To make financial system more equitable, give CDFIs more support

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Beth Bafford August 24, 2022

By Beth Bafford August 24, 2022, 10:33 a.m. EDT

When COVID hit the U.S. economy in March 2020 and tens of millions of small businesses across the country shut down, it provided a rare, systemwide glimpse of the glaring shortcomings in our banking system. If the system was an electric grid — connecting capital to individual businesses — we learned that a massive share of our economy was in the dark.

Lawmakers had moved quickly to create the Paycheck Protection Program to help American businesses weather the storm and enlisted commercial banks to disburse the funds. Unsurprisingly, however, the lion's share went to their best and biggest customers. A recent analysis of the program found that 72% of PPP funds were captured by households with incomes in the top 20%, adding to earlier studies that show the enormous disparities in the program's distribution of aid.

But PPP was just one of hundreds of new programs that have been passed through landmark legislation. There is a once-in-a-generation level of public funding coming through federal and state governments that could help transform American life, but the banking system is not prepared to take full advantage of these infusions because of chronic underinvestment in a critical piece of infrastructure: community finance.

The financial system that developed over the last 30 years has prioritized consolidation and scale in pursuit of profit — as the private companies within it are incentivized to do — and the levers available to government to ensure access and equity have failed to adapt at the scale and speed required. Tools like the Community Reinvestment Act and antitrust regulation have not evolved to address stronger market forces, leaving millions of Americans without access to the credit required to start businesses, strengthen communities and build better lives.

Luckily, there is a subset of the financial system that was created — through legislation and regulation born out of the civil rights era — to address these gaps through the formation of community development financial institutions and similarly structured community-based lending and service organizations. There are more than 1,200 such organizations across the country designed to build financial products and services for people, families, businesses and communities that are otherwise largely "unbankable" — in other words, not profitable for banks to serve.

These critical organizations, however, are individually and collectively very small. The entire CDFI industry has a combined $222 billion in total assets. By comparison, JPMorgan Chase — one bank — has $2 trillion of assets, or nine times the assets of the entire CDFI industry. The industry's size is often used as an excuse by policymakers and others in power to dismiss CDFIs' role in addressing the flaws in the financial system. But the industry's size is a symptom of disinvestment and lack of attention, despite the outsize role CDFIs play in times of crisis and every day in between.

If we want to have a more diversified and inclusive economy — and put critical federal resources to work — we need a much larger and stronger delivery system for community-based capital solutions.

CDFIs stepped up significantly during the pandemic, as they have repeatedly throughout economic crises. They made $30 billion in PPP loans, with much higher reach to very small businesses, low-income communities and communities of color. They came together to scale their lending to small businesses, while the rest of the credit markets backed off. And they provided hands-on, empathetic support to thousands of families and business owners who needed a place to turn during a prolonged period of uncertainty.

When properly resourced, CDFIs are responsive to the needs in their local community, state or region. In California, Accion Opportunity Fund saw a need for independent truckers to access financing to upgrade their long-haul trucks to meet heightened state emissions guidelines. With access to financing, these entrepreneurs can maintain their independence while reducing their carbon footprint.

In West Virginia, Partner Community Capital works with local governments to promote tourism and local entrepreneurship in a region transitioning to a more diversified post-coal economy.

In Oakland, California, Pacific Community Ventures has partnered with local organizations to address structural racism in lending by providing restorative capital to local Black-owned businesses.

In Texas, River City Federal Credit Union, as a result of its robust PPP lending, identified new opportunities to better serve its members running sole proprietorships. The credit union has now revamped its underwriting procedures with sole proprietors in mind to provide broader financing options with the best rates possible.

Far from handouts, these lending programs have proved that their clients are not riskier, they are just less efficient to serve than their much larger counterparts, so they require a mission and intention beyond pure profit.

Numerous programs authorized in the Rescue Plan, Infrastructure and Jobs Act and the recently announced Inflation Reduction Act, such as the State Small Business Credit Initiative, the Energy Efficiency Revolving Loan Fund, broadband access programs and the Greenhouse Gas Reduction Fund, will benefit from a distributed, community-based financial system.

Like PPP, these are all large programs built to leverage the private sector to ultimately support households, businesses, and local communities. To be successful, they require tested and trusted partners to ensure broad reach and equitable distribution.

These programs will take time to work their way through the system, so the window of opportunity is open — but won't be for long. Passing these bills and programs is an incredible first step but will mean nothing if it's not translated into direct, positive impact on people's lives.

For CDFIs to scale their capacity to participate in these programs, they need support now. Grants from Mackenzie Scott to many of the largest CDFIs across the country were the first scaled example of unrestricted support meant to build capacity, technology, systems and staff. But scaling CDFIs and other community-based organizations should not be reliant on smart giving by one wealthy woman. A resilient, equitable financial system requires a more holistic solution across all levels of philanthropy and government.

The U.S. was woefully unprepared to implement PPP in a way that reached the people and businesses that needed support the most. Putting in the work now can ensure they aren't left in the dark again.

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