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Responsible Banking Ordinances for the UK: Making banking competition a 'race to the top'

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There has been much debate since the financial crisis and during the financial recovery about the role that mainstream banks have as an investor in small and medium sized enterprises and to individuals. This argument surfaced again in 2013 when the Government announced that the UK's biggest lenders would be publishing annual reports on how much they lent at a local level, for housing, loans, and for businesses. Here, referring to the development of Responsible Banking Ordinances (RBOs) in US cities, I provide an analysis of what the UK can learn from the US on the topic of responsible banking oversight.

There has been in recent times a recognition that mainstream banks could do more to support people and businesses in the local communities that they operate. 'Project Merlin', established by the four major UK banks – HSBC, Barclays, Royal Bank of Scotland and Lloyds Banking Group – produced the blueprint for a series of reforms which would improve stability and competition between banks. However, in the year following the agreement, bank lending fell for Britain's top banks in every quarter[1].

Additionally, from 2007 in the years after the financial recession, there was a sharp rise in demand for payday loans, predominantly by communities who were either unserved or

[1] http://www.independent.co.uk/news/business/news/bank-lending-falls-despite-project-merlin-agreement-6849656.html

underserved by mainstream financial institutions. What then resulted was the people with the fewest means, were forced to pay the most for their credit in the form of short term high cost credit from firms such as Wonga and The Money Shop.

As funding for businesses dropped and greater numbers of people become in hock to high cost credit, some groups and individuals[2] in the UK called on the Government to establish an equivalent of the Community Reinvestment Act (CRA)[3]. Introduced in 1977, the CRA was established upon the realisation that many banks had been indirectly discriminatory towards certain communities populated with low-income and/or large numbers of ethnic minorities by underserving them – a practice known as redlining.

Under the CRA banks were encouraged to help meet the needs of borrowers in all parts of their communities, and still are, including among low-income households and areas of depravation, while failure to do so from 2002 could result in the Office of the Comptroller of the Currency (OCC) doing one or both of the following: a) ordering that a bank's interstate branches be closed down, b) not permitting the bank to open a new branch in that state unless it was proven and demonstrated to the OCC that it will meet the needs of all in that community[4] (though enforcement of these rules have come under scrutiny[5]).

In its early years the CRA did suffer a number of teething problems. Community groups that provided oversight for the enforcement of the CRA found that regulators were not rigorous

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[2] See for example from the Community Development Finance Association (available here: http://newstartmag.co.uk/features/improving-access-to-credit-learning-from-the-us-community-reinvestment-act/); ResPublica (available here: http://www.localgov.co.uk/Think-tank-calls-community-reinvestment-act/35532); and Ed Mayo (available here: https://edmayo.wordpress.com/2009/07/27/a-community-reinvestment-act-for-the-uk/).

[3] See for more information on the Community Reinvestment Act http://www.federalreserve.gov/communitydev/cra_about.htm and Appleyard, L. (2012), 'Why the UK needs a Community Reinvestment Act (CRA)'. CHASM Briefing Paper. Available at http://www.birmingham.ac.uk/Documents/college-social-sciences/social-policy/CHASM/briefing-papers/2012/briefing-paper-cra-march2012.pdf

[4] OCC, Community Reinvestment Act and Interstate Deposit Production Regulations. Available at: http://www.occ.gov/topics/compliance-bsa/cra/12cfr25.html#2565

[5] Fishbein, A.J. (1992), 'The Community Reinvestment Act After Fifteen Years: It Works, But Strengthened Federal Enforcement is Needed', 20 Fordham Urb. L.J. 293. Available at: http://ir.lawnet.fordham.edu/ulj/vol20/iss2/4

enough in supervising reforms and that subsequently the new requirements for banks were not effective[6].

By 1989, Congress had moved to amend the act requiring regulators to make their CRA evaluations more transparent. This was to have very positive results. From 1990-1992, only 939 banks (9.8 per cent) were deemed in need of improvement and 87 (0.9 per cent) substantially non-compliant out of 9,520 banks covered by the CRA[7].

Allen J. Fishbein, then of the Center for Community Change, who in 1992 carried out a fifteen-year evaluation of the CRA, summarised his findings with the following:

> *"Despite the perception by many bankers that lending in low and moderate income areas is too risky and unprofitable, the experience over the last fifteen years has debunked these myths. Numerous examples of successful community reinvestment partnerships that have come into being since the CRA's enactment demonstrate that lending to the residents of older urban neighborhoods is both prudent and profitable for banking institutions."*[8]

To this end in the UK, many groups saw the Government's move to publish local lending data in 10,000 postcode areas a significant victory and a major step towards an equivalent CRA in the UK. The UK Treasury announced in 2013 that it would be publishing the local lending data in agreement and partnership with the British Bankers Association (BBA) and the Council for Mortgage Lenders (CML).

