2000 CRA Roundtable Dates

Financial institution CRA officers and bank community development staff are invited to participate in the Roundtables. These meetings are valuable sources of information about CRA regulatory compliance and about local community credit, service and investment opportunities.

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<th>City</th>
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<td>Boise</td>
<td>March 9</td>
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<td>Greater Los Angeles</td>
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Community Affairs Contacts for Roundtables:

Adria Graham Scott (213) 683-2785 (Los Angeles, Phoenix, San Diego)  
Craig Nolte (206) 343-3761 (Boise, Portland, Seattle)  
Fred Mendez (415) 974-2722 (Northern California, Las Vegas, Utah)  
Lena Robinson (415) 974-2717 (Leadership Councils)

Free subscriptions and additional copies are available upon request from the Community Affairs Unit, Federal Reserve Bank of San Francisco, 101 Market Street, San Francisco, California 94105, or call (415) 974-2978.

Change-of-address and subscription cancellations should be sent directly to the Community Affairs Unit. Please include the current mailing label as well as any new information.

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Credit Scoring for Small Business Lending

We present the results of a 12th District banking survey that examined the use of credit scoring for small business underwriting. Key differences between large and small banks illuminate potential industry trends and raise interesting research possibilities for future study.

Creating Cultural Windows to Banking Opportunities

New immigrant communities across the United States represent tremendous, untapped potential. This article presents some key findings from an ethnic banking study conducted in Los Angeles, and suggests cultural adaptations as a way to reach this underserved market.

Home For Dinner Home Buyers Program

Committed to "finding a way home," a group of Las Vegas financial institutions create an employer-assisted mortgage loan and down payment program for low- and moderate-income employees.

Special Insert:

More on CRA Investments...

We hope you’ll enjoy this edition’s special insert featuring excerpts from the 1999 National Conference on Community Development. You’ll find solid technical information, and practical tips for today’s shrewd CRA investor.
The last month has seen a flurry of editorial activity and op-ed pieces written about the Financial Services Modernization Act of 1999. Clearly, the debate isn’t over relative to its potential impact and long-term value. Time and experience will likely serve as the ultimate arbiters.

Debate and conjecture notwithstanding, the Federal Reserve Board is heading into its own flurry of activity to meet the March 2000 deadline for completion of the legislation’s implementing language. We expect this will include the new CRA provisions as well. Although time is short, there are a few proactive steps that financial institutions can take to ensure readiness for implementation of the new law:

➤ Develop a mechanism to internally assess and monitor the CRA activities of financial subsidiaries and affiliates. This is an area where CRA actually got some additional “teeth,” since the new law mandates that all financial institution subsidiaries of a bank holding company have at least a satisfactory CRA rating in order to engage in any of the new activities granted under the bill. If even one subsidiary is rated below satisfactory, the expansion application will be denied.

➤ Review current CRA agreements and create a more formal tracking system for activities within these agreements. Under the new sunshine requirements, both banks and their non-profit partners will be obliged to report (on an annual basis) CRA-related payments, fees, loans, investments, and services and their terms and conditions. Non-profits must also report on the use of said funds, including compensation, administrative expenses, travel, entertainment and consulting/professional fees. Current thresholds mandate reporting of cash payments and grants (individual or aggregate) in excess of $10,000 and loans (individual or aggregate) in excess of $50,000.

➤ Consider formalizing a CRA self-assessment process and establish close ties with your compliance examiners to make sure you’re on the right track. This will be especially important for small banks with satisfactory or outstanding ratings because they will now be examined for CRA compliance every 4-5 years. (Don’t forget that this only applies to CRA, and not other compliance examinations!)

Over the next several months, Congress has charged the financial services industry and its regulators to develop a framework that supports readiness for implementation of the new law.

The site is http://www.1stsource.kc.frb.org/programs/index.asp. For more information, call John Wood at the Federal Reserve Bank of Kansas City at (800) 935-1010, ext. 2205.

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TOWARD A SUSTAINABLE AMERICA
The President’s Council on Sustainable Development (PCSD) has released Toward a Sustainable America: Advancing Prosperity, Opportunity, and a Healthy Environment for the 21st Century. This report updates PCSD’s 1996 version, and includes current policy recommendations. It highlights the council’s objective to improve prosperity and quality of life while reducing human pressures on the environment. Appendices include examples of successful community initiatives, resources, and community member profiles.

For more information or a copy of the report, contact the PCSD at (202) 408-5296 or at www.whitehouse.gov/PCSD.

ECONOMIC EDUCATION PROGRAM SATISFIES CRA CRITERIA

Bankers may want to consider Junior Achievement’s (JA) innovative, economic education program as one option in fulfilling their CRA requirements. JA programs are designed to train students from kindergarten through 12th grade with work-force ready economic skills and knowledge. The majority of the programs are delivered to low-income students.

One of JA’s primary programs is called the Whole School Program. Banks and businesses may fund classrooms, whole grades, or adopt an entire school. Banks can receive Investment Test credit when they provide funding to sponsor a Whole School Program in a low-income neighborhood. They can also receive Service Test credit if their employees volunteer in the sponsored school.

For more information about Junior Achievement programs, contact Senior Development Manager, Julie Ringwood, at (532) 357-1816, ext. 20.

NEW WEB SITE LINKS PROJECTS TO PROGRAMS AND RESOURCES

1stSource is a new Internet site launched in October by the Federal Reserve Bank of Kansas City. The site is a guide to information about programs that assist community and economic development projects. Whether you are a developer trying to build affordable housing, a small business entrepreneur seeking financing, a small farmer operating a farm, or a community seeking to improve its infrastructure, 1stSource can help you easily and quickly cut through the mass of programs. With a little information from you about your project, 1stSource will provide you with a summary description of those programs that best fit your project’s needs.

