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Minority-Owned Depository Institutions

A Market Overview

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Small businesses are the backbone of broad-based economic development, and adequate funding for these enterprises is key to ensuring their ability to create jobs. At the same time, the United States has seen a significant (and growing) underrepresentation of minority-owned small businesses. The Milken Institute has been at the forefront of investigating the root causes of this discrepancy and the related negative effects on job creation and wealth generation within minority communities.

EXECUTIVE SUMMARY

Building on initial conversations carried out at the White House in 2016, the Milken Institute and the US Small Business Administration formed an initiative to develop actionable solutions to the challenges limiting minority-owned small businesses' access to capital. The Partnership for Lending in Underserved Markets (PLUM), a two-year pilot program, was launched to this effect in September 2016 and has since completed its research.[1] Building on the initial findings of PLUM, the Milken Institute has committed to exploring market-based solutions that specifically address the identified shortcomings in this space. This paper deals with the potential opportunities afforded by minority-owned depository institutions (MDIs), in particular to fuel small business lending in low- to moderate-income communities.

The primary source of startup and acquisition funding for all small businesses is savings and equity investments from personal networks and, secondarily, bank loans. However, for minority-owned businesses, the second most prevalent source of funding is credit cards, which are typically higher-cost products designed to fund short-term liquidity, not catalyze long-term growth. This places minority-owned businesses at a disadvantage and potentially stymies job creation. Increasing access to traditional bank lending is an important component of improving the potential for both growth of minority-owned small businesses and associated employment gains in the communities in which they operate.

Unfortunately, there is some evidence that minority-owned small businesses may have restricted financing choices. According to the findings of an article published in the Journal of Consumer Research,[2] minority business owners are presented with more loan requirements and offered less help to fulfill them during their pre-application (loan inquiry) interactions with banks. These challenges could make them less likely to continue their financing application due to a negative perception of the process and its outcome. Approximately 70 percent of minority neighborhoods do not have a bank branch.[3] Given the challenges faced by small businesses,[1] especially minority-owned small businesses, it is imperative to assess which type of banks are best placed to provide access to capital for minority communities.

1 In 2018, the Milken Institute released final summaries of its Partnership for Lending in Underserved Markets, the joint Milken Institute-US Small Business Administration initiative. The May 2018 paper details the operational activities in two target markets. The November 2018 paper details challenges of minority-owned small businesses in relation to capital access.

2 Bone, S., Christensen, G., and Williams, J., 2014, "Rejected, Shackled, and Alone: The Impact of Systemic Restricted Choice on Minority Consumers' Construction of Self," *Journal of Consumer Research*, 41: 451-474.

3 "Minority neighborhoods" refer to census tracts where more than 50 percent of the population is non-white as designated in Office of Management and Budget Census Delineation files that identify the name of the state, county, and core-based statistical area for each tract coupled with Federal Financial Institutions Examination Council Census files. Tracts with no demographic data and MSA/MD=99999 were excluded. Branch data come from the June 2019 Summary of Deposit file.

One particular category of banks worth examining is MDIs. The Federal Deposit Insurance Corporation (FDIC) designates MDIs according to criteria that determine minority ownership of the depository institution.[4] The minority ownership designation primarily refers to Asian, Black, Hispanic, and Native American populations.[5] According to Home Mortgage Disclosure Act (HMDA) data,[6] MDIs are far more likely to have both branches in minority neighborhoods and a significant portion of their lending activity targeting minorities. Furthermore, according to our analysis, MDI branches are located in census tracts with an average 77 percent minority population, compared to the 31 percent for all FDIC-insured depository institutions. Potentially, this puts the MDIs in the right location to be valuable partners for minority-owned small businesses and to create an economic multiplier effect for communities of color. Recent research commissioned by the Federal Reserve supports indications that MDIs are more likely than non-MDIs to focus on lending within communities of diverse ethnic backgrounds,[7] and particularly to co-ethnics[8] (i.e. individuals with ethnic backgrounds that includes more than one minority group).

Unfortunately, MDIs themselves have experienced a period of significant decline. Since 2009, nationally, the number of MDIs has dropped from 215 to 155 at the end of the second quarter of 2018. In addition, MDIs are far smaller than the average non-MDI bank. Compared to commercial banking institutions on average, they are very small; the largest institution has only $38 billion in total assets. Black and Hispanic MDIs have average assets of $245 million and $2.7 billion, respectively, compared to an average of $3.1 billion for all US banks.[9]

4 Section 308 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) defines the term "minority depository institution" as any depository institution where 51 percent or more of the stock is owned by one or more "socially and economically disadvantaged individuals." Given the ambiguous nature of the phrase "socially and economically disadvantaged individuals," the FDIC's Policy Statement defines "minority depository institution" as any federally insured depository institution where 51 percent or more of the voting stock is owned by minority individuals. "Minority" as defined by Section 308 of FIRREA means any "Black American, Asian American, Hispanic American, or Native American." The voting stock must be held by US citizens or permanent legal US residents to be counted in determining minority ownership. In addition to institutions that meet the ownership test, institutions will be considered minority depository institutions if a majority of the Board of Directors is minority and the community that the institution serves is predominantly minority.

5 "Minority" as defined by Section 308 of The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 means any "Black American, Asian American, Hispanic American, or Native American," (https://www.federalreserve.gov/publications/2013-preserving-minority-depository-institutions-section-308-firrea.htm).

6 The Home Mortgage Disclosure Act (HMDA) is a 1975 US federal law that requires financial institutions to provide mortgage data to the public.

7 Toussaint-Comeau, Maude, and Robin Newberger, "Minority-owned banks and their primary local market areas," *Economic Perspectives* 4 (2017): 1-31.

8 Li, Wei, "Minority Depository Institutions at the Dawn of the 21st Century."

9 The Milken Institute recognizes the difference between "Hispanic" and "Latino" designations and the ongoing debate regarding which is most appropriate. However, because this is a data-driven report and the US Census Bureau uses the "Hispanic" classification, for consistency we chose to use "Hispanic" throughout, unless source data denote otherwise. Likewise, we will defer to "Black" versus "African American," again consistent with the Census Bureau classification, unless source data denote otherwise.

Although Asian and Native American institutions are included as minority-owned, we focus on Black and Hispanic MDIs in this paper.[10] Accordingly, and for Black MDIs in particular, the smaller scale may translate to difficulty navigating and operating in a highly regulated, quickly transforming industry, which limits their ability to serve the communities that need their help. For MDIs to scale up their efforts to provide funds to minority communities, they require more funds themselves. With more capital, organizational transformation strategies for these institutions have the potential to unlock much greater mobilization of funds for their communities.

However, more research is essential to determine MDIs' ability to foster economic development in underserved communities, including by lending to minority-owned small businesses. Could responsible capitalization and operational transformation of MDIs spur their growth and the growth of underserved economies across the United States? Is it possible healthier MDIs may be better positioned to support small businesses in their communities—often minority-owned ones? Can MDIs serve as a conduit for job creation and wage growth within low- to moderate-income communities? As research continues, we will investigate these issues by assessing capacity constraints of MDIs and conducting a quantitative analysis of the potential impact of more equity capital for these institutions to scale in size and efficiency.

