

## Savings Banks and Community Development: A Remedy for Runaway Capital

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Economic development of the inner-city is one of the decade's most pressing political and social problems. No politician today makes a major domestic policy speech without appropriate reference to bringing the ghetto into the "mainstream" of American society. However, there is no general agreement on the proper approach to accomplishing this goal.

Our basic assumption in this article is that the pivotal element of the process of increasing inner-city wealth-production is the free access to "risk" capital for new enterprise. Even cursory study of the history of American industry leads to the conclusion that without the initial influx of British investment money the American industrial machine would not have been built so rapidly nor have become self-sustaining at such an early date. Assembling the essential factors of production — industrial plant, machinery, skilled labor and management, technological advances — requires a substantial initial capitalization; if the inner-city is to realize the potential of its labor force, it must find the capital or credit to build the apparatus necessary to use that asset in wealth production. This is all fairly common economic doctrine. Of course, it would be foolish to suggest that an ample supply of risk capital or credit will solve all the problems of economic development of the inner-city; however, all the skill and potential of a people and a community cannot increase their wealth without it.

The shortage of capital in the inner-city today is easily measured. First, the difficulties that citizens

of the inner-city experience in trying to obtain capital and credit through the normal investment money outlets of the American economy are well known.<sup>1</sup> Economic statistics uniformly indicate the poverty of the inner-city areas. Not only is there personal poverty (as illustrated by the familiar range of unemployment and income-level statistics<sup>2</sup>), but there is little social overhead (as measured by housing, health care, education, crime and drug addiction statistics). To begin building all the institutions of an economically developed community — hospitals, schools, industries and housing — requires huge outlays of development capital.<sup>3</sup>

This needed capital is not available from the significant sources of capital in the United States, including commercial banks,<sup>4</sup> the securities market, and existing industrial corporations. As Theodore Cross indicates:

"No profit opportunities exist (in the inner-city) to overcome the chaotic economic dis-incentives which act as a barrier to moving established outside capital into the slum . . . Credit is not exported to the ghetto because the ghetto borrower is risky, unpredictable, and unreliable."<sup>5</sup>

Large commercial banks, in short, are afraid of inner-city loans. This fear is probably not altogether rational, or predicated entirely on business considerations, since in the white economy loans are made even when there is a statistical certainty of some failure. Only recent social and political pressure has induced established industrial and commercial enterprises to build and invest in the inner-city. And this effort has been too small to make a real difference.

The problems encountered by the individual minority businessman in attempting to finance his operations are not very different from those faced by the community development corporations and other minority enterprises. Obtaining funds from the federal government, the primary source of cash, requires a long upstream pull through the red tape of the bureaucracy.<sup>6</sup> But the government units of the country will supply only a fraction of what the inner cities need. The costs of economic development, over and above what the government will supply or guarantee, must be assumed by inner-city residents themselves. The only people who can overcome the "economic disincentives" of the inner-city are those who live there. Inner-city people either individually or collectively must develop their own wealth producing apparatus — which in turn will create the tax base which can produce health, educational and cultural institutions which are essential to a decent standard of living. Any non-romantic reading of American politics must lend itself to this interpretation.

Thus it is essential that people of the inner-city find a viable credit or capital outlet to serve their many pressing needs. We believe that savings banks, community institutions existing mostly in urban areas, may be able to provide some of this capital and credit. Their accumulated surplus of investment funds<sup>7</sup> and the manner in which these funds are now regulated by the states suggest, as we shall attempt to show, a unique opportunity for leaders of the country's decaying inner-city areas to obtain the capital they need to

begin genuine development efforts.

### Savings Banks: The potential and the practice.

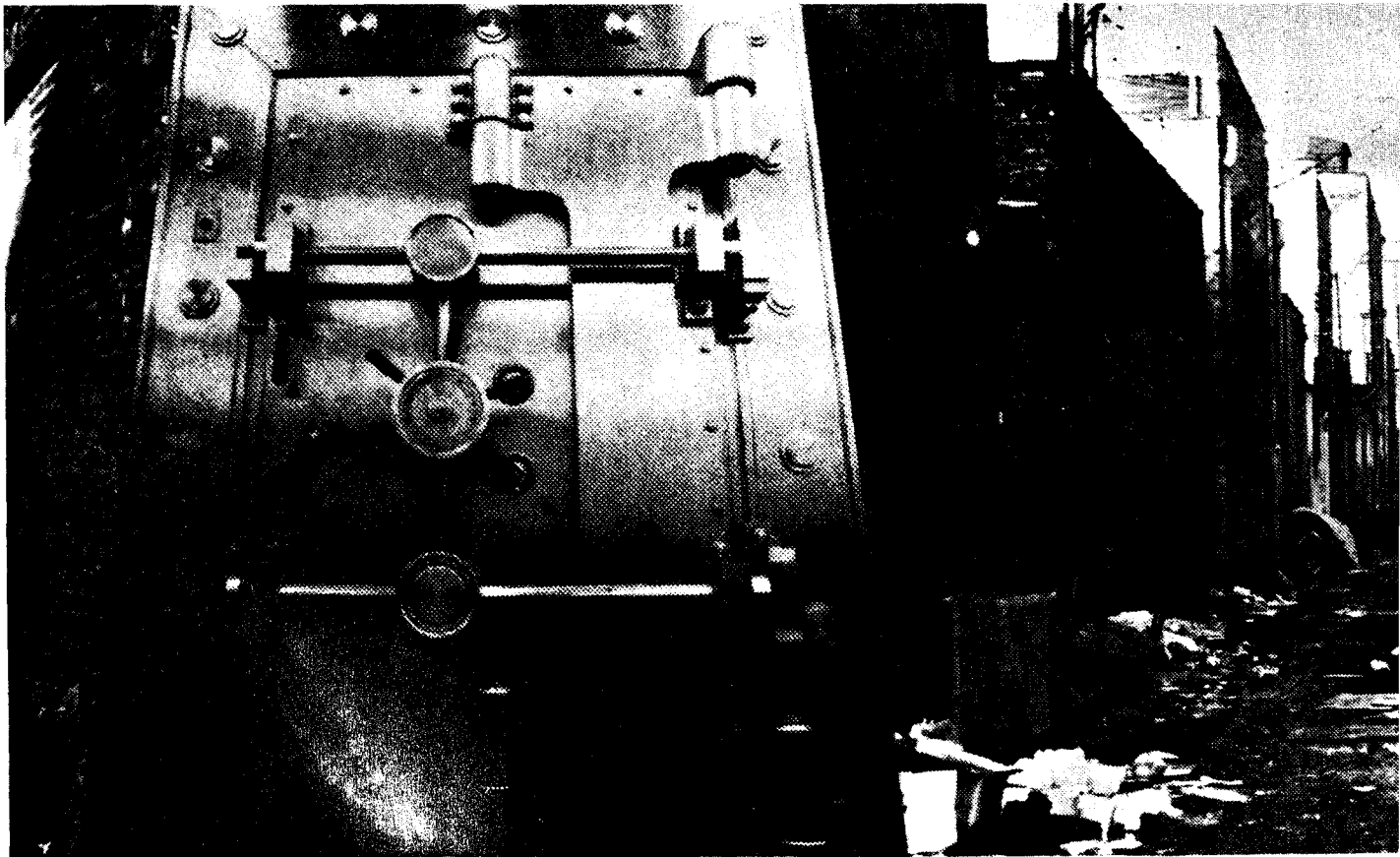
The potential of existing mutual savings banks as a capital source for the revitalization of urban areas, for community development, and for the support of minority enterprises should not be underestimated. The savings bank sector of the banking industry is a rapidly growing one that controls enormous wealth. At the close of 1970, the 494 mutual savings banks in the country held total assets of approximately \$79 billion, representing an increase of 97% in the ten years since 1960. The time deposits held by these institutions accounted for approximately 18 per cent of the total funds held in individual savings accounts at the close of 1970.<sup>8</sup>

