The Fall (and Rise?) of Community Banking: The Continued Importance of Local Institutions

Bob Solomon*

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INTRODUCTION

Even before the banking crisis of 2008, the banking world was in the midst of a major transformation. Pushed by increasing competition and narrow profit margins, along with the need for more efficient and cost-effective back office operations, the industry adopted a bigger-is-better philosophy, and larger banks absorbed smaller institutions like sharks swimming through a school of fish. This consolidation has resulted in a banking system where products, especially at the lower end of the market, have become more standardized and, if not profitable in bulk, nonexistent, especially in smaller communities.

* Clinical Professor of Law, University of California, Irvine School of Law. My thanks for remarkably helpful comments and insights to Raymond Brescia, John DeStefano, Jr., Robin Golden, Peggy Delinois Hamilton, Sarah Lawsky, Eugene Ludwig, David Min, Cantwell F. Muckenfuss III, Laurence Nadel, William Placke. Katerina Rohner, and Jeffrey Selbin. My thanks to Jennifer Henry for excellent research assistance and to Christopher Leslie and Katherine Porter for organizing the Business Law as Public Interest Law Symposium at the UC Irvine School of Law and for encouraging me to participate and write this Article.

The premise of this Article is that there is a critical role in the banking system for community banks, especially community development financial institutions (CDFIs). A CDFI is a legally existing organization with a primary mission of promoting community development and serving eligible target markets.[1] A CDFI cannot be a governmental entity or be controlled by a governmental entity.[2] CDFIs are certified by the Department of Treasury as set forth in the CDFI regulations.[3] In July 2012, there were 999 certified CDFIs.[4] The question with CDFIs, however, is whether their importance mandates subsidizing them and whether they should be regulated differently from other financial institutions.

In this Article, I argue that U.S. banking policy wrongly privileges larger banks over smaller community-based institutions, which results in both a quantitative and qualitative loss of services. I start with a review of recent banking concentration. I follow with four principles on which I base the analysis that follows. I then review four banking experiences: ShoreBank in Chicago, Illinois; Start Bank, a de novo bank in New Haven, Connecticut; the romanticized Bailey Banking & Loan from *It's a Wonderful Life*; and a long-standing community bank in Seneca Falls, New York. I conclude with proposals to turn the current privilege around, with suggestions of ways to preserve community banking. Specifically, I propose that the monolithic nature of bank charters disadvantages smaller institutions and that community-based institutions, in exchange for restricting their activities, should have the option of obtaining a special charter that is not subject to the same regulatory regime as larger banks.

I. THE REALITY OF BANK CONCENTRATION

The United States once had over 25,000 banks, and as recently as 1987, it had 13,723 banks.[5] Many of those disappeared during the savings and loan crisis,[6] resulting in 8080 banks in December 2001.[7] Ten years later, further bank reductions resulted in 6290 banks in December 2011.[8] Since the Federal Deposit

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1. Robert W. Shields, *Community Development Financial Institutions and the Community Development Financial Institutions Act of 1994: Good Ideas in Need of Some Attention*, 17 ANN. REV. BANKING L. 637, 641 (1988).

2. 12 C.F.R. § 1805.201(b)(6) (2012).

3. 12 C.F.R. § 1805.201.

4. *CDFI List—07-31-12*, CMTY. DEV. FIN. INST. FUND, http://www.cdfifund.gov/docs/certification/cdfi/CDFI%20List%20-%2007-31-12.xls (last visited Nov. 8, 2012).

5. *Historical Statistics on Banking (HSOB)*, FED. DEPOSIT INS. CORP., http://www2.fdic.gov/hsob (follow "Commercial Bank" hyperlink; then click "CB01: Number of Institutions, Branches and Total Offices") (last visited Nov. 8, 2012).

6. *See* John J. McDonald, Jr., *Similarities Between the Savings and Loans Crisis and Today's Current Financial Crisis: What the Past Can Tell Us About the Future*, 76 DEF. COUNSEL J. 470, 470–71 (2009).

7. *Statistics at a Glance: As of December 31, 2001*, FED. DEPOSIT INS. CORP. (Dec. 31, 2011), http://www.fdic.gov/bank/statistical/stats/2001dec/industry.pdf.

8. *Id.*

Insurance Corporation (FDIC) reported ninety-two bank failures in 2011 and another thirty-three through July 21, 2012,[9] we can state with confidence that the number of banks will continue to go down. Inevitably, these numbers will be further reduced by the time this Article is printed. For the most current number, just go to the FDIC's website, where bank failures and mergers and acquisitions are listed prominently on the home page.[10]

A recent survey by Crowe Horwath LLP and *Bank Director* magazine shows that bank merger and acquisition activity has slowed significantly, as larger banks are leery about purchasing unhealthy banks. Those in trouble are still subject to assisted sales through the FDIC, and almost 20% of the survey respondents are still interested in purchasing healthy banks.[11] There were "only" 167 mergers in 2011.[12] Since 1990, we have seen 6.5 mergers for every bank failure, so the current 1.8-to-one ratio is an aberration and a sign that mergers are likely to increase as the economy improves.[13]

Not surprisingly, consolidation has a dramatic effect on the number of smaller banks. In 2009, a study by Celent, a research and consulting firm, reported that from 1992 to 2008, the number of U.S. commercial banks with assets under $100 million went from over 8000 to under 3000.[14] By 2010, the number of banks with assets under $100 million dropped to 2625, a reduction of almost 75%.[15] At the 2012 FDIC Community Banking Conference, the FDIC Community Banking Research Project reported that the number of banks with assets less than $100 million dropped from 13,631 in 1985 to 2625 in 2010.[16] During the same period, the number of banks with assets greater than $10 billion increased from thirty-six to 107.[17]

The concentration of capital is even starker. In 1995, the five largest banks had an 11% share of deposits.[18] By 2012, that share had increased to 35%.[19] The

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9. *Historical Statistics on Banking*, *supra* note 5.

10. FED. DEPOSIT INS. CORP., http://www.fdic.gov (last visited Nov. 8, 2012).

11. *2012 Bank M&A Survey: Waiting for the Market to Improve*, CROWE HORWATH LLP, http://www.crowehorwath.com/folio-pdf/FS12020B_2012_MA_Survey.pdf (last visited Nov. 8, 2012).

12. JP Nicols, *Is Bank Merger Mania Imminent?*, JP NICOLS BLOG (Mar. 26, 2012), http://jpnicols.com/2012/03/26/bank-merger-mania-imminent.

13. *Id.*

14. Anita Campbell, *R.I.P.: The Death of the Small Community Bank*, SMALL BUS. TRENDS (Feb. 3, 2009), http://www.smallbiztrends.com/2009/02/death-small-community-bank.html.

15. Richard A. Brown, Chief Economist, FDIC, The FDIC Community Banking Research Project: Community Banking by the Numbers, Presentation at the FDIC Future of Community Banking Conference (Feb. 16, 2012), *available at* http://www.fdic.gov/news/conferences/communitybanking/community_banking_by_the_numbers_clean.pdf.

16. *Id.*

17. *Id.*

18. Bart Narter & Stephen Greer, *It Takes More Than a Village Redux: The Decline of the Community Bank*, CELENT (Aug. 9, 2011), http://www.celent.com/reports/it-takes-more-village-redux-decline-community-bank.

Independent Community Bankers of America reports that 91% of U.S. banks have less than $1 billion in assets, and 33% have assets less than $100 million, but that belies the trend of disappearing small banks.[20] Perhaps more telling, the Celent report finds that the difference in efficiency ratio (the cost required to generate a dollar of revenue) between small and large banks was less than 1% in 1992, but almost 25% in 2010.[21] Banking has become more complex and smaller banks are at a disadvantage.[22] This fact alone provides bankers with a tremendous incentive to become larger in order to thrive.

Numbers are data, not policy conclusions, and there are different ways to interpret these numbers, both positive and negative. Those who support bank consolidation argue: (1) We have too many banks, and a reduction in the number of banks is good news; (2) The market is efficient, and if a bank cannot survive on its own, it should die. Mergers and acquisitions are an efficient way for the market to adjust; (3) Banks are answerable to their shareholders, and their purpose is to maximize profits; if they fail, they fail, just like any other business. Those who oppose consolidation interpret the same data to argue: (1) The reduction in the number of banks is disproportional, with small communities, small businesses, and marginal customers being affected more adversely than those who already have adequate access to capital; (2) The concentration of capital in so few banks increases risk and forces the government to intervene when it should not, as happened with Troubled Asset Relief Program (TARP);[23] (3) The market does not work, and banks benefit from government subsidies and support and need to be answerable to the community as well as their shareholders.

As Woody Allen once said, "It's better to be rich than poor if only for financial reasons."[24] It may be obvious to say that markets serve the wealthy better than they serve the poor, but some markets are more flexible than others. Like banking, the housing market provides critical services, but offers a useful contrast to banking. While almost everyone participates in the market, some people live in castles, some live in slums, and most live somewhere in the middle. The difference between the top and the bottom is enormous, even scandalous, but housing is a commodity that adjusts itself so as to be generally available. The market works to the extent that most people in the United States are housed with basic amenities like electricity and running water. Like banking, the housing market is highly regulated. Habitability laws and code enforcement have become the norm,

19. *Id.*

20. *About ICBA*, INDEP. COMTY. BANKERS AM., http://www.icba.org/files/ICBASites/PDFs/cbfacts.pdf (last visited Nov. 8, 2012).

21. Narter & Greer, *supra* note 18.

22. *See* Campbell, *supra* note 14.

23. *See* David T. Riley, *Roll Up the Constitution and Unfurl the TARP: How Spending Conditions in the Troubled Asset Relief Program Violate the Constitution*, 98 KY. L.J. 595, 620–21 (2009-2010).

24. QUOTE FACTORY, http://www.thequotefactory.com/quote-by/woody-allen/its-better-to-be-rich-than-poor/58979 (last visited Nov. 8, 2012).

landlords are required to provide essential services like electricity, heat, and hot water, and the federal government subsidizes four million public housing units and Section 8 subsidies. All of this serves to move more people within the spectrum of habitability.

Although banking is also a critical market, banking is different because a larger portion of the population does not participate. A 2011 FDIC study found that an estimated 8.2% of U.S. households—approximately ten million households—are unbanked, meaning that they do not have a checking or savings account.[25] An additional 20.1% of U.S. households—approximately twenty-four million—are underbanked, meaning that although they have a checking or savings account, they also relied on alternative financial services, like check cashers, payday loans, rent-to-own agreements, pawn shops, or refund anticipation loans at least once in the past year.[26]

Certain minorities are much more likely to be unbanked or underbanked. An estimated 21.4% of black families, 20.1% of Hispanic families, 14.5% of American Indian/Alaskan families, 4.0% of white families, and 2.7% of Asian families are unbanked.[27] The same is true for the underbanked, with an estimated 33.9% of black families, 28.6% of Hispanic families, 26.8% of American Indian/Alaskan families, 16.6% of Asian families, and 16.1% of white families meeting the definition.[28]

As a general principle, the for-profit banking system does not care about the unbanked. As many commentators have pointed out, the purpose of banks is to maximize profits, and the poor, with limited assets, do not cross that threshold limit that makes a bank account profitable or at least profitable enough. That is not to say there are no alternatives. The unbanked can operate within a cash economy or move to the alternative banking system of check cashers, payday lenders, and the use of credit cards as a floating loan, at least until the credit card gets maxed out. We could argue that this alternative banking system is simply the bottom of the market, just like blighted housing is the bottom of the housing market. The difference, however, is that the alternative market is extremely limited when it comes to providing access to capital, which means that for those participating in the alternative market, a major part of the banking package is missing.

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25. FED. DEPOSIT INS. CORP., *2011 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS* 4 (Sept. 2012), *available at* http://www.fdic.gov/householdsurvey/2012_unbankedreport.pdf.

26. *Id.* at 4 n.2.

27. *Id.* at 14.

28. *Id.* at 17.

II. FOUR PRINCIPLES

Before I discuss community banking, I want to make four broad generalizations: (1) the history of banking is a story of maximizing access to capital while limiting risk; (2) bankers do not like to be regulated (not that they are unique in this regard); (3) it is easier to prohibit bad behavior than to regulate good behavior; and (4) local institutions are important, and their disappearance has unintended consequences.

First, the history of banking is a straight line to finding ways to maximizing access to capital using other people's money while limiting risk and profiting from each transaction. The earliest Venetian banks were set up to facilitate trade,[29] much as the earliest corporations were set up to facilitate exploration and colonialism,[30] and both were based on private investment, which required profits to succeed.

