



Banking as if people mattered: How to use market mechanisms to achieve social objectives

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Ron Grzywinski: We started what is now called ShoreBank in 1973, but it was after the group of the four of us had worked together for about four or five years doing minority small business lending.

It was a very lonely place for a long time, and then we managed to get the Community Reinvestment Act passed in this country in '77. But that was more in word than in deed, even though it was the law of the land. **But we feel sometimes like we're making progress. Sometimes it's a step and a half forward and a step backwards.**

Katrin Kaeufer: *How do you experience the current crisis in the bank?*

Ron Grzywinski: What we see institutionally is what everybody else sees. The rate of foreclosures is increased. People are having a harder time. Unemployment rates are up. **I think the major problem is the extent to which there's a feeling among many people in this community development/finance field that very slowly we're making some progress on generally—not everywhere but generally—bringing back some urban neighborhoods. And the feeling now is that that effort has really been set back a decade or more,** a lot of the progress of the past 10 or 20 years, because there are areas that have been quite fragile and people were beginning to build and buy homes and build stronger communities, but that's all been weakened.

We started in this one neighborhood of South Shore, as you know, in 1973, but then we slowly expanded so that today we're probably in half the neighborhoods of Chicago. **So we're probably in about 35 or so neighborhoods throughout the**

city. And in the stronger of those neighborhoods, like South Shore and Chatham and some of the others, they're holding up reasonably well.

The problems that we see are where people more recently, sometimes with predatory financing or sometimes without enough capital, began to do what others before them had done, to purchase rental buildings and rehabilitate them. Some of those buildings have now gone into foreclosure. Loans were made by less knowledge and sometimes unscrupulous lenders. And so you just drive the streets—some streets, not all of them—you drive the streets and you'll see more boarded-up buildings than we've seen in a very long time.

In other places where we work, like Detroit and Cleveland, the situation is dire. Detroit in particular where there had been very little progress as jobs had disappeared and the entire automobile industry had gone down. The neighborhoods had originally supported decent housing for people who had blue-collar jobs manufacturing cars over probably 30 years now. But as the industry has gone down, and with all the racial tension that has existed within Detroit, very large areas of Detroit have been totally abandoned.

We have an office on the far East Side which is a quite distressed area, and there have been so many homes and buildings torn down that it's not uncommon to see pheasants. **You normally only see them wild, but there are pheasants right in the city in these blocks.** Three women that we met recently have been working at this now for about half a dozen years, and they have an organization that's helping people to become urban farmers to get control of some of that land, and immediately in the city to begin to grow and sell vegetables.

We were interested in them. Without any knowledge that they existed, I personally have had some interest in how all that vacant urban land is going to be used. And it turned out that there's actually an organization there, and it turns out there's now another one, unrelated, in Chicago, doing that, trying to create sometimes just green space with trees, but more seriously teaching people how to grow and package and price and sell product.

You can buy homes in Detroit now for about \$1,500. There was an article in the *New York Times* within the past I would say 60 days which showed that young artists [buying these inexpensive homes]; in this particular case they profiled a white man and a woman having bought a house for about that price and fixing it up.

And I found that somewhat encouraging only because it's pretty well known how in otherwise healthy cities artists and art galleries are often the ones that go into new areas that are less expensive, and they open galleries, and then the areas begin to take off. We've seen that in Chicago. Portland of course has a big area like that.

So I thought that if we have people with the skills and aesthetic taste of artists being able to buy homes at that price and fix them, when you have streets and sewers and water and all those infrastructure improvements already in the land, maybe there's some hope that someday people will start to move back.

You can buy a very cheap home in Detroit today. And Cleveland is the same thing. Not exactly the same, but quite similar.

KK: *And are you concerned about the foreclosure rate among your customers?*

Ron Grzywinski: Oh, yes. We work very hard to avoid foreclosures. About 18 months ago, we started a special program here in Chicago. **It's called a rescue loan program. And it reaches out to people who are not our customers and who have been the victims of predatory loans.**

We try to work with them to put them into a conventional, fixed-rate, 30-year loan with payments that they can manage. That's gone quite well. I'll make a note to tell you later the name. A woman by the name of Michelle Collins runs that program. She's been invited twice this year to go to Washington to talk to the Treasury secretary about what she's doing.

One of the things we're seeing, though, is that the rate at which we are able to correct those problems as a percentage of the number of applicants is slowing down because people are losing income. Sometimes where there have been two wage-earners in a family, it's been reduced to one. Or there's been a reduction in their income.

