Participatory Investment in Banking

Opportunities and options for banks to shift power to the communities they serve

March 2023

beneficial state foundation

transform finance

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This guide was co-authored by:

- Andrea Armeni (Executive Director, Transform Finance)
- Curt Lyon (Deputy Director, Transform Finance)
- Erin Kilmer-Neel (Executive Director and Chief Impact Officer, Beneficial State Foundation)
- Maria Kei Oldiges (Director of Social Impact Research & Evalution, Beneficial State Foundation)

About Transform Finance

Transform Finance is a research, education, and implementation partner that supports all stakeholders to challenge legacy investment approaches, seed transformative investment models, and build movement power.

They help investors move capital in accordance with the Transformative Finance principles: provide ownership and governance opportunities for non-investors, add more value than they extract, and fairly balance risks and returns. They help social change actors leverage the power of investors to achieve movement goals. They also help change enablers, like philanthropic actors and government, support these new approaches to capital.

About Beneficial State Foundation

Beneficial State Foundation is a 501(c)3 nonprofit that works to advance financial justice and impactful systemic change in our communities and in the banking system. The foundation is the founding investor of Beneficial State Bank, a triple-bottom-line certified Community Development Financial Institution, and the administrator of the Clean Vehicle Assistance Program which provides grants and affordable financing to help income-qualified Californians purchase clean vehicles.

About This Guide

This document was prepared by Transform Finance and Beneficial State Foundation, following a three-part workshop with Beneficial State Foundation and two member banks of the Underwriting for Racial Justice national working group, Berkshire Bank and Virginia Community Capital. It combines reflections from prior work by Transform Finance on Participatory Investment and novel insights that emerged from the engagement with Beneficial State Foundation.

Building on the workshop, the document provides a non-comprehensive overview of major findings and recommendations for individual banks and the banking sector as a whole to adopt Participatory Investment practices.

Who This Guide Is For

This guide is designed primarily for banks that are interested in deepening their impact commitments, particularly in terms of fostering racial equity, reducing wealth gaps, and building community power.

Grassroots stakeholders, especially community-based organizations that seek to interface with banks and other community development actors, can use this guide to gain a sense of how banks can deepen their community engagement.

This guide is also relevant for field builders, such as industry networks, advisors, technical assistance providers, and researchers who work with the banking industry.

Lastly, while this guide addresses banks specifically, credit unions and non-depository lending institutions like CDFIs will find many of the concepts and recommendations relevant for their work, albeit within a slightly different regulatory environment.

Is your bank exploring Participatory Investment? We would love to hear about your experiences and recommendations. Please reach out to Maria Kei Oldiges using our contact form:

https://beneficialstate.org/our-team/contact-us/

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Introduction

This guide helps paint a vision of Participatory Investment approaches as applied to the provision of bank loan capital, and helps banks identify and implement the steps to get there.

Introduction

Participatory Investment (PI), as defined in Transform Finance's report *Grassroots Community Engaged Investment*, is the process and practice of investing with meaningful input, decision-making power, and/or ownership from grassroots stakeholders.

Participatory Investment usually takes place in the context of place-based investment, community development, and community investment: situations where capital seeks to create positive impact within a geographically-defined community. Projects that implement Participatory Investment can be seen in many different contexts: community-governed funds that invest in enterprises or real estate; commercial real estate projects that put land and governance in community hands; innovative consumer lending programs; multi-stakeholder cooperatives that invest in housing; and more.

The most participatory projects feature community members with complete or majority control of decision-making throughout product and service delivery. Many times, this looks like community members creating new organizations, funds, or intermediaries. Other times it looks like partnerships between traditional community development players, especially Community Development Financial Institutions (CDFIs), foundations, and grassroots organizations, leveraging the best of each actor's expertise. More than banks, CDFIs and foundations are likely to have the tools and experience with innovations to provide capital on terms appropriate for the projects; banks can learn from their experiences to design products, programs, and even governance structures to be more participatory.

This guide helps paint a vision of Participatory Investment approaches as applied to the provision of bank loan capital, and helps banks identify and implement the steps to get there.

Banking and Participatory Investment

Participatory Investment serves as an opportunity to advance a bank's impact goals and further the goals of grassroots actors in the banks' communities.