In certain sections of the country, the economic importance of savings institutions is even more pronounced than national figures indicate. Due primarily to the restrictions imposed by state-chartering, most savings banks are located in New England, the Middle Atlantic states and the Pacific Northwest. This concentration amplifies their role in the economy of these particular regions. Indeed, in five states —

New York, Connecticut, Massachusetts, New Hampshire, and Maine — mutual savings banks hold more savings than commercial banks and savings and loan associations combined.<sup>9</sup>

In certain local areas, the dominance of savings banks in the local savings market is even more striking. In several major metropolitan areas in the East, savings banks, in spite of competition from commercial banks and savings and loan associations, hold over half of the total volume of savings deposits. These areas include New York, Boston, Buffalo, Providence, Albany-Schenectady-Troy, Bridgeport, New Haven, and Hartford. In several others, including Philadelphia, Newark, and Rochester, N.Y., savings banks outrank either of their competitors.<sup>10</sup> The consequence of this geographically concentrated power enjoyed by savings banks is that their investment policies play a crucial, if not determinative, role in the economic development of these regions.

In spite of this regional concentration, savings banks are a major source of funds in the national housing market. Traditionally, savings banks have channeled their funds into long term investments, primarily mortgage loans. In 1970, mortgage holdings represented 73 per cent of their total assets. As a result, savings banks play a key role in mortgage markets. They rank first among *all types* of financial institutions in holdings of FHA and VA mortgages, holding more than one-fourth of mortgage debt guaranteed by the federal government. Because



their mortgage investments are concentrated in "owner-occupied residential housing," savings banks are the second largest source of non-farm residential mortgages of all types in the country.<sup>11</sup> Furthermore, a significant portion of this mortgage lending is on properties outside the state where the lending bank is chartered.

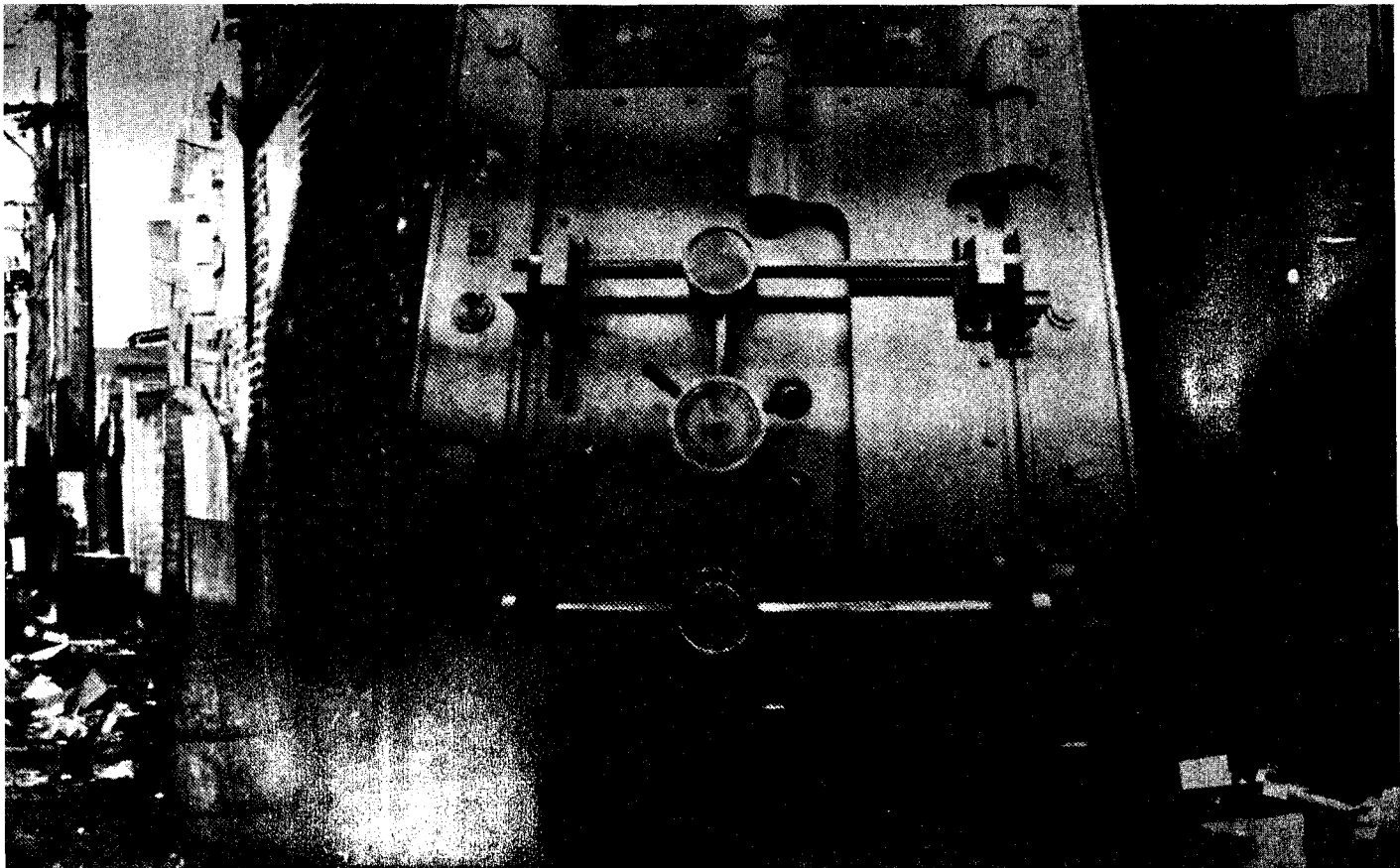
That mutual savings banks have developed such sizable economic power is testimony to the diligence and efficiency with which these institutions have pursued the savings dollar of middle- and lower-income Americans. Mutual savings banks were originally established to encourage thrift by providing a financial institution where relatively small savings could be deposited safely and with profit.<sup>12</sup> Many of the first savings banks restricted the size of accounts to relatively small deposits. Today these restrictions still remain at several banks, and, in some states, have been written into law.<sup>13</sup> Thus, even today, savings banks rely primarily on the small depositors: as of June 30, 1970, 60.2 per cent of the individual savings accounts in these banks showed a balance of less than \$1,000.<sup>14</sup> Furthermore, these depositors are almost exclusively people who live or work within the immediate area served by the bank.<sup>15</sup> In addition, in most states savings banks may not accept deposits from any commercial enterprise; only individuals and non-profit organizations may hold accounts.<sup>16</sup>

This deposit pattern has certain implications that must be considered in determining the proper invest-

ment role of savings banks. Unlike commercial banks and life insurance companies, mutual savings banks do not, and are not expected to, finance large corporations. Rather, a savings bank is expected to pursue an investment policy that serves the best interests of its depositors, who are the low- and middle-income residents of the town or city in which the bank is located. The structure of these banks, that is as mutual institutions with sharp restrictions on branching, implies the same.