The site is http://www.1stsource.kc.frb.org/programs/index.asp. For more information, call John Wood at the Federal Reserve Bank of Kansas City at (800) 935-1010, ext. 2205.

CRAB LEADERSHIP COUNCILS

January 7, 2000 is the final day to submit a nomination form for the CRA Leadership Council. The Leadership Councils are a voluntary advisory board of CRA officers who will serve as representatives of their local roundtable. For further information on the program or to receive a nomination packet, please call Lena Robinson at (415) 974-2717 or contact her via e-mail at: lena.robinson@sf.frb.org.
The Federal Home Loan Bank of San Francisco and the Federal Reserve Bank of San Francisco are pleased to invite financial institutions to participate in a Products and Services Awards competition. The awards program is an effort to recognize and share innovative and outstanding examples of CRA-eligible products or services in the categories of lending, service, investment and community development. Entries in any or every category will be accepted until February 15, 2000.

Entry information was sent out in mid December. If you did not receive it or would like more detailed information, please contact Lena Robinson at (415) 974-2717 or by e-mail at lena.robinson@fnbfrb.org.

The following presents highlights of the survey results, which cover the extent that scoring is used among large and small banks and the varying approaches to scoring system implementation. The results will also serve as the basis for future Fed research on this topic.

**MODELS FOR BUSINESS LENDING**

Similar to consumer loan models, small business models use credit history information from credit bureaus to statistically estimate the likelihood that borrowers will repay their loans. For business lending models, credit bureau information for the business’ principal owner is used. Additionally, the models factor in information from the loan application such as the business owner’s deposit account relationships, liquid assets, and type of business. Sometimes, credit history variables on the small business owner's credit record are factor in information from the loan application such as the business owner’s deposit account relationships, liquid assets, and type of business. Sometimes, credit history variables on the small business owner's credit record are

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During the first half of 1999, the Federal Reserve Bank of San Francisco conducted a survey of 51 12th District financial institutions to learn more about the use of credit scoring in underwriting small business loans. The following presents highlights of the survey results, which cover the extent that scoring is used among large and small banks and the varying approaches to scoring system implementation. The results will also serve as the basis for future Fed research on this topic.

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credit scoring models, just as consumer and mortgage lending is similarly dominated by scoring users. Also, given the competitive advantage that is possible, it appears that more and more small and mid-sized banks will adopt scoring over time.

Survey questions
Respondents were asked a variety of questions about their credit scoring programs. A summary of their responses follow:

Length of time used: Eight of the nine users implemented their scoring programs within the past three years. Only Wells Fargo started its program earlier. This industry pioneer in credit scoring implemented its small business scoring model in 1989.

Automatic approvals: Six of the nine banks that use scoring automatically grant some loan requests based on customer scores. The other three use scoring to streamline their lending processes, but they continue to subject all loan applications to human review.

Scoring for business expansion: Three use scoring as a means to attract new customers through mail solicitations, but only one uses scoring to expand outside its normal geographic area.

Home-grown or vendor models: Interestingly, all nine of the respondents use scorecards purchased from Fair Isaac and Company, San Rafael, California. Seven use scorecards from an off-the-shelf Fair Isaac (FICO) model, and two use a customized FICO model. Wells Fargo also uses an internally developed model.

Overall reliance on scoring models: Some of the usage factors and considerations are listed below. Financial institutions could choose either to sponsor or invest in these trusts. Sponsors could create the trusts and could originate bridge loans, secured by tax anticipation notes, which would initially fund the trusts. Municipalities would, of course, place their yet-to-be-subscribed obligations into the trusts.

Investors, including financial institutions, would then purchase “community reinvestment certificates” issued by the trusts, much as they would purchase securitized packages of credit card receivables or automobile loans. This same process could apply for the sale of securitized municipal tax liens, which are projected to grow at $6 billion per year.

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Financial Institutions face unique challenges in complying with the CRA in smaller “micropolitan” communities where there are few investment opportunities with acceptable portfolio risk. Opportunities that can be found tend to be characterized by high levels of distressed infrastructure. Small municipal governments face their own challenges in financing community facilities and making physical improvements. The costs of debt rating and issuance of debt are frequently prohibitive because of relatively small-sized issuances. The use of scoring to facilitate business and geographic expansion.

This article offers a potential solution for both financial institutions and small community governments: special asset securitization trusts. These trusts, while still in a conceptual phase, could operate as revolving debt pools for small cities. Small city governments, special districts, schools, hospitals and other taxing jurisdictions could collectively issue debt obligations to secure community facilities and make physical improvements. The IRS allows for the creation of trusts that securitize pooled debt obligations. These obligations are treated as debt for federal income tax purposes so that interest is deductible.

Institutions shown towards the top place greater reliance on the scoring models. In other words, they are more liberal users of the models. Those listed toward the bottom are more conservative users. Based on this survey group, it appears that the longer an institution uses scoring, the more liberal their usage becomes.

Performance of scored loans: The respondents all indicated that the performance of scored loans has been at least as good as expected, with most reporting “better than expected” performance. Five also believe that their scored loans have outperformed their non-scored loans in terms of charge-offs and delinquencies, although to some, this could also be a function of an improved economy. One respondent reported that scored loans have underperformed non-scored loans, although this lender is still satisfied with its scoring system results.

Why scoring is used: Lenders that use scoring models claim several benefits: 1) faster loan decisions, 2) substantial efficiencies, and 3) improved underwriting consistency across an entire organization.

Why other institutions don’t use scoring: Many of the forty-two respondents that do not use scoring models for small business lending prefer to give individual attention to each loan request. They feel that scoring would interfere with the existing culture of the institution, which emphasizes close customer relationships. Many also reported cost as a factor, citing an insufficient scale of business lending to justify the expense of a scoring model.