BACKGROUND OF MINORITY-OWNED SMALL BUSINESSES IN THE US

Steady economic growth and ongoing job creation over time has led to prosperity in the United States. However, not all segments of society have been able to participate in this prosperity; pockets of inequality do exist. Ensuring all segments of society have the opportunity to contribute and benefit when the economy grows, and more people find employment, is critical to an equitable and just society. In this respect, small businesses play an important role. They account for 99.9 percent of all businesses and employ 47.8 percent of the private workforce throughout the nation, according to the US Small Business Administration (SBA).[11]

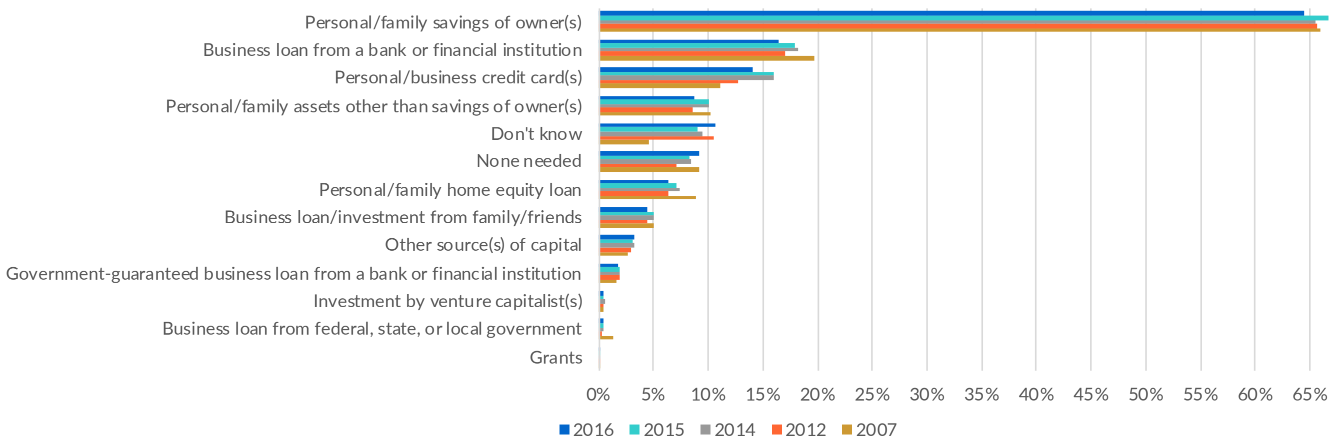
Ample funds are always necessary to support the creation of new small businesses and the continued growth of existing small businesses. In 2016, for small businesses overall, the primary source of funds to start or acquire a business was personal or family savings, at 64.4 percent. The second most common form of funding was bank loans, at 16.5 percent, as shown in Figure 1. The figure also shows that personal/business credit cards have become almost as important as loans from banks and are being used increasingly over time. Additional sources of funds, such as venture

10 In September 2017, the Milken Institute released a summary of the first phase of its Partnership for Lending in Underserved Markets. The Background of this current paper provides greater detail of the Asian and Native American communities being less present in small business lending than African American and Hispanic American communities. Data related to Native Americans are limited given their small population. Asian-owned small businesses exceed Asian population percentages compared to African American and Hispanic American and, as a result, the focus in this paper is on African American and Hispanic-owned businesses.

11 SBA, https://www.sba.gov/sites/default/files/advocacy/United_States_1.pdf, accessed April 13, 2018.

capital investment, are utilized far less than personal or family savings, banks, and credit cards.

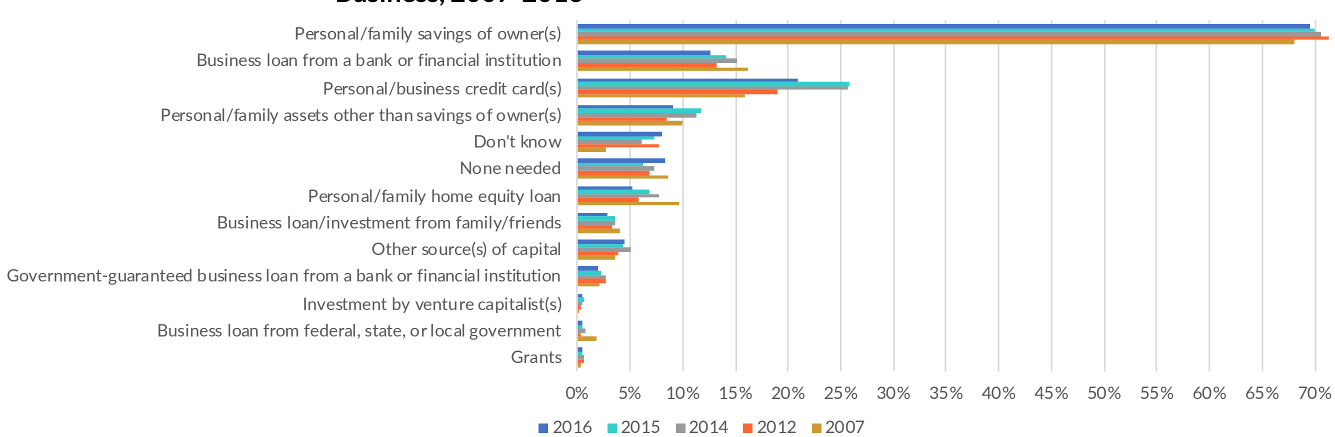
Figure 1: Share of Sources of Capital Used to Start or Acquire a Business, 2007-2016



Source: US Census Bureau, 2016 Annual Survey of Entrepreneurs.

Focusing on Black-owned businesses, Figure 2 shows that personal or family savings also rank first as a source of funds, at 69.6 percent in 2016. However, in contrast to the full small business community utilizing credit cards at 14 percent, Black-owned businesses utilized credit cards at 21 percent, making it the second most prevalent source of startup funds. Moreover, Black-owned small businesses utilized bank loans at 12.6 percent compared to 16.5 percent for all small businesses. Although sources of capital for existing businesses may differ, the initial inability to secure lower-cost commercial bank loans for a new business may pose a material barrier.

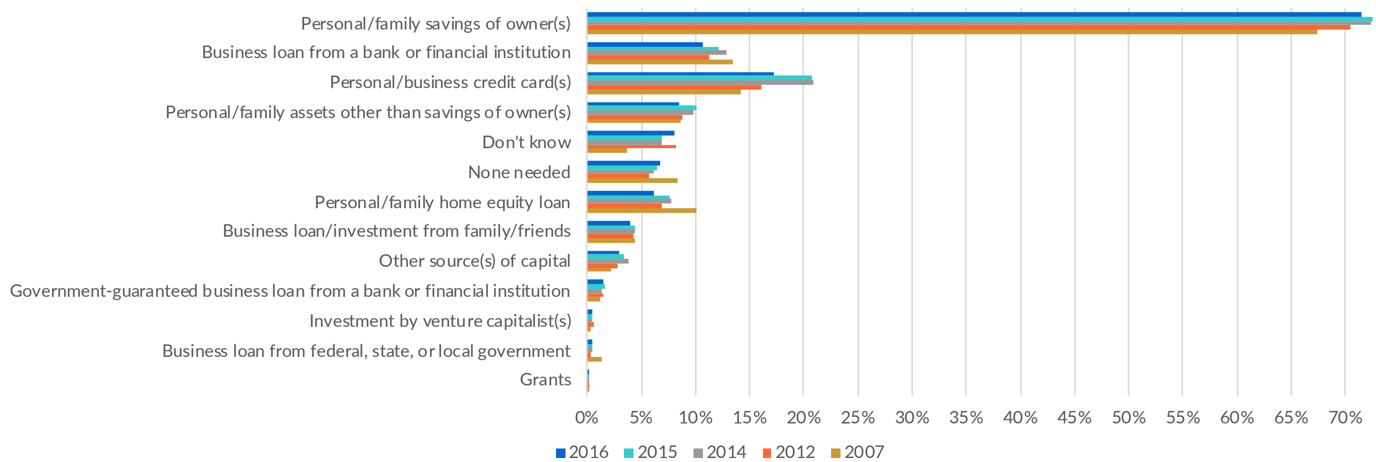
Figure 2: Share of Sources of Capital Used to Start or Acquire a Black-Owned Business, 2007-2016



Source: US Census Bureau, 2016 Annual Survey of Entrepreneurs.