It has long been assumed, by savings bankers and their critics, that this purpose of promoting the financial welfare of lower income depositors was served by sound, conservative investment policies which assured security and guaranteed a reasonable return on the savings dollar. Whether this narrow view of the purpose of savings banks is justified today is open to serious question. Would not the best interests and needs of the depositors be better served by investment policies oriented to local economic development and urban redevelopment? But would the pursuit of such an investment policy be inconsistent with the traditional conservative money management principles of savings bank management? If so, how should these tensions be resolved?

Whatever the ideal resolution of this conflict, there is considerable doubt whether the current investment policies pursued by savings banks serve the best interests of their main depositors and the local community. The largest savings banks are located in large cities, and their depositors are primarily city



residents. Despite the desperate need for capital to rebuild inner-city housing and to finance community development, savings banks *export* the capital raised from inner city residents. Today 39.1 per cent of the mortgage holding of savings banks are on out-of-state property. These out-of-state holdings are concentrated in California, Florida, Texas, and Virginia, none of which is known as capital-poor.<sup>17</sup> Over 48 per cent of the mortgage holdings of savings banks are FHA and VA underwritten mortgages; this ties savings banks into the single family residential-suburban patterns of these institutions.<sup>18</sup> The net effect of these investment policies is that suburban growth is financed with capital raised in the city.

This policy of exporting capital, in addition to reducing the amount of capital available for inner city development, increases the living costs of the very city residents who contribute this capital. As suburbs continue to expand, financed to a great extent by capital made available through savings banks, the relative position of the inner city in the American economy declines. The upper and middle classes migrate out to suburban areas followed by businesses in search of qualified labor and more accessible markets. The net effect of this trend is to decrease the property tax base of the inner city. Municipal expenditures are then financed through higher property tax rates. A recent authoritative study indicated that, with a few exceptions, per capita property tax revenues are significantly higher in inner cities than in their suburbs.<sup>19</sup> Furthermore, the same study demonstrated that residential property taxes are extremely regressive since property tax payments constitute a significantly larger portion of the budget of lower-income families, whether they rent or own their dwellings, than of their wealthier counterparts.<sup>20</sup> Thus, the low and middle-income inner-city resident suffers significant financial detriment because suburban expansion chips away at the inner city tax base. Savings bank investment policies that fuel this suburban expansion hardly serve the interests of inner-city residents.

The irresponsible performance of the savings banks in refusing to recognize the needs of their depositors and the community in which they exist dictates a re-examination of the legal and political structure in which they operate.

The need for critical examination by the legislature of savings banks and their investments is made more compelling first, by evidence that savings bankers in certain areas have consciously induced and supported the concentration of racial minorities in the inner city and second, by pressures for the adoption of federal charter legislation for mutual savings banks.

Hearings before the Antitrust and Monopoly Subcommittee of the Senate Judiciary Committee held in Boston in September of this year reveal that the Boston Banks Urban Renewal Group, a consortium of Boston area savings institutions, had tightly regulated the flow of federally supported home mortgages that were available to blacks so as to maintain a pattern of separate black and white communities.<sup>21</sup> Loans were available only on homes within the

specified boundary lines drawn by the banking cartel. Minority citizens were thus unable to obtain mortgage financing in other parts of Boston. And certain neighborhoods within "the area" were subject to the destructive cycle of speculation and blockbusting. The impact of this program of urban renewal, supposedly beneficial to minority groups, was aptly described by a minority group representative at the hearings.

"Real estate brokers just didn't show houses outside the area because they knew that the banks would reject mortgage applications for them. . . The BBURG coalition had decided where the black community could live. . . [The whole system] limits free competition and access to banks that whites enjoy in shopping for mortgages under a free enterprise system."<sup>22</sup>

The Subcommittee plans to hold further hearings, examining similar allegations in other major cities.

The attempt on the part of the savings bank industry to persuade Congress to adopt a system of nationwide federal chartering for mutual savings institutions provides a second reason for re-examining the investment practices of savings banks.<sup>23</sup> If enacted, federal charters would enable the savings bank industry to expand into 31 additional states, increasing their economic power in the process. The federal chartering movement presents an excellent opportunity to reevaluate existing policy towards savings banks and to shape more enlightened policy for the future.

Unfortunately, there has been little indication in congressional proceedings to date that any major revisions of policy can be expected. The most recent federal chartering bill to receive committee approval, the Federal Savings Institution Act of 1967, proposed essentially to adopt the existing patterns of state regulations in the federal sphere. The major concern expressed by the committee was the need to assist savings banks in performing their traditional role as a source of funds for the national mortgage market.<sup>24</sup> Hearings held on the proposed legislation produced only bickering among commercial banks, savings banks, and savings and loan associations over how the national savings pie should be divided.<sup>25</sup> The viewpoints of those who may have sought revisions in the traditional loan and investment policies of savings institutions were not represented at the hearings, nor were they recognized in the committee report. Congressional policy should not be predicated on such a one-sided legislative record.

In terms of the development of the inner-city, it is crucial that public interest representatives illuminate the social irresponsibility of savings banks and present constructive proposals for reform when the battle for federal chartering is renewed in Congress. Furthermore, federal chartering need not be viewed only as a means of reform. Whatever their faults, mutual savings banks have proven to be effective institutions for accumulating capital. The mutual savings bank provides an excellent model upon which to structure new institutions specifically designed to raise capital in lower-income communities and to apply this capital to the economic development of such communities. Federal legislation should not seek solely to reform *existing* banks — a task that may prove

extremely difficult due to the inbred conservatism and the political clout of these banks. If "federal chartering" legislation were enacted which incorporated the specific structure, disclosure, and investment regulations we propose later in this article, the opportunity would be ripe for inner-city communities to create new savings banks particularly oriented to inner-city capital and credit needs.

## Savings Banks: The legal framework.

### 1. Internal Organization

The evolution of the early savings banks into so-called "modern" savings institutions has been substantially uniform throughout the country. The pattern in Connecticut is representative.<sup>26</sup>

Typically, savings banks have been founded by small groups of individuals within a community who pool their financial resources and petition the state legislature for a charter to operate a bank in their community. The initial charter granted by the legislature then designates this group as the "incorporators" or "trustees" who are empowered to manage the bank.

Each charter granted by the legislature also names another group, the "corporators" or "members of the corporation," usually between ten and twenty-five members in size. There are no limits on the terms of office of the corporators, and the group is self-perpetuating, selecting new members by internal election. This body has powers analogous to those of the shareholders in a regular corporation: it elects the board of trustees and any other boards necessary for the management of the bank's business, and prescribes the by-laws under which the bank operates.

The board of "trustees" is responsible for overseeing the management of the bank and for deciding major issues of bank policy. In the early days of each bank, the trustees usually managed the business personally, but as the bank expands the trustees usually find it necessary to appoint officers to oversee everyday activities.<sup>27</sup> The state charters of these banks and the relevant state statutes give few guidelines for the selection of new corporators or trustees. The standard (though not universal) practice is to select as trustees only persons who are also corporators, and to select both groups with an eye toward representing various business, financial, and professional interests in the community.<sup>28</sup>

Neither by charter, statute, nor by-law do the depositors of a savings bank have any vote or direct voice in selecting officers or of influencing bank policies. Within the bank, the corporators and trustees are legally accountable only to themselves.

While minor variations upon this pattern exist from state to state, two essential features are common to

all of the states where savings banks have been chartered. First, the bank is managed by, and its policies are determined by, a closed, self-perpetuating group. Some states limit the terms of trustees and specify a fixed retirement age. None, however, has restricted this self-perpetuation, not even the Western states such as Washington, which adopted its savings bank statutes in 1955.<sup>29</sup> Second, in no state do depositors have any formal voice in the formulation of bank policy, not even the right to elect officers or trustees.

### 2. Statutory Regulation of Investment

The legislatures of the several states have prescribed rather complex regulations for the investment activity of savings banks.<sup>30</sup> However, this regulation largely provides statutory support for the natural inclination of savings bank management toward conservative, secure, and protected investment policies.

The usual pattern is for the legislature to authorize investment in a specified class of investments and to prescribe the maximum percentage of assets a savings bank may place in that class. Only investments thus authorized are permitted. Rarely does a state require that a minimum percentage of a savings banks total investments be devoted to a particular use. Again, Connecticut is exemplary of the standard pattern. The applicable Connecticut statutes<sup>31</sup> authorize investment, up to a fixed maximum limit, in federal, state, and municipal, and other public sector bonds and obligations; in bonds and obligations of specified public utilities and railroads; in bank and insurance company stocks; in various types of real estate construction and mortgage loans; and a limited amount of installment and educational loans. In addition, a residual category authorized investment of up to 8% of the bank's assets in debt securities issued by "corporations incorporated and doing a major portion of their business in the United States which in the opinion of the savings bank making the investment. . . are prudent for it to make."<sup>32</sup> This requirement of prudence tends to limit such holdings to non-speculative, "blue chip" securities. In addition, the charters of the individual banks all require that their funds "be used and improved to the *best advantage*." Again, "best advantage" has commonly been construed from the narrow viewpoint of the investment analyst.

Overseeing this maze of banking regulations in Connecticut, for instance, is the Bank Commissioner who reports annually to the Governor.<sup>33</sup> Prior to his report, the Commissioner is directed to examine each bank "to determine if it is complying with the law."<sup>34</sup> As the basis for this determination, each savings bank must report annually its financial condition to the Commissioner, and at least once a year the Commissioner's office conducts an examination and audit.<sup>35</sup> The primary regulatory function of the Banking Commission is the promulgation each year of a "legal list" specifying those investment securities which are legally permissible investments under applicable statutes.<sup>36</sup> Through this device, he is able to police the statutory mandate quite effectively.

The major result of such statutory regulation of investment is to reinforce and assure conservative, traditional money management by bank officers. The unfortunate corollary is that savings bank management is discouraged, indeed prohibited, from expanding the traditional, narrow view of its investment responsibilities to a view that is more aware of and responsive to the economic development needs of the communities it purports to serve.

### 3. Federal Tax Provisions

As with any other business, the legal framework within which savings banks operate cannot be fully understood without studying the impact of federal income taxation upon savings bank investment policies. The major tax carrot which policy-makers offer to savings banks is the income tax deduction for "bad debt reserves." The 1969 Tax Reform Act attempted to manipulate this deduction to encourage investment in residential real estate mortgages.<sup>37</sup> The effect is to provide some incentive, the strength of which is not entirely clear, for investment by savings banks in residential real estate mortgages. Since savings banks, as we have seen, already invest considerable amounts in residential real estate mortgages, this legislation is not expected to affect many changes in basic investment policy. Moreover, the policy lying behind this manipulation of the "bad debt reserve" deduction is open to serious question. One doubts that the proper governmental policy towards savings banks, at this juncture, is to encourage even more investment in suburban, ranch-house mortgages.

### Savings Banks: Proposal for reform.

The financial resources of savings banks are a source of capital funds that could be redirected from ultra-safe governmental, residential, and commercial investments to meet inner-city capital and credit needs. Savings banks presently have a surplus of funds accumulated by careful, conservative investment; these banks can begin to address the money needs of the inner-city. However, in order to bring about a shift in savings bank investment policies, it will be necessary to do more than morally exhort the small, internally selected group of "corporators" and "trustees" who today control savings bank policies. Realistic attempts at reform should consider not only changes in manner of selection of the bank directors and in the definition of the "constituency" to which these directors must finally be responsible, but also major changes in the state laws that presently regulate savings bank investment policies. This section presents and discusses the alternatives which community action groups may present to their legislatures for consideration and adoption.

### 1. Depositor Election of Directors.

One way of reforming the selection of savings bank directors is to have the depositors of each savings bank elect the directors for that bank. Depositor control of savings banks is not such a radical suggestion as one might think. The 1964 Federal Savings Bank Bill contained provisions for depositors election of directors.

"Except in the case of initial directors and directors of converted institutions with grandfather rights, directors of Federal savings banks are normally to be elected by the depositors. The [Federal Home Loan Bank] Board is given power to provide by regulation for the terms of office of directors; the manner, time, place and notice of election; [and] the minimum amount and holding period. . . giving rise to [a] voting right. . ."<sup>38</sup>

Amendment could easily provide for the conversion to elected directors instead of selected trustees, thus shifting the control of funds, at least indirectly, to depositor pressure. The theoretical justification of such a proposal is that direct accountability to depositors will exert institutional pressures upon bank management to be more attentive to the needs and desires of the depositors in formulating bank policies.

Although a workable system of depositor election of directors probably could be devised, one must take into consideration several difficulties which are likely, in practice, to reduce the effectiveness of election devices in affecting the investment policies of the banks.

First, there is no assurance that the depositors are sufficiently concerned or knowledgeable about bank affairs to engage in efforts to upset the present applecart so long as their dividends are regularly paid. Their interest in an adequate return on their savings may deter them from arguing strongly for "public interest" investments. A further barrier to the meaningful effect of depositors on directors is the absence of exact data on the uses of savings bank investment policy has permitted savings bank management to substitute statements of concern about urban crisis for positive investment policies that could assist in urban development. Only when disclosures are more meaningful will it be possible to have depositors make informed choices about the policies of the bank or the nominees for directorships.

These difficulties do not cancel out all the merits of a scheme of depositor election of directors. Depositor selection of directors of course does not guarantee that depositors will have effective control of the investments of all savings banks. It does, however, create the possibility that community groups might influence some savings banks whose policies vitally affect their economic and social well-being. In the long run, probably only relatively well-organized and highly motivated community groups and organizations will develop the "depositor voting power" necessary to alter the existing investment policies of conservative savings banks. But the possibility that some communities may not take full advantage of depositor control, should not mean that depositor control be denied to all communities. The ideals of free enter-

prise and individual opportunity that presumably pervade government economic regulation require that active communities be given every opportunity to advance themselves.

## 2. Lifting the "prudency" standard

Another and rather obvious mode of reform of savings bank investment policies is to change the state statutes which presently regulate investments. If savings banks are to devote their substantial assets to more socially productive ends, road blocks imposed by state regulations of savings-bank investment policies must be removed. Savings banks are often prohibited from so-called "high-risk" investments by state laws which set a "prudency" standard for savings banks. Any legal and political campaign to make savings banks more responsive to social needs should include a relaxation of these stringent legal requirements. Few problems would be presented in the drafting of new legislation along these lines; in most states, an addition or amendment to the existing section of the present statute which specifies the classes of "legal investments" for savings banks would suffice. Such an amendment would simply allow a savings bank to invest up to a fixed maximum percentage of its assets in socially-productive, high-risk investment such as low- and moderate-income urban housing, debt or equity securities issued by minority enterprises, community development corporations, and similar operations.

Such an amendment would be an excellent first step in a long-range strategy of legal reform. The savings banks would be unable to lobby against it with any credibility, since it merely authorizes the banks to serve public needs as they see fit. If the amendment includes provisions for periodic review of the vigor with which savings banks are exercising their new authority, the savings banks may be spurred to change existing policies to prevent the legislature from adopting requirements that savings banks must invest in socially productive enterprises.

## 3. Minimum percentage of "risk" investments

Another path of legislative reform of savings banks could be the adoption of a "minimum required percentage" approach. A state legislature could fix a certain percentage of a savings bank's investment portfolio which *must* be placed in certain types of desirable but relatively risky investments, such as low-income housing or small businesses in the local community. The rationale for such legislative action is that savings banks, in the course of their standard "risk minimizing" investment policies, are unlikely to devote sufficient investment funds to socially beneficial purposes in the absence of authoritative regulation requiring such investments.

One advantage of this technique, if the proper formula is chosen, is that a more desirable allocation of investment would be mandated. However, there are a number of potential problems associated with such an approach which should be considered.

First, the "minimum required percentage" formulas must be carefully drafted so that the banks are not required to undertake too many high-risk projects, thus threatening the safety of their deposits.

Second, because only the legislature could make changes in this required percentage the formula would be relatively inflexible. Savings banks should be able to adjust their investments to changing market circumstances, often on short notice. A statutory formula would not be likely to give bank directors the requisite flexibility necessary for sound management.

While these problems may not be insuperable, this approach, since it does tamper with the basic principle of management discretion, may involve serious risks of harm to depositors. Furthermore, the administrative and enforcement costs will be high, as will the cost in time and effort of frequent statutory revision. Such risks and costs are acceptable only if the benefits of this method are significantly greater than those of alternatives. This does not appear to be the case.

## 4. Community Control

Achieving changes in the investment activity of mutual savings banks — with little disruption to the current structure of these institutions — could perhaps be accomplished by establishing a series of mechanisms for allowing the community to exert pressure on the management of savings banks. Legislation could be drafted which would impose general "development investment" responsibilities upon savings banks; which would require savings banks to disclose complete and specific data on their investment portfolios; which would authorize a state administrative agency to create a "development investment" plan for each savings bank in the state; and which would grant both the administrative agency and depositors of each bank the authority to exert formal pressure to increase the extent to which the investment portfolios of each savings bank matched the "development investment" plan adopted by the state agency.

This section of our article sets out and examines in some detail the major provisions of draft legislation we prepared for the Connecticut legislature.<sup>39</sup> The particular measures and language proposed here do not purport to end discussion on the subject of changing savings bank investment patterns. Rather, our intention is to highlight the problems that any legislation on savings banks must deal with, and to suggest one set of solutions to these problems.

*General statutory duty.* Legislation designed to achieve changes in the investment patterns of savings banks should contain a statement of the general "public-interest responsibilities" which the legislature believes the investments of savings banks should serve. These "public-interest responsibilities" should be translated into a concrete definition and exposition of both the specific type of investments by savings banks which meet these responsibilities and the duty of savings banks to make these investments. In draft legislation for the Connecticut legislature, we proposed the following:

"1. Development investments shall include

- (a) any direct mortgage loan made for any of the purposes set forth in subsection (g) of this section;
- (b) secured or unsecured loans made for any of the purposes set forth in subsection (g) of this section;
- (c) shares or interests in mortgages or loans originated by other lenders, whether secured or unsecured, made for the purposes set forth in subsection (g) of this section;
- (d) purchases of, or loans made on the security of, the securities or stock of public or private bodies engaged in activities promoting the purposes of subsection (g) of this section; and
- (e) direct ownership of any interest or interests in the foregoing loans, mortgages, or securities, or in real property, which real property is used as the principal office and place of business of the bank, or a branch thereof.

(g) The purposes the foregoing investments shall seek to promote are

- 1 - the economic or social development of disadvantaged or minority persons or groups, or
- 2 - the improvement of areas of poverty or decay in all areas of the state, or
- 3 - inner city real estate development, management or construction.

"2. Unless inconsistent with applicable federal or state statutes or regulations, each mutual savings bank is authorized and directed to make development investments and each bank shall make such investments in a manner which will promote and assist the economic, physical, human, social, and community development of the area in which the office of each bank is located."

A general statement of legislative intent, above, serves several purposes. First, it tells bank officials (and the courts) that the "prudent man role" should not be applied to prohibit the potentially "risky" investments that an aggressive, socially-oriented investment and financing program is sure to include.<sup>40</sup> Second, because the statutory obligation is "general," it is readily adapted to the particular circumstances that any one savings bank may encounter. It is likely that the development needs and related capital requirements of different regions within a state will vary considerably; thus, the local savings bank, if it is to be genuinely responsive to community needs, market conditions, government regulation, and subsidy programs, should have flexibility in tailoring its own development investment program.

Finally, these two sections - the first defining "development investments" and the second expositing a general duty to make "development investments" - provide a base for other legislative provisions which create mechanisms to enforce compliance with the statutory obligation to conduct development investment activities in accordance with local social needs.

*Disclosure.* Prior to formulation of intelligent "development investment" plans, all interested parties must possess relevant data on the present investment activities of the bank. We propose disclosure to state officials and the public at large of the current investment program of each savings bank. Since this data is already in the files of the individual banks, a requirement that the banks disclose it to the public should impose no great financial or administrative burden on the banks. In addition, disclosure is certainly a more efficient means of acquiring the relevant data than administrative investigations and public hearings. In order to insure compliance with the disclosure requirement,

legislation should include penalties for failure to disclose properly and adequately all required data.

The required data should include a description of the general categories of non-development investment loans, complete with the amount invested in each category, the city or area where these investments are located, and the amount invested at each location.<sup>41</sup> For the development investment category, the savings bank should provide a detailed description of each investment, specifying the amount, the geographic location, and the type of activity supported (e.g., shopping centers, office buildings, multiple-unit low-income dwellings, FHA home-owner mortgages, community development corporations, etc.). Legislation should also authorize an appropriate administrative official to issue regulations requiring such further disclosure of any other data as may be needed to fully delineate the proper development investment policies for a particular savings bank.

Because the purpose of this legislation is to encourage a pattern of investment more consistent with the economic, physical, and human resource development of the state and local community, legislation should require disclosure to all state and local officials charged with responsibility for executing programs or formulating state, regional, or local development plans. Disclosure should be broadly mandated so as to encompass officials related to every program which could benefit from the coordination of savings bank development investments.

Furthermore, legislation should provide for publication of this data, summarized in the form of an annual report, in a local newspaper of general circulation in the community in which each particular savings bank operates, so that interested members of the community may have access to the reports at relatively little expense and with no administrative obstacles.

*The Investment Plan.* After disclosure has been made, each administrator of a program or agency concerned with the development investment policy of savings banks would be required to evaluate the investment patterns revealed by this disclosure. Obviously, the administrator would be using the "development investment" criteria set out in the legislation. After analysis of the investments of each, each administrator would submit a written statement setting out in detail the changes he thinks are required to bring the investment pattern of each bank within the statutory investment standard. This statement would go both to the bank and to a state administrative agency designated in the legislation to co-ordinate savings bank investment policy.

The purpose of this interchange between the agency and the bank would be to isolate the points of contention between the administrators and the bank's management. These written statements would set out those local investments which are, in the opinion of each administrator, available to the bank as "development investments."

The next stage in our proposal is the formulation of specific "development investment" plans for each savings bank. One effective procedure that could be adapted to this task is the administrative method

presently utilized by the Department of Labor and the Office of Federal Contract Compliance in the formulation of the so-called "Philadelphia Plans." In the Philadelphia Plan procedure, one administrative agency is required to "approve" a detailed plan which is based upon proposals submitted by affected public and private parties. This approval is contingent upon an administrative finding that the plan submitted is in compliance with the standards set out in the governing statute.

In the context of savings bank regulation, the legislation for this administrative process would take the following form. First, written into the legislation would be a requirement that detailed investment programs shall be developed by each bank and certified by a designated administrative agency of the state. Second, the legislation would set forth criteria to be used by the administrator in determining whether a particular plan warrants approval. For example, we made the following proposal in our legislative draft:

"In determining whether to approve the proposed development investment program of a bank, the administrator shall consider the following factors:

- (1) the projected financing requirements of inner-city businesses;
- (2) the projected financing requirements for low-cost housing;
- (3) the availability of capital for these purposes from other sources, either public or private."

Third, the legislation would spell out a procedure for the certification of these plans. Banks would propose their specific plan for restructuring their investments, as stated above. In addition, community residents, individually or in groups, would be permitted to propose alternative plans. These plans would be presented at administrative hearings at which all parties submitting plans would be entitled to participate. The administrator would be permitted to propose amendments to these various plans either before or at the hearings. The administrator would be permitted to propose amendments to these various plans either before or at the hearings. The administrator would then be directed to construct and certify the final plan which in his determination most adequately fulfills the statutory requirements.<sup>42</sup>

Each bank would have the statutory authority to obtain judicial review of its certified plan, if it wished to do so.<sup>43</sup> Finally, legislation should provide for state agency certification of new development investment plans at two or three year intervals.

**Implementation and Enforcement.** Once the development investment plan has been certified, the bank would implement the investment policy contained in the final plan. But without some enforcement mechanism, genuine bank compliance might be difficult to obtain. Savings banks, even if they are operating in good faith, will tend to define in the narrowest terms the type of investment sufficient to constitute compliance with the plan. The administrative agency which approved the development investment plan would be granted power to enforce compliance with the plan through the use of court orders, in much the same

manner as federal agencies presently do.

Nevertheless, the probability of strong and effective enforcement by the state agency is seriously weakened by at least three factors: (1) such agencies seldom have sufficient staff to effectively police all of the banks in the state, (2) the local nuances of each development investment plan will not always be visible to an administrative staff responsible for policing banks throughout the state, and (3) state agencies have traditionally been unwilling energetically to enforce regulations concerning private enterprise. Therefore, we have proposed that legislation for regulating savings banks include authorization for a private suit by depositors against their savings bank for the purpose of insuring compliance with the certified development investment plan.<sup>44</sup>

The major problems involved in using a private suit for enforcing compliance with the administratively approved plan are: (1) the difficulties of proof and specification of remedy that the depositor will face when he brings suit and (2) the possibility of harassment suits.<sup>45</sup> In the draft legislation, a cause of action exists when a depositor has alleged in good faith (1) that a plan for investments has been developed and approved as specified by statute, (2) that such plan has been in existence for six months, and (3) that the savings bank has not achieved compliance with the plan.

In presenting his case, the depositor-plaintiff would have the benefit of two reputable legal tools. The first of these would be his discovery rights against the bank: he would be allowed to secure from the bank the information and evidence necessary to prove a failure of the bank to comply with its approved investment plan. This would ease the burden of obtaining evidence for trial.

The second device would be a rebuttable presumption, created by the statute, that the savings bank has failed to comply with its development investment plan if the plaintiff has introduced any evidence that the bank has not met the requirements of the certified plan. Without this presumption the plaintiff would have to introduce evidence which proved by a preponderance of the evidence (1) the terms of the certified plan, (2) the existence of the certified plan for longer than six months and (3) a failure on the part of the bank to implement the certified development investment plan. The last element is obviously the most difficult to prove. But with the statutory presumption the plaintiff will make his case upon the introduction of *any* evidence that shows a failure of the bank to implement the plan and will thus shift the burden of going forward with further evidence onto the bank, the party to the suit with total access to the critical evidence.

For the bank to overcome this presumption of non-compliance (which would be sufficient to warrant judicial intervention), the savings bank would have to show to the satisfaction of the court (1) that it has committed all the resources it can to the execution of the development investment plan, (2) that external conditions, such as banking regulations or financial environment, have so changed from the time the plan

was approved to render compliance with plan an undue burden or (3) that the investments of the bank constitute compliance with the requirements of the approved investment plan. The defense by the savings bank that it has not complied with the plan because of an exercise of discretion or judgment on the part of the bank's directors would be specifically excluded.

To keep the court from acting as a "savings bank loan review board," legislators should carefully consider what remedies should be available to the depositor-plaintiff. If the relief requested by the plaintiff is beyond the scope of the development investment statute, the bank can raise this as an affirmative defense. The remedies we envision are equitable orders that require the bank to take such steps as will produce compliance with the certified development investment plan within six months or a year; in some cases the order could be more specifically drawn, directing the particular bank to make a certain dollar amount of loans to one of the specific categories contained in its development investment plan. If the bank demonstrates a genuine inability to meet its plan obligations, the court order should make appropriate adjustment in the degree of compliance the bank must attain. Finally, the order should contain provisions for a review of the performance of the bank after six months or a year; upon review, and if warranted, the court could hold the bank in contempt.

During the period that the order is in effect, all other suits based on our proposed statute would be stayed; if the order expires and the bank upon review is found to be in compliance with the plan, the first decision would be *res judicata* for a year or eighteen months, or until a new plan is approved. Liberal joinder and notice provisions in the statute would insure that all interested parties, including *amici curiae*, had opportunity to participate in the main suit against the bank.

### "People Banks": Conclusion

Legislation directed toward reform of savings bank investment policy will not be adopted until legislative inertia and the lobbying power of savings bank are overcome by political pressure from capital-starved groups. We have operated from three basic assumptions in this article:

(1) that minority entrepreneurs and other persons engaged in development activity in the inner-city will seek financial assistance from savings banks;

(2) that development activities and minority businesses are a net benefit to the inner-city community affected, and

(3) that savings banks, as unique financial institutions in our society, are constitutionally amenable to legislative regulation.

We have attempted to present, in some detail, the various ways in which the funds now held by savings banks could be channeled into development investments. At the heart of these proposals is the idea that savings banks have a special obligation to their depositors and their communities to do all that they

can for the development of those communities. It is clear enough that the funds are needed; we have tried to make clear various ways in which the use of these funds could be influenced by persons and groups not currently in positions of control in the savings bank structure.

Depositor election of directors, fixed percentage rules, and administrative/judicial enforcement of statutory policy are all realistic mechanisms that can push savings banks toward what they advertise themselves to be — "people banks!" Federal chartering of savings banks, a proposal favored by the savings bankers' associations and likely to be scheduled for Congressional hearings in the near future, provides a prime opportunity for policies of savings banks by moving for federal legislation similar to that we have suggested for the states.

The savings bank has long enjoyed a secure life, funded by local depositors, supported by the community, and sustained by favorable state legislation. Now it is time for these banks to return past favors by participating significantly in the development of viable inner-city communities.

1. For example, see the statement of Sen. Charles Percy (R.-Ill.) before the Sub-Committee on Financial Institutions Senate Banking and Currency Committee, *Hearings on Private Investment in the Inner City*, 90th Cong. 2nd Sess. (1968).

2. According to the most recent results of the 1971 Current Population Survey, between 1969 and 1970, the number of blacks and whites below the low income level increased. By 1970, there were 7.7 million blacks and 17.5 million whites who were below the low income level compared to 7.2 and 16.7 million low income blacks and whites, respectively, in 1969. These absolute figures represent 10% of the white population of the country and 32% of the non-white population. In major metropolitan areas nearly half of the blacks lived in poverty areas, as compared with 10% of the whites. The poverty level was defined in the Special Study as follows: "The low income threshold for a non-farm family of four was \$3,968 in 1970, \$3,743 in 1969, \$2,793 in 1959. In 1970, the low income threshold ranged from about \$2,500 for a family of two persons to \$6,400 for a family with 7 or more persons." *The Social and Economic Status of Negroes in the United States, 1970*, Census Bureau, Dept. of Commerce Current Population Reports, Series P-23, No. 38, at 35.

3. This analysis sets to one side the large questions of ownership of these potential "means of production," the training of the inner city labor force, the allocation of this capital to the various needs of the community, the distribution of new wealth, and the problems of developing new wealth-producing industries which produce significant numbers of jobs in the present economic structure.

4. See Note, *Commercial Banks and Minority Entrepreneurship*, 80 Yale L.J. 614, at 620, 627 (1971).

5. T. Cross, *Black Capitalism: A Strategy for Business in the Ghetto* 58 (1970).

6. Under Title I-D S 2763-2768 of the 1964 Economic Opportunity Act, a major source of federal financing for business in the ghetto, funds are available to private organizations proposing "economic and business development programs [to] provide financial and other incentives to business to locate in or near the areas served, [programs] for small businesses in or owned by residents of such areas. . . , and manpower training programs." A key restriction on the availability of these funds is that only a limited number of projects will be funded by the Director of the Office of Economic Opportunity in any area in hopes that projects funded will be of "sufficient size and scope to have an appreciable impact on the area served." 42 USC S2764. The person

seeking the loan bears the burden of proof in this determination, not only of the economic soundness of his proposal but also of the qualification of the proposed project under the terms of the Act.

The Public Works and Economic Development Act of 1965, 42 USC § 3121, et seq., provides another example of the handicaps which minority enterprises must overcome to obtain federal funds. Section 3142 authorizes loans and loan guarantees for private businesses in areas designated under the Economic Development Act as "redevelopment areas," S316, only when ten special conditions are met, S3142(b). The most interesting condition is the requirement of S3142(b) (2) that any applicant, public or private, must "have been approved for such assistance by an agency or instrumentality of the State or political subdivision thereof in which the project to be financed is located," which State agency must be concerned with the economic development of the State.

See also § 3142 (a) (10) requiring a plan of development for the area and a state finding that the proposal will be consistent with such plan. A positive effect of this type of requirement is to promote some co-ordination of federal funds and local plans, but it also has the negative effects of channeling funds only to those persons who cooperate with the local persons even slightly beyond the accepted political boundaries of the area. It is frequently the less-acceptable, more radical groups or persons that will be most effective in arousing community interest in resource-utilization projects.

7. The surplus accounts of savings banks insured by the Federal Deposit Insurance Corporation represented 7.3% of the total assets of savings banks and 7.7% of the assets of savings banks other than cash or government securities, 1969 Annual Report of the Federal Deposit Insurance Corp. 268 Table 109. These percentages represent a total of \$4,697,716,000.

8. National Association of Mutual Savings Banks, *National Fact Book of Mutual Savings Banking - 1971* 8-9, 41. (Hereinafter cited as *1971 Fact Book*.)

9. *Id.* at 41.

10. *Id.* at 48.

11. *Id.* at 8, 49; *Report of the President's Commission on Urban Housing, "A Decent Home"* 130 (1968).

12. A Teck, *Mutual Savings Banks and Savings and Loan Associations: Aspects of Growth* 4 (1968). (Hereinafter cited as Teck); *Hearings Before Subcommittee on Bank Supervision and Insurance of the House Committee on Banking and Currency*, 90th Cong., 1st Sess. 562 (1967). (Hereinafter cited as *Hearings - 1967*).

13. Teck, at 39.

14. *1971 Fact Book* at 21.

15. Teck, at 74; *Application of Howard Savings Institution of Newark* 32 N.J. 29, 159 A.2d 113, 119 (1960).

16. *Hearings - 1967, supra*, at 462.

17. *1971 Fact Book* at 56.

18. *Id.* at 27.

19. Netzer, *The Economics of the Property Tax* 118, 121-122 (1968).

20. *Id.* at 46-52.