PI can also be a means to redress the historical and current inequities that the banking system has contributed to. As an integral and leading part of the founding and growth of our modern economy, the banking system has contributed to global, national, and local inequities in many ways that are important to note and reflect on. By recognizing and examining how banking practices have exacerbated inequality and concentrated power, those of us in the banking industry can both recognize why redress is important, and explore how we can use banking practices to further racial equity and share power. A few key examples:

An *impact thesis* (in contrast to an investment thesis) is the "what," "why," and "how," of your bank's intended social or environmental impact: What impact does your bank hope to make (either with its business overall or with a specific project/ investment)? Why is this impact important and relevant to the specific context in which you operate? How will you make this impact? An impact thesis may be accompanied by a theory of change, which further elaborates the "how".

- **Activities financed:** Financing the settler occupation of indigenous lands and the trans-Atlantic slave trade
- **Collateral:** Treating human beings — enslaved people — as collateral in underwriting processes; redlining, undervaluing Black-owned homes and homes in Black neighborhoods in appraisals
- **Covenants and restrictions:** Redlining; mandating racial covenants in housing projects
- **Customer service:** Actively discriminating by providing poor and disrespectful treatment, offering less information, and denying services to customers of color
- **Product pricing and terms:** Charging customers of color higher fees; preying on BIPOC homeowners with higher-cost loans
- **Underwriting:** Refusing to accept fixed forms of income (e.g. Social Security income or disability) as income in loan applications; continuing to rely on credit scoring and underwriting methods despite their racist impacts

By incorporating a deep analysis of how banking activity contributes to root causes of inequality and by incorporating redistribution and power-building into a bank's impact thesis, banks can move toward genuine redress and community empowerment.

Community engagement in the investment process and ownership in the resulting investments (such as real estate, business, and housing) represent a break from the status quo in banking. The impact of such engagement and ownership is fundamentally different from the impact of even the most community-minded banking practices common today. This is because these types of investments not only provide wealth and asset-building opportunities for disinvested and disenfranchised communities, they also help build power within those communities and for broader movements. They bring existing social justice movements into conversations around capital where they were previously excluded, forge productive connections between grassroots and institutional stakeholders, build community knowledge around local finance and economic development ecosystems, and fund projects that are supported by and reciprocally support existing movements in the community.

Participatory Investment is about much more than having robust customer feedback mechanisms or incorporating human-centered design principles into product development; it is about true engagement and ownership. With this paper, we propose that banks can learn from the organizations and agencies that are currently practicing the deepest forms of community engagement and, in so doing, are creating more meaningful social impact.

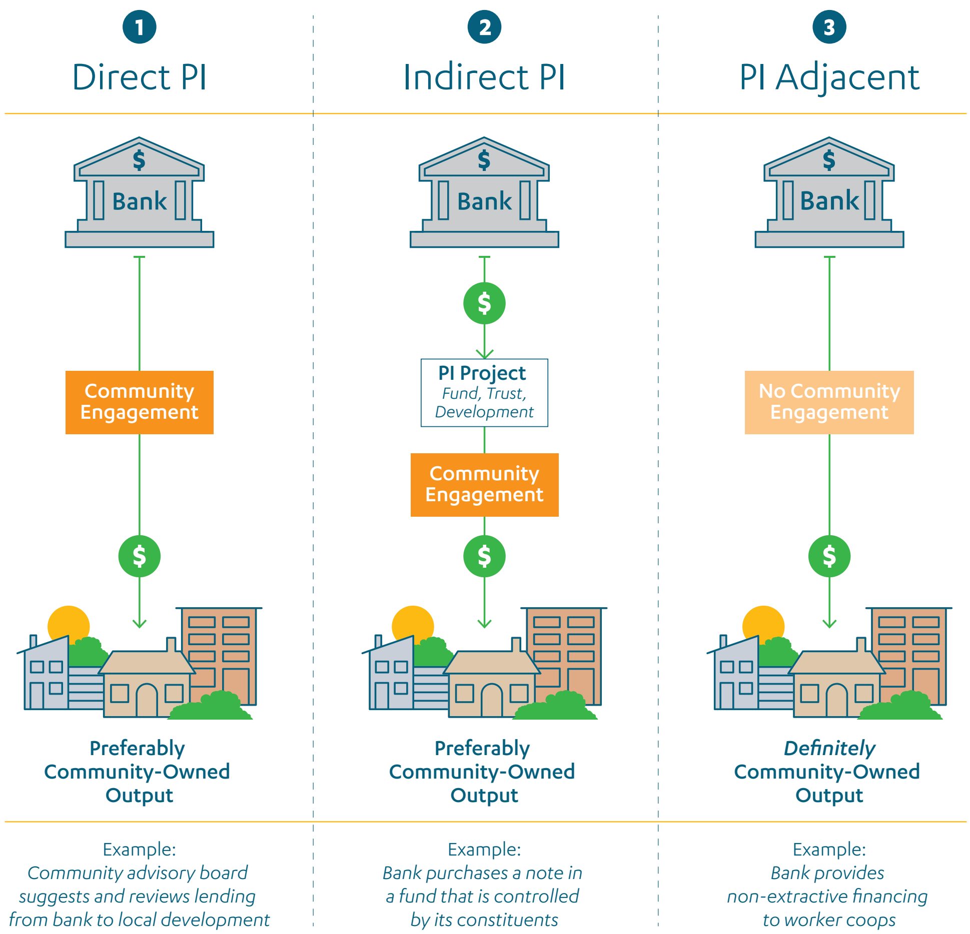
For banks seeking positive social impact, Participatory Investment increases opportunities for a more robust layer of impact. There are three broad categories of Participatory Investment activity in banking:

- **Direct PI:** Banks adopt participatory governance mechanisms at the bank level itself. Examples include revisiting board constitution or the bank ownership structure itself, establishing community advisory boards or special planning committees, and creating program-specific pools of capital that allow grassroots stakeholders to direct bank investments.
- **Indirect PI:** Banks prioritize and capitalize Participatory Investment Projects. Examples include buying notes in community-governed funds or providing loans for community-led real estate development projects.
- **PI-Adjacent Investments:** Banks invest in entities that result in shared community ownership, even if those investments aren't being directed by community actors themselves. Examples include building a loan portfolio of worker-owned cooperatives or financing Community Land Trusts.

These distinctions make clear that: 1) banks have the ability to transfer some of their own decision-making power to communities; 2) banks can and should support the field of Participatory Investment by capitalizing other PI Projects; and 3) in addition to doing PI directly or indirectly, or when there are not many opportunities for doing PI, banks can support projects with similar missions of transferring power that do so outside of the process of making investments themselves.

The chart below delineates these distinct opportunities:

Three Different Pathways of PI for Banks and Other Lending Institutions



Findings and Recommendations

Findings and Recommendations

We group our findings and recommendations within the following categories:

- Working within the Banking Industry and Creating an Enabling Environment
- Deepening Current Bank Practices around Community Engagement
- Adopting New Governance Structures and Program Engagement Mechanisms
- Adding Indirect and Adjacent forms of Participatory Investment to Impact Thesis
- Leveraging Institutional Power to Support the Field

For each category, we detail our core findings, provide recommendations that address each finding, and offer up areas of further inquiry.

Working within the Banking Industry and Creating an Enabling Environment

Overview

A major theme around applying Participatory Investment to the banking sector is the need to uproot pre-existing norms and assumptions. This work is a precursor to deeper exploration and adoption of Participatory Investment.

These norms and assumptions touch on some fundamentals of banking, such as perceptions of lending risk, general risk aversion and aversion to change and experimentation, and inform what community engagement looks like.

Banking, as a highly regulated industry, relies on signals and constraints from its regulators. Banks can both take advantage of openings and opportunities that come from regulators to do Participatory Investment and push for a different culture in the regulatory space. Standards setters, sector networks, and thought leaders all have a critical role to play in facilitating Participatory Investment for the sector. Bank affinity spaces, in particular, are well situated to provide exposure and technical understanding.

Findings and Recommendations

Like the rest of the private sector, the long-standing default for banks has been to maximize profit while controlling risk and, when possible, use portions of that profit for corporate philanthropy. The role of corporations and banks has not been to seek proactive ways of addressing root causes of inequality or creating power in communities. Acting in this role requires a significant culture shift and this guide aims to support banks in this shift.

Base Level Recommendation

- Provide training for bank staff and board members to ensure all have a shared understanding of the history of banking, our economy, and racial inequity; the power dynamics of capital; and how to fully examine the sharing of risk and reward in the provision of capital. Provide training for staff and board members on social equity principles, the importance and methods of community-driven governance, how to be inclusive of community voices, and how to invite and manage dissent.

The cost and risk aspect of Participatory Investment is but one side of the equation; banks should also look at the potential returns. From a financial perspective, returns from PI projects could range from market rate to break-even to a net cost. Importantly, in all cases, PI projects can be a major impact win. Projects with community voice or leadership can range from low-risk real estate purchases and financing for established successful businesses to higher-risk loans to newer enterprises. In the broad array of PI possibilities, costs and risks can range from negligible to significant. Furthermore, PI operates on a longer time horizon than traditional investments; what may be seen as a cost upfront may pay off in the long run.

Banks may even view Participatory Investment as a risk mitigation factor as it can create community support for the projects, increase community resilience to future economic shocks, expand a bank's customer base, provide more favorable conditions for funding and certifications, and strengthen a bank's reputation among its core constituencies. Ultimately, we must re-evaluate the very notion of risk and understand the risks borne by communities when banks fail to operate with community interests at heart.

Base Level Recommendations

- Build on the recommended training above by engaging in bank-wide conversations about risks and rewards related to mission-driven and Participatory Investment projects.
- Include a checklist for bank staff when exploring new products, programs, loan deals, and partnerships to analyze the opportunities, risks, and risk-mitigation potential of including a Participatory Investment element. For risk mitigation the checklist could ask whether the community-initiated project or community engagement process would
    1. *Create community support*
    2. *Increase community resilience to future economic shocks*
    3. *Expand the customer base*
    4. *Provide more favorable conditions for funding and certifications the bank is seeking*
    5. *Strengthen the bank's reputation among any core constituencies*

Deeper Recommendation

- Seek mechanisms to further de-risk Participatory Investment Projects as needed, such as through philanthropic support for loan loss reserves and guarantees.

Participatory Investment functions and programs derived from these activities might be seen as additional, rather than core bank functions or programs, and may be seen as subsidized by other programs or departments. However, because banks are mandated to serve the convenience and needs of the community, Participatory Investment functions and programs should be essential. In this sense, the costs of PI are the costs of doing business — much like the costs of paying for legal counsel, the costs of compliance staff, or costs of data management software. These basic overhead costs undergird a bank's ability to operate and are considered profitability factors for the entire business, not for a particular accounting cost center. For community banks in particular, PI activities should be considered foundational to their credibility and ability to achieve their mission, as community participation is the essence of community banking.

There will be costs, as with many other programs that are community-driven and participatory. Moreover, community-driven participation, by its nature, resists scale and does not allow for defraying costs across larger dollar amounts. If your geographic scope is small and rural, be aware of some of the challenges and costs of bringing together community members. Be patient and talk to participants about how to make the engagement meaningful but manageable and be mindful of keeping PI activities that are sustainable.

Base Level Recommendations

- Approach the costs of the initial investment of time and resources into learning and setting up Participatory Investment projects as the bank would approach investment into other R&D projects and innovative pilots.
- Budget for ongoing PI activities with the understanding that PI activities provide a core function — a minimum license to operate — in the absence of which the bank cannot deliver its products and services.

Participatory Investment activities — designing with community members, implementing programs originated by community members, and engaging community members in the underwriting design or decision-making processes — are not common in the banking context, and are likely to be perceived as regulatory risks. However, the regulatory environment need not be an automatic reason to avoid PI, and in fact can be leveraged in favor of PI. There may be ways to use current programs as on-ramps to PI, such as by using PI to meet Community Reinvestment Act (CRA) requirements or through favorability in Treasury programs. Some existing tools like Special Purpose Credit Programs (SPCPs) are already consistent with Participatory Investment approaches.

Base Level Recommendations

- Compliance officers and bank staff who are exploring Participatory Investment approaches can work together to determine real and perceived regulatory risks and make a plan to address them.
- Approach regulatory evaluation and your bank's impact thesis from a PI angle, especially with new lending programs that direct more resources into low-income communities or communities of color.

Deeper Recommendation

- Take advantage of the option to develop your own CRA adherence strategy and build a strong Participatory Investment component into it. Community Benefit Agreements (CBAs) are one method that some banks have used to *strengthen their CRA performