scale within the Bay Area, however, the size of its operations may require that it move to a more intentional and strategic approach for its community development efforts. Attempting to do so while preserving the organic, natural and “bottom-up” nature of its initiatives will be challenging, but the recommendations that follow have been designed to meet this challenge.

Though most recommendations are intended for Presidio, we also include in this section actions that other types of banks, industry associations, and regulators might take to enhance local community impact. As stated previously, banks have different business models, and as such, certain recommendations that are not relevant for Presidio might be germane to its peers. As this report will be publicly distributed, including such recommendations allows these banks to learn from Presidio’s approach and apply it to their own business model. In addition, banking is a heavily regulated activity. Some actions that banks might wish to undertake may not be possible or desirable given current rules and may require regulatory approval or changes, which is why recommendations for regulators have also been included.
A. Supply Chain Recommendations:

1. **More Explicitly Leverage the Power of the Supply Chain By Categorizing Suppliers to Improve Awareness of the Bank’s Local Footprint; Also Consider Using CRA–qualified suppliers.** As Presidio grows, like many organizations that achieve a certain size, the “friends and family” element of its culture may be at risk of being displaced by a bureaucratic approach. One of the founders of social science, Max Weber, in his seminal work *Economy and Society*, noted this pattern of progression with sustained, growing organizations as seeming to be nearly universal in the modern era. As such, practices such as the local sourcing of wine and other informal local procurement policies may be at risk of being inadvertently swept aside.

Presidio might maintain—and in the near term, improve—the degree to which its supply chain is locally sourced by proactively tracking and measuring its local supply chain in order to improve internal decision-maker awareness of its supply chain choices.

To be sure, there are some components of the bank’s supply chain which cannot be locally sourced: as a bank, Presidio requires financial market data products and software platforms, for example, for which there are no locally made/owned alternatives. Nonetheless, there are still additional areas where Presidio might choose to contract with local service providers, e.g. using a large, locally owned and based law firms, IT services firms, accounting/audit firms or employment search firms, rather than out-of-market companies as it currently does in these categories.

By categorizing suppliers across two measures, in terms of their electiveness (as either “elective”, “potentially elective”, or “non-elective” for suppliers where the bank must use a certain vendor), and their localness (“locally headquartered and owned” vs. “out-of-market”) the bank can measure how much of its supply chain remains local in nature. Just as consumers on a financial budget are advised to write down all of their expenditures to enhance their awareness of their choices, so too with businesses: this process of tracking and measuring alone will likely enhance the awareness over the impact of procurement decisions.

The bank might also consider, where possible, using CRA-qualified vendors/suppliers in its supply chain. While currently not considered as a “creditable” activity in a traditional CRA exam, it is MIT’s understanding, based on interviews with regulators, that as banks innovate and attempt new CRA approaches, the regulators can respond by seeking guidance from Washington, DC, one avenue by which precedent can be changed so that such activities are creditable under CRA and can be replicated and diffused to other banks.
2. **Choose New Branch Locations in High-Impact Neighborhoods and Buildings: Near Revitalization Corridors, or Near Non-Profit Incubators or Accelerators.**

Given Presidio’s significant presence in commercial real estate lending, a natural high-impact avenue for community development might be to invest in and/or locate in or near a building with non-profit incubator space. The Tides Foundation, for example, has backed a wide-range of such incubators, with several dozen located throughout Northern California. By co-locating in the same building with such programs, Presidio might, through proximity and daily interaction with such neighbors, naturally enhance its network of client and community relationships.

Presidio might also consider helping to use its new offices to physically anchor redevelopment corridors. As such corridors are generally the product of intense public-private partnership, investment, and policy effort to improve the quality and quantity of economic activity, Presidio might again, through proximity and daily interaction, organically enhance its network of client and wealth-enhancing opportunities.

### Mission Asset Fund:
**Documenting Lending Circles**

Mission Asset Fund, based in San Francisco’s Mission District, works with social lending circles to document the financial activities of their participants, as to increase their credit scores and improve their access to a wide range of opportunities (financial, employment, housing) that use these scores. Program evaluations of Mission’s work have found a significant increase in participants’ credit scores. Mission is now partnering with organizations in California and beyond.

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**1. Continue to Support Banking Services for the “Underbanked” Through Strategic Partnerships (e.g. Working Solutions) But Consider Additionally Supporting Organizations Who Have a Diagonally Different View of How and Why Being “Underbanked” is a Problem.**

According to a 2011 FDIC survey and report on the unbanked and underbanked, only two-thirds of US households are “fully banked”, with another third making frequent use of high-cost, alternative financial products such as check cashing, payday loans, refund anticipation loans, and non-bank money orders. As detailed in the survey and report, the unbanked and underbanked population disproportionately consists of non-Asian minority, low-income, unemployed, and non-native born households.
Many financial advocates lobby for banks to utilize modern technology to provide low-cost, minimalist checking and savings accounts for low-income consumers as a superior alternative to payday lenders and other high fee-for-service check cashing services. But some consumers and businesses may simply not be able to be profitably served by a bank: they may have irregular income and expense streams, for example, which are inconsistent with the economics of maintaining an account with regular monthly fees. Further, some of these individuals may be having their current credit needs partially met through the informal sector, through mechanisms such as community lending circles, whereby informal social networks pool their resources to meet the credit needs of members on a rotating basis. These types of informal groups have a long history around the world, and have been well documented by academics (e.g. Portes, Castells and Benton, 1989). Yet what happens when members of such networks have need for a financial product beyond the scope of their lending circle? If they lack a formal, documented credit history, they may have difficulty getting approved by a banking institution. Mission Asset Fund (whose sponsors include the Ford Foundation), based in San Francisco’s Mission District but diffusing its innovative approach across other parts of California and the nation, seeks to enhance the power of these informal networks by documenting members’ activity within them for credit scoring purposes, establishing and/or enhancing their financial history, and improving their access to formal (and potentially lower-cost than alternative services from payday lenders) banking services when needed.

In addition to the long-term business value (via new business and consumer clients) that such efforts might reap for banks, financial institutions have a secondary interest in supporting such efforts: if credit scores largely ignore a host of imputed and/or informal financial transactions, the score may be systematically biased and unrepresentative, thereby causing banks to misestimate risk and ignore compelling market opportunities. Enhancing the completeness of credit scoring to include informal financial markets would enhance the validity of credit scores and reduce barriers to providing more services to traditionally underserved sectors.

2. **Do What You Know: As Scale Permits, Contribute Banking Services to Non-Profit and CRA-Qualified Groups.** Many small community development financial institutions, such as revolving loan funds or microcredit organizations, may find the purchase of loan servicing software and infrastructure to be a formidable investment that reduces the funds they have available to disburse into the community. Small banks that have grown to a size such that their loan servicing operations have sufficient capacity, might consider handling the basic loan servicing of performing financial assets for small CDFIs on a *pro bono* basis. Such servicing would not entail any liability issues for the bank, which could then treat the time and resources (if on behalf of a CRA-qualified organization) as a donation for consideration in its community development rating.

Based on an interview with a current loan servicing specialist, Presidio’s loan servicing operation might be in a position to consider offering such services to one of its CDFI beneficiaries once the bank reaches $1 - $1.5B in assets, effectively double to triple its size today.
3. **Consider Partnering with Local Merchants Associations, and/or Sponsoring Targeted Corridor/Improvement Districts to Enhance Local Wealth and Bank Opportunities.**

The bank might consider partnering with and/or sponsoring merchants associations and corridor improvement districts in such areas where it is expanding. Such sponsorship of local associations might enhance the quality of its relationships and open new avenues by which it could fund locally-owned merchants and economic development.

4. **Consider Donating Equipment and Other Collateral on Secured/Recourse Loans.** Presidio has an exceptionally low delinquency rate and default history. Given that it does not explicitly offer residential real estate mortgages, it also does not have a significant share of loans secured by real property. Many of its business loans, however, may involve equipment, supplies and other business goods as collateral which the bank would repossess should a loan go into default. Presidio might consider a policy whereby such collateral, rather than being auctioned for a share of its market value, might be donated outright or sold below-cost to CRA-qualified community development partners or non-profit clients, should such entities be able to make use of the specific type of collateral repossessed.

While Presidio has very few troubled loans, and none involving residential real estate, for banks holding soured residential mortgages such a strategy could create untold value for those communities struggling with the impact of residential foreclosure.

5. **Consider Urban Agriculture Loans To Fill Lack of Agricultural Loans in Presidio’s Portfolio and Tie Into the “Locavore” Movement, Highlighting the Bank’s “Local” Brand.** Urban Agriculture is a growing movement in both vibrant, mixed-use 24-7 cities like San Francisco, Chicago and New York; and post-industrial cities from Oakland to Detroit struggling with underemployment and underutilized tracts of urban land. These efforts can reduce food deserts, create low and middle-skilled employment opportunities, productively reuse vacant land, and allow urban residents to feed their families with food grown within the local economy, not exported from outside the region. Oakland, for example, created new zoning codes to initially allow urban agriculture throughout much of the City in 2011, with more detailed guidance in the code currently being developed and underway. A host of organizations are involved in promoting urban agriculture on deserted, vacant, and underutilized land in the East Bay. Donations and/or investments in such organizations would not only help the bank improve its scope of activities in the Easy Bay (which is a fairly new market for the bank and was noted as one of the few areas where the bank could do more in its CRA exam), but would also help diversify its lending, as call reports obtained from the FFIEC indicate the bank currently has no agricultural lending in its portfolio.
C. STRATEGIC OPERATIONAL AND PROCESS RECOMMENDATIONS

1. TRACK EMPLOYEE COUNT AND REVENUE OF BORROWERS AND CLIENTS TO DIRECTLY MEASURE THE LOCAL ECONOMIC IMPACT OF THE BANK’S CORE BUSINESSES. As noted in the prior section, it is difficult to directly measure the local impact of Presidio’s lending activities without information on the borrower’s total employee head count and actual revenue. MIT recommends adding fields to its databases to track such information, which could be initially populated using employer data from a relevant research service (e.g., Dun & Bradstreet). The data could then be cleaned by a Presidio employee or intern, who could notify the bank’s client relationship managers that they will call the client to confirm the D&B information on revenues and headcount. Going forward, such information could be captured on an ongoing basis for new loans and/or clients as part of the initial application process and could be updated once a year at the same time, allowing the bank to assess how many new local jobs and how much new local area revenue its financial products enabled.

While some clients might be reticent to share such information, Presidio might assuage their concerns by explaining that individual-level account data would not be disseminated, and that the purpose is only to measure the extent of local community business activity the bank is supporting. Client relationship managers might also want to make the call to update this information themselves. The contact would be yet another opportunity to check in with their clients, potentially leading to more business opportunities.

2. CREATE A FOUNDATION, HAVE A TOP-DOWN STRATEGY REVIEW. CONSIDER BRANDING COMMUNITY ENGAGEMENT EFFORTS BY CREATING A FOUNDATION TO ORGANIZE COMMUNITY INVESTMENT, DONATIONS AND SERVICES. Many large private enterprises have long maintained separate foundations, often with 501(c)3 tax-exempt status, for their charitable and philanthropic activities. As online tools enable automating the more routine legal and financial documentation requirements associated with the creation and maintenance of a foundation, the barriers for smaller enterprises, including community banks, to utilize a foundation structure have diminished. The Association of Small Foundations (ASF) notes that attorney’s fees for articles of incorporations, bylaws, and annual financial filings can run as little as $2,000 to $5,000, and that a small foundation’s sponsor may often double as a volunteer staff and board, reducing its administrative costs to negligible levels. Presidio might consider making some of its donations to its self-created foundation, which might also have a clearly stated strategy related to the bank’s mission. Brand awareness among clients and other potential donors of the Foundation might attract additional donations, effectively creating another “matching funds” program through which the Bank is donating alongside its clients.

While Presidio currently has a number of foundation and philanthropic clients, this need not be a conflict, as Presidio might choose to donate alongside or in conjunction with some of these entities.

Further, a foundation with an annual strategy-setting process might encourage the bank to engage in periodic reviews of the nature of its giving, and compare it to the needs of its community as they change over time. As shown in the brief review of key Bay Area Metrics, supra, different micromarkets within the bank’s operating
footprint have different compelling needs: San Francisco, where a dense concentration of jobs draws residential demand which far outstrips supply, has an affordable housing crisis. In contrast, Oakland’s and the East Bay’s home prices are still high when viewed on a national level, but they are far lower than those in San Francisco, both absolutely and as compared to local incomes. The East Bay has a shortage of quality jobs and a high unemployment rate; workforce training and economic development are critical issues there. Over time, however, these issues could shift with cyclical economic forces: San Francisco is in the midst of a market-rate housing boom that might relieve some of the supply pressures on the existing housing stock. Rising office rents might spur some businesses to relocate to Oakland, enhancing local job opportunities there. The annual/periodic priorities review process that comes with a formal structure like a foundation might help Presidio to be more responsive to shifts in its communities’ needs over time.

In conjunction with this, the bank might also consider opening a “Foundation Office” or practice, to formally serve foundation clients as well as administer the bank’s own efforts.

3. **Whether or not via a Foundation, Focus on Generative vs. Distributive Community Development Activities.** Presidio prides itself on not engaging in “check the box” activities: it does not become perfunctorily involved with community development efforts, but rather with endeavors that its employees care about. Nonetheless, not all philanthropic efforts have equal impact on communities. MIT suggests that Presidio prioritize and encourage employee involvement with organizations which are generative, rather than distributive in their impact. What does this mean? Distributive efforts, while they are certainly worthwhile, focus on distributing existing resources to the needy: for example, providing nourishment for the food insecure or underfed population. But providing food to such individuals does not empower them with the skills or resources to replenish their stock of food. Generative efforts focus on precisely this issue, on making sure the needy have the skills and resources to meet their own needs. Don’t just distribute wealth, help others generate it. By using a “Distributive vs. Generative” framework to evaluate and screen local non-profits for inclusion in various bank efforts, Presidio can enhance the multiplier effects and impact of its donations.

4. **Create a bank-wide “Community Promote Structure”, Donating a Certain Percentage of Bank Profits over a Specified Achieved Threshold to Community Groups.** Banks frequently make investments that involve promotes, perhaps with “waterfall structures” whereby when certain investment return thresholds are achieved, all returns above that threshold accrue at a proportionately different rate to different investors. Presidio might consider deploying such an initiative bank-wide. This is a banking variant on the more commonly known profit-donation approach used in other industries, from Newman’s Own Organics to CREDO/Working Assets telephone services. The proceeds could actually seed a Presidio Foundation, if one was created. By explicitly announcing and naming such a bank-wide practice, the bank would improve employee, client, investor and community development grantees’ awareness of the importance of their shared, collective success.
5. **Create a rate sheet for time value of volunteer efforts, and recognize those who achieve a certain threshold.** Presidio currently tracks the number of hours that employee spend volunteering with community organizations. Yet all types of volunteering do not have the same impact. By creating a rate sheet which attempts to quantify the comparative value being contributed by each employee, the bank can better measure the impact its employees are having in their communities while also incentivizing everyone to maximize their impact. Specifically, a rate sheet can help employees think about the impact of their volunteering by prioritizing high-impact activities, and can raise awareness of the impact that they are having. For example, if a bank employee with significant financial and accounting skills is volunteering as a member of a community organization, but then becomes the Treasurer of that group, the additional value she is contributing should be honored and recognized, both by the bank in how it values such efforts, and by the employee as he or she considers how to make the greatest community impact with his or her time. Presidio might create personal community targets for each employee to contribute time equal to, for example, 10% of their compensation. The rate sheet would ideally be stratified by employee level, so that the market value of an employee’s time is somewhat accounted for (using some percentage of industry benchmarks for hourly compensation of C-Suite, Director, Administrator, etc. level employees), and by volunteer function (President, Treasurer, Director/Board Member, Committee Chair/Member, Regular Member).

6. **Quantify bank donations of rates, fee waivers.** MIT is working with the bank’s Chief Marketing Officer to set up a tracking template for these activities. As previously discussed, the bank, when it can, offers discounted pricing to highly qualified non-profit clients. By doing so, the non-profit’s additional retained income enable it to fund more of its core mission activities. By quantifying these discounts, the bank might improve awareness of the occurrence and value of such offers, and in addition report such activity in its CRA activities.

7. **Support the Community Reinvestment Modernization Act.** Though banks are often loathe to support any act that might imply more regulations, critics of the Community Reinvestment Act have rightly noted that as currently written it does not apply to a host of financial and quasi-financial institutions which may directly compete with community banks. To ensure a “level playing field” among all market participants, community banks should back efforts to rewrite CRA so that it applies to all firms operating in the financial markets, and not just specific types of chartered banks. While the most recent legislative effort, the Community Reinvestment Modernization Act, is on hold, the National Community Reinvestment Coalition continues to lobby for certain of its elements. This group has, among other reforms, called for the public sector to contract only with highly CRA-rated banks for financial services.

8. **Consider the strategic plan option for community reinvestment evaluation.** While Presidio received an outstanding rating for the community development portion of its most recent CRA exam, the bank will have to be re-evaluated again over the next several years. One underutilized option is the strategic plan. A negligible share of all CRA examinees elect to be evaluated based on their own strategic CRA plan. This allows
the bank to devise a plan that is unique to its own culture and approach, and to get “credit” for activities which may not normally be considered in the CRA exam’s quantitative evaluation section.

D. Regulator And Industry Association Implications

1. For Banking Industry Associations: Build on the “Locavore” Movement by Creating a “Locally Sourced Bank” or “Locally Managed Bank” Program to Allow Banks to Use Their Localness as a Branded, Competitive Advantage in the Marketplace. Branding and labeling is a powerful tool, as has long been known by purveyors of luxury products that are most prone to be the target of conspicuous consumption. But channeling the human urge to consume can be used for nobler purposes: the “organic” label means something to consumers, who will pay more for such products. Conspicuously-badged hybrid cars, like Toyota’s Prius Family, also command a pricing premium. Eco-conscious businesses, too, will pay more to lease space in LEED-certified office buildings. Not only do these labels assure the user that they are getting a product that they want and that is consistent with their values, but via signage and labeling the user can let everyone else know about their choices. Clients of an eco-conscious company, for example, will likely see the LEED-certification as they walk into the lobby of an office building.

In a time of increasing awareness about the importance of local, sustainable sourcing of all types of goods and services—from the “Made in the USA” movement to promote domestic manufacturing, to the “locavore” food movement to promote locally-produced foods—community banks have an unprecedented opportunity to leverage the power of their localness. The MIT Wealth Creation Clinic believes that an industry association, such as the Independent Bankers’ Association, for example, might seek to create a badging/branding program for community banks, with various levels of achievement to certify and market how local a bank’s business is. Just as the LEED program for green real estate has multiple levels (LEED-Silver, Gold, Platinum; LEED-New Construction), so too could this type of branding program, perhaps building on the emergent term “locavesting”, which describes those who engage in intentionally local investment decisions.

In sum, creating a named “locavestor” system would also create healthy competition. Awards for banks striving to be “more local” might give these institutions more incentive to use local suppliers, knowing that their local rating would go up/down vis-à-vis their rivals.

At a time when small banks continue to struggle in the face of “too big to fail” rivals, competitive branding tools may help local community banks better attract customers, ensuring that businesses and consumers continue to have local, community-embracing banking choices.

2. For Banking Regulators: Consider Crediting CRA Suppliers As A Qualified Activity: The Local Procurement Power of Community Banks Combined Can Make Them “Anchor Institutions.” As discussed, Community Banks contract for all kinds of services locally: to clean their buildings, to cater meetings, to procure office supplies, furniture, art, and so forth. From whom? Are locally-owned businesses given
systematic preference in procurement, ensuring that the business the bank internally generates also creates wealth locally? Are CRA-qualified businesses given preference? Can banks receive CRA credit for such initiatives? In Cleveland, the Evergreen Co-operatives are a series of small businesses providing employment to low-income individuals by servicing the procurement needs of nearby “Anchor Institutions,” typically universities and hospitals who act to anchor the economic vitality of their neighborhoods. By contracting for services from locally-owned businesses in their immediate neighborhoods, rather than through physically remote and large firms which may be owned by out-of-market investors, these Anchor Institutions enhance the economic base of their catchment area. The “Anchor Institutions” approach of the Evergreen Co-operatives model is spreading to other cities. If banking regulators were to allow financial institutions to explicitly receive CRA credit for embracing such suppliers, the Anchor Institutions model could be adjusted and redeployed among community banks, whose combined purchasing power might help improve economic and community development activity in other struggling areas as in Cleveland.

3. For Banking Regulators: Consider a Broader Distribution of CRA Ratings. As discussed in this report, roughly 90% of banks receive a “satisfactory” rating on the CRA exam. Do regulators, legislators, and communities around the US maintain that 90% are doing a satisfactory job engaging in their communities, and that the remaining 10% fall into three other categories? Such an uneven distribution of ratings, coupled with the lack of rating methodology transparency, begs the question of whether or not the existing regulations are being effectively implemented and applied.

4. For the FDIC: Consider Formally Defining Institutions as Community Banks Using New Research Criteria. As mentioned repeatedly in this report, there is power in naming and labeling practices. The FDIC’s new working research definition of a community bank should be expanded to become a formal legal category of bank, which might allow such institutions not only to more explicitly “brand” themselves and become more competitive in the market, but also enable application of different regulatory standards vis-à-vis the megabanks. While extremely large banks are increasingly subject to additional tests and standards, formally naming community banks might enable more paths for regulatory and market differentiation.
Banking Deregulation: The diagram below offers a summary of key U.S. legislative and judicial moments occurring in the deregulation of the banking industry, from 1978 to 1999. As noted by economists Carmen Reinhardt and Kenneth Rogoff in their 2009 study “This Time is Different: Eight Centuries of Financial Folly”, the U.S. has had sixteen banking crises since its founding. The first fourteen occurred between 1814 and 1933. After a host of regulatory reforms put in place after the 1929-1933 crisis and subsequent, worldwide Great Depression, there were no financial crisis in the U.S. for more than forty years, despite repeated economic recessions (notably in 1960-1961, 1969-1970, 1973-1975). This is the longest period in U.S. history without a major banking crisis. Since the deregulatory period began in the late 1970s, however, systemic banking crisis have returned: the S&L crisis from 1984-1991 (which encompasses the 1987 stock market crash and 1989-1991 economic recession), and the most recent crisis which commenced in 2008.
**History of Anti-Monopoly Sentiment in the U.S. Encompasses Many Industries, Not Just Banks:** In the popular press’ recent depictions of banking, the industry has morphed from a world of the community-building, neighborhood bank of Bailey’s Building & Loan, as immortalized in 1946’s “It’s A Wonderful Life”, to a cabal of global “vampire squid”, as one large investment bank was called in a famous Rolling Stone article in 2009, using imagery that harkened back to a prior century’s characterization of John D. Rockefeller’s monopolistic Standard Oil as a globe-circling octopus.

The leap from octopus to vampire squid isn’t far, and in fact, much of the rhetoric and iconography used by groups like Occupy and by the press against banks today directly builds on the anti-trust and anti-monopoly imagery that emerged in the last Gilded Age, used to call for splitting up giant railroads, oil companies, telephones, and “natural monopoly” utility functions at various points over the course of the last century and a half in U.S. history (see figure below).

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**The Changing Focus of Anti-Monopoly Sentiment As Seen Through Historic U.S. Political Art**

1880 – Standard Oil
1882 – Railroads
1899 – Conglomerates
1904 – Standard Oil
1907 – Telephones
1912 – Fed/Central Bank
1998 – Computers
2011 – Banks

*Source: MIT Wealth Creation Clinic Archival Research*
**Community Banking Definition:** Though there is no regulatory or legal definition of a Community Bank, the FDIC recently produced a working “research definition”, which is summarized in the table below.
Major Bank Mergers: The following table, sourced from the Federal Reserve and Government Accountability Office (GAO) and as published in Mother Jones magazine in January 2010, details some of the post-1990 major banking mergers that created today’s “Big Four” banks.
Selected References:


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Cover art image based on original work of Massachusetts artist Paul Schulenburg (Getty Images) as used in CNNMoney/Fortune’s 2/27/2012 article on community banks.

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