In the Henry et al (2014) research from Coventry University and Newcastle University on local lending patterns, they found that total personal lending tends to decline as the area's deprivation level increases (once adjusted for population size), while median personal lending per head of the adult population across Postcode Sectors in Great Britain in 2013

[6] ibid
[7] ibid
[8] ibid

was £602, with lending per adult in the lowest 10 per cent of Postcode Sectors at around two-thirds of this figure or less[9].

While the move has been groundbreaking in placing in the public domain details of more than £1tn of lending across the UK for mortgage lending, SME funding, and unsecured personal loans, there are still a number of issues with it that need addressing[10].

One major problem highlighted is that the data release as it currently stands is voluntary. The participating lenders for the first year, which include Barclays, Lloyds Banking Group, HSBC, RBS, Santander UK, Clydesdale & Yorkshire Bank and Nationwide Building Society, made up only 60 per cent of unsecured personal loans, and 30 per cent of the total national unsecured credit market[11] – which demonstrates the need for more financial institutions to be brought in as participants of data disclosure.

Part of the plan to release this data was to bring more competition into the banking and finance sector, by allowing small firms like Credit Unions and Community Development Financial Institutions to work out which communities are under-served by mainstream finance. As it is, with the lending data being so partial it has not completely solved the problems that those smaller organisations face.

Here I suggest the UK adopts what in the US is called Responsible Banking Ordinances (RBO). Following on from the CRA, the RBO is a specific evaluation guideline which banks must complete in order to make their investment in a local community more transparent in the cities where this has been adopted, including Boston, San Diego, Los Angeles, Dayton, New York, Philadelphia, Pittsburgh and Cleveland.

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[9] Henry et al (2014), 'Tackling Financial Exclusion: Data Disclosure and Area-Based Lending Data', Coventry University. Available at: http://www.coventry.ac.uk/Global/08%20New%20Research%20Section/Researchers/CCSJ/FINAL_Full%20Report.pdf

[10] As the Coventry research on local lending data points out, *"current limitations substantially constrain analysis of area-based lending patterns."* (p.6 of Henry et al. Available at: http://www.coventry.ac.uk/Global/08%20New%20Research%20Section/Researchers/CCSJ/FINAL_Executive%20Summary.pdf).

[11] See the tab entitled 'Notes' on the BBA's figures on personal loans from 2014. Available at: http://bit.ly/1HtQDv9

The information that needs to be disclosed in full, from all banking firms operating in a given City, is the following:

- Residential lending information;
- Small business lending information;
- Community development loans and investments;
- Branches and deposits information;
- Consumer loan data;
- An affidavit by an authorised officer;
- A CRA evaluation;
- Copy of branch closing policy;
- Information regarding number of minorities, females and city residents employed by the depository as loan officers/senior staff etc; and
- Any additional information requested at a local level.

The National Community Reinvestment Coalition, an association of over 600 organisations and a key organisation to the creation of RBOs, have made clear the justification for adding an additional set of disclosures for financial institutions at a City-level, by adding the following in a 2012 report:

> *"…in return for the privilege of safeguarding and investing the community's wealth and doing business with the City, the financial institutions have a continuing and affirmative obligation to serve the credit and other financial needs of all communities, including and especially minority and low- and moderate-income communities and older adults, consistent with safety and soundness. The City shall assess financial institutions' performance in meeting community needs and use this assessment as a factor in its decision to place municipal deposits in financial institutions and conduct other business with financial institutions."*[12]

[12] National Community Reinvestment Coalition, (2012), 'How Cities Can Pursue Responsible Banking: Model Local Responsible Banking Ordinance Creates Community Reinvestment Requirements for Financial Institutions'. Available at http://www.ncrc.org/images/stories/pdf/research/ncrc%20model%20city%20ordinance%20update_0712%20final.pdf

There will be some from within the banking industry who may feel that an RBO for the UK, as an addition to the move for more transparency on local lending data, will produce more burden for banking professionals. Also, that banking is a business not a utility, and that in a free market banks deserve to operate as they see fit. Against this, however, is a social welfare view that says where a mainstream bank fails to adequately serve in a particular community, society is left to pick up the costs.

In any case, where an RBO has been tried and tested before it has sought to encourage banks and other financial institutions to compete on a positive basis with each other, through strong and intelligent enforcement from regulatory agencies and a panel of interested citizens. With an ordinance of investment commitments by financial institutions, which in turn would assist the community-based financial sector work out where unserved communities are and how they can help them, we move closer to a system that differentiates banks from one another on how accomplished they are on improving financial inclusion and community business development: banking as a ‘race to the top’.

The views expressed in this briefing are the views of the author and do not necessarily represent the views of CHASM as an organisation or other CHASM members.