The resulting analytical tool, with the institution names excluded here, considers four factors: 1) the lender use of scoring for automatic loan approvals; 2) the maximum size of loan applications scored; 3) the volume of scored loans on the organization’s books; and 4) the use of scoring to facilitate business and geographic expansion.

This article offers a potential solution for both financial institutions and small community governments: special asset securitization trusts.
Additionally, even a qualified credit scoring system does not eliminate fair lending concerns. For example, lenders often offer a limited volume of overrides in their use of scoring models. Care must be taken to ensure that reasons for overrides are objective and nondiscriminatory; the reasons for the overrides should then be documented. Lenders should also track the performance of overrides.

**Conclusions and Next Steps**

It is evident that small business lending is now dominated by lenders that use credit scoring models, and that scoring is continuing to attract new borrowers for cost and competitive reasons. It is also clear that the vast majority of these lenders use models from one vendor, and that the fair lending implications of these models appear to be mostly positive.

The Federal Reserve is continuing to research issues related to credit scoring. Some of the areas of possible further research include:

- Evaluating the variables and methodology used by the popular scoring models;
- Obtaining information on the application integrity risk controls in place by vendors and credit bureaus to prevent the distribution of erroneous information;
- Looking at how lenders validate the models they use to ensure that the scoring systems are leading to appropriate decision-making;
- Considering the implications of scoring on credit risk at individual institutions and the entire banking industry;
- Considering differences in regulatory risks faced by lenders based on their selection of vendor or home-grown models.

For more information on this survey or future Fed research please call Gary Palmer at (415) 974-3003.

**Roles of Home for Dinner Partners**

**Bank of America, U.S. Bank, Wells Fargo**

- Provide first mortgages, using specially designed loan products with favorable terms.
- Present the program to Household Bank employees at series of informational sessions.
- Work with potential clients to help them understand various mortgage loan programs and the loan process.

**BankWest of Nevada**

- Provide a loan secured by a second deed of trust to assist the employees of Household Bank with down payment and/or closing costs.

**Household Bank**

- Provide access and marketing to employees.
- Provide space at their facilities for informational and education sessions associated with the program.
- Deposit $50,000 in a CD account to write-down the seconds offered by BankWest of Nevada.

**Nevada Fair Housing Center & Consumer Credit Counseling Service**

- Determine eligibility of each employee and, when appropriate, refer them to Consumer Credit Counseling Service for pre-purchase credit preparation.
- Lead home buyer education sessions, provide credit and post-purchase counseling for employees who participate in the program.
- Serve in a liaison capacity for participants seeking one-on-one assistance throughout the process.

For more information on the Home for Dinner Home Buyer Program, please contact Josey Cousins at Bank of America Nevada (702) 654-7848, Dorreen Davis-Peterson at U.S. Bank Nevada (702) 688-3565, or Steve Linder at Household Bank (702) 243-1390.

**About the Authors**

**Gary Palmer**

Gary Palmer has nearly 20 years of experience at the Federal Reserve Bank of San Francisco. He currently serves as banking staff officer in the Division of Banking Supervision and Regulation. Mr. Palmer’s recent work has focused on researching emerging issues and trends within the banking industry. Previously, he served as information technology officer and as financial analysis officer within the Division. Mr. Palmer holds an M.B.A. degree from the University of California at Berkeley and is a graduate of the Pacific Coast Banking School in Seattle.

**Joselyn Cousins**

Ms. Cousins currently serves on several boards including North Las Vegas Neighborhood Housing Services, Nevada Microenterprise Initiative and the Community Development Recommendation Board for the City of Las Vegas. She attended California State University, San Bernardino and holds a B.A. in Administration.

**Dorreen Davis-Peterson**

Ms. Davis-Peterson began her banking career in 1986, and has been a member of the Bank of America team since 1995. She was appointed member of the Nevada State Department of Human Resources Block Grant Commission in 1997. She joined U.S. Bank in 1992, was named CRA manager in 1993, and undertook the community relations function in 1999. Ms. Davis-Peterson has also held roles in lending, credit analysis, branch management and customer service.

Ms. Davis-Peterson is currently serves on the Advisory Board of the Ethнич Student Resource Center at the University of Nevada, Reno and is an appointed member of the Nevada State Department of Human Resources Block Grant Commission. She holds an A.A. from Truckee Meadows Community College and is currently attending the University of Nevada, Reno.
HOME FOR DINNER HOME BUYERS PROGRAM
Finding a Way to Increase Homeownership Opportunities for Las Vegas Employees

By Joselyn A. Cousins, Vice President, Community Development Banking, Bank of America Nevada and Doreen Davis-Peterson, Community Investment Manager, U.S. Bank Nevada

➤ a sponsoring employer with a base of at least 1500 employees;
➤ a home owner-education and credit counseling component;
➤ down payment assistance options for qualifying borrowers; and,
➤ affordable mortgage products, with rates that could be offered below market.

At the outset of the effort, casinos head-quartered in both Reno and Las Vegas were targeted as sponsoring employers, an obvious first choice in Nevada. But the team found little success with the gaming industry. In late 1998, the Nevada Fair Housing Center (NFHC) joined the planning effort, and several non-gaming employers were identified as Home for Dinner prospects.

Meanwhile, the mortgage divisions of participating banks were busy identifying and creating affordable lending products for the Home for Dinner program. By February 1999, the lending products were in place, and the role of each program partner was clarified. With these steps completed, the planning team was ready to share its Home for Dinner program with three target employers, two of which were local governments, and the other, a credit card bank with a large back-office operation in Southern Nevada.

HOUSEHOLD BANK accepts the concept
Seizing an opportunity to fulfill investment test requirements under the Community Reinvestment Act, Household Bank decided to pilot the program and market it to its Las Vegas employees. But this decision was not without its set of challenges and limitations.

The primary challenge was how to participate in the down payment assistance piece without violating employee benefits law. At its most basic level, the law requires that all non-salary related benefits be made equally available to employees of a corporation. Since Household has offices and staff in other states, and because the program targets those earning 60% or less of area median income, management determined that its participation would have to be “invisible” to employees. Since down payment grants were not an option, an additional partner was needed to complete the puzzle.

In August 1999, a local community bank, BankWest of Nevada, joined the initiative, agreeing to offer second deed of trust loans for a period of five years. The majority come from Asia and so much baggage, it’s just easier to ignore it altogether. The numbers are economically significant. Approximately 1 million new immigrants enter the United States each year. The majority come from Asia and the Americas, and as a result, Los Angeles has replaced New York as the primary point of entry into this country. Although there are new immigrants living in cities and towns across the nation, many regard L.A. as a “living laboratory” . . . the perfect place to study and better understand immigrant issues. In L.A., for example, one out of three residents is foreign born, and the area’s cultural diversity is so great that 79 different languages are spoken in the L.A. Unified School District.

Lessons from the Study

There is a recurring condition in this country’s economic landscape that leaves large segments of our population sitting on the sidelines. The underserved market to which I refer represents enormous, yet still untapped, economic potential. It includes individuals who are systematically lumped into the “unbanked” category; a catch-all word that carries so many stereotypes and so much baggage, it’s just easier to ignore it altogether. The numbers are economically significant. Approximately 1 million new immigrants enter the United States each year. The majority come from Asia and the Americas, and as a result, Los Angeles has replaced New York as the primary point of entry into this country. Although there are new immigrants living in cities and towns across the nation, many regard L.A. as a “living laboratory” . . . the perfect place to study and better understand immigrant issues. In L.A., for example, one out of three residents is foreign born, and the area’s cultural diversity is so great that 79 different languages are spoken in the L.A. Unified School District.

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CRA OFFICERS TAKE THE LEAD
To address this growing problem, a small group of CRA officers met in April 1997, and discussed ways to better capture Las Vegas’ lower wage market. After researching various programs around the country, the team decided to pursue the creation of an employee-assisted housing (EAH) program. The program, which eventually came to be known as the “Home for Dinner Home Buyers Program,” would have four important components: CRA OFFICERS TAKE THE LEAD
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A good starting place is to look at boilerplate requirements that most banks use to determine the stability and creditworthiness of their customers. In the case of new immigrants, these requirements may simply be missing the mark, and with it, opportunities for communities as well as financial institutions. Questions to pose are “what do we really need to know?” and, “Is there another way to achieve the same results?” Concrete action steps for banks to consider include:

**Develop flexible identification requirements**

Bank accounts are a basic point of entry to the financial mainstream of the U.S., but the requirement to provide credit cards and/or multiple forms of photo identification often preclude the ability of newcomers to open a bank account. SAJE has worked with several banks to identify what they really need to know about people, and to develop alternative identification requirements that meet the banks’ needs and are more feasible for our constituents.

**Take a more flexible approach to evaluating credit history and creditworthiness**

Establishing a credit-history is difficult for most first-generation immigrants, even though they may have excellent credit records in their country of origin. The fact that a person or organization has been operating successfully outside the U.S. financial mainstream could be seen as an asset rather than a liability. More respect should be paid to financial success in another country as a valid credit history. An alternative is to accept non-traditional forms of credit history—consistent and timely payment of bills, for example, over a substantial period of time.

**Develop flexible strategies that increase loan opportunities for immigrants**

Cultural adaptations are the key components of successful programs that build and extend credit to new immigrant populations. Korean banks, for example, have helped their customers build credit histories by establishing installment savings accounts that borrow from Korean cultural practices. Autofin, described later, incorporates the familiar tanda process in an institutional lending setting. These are not dissimilar from Christmas Clubs and other traditional American banking products, yet are designed to resonate with the experience of immigrant consumers.

This type of thinking and approach actually opens doors for all underserved people, native Americans and immigrants alike. Indeed, one of the great advantages of accommodating immigrants is how it accomodates the rest of us as well. The following story illustrates how cultural traditions can be adapted to U.S. banking practices in order to reap substantial collateral benefits.

**The Story of Autofin**

Autofin is a large Mexican finance company with over 60,000 customers. The company’s lending strategy is designed to capitalize on tanda, a traditional informal lending circle typically used by women in Mexico to pool resources for “once in a lifetime” expenses such as weddings, quinceneras, or funerals.

Autofin has adapted and formalized the concept so that applicants enter an established lending group defined by the loan amount they are seeking. Autofin, like tanda, requires participants to make monthly contributions to a common fund prior to actually applying for a loan. This way, potential applicants build up savings while establishing a “repayment” history at the same time. After a minimum number of payments into the loan pool, applicants are able to receive car, home, or business loans. But now, instead of making monthly contributions to the pool, they are making monthly loan repayments, under much the same terms as before.

The Autofin story describes how traditional banking products such as savings clubs and secured loans can be adapted to emulate cultural practices around lending and money. This is a relatively new concept for U.S. banks, which adapt to cultural contexts in order to compete in foreign markets, but still shape their domestic products around a white, middle-class consumer model.

Today, substantial “foreign markets” reside in American cities. SAJE plans to continue the ethnic banking project to learn more from other, diverse communities in L.A. Based on our past experience, we are confident that merging the culture of banks with that of new immigrant communities can result in great opportunity and significant potential for both.