Figure 3 provides similar information for Hispanic-owned businesses. Once again, the most utilized source of funds is from personal or family savings, at 71.5 percent. As was the case with Black-owned businesses, personal or business credit cards are the second-most utilized source of funds to start or acquire a business, at 17.2 percent. These two sources of funds are followed by loans from banks, at 10.7 percent, even less than Black-owned and all small businesses.

Figure 3: Share of Sources of Capital Used to Start or Acquire a Hispanic-Owned Business, 2007-2016



Source: US Census Bureau, 2016 Annual Survey of Entrepreneurs.

More generally, the representation of these two ethnic groups in the private sector lags behind their percentages of the population. For example, in 2016, 12.7 percent of the population was Black, 17.8 percent was Hispanic, and 5.4 percent was Asian.[12] Table 1 and Table 2 show that Blacks' shares of firms, sales, employees, and payroll are far below their share of the population.[13] The same is the case for Hispanics, though to a lesser degree as compared to Blacks. Asians, however, hold a percentage of firms larger than their share of the population.

12 US Census Bureau, https://www.census.gov/quickfacts/fact/table/US/PST045217, accessed May 29, 2018.

13 Of the total number of US businesses, or 29.6 million, 99.9 percent are small businesses. Of the small businesses, 5.4 million have paid employees. See US Census Bureau, 2014 Annual Survey of Entrepreneurs.

Table 1: Firms, Sales, Employees, Payroll, and Shares by Ethnic Group (%), 2016

	Number of firms with paid employees	Sales, receipts, or value of shipments of firms with paid employees ($1,000)	Number of paid employees for pay period	Annual payroll ($1,000)
TOTAL	**5,601,758**	**34,398,096,007**	**121,083,343**	**6,104,546,025**
Black (%)	2.2%	0.3%	0.9%	0.5%
Hispanic (%)	6.0%	1.2%	2.3%	1.5%
Asian (%)	9.9%	2.0%	3.7%	2.3%

Source: US Census Bureau, 2016 Annual Survey of Entrepreneurs.

Table 2: Overrepresented (+) vs. Underrepresented (-) Share of Firms, Sales, Employees, and Payroll by Ethnic Group Based on Percentage of US Population, 2016

	Number of firms with paid employees	Sales, receipts, or value of shipments of firms with paid employees	Number of paid employees for pay period	Annual payroll
Black (%)	-82.9%	-97.6%	-92.6%	-95.9%
Hispanic (%)	-66.1%	-93.3%	-87.0%	-91.6%
Asian (%)	82.4%	-63.0%	-32.7%	-57.2%

Source: US Census Bureau, 2016 Annual Survey of Entrepreneurs.

When evaluated in conjunction with data on the types of funding available to small businesses, the information in these tables raises the question of whether minorities desiring to start a small business or expand an existing small business are at a disadvantage compared to non-minorities. If this is the case, then the opportunity to contribute to and benefit from economic growth and job creation is not available equally throughout society.

In an article published by the Journal of Consumer Research, a mystery shopping field study revealed that bank loan officers treat white and minority business owners differently in the pre-application (or loan inquiry) stage of the financing process.[14] As seen in Table 3, minority business owners were presented with more of the loan application requirements and offered less help to fulfill them during their preliminary interaction with the bank. This disparate treatment could systemically restrict minorities' choice to apply for financing due to a negative perception of the process and its outcome. An interview-based study of consumers in the same article examined differences across ethnic groups when selecting loan providers.

14 Bone, S., Christensen, G., and Williams, J., 2014, "Rejected, Shackled, and Alone: The Impact of Systemic Restricted Choice on Minority Consumers' Construction of Self," *Journal of Consumer Research*, 41: 451-474.

Unlike white respondents, minority respondents cited ethnicity friendliness as a choice criterion in bank selections.[15] In this regard, according to research commissioned by the Federal Reserve, MDIs tend to focus on lending within diverse communities,[16] and particularly in communities with biracial populations.[17]

Table 3: Mystery Shopper Study of Loan Officers and Minority vs. White Customers

Activity		Minority Business Owners	White Business Owners	Delta
Requested loan documentation	Income tax returns	86%	52%	1.7x
	Business financial statements	83%	50%	1.7x
	Credit card debt	42%	13%	3.2x
	Personal financial assets	60%	22%	2.7x
Loan officer assistance offered	Assistance completing loan application	18%	59%	31%
	Offered business card	43%	82%	52%

Source: Bone, S., Christensen, G., and Williams, J., 2014, "Rejected, Shackled, and Alone: The Impact of Systemic Restricted Choice on Minority Consumers' Construction of Self," Journal of Consumer Research, 41: 451-474.

Furthermore, based on data from the HMDA,[18] the National Community Investment Fund (NCIF) analyzed the relative difference between the proportion of different types of financial institutions' mortgage activities and branch locations in low- and moderate-income census tracts.

15 For example, many minority respondents reported trying to find a "minority lending company."

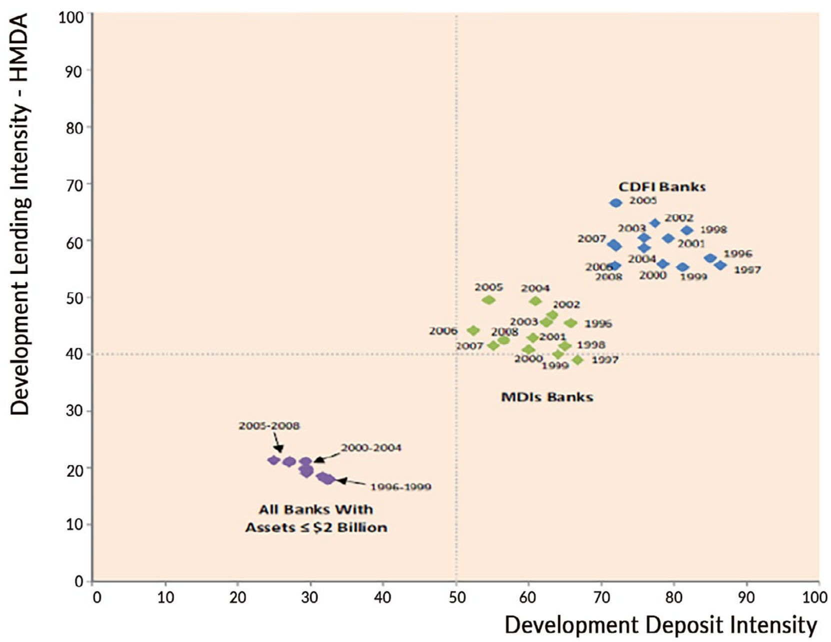
16 Toussaint-Comeau, Maude, and Newberger, Robin, "Minority-owned banks and their primary local market areas," *Economic Perspectives* 4 (2017): 1-31.

17 Li, Wei, "Minority Depository Institutions at the Dawn of the 21st Century."

18 The Home Mortgage Disclosure Act (HMDA) is a 1975 US federal law that requires financial institutions to provide mortgage data to the public.

As shown in Figure 4, the analysis[19] compared the Development Deposit Intensity (DDI)[20] and Development Lending Intensity (DLI)[21] of community development financial institutions (CDFIs),[22] MDIs, and all other banks (those with assets less than or equal to $2 billion) and found that for the decade preceding the financial crisis, CDFIs, followed closely by MDIs, were more likely to locate and provide mortgages to low-income communities as compared to all other banks. Later in this report, we explore a similar relationship in relation to small-business lending. MDIs are a key focus of this paper because of their for-profit status, as opposed to nonprofit enterprises like some CDFIs.

Figure 4: CDFI Bank Average NCIF Social Performance Metrics (SPM) Comparison (1996-2008)



Source: National Community Investment Fund, Social Performance Metrics.

19 Fairchild, Gregory and Jai, Ruo," Risk and Efficiency among CDFIs: A Statistical Evaluation using Multiple Methods, Office of Financial Strategies and Research," CDFI Fund, US Department of Treasury, August 2014 https://www.cdfifund.gov/Documents/Risk%20and%20Efficiency%20among%20CDFIs%20Report.pdf.

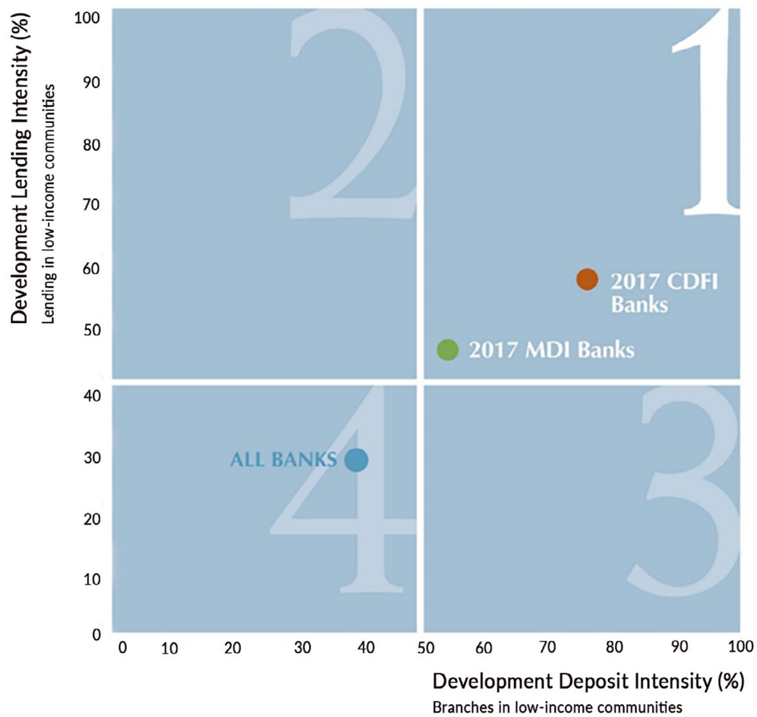
20 DDI is defined as the percent of branches located in Investment Area census tracts as defined by the CDFI Fund. Census tracts are defined as Investment Areas if they have a poverty rate greater than 20 percent, an unemployment rate greater than 1.5 times the national average, or a median family income that is less than 80 percent of the relevant statistical area. To calculate DDI, bank branch addresses from the FDIC are geocoded and compared to Investment Area census tracts.

21 DLI-HMDA (Development Lending Intensity-HMDA) is defined as the percentage of HMDA-reported loans located in CDFI Investment Areas. To calculate DLI-HMDA, loan information is collected from FFIEC, geocoded, and compared to CDFI Fund Investment Areas.

22 CDFIs are mission-driven financial institutions that create economic opportunity for individuals and small businesses, quality affordable housing, and essential community services throughout the United States. There were 141 CDFI banks as of December 31, 2017.

As shown in Figure 5, NCIF analysis reveals this relationship still held in 2017.[23] CDFIs and MDIs are more likely to locate in and support low-income communities compared to all other banks.

Figure 5: CDFI Bank Average NCIF Social Performance Metrics (SPM) Comparison (2017)[24]



Source: National Community Investment Fund, Social Performance Metrics.

OVERVIEW OF MINORITY-OWNED DEPOSITORY INSTITUTIONS

According to the FDIC, an MDI is "any depository institution where 51 percent or more of the stock is owned by one or more 'socially and economically disadvantaged individuals.'" These are defined to primarily include members of the Black, Hispanic, Asian, and Native American populations.[25] The FDIC maintains a database of institutions classified as MDIs, and we used this database for our report.

Given the ability of banks to potentially affect a community's economic resilience, it is imperative to examine the extent to which banks owned by minorities can be

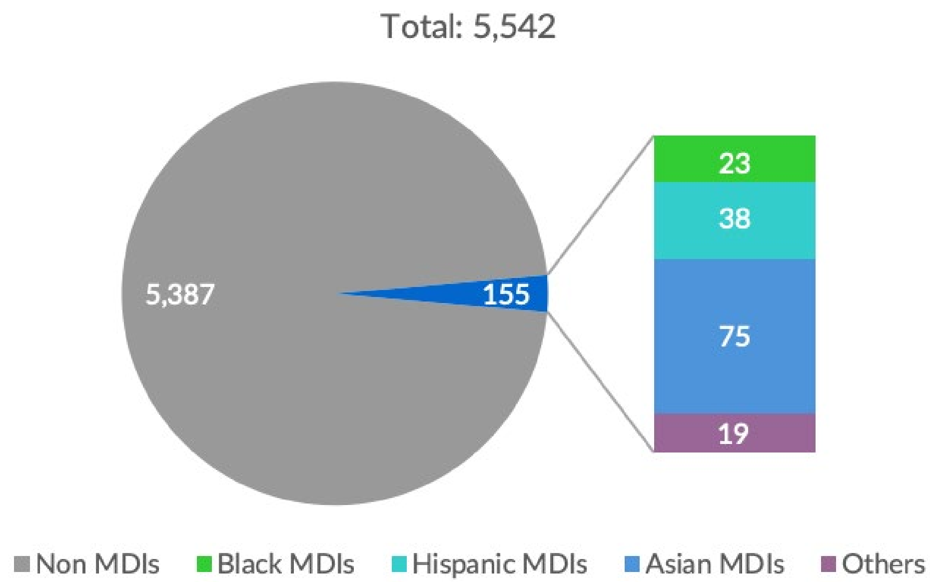
23 One nuance is that while the pre-crisis view only captures banks with assets less than or equal to $2 billion, the post-crisis view includes all banks regardless of assets. This should not influence the overall conclusion of the comparison.

24 NCIF SPM Quadrant Analysis as of April 26, 2018, provided by NCIF.

25 "Minority" as defined by Section 308 of FIRREA means any "Black American, Asian American, Hispanic American, or Native American" (source: FDIC Minority Depository Institutions Program). We focus on the first three of the types of MDIs.

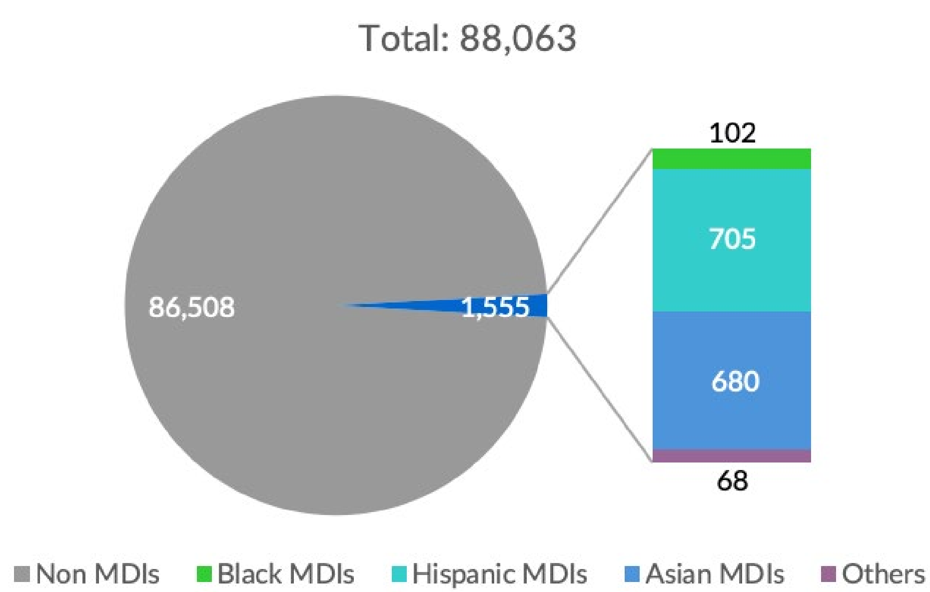
effective financing partners to minority-owned businesses. As shown in Table 1, in 2016, the percentage of businesses with paid employees owned by minorities was as follows: Blacks - 2.2 percent, Hispanics - 6.0 percent, and Asians - 9.9 percent.

Figure 6a: Number of FDIC-Insured Institutions and MDIs by Ethnic Group, June 2018



Source: Federal Deposit Insurance Corporation.

Figure 6b: Number of Branches of FDIC-Insured Institutions and MDIs by Ethnic Group, June 2018



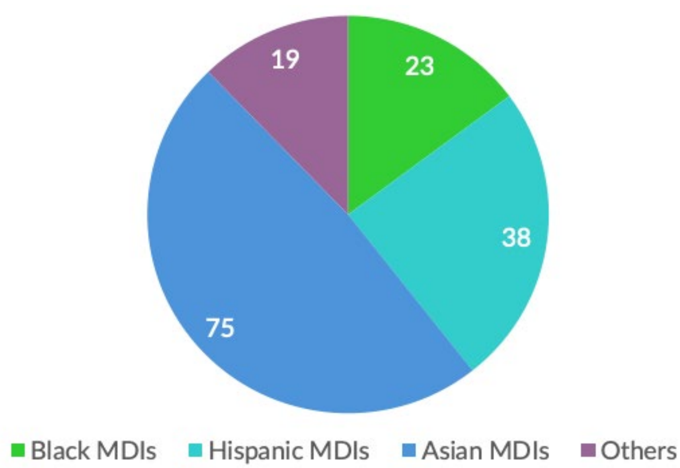
Source: Federal Deposit Insurance Corporation.

The following sections of this report present an overview of the MDI sector over the past 15 years. More specifically, we discuss the number of MDIs and their branches, as well as their location in census tracts throughout the country. In addition, we discuss the relative importance of the different types of MDIs, including the magnitude of their funding for small businesses. Furthermore, we identify the socio-economic and racial makeup of the areas in which the MDIs' headquarters are located. Taking all this information into account, this report poses the question of whether MDIs could present a unique way to more effectively help some communities—particularly minority communities—financially and economically through increased access to capital.

OWNERSHIP ETHNICITIES

As already noted, there are different types of MDIs concerning ethnicity of ownership. Figure 7 shows most MDIs are classified as Asian, at 75 institutions. Hispanic MDIs are second in number, at 38 institutions. Black MDIs are third in number, at 23 institutions. The remaining 19 MDIs are classified as having ethnicities different from these three groups.[26] The three largest ethnic groups identified account for 87.7 percent of all the MDIs.

Figure 7: Number of MDIs by Ethnic Group, June 2018



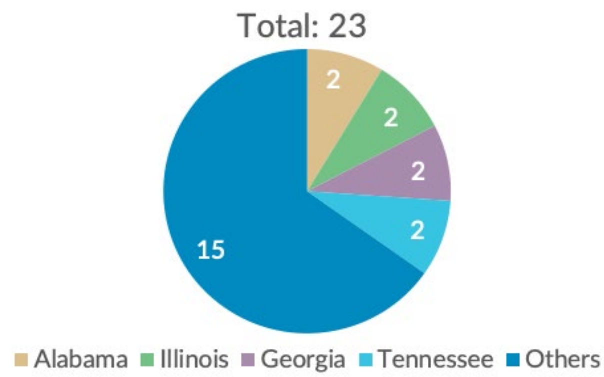
Source: Federal Deposit Insurance Corporation.

Figures 8, 9, and 10 illustrate the breakdown of the overall MDIs by ethnic group to specifics concerning each of the three largest ethnic groups by the top four states. Figure 8 shows that there are 23 Black MDIs, with the top four states being Alabama, Illinois, Georgia, and Tennessee. Each of these states has two Black MDIs, while each of the other 15 states has one Black MDI. Figure 9 shows that there are 38 Hispanic MDIs, with 14 in Texas, 11 in Florida, five in Puerto Rico, and three in California.

26 The remaining MDIs include Multi-Racial American and Native American or Alaskan Native American.

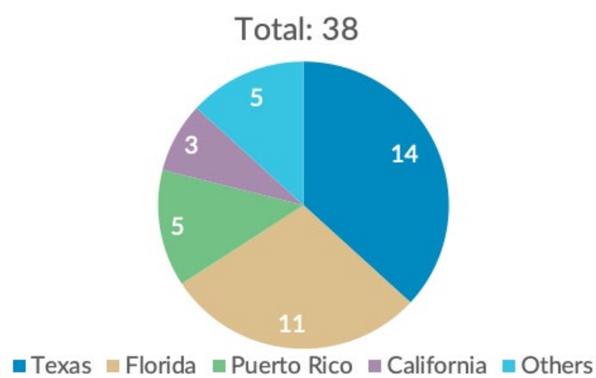
The remaining five MDIs are headquartered in three other states. Figure 10 shows that there are 75 Asian MDIs, with 35 in California, nine in New York, seven in Texas, six in Georgia, and 18 in other states.

Figure 8: Number of Black MDIs by State, June 2018



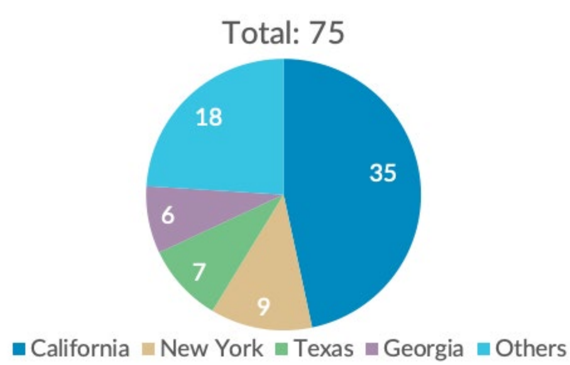
Source: Federal Deposit Insurance Corporation.

Figure 9: Number of Hispanic MDIs by State, June 2018



Source: Federal Deposit Insurance Corporation.

Figure 10: Number of Asian MDIs by State, June 2018



Source: Federal Deposit Insurance Corporation.

NUMBER, LOCATION, AND OWNERSHIP TYPE

Table 4 provides information on the number of MDIs and their branches by state and locations outside the United States. According to our analysis, there were 155 MDIs with 1,555 branches as of June 2018. MDIs are present in 41 locations, although only 32 of those have headquarters. American Samoa, Micronesia, the Marshall Islands, the Northern Mariana Islands, Mississippi, Nevada, Palau, Virginia, and the Virgin Islands have no MDI headquarters, and are served only by branches. For these locations, a "0" is in the table for the number of MDIs, while the number of branches is also indicated. The branches belong to MDIs headquartered elsewhere. Remarkably, there are nine locations with branches but without a single MDI headquarters.

Although one would presume that locations with a large number of minority populations would always have an MDI headquarter, that is not necessarily the case. Nevada and Arizona, for example, have relatively high minority populations, but Nevada is only served by MDI branches while Arizona is not served by an MDI at all.[27] California has the most MDIs, at 39 institutions, as well as the most branches, at 367. Texas ranks second, with 22 MDIs and 306 branches. Puerto Rico has the third largest number of branches, at 301, but with only five MDIs headquartered there.

Table 4 also presents information on the overall friendliness to such firms by states on a scale from A+ to F, based on the 2018 Thumbtack Small Business Friendliness Survey.[28] There does not seem to be a significant connection between a state's score and its prevalence of MDIs. For example, the state with the most MDIs, California, has a score of D, while the state with the second largest number of MDIs, Texas, has a score of A. Moreover, both states with F scores have MDIs located there. There is no similar information for the MDIs located outside the United States.

27 US Census Bureau, QuickFacts.

28 Federal Deposit Insurance Corporation and Thumbtack.com Small Business Friendliness Survey, https://www.thumbtack.com/survey#/2018/1/states, accessed January 10, 2019.

Table 4: Number of MDIs, MDI Branches, and Small Business Friendliness Score, by State or Other US Territory, June 2018

State/Territory	Number of MDIs	Number of MDI Branches	Small Business Overall Friendliness Score
Alabama	2	10	A-
Alaska	0	0	A+
American Samoa	0	2	N/A
Arizona	0	0	A-
Arkansas	0	0	A-
California	39	367	D
Colorado	1	1	C+
Connecticut	0	0	C-
Delaware	0	0	B-
District of Columbia	1	5	C+
Florida	12	85	C+
Georgia	9	39	A
Guam	3	18	N/A
Hawaii	3	30	F
Idaho	0	0	A-
Illinois	6	38	F
Indiana	0	0	A-
Iowa	1	1	C+
Kansas	1	2	C
Kentucky	1	1	D
Louisiana	1	11	B
Maine	0	0	A-
Marshall Islands	0	1	N/A
Maryland	1	10	B+
Massachusetts	2	13	A-
Michigan	1	5	A+
Micronesia	0	4	N/A
Minnesota	1	7	A-
Mississippi	0	1	B
Missouri	1	5	C-
Montana	1	2	A-
Nebraska	0	0	B+

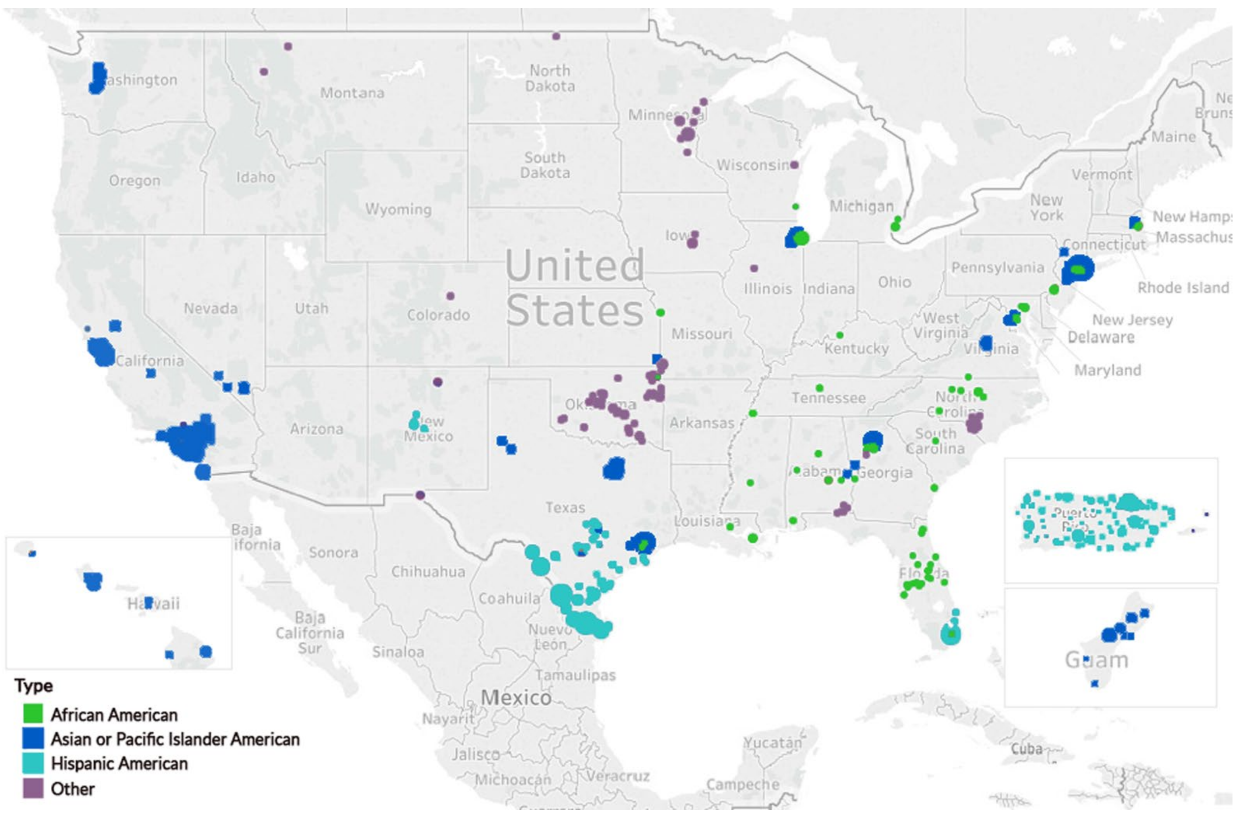
Table 4 Continued: Number of MDIs, MDI Branches, and Small Business Friendliness Score, by State or Other US Territory, June 2018

State/Territory	Number of MDIs	Number of MDI Branches	Small Business Overall Friendliness Score
Nevada	0	6	C
New Hampshire	0	0	B
New Jersey	3	30	D+
New Mexico	2	7	D
New York	12	125	D+
North Carolina	2	22	A-
North Dakota	1	1	A-
Northern Mariana Islands	0	5	N/A
Ohio	0	0	B
Oklahoma	12	38	C
Oregon	0	0	C
Palau	0	2	N/A
Pennsylvania	3	8	C
Puerto Rico	5	301	N/A
Rhode Island	0	0	D
South Carolina	1	1	A
South Dakota	0	0	A+
Tennessee	2	4	A+
Texas	22	306	A
Utah	0	0	A+
Vermont	0	0	C-
Virgin Islands	0	18	N/A
Virginia	0	5	B
Washington	1	15	C+
West Virginia	0	0	C-
Wisconsin	2	3	C
Wyoming	0	0	D
Total	**155**	**1,555**	

Source: Federal Deposit Insurance Corporation and Thumbtack.com Small Business Friendliness Survey.

Figure 11 provides a more detailed visualization of all MDI headquarter and branch locations. As shown in the figure, MDIs and their branches tend to be clustered in relatively few places across the nation. Although not every location with a larger minority population has an MDI headquarter or branch, most MDIs are located principally where there are high minority concentrations. Most MDIs are clustered along the Gulf coast, Texas border, and East and West coasts. There is limited overlap in location for Black, Hispanic, Asian, and other MDIs. Oklahoma provides an interesting view. It has 12 MDIs and 38 branches, with 11 MDIs owned by Native Americans (understandable, given approximately 9 percent of the state population is Native American). In juxtaposition, Arizona, another state with a high Native American population (more than 5 percent of its population), does not have a single MDI.