In 1600, the King of England granted the British East India Company a fifteen-year monopoly on East Indies trade, and by 1611, shareholders were earning a 150% annual return on investment.[31] This encouraged other investors to follow suit, including those who petitioned and received a charter for the Massachusetts Bay Company, and there is no question that John Winthrop felt an obligation to satisfy both the Crown and his investors.[32]

The Bank of England, considered to be the model of modern centralized banking, was also formed to meet the needs of the Crown. After the Revolution of 1688 brought William and Mary to the throne, William III was unable to borrow funds.[33] William Paterson conceived of a banking corporation in which the bank would loan the Crown 1.2 million pounds in exchange for an exclusive charter to the Governor and Company of the Bank of England, with exclusive possession of government finances and the exclusive right to issue bank notes. William granted the charter in 1694.[34] Although this seemed like a risky idea, the subscription was raised and, as with corporations, the investors made money.[35]

As bankers used to say in the old days, the secret to success is 3-6-3 banking: borrow at 3%, lend at 6%, and go play golf at three in the afternoon. If a banker

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29. *See, e.g.*, George T. Anagnost & Richard C. Jensen, *Looking Back in Time: Sixteenth Century Wherefores and Therefores as Part of the Continuum of Western Legal Thought*, 18 SEATTLE U. L. REV. 1, 4–5 (1994).

30. *See, e.g.*, Clive M. Schmitthoff, *The Origin of the Joint-Stock Company*, 3 U. TORONTO L.J. 74, 74 (1939).

31. JOHN KEAY, THE HONOURABLE COMPANY: A HISTORY OF THE EAST INDIA COMPANY 9, 113 (1991).

32. For a wonderful description of the need to satisfy investors, the Crown, and the colonists, see SARAH VOWELL, THE WORDY SHIPMATES (2008).

33. *See* Paul F. Figley & Jay Tidmarsh, *The Appropriations Power and Sovereign Immunity*, 107 MICH. L. REV. 1207, 1227–30 (2009).

34. *See Major Developments*, BANK OF ENG., http://www.bankofengland.co.uk/about/Pages/history/major_developments.aspx (last visited Nov. 8, 2012).

35. *Id.*

went to a local school to explain bank accounts (and they did), it was not part of a charitable financial literacy program. It was a way to get customers. As many studies have shown, people do not like to change banks, and bank loyalty was even greater when customers were less mobile. If you could get a second-grader to open a bank account with a one dollar deposit, there was a good chance that those deposits would increase with summer jobs, and in ten years you would be lending him money to buy a car, and a few years after that, writing a mortgage. The key was getting the customers, and the rest would take care of itself. That is not the modern banking system.

It is almost a decade since *The New York Times* reported that

> [a]t least 1,000 banks are encouraging customers with low balances to overdraw their checking accounts, allowing the banks to skirt credit laws and collect billions of dollars in new fees . . . . Now, with banks increasingly dependent on fees from consumers, overdrafts have become a source of profit.[36]

Today, banks are even more dependent on fees.[37] While Bank of America withdrew its proposed $5.00 monthly fee for debit card use, its fee schedule includes a charge to make a deposit at a teller as opposed to an ATM, not to mention a monthly maintenance fee for checking *and* savings accounts, waived if you maintain minimum levels.[38] Bank of America, like other banks, charges $5.00 to $12.00 per month to maintain a savings account. Since the interest on these accounts is currently less than 2%, unless you have over $3000 in a regular account or $7200 in a money market account, you are losing money each year.[39] You are better off keeping the money in a checking account, where you will pay for one account instead of two.

Since a deposit is a loan to the bank, many depositors are paying for the privilege of lending money to the bank. This is bizarre in the abstract, but what the bank is really saying is that it may claim it wants more customers but only those who are middle class or above and will rarely, if ever, use a teller. Bank of America, Citibank, Chase, and Wells Fargo—combined—have more than 45,000 ATMs,[40] and, along with electronic banking and direct deposit, they hope to never see a customer for a transaction that can be handled electronically. The nature of the relationship has changed, and the depositor's loan to the bank has become an

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36. Alex Berenson, *Banks Encourage Overdrafts, Reaping Profit*, N.Y. TIMES, Jan. 22, 2003, at A1.

37. *See, e.g.*, Christopher Elliott, *Airlines, Banks, and Credit Cards: The ABCs of Hidden Fees*, MINTLIFE (May 10, 2012), http://www.mint.com/blog/consumer-iq/the-abcs-of-hidden-fees-052012. The Center for Responsible Lending has several reports on the predatory practices of large banks. These can be found at http://www.responsiblelending.org.

38. For detailed information on Bank of America's fees, see *Fees at a Glance*, BANK AM., https://www.bankofamerica.com/deposits/index.action?body=feehub (last visited Nov. 8, 2012).

39. *Id.*

40. *Compare Banks*, FINDTHEBEST, http://consumer-banking.findthebest.com (last visited Nov. 8, 2012).

agreement whereby the depositor pays for services while the bank has free use of the money.

As a second proposition, bankers do not like to be regulated. Even in the post-banking crisis era, bankers from large banks believe that financial innovation drives prosperity, innovation is important to determine new ways to maximize the availability of capital, and eliminating risk will eliminate innovation. This view is best exemplified by J.P. Morgan CEO Jamie Dimon's comments after J.P. Morgan lost $5.8 billion in May 2012, which can be summarized as: "We screwed up. We were stupid. We will deal with this internally. Don't forget that we still made money this year."[41] On the other side of the banking spectrum, bankers from small banks believe that many regulations should apply only to large banks.

The degree to which the banking industry actually drives economic growth is a critical question, and one whose answer is not self-evident. As Eduardo Porter wrote in *The New York Times*,

> The economics suggest that big banks are less efficient at credit creation than smaller ones. And there is no evidence that the simpler financial system we had from the 1940s through the 1970s restrained growth. In fact, for all its innovation, the financial industry of today is less efficient than it was in the age of the railway, according to research by Thomas Philippon at New York University. That is, it charges the rest of society more for financial intermediation than it did 130 years ago.[42]

Banks have benefitted from governmental support and subsidies, and bank performance during the depression, the savings and loan crisis, and the 2008 crisis, is evidence for the proposition that the economy drives the banks, not the other way around. This is not to suggest that the economy is not dependent on banks. It is precisely that dependence that leaves government little choice but to intervene to prevent failure.

Jonathan Macey points out that few people oppose all banking regulation,[43] and even Milton Friedman believed that regulation in the nature of government guarantees is necessary to avoid bank failure.[44] People may have opposed the bailout (though not many bankers did), but FDIC deposit insurance is widely considered to have been a success for almost eighty years, and those commentators who suggest its elimination would replace FDIC insurance with a generally more market-based substitute. As John Allison, former CEO of BB&T Bank, suggested in December 2009, "I'd vote to get rid of FDIC insurance, not

41. For a summary of Dimon's statements, see, for example, Richard Adams, *JP Morgan Boss Jamie Dimon Faces Down Senate Critics—As It Happened*, GUARDIAN (U.K.) (June 13, 2012), http://www.guardian.co.uk/business/blog/2012/jun/13/jp-morgan-jamie-dimon-senate-live.

42. Eduardo Porter, *The Modest Worth of Big Banks*, N.Y. TIMES, May 23, 2012, at B1.

43. *See* Jonathan R. Macey, *The False Promise of De-Regulation in Banking*, YALE L. SCH. LEGAL SCHOLARSHIP REPOSITORY 2 (2005), http://digitalcommons.law.yale.edu/fss_papers/2.

44. Jonathan R. Macey, *Commercial Banking and Democracy: The Illusive Quest for Deregulation,* 23 YALE J. ON REG. 1, 6 (2006).

that we don't need it, we need some kind of insurance, but I think it ought to be an industry-based, industry-controlled pool where we would have a huge motivation to discipline all the participants in the pool."[45]

Allison's opposition to the FDIC is based on his disapproval of its regulatory performance, which goes well beyond its pure insurance function. Not surprisingly, the notion of an industry-controlled regulatory scheme is not popular.[46] More recently, Peter Atwater, who helped build J.P. Morgan's securitization business, wrote in favor of eliminating the FDIC:

> [A]s a consequence [of the insurance], depositor due diligence is non-existent. . . . [H]undreds of now-failed banks took excessive risk in their traditional banking business and their insured depositors neither cared nor were adversely impacted. . . . If we're truly going to eliminate "moral hazard"/"too big to fail" we must eliminate deposit insurance in the process.[47]

Atwater's comment reminds me of an old joke about a corrupt town. The Mayor's son runs a red light and hits a pedestrian in the crosswalk, knocking him fifty feet down the road. Instead of the Mayor's son getting charged with a crime, the pedestrian is charged with leaving the scene of an accident. Similarly, Mr. Atwater wants to blame the pedestrian for not checking the Mayor's son's driving record before crossing the street.

The notion that depositors, most of whom are unsophisticated, should use due diligence to determine a bank's financial status and investment policies before making a deposit, is an odd use of the moral hazard argument. Mr. Atwater's byline notes that he "helps his clients better understand the issues affecting the financial services industry,"[48] which may include where to bank, but the rest of us will be rolling the dice. I guess you could always ask the tellers.[49] I have watched Mr. Atwater talk about banking issues, and he is a smart guy, but smart is not everything, and blaming depositors for their lack of financial acumen does not make much sense. It does, however, imply a banking system geared toward the financially sophisticated, in which the depositor is treated like an investor.

That brings me to my third proposition. It is easier to prohibit bad behavior than to require good behavior, and regulations that require good behavior do not

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45. John Allison, *Transcript*, BIGTHINK (Dec. 16, 2009), http://bigthink.com/ideas/17850.

46. *See* Eugene N. White, *The Legacy of Deposit Insurance: The Growth, Spread, and Cost of Insuring Financial Intermediaries*, *in* THE DEFINING MOMENT: THE GREAT DEPRESSION AND THE AMERICAN ECONOMY IN THE TWENTIETH CENTURY 87–122 (Michael D. Bordo et al. eds., 1998), *available at* http://www.nber.org/chapters/c6889.pdf.

47. Peter Atwater, *Five Suggestions for Banking Reform*, YAHOO! FIN. (Mar. 26, 2010), http://finance.yahoo.com/news/pf_article_109184.html

48. *Our Professors: Peter Atwater*, MINYANVILLE, http://www.minyanville.com/gazette/bios.htm?bio=106 (last visited Nov. 8, 2012).

49. Credit for this suggestion goes to Katie Rohner. Since it made me laugh out loud, I could not resist including it.

generally work. By regulation, I do not mean regulations pursuant to tax expenditures, like the Low-Income Housing Tax Credit (LIHTC). The LIHTC is not a regulatory regime. It is a governmental request for proposals, with substantial financial rewards. By regulation, I am referring to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Patriot Act, and the myriad regulations that help define banking as a heavily regulated industry.

Lest you think I am not sympathetic to the claim of over-regulation, I was a bank director for a short period of time, and I am quite sympathetic. I accept that bankers do their best to comply with these regulations, which are largely prohibitory and require a great deal of reporting. If you engage in a transaction that implicates the Bank Secrecy Act or the Patriot Act, you can bet that your bank has a policy covering the transaction and what must be reported, and that failing to report a reportable transaction will be treated seriously. Through this legislation, Congress has identified bad behavior and has placed the onus on banks to participate in enforcement. Bankers grit their teeth but comply.

Regulations are less effective when they require the performance of a "good act." Faith-based institutions are successful in soliciting voluntary contributions; government is not. We could identify the unbanked as a social problem worth addressing and regulate to require banks to reach out to distressed communities and report their activities. If we enacted such a regulation, we could safely assume that the government would accumulate a lot of reports.

Those banks that do not wish to do the work will minimize the effort and maximize the report. While many financial institutions are philanthropic, I do not think that we can successfully regulate philanthropy. My position is based on efficiency, not a belief that banks—which are heavily subsidized—do not have a social obligation. We are more likely to accomplish a social purpose, i.e. the "good act," if banks outsource these activities to institutions that have a mission to provide banking services to otherwise-excluded communities.

My fourth and final proposition is that local institutions are important, and their disappearance has unintended consequences. Large, monolithic organizations and government look for cookie-cutter solutions, and local interests get lost in the execution. The question is whether institutions are important enough to subsidize. We have chosen to subsidize home ownership, affordable housing, the film industry, farming, corn, open space, defense contractors, large banks, water, professional sports, and a host of other things. We have let the market take care of local banks, and the result has been their absorption into larger banks, which in turn have themselves been absorbed. Before we allow more local banks to disappear, we need to understand the effect on the local economy. The greater the effect, the more reason to find ways to sustain local banking services.

In examining the roles of CDFIs and community banks, I start with a discussion of the collapse of ShoreBank, the grandfather of CDFIs and the model of community banking over the last forty years. Then, to review the difficulties of starting a de novo community bank, I turn to a discussion of events in New Haven, Connecticut, where I was part of an effort to resist the demutualization of a mutual savings bank, which led in turn to the development of a smaller community bank, with the goal of that bank qualifying as a CDFI. At that point I proceed to discuss the romanticized version of *It's a Wonderful Life*, and how that scenario played out in a small upstate New York town. Finally, I end with some thoughts about different ways to look at local financial institutions, with suggestions for bolstering the remaining community banking sector.