SAJE’s ethnic banking study entitled “Transactions: Building Access to Financial Services and Credit Across L.A.’s Immigrant Communities” is available free of charge. SAJE is actively soliciting partnerships with banks that wish to develop innovative, culturally responsive strategies for serving immigrant populations. For a copy of the report or additional information, please contact Gilda Haas, executive director, at (323) 732-9961.
SAJE is a 501(c)3 corporation founded on the premise that many of Los Angeles’ social problems have economic roots. Our primary mission is to build economic power among grassroots people. SAJE’s strategy is a bottom-up approach that convenes people affected by a problem and helps them create solutions with others at a much greater scale.

Our unique contribution to community development in Los Angeles is our focus on the relationships between ownership, capital and participation. Towards this end, SAJE’s core programs promote access to banking services, the development of sustainable jobs through cooperative enterprises, and the creation of public policies that make capital more accountable to community and worker needs.

RECENT ACCOMPLISHMENTS

SAJE has been building new economic options for working class people in Los Angeles since our inception in 1994. In addition to our ethnic banking project, some of our accomplishments include:

➤ Welfare-to-Work Banking: SAJE has created a partnership among community reinvestment activists, welfare recipients, advocates, L.A. County’s Department of Social Services, and Washington Mutual Bank to create the County’s first direct-deposit policy and a welfare-to-work bank account that may ultimately serve thousands of people on aid in L.A. County. Presently in the pilot stage, the program anticipates federally mandated electronic benefit transfer laws that must be implemented across the country by the year 2001. It will provide an alternative banking model for people who are being mainstreamed from welfare checks to paychecks.

➤ Cooperative Job Development: SAJE has organized immigrant low-wage workers into cooperative job development programs that provide alternatives to exploitative working conditions, provide living wages, and a sustainable foundation for the future. To date, our Hollywood Domestic Workers Cooperative has generated over 200 housecleaning jobs which pay an average of $10 per hour.

➤ Healthy Homes Collaborative: SAJE is the lead organization of a collaborative which includes Esperanza Community Housing, St. John’s Well Child Clinic, and L.A. County’s Childhood Lead Poisoning Prevention Program. The project seeks to prevent lead poisoning in SAJE’s own “lead hot spot” neighborhood by integrating housing, health, and employment initiatives into a comprehensive approach. We have recently trained 15 neighborhood residents as State-certified lead abatement workers and are building a foundation for a more strategic lead abatement policy in L.A.

For more information, please call or write us:

SAJE, 2636 Kenwood Avenue, Los Angeles, CA 90007, (323) 732-9961

ABOUT THE AUTHOR

GILDA HAAS is an organizer, educator, and economic development professional who has been assisting community and labor organizations in building economic development projects and policies from the ground up for over twenty years. She is the director of Strategic Actions for a Just Economy (SAJE), an organization dedicated to building economic power for working class people in Los Angeles.

Ms. Haas’ contributions to economic development are varied. She founded Communities for Accountable Reinvestment, a diverse coalition based in Los Angeles that fights against redlining and for community development banking. She was also founding Board member of South Central People’s Federal Credit Union. Ms. Haas also created the Community Scholars Program, housed in UCLA’s School of Public Policy and Social Research, where she has taught economic development courses for the past 15 years. Congress has tapped Ms. Haas’ expertise numerous times by requesting her testimony on community banking issues.
The Las Vegas Valley is home to thousands of companies that employ low- to moderate-income wage earners. Visitors are often amazed by the sheer number of dealers, waiters, parking attendants, and others who work hard to maintain the city’s reputation as America’s greatest play land. While hourly wages tend to be low in the hospitality industry, employees fare pretty well—mainly because tips supplement their low pay. But in the large urban valley that exists beyond the Strip, there are hundreds of other companies where tips aren’t part of the trade. For employees of these companies, their paychecks are often their sole source of income.

Employment opportunities at all levels of the income scale have fueled explosive population growth in the Las Vegas area. As a result, the ratio of renters to owners has reached an all-time high. Nevertheless, Las Vegas continues to place a high priority on home ownership, and the development of affordable, single-family housing is a prevalent lending activity for many financial institutions operating in Southern Nevada.

Affordable mortgages are also high on the area’s priority list, again fueled by population growth. But banks have struggled with how to effectively reach and serve a potentially profitable segment of the market… the thousands of low- and moderate-income wage earners slowly being shut out of the Las Vegas housing market.

CRA Officers Take the Lead

To address this growing problem, a small group of CRA officers met in April 1997, and discussed ways to better capture Las Vegas’ lower wage market. After researching various programs around the country, the team decided to pursue the creation of an employee-assisted housing (EAH) program. The program, which eventually came to be known as the “Home for Dinner Home Buyers Program,” would have four important components:

- a sponsoring employer with a base of at least 1500 employees;
- a home owner education and credit counseling component;
- down payment assistance options for qualifying borrowers; and,
- affordable mortgage products, with rates that could be offered below market.

At the outset of the effort, casinos head-quartered in both Reno and Las Vegas were targeted as sponsoring employers, an obvious first choice in Nevada. But the team found little success with the gaming industry. In late 1998, the Nevada Fair Housing Center (NFHC) joined the planning effort, and several non-gaming employers were identified as Home for Dinner prospects.

Meanwhile, the mortgage divisions of participating banks were busy identifying and creating affordable lending products for the Home for Dinner program. By February 1999, the lending products were in place, and the role of each program partner was clarified. With these steps completed, the planning team was ready to share its Home for Dinner program with three target employers, two of which were local governments, and the other, a credit card bank with a large back-office operation in Southern Nevada.

Household Bank Accepts the Concept

Seizing an opportunity to fulfill investment test requirements under the Community Reinvestment Act, Household Bank decided to pilot the program and market it to its Las Vegas employees. But this decision was not without its set of challenges and limitations.

The primary challenge was how to participate in the down payment assistance piece without violating employee benefits law. At its most basic level, the law requires that all non-salary related benefits be made equally available to employees of a corporation. Since Household has offices and staff in other states, and because the program targets those earning 60% or less of area median income, management determined that its participation would have to be “invisible” to employees. Since down payment grants were not an option, an additional partner was needed to complete the puzzle.