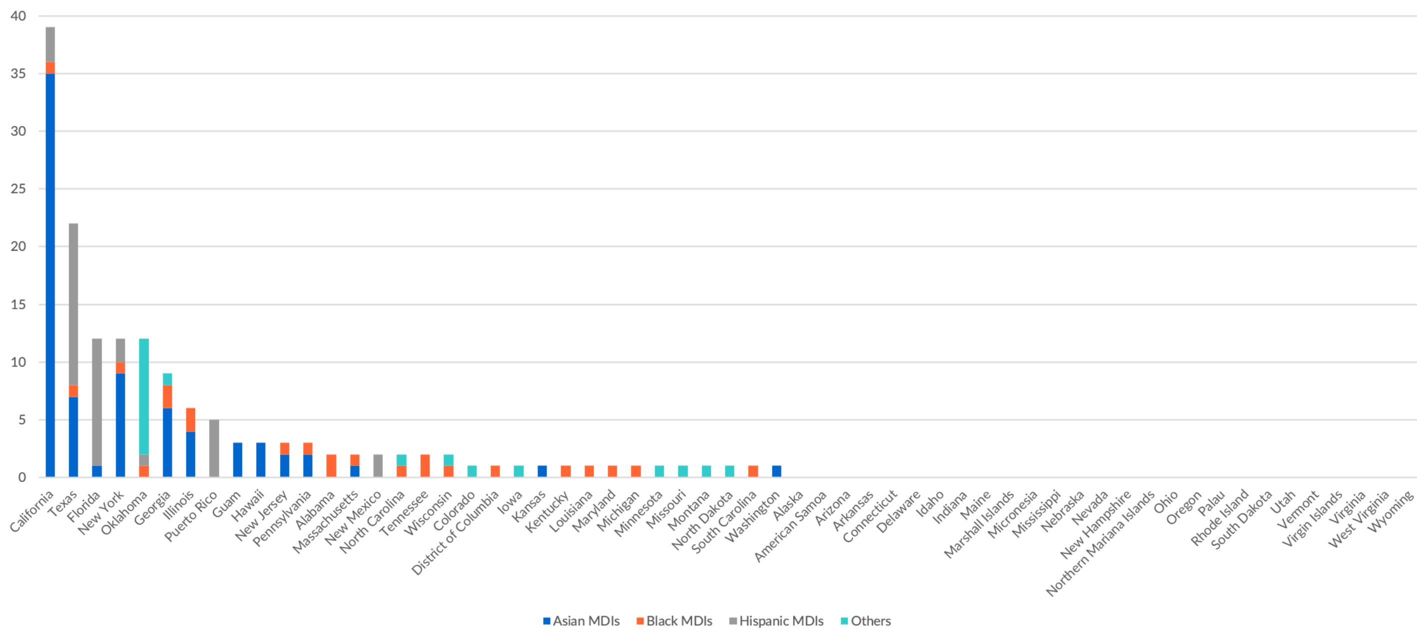
Figure 11: Location of MDIs and Branches, June 2018



Source: Federal Deposit Insurance Corporation.

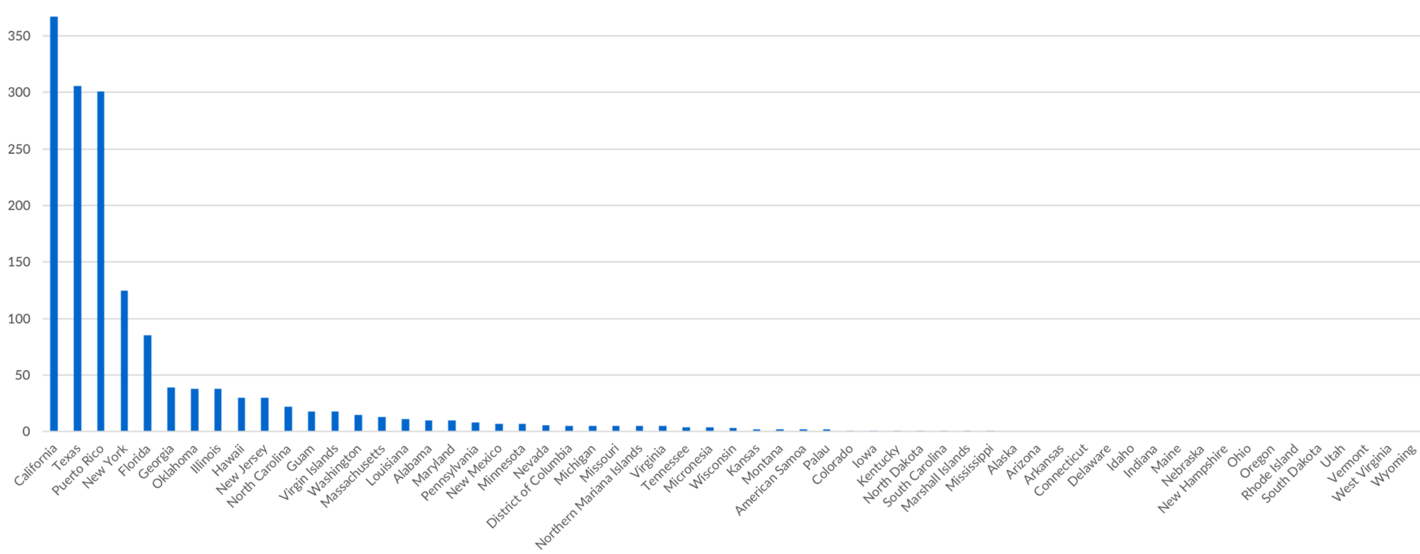
Figures 12 and 13 provide additional visualization of both the number of MDIs and the number of branches of MDIs at the state level. Five states (California, Texas, Florida, New York, and Oklahoma) account for over 60 percent of the total number of MDIs, while five states (California, Texas, Puerto Rico, New York, and Florida) account for just over 50 percent of the total number of branches. Four of the top five states account for both 50 percent of the total number of MDIs and total branches.

Figure 12: Number of MDIs by State, June 2018



Source: Federal Deposit Insurance Corporation.

Figure 13: Number of MDI Branches by State, June 2018



Source: Federal Deposit Insurance Corporation.

NEW ENTRANTS AND EXITS

Table 5 presents information on the entry and exit of MDIs from the beginning of 2002 to the second quarter of 2018. It shows the number of MDIs decreased from 164 institutions at the beginning of the period to 155 institutions at the end of the period. The maximum number of MDIs was 215 institutions in 2009, which was towards the end of the recession brought on by the 2008 financial crisis (December 2007 to July 2009). The number of MDIs began to decline after that, reaching a low of 155 institutions at the end of 2017.

The maximum number of new MDI charters issued was 12 in 2006. Since 2008, no new MDI charters have been issued. With regards to institutions that gained MDI status, the maximum number was 17 in 2005, while the maximum number of institutions that lost MDI status was three in both 2008 and 2011. The table presents information on MDIs that voluntarily merged or closed, as well as those that failed. Some MDIs that exited were acquired by other MDIs (38), while others were acquired by non-MDIs (37). Very few MDIs voluntarily closed without an acquirer (only five over the period). Forty MDIs failed over the period, with 12 failing in 2010. Importantly, exits did not affect ethnicities equally—the number of Black MDIs decreased, while the number of Asian-owned MDIs increased.[29] This disparity is concerning because recent evidence shows a negative relationship between bank closings and growth in low- and moderate-income and minority neighborhoods.[30]

29 Kashian, Russell D., Contreras, Fernanda, and Perez-Valdez, Claudia, "The Changing Face of Communities Served by Minority Depository Institutions: 2001-2015," working paper draft, posted on Partnership for Progress website and available at https://www.communitybanking.org/~/media/files/communitybanking/2016/session1_paper4_kashian.pdf.

30 Toussaint-Comeau, Maude, and Newberger, Robin, "Mission-oriented bank closings and small business credit availability in low-income and minority neighborhoods," Federal Reserve Bank of Chicago, Community Development and Policy Studies, white paper, forthcoming (2017).

