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Unintended Consequences: New Regulations Threaten Community Banks

In the wake of the financial crisis, regulators have enacted rules to rein in the big banks that are threatening to crush the more responsible smaller banks who contributed little to the crisis in the first place.

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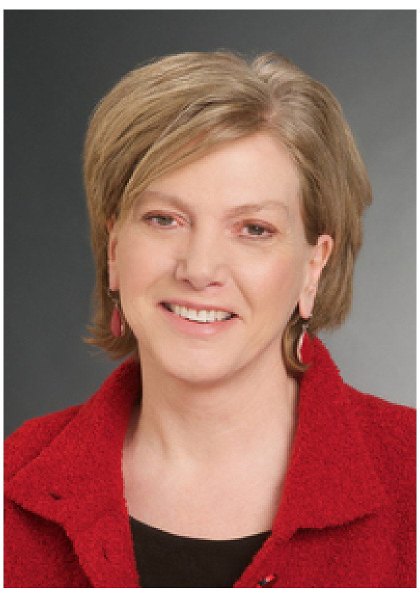
Posted: Sep 11, 2012 – 09:00 AM EST
Series: The Generative Economy: Owning Our Future
Tags: community development, community banks, wall street, economy, jobs, social enterprise, law, sustainability



By Marjorie Kelly

Did you ever have older siblings who acted out big time, and you ended up getting punished alongside them, for things you never did?

That's what's happening today to the nation's community banks.

Even as the big banks' antics pushed the nation toward financial collapse, smaller banks rooted in community – like cooperative banks, credit unions, community banks, and state-owned banks – generally remained responsible lenders. I discussed that phenomenon in a recent CSRwire blog post. Today, I share the discouraging postscript: in the wake of the crisis, regulators enacted rules to rein in the big banks that are threatening to crush the more responsible little guys who contributed little to the crisis in the first place.

Few Foreclosures At Community Banks

Consider, for example, Beverly Cooperative Bank in Salem, Mass., where I do my own banking.

This small bank has $300 million in assets and four locations, all of which I could reach in a single afternoon on my bike. It's rooted in a single community. It's also a mutual bank, a cooperative bank. That means its purpose is to serve its community, not to enrich absentee shareholders. That purpose is built into its charter, its operating license from the state.

For 120 years, Beverly Cooperative Bank has been chartered as a mutual bank. Cooperative banks are classic hometown banks, the most famous being Jimmy Stewart's fictional Bailey Building and Loan in the movie *It's a Wonderful Life.* These banks have no outside investors and are run in the interest of their depositors. Historically managed in conservative ways, they stayed on a relatively even keel through the Great Depression and the go-go years of reckless mortgage lending.

Beverly Cooperative Bank

Few of Beverly Cooperative's mortgages have gone bad: less than five in the last three years, out of 800 loans.

> *"If you look at other community banks, you'll see similar stuff," bank president Bill Howard said. "They understand the community and have good underwriting standards."*

When some of his borrowers lost their jobs, the bank worked with them.

> *"We may go interest-only on their mortgage for a period of time," he said. If borrowers need to talk, they can find him with relative ease. "Good luck finding anyone at Bank of America or Citibank," he added.*

Burdened by Costs They Didn't Cause, More than 2,000 Community Banks Could Close

In its community orientation, Beverly Cooperative is similar to other small, locally owned community banks. There are 7,600 community banks today. But within five or ten years, Howard predicts only 5,000 will remain. The reason: community banks are under siege because of regulations triggered by the misdeeds of the big banks.

> *"We're audited to death," Howard said. "We have an internal auditor. We have an external auditor. We have a commercial lending auditor. We have an IT [information technology] auditor. The state and the FDIC audit us. It's rare we don't have an auditor in here, and it increases every year. How can small banks do all this and survive?"*

At one time Beverly Cooperative paid $26,000 a year to the Federal Deposit Insurance Corporation [FDIC]. But after the fund was depleted by rescues of irresponsible banks, Beverly Cooperative had to pony up $1.15 million in a single year. That's a big check.

FDIC Fund Balance

Going forward, Beverly Cooperative will pay around $200,000 a year. Facing these and other new requirements, many community banks won't survive. They'll go under, Howard said, or sell out to bigger banks. The big banks will end up stronger than ever.

Community Banks Part of the Solution, Not The Problem

The story could have ended differently, if our society recognized not all banks are alike.

The difference is about more than size. It's also about *design – ownership design.* Because of their ownership design, community banks like Beverly Cooperative have a built-in tendency to be responsible and community oriented. They're part of a larger family of enterprises designed to serve human communities.

Citi cartoon

In my book *Owning Our Future: The Emerging Ownership Revolution*, I call this a family of *generative ownership design.* The purpose is to generate the conditions for life, to help people buy homes, run businesses. That's in contrast to Wall Street-owned companies, which have an *extractive ownership design.* Their purpose is to extract maximum amounts of financial wealth for the few.

Had lawmakers recognized the importance of ownership design, they might have treated community banks as part of the solution. They could have used bailout money not to prop up failing megabanks, but to shift mortgage assets to community banks. They could have written regulations giving locally rooted lenders a leg up in issuing mortgages to the communities they understand so well.

Move Your Money

If regulators didn't support community banks, citizens have begun to, with initiatives like ***Move Your Money***, which encourages people to shift deposits to local banks. On Wall Street and in Washington people may not see it, but on Main Street there are stirrings of an ownership revolution, sowing the seeds for a new kind of economy, a generative economy – one that's focused not on extracting from communities, but on serving them.

Previously:

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