21. See N. Y. Times, August 15, 1971 at 37; Boston Globe, morning edition, Tuesday, Sept. 14, 1971 at 3; Wed. Sept. 15, 1971 at 5; Thurs., Sept. 16, 1971 at 5. A published hearing record will be available from the Antitrust and Monopoly Subcommittee of the Senate Judiciary Committee in mid-November, 1971.

22. Boston Globe, Tues., Sept. 14, 1971 at 3.

23. An excellent summary of the moves within the federal government towards adoption of a system of federal chartering is contained in *Federal Savings Institutions*, House

Committee on Banking and Currency, Report No. 1042, 90th Cong., 1st Sess. 14-19 (1967).

24. *Id.* at 4-11.

25. See *Federal Charter Legislation for Mutual Savings Banks - 1966, Hearings before the Subcommittee on Bank Supervision and Insurance of the Committee on Banking and Currency*, House of Representatives, 89th Cong., 2nd Sess., Feb. 23, Mar. 1 and 2, 1966; *Federal Charter Legislation for Mutual Savings Banks - 1967, Hearings before the Subcommittee on Bank Supervision and Insurance of the Committee on Banking and Currency*, House of Representatives, 90th Cong., 1st Sess., July 13, 18, 19, 20, 1967.

26. See generally Conn. Gen. Stat. Ann. § § 36-117 to 36-142.

27. Teck, at 36.

28. Interview with officers of the Connecticut Savings Bank, New Haven, Ct., November 1970.

29. See Rev. Code Wash. Ann. § § 32.16.010 to 32.16.120.

30. Compare the similarity of the provisions of the following representative state statutes: *Conn. Gen. Stat. Ann.* secs. 36-96 to 39-142; *Ann. Laws Mass.*, Ch. 168; *J.J. Stat. Ann.* Secs. 17:6-52 to 17:6-63; 17:9A-174 to 17:9A-304. *Rev. Code Wash. Ann.* Ch. 32.04 to 32.98.

31. Conn. Gen. Stat. Ann. § § 36-94 to 36-116.

32. Conn. Gen. Stat. Ann. § § 36-96 (13).

33. Conn. Gen. Stat. Ann. § § 36-10, 36-13.

34. Conn. Gen. Stat. Ann. § § 36-15.

35. Conn. Gen. Stat. Ann. § § 36-127, 36-15.

36. Conn. Gen. Stat. Ann. § § 36096 (14).

37. Section 432 of the 1969 Act amended Section 593 of the Internal Revenue Code, allowing a mutual savings bank to claim larger "bad debt reserve" deductions (thus lowering the effective current tax rate) for assets invested in "qualifying real property loans." "Qualifying loans" are so defined as to include mortgage loans on all types of real estate, excluding, generally, only loans to public instrumentalities or other banks. See I.R.C. § 593 (e) (1). However, many banks may claim the full amount of this increased deduction only if at least 72% of their assets are invested in accordance with a prescribed formula that includes residential real estate mortgages (of all income classes) but not commercial or industrial real estate mortgages. See I.R.C. § 593 (b) (2) (B) (ii), § 7701 (a) (19) (C).

38. Federal Savings Bank Bill, House Subcommittee on Bank Supervision and Insurance, 1964, Staff Analysis, p. 12; cf. Federal Credit Union Act, 12 U.S.C. § § 1751-1775: "The business affairs of a Federal Credit Union shall be managed by a board of directors... and a credit committee... all to be elected at the annual members' meeting by and from the members..." § 1761.

39. A complete text of the proposed legislation, drafted with reference to Connecticut law, is available upon request from the Editors.

40. See *Liffiton v. National Savings Bank of City of Albany* 44 N.Y. S. 2d 770, 267 App. Div. 32, App. Div. 3rd Dept./1943/Opp. Den. sub nom In re Halper's Will, 47 N.E. 2d 275, 267 App. Div. 840, Aff'd 59 N.E. 2d 35, 293 N.Y. 799 (1944); where the court discussed bank management:

"The State has made stringent provisions for the administration of savings banks and bearing in mind the character of such institutions and the purposes for which they were formed, entrusted as they are with the savings of a multitude of poor people, there should be no relaxation of the rule requiring the officers and agents to exercise reasonable care and diligence in the performance of their duties. The law makes provision for the investment of deposits and the dominant purpose has been to provide in this way for the

safety of the money entrusted to them and to hold the officers entrusted therewith to a strict accountability. For honest errors of judgment made while acting with ordinary skill and prudence, measured according to the demands of the duties or business which they have taken upon themselves, they are not to be held liable. However, when one deposits money in a savings bank he has the right to expect that those in control of the institution will, in the management of his property, exercise the same degree of care and prudence, that prompted by self-interest generally exercise in their own affairs."

44 N.Y.S. 2d, at 774.

41. If savings banks object to the disclosure of general data about non-development investments because such disclosure weakens their competitive position with other savings banks, limiting disclosure to a detailed statement of *development* investments and a standard financial statement, will not weaken the statute for the purposes we have in mind.

Because the statute requires the savings bank to make development investments, the savings bank will disclose every investment which it thinks qualifies as a development investment. The tendency will be to over-disclose so as to prevent enforcement proceedings, and thus to provide data on all the investments relevant to the purposes of this statute.

42. This brief discussion of the administrative procedure for approval of the plans passes over certain fundamental problems with which all students of the law are well aware, and which must be taken into consideration in the formulation and drafting of a specific proposal. The choice of an agency to administer the program is crucial. Consideration must be given to the vulnerability of the agency to "capture" by the special interest group affected here, the savings banks; to whether the levels of funding and staffing of the agency are sufficient for the assigned task; and to the ability and ideology of the particular administrators likely to be involved.

43. Some provision for judicial control of the exercise of administrative discretion is essential. The form this judicial control should take is a subject beyond the scope of this article.

44. The propriety of privately initiated action to enforce public policy regarding institutions of a public nature is not seriously challenged today. Although there is no clear legislative grant of the right, private civil suits have been held to lie under Section 17(a) of the Securities Act of 1933 on the basis of the word "unlawful." *Fischman v. Raytheon Manufacturing Co.* 188 F.2d 783 (2nd Cir. 1951) (Esp. n. 2); *Thiele v. Shields* 131 F. Supp. 416 (S.D.N.Y. 1955); *Globus v. Law Research Service, Inc.* 418 F.2d 1276 (2nd Cir. 1969).

Similarly, private parties asserting a public interest in the environmental resources of an area were held to have standing to sue under the Rivers and Harbors Act of 1899, 33 U.S.C. § 401 et seq. Administrative Procedure Act, 5 U.S.C. § 701 et seq. in *Citizens Committee for the Hudson Valley v. Volpe* 425 F.2d 97 (2nd Cir. 1970). Rather than wait for judicial explication of a right for private suits under legislation channeling savings bank funds into "development investments," we would suggest that the statute contain a clear grant of such standing.

45. A third possible problem is the "friendly depositor" suit, where the bank attempts to get a favorable ruling on its behavior before sentiment against the bank's investment policy has developed. This problem is easily solved by allowing suits only after the investment plan has been in effect for a certain number of months, for instance, six months, and by allowing liberal joinder of plaintiffs once a suit is commenced.