Table 5: Total Number of MDIs, Including New Entrants, and Exits, 2002 to Q2 2018

Year	Number of MDIs at Start of Period	New MDI Charters	Gained MDI Status	Lost MDI Status	MDIs Voluntarily Merging or Closing			MDIs That Failed			Number of MDIs at End of Period
					Acquired by Other MDI	Acquired by Non-MDI	Voluntarily Closed (No Acquirer)	Acquired by Other MDI	Acquired by Non-MDI	Depositor Payoff	
2002	164	0	6	0	-3	0	0	0	-1	0	166
2003	166	1	8	0	-5	-4	0	0	0	0	166
2004	166	0	11	-2	-3	0	0	0	0	0	172
2005	172	7	17	-2	0	-4	-1	0	0	0	189
2006	189	12	5	-2	-2	-8	0	0	0	0	194
2007	194	10	10	-1	-1	-1	0	0	0	0	211
2008	211	2	10	-3	-2	0	-1	-1	-1	0	215
2009	215	0	5	-2	-2	-2	0	-2	-5	0	207
2010	207	0	8	-1	0	-5	0	-4	-7	-1	197
2011	197	0	6	-3	-4	-3	0	-3	-3	0	187
2012	187	0	1	-2	-1	-1	0	-2	-1	0	181
2013	181	0	6	-2	-5	-1	-3	-1	0	-1	174
2014	174	0	6	0	-3	0	0	-1	-1	0	175
2015	175	0	0	0	-4	-4	0	0	-3	0	164
2016	164	0	0	-2	-3	-1	0	0	-1	0	157
2017	157	0	1	-1	0	-1	0	-1	0	0	155
2018 Q1	155	0	0	0	0	0	0	0	0	0	155
2018 Q2	155	0	2	0	0	-2	0	0	0	0	155

Source: Federal Deposit Insurance Corporation.

LOCATION, ETHNIC TYPES, ASSETS, SMALL-BUSINESS LOANS, CAPITAL, DEMOGRAPHIC, AND INCOME INFORMATION

Of all the MDIs, the largest is East West Bank in Pasadena, California, with $38 billion in assets. The smallest MDI is Columbia Savings and Loan Association in Milwaukee, Wisconsin, with $24 million in assets. We provide additional information in Tables 6a and 6b, comparing MDIs and all FDIC-insured depository institutions based on selected bank, demographic, and income items. Table 6a shows the median values for the variables, while Table 6b shows the mean values. In Table 6a, one sees that MDIs are located in census tracts with populations that have a median percentage of 85 percent minorities, compared to the 24 percent for all FDIC-insured depository institutions. MDIs also have a 4 percentage point lower median ratio of small-business loans to total assets and a 1 percentage point higher median capital-MDIs also have a 4 percentage point lower median ratio of small-business loans to total assets and a 1 percentage point higher median capital-to-asset ratio.

Black MDIs are located in census tracts with a median Black population of 73 percent. These MDIs have the highest median percentage of small-business loans to total assets but have the lowest median capital to asset ratio. Only Black MDIs have a median tier 1 capital to total assets ratio lower than the median for all FDIC-insured institutions. These points are particularly significant given recent research[31] that finds small bank-dependent businesses benefit more from borrowing from well-capitalized banks relative to larger businesses with access to bond markets. Additionally, Black MDIs operate in areas with the second lowest median family income level. Black MDIs, moreover, have the lowest median total assets, except for MDIs classified as "other" (i.e. representing multiple ethnic groups).

Hispanic MDIs have the highest median total assets but the lowest median percentage of assets that are small-business loans. Hispanic MDIs are located in census tracts in which the median Hispanic population is 94 percent. Hispanic MDIs also operate in areas with the lowest median family income.

Asian MDIs are located in census tracts in which the largest median percentage of the population is Asian, at 39 percent. In addition, these census tracts have the highest median family income level of all institution categories. These MDIs also have the second-lowest median ratio of small-business loan to total assets, but the highest median capital to asset ratio of all groups of institutions.

The results tend to be similar when focusing on means rather than medians—that is, when comparing Tables 6a and 6b.

31 Schwert, Michael, "Bank capital and lending relationships," *The Journal of Finance* 73.2 (2018): 787-83.

Table 6a: Medians for Selected Bank, Demographic, and Income Items by Type of Bank and Census Tract, 2017

	Total Assets ($'000)	Number of Small-Business Loans	Small-Business Loans to Total Assets (%)	Tier 1 Capital to Total Assets (%)	Percentage of Total Population (%)				Median Family Income ($)
					Minority	Hispanic	Black	Asian	
All FDIC-Insured Institutions	212,688	357	17.10	10.39	23.92	6.24	3.33	1.77	69,679
All MDIs	312,360	224	13.24	11.36	85.36	35.37	1.27	3.72	55,790
Black MDIs	173,477	165	19.35	9.09	91.02	4.87	73.15	1.60	46,490
Hispanic MDIs	469,282	285	8.43	10.98	96.22	93.59	0.00	0.00	42,917
Asian MDIs	363,516	194	13.27	11.87	75.46	17.40	2.83	39.18	72,801
Other MDIs	103,493	259	18.76	11.15	36.87	4.99	2.67	0.66	51,413

Table 6b: Means for Selected Bank, Demographic, and Income Items by Type of Bank and Census Tract, 2017

	Total Assets ($'000)	Number of Small-Business Loans	Small-Business Loans to Total Assets (%)	Tier 1 Capital to Total Assets (%)	Percentage of Total Population (%)				Median Family Income ($)
					Minority	Hispanic	Black	Asian	
All FDIC-Insured Institutions	3,082,342	4,792	18.63	11.65	30.99	13.07	9.60	5.18	78,402
All MDIs	1,439,393	535	15.89	12.08	76.98	47.84	8.54	17.30	65,092
Black MDIs	244,932	199	20.97	9.41	79.04	9.21	63.27	4.00	58,602
Hispanic MDIs	2,695,374	833	10.95	12.12	85.17	78.78	2.80	2.71	53,488
Asian MDIs	1,479,508	531	15.31	13.09	70.94	22.78	5.93	38.18	80,768
Other MDIs	150,324	341	22.19	11.08	41.92	6.88	11.31	1.14	54,507

Source: Federal Deposit Insurance Corporation.

CONCLUSION

The findings of this report raise the possibility that MDIs (especially Black and Other MDIs), although small in scale, could be meaningful funding sources for minority-owned small businesses, and therefore, important economic development engines. However, many questions remain about what these MDIs would need—Tier 1 capital, human capital, technology—to prudently increase their scale. In addition, what community impact would result? Would small business loans be more highly prioritized by these institutions?

One important finding from the paper is that where MDIs exist (and where their branches are located), the ownership of an MDI often corresponds to the prevalent minority population of the relevant census tract. Also, due to their location, MDIs are more likely to recycle capital within their low-income communities, as evidenced by HMDA data. Therefore, minority-owned banks may be better suited to meet the needs of minority-owned businesses in their communities.

With a host of national policy initiatives seeking to address the lack of capital in low- and moderate-income communities, additional research into the opportunity presented by MDIs is necessary. While this report presents data on MDIs' support of local small-business lending, assessing MDI capacity to serve as a fulcrum of economic development in underserved communities requires an understanding of their operational capabilities. MDIs are small in the broader commercial banking context and are more susceptible to challenges associated with compliance costs, operational complexity, and a fast-paced, technology-enabled market.

Responsibly deploying more capital through these institutions, therefore, is inextricably linked to organizational transformation strategies.

Determining the answers to the following questions is needed in assessing MDIs' potential:

> *What are the capital constraints of such institutions?*
>
> *How would MDIs react to more capital on their balance sheets?*
>
> *Which groups of MDIs are most in need of additional equity?*
>
> *What additional capacity improvements—human and technological—are required for MDIs to increase both their scale and efficiency to ensure prudent activities in their communities?*

The Milken Institute plans to explore these questions during the next phase of our project. In doing so, we hypothesize that MDIs may react positively to equity infusions and may already have market understandings sophisticated enough to responsibly deploy higher levels of lending within their communities. Furthermore, we posit that through several organizational transformations, MDIs may have the potential to increase their efficiency and profitability. Ultimately, we believe answering these questions will reveal if and how new and existing MDIs can serve as job-creation conduits within underserved communities.

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