Last year our own loss rate on owner-occupied, single-family homes was very low. It was eight basis points, eight one-hundredths of one percent. Quite low. But the numbers for single-family homes owned by real estate developers, and these were people who we financed to buy and rehabilitate and who then sell the homes, that loss rate was, as I recall, about 2 percent. So quite a bit higher than that. **What happened there was the market for buyers of those rehabilitated homes just disappeared, and the prices also dropped precipitously.**

We're also seeing the same kind of problem with people who more recently got into the business of buying and rehabilitating walk-up rental buildings. If they had not been in the business for a long time, if they paid at the high end of the price, they did not have enough of their own equity capital. We're feeling stress there.

KK: So the next question concerns the root causes of the current crisis.

Ron Grzywinski: I'm not sure that I can say anything that hasn't already been said by many others. **It's excessive leverage, you could say, leverage and greed, across the board.** I don't think that there's much in the way of exceptions, whether it starts with people who have always had a legitimate aspiration to have a home of their own and then did not quite have enough savings and were taken in by unscrupulous mortgage brokers and everybody else, but there's some responsibility there. But all the way up the system it was just everybody saw a way to make money.

But then the other thing was just the—again, it's been written by everybody—just **the inadequate regulation oversight**, and I think the fallacy of the self-regulation of financial markets. That's my personal belief. When all the large finance organizations lobbied and succeeded probably back in the '90s in loosening up the barriers between investment banking and commercial banking. It was people like now deceased Gail Cincotta, who worked for things like the Community Reinvestment Act and who mobilized communities around the country to produce legislation in the '70s to get banks focused on financing in neighborhoods.

KK: My next question comes down to whether you see a blind spot in our current economic thinking. Is there something economists are missing, from your perspective?

Ron Grzywinski: In terms of a blind spot, I think that **we have come to believe that financial instruments are real assets rather than a reflection of some other value.** And it's been said for 30 or more years in this country that we've forgotten how to make things. That's not entirely true, but true enough.

And then all the smart talent went from our best business schools and others to Wall Street and to the consulting business, so if there's a blind spot it's—again I'd have to be a trained economist to fully understand—it's **how we have not put enough of our talent resources, and maybe our capital, into creating real assets.** There have been perhaps inadequate incentives in the tax code and elsewhere and perhaps in society at large about creating real assets rather than just

financial assets. The wealth has all been in the financial assets. And it's apparently the same thing that happened in the '20s before the big crash, from what I've read.

So I would say that's been a major blind spot. Even on the financial side of this new administration, which I support, **there is inadequate understanding of what the economies of what the cities are really like.** It's all people think there's a difference between Wall Street and Main Street. People who are in Treasury and in the Fed are much more focused on Wall Street than they are on Main Street. I remember back before all these problems started, [Fed Chairman Ben] Bernanke was in Chicago and made a speech that was widely reported in which he thought everything was going to be just fine but made absolutely no reference or mention of what was happening in the neighborhoods.

There's an inadequate recognition of what the realities are in communities, neighborhoods, cities, community banks, things of that sort.

KK: What is not being seen?

Ron Grzywinski: Oh, they didn't realize the extent to which property values had become inflated out of all proportion to their real worth. They did not have an insight as to the kinds of loans that were being made against inflated appraisals. **They just did not see the way everything was being inflated as paper without real values.**

There's a need to save the global financial system—that's important and it has to be done. But there's still not enough focus on the neighborhoods. **There is no understanding that financial instruments are not, by themselves, real assets.** And there is no knowledge of neighborhoods and the values and the role of community banks.

There is a whole history in this country of how we got into the dual banking system in which I think each of the states has the authority to charter banks. And my vague recollection of a history I never knew very well was that it all had to do with financial populism and **the recognition that the large financial institutions did not deal adequately with the needs of farmers, ranchers, and small business people at the local level, and that we got into state-chartered banks for that purpose.**

We created as a nation the savings and loan industry when the banks would not finance home purchases. And I think it's lessons like that that we have forgotten. **We forgot why we, as a society, created those mechanisms and those institutions,** and even though the world has become a much smaller place, people still live in small communities. **People live in pretty much human-scale environments, but the financial institutions by and large have become of global scale.** But that doesn't mean that the neighborhood scale doesn't still exist.

KK: What is your prediction for where we will be 5 to 8 years from now?

Ron Grzywinski: I'm an optimist. I have to be an optimist. I guess bankers aren't supposed to be optimists, but to do what we've done, I don't think there's any other way.

I see the economy growing. These days, I look at every little possible suggestion and say, "Aha, maybe we've finally hit the very bottom," and then something comes up like this morning's newspaper that says retail sales are still down.

But still, **personally I think we are close to the bottom.** That doesn't mean that we will not see some further increases in the unemployment rate, but I think those massive drops in the employment rate and in retail sales, those very deep, precipitous cuts, have happened. I do believe that the incentives, of the economic recovery plan or whatever they call it in Washington, are important both psychologically and financially. And I think that it will begin to take hold. There are signs of people beginning to buy homes. Those are bottom-feeders, of course, in large measure, but still somebody is beginning to buy, is beginning to set a price.

Moving beyond that, **I believe that there is going to be an enormous emphasis on investment in various forms of energy efficiency and sustainable energy, and that those are going to create significant opportunities for growth.** If we can muster the technology in this country, which we've been able to do, though not alone, there could be a significant growth industry for some time.

I think the other opportunities are there, if they can ever straighten out the mess in Detroit and put some modern management in place in some of those companies, and if they have enough capital resources to do the research and the manufacturing and create reliable products. Those are all big, big "ifs" that one shouldn't feel comfortable with. That industry could come back. They do know how to sell. But

the people who are there now can't do it. **This country, as you know, has enormous unmet need for better public transportation in a variety of ways.**

So I think that if the government continues to wisely stimulate the economy—and one shouldn't have a whole lot of confidence that the government can do that wisely over any length of time—perhaps even in the short term there are opportunities there and the economy will start growing again and we will create new jobs and there will be a strong enough knowledge component in those jobs. But there will also be other jobs with less knowledge component.

I think that one of the very early trends we're seeing is that students coming out of the better schools are thinking harder about whether they want to go to Wall Street or do something more. They are thinking about other futures. It takes a while to pay off, but it's often a good indicator.

The need to rebuild the city, the places where we work, continues. **I think rebuilding cities and rebuilding the neighborhoods is such an enormous opportunity because it's labor intensive, it's shielded from trade protocols. You can't rehab a house on the south side of Chicago by sending it to China and having it come back. You've got to do it here, and at the same time make homes more energy efficient. Homes are the first or second largest cause of greenhouse gases.**

But we've got to get focused. It's part of what I might tell the Obama administration, even. There are opportunities if we're smart enough to look at them and put enough of our capital, both human capital and financial capital, looking to the future and not just bailing out the past.

KK: *What is a transformation strategy?*

Ron Grzywinski: These are more radical thoughts. I don't think we can ever change this one, but **one of the problems in capitalist society is that there's a notion that return on equity is open-ended.** There is no ceiling. The tax code is supposed to take care of some of that, but it really doesn't.

And the other corollary to that one is that **there's no way to measure social benefit or social good.** We have GAAP accounting and we have a rule-making body, and so financial results are fairly reliable and reported uniformly. **But there's nobody who reports the community-development work that we do here. There is no standard.**

So if somebody's going to invest equity capital, and we tell them we're doing all these great things with their money, they're taking our word for it. There's no way that they can compare it.

I think **if we measured social output with private capital, this could have the potential for a transformative strategy.** Two or three years ago, I shared the panel with our friend Muhammad Yunus in Oxford at the Skoll Forum. We started to work with Yunus back in 1983. **Both of us were arguing in favor of a social stock exchange.** There must have been 500 people in the room. I think when we got all done, he and I were still the only believers in it. But I think we both believed in it strongly as one possible tool to begin to use private capital in a market-disciplined way to achieve social objectives.

We were looking at ways to do tax benefits for equity investments, things like CDFIs, certified banks. For instance, the Treasury now has a program that certifies commercial banks and others as Community Development Financial Institutions. So there's a beginning of a mechanism in place. **If there were those kinds of benefits for equity investments in those kinds of banks or for sustainable energy funds or for small-scale development in developing countries, that would help.** Mary may have told you we do a fair amount of that work now. These would be some of the kinds of transformative strategies.

It's a question of how to begin to change the paradigm in banking.

I'm reminded of a book written 30-some years ago called *Streets, as if People Mattered*. And it was good. It was a criticism of contemporary architecture at the time. You could think about financing in the same way, as "**Financing or banking as if people mattered.**" That is where I think we need to go in terms of a transformative strategy.

KK: The social stock exchange, how would that work?

Ron Grzywinski: Companies could be listed or delisted based on a set of criteria and a judgment by an independent board of governors as to whether they were meeting social criteria. So if you or I or the next thousand people wanted to invest our money in a company that was being socially responsible, sort of in the same way that today we can pay a small premium and buy organic milk or pay a premium and buy a hybrid car, that sort of thing. If we knew that we could make an equity investment in a pool of companies and knew that there was some

objective, and somebody looked at what those companies were doing, it could begin to attract more private capital.

Then we might be able to see returns on capital down into the low double-digits, 10 or 11 percent, and at the same time have a high social dividend. We would then be able to get more capital going into a number of these areas.

Triodos Bank runs a portfolio of different funds that pay below market rate. They are not bank deposits or funds. **But there is some tax advantage in the Dutch tax code, so if a person wants to support the arts or wants to support sustainable energy or community development, there's a whole list of investments they can choose from.** And so they know their money is going into sustainable energy production. There are criteria and there are vehicles, **and they get a tax benefit for putting some of their money into that.** I don't know the details, but I know that's how Triodos attracts capital.

KK: This morning I talked to ABS, a Swiss alternative bank, and they have a fund for sustainable investment. The investor knows when you invest 100,000 Swiss francs, you reduce carbon emission by 7.5 tons per year. So I thought that's a clear figure. What sort of figure would work for social investments? How can we define indicators there?

Ron Grzywinski: I just believe that we have got to do more to release the creative energies of people to do this. Government can't make the computers and they can't make all the software, but they can create incentives. If it's done wisely, incentives would get the capital flowing in a new direction.

Now we use these crude instruments and we use capital gains tax, but it doesn't have anything to do with progress. It's people buying and selling existing shares. We just need more fine-tuning to achieve the objectives. To me, this is a major opportunity. In Europe some of this has been going on, but if the United States got into this, **we could begin to see more societies looking at ways to channel capital into more socially progressive areas.** Just in 25 years we have seen a change in Bangladesh, which is still an impoverished country but was incredibly impoverished when we started, and the progress that we have seen in terms of how bank regulation is done, how accounting is done, is impressive.

KK: *What would your advice be to Barack Obama?*

Ron Grzywinski: He was our state representative. He lived about two blocks from me in Hyde Park and now he lives about six blocks away. We know him, but we don't know him well.

The first thing, I would say to him is, work on the tax code to favor genuine investments in community development, in new technologies, and have some system to review whether those incentives are working or need to be changed. And review them with some regularity by an impartial body or by somebody who has got life tenure or something of that sort. **But work on the tax code to create the incentives that you need. That would be Number one.**

Number two goes back to the point I was making much earlier, to give a higher priority to the issue of wealth creation for blue-collar and middle-class citizens. His biases and his prejudices I think run there, but so far there's no evidence that his departments are being staffed with those kinds of people. They may be. I just don't know.

And the third one might be very much like the first one, but it's intended to be broader, which is to create financial incentives for the new –edge-technology businesses and for those activities that are under-resourced, like lower-income communities.

An example is the Community Reinvestment Act. I was the only banker that testified in favor of the Community Reinvestment Act, and I actually did a little more with it before that. So I'm not an unbiased reporter, but I've been pretty much uninvolved with any of it since that time. **But the Community Reinvestment Act can work when it is being aggressively implemented. The problem with it is that it doesn't create enough incentives for financial institutions to be inventive and creative.** You can get good marks by people—banks used to get good marks by making mortgage loans or buying these predatory loans that ended up getting Triple A ratings that they didn't deserve. There wasn't enough rigor applied.

But there should be better regulation and maybe even on the CRA side regulation by people who are not traditional banking examiners. While they've gotten better over the years, the bias is still very strongly on safety and soundness issues, and **there are many people in this country, both academics and others, who really know much more about the community development field than bank regulators do. And that talent ought to be brought to bear.** They ought to be made part of bank examination teams. It would be an important tool that for sure

does not encourage banks to make unsafe loans, but it simply says that in exchange for the bank charter, the banks have a continuing and affirmative obligation to meet the credit needs of their community service areas.

If you took language like that, constitutional-type language, and applied it in some other places—what would happen? Just to stretch your imagination or even mine, what would happen if a law was passed that simply said **that health care providers had a continuing and affirmative obligation to meet the health needs of their community service areas**. Imagine that, and that there was an examining mechanism with some teeth in it.

Government doesn't have to tell people how to do it, but it needs to tell people what it wants done. And so if I were talking to the President, I would try to get him to think in that way. How do you use this massive private enterprise system, whether it's in banking or health care or all the other things, how do you make it so that it achieves the social results that we want and need, and release the creative energies of a lot of people? But I may not live that long.

KK: *What are important future research questions?*

Ron Grzywinski: **How to use market mechanisms to achieve social objectives.** If you did nothing else for the next 50 years, you would accomplish a great deal. It would be **a paradigm shift**.

People have been dabbling in it. They dabble with it a little bit at Skoll. They dabble with it a little bit at Davos. But it's all dabbling. And it all needs much more rigorous discipline. It needs more people thinking about it. It means getting to questions like: *should return on equity always be open-ended? Should there be objective measures equivalent to GAAP accounting to measure social performance?* It's that whole host of questions. *How do you use the marketplace, how do you use market mechanisms, market tools, to achieve social objectives?* I think it's a lifetime of work.

I feel like there's this thinking now that small banks are not the problem, **and that they're too small to matter**. Things like that. I don't know that that's really true.

I can imagine an argument being made that smaller banks are too expensive to regulate, they're too expensive to examine. I don't know whether they make that argument or not. **But when you think about the size of the payments that are made when the big banks fail, I think it makes up for any subsidized cost that**

might go into examining small banks. But that may be a false position that I'm raising.

KK: Thank you!