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Lessons From the Study

Banks that are interested in playing a larger role in the financial lives of new immigrants may borrow some lessons from the SAJE study. There are countless communication efforts that can be made, such as hiring staff who speak the language, both literally and culturally, and providing materials in languages other than English. But to learn how banking issues interface with the immigrant experience requires flexible thinking.
ABOUT THE AUTHOR

GARY PALMER has nearly 20 years of experience at the Federal Reserve Bank of San Francisco. He currently serves as banking officer in the Division of Banking Supervision and Regulation. Mr. Palmer’s recent work has focused on researching emerging issues and trends within the banking industry. Previously, he served as information officer within the Division. Mr. Palmer holds an M.B.A. degree from the University of California at Berkeley and is a graduate of the Pacific Coast Banking School in Seattle.

Additionally, even a qualified credit scoring system does not eliminate fair lending concerns. For example, lenders often allow for a limited volume of overrides in their use of scoring models. Care must be taken to ensure that reasons for overrides are objective and nondiscriminatory; the reasons for the overrides should then be documented. Lenders should also track the performance of overrides.

CONCLUSIONS AND NEXT STEPS

It is evident that small business lending is now dominated by lenders that use credit scoring models, and that scoring is continuing to attract new followers for cost and competitive reasons. It is also clear that the vast majority of these models use single vendor, and that the fair lending implications of these models appear to be mostly positive.

The Federal Reserve is continuing to research issues related to credit scoring. Some of the areas of possible further research include:

➤ Evaluating the variables and methodology used by the popular scoring models;
➤ Obtaining information on the application integrity risk controls in place by vendors and credit bureaus to prevent the distribution of erroneous information;
➤ Looking at how lenders validate the models they use to ensure that the scoring systems are leading to appropriate decision-making;
➤ Considering the implications of scoring on credit risk at individual institutions and the entire banking industry;
➤ Considering differences in regulatory risk factors for lenders based on their selection of vendor or home-grown models.

For more information on this survey or future Fed research please call Gary Palmer at (415) 974-3003.

senitives of the three participating mortgage lenders—Bank of America, U.S. Bank and Wells Fargo—along with team members from Nevada Fair Housing Center and Consumer Credit Counseling Service presented the FAH concept. Presentations included an overview of the program, homeownership education requirements, and steps in the mortgage lending process.

It is not yet known how many of those first 95 will proceed through the program and qualify for a mortgage. The estimated time for completion is anywhere from 1–12 months, depending on the condition of the applicant’s credit.

And, although the program is targeted to serve people earning from 50–80% of the area median income, the team is committed to offering it to anyone interested in pursuing home ownership.

This commitment is demonstrated by the critical roles played by the Nevada Fair Housing Center and the Consumer Credit Counseling Service. In addition to leading the educational effort, the NFHC received a program grant from the U.S. Department of Housing and Urban Development to serve in a liaison capacity for participants who need one-on-one assistance throughout the entire process. If requested, NFHC staff will guide participants through every step to ensure that nobody “gets lost in the shuffle.” For those with weak credit, Consumer Credit Counseling Service is on-hand to provide free credit counseling and credit repair.

The Future of the Program

After the initial round of sessions are complete, the Home for Dinner team will meet to discuss next steps for the program. Topics for discussion will likely include outreach to additional Las Vegas employers and the creation of non-profit partnerships to expand down payment and closing cost options. In the meantime, hundreds of Household Bank employees will be building a financial edge for their futures and contributing to the stability of the neighborhoods they choose to call home.

ROLES OF HOME FOR DINNER PARTNERS

Bank of America, U.S. Bank, Wells Fargo

➤ Provide first mortgages, using specially designed loan products with favorable terms.

➤ Present the program to Household Bank employees at series of informational sessions.

➤ Work with potential clients to help them understand various mortgage loan programs and the loan process.

BankWest of Nevada

➤ Provide a loan secured by a second deed of trust to assist the employees of Household Bank with down payment and/or closing costs.

Household Bank

➤ Provide access and marketing to employees.

➤ Provide space at their facilities for informational and education sessions associated with the program.

➤ Deposit $50,000 in a CD account to write-down the seconds offered by BankWest of Nevada.

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➤ Determine eligibility of each employee and, when appropriate, refer them to Consumer Credit Counseling Service for pre-purchase credit preparation.

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JOSELYN COUSIN is a vice president in Community Development Banking at Bank of America in Nevada. Ms. Cousin is responsible for the organization’s performance under the Community Reinvestment Act. She administers this Community Reinvestment Act program through partnerships with community group representatives and Bank of America senior management.

Ms. Cousin began her banking career in 1986, and has been a member of the Bank of America team since 1995. She was appointed to her current position in 1994. Her past roles include residential lending, construction lending and retail banking.

Ms. Cousin currently serves on several boards including North Las Vegas Neighborhood Housing Services, Nevada Micenterprise initiative and the Community Development Recommending Board for the City of Las Vegas. She attended California State University, San Bernardino and holds a B.A. in Administration.

DORREEN DAVIS-PETERSON is a vice president and manager of U.S. Bank’s Community Investment Department in Nevada and Utah, responsible for assuring the organization’s compliance with the objective and technical requirements, and implementation of the Federal Community Reinvestment Act. In addition, she manages community relations for U.S. Bank in both states, including corporate philanthropy, employee volunteerism, and community partnerships.

Ms. Davis-Peterson began her banking career in 1977. She joined U.S. Bank in 1992, was named CRA manager in 1993, and undertook the community relations function in 1999. Ms. Davis-Peterson has also held roles in lending, credit analysis, branch management and customer service.

Ms. Davis-Peterson currently serves on the Advisory Board of the Ethnic Student Resource Center at the University of Nevada, Reno and is an appointed member of the Nevada State Department of Human Resources Block Grant Commission. She holds a A.A. from Truckee Meadows Community College and is currently attending the University of Nevada, Reno.
CRA INVESTMENT CONCEPT

This article offers a potential solution for both financial institutions and small community governments: special asset securitization trusts. These trusts, while still in a conceptual phase, could operate as revolving debt pools for small cities. Small city governments, special districts, schools, hospitals, and other taxing jurisdictions could collectively issue debt obligations through credit scoring, we wanted to test the efficiency of credit scoring models in expanding credit access and reducing fair lending risks. Scoring models can have positive fair lending implications. A properly constructed model avoids using any variable that is among the prohibited bases in Regulation B. A scoring program can therefore help reduce fair lending risks to lenders and facilitate an equitable expansion of credit access.

Financial institutions face unique challenges in complying with the CRA in smaller “micropolitan” communities where there are few investment opportunities with acceptable portfolio risk. Opportunities that can be found tend to be characterized by high levels of distressed infrastructure. Small municipal governments face their own challenges in financing community facilities and making physical improvements. The costs of debt rating and issuance of debt are frequently prohibitive because of relatively small-sized bond issues in micropolitan areas.

This resulting analytical tool, with the institution names excluded here, considers four factors: 1) the lender use of scoring for automatic loan approvals; 2) the maximum size of loan applications scored; 3) the volume of scored loans on the organization’s books; and 4) the use of scoring to facilitate business and geographic expansion.

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credit scoring models, just as consumer and mortgage lending is similarly dominated by scoring users. Also, given the competitive advantage that is possible, it appears that more and more small and mid-sized banks will adopt scoring over time.

Survey Questions
Respondents were asked a variety of questions about their credit scoring programs. A summary of their responses follow:

Length of time used: Eight of the nine users implemented their scoring programs within the past three years. Only Wells Fargo started its program earlier. This industry pioneer in credit scoring implemented its small business scoring model in 1989.

Automatic approvals: Six of the nine banks that use scoring automatically grant some loan requests based on customer scores. The other three use scoring to streamline their lending processes, but they continue to subject all loan applications to human review.

Scoring for business expansion: Three use scoring as a means to attract new customers through mail solicitations, but only one uses scoring to expand outside its normal geographic area.

Home-grown or vendor models: Interestingly, all nine of the respondents use scorecards purchased from Fair Isaac and Company of San Rafael, California. Seven use scorecards from an off-the-shelf Fair Isaac (FICO) model, and two use a customized FICO model. Wells Fargo also uses an internally developed model.

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All respondents use scoring models. They range in size from less than one million dollars to over one hundred billion. The survey found that, for these 51 banking organizations all use credit scoring models for business lending: Wells Fargo & Company, Union Bank of California, First Security Corporation, Zions Bancorporation, and BankWest Corporation. These findings provide support to the notion that small business lending is now dominated by those that use credit scoring models, just as consumer and mortgage lending is similarly dominated by scoring users. Also, given the competitive advantage that is possible, it appears that more and more small and mid-sized banks will adopt scoring over time.

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Credit Scoring for Small Business Lending

Credit scoring models are increasingly replacing human judgment in lending decisions. Scoring dominates the consumer-lending arena, with the vast majority of credit card and mortgage originations aided by credit scoring models. All indications are that small business lending is going the same route.

During the first half of 1999, the Federal Reserve Bank of San Francisco conducted a survey of 51 12th District financial institutions to learn more about the use of credit scoring in underwriting small business loans. The following presents highlights of the survey results, which cover the extent that scoring is used among large and small banks and the varying approaches to scoring system implementation. The results will also serve as the basis for future Fed research on this topic.

Models for Business Lending

Similar to consumer loan models, small business models use credit history information from credit bureaus to statistically estimate the likelihood that borrowers will repay their loans. For business lending models, credit bureau information for the business’s principal owner is used. Additionally, the models factor in information from the loan application such as the business owner’s deposit account relationships, liquid assets, and type of business. Sometimes, credit history variables on the small business itself are also incorporated into the models used. This data usually comes from Dunn and Bradstreet.

Typically, the models use some 20–25 variables, and the end-result is a single measure, or score, for each small business. Scores normally range from 300 to 900. The higher the score, the greater a small business’s creditworthiness.

Automatic decisioning: Lenders often set policies to allow for automatic lending decisions. Applicants receiving scores above a designated cut-off number are automatically approved, and those receiving scores below another cut-off are rejected. Generally, there’s a gray-area in between where human judgment is involved. In the example below, a lender automatically approves a business loan application when the amount requested is for $50 thousand and less and the business’s credit score is 650 and higher. A score between 600 and 649 requires credit officer review, while lower scores result in automatic rejection. This would be the general policy followed by the lender, but with overrides allowed in certain situations.

LENDER SURVEY

To find out more about scoring usage within the 12th Federal Reserve District, a survey was administered informally to a sample of lenders. Completed surveys were returned from the five largest banking companies head-

### TRAINING SESSIONS AT-A-GLANCE

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CRA Conference brochures with detailed session and registration information will be mailed in mid-January. Contact Lena Robinson at (415) 974-2717 if you do not receive a brochure or if you would like more information.

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By Gary Palmer, Banking Studies Officer, Division of Banking Supervision & Regulation, the Federal Reserve Bank of San Francisco

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### EXAMPLE OF DECISIONING POLICY USING CREDIT SCORES

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<tr>
<td>650–900</td>
<td>Approve</td>
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<tr>
<td>650–900</td>
<td>Review (&quot;gray area&quot;)</td>
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<tr>
<td>300–599</td>
<td>Reject</td>
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</tbody>
</table>

| Loans over 50K |
| 600–900 | Review |
| 300–599 | Reject |
The last month has seen a flurry of editorial activity and op-ed pieces written about the \textit{Financial Services Modernization Act of 1999}. Clearly, the debate isn’t over relative to its potential impact and long-term value. Time and experience will likely serve as the ultimate arbiters.

Debate and conjecture notwithstanding, the Federal Reserve Board is heading into its own flurry of activity to meet the March 2000 deadline for completion of the legislation’s implementing language. We expect this will include the new CRA provisions as well. Although time is short, there are a few proactive steps that financial institutions can take to ensure readiness for implementation of the new law:

- **Develop a mechanism to internally assess and monitor the CRA activities of financial subsidiaries and affiliates.** This is an area where CRA actually got some additional “teeth,” since the new law mandates that all financial institution subsidiaries of a bank holding company have at least a satisfactory CRA rating in order to engage in any of the new activities granted under the bill. If even one subsidiary is rated below satisfactory, the expansion application will be denied.

- **Review current CRA agreements and create a more formal tracking system for activities within these agreements.** Under the new sunshine requirements, both banks and their non-profit partners will be obliged to report (on an annual basis) CRA-related payments, fees, loans, investments, and services and their terms and conditions. Non-profits must also report on the use of said funds, including compensation, administrative expenses, travel, entertainment and consulting/professional fees. Current thresholds mandate reporting of cash payments and grants (individual or aggregate) in excess of $10,000 and loans (individual or aggregate) in excess of $50,000.

- **Consider formalizing a CRA self-assessment process and establish close ties with your compliance examiners to make sure you’re on the right track.**

**ECONOMIC EDUCATION PROGRAM**

Whole School Program.

Banks and businesses may fund classrooms, whole grades, or adopt entire schools. Banks can receive \textit{Test credit} when they provide funding to sponsor a Whole School Program in a low-income area for sustainable business ventures. They are seeking matching funds to banks for a loan pool, as well as grants for technical assistance.

For more information, please contact Michele Prichard, director of Special Projects at (310) 455-5611, ext. 104.

**NEW WEB SITE LINKS PROJECTS TO PROGRAMS AND RESOURCES**

\textit{1stSource} is a new Internet site launched in October by the Federal Reserve Bank of Kansas City. The site is a guide to information about programs that assist community and economic development projects. Whether you are a developer trying to build affordable housing, a small business entrepreneur seeking financing, a small farmer operating a farm, or a community seeking to improve its infrastructure, \textit{1stSource} can help you easily and quickly cut through the mass of programs. With a little information from you about your project, \textit{1stSource} will provide you with a summary of those programs that best fit your project’s needs.

The site is \texttt{http://www.1stsource.kc.frb.org/programs/index.asp}. For more information, call John Wood at the Federal Reserve Bank of Kansas City at (800) 835-1010, ext. 2205.

**THE SOCIAL ENTREPRENEURIAL FUND (SEF)**

In its first two years of operation, the Social Entrepreneurial Fund (SEF) of the Liberty Hill Foundation has distributed over $300,000 in grants to nine non-profit and/or worker-owned micro-enterprises in low-income communities of Los Angeles. Based on lessons learned from this non-profit program, Liberty Hill is ready to proceed with micro-loans to private entrepreneurs in low-income areas for sustainable business ventures. They are seeking matching investment funds from banks for a loan pool, as well as grants for technical assistance.
2000 CRA Roundtable Dates

Financial institution CRA officers and bank community development staff are invited to participate in the Roundtables. These meetings are valuable sources of information about CRA regulatory compliance and about local community credit, service and investment opportunities.

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<th>2nd Quarter</th>
<th>3rd Quarter</th>
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COMMUNITY AFFAIRS CONTACTS FOR ROUNDTABLES:

Adria Graham Scott (213) 683-2785 (Los Angeles, Phoenix, San Diego)
Craig Nolte (206) 545-1761 (Boise, Portland, Seattle)
Fred Mendez (415) 974-2722 (Northern California, Las Vegas, Utah)
Lena Robinson (415) 974-2717 (Leadership Councils)

Free subscriptions and additional copies are available upon request from the Community Affairs Unit, Federal Reserve Bank of San Francisco, 101 Market Street, San Francisco, California 94105, or call (415) 974-2978.

Change-of-address and subscription cancellations should be sent directly to the Community Affairs Unit. Please include the current mailing label as well as any new information.

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Seasons Greetings from the Staff of Community Affairs

FEDERAL RESERVE BANK OF SAN FRANCISCO
101 Market Street
San Francisco, CA 94105
Address Service Requested

ATTENTION:
Chief Executive Officer
Compliance Officer
CRA Officer
Community Development Department

Credit Scoring for Small Business Lending

We present the results of a 12th District banking survey that examined the use of credit scoring for small business underwriting. Key differences between large and small banks illuminate potential industry trends and raise interesting research possibilities for future study.

Creating Cultural Windows to Banking Opportunities

New immigrant communities across the United States represent tremendous, untapped potential. This article presents some key findings from an ethnic banking study conducted in Los Angeles, and suggests cultural adaptations as a way to reach this underserved market.

Micropolitan Community Reinvestment Trusts: A CRA Investment Concept for Small Communities

Searching for investment opportunities in small towns can be a CRA officer’s worst nightmare. Read on to learn how this CRA investment concept might benefit your financial institution and its assessment area.

Home For Dinner Home Buyers Program

Committed to “finding a way home,” a group of Las Vegas financial institutions create an employer-assisted mortgage loan and down payment program for low- and moderate-income employees.

Special Insert:

More on CRA Investments...

We hope you’ll enjoy this edition’s special insert featuring excerpts from the 1999 National Conference on Community Development Investments. You’ll find solid technical information, and practical tips for today’s shrewd CRA investor.