III. SHOREBANK—THE MODEL FOR COMMUNITY DEVELOPMENT BANKING

ShoreBank was the model for community banking in the modern era. In 1973, its founders paid $3.2 million to acquire the unsuccessful $40 million South Shore National Bank, serving eighty thousand people on the south side of Chicago, and built it into a $2.6 billion multi-faceted banking organization.[50] Its accomplishments were prodigious, including redeveloping the South Shore neighborhood, creating a nonprofit organization to focus on job training and placement, forming a loan fund for minority entrepreneurs, and creating a real estate development company to develop properties in the blighted South Shore neighborhood.[51]

While most banks look at a single bottom line of maximizing shareholder profits, and CDFIs look to a double bottom line of profits and social return, ShoreBank took pride in its triple bottom line: profitability, community development impact, and an environmental return.[52] ShoreBank's annual reports reviewed its performance in development investment and conservation loans.[53]

Outside of Chicago, its influence was even greater. ShoreBank founded the National Community Investment Fund (which became the largest investor in CDFIs in the United States), the Center for Financial Services Innovation (an authority and advocate for the unbanked and underbanked), and invested in banks in the developing world, becoming a major force in international development.[54]

When Muhammad Yunus sought a consultant before starting Grameen Bank, he turned to ShoreBank, as did everyone else who wanted to start a CDFI.[55] The people at ShoreBank were remarkably generous with their time. During my work with the Yale Law School Community and Economic Development Clinic representing the City of New Haven in its development of Start Bank, students

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50. David Oser, *Why ShoreBank Succeeded . . . and Why It Failed*, OSER VIEW (Sept. 7, 2010), http://shorebank.typepad.com/the_oser_view/2010/09/index.html.

51. *Id.*

52. WatchDog, *ShoreBank and the Triple Bottom Line: Too Important to Fail?*, CENT. ILL. 9/12 PROJECT (Aug. 12, 2010), http://www.centralillinois912project.com/?p=6343.

53. *Id.*

54. *Id.*

55. *Id.*

traveled to ShoreBank for a day's tutorial. Ron Gryzwinski and George Surgeon, ShoreBank's CEO and CFO, came to New Haven more than once.[56] By the end of 2009, ShoreBank was the largest CDFI in the United States, its holding company had made $4.1 billion in mission-driven loans, it provided consulting services in sixty countries, and it trained almost 4,000 bankers.[57]

When the economic crisis hit in 2008, Chicago's South Shore was economically devastated. Unemployment exceeded 30% and may have been as high as 40%.[58] A 2009 analysis of census data reported that the South Side had an unemployment rate of at least 23.2% (and probably higher), second only to neighborhoods in Detroit.[59] ShoreBank had expanded into Arkansas in 1987 and later into Cleveland and Detroit, as well as the West Side of Chicago, all of which proved to be difficult markets.[60]

Although ShoreBank did not make subprime loans, by the spring of 2010, ShoreBank was insolvent.[61] Ron Gryswinski and Mary Houghton, two of ShoreBank's founders, tried to raise $50 million in new capital to stabilize ShoreBank,[62] but the financial situation worsened until the estimate of needed capital rose to approximately $220 million in federal and private funds to avoid an FDIC takeover.[63]

Remarkably, ShoreBank—largely through the efforts of former Comptroller of the Currency and Chief Executive of Promontory Financial Group Eugene Ludwig—raised almost $150 million from banks, private equity, and philanthropic sources.[64] ShoreBank applied for $70 million of support from the Troubled Asset Relief Program (TARP).[65] On August 10, 2010, in a story titled "Small Enough to

56. The author was present at these events.

57. James E. Post & Fiona S. Wilson, *Too Good to Fail*, STAN. SOC. INNOVATION REV. 66, 68 (Fall 2011), http://www.ssireview.org/images/articles/Fall_2011_Case_Study_Too_Good_to_Fail.pdf.

58. Oser, *supra* note 50.

59. Steve Rhodes, *South Side Neighborhoods Own Second Worst Jobless Rate in US*, NBC CHI. (Nov. 25, 2009, 12:04 PM), http://www.nbcchicago.com/news/politics/South-Side-Depression-72523967.html; *Unemployment on Chicago's South Side Trails Only Detroit Nationally*, HUFFINGTON POST (Mar. 18, 2010), http://www.huffingtonpost.com/2009/11/19/unemployment-on-chicagos_n_364636.html.

60. *See* Post & Wilson, *supra* note 57, at 68.

61. Curtis Black, *The Myths of ShoreBank's Failure*, COMTY. MEDIA WORKSHOP (Dec. 15, 2010), http://communitymediaworkshop.org/2010/12/newstips-the-myths-of-shorebank%E2%80%99s-failure; Tim Fernholz, *Too Small to Save*, AM. PROSPECT, Jan./Feb. 2011, at 19, *available at* http://prospect.org/article/too-small-save-0.

62. David Greising, *Recession Played a Part, but ShoreBank Wounded Itself, Too*, N.Y. TIMES, May 22, 2010, at A25A.

63. Becky Yerak, *ShoreBank's Financial Hole Deepens*, CHI. BREAKING BUS. (Aug. 2, 2010, 9:34 AM), http://archive.chicagobreakingbusiness.com/2010/08/shorebanks-financial-hole-deepens.html.

64. Jeremy Hobson, *Big Banks to ShoreBank's Rescue*, AM. PUB. MEDIA (May 18, 2010), http://www.marketplace.org/topics/world/big-banks-shorebanks-rescue; Becky Yerak, *Chicago's ShoreBank Fails, Is Bought by Investors*, CHI. TRIB., Aug. 20, 2010, § 1, at 25.

65. *Small Enough to Fail: The Sorry End to a Bold Banking Experiment*, ECONOMIST, Aug. 28, 2010, at 62 [hereinafter *Small Enough to Fail*].

Fail: The Sorry End of a Bold Banking Experiment," *The Economist* reported that, according to a source close to the process, the government had indicated that if ShoreBank could raise $125 million in private capital, it would receive $75 million in TARP funds, but that "criticism from some Republican politicians and like-minded media pundits seems to have 'made the Obama administration afraid that it would be accused of favouring a Chicago institution; had it been from New York or Houston, it would have been saved.'"[66] As Mr. Ludwig described the rescue,

> [t]his is an institution that's recognized by world figures all over the world, and for it to have failed would have been, I think, a blow not just to the Midwest, and not just to the people at ShoreBank, but to U.S. prestige and its leadership in this important area of global development.[67]

Perhaps this could have been a time for a thoughtful discussion of the role of small banks in the too-big-to-fail world, but instead we had Glenn Beck using a blackboard to connect ShoreBank to President Obama, the Service Employees International Union, Tony Rezko, the Community Reinvestment Act, Tim Geithner, Hillary Clinton's college roommate, the Ford Foundation, Bill Ayres, Van Jones, green energy, Fannie Mae, and the ability of the federal government to lock everyone's electrical outlets from outside their homes.[68]

For years, ShoreBank had advertised in *The New Yorker* and elsewhere, offering competitive rates to depositors seeking a socially responsible investment. Depositors across the country opened accounts, for no reason greater than their desire to lend to a socially responsible institution as opposed to another bank. This was not quite the stuff of a Dan Brown thriller. Beck, however, emphasized that environmental advocate and civil rights activist Van Jones had an account at ShoreBank even though he did not live in Chicago, which, to Beck, was evidence of a great conspiracy.[69]

On the same day as the Beck report, Rep. Judy Biggert (R-Ill.) demanded information on White House efforts to save ShoreBank.[70] Within twenty-four hours, Media Matters reported that "Glenn Beck repeated discredited falsehoods about the Community Reinvestment Act and President Obama's Chicago house, while baselessly suggesting that the Obama administration is aiding a troubled

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66. *Id.*

67. Hobson, *supra* note 64.

68. Glenn Beck, *Shorebank's Tangled Web*, FOX NEWS (May 20, 2010), http://www.foxnews.com/story/0,2933,593343,00.html.

69. *Id.*

70. Lynn Sweet, *ShoreBank Deserves a Fair Chance at Survival: What Do Regulators Want?*, CHI. SUN-TIMES (June 25, 2010, 5:41 AM), http://blogs.suntimes.com/sweet/2010/06/shorebank_deserves_a_fair_shot.html ("Rep. Judy Biggert (R-Ill.) on May 19 wrote the White House asking about 'perceived involvement' of high-ranking Obama administration members intervening on ShoreBank's behalf.").

'politically-connected Chicago bank.'"[71] The political football, however, was in the air. A month later, Biggert asked, "At a time when hundreds of other banks are failing, including dozens here in Illinois, why was this bank singled out?"[72]

Instead of answering her question on the merits, the blogosphere took over, and we could read such thoughtful statements as, "Most peculiar is how ShoreBank's logo and motto resemble Obama's colors in his logos and his pre-election mantra. Their motto, 'Let's Change the World.' Creepy, and telling."[73] Well, it is creepy and telling, but not about ShoreBank.

As *The New York Times* reported, the recession was not the only problem. ShoreBank's expansion at the height of the housing bubble was a risky strategy, especially since ShoreBank was slow to foreclose on loans. ShoreBank was proud that its "triple bottom line," making a profit while creating jobs and improving the environment, set a high standard for socially responsible lending, but some of its lending decisions made traditional bankers nervous.[74]

Critics argued that the commitment to the social purpose at the expense of the financial bottom line caused the failure. Richard Taub, a University of Chicago professor specializing in community building and community development who had consulted with ShoreBank for thirty years, blamed the desire to expand too fast and an overcommitment to the social mission.[75] Still, as late as 2006, ShoreBank—with $2 billion in assets—had only $22 million in loans in nonaccrual status (ninety days with no interest payments). By May 2010, that number reached $250.7 million. The bank did not move quickly on these loans, and held only $2.5 million in real estate, showing little action on the foreclosure front.[76]

In ShoreBank's defense, the collapse of the real estate market in the South Side may have made foreclosure counterproductive, since it would have resulted in the bank owning property it could not sell. Holding mortgages without value is a lot better than paying insurance, taxes, utilities, and management fees on property for which there is no market.

In the early 1980s in New Haven, Connecticut, I represented a small contractor who bought dilapidated three-to-six family houses, fixed them up, and rented out the units. He was quite successful and highly regarded in the neighborhoods in which he worked. When the economy took a serious downturn,

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71. Terry Krepel, *Beck Rehashes False Claims in Baselessly Suggesting Obama Acting on Behalf of Bank*, MEDIA MATTERS (May 21, 2010, 12:17 AM), http://www.mediamatters.org/research/2010/05/21/beck-rehashes-false-claims-in-baselessly-sugges/165081.

72. Press Release, U.S. Rep. Judy Biggert, Biggert Amendment Opens Investigation into ShoreBank Bailout (June 24, 2010), *available at* http://www.biggert.house.gov/press-releases/biggert-amendment-opens-investigation-into-shorebank-bailout.

73. Bridgette, *Tidal Wave Set to Hit Shorebank and Its Cronies Updated!*, WE THE PEOPLE (May 22, 2010), http://wtpotus.wordpress.com/2010/05/22/tital-wave-set-to-hit-shorebank-and-its-cronies.

74. Greising, *supra* note 62; WatchDog, *supra* note 52.

75. *Id.*

76. *Id.*

rent collections suffered and he was unable to pay his various mortgages. National unemployment was 9.7% in 1982 and 9.6% in 1983, and unemployment was much higher in New Haven's low-income neighborhoods.[77] My client planned to file for bankruptcy when the wave of foreclosures started. He waited eighteen months before walking away. The banks had determined that the property had a negative value and would not foreclose until the market improved.

The Economist noted that while ShoreBank could be criticized for "straying too far into riskier parts of the property business," including lending too much to developers, its failure was the result of sticking to its original mission, and that for ShoreBank's South Chicago market, "it was a one-in-500 year flood."[78] To survive, ShoreBank needed greater reserves, greater geographical diversification, and more small business lending.[79]

That was not ShoreBank's model, and it is fair to ask whether we need to rethink the model. As bank consultant Bert Ely said, "The question comes up, was this bank managed as well as it could have been? Or were they too much into the social-welfare thing?"[80] Mr. Taub, a long-time ShoreBank advisor, felt that ShoreBank was overly zealous in its commitment to its original mission, and that the board did not exercise adequate scrutiny of bank operations.[81]

After the collapse of its TARP funding, the private investment went toward reorganization, and ShoreBank was reorganized as Urban Partnership Bank.[82] While the private investment remained the same, the absence of $70 million of TARP funds meant that the FDIC deposit insurance absorbed a $367.7 million loss.[83] Urban Partnership, funded by American Express, Bank of America, Citicorp, Ford Foundation, JPMorgan Chase, Goldman Sachs, Wells Fargo, and others, was the sole bidder for ShoreBank, purchasing $1.54 billion in deposits, $2.16 billion in assets, and assuming 20% of the losses, with the FDIC assuming the other 80%.[84]

Under the heading, "ShoreBank, R.I.P.," Felix Salmon wrote that

> it's interesting to me that the government, given the choice between losing $368 million of the Deposit Insurance Fund or investing an extra $75 million in bailout funds, chose the former option. The deposit insurance fund, I guess, isn't really considered taxpayer money, and will

77. *Historical Labor Force/Unemployment Data for United States*, N. IND. DATAPLUS, http://www.nidataplus.com/lfeus1.htm (last visited Nov. 8, 2012).

78. *Small Enough to Fail*, *supra* note 65.

79. *Id.*

80. Greising, *supra* note 62 (internal quotation marks omitted).

81. *Id.*

82. Yerak, *supra* note 64. For a description and history of Urban Partnership Bank, see *About Us*, URB. PARTNERSHIP BANK, https://www.upbnk.com/about-us (last visited Nov. 8, 2012).

83. Yerak, *supra* note 64.

84. *Id.*

> ultimately (eventually, hopefully) be repaid with future insurance premiums.[85]

Salmon added that ShoreBank seemed to have failed not because of its community lending, but more because of its overexposure to speculative commercial real estate ventures, ending with another thought: "Urban Partnership Bank, I trust, will stick to its core competency, and do well for all concerned by doing so."[86]

In the banking community, many people felt that the ShoreBank business model was a thing of the past and, at a minimum, Urban Partnership would have to tighten its lending practices and diversify its loans geographically. Multifamily rehabilitation loans were seen as a particular vulnerability. Urban Partnership, however, indicated that it remained committed to a focus of serving poor neighborhoods in Chicago, Detroit, and Cleveland.[87]

Eugene Ludwig stated that these efforts "provide continuity for the working people in Chicago's South and West sides and in Cleveland and Detroit, where community development financial institutions have long exerted a transformative influence."[88]

Mr. Ludwig's comments undoubtedly reassured the CDFI community that the ShoreBank collapse and sale might be something less than a complete collapse of the CDFI movement, but people working in the field had to wonder whether they were engaging in a fruitless enterprise. CDFIs are mission-driven financial institutions providing services to otherwise underserved communities, operating with a double bottom line (forget ShoreBank's triple bottom line![89]) of financial responsibility and socially responsible investment. What exactly did geographic diversification and tightened lending practices mean? Given the small margins of successful CDFIs, a loosening of geographic boundaries and a tightening of lending practices would leave little room for the mission-oriented loans for which the CDFI was founded.

What lesson should we take from the banking crisis of 2008? If the lesson is that we will use taxpayer funds as a last resort for necessary interventions for those banks whose failure places an untenable risk on the financial system, i.e. those too big to fail, then we are privileging those institutions at the expense of smaller banks. Once we accept that, we can take for granted that small banks are inefficient, have no special purpose, and will inevitably be absorbed into larger, more efficient banks.

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85. Felix Salmon, *ShoreBank, RIP*, REUTERS (Aug. 20, 2010), http://blogs.reuters.com/felix-salmon/2010/08/20/shorebank-rip.

86. *Id.*

87. Yerak, *supra* note 64.

88. *Id.* (internal quotation marks omitted).

89. *See supra* note 52 and accompanying text.

There is a different interpretation of these events. David Roeder wrote recently that "[t]he takeover essentially relaunched Urban Partnership as an outsourced social conscience for major banks that put up the equity, including Goldman Sachs Group, Wells Fargo & Co. and J.P. Morgan Chase. All receive credit under the Community Reinvestment Act for supporting Urban Partnership."[90]

Roeder noted that Urban Partnership was closing some branches but planned to reopen new, smaller branches.[91] It will take some time before we know whether this is a move away from ShoreBank's mission or a reinforcement of its model in a changed environment. To understand the difficulty of maintaining a mission-driven bank, we should also look at New Haven, Connecticut, where a new community bank was opening as ShoreBank was closing.

IV. THE DIFFICULTIES OF STARTING A DE NOVO BANK—THE NEW HAVEN EXPERIENCE

In 1838, the Connecticut state legislature granted a bank charter to some of New Haven's most prominent citizens to form a mutual savings bank under the name New Haven Savings Bank (NHSB).[92] This was an effort by the legislature to make capital more accessible to New Haven residents, and, by all accounts, it was successful. By 2003, NHSB was the largest state-chartered bank in New England and the eighth largest bank in Connecticut. It had assets of \$2.4 billion, \$1.8 billion in deposits, an outstanding Community Reinvestment Act rating, and it did the large majority of its lending in greater New Haven.[93] NHSB had the largest market share of all banks in greater New Haven, and by all accounts was positioned to continue its history as a successful local bank.[94]

In April 2003, the Greater New Haven Chamber of Commerce announced that NHSB was the recipient of its annual award to an institution that served New Haven for more than a century. Chamber officials said that "[w]ith 165 years of uninterrupted service and its commitment to helping build and maintain the

90. David Roeder, *Urban Partnership Bank Pledges to Pick Up ShoreBank's Local Mission*, CHI. SUN-TIMES (Aug. 4, 2011, 4:20 PM), http://www.suntimes.com/business/3603025-420/shorebank-vitale-bank-partnership-urban.html.

91. *Id.*

92. *FDIC Institution Directory*, FDIC, http://www2.fdic.gov/idasp/index.asp (follow "Bank Find" hyperlink; then search "Name" for "New Haven Savings Bank" and search "State" for "Connecticut"; then follow "Find" hyperlink; then follow "Historical Profile" hyperlink) (last visited Nov. 8, 2012).

93. *Summary*, A MERGER PROPOSAL, ALLIANCE BANCORP OF NEW ENGLAND, *available at* http://secfilings.nyse.com/filing.php?ipage=2486910&DSEQ=&SEQ=12&SQDESC=SECTION_PAGE (last visited Nov. 8, 2012).

94. *See* Paul Johnson, Editorial, *FORUM: New Haven Savings Bank Turns Its Back on 166 Years of History*, NEW HAVEN REG., Aug. 3, 2003, at B3.

economic and social vitality of south-central Connecticut, New Haven Savings Bank has been a pillar of excellence in the financial and corporate world."[95]

The award came amid rumors that NHSB's commitment to New Haven and its local market was about to change. Charles Terrell, the long-time president of NHSB, was a New Haven supporter who resisted demutualization. Terrell died in late 2000, and Peyton Patterson, the new CEO, was thought by many to favor demutualization, a public stock offering, and expansion.[96] By June 2003, the rumors were strong enough that New Haven Mayor John DeStefano wrote Patterson, urging against demutualization:

> Ultimately, the bank's self-interest will no longer be primarily tied to the economic well-being of our community. . . . The bank will increasingly be pushed to send local capital to far off locations in search of the highest return for anonymous shareholders . . . . My hope is that you will resist the urge to march the bank into a marketplace that has spent the last few years creating startling spectacles of greed gone awry.[97]

Patterson replied that the bank remained committed to New Haven, but by July she was hedging, stating that "[w]e are very excited about expanding our market presence across Connecticut. . . . While our headquarters will remain in New Haven, we look forward to being a significant new banking partner in Hartford, Tolland and Windham counties."[98]

Patterson called the possible merger a "once in a corporate lifetime opportunity,"[99] but the question remained whether the opportunity was for the community or the directors, each of whom stood to receive a financial windfall for serving on a board that had always been seen as serving community, not private interests. Their votes for merger were viewed by many as posing direct conflicts of interest, and many people felt that the NHSB board had placed their personal financial interests over the mission of NHSB.[100] To those opposing the merger, the directors' actions were particularly galling given that the board had done little or nothing to generate NHSB's assets.[101]

95. *In Other Business*, NEW HAVEN REG., April 16, 2003, at E1.

96. John R. Engen, *A Town Divided*, AM. BANKER (June 1, 2004, 2:00 AM), http://www.americanbanker.com/magazine/114_6/-223036-1.html; *The 'Very Nice Bank' Gets a Very New Boss*, BUS. NEW HAVEN (Feb. 4, 2002), http://www.conntact.com/archive_index/archive_pages/242_Business_New_Haven.html.

97. Steve Higgins, *DeStefano Confronts Local Bank*, NEW HAVEN REG., July 4, 2003, at B12 (internal quotation marks omitted).

98. Press Release, New Haven Sav. Bank, New Haven Savings Bank to Acquire Connecticut Bancshares Inc. and Alliance Bancorp of New England; Conversion from Mutual to Public Ownership to Occur Simultaneously (July 16, 2003), *available at* http://www.businesswire.com/news/home/20030716005330/en/Haven-Savings-Bank-Acquire-Connecticut-Bancshares-Alliance (internal quotation marks omitted).

99. *Id.*

100. Johnson, *supra* note 94.

101. *Id.*

Paul H. Johnson, the former CEO of Connecticut Savings Bank (CSB) and one of many local bankers who opposed the demutualization, published an op-ed raising these issues:

> For the organizers of New Haven Savings Bank there was no personal reward for their efforts, other than the satisfaction of creating a community bank that benefited the individuals that could not be served by the then existing banking system . . . . The bank would be owned by the depositors, not the board of directors or shareholders . . . . New Haven Savings Bank will become owned by the shareholders, not depositors.
>
> Predictably, after the five-year "wait-period" the bank will be purchased by one of the megabanks of the world. . . . [T]he regional bank will then be run by a "regional manager" who will operate the bank for the benefit of shareholders and give lip service to the needs of the community until he or she is promoted to take on a larger region within the megabank. The New Haven region will lose a bank that is dedicated to the New Haven region, and has no good business reason to change except to form a lucrative gift for the present management. . . .
>
> Soon after the conversion comes the stock options, stock grants, incentive compensation in the form of stock and all the other forms of enrichment that the public has witnessed in daily examples that they have come to view as corporate greed. . . . Is larger better? Will the services be more extensive or less expensive? Is New Haven Savings Bank short of capital or hampered in their efforts to expand their base or products in their region? The reality is that New Haven Savings Bank is one of the most highly capitalized banks in the United States.[102]

There was an irony to Johnson's comments. CSB had failed during his tenure. He acknowledged both the failure and his resistance to selling stock in CSB, but he still maintained that going public would not have changed the result.[103]

DeStefano was even stronger, holding a press conference in front of NHSB headquarters and announcing, "I'm here to report on a bank theft. My bank is being stolen, and I know who is doing it," and then reading the names of the thirty-one "corporators" of NHSB.[104] The City of New Haven proceeded to fight the demutualization and merger before the Connecticut Department of Banking, FDIC, and Federal Reserve Board. The Yale Law School Community and Economic Development Clinic represented the City in those efforts.[105]

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102. *Id.*

103. *Id.*

104. Steve Higgins, *DeStefano Takes Aim at Bank's Directors*, NEW HAVEN REG., Sept. 6, 2003, at A1 (internal quotation marks omitted).

105. The author was counsel on behalf of the City of New Haven in this effort.

In proceedings before the FDIC, the City contested the demutualization and acquisition of two smaller Connecticut banks, but the parties ultimately negotiated a settlement whereby on completion of the merger, the new entity—NewAlliance Bank—would pay $25 million to a nonprofit entity.[106] My colleague Peggy Hamilton, who had been general counsel for City First Bank in Washington, D.C., suggested that the City consider using the funds to form a new community development bank. Mayor DeStefano was enthused about the idea but concerned about the capitalization costs, as conventional bankers suggested the need for $50 million in capital to start. Hamilton felt this was too high for a community bank and suggested a budget of $17 million—$10 million in start-up capital, $2 million for start-up costs, and $5 million for collateral community development activities outside the banking realm. Based on these numbers, $25 million was more than adequate, especially when augmented by a $2 million Yale University grant to the bank, when and if it was formed.[107]

The sticking point in the settlement negotiations was a time frame for starting a new bank. NewAlliance, the successor to NHSB, was about to embark on a $1.2 billion IPO, yet raised concerns that a new $10 million community development bank would present too much competition. NewAlliance was willing to settle for a five-year waiting period before its funds would be used to capitalize a new bank. The City of New Haven opposed any waiting period. The parties compromised at three years.[108] In 2004, NewAlliance went public, with its $1.2 billion IPO oversubscribed.[109] Shares rose 50% on the first day of the offering.[110] The irony was that it took seven years for the new bank to get Federal Reserve Board and FDIC approval.[111]

By that time, events had confirmed Mayor DeStefano and Paul Johnson's predictions about the future of NewAlliance. NewAlliance sold itself to First Niagara Bank, a bank headquartered in Upstate New York, to the great benefit of its officers and directors. Peyton Patterson, who had remained CEO of NewAlliance, departed with the First Niagara deal.[112] Various reports calculated

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106. Angela Carter, *Bank Aiming to Serve Poor Advances*, NEW HAVEN REG., June 24, 2009, at D1.

107. The author was involved in these discussions.

108. Agreement between City of New Haven and NewAlliance Bank (Jan. 26, 2004) (on file with author).

109. The demand led to federal charges of fraudulent purchases. *SEC Charges Individuals with Fraudulent Scheme to Obtain Stock in NewAlliance Bankshares IPO*, SEC (June 28, 2005), http://www.sec.gov/news/press/2005-93.htm.

110. Steve Gelsi, *NewAlliance Bancshares up 50%*, MARKETWATCH (Apr. 2, 2004, 4:11 PM), http://www.marketwatch.com/story/newalliance-bancshares-rings-up-50-percent-gain.

111. Start Bank received its charter in December, 2010. *History: The Short Story of a Big Idea*, START COMMUNITY BANK, https://www.startbank.com/history.html (last visited Nov. 8, 2012).

112. *See* Cara Baruzzi, *Sign of the Times—First Niagara Buys Norwalk Brokerage Firm*, NEW HAVEN REG., Apr. 15, 2011, at D1; Cara Baruzzi, *'There's No Benefit to (New Haven),'* NEW HAVEN REG., Dec. 8, 2010, at A1, A4.

her payout to range from $16 to $23 million, but that did not include all the components of her compensation.[113] Forbes reported her annual compensation as $3,777,389 for 2009.[114] *The New York Times*, comparing the merger to comparable bank deals, reported that Patterson's payout was disproportionate to both the size of the bank and the size of the merger.[115]

In an editorial titled "New Haven Bank Sale: Take the Money and Run," *The New Haven Register* wrote that "NewAlliance insiders will richly profit, while leadership grows more distant. Count New Haven as a brief and very profitable stop in Peyton Patterson's career as a banker."[116] NewAlliance justified the sale to First Niagara as necessary to allow growth and to compete in the new banking world. It was déjà vu all over again. The bank that had been formed in 1838 to make capital available to residents of New Haven was now a part of First Niagara, a bank with an impressive record of expansion, headquartered in Buffalo, New York, with branches as far west as Pittsburgh, Pennsylvania, as far east as eastern Massachusetts, as far north as Buffalo, and as far south as New Haven, with 430 branches in between.[117]

The agreement between the City of New Haven and NewAlliance required that NewAlliance pay $25 million to an IRS-approved tax-exempt entity. Represented by the Yale Law School clinic, the City and other interests named in the agreement formed a foundation to receive the funds. Pursuant to § 509(a)(3) of the Internal Revenue Code, First City Fund Corporation (FCFC) was organized as a supporting organization of the City of New Haven's community development activities. As the IRS points out on its website, supporting organization classification is important as a way to avoid private foundation status, which is "a status that is subject to a much more restrictive regulatory regime. The key feature of a supporting organization is a strong relationship with an organization it supports. The strong relationship enables the supported organization to oversee the operations of the supporting organization."[118]

The FCFC application was unusual in that the bulk of the foundation funds would be invested in a largely nonperforming asset. Because of this unusual circumstance, the FCFC application for a tax-exemption was quite explicit concerning the use of the funds as an investment in a community development bank along with substantial detail concerning the bank and its operations. The

113. *See* Editorial, *Bank Sale: Take the Money and Run*, NEW HAVEN REG., Aug. 29, 2010, at B3; Eric Dash, *23 Million Possible Reasons for Chief to Leave Her Bank*, N.Y. TIMES, Aug. 21, 2010, at B6.

114. *Peyton Patterson*, FORBES, http://www.forbes.com/profile/peyton-patterson (last visited Nov. 8, 2012).

115. Dash, *supra* note 113, at B6.

116. *Bank Sale: Take the Money and Run*, *supra* note 113.

117. *Corporate Summary: 2012 First Quarter Facts, Figures and Community Impact*, FIRST NIAGARA 10 (Apr. 30, 2012), https://www.firstniagara.com/pdf/factsheet.

118. *Section 509(a)(3) Supporting Organizations*, IRS (Nov. 8, 2012), http://www.irs.gov/Charities-&-Non-Profits/Section-509(a)(3)-Supporting-Organizations.

bank, under the name Start Bank, filed for and received a Connecticut charter. A state charter permits a bank to operate within the state, but the bank still needed federal regulatory approval in order to qualify for FDIC insurance, and without FDIC insurance, there would be no bank.

As it happens, the Federal Reserve Board and the FDIC had many questions and a few objections to the relationship between the City of New Haven, FCFC, and Start Bank. Basically, the regulators kept returning to the same issue, which was their discomfort with the interrelation between the bank and a governmental entity. The regulators were concerned with the organizational form of a bank and bank holding company that were controlled by a § 509(a)(3) supporting organization, even though this precise form had been approved by the IRS. As this process dragged on for eighteen months, with the same questions being asked, answered, and re-asked, it was evident that the IRS, FRB, and FDIC were disconnected, with no sense that they might be working toward a common goal.

Whether or not form was the real issue, there is no question that the FDIC had put the brakes on approvals for de novo, or new, banks, as opposed to mergers and acquisitions. In the post-collapse regime, the corollary to "too big to fail" was "too small to open." The federal government was looking for big solutions and trying to avoid big failures. Finding small solutions for local problems was not on the radar.

In August 2009, the banking blog *Bankerstuff*, under the heading "FDIC Making It Harder for De Novo Banks," reported that the FDIC's release of *Financial Institutions Letter 50-2009* evidenced tightening regulations on de novo banks, based on a pattern among failed or troubled de novo banks of rapid growth, deviations from business plans, weak risk managements policies, involvement with third-party relationships without adequate oversight, and other factors.[119] While the blog referred to this as "a classic case of slamming the barn door after the horses are loose," *Bankerstuff* had a more ominous note for those still hoping to start a small bank:

> The fact that the FDIC is not granting many, if any, new FDIC insurance applications for a de novo institution, (notwithstanding the FDIC's denial of the existence of an informal new charter "moratorium") makes the new policy of more immediate interest to people other than those cock-eyed optimists who still hope to start a brand new community bank from scratch in these most difficult of times. . . . There's absolutely no doubt that starting a new bank has gone from very difficult to extremely difficult.[120]

One year later, *The New York Times* reported that federal regulators had approved Lakeside Bank and its CEO, Hartie Spence, as the first new federally

119. *FDIC Making It Even Harder for De Novo Banks,* BANKERSTUFF (Aug. 30, 2009), http://www.banklawyersblog.com/3_bank_lawyers/2009/08/fdic-making-it-even-harder-for-de-novo-banks.html.

120. *Id.*

approved bank in 2010, as opposed to 151 new banks approvals in 2006:

> The only new start-up bank to open in the United States this year operates out of a secondhand double-wide trailer, on a bare lot, in front of the cavernous Trinity Baptist Church [in Lake Charles, LA] . . . . Asked how his bank in this steaming town of oil refineries and oversized casinos managed to win over federal regulators, Mr. Spence, 70, said, "I'm still thinking it's my looks that did it."[121]

The new bank, named Lakeside Bank, had raised $13 million in capital. *The New York Times* reported that regulators were being "particularly stingy" in approving new banks. Ralph MacDonald III, a bank lawyer from Atlanta, Georgia, was quoted as stating that the FDIC had imposed an "unofficial moratorium" on new charters.[122] The FDIC denied the charge.[123] In pure numbers, the previous low for new charters in any single year was fifteen in 1942.[124]

In December 2010, just before Christmas, New Haven's Start Bank was awarded the second and final FDIC de novo approval of the year. Two days later, Reuters columnist Rob Cox wrote that, just as families are sitting down to watch *It's a Wonderful Life* starring Jimmy Stewart as George Bailey, the most-beloved small town banker in the history of the United States,

> [M]ost Americans probably don't realize he's the most endangered species in finance. Hundreds of community banks, a fixture of small-town America, have failed or sold out to bigger rivals in the past year. But many more of the country's 7,700-odd smaller banks will disappear in the next few years—a consequence, unintended or otherwise, of government and regulatory decisions codifying the biggest banks as infallible.[125]

Start Bank opened in the middle of Connecticut's winter of record snowfall. Prior to 2011, the record for January was forty-five inches in 1945.[126] The record was broken in January 2011 with over fifty-nine inches.[127] Streets were clogged, bus routes altered, and many cars remained in plowed-in parking spaces for weeks. Start Bank had virtually no walk-in traffic.[128] According to William Placke, Start's president and CEO, that was not the only problem:

> We were visited by the Federal Reserve, FDIC, and the State Department

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121. Andrew Martin, *In Hard Times, One New Bank (Double-Wide)*, N.Y. TIMES, Aug. 29, 2010, at A1.

122. *Id.*

123. *Id.*

124. *Id.*

125. Rob Cox, *Endangered Financial Species: U.S. Community Banks*, REUTERS (Dec. 22, 2010), http://blogs.reuters.com/breakingviews/2010/12/22/endangered-financial-species-u-s-community-banks.

126. LeAnne Gendreau, *Record Snowfall—4 Feet, 11 Inches*, NBC CONN. (Jan. 27, 2011, 7:02 PM), http://www.nbcconnecticut.com/weather/stories/Connecticut-Digs-Out-Again--114706889.html.

127. *Id.*

128. Telephone Interview by Jennifer Henry with William Placke, President and CEO, Start Bank (Feb. 9, 2012); e-mail from William Placke, President and CEO, Start Bank, to Robert Solomon, Clinical Professor of Law, Univ. of Cal., Irvine Sch. of Law (June 29, 2012) (on file with author).

> of Banking three months after we started. Two of the months had to do with us getting to work through blizzards. We had no business. They were looking at our compliance and discovered that not every "t" was crossed, not every "i" was dotted. . . . We had no mortgage loans at that time.
>
> Three months after we started, during which time it was very difficult to attract business because of the weather, we were visited by the Federal Reserve Bank, the FDIC and the State of Connecticut Department of Banking. While it is customary for regulators to do an early "look see" of a de novo bank from an operational standpoint, we had very few account relationships on which to make an assessment. Nevertheless, the regulators found fault with a number of processes which had very little relevance to the scope of our business base.
>
> The irony is that the small banks that exist are the heart and soul of the financial system, and we are painted with the same broad brush that should be used on the giant multinational banks that helped exacerbate the financial crisis in the first place. There are hundreds of regulators on site full time at Citicorp. They still don't seem to be able to identify looming issues in advance of their becoming real problems. Regulations and regulators should identify risks in advance. They are supposed to be preventative, but it never seems to turn out that way.
>
> Federal regulations appear to attack issues with a sledgehammer instead of a scalpel. Oftentimes, they apply the same broad brush to a small bank as they do to Bank of America. It turns out to be immensely time consuming for a small staff and leaves the impression of overkill. This is an issue not just for regulatory agencies but for Congress itself.[129]

Start Bank has innovative programs to reach out to the underserved community. It instituted a "Loot Camp" for participants in New Haven's "Youth@Work" program to provide direct deposit bank accounts and literacy training, with a lottery for an iPad for those who open accounts, and reached out to Connecticut's nonprofit world to establish a statewide pilot program on financial literacy and the importance of bank accounts.[130] These are important programs and should help to build the depositor base, but it remains to be seen whether Start Bank can become a catalyst for community development. No matter how strong its mission, its first priority must be to become profitable within the time limits set forth in its business plan or face action by its regulators. As a small bank, it faces the efficiency problem of all small banks. Since the transaction costs are identical or similar for each transaction, regardless of size, those banks with small loans face the additional impediment of higher transaction costs per loan. To reduce this burden, Start Bank will need to increase its capacity to make larger

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129. *Id.*

130. START BANK NEWSLETTER (Start Bank, New Haven, Conn.), Aug. 2012 (on file with author).

loans, even as it attempts to foster the small business, faith-based, and consumer loans necessary to build a community development presence. It is a daunting task and will take years before we can even begin to appraise Start's success.

V. THE FANTASY

As NHSB was about to disappear, the New Haven community romanticized its history into something it had never been. For most of its history, NHSB met the banking norm by lending to New Haven's white male homeowners and businesses. From 1960 to 1970, New Haven lost 25% of its population, with a large portion of the Italian-American population moving to the north and east and the Jewish population moving to the west, populating the rapidly expanding suburbs of greater New Haven.[131] As was common across the country, NHSB followed the customers. Minority lending had never been a large part of the portfolio, and by the time of the merger, NHSB originated only 17% of its loans within the City of New Haven.[132] In other words, it had been decades since NHSB was similar to Bailey Building & Loan Association from *It's a Wonderful Life,*[133] and New Haven was not quite Bedford Falls.

In the movie, George Bailey provided affordable mortgages and consumer loans to the working people of Bedford Falls, including the original Bert and Ernie. Bailey sacrificed his dreams and financial success to meet the needs of his family and community. Facing financial ruin and unfair criminal charges, George also faced spiritual crisis, until Clarence the Angel came to earth to show him how rich he was, with family and friends who loved him with a depth he could not have imagined without Clarence's help.

It's a Wonderful Life is, of course, a fantasy, since it requires a huge leap of our sense of reality. I am not referring to Clarence. I take no position on the existence of angels. I am referring instead to a banker who, at his wife's urging, uses their honeymoon money and life savings to stop a run on the bank, who stays in a community he desperately wants to leave in order to save his bank and to prevent an evil banker, Potter, from taking over the savings and loan, and who gives up the opportunity to sell his interest to Potter for a substantial profit, thus risking financial ruin. George Bailey may be America's favorite banker, but it is his wife Mary who understands that Bedford Falls will not be the same without George

131. *See* Anthony V. Riccio, THE ITALIAN AMERICAN EXPERIENCE IN NEW HAVEN 435 (2006).

132. *See* Patrick Woodall et al., *A Very Red Line: New Haven Savings Bank Fails to Serve Connecticut's Low- and Moderate-Income Families and Communities of Color*, CONN. CENTER FOR NEW ECON. (Sept. 2003), http://www.ctneweconomy.org/wp-content/uploads/nhsb.pdf.

133. *See* IT'S A WONDERFUL LIFE (Liberty Films 1946); *It's a Wonderful Life (1946)*, ROTTEN TOMATOES, http://www.rottentomatoes.com/m/1010792-its_a_wonderful_life (last visited Nov. 8, 2012) (noting that the film starred Jimmy Stewart and Donna Reed, was directed by Frank Capra, and is considered an American classic). The film debuted in 1946, and is widely viewed each Christmas season. With almost 200,000 user ratings, Rotten Tomatoes reports a "like" rate of 94%. *Id.*

and the bank, and she is not willing to give up either. Mary Bailey believes in community and the role of local institutions, and her spontaneous act in offering her honeymoon funds to save the bank is a remarkable act in support of that belief.

The FBI considered *It's a Wonderful Life* to be subversive. On May 26, 1947, in an internal memo, the FBI stated that the film

> represented rather obvious attempts to discredit bankers by casting Lionel Barrymore [Potter] as a "scrooge-type" so that he would be the most hated man in the picture. [Some sources say this] is a common trick used by Communists [. . . and] that the scene wouldn't have "suffered at all" [had Potter been portrayed] as a man who was protecting funds put in his care by private individuals and adhering to the rules governing the loan of that money rather than portraying the part as it was shown.[134]

The FBI did not mention George Bailey, but apparently his saintly portrayal did not justify the communist-inspired propaganda of portraying Potter as the Darth Vader of banking. It is, however, George Bailey who lives on.

Things worked out differently for the real George Baileys of the world. George would most likely have gone on his honeymoon, traveled with Mary, and never returned to Bedford Falls, other than on a nostalgic trip to show their children where their parents grew up. Potter would have purchased the Building & Loan for peanuts, but it may have failed anyway, and its depositors' savings and homes would be lost. Their loss, part of a nationwide banking disaster, led to our modern banking system. When the Eisenhower administration built the interstate highway system, the suburbs were opened up for housing development, and the newer, bigger, more ambitious banks discovered that rebuilding Bedford Falls was a better investment than the old, decaying city.

In the "bank run" scene in *It's a Wonderful Life*, when depositors demand their money, George tells them:

> You're thinking of this place all wrong. As if I had the money back in a safe. The money's not here. Your money's in Joe's house right next to yours. And in the Kennedy house, and Mrs. Macklin's house, and a hundred others. Why, you're lending the money to them to build, and then, they're going to pay it back to you as best they can. Now what are you going to do? Foreclose on them?[135]

Today, the answer would be, "I have no idea where your money is. You like to travel? Some of your money may be in a pension fund in Iceland." Today, both banks would be gone, sold, or merged several times. Bedford Falls and the City are serviced by the same banks, more or less. Nobody really knows their banker,

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134. Will Chen, *FBI Considered "It's a Wonderful Life" Communist Propaganda*, WISE BREAD (Dec. 24, 2006), http://www.wisebread.com/fbi-considered-its-a-wonderful-life-communist-propaganda.

135. *It's a Wonderful Life*, INTERNET MOVIE SCRIPT DATABASE, http://www.imsdb.com/scripts/It's-a-Wonderful-Life.html (last visited Nov. 8, 2012).

people bank online and, thanks to market forces, everybody has access to whatever banking services they need. So, why is it that 49.8% of low-income families are unbanked, without a checking or savings account, or underbanked?[136]

As banks got larger, marginal business fell to the side. George Bailey's desire to provide banking services to as many of his neighbors as possible was not unusual. It was the norm. Banks recruited small depositors, not for altruistic reasons, but because it was good business. Because banks depended on local customers, it was the only way to stay in business.

With deregulation, all of that changed. Banks pick and choose, they expand and contract, and they look for their niche in the market. When they talk about survival, they do not ask how to compete for new customers, but rather how to compete for profitable customers. This creates an anomaly—after deregulation, low-income borrowers have more access to credit, even as they remain unbanked and underbanked. For subprime lenders, low-income borrowers were quite profitable, but for retail banking they remained unprofitable and, as a result, expendable. Let them use check cashing services, borrow against their paychecks, and rent their appliances at exorbitant rates. In other words, let those who can least afford it pay the highest possible rates, both for banking and access to capital.

The repercussions are enormous. Not only do low-income people pay more, but they also lose access to capital. They do not save. They do not buy houses through regularized banking services. When they finally enter the market, it is through the world of mortgage brokers, teaser rates, and subprime lenders. They stay poor. For them, the market has failed, not because George Bailey is fictional, but because in too many communities the phrase "local banker" has become an oxymoron. Some of this may change with the cost savings and innovations of electronic banking, but the real question is whether communities can create and maintain institutions that see the marginal banking customer as an asset, not a liability.

VI. THE FANTASY IN THE REAL WORLD—THE SENECA FALLS EXPERIENCE

Seneca Falls, New York claims to be the model for Bedford Falls.[137] Seneca Falls is best known for the 1848 Seneca Falls Convention, organized by Lucretia Mott and Elizabeth Cady Stanton,[138] and by 1848, banking was well established there. Seneca County Bank was established in 1833, but Erastus Partridge opened the first bank within Seneca Falls itself, and Partridge quickly became the most

136. *See* FED. DEPOSIT INS. CORP., *supra* note 25, at 5.

137. Seneca Falls has its own The Real Bedford Falls website, which provides the history and events (every December). *See* REAL BEDFORD FALLS, http://therealbedfordfalls.com (last visited Nov. 8, 2012).

138. The Seneca Falls Convention, an early women's rights convention, was held in Seneca Falls from July 19–20, 1848. *See The Seneca Falls Convention*, LIBR. CONG. (July 27, 2010), http://www.loc.gov/exhibits/treasures/trr040.html.

prominent banker in Seneca Falls, not to mention the most prominent citizen.[139] As noted in *Brigham's Geneva, Seneca Falls and Waterloo Directory and Business Advertiser for 1862 and 1863*, on October 5, 1837, Partridge began advertising his mercantile business, and in 1848, "Mr. Partridge commenced private banking, and in 1854, he organized, with a capital of $50,000, the Bank of Seneca Falls, with Erastus Partridge as President and Leroy C. Partridge as Cashier."[140]

Partridge may have done some "banking and exchange" out of his store as early as 1837—the FDIC reports that the Bank of Seneca Falls, also known as the National Bank of Seneca Falls and Partridge Banking House, was originated on January 1, 1837, and operated continuously in that form until 1984.[141] *America's Successful Men of Affairs*, published by *The New York Tribune* in 1896, includes a profile of Erastus Partridge and reports that "[w]hile exact, firm and self-respecting, Mr. Partridge never oppressed a creditor and never wronged any man."[142]

When Partridge died in 1873, he was succeeded by his son, and two years later, by his son-in-law, Albert Cook, who served until his death in 1883, when he was succeeded by his widow, Partridge's daughter, who served until 1892.[143] The bank survived the "great financial revulsion of 1857" along with later financial crises, including the depression, obtaining FDIC insurance on January 1, 1934. As H. Chamberlain noted in 1906,

> The soundness of the Partridge bank was never questioned by our people. It stood above all doubt during every sharp experience through which it passed. The panic of '57 was severe, the money stringency so great, the values of everything so uncertain, that everywhere there was a feeling of distress and paralysis of business. The wave swept over us, curtailing our operations, but fortunately the faith of our people was safely anchored in our bank, whose ability was undoubted, and more, whose willingness was shown in aiding our people to weather the storm.

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139. 2 HENRY HALL, AMERICA'S SUCCESSFUL MEN OF AFFAIRS: AN ENCYCLOPEDIA OF CONTEMPORANEOUS BIOGRAPHY 611 (1896).

140. A.D. BRIGHAM, BRIGHAM'S GENEVA, SENECA FALLS AND WATERLOO DIRECTORY AND BUSINESS ADVERTISER FOR 1862 AND 1863: INCLUDING THE TOWNS OF PHELPS, FLINT CREEK, SENECA CASTLE AND STANLEY CORNERS, WITH HISTORIES OF THE TOWNS FROM THEIR EARLIEST SETTLEMENT (1862); HISTORY OF SENECA COUNTY, NEW YORK: WITH ILLUSTRATIONS DESCRIPTIVE OF ITS SCENERY, PALATIAL RESIDENCES, PUBLIC BUILDINGS, FINE BLOCKS, AND IMPORTANT MANUFACTORIES, FROM ORIGINAL SKETCHES BY ARTISTS OF THE HIGHEST ABILITY 19 (1876), *available at* http://tcpl.org/local-history/books-counties-cny-SenecaCo_1876.php.

141. *See The State Bank of Seneca Falls*, FDIC, http://www2.fdic.gov/idasp/confirmation_outside.asp?inCert1=11496 (last visited Nov. 8, 2012) (click "More Demographic Information").

142. HENRY HALL, *supra* note 139.

143. H. Chamberlain, *Banking Houses of Seneca Falls*, *in* PAPERS READ BEFORE THE SENECA FALLS HISTORICAL SOCIETY FOR THE YEAR 1906, at 43–47 (1906); HISTORY OF SENECA CO., *supra* note 140.

> The crisis passed with little suffering, comparatively, because, sustaining us, stood our bank, firm and with unimpaired credit.[144]

The bank underwent many changes: In 1984, it merged with Security Trust Company in Rochester, New York. In 1985, it changed its name to Security Norstar Bank. In 1987, it merged with Norstar Bank. In 1992, it merged into Fleet Bank of New York. In 1993, it acquired Jefferson Bank. In 1994, it acquired Fleet Bank of Melville, New York. In 1996, it acquired Shawmut Trust. In 1997, it merged into Fleet Bank of Providence. The bank acquired or merged with eleven smaller banks between 2000 and 2005, until it finally merged into Bank of America.[145] The Partridge family had long since left the building.

However, Seneca Falls had other models, including Seneca Falls Savings Bank (SFSB), which was established in 1870 as a New York chartered mutual savings bank.[146] While SFSB restructured by forming Seneca-Cayuga Bancorp, Inc., which holds all the bank stock but is itself publicly traded and has rebranded itself as Generations Bank, the bank's activities remain local.[147] The 2011 annual report values the bank's assets at $244 million.[148] The report also includes a statement from its President and CEO, Menzo D. Case, which offers an interesting combination of frustration with government and private industry, individualism and compassion, conservative economics and populism, all with a sense of community and a willingness to innovate. Mr. Case manages to be both cantankerous and inspirational at the same time:

> Regardless of political leanings, it's hard to deny that the present economic climate produces less than an optimistic view of the future . . . . The U.S. dollar is worth less and less as the Federal Reserve continues to pump liquidity into an already highly liquid worldwide economy . . . . Politics are funded by unlimited contributions from private concerns—with an emphasis on elevating individuals rather than ideals. Private industry is just as troubling. We see behemoths that control vast amounts of capital making decisions that ensure their continuance at the cost of competition, fair play and sound economic theory . . . . However, this prevailing attitude smacks in the face of that which made our country great—individualism, entrepreneurship and freedom.
>
> We haven't lost sight of our purpose. We serve our communities by providing access to loans that finance homes, cars and dreams—but only to those who show a commitment to financial integrity . . . . We support local organizations that reflect the values of our communities . . . . We believe that compassion is needed in this world . . . . We are

144. Chamberlain, *supra* note 143.

145. *The State Bank of Seneca Falls*, *supra* note 141 (click "Generate History").

146. *Here's the Thing About Us…*, GENERATIONS BANK, https://www.mygenbank.com/pages/about (last visited Nov. 8, 2012) (click "Corporate Profile").

147. *Id.*

148. SENECA-CAYUGA BANCORP, 2011 ANNUAL REPORT 18 (2011).

> partnering . . . to finance the renovation of a former convent to provide five additional units designated as transitional housing for homeless women. Unfortunately, many continue to carry with them the stereotypical view of the homeless—people who have no desire to succeed, living off the system, looking for the next handout. Nothing could be further from the truth! . . . I am, by nature, a staunch capitalist and humanitarian and believe that private entities should provide for the support of those who are unable to care for themselves. Our compassion compels us to take this action.[149]

Even before he became CEO, Mr. Case expressed strong views about the role of community banks. In an August 30, 2006 letter to the Office of Thrift Supervision, commenting on two proposed regulations concerning stock benefit plans, Mr. Case wrote that

> [t]he disappearance of community banks, with their roots in the communities served, has a terrible impact on the community. Community banks serve as a uniting force in their markets and often bank management plays a vital role in local economic efforts. When the community bank disappears, the community is stripped of that vital resource.
>
> The approval process for MHC stock benefit plans should not ignore the rights of depositors . . . . I understand that there would be additional costs involved for the Bank, but the recognition of the depositors' ownership rights under the mutual form should not be ignored.[150]

In late 2009, an article in *USA Today* on Seneca Falls compared Mr. Case to George Bailey. Joyce Sinicropi, a local florist, is quoted as saying, "We were proud that *our* banks did it by the rules." Case said that "[w]hen I make a loan I sit across the desk, look them in the eye and ask, 'if you're gonna borrow money from us, are you gonna pay it back?'" Case predicts,

> This will be a brutal recession, but we'll get through it . . . . Upstate New York has been economically depressed for the last 20 years, so there's no huge adjustment here. I don't live in a mansion on the lake. I drive a 2000 Honda. I don't need to downscale much further . . . . Helping the community is part of our charter.[151]

The question remains, as it has with so many other local banks, including NHSB, whether Mr. Case represents a structural commitment by Seneca-Cayuga Bancorp to remaining a small community-oriented bank and whether market forces will allow it to survive in the same community as Bank of America, as other

149. *Id.* at 9–15.

150. Letter from Menzo D. Case, President of Seneca Falls Savings Bank, to Chief Counsel's Office, Office of Thrift Supervision (Aug. 30, 2006), *available at* http://www.ots.treas.gov/_files/comments/b8896672-e32e-4cd1-a7f8-9f9b3c875aba.pdf.

151. Rick Hampson, *Seneca Falls, NY., Looks to 'Wonderful Life' Movie for Hope*, USA TODAY (Nov. 26, 2008), http://www.usatoday.com/news/nation/2008-11-25-seneca-falls_N.htm.

small banks continue to merge. The establishment of Seneca-Cayuga Bancorp as a bank holding company is an effort to institutionalize the community banking effort, but, as we have seen so many times in the recent past, community banking depends too often on the commitment and efforts of a few individuals.

When I was involved with selecting a CEO for a community bank, I was struck by the fact that each candidate seemed to fit into one of two pools. One pool consisted of younger bankers who had risen through the ranks of a community bank and were committed to the community banking enterprise but had never held a senior banking position. The second pool consisted of senior bankers who had run traditional banks and were enthused about using their skills to benefit the community. Strong leaders can come from either pool, but the conservative nature of banking, with the sense of regulators ready to intervene at the slightest financial problem, biased the process toward experienced bankers. Community banks are swimming against the tide, and their success may depend on an ability to cultivate new leadership from within.

VII. TRANSITIONS

If you have any doubt that we are in a transitional period in the U.S. banking world, just check your favorite news source, and you will find that there are signs of change on a daily basis. Consider just a few:

1. Small banks are opting out of the federal regulatory scheme. On April 2, 2012, *The New York Times* reported that thirty-five of the country's 600 savings and loan associations applied over the previous nine months to switch from national to state charters.[152] Dodd-Frank closed the Office of Thrift Supervision, the savings and loan association regulator, and many small banks are objecting to the more rigorous oversight of the Office of the Comptroller of the Currency. Some small banks are reforming as credit unions.[153]

2. Credit unions are expanding their activities to include commercial lending.[154] Between March 2009 and March 2011, credit union loans increased by 5% while commercial bank loans decreased by 3%.[155] While credit union loans are miniscule in proportion to the commercial bank numbers (credit unions represent about 8% of the loan pool),[156] the trend of credit unions being more robust in the lending arena is likely to increase as credit unions loosen their membership requirements and more people learn about credit unions as a viable alternative for limited banking services. Small businesses are starting to discover credit unions,

152. Jessica Silver-Greenberg, *Small Banks Shift Charters to Avoid U.S. as Regulator*, N.Y. TIMES, Apr. 2, 2012, at B1.

153. *Id.*

154. Adam Belz, *Credit Unions Growing Commercial Lending Practice*, USA TODAY (July 10, 2011), http://www.usatoday.com/money/industries/banking/2011-07-11-credit-unions-small-business_n.htm.

155. *Id.*

156. *Id.*

often after being denied credit by commercial banks.[157] In 2011, credit unions added 1.3 million new members, reaching a new record of 91.8 million members by the end of the year.[158]

3. Credit unions are lobbying to liberalize their lending rules by raising the regulatory cap on business lending from 12.25% of total assets to 27.5%.[159] Senate Bill 2231,[160] which would ease the lending rules, has been voted out of committee.[161] Not surprisingly, banks are lobbying in opposition. Stephen Wilson, Chair of the American Bankers Association, testified at a Senate hearing that the proposed legislation was "nothing less than legislation that would allow a credit union to look and act just like a bank, without the obligation to pay taxes or have bank-like regulatory requirements applied to them."[162] Banks usually win these fights, but the sands are shifting, and there is more pressure this year. Small business interests are lobbying in favor of the bill, seeing passage as a way of increasing access to capital.[163] The credit union bill has the support of many conservatives in Congress, breaking from their usual alliance with the bank lobby.[164] Openmarkets.org, the blog of the Competitive Enterprise Institute, reported that: "Center-Right Coalition Calls for Credit Union Deregulation to Lift Lending."[165]

4. The Presidents of the Federal Reserve Banks in Dallas and Kansas City, former FDIC Chair Sheila Bair, MIT Professor Simon Johnson, UCLA Professor Lynn Stout, former Merrill Lynch and TIAA-CREF President Herb Allison, the Center for Corporate Policy Director Charlie Cray, Jesse Eisinger from ProPublica, Gerald O'Driscoll in Cato@Liberty, and U.S. Senator Bernie Sanders (D-Vt.) probably could not agree on where to go to lunch, but they have all called for breaking up the megabanks.[166]

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157. *Id.*

158. Blake Ellis, *Credit Unions Hit a Record Number of Members*, CNN MONEY (Mar. 1, 2012), http://money.cnn.com/2012/02/29/pf/credit_unions_members/index.htm.

159. There is a great deal of press around S. 2231, 112th Cong. (2012). *See* Gary Haber, *Credit Unions Face Senate Vote on Commercial Lending*, BALTIMORE BUS. J. (Apr. 20, 2012), http://www.biz journals.com/baltimore/print-edition/2012/04/20/credit-unions-face-senate-vote-on.html.

160. S. 2231, 112th Cong. (2012).

161. *See Bill Summary & Status*, LIBR. CONGRESS, http://thomas.loc.gov/cgi-bin/bdquery/z?d112:SN02231:@@@D&summ2=m& (last visited Nov. 8, 2012).

162. Belz, *supra* note 154.

163. *See* John Berlau, *Center-Right Coalition Calls for Credit Union Deregulation to Lift Lending*, OPENMARKETS.ORG (May 3, 2012), http://www.openmarket.org/2012/05/03/center-right-coalition-calls-for-credit-union-deregulation-to-lift-lending (supporting the bill based on deregulation considerations); *Mayors Join Broad Coalition of MBL Support*, CREDIT UNION NAT'L ASS'N (July 24, 2012), http://www.cuna.org/newsnow/12/wash061812-3.html (reporting that the U.S. Conference of Mayors encouraged support of the legislation).

164. Berlau, *supra* note 163.

165. *Id.*

166. Sheila Bair, *Why It's Time to Break Up the 'Too Big to Fail' Banks*, FORTUNE, Feb. 6, 2012, at 56; Thomas M. Hoenig, *Too Big to Succeed*, N.Y. TIMES, Dec. 1, 2010, at A37; Simon Johnson et al., *Should Megabanks Be Broken Apart?*, N.Y. TIMES (Dec. 7, 2010), http://www.nytimes.com/roomfordebate/

5. On July 25, 2012, Sanford Weill, who lobbied for the repeal of the Glass-Steagall Act that separated commercial banks from investment banks, shocked the financial world by advocating for rebuilding the wall separating investment banking from retail banking.[167] Since Weill was the architect of Citicorp as a megabank and considered by many to be the father of big-banking, his comments were considered to be a major conversion.[168] *The New York Times* compared this to Nixon going to China and Obama supporting same-sex marriage.[169] The *Wall Street Journal* article started with, "In a few seconds, Sanford Weill disavowed the work of a lifetime."[170] In an editorial, the *Times* noted that it too had supported the repeal of Glass-Steagall, but that "[h]aving seen the results of this sweeping deregulation, we now think that we were wrong to have supported it."[171]

6. Occupy Wall Street has an Alternative Banking Group.[172] Some proposals start with disclaimers like, "[w]hile there are many who would suggest all Bankers should be lined up against a wall and shot in the face . . . I am not one of them,"[173] (which is an interesting way to assert one's credibility), but the movement as a whole is growing and is organized by serious people looking toward both reform and building new systems. Think *Revenge of the Quants*, with Carne Ross and Cathy O'Neil as Yoda and Obi-Wan, explaining how the Force is really about math skills and quantitative analysis. Carne Ross, a former British diplomat, founded the Alt Banking Group, which subsequently divided into structural change and reform subgroups.[174] The reform effort is facilitated by Cathy O'Neil, an MIT post-doctorial scholar in mathematics, who came to doubt the value of using her quantitative skills to outsmart the market and is applying her substantial skills to look at ways to reform the financial markets. Ross is working toward constructing a new system, including a national bank that would, in his words,

2010/12/07/should-megabanks-be-broken-apart; Gerald P. O'Driscoll, *Too Big to Fail*, CATO@LIBERTY (July 2, 2009, 11:57 AM), http://www.cato-at-liberty.org/too-big-to-fail; Christopher Whalen, *More Evidence TAG Helps Only the Big Banks*, AM. BANKER (June 19, 2012), http://www.americanbanker.com/bankthink/Transaction-Account-Guarantee-program-hurts-small-banks-1050230-1.html; BERNIE SANDERS, http://www.sanders.senate.gov/newsroom/news/?id=0e2d9300-75f4-4171-b6d8-82b56c8efce5 (last visited Nov. 8, 2012) (quoting Jim Puzzanghera, *Cutting 'Too Big To Fail' Down to Size*, L.A. TIMES, Nov. 24, 2009, at B1).

167. This was a widely reported event. *See, e.g.*, E.S. Browning & David Benoit, *Big-Bank Pioneer Now Seeks Breakup*, WALL ST. J., July 26, 2012, at A1, *available at* http://online.wsj.com/article/SB10000872396390444840104577549441815973130.html.

168. *See, e.g.*, Heidi N. Moore, *Father of Big Banking Sandy Weill Changes Tune*, MARKETPLACE (July 26, 2012), http://www.marketplace.org/topics/business/father-big-banking-sandy-weill-changes-tune.

169. Editorial, *The Big Banker's Change of Heart*, N.Y. TIMES, July 26, 2012, at A22.

170. Browning & Benoit, *supra* note 167.

171. *The Big Banker's Change of Heart*, *supra* note 169.

172. Josh Harkinson, *Meet the Financial Wizards Working with Occupy Wall Street*, MOTHER JONES (Dec. 13, 2011), http://www.motherjones.com/politics/2011/12/ows-alternative-banking.

173. Mosheh Thezion, *A Serious Plan to Fix Banking!!!!!!!.*, N.Y.C. GEN. ASSEMBLY, http://www.nycga.net/groups/alternative-banking/forum/topic/a-serious-plan-to-fix-banking (last visited Nov. 8, 2012).

174. Harkinson, *supra* note 172.

> be accessible to all equally, . . . be democratic . . . [and] . . . run by its customers, perhaps as a cooperative . . . [to] promote . . . environmental sustainability, social justice and transparency . . . [I]t should be competitive with the services offered by the mainstream "mega" banks.[175]

Ross notes that "credit unions embody many of these characteristics, but they have yet to go 'mainstream.' Perhaps we can make that happen."[176] Perhaps. Perhaps nothing will come of any of this and banking consolidation will continue, until regional banks absorb the local banks and the megabanks absorb the regional banks, and 2007 through 2012 is viewed as an odd blip in the history of banking.

It is always difficult to legislate in the banking arena, and the difficulty in the wake of the 2008 collapse proves the point. The market may be a more fruitful arena for change. Depositors have tended to be loyal to their banks, in part because of the inconvenience of changing accounts, but I suspect that we will see a greater willingness on the part of consumers to switch financial institutions. The larger question may be whether their options will increase or decrease. Without viable options, consumers will continue to bank at familiar institutions.

In a May 2012 article on bank losses and dramatic reductions in return on equity, *The Economist* asked "whether banks can attract investors with a combination of utility-like returns and bank-like volatility."[177] In June 2012, in a report that will surprise no one, Pew Charitable Reports updated its 2011 study, "Hidden Risks: The Case for Safe and Transparent Checking Accounts," and found that even with recent improvements, checking accounts are confusing and overdraft fees are too high.[178] In a response that is unlikely to generate much consumer support, Nessa Feddis, vice president and senior counsel at the American Bankers Association, stated that many banks were "going the extra mile" to explain the fees and disclosures to their customers, and that "we all want everything to be free."[179] At least for the moment, banks are subject to internal and external pressures. Something has to give.

VIII. SOME MODEST AND IMMODEST PROPOSALS

Sarah Lawsky, in an article titled *Money for Nothing: Charitable Deductions for Microfinance Lenders*, advocates for amending the Internal Revenue Code to permit

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175. Carne Ross, *Alternative Banking—Some Suggestions*, CARNE ROSS (Oct. 23, 2011), http://www.carneross.com/blog/2011/10/23/alternative-banking-some-suggestions?page=2.

176. *Id.*

177. *Investing in Banks: The Not-for-Profit Sector*, ECONOMIST, May 5, 2012, at 69.

178. *Still Risky: An Update on the Safety and Transparency of Checking Accounts*, PEW CHARITABLE TRUSTS (June 12, 2012), http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Safe_Checking_in_the_Electronic_Age/Pew_Safe_Checking_Still_Risky.pdf; *Hidden Risks: The Case for Safe and Transparent Checking Accounts*, PEW CHARITABLE TRUSTS (Apr. 2011), http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Safe_Checking_in_the_Electronic_Age/Pew_Report_HiddenRisks.pdf.

179. The comment was widely reported. *See, e.g.*, Jim Puzzanghera, *Banking Fees Still Too High, Study Says*, L.A. TIMES, June 9, 2012, at B1.

loans to microcredit websites, like Kiva, to be tax deductible.[180] Currently, the loans pay no interest, and the lenders lose the time-value of their money, even if they are ultimately repaid. Professor Lawsky argues that taxpayers who lend to a tax-exempt microfinance organization and receive no or below-market interest should have the option of claiming a tax deduction for the lost interest. Professor Lawsky suggests that the easiest way to accomplish this would be to allow the lender to take a charitable deduction in the amount of the loan for the year in which the loan is made, then claim it as income when and if it is repaid.[181]

Professor Lawsky's basic point could also apply to nonperforming investments in CDFIs. This would not be permitted under current law, and, as Professor Lawsky points out, her proposal is limited to loans to institutions that are already tax-exempt. While extending the "charitable contribution investment" idea to for-profit CDFIs would be a bigger leap, there are sound policy reasons for considering certain investments, even in a for-profit institution, to be charitable and taxed as such.

As an example, earlier in this paper I discussed the ShoreBank reorganization and the need to raise private capital. A private donor who believed in ShoreBank's mission might be willing to invest a substantial sum with the understanding that the investment would be nonperforming for several years, with the expectation, but not assurance, that the investor would have an exit strategy. In other words, the funds would be at risk, but the investor would know in advance that there would be no return. The difference from Kiva, as described by Professor Lawsky, is that the funds would be in the form of equity, not a loan, and the recipient would be a taxable entity. While it would require legislation to recognize this particular form of investment as a non-taxable transaction and effectively change the investment to a contribution for tax purposes, there is no intrinsic reason that this investment should not be as privileged as other tax expenditures or investment tax credits.

Under current law, CDFIs are eligible to receive federal grants.[182] Those grants are considered income and are taxable. As Cantwell F. Muckenfuss III—a former deputy comptroller of the currency, a prominent banking lawyer, and a major force behind two community development banks—CityFirst in Washington, D.C. and Start Bank in New Haven—points out, this makes no sense. Grants, like contributions, should not be considered taxable income.[183] Muckenfuss goes on to pose a broader question:

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180. Sarah B. Lawsky, *Money for Nothing: Charitable Deductions for Microfinance Lenders*, 61 SMU L. REV. 1525, 1542 (2008).

181. *Id.* at 1546.

182. For details of CDFI funding, see CMTY. DEV. FIN. INST. FUND, http://www.cdfifund.gov (last visited Nov. 8, 2012).

183. Interview with Cantwell F. Muckenfuss III, former deputy Comptroller of the Currency (Feb. 6, 2012) (on file with author).

> Why would you be a community development bank? You think the financial system may not be serving individuals or enterprises in those areas. Why not? Because of discrimination, because of market failure. Loans are harder to make. They are riskier. Regulators don't like risk. Regulators don't understand what community development banks do.
>
> If you are lending to a harder population, you have to work harder. There's more overhead. From a safety and soundness/supervision point of view, you have to understand that the ratios and risk analysis are different. Republicans say there is overregulation, banks say they are overregulated. If a big bank thinks they are overregulated to begin with, a community development bank might think they ought not to be subject to it either. Are there government regulations that the government doesn't need to do, that are over-burdensome? They need to make allowance for the fact that because of a community development bank's mission/charter, they should recognize they are dealing with more risk.[184]

On the political stump, everyone supports small business, but this rarely translates to legislation. However, at this particular historical moment, the stars may be aligned so as to permit legislation that favors small banks as a way to support local businesses by making credit more accessible. Tim Kaine, former Virginia governor and current Democratic U.S. Senate candidate, has made community bank deregulation a campaign issue. At a campaign stop in Hopewell, Virginia, with a population of twenty-five thousand, Kaine said, "You have to get regulatory balances right . . . . Access to capital is important for economical growth."[185] Kaine said that community banks were not part of the financial collapse, but that federal regulations made it harder for them to lend to small businesses, and he stated, "[W]e need to ease up a little bit on community home town bank strategy to enable them to be a little more aggressive in loans that they make."[186] The Republicans did not challenge Kaine's conclusion, but countered that he was not really pro-business, small or otherwise.[187]

Of course, in politics and legislation, not everything is what it seems. In April, the House of Representatives passed the Small Business Credit Availability Act (SBCAA),[188] which would ease some of Dodd-Frank's restrictions on new swaps for community lenders and small businesses.[189] William Grant, testifying

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184. *Id.*

185. Markus Schmidt, *Kaine Wants to Ease Regulations on Community Banks*, PROGRESS-INDEX (May 15, 2012), http://progress-index.com/news/kaine-wants-to-ease-regulations-on-community-banks-1.1315313; *see also* Caitlin Davis, *Candidate Discusses Economy, Downtown*, HOPEWELL NEWS & PATRIOT (May 16, 2012), http://www.hopewellnews.com/article_4503.shtml#.UBYyOWGe7Gk.

186. Schmidt, *supra* note 185.

187. *Id.*

188. H.R. 3336, 112th Cong. (2012).

189. *See HR 3336 Small Business Credit Availability Act (112th)*, DODD FRANK UPDATE (Apr. 26, 2012), http://www.doddfrankupdate.com/DFU/DFULibrary/HR-3336-Small-Business-Credit-Availability-Act-112-1499.aspx.

before the House Financial Services Committee, on behalf of the American Bankers Association's Community Bankers Council, stated that the regulatory environment was stifling community banks, drawing attention to Dodd-Frank provisions that limited community banks' ability to make affordable loans to consumers and small businesses.[190]

Grant predicted "an appalling contraction of the banking industry, at a pace much faster than we've witnessed over the last decade."[191] He noted that moneys that should be used for small business products are instead used to pay for attorneys, compliance officers, and regulatory professionals, and that

> [b]anks appreciate the importance of regulation that protects the safety and soundness of the bank and protects the interests of our customers. We know that there will always be regulations that control our business—but the reaction to the financial crisis has layered on regulation after regulation that does nothing to improve safety or soundness and only raises the cost of providing credit to our customers.[192]

Not everyone agreed. William Cohan, writing on *Bloomberg View*, wrote that the SBCAA was an example of how "Wall Street's well-paid army of lawyers and lobbyists continues to make a mockery of the whole re-regulation process" and that SBCAA, "[u]nder the guise of helping community lenders," will allow "more and more swaps to be written with less and less oversight."[193]

The disagreement was played out in *American Banker*. Jim Wells, who had worked for Citibank and Hongkong Bank USA, started with the comment that

> [a]s a former banker, I watched in amazement and disgust as the country's largest banks morphed from trusted fiduciaries of consumer financial assets to unrepentant predators of consumer financial assets in just a few decades . . . [and] as federal regulatory agencies morphed from policing the condition and conduct of the nation's financial institutions to defending abusive bank practices from state consumer protection laws.[194]

Wells considered Grant's testimony to be part of a tactic by the American Bankers Association, "the traditional trade group of the largest banks," to reframe arguments in terms of the effect of reforms on small banks. Wells' basic position, however, was that community banks need to separate themselves from larger

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190. *Rising Regulatory Compliance Costs and Their Impact on the Health of Small Financial Institutions: Hearing Before the Subcomm. on Fin. Inst. & Consumer Credit of the Comm. on Fin. Serv.*, 112th Cong. (May 9, 2012) (statement of William B. Grant, Chairman and CEO of First United Bank and Trust), *available at* http://financialservices.house.gov/UploadedFiles/HHRG-112-BA15-WState-WGrant-20120509.pdf.

191. *Id.* at 3.

192. *Id.*

193. William Cohan, *Does Congress Want Another Economic Meltdown?*, BLOOMBERG (June 10, 2012), http://www.bloomberg.com/news/2012-06-10/does-congress-want-another-economic-meltdown-.html.

194. Jim Wells, *Are Small Banks Big Banks' Pawns in Assault on Dodd-Frank?*, AM. BANKER (May 11, 2012), http://www.americanbanker.com/bankthink/small-banks-are-big-banks-pawns-in-assault-on-dodd-frank-1049260-1.html.

banking institutions and "denounce the unfair, deceptive, abusive acts and practices of larger banks . . . and seek to have reforms more specifically applied to the big banks that employed these practices, rather than small banks that did not." If community banks fail to do so, Wells stated, "they risk appearing to be agents—or dupes—of the bigger banks."[195]

Cam Fine, the president and CEO of the Independent Community Bankers of America (ICBA) ("the nation's voice for more than 7,000 community banks of all sizes and charter types," according to the ICBA website),[196] agreed in a comment to Wells' article, stating that "I continue to be appalled at the tactics that these same large banks and their trade groups are using to manipulate the views of unsuspecting community bankers."[197] Fine agreed that community banks needed to separate themselves from big banks and added that the only way for community banks "to avoid further regulatory burden and to achieve tiered regulation is by differentiating their business model from that of Wall Street."[198] The House passed the SBCAA by a vote of 312 to 111.[199] Most of those in opposition were liberal Democrats.[200]

Ultimately, if we truly believe in community banking as more than something to talk about at campaign events, we need to think on a larger scale. Expanding the role of credit unions, encouraging investment in community banks, and selectively exempting small banks from reregulation are all good ideas, but they are all about the margins when we need fundamental change. Our cookie-cutter model forces small community banks to fit into the big bank framework. Unless we break up the megabanks (an unlikely scenario), our regulatory response to "too big . . ." is likely to make banking more uniform, not less. Adjusting the margins may help existing institutions survive, but it will do little in the way of structural change.

In an October 3, 2001, memorandum to prospective community development bank organizing groups, the comptroller of the currency outlined the criteria used by the OCC in granting a community development bank (CDB) charter.[201] OCC defined a CDB as "a depository institution with a stated mission primarily to benefit the underserved communities in which it is chartered to

195. *Id.*

196. *About ICBA*, INDEP. CMTY. BANKERS AM., http://www.icba.org/aboutICBA/index.cfm?itemnumber=527&pf=1 (last visited Nov. 8, 2012).

197. Wells, *supra* note 194.

198. *Id.*

199. 158 CONG. REC. H2107 (daily ed. Apr. 25, 2012).

200. *Id.* For the full vote, see *H.R. 3336: Small Business Credit Availability Act (On Motion to Suspend the Rules and Pass, as Amended)*, GOVTRACK, http://www.govtrack.us/congress/votes/112-2012/h180 (last visited Nov. 8, 2012).

201. Memorandum from Julie L. Williams, First Senior Deputy Comptroller & Chief Counsel, Comptroller of the Currency, to Prospective Cmty. Dev. Bank Org. Grps. (Oct. 3, 2001), *available at* http://www.occ.gov/topics/community-affairs/resource-directories/native-american/tribalp.pdf (Appendix D).

conduct business."[202] "A CD bank pursues this specialized mission," the memorandum continues, "by providing financial services to low- and moderate-income (LMI) individuals or communities or benefiting other areas targeted for redevelopment by local, state, tribal, or federal government."[203] As everyone acknowledges, in a CDB the risk is greater and the profit margin is smaller. Underwriting and servicing loans are more time-consuming. The opportunity for officers and directors to get rich is nonexistent. People in the field regard operating a CDB as more charitable than profit-making. So, with all of that in mind, why are these activities taxable?

Credit unions were authorized by federal legislation in 1934 and granted a federal tax exemption in 1937, largely on the assumption that they would better serve the unbanked of the depression years.[204] It is time to extend that tax exemption to those full-service banks most likely to fulfill the original mission of expanding banking services to those otherwise underserved. Existing banks will complain about the unfair hardship of competing with a tax-exempt entity, but the complaint is based on the false premise of competition in areas barely touched by large banks. If a bank is willing to restrict its activities by size, geography, and mission, it is not competing with larger, profit-oriented banks. If it succeeds in luring mission-oriented consumers, as ShoreBank did, so much the better. We are not talking about competition, but a parallel banking universe. In the end, large banks will find that small, mission-oriented banks are complementary and worth supporting, much as megabanks supported ShoreBank and others.

CONCLUSION

I do not think it is enough to differentiate the community banking business model. We need legislation that will allow for fundamental change in the form of a different model based on a different charter, in which community development banking is privileged, much as we privilege other charitable activities. We should combine the best of credit unions, community development banks, and community loan funds, with a plan of deregulation, tax credits, and direct subsidies. We should use every tool we have to ensure that community banking services are sustained, so that banks can help sustain their communities.

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202. *Id.* at 57.

203. *Id.*

204. For a discussion of credit unions and tax policy, see JAMES M. BICKLEY, CONG. RESEARCH SERV., SHOULD CREDIT UNIONS BE TAXED? (2005), *available at* http://www.policyarchive.org/handle/10207/bitstreams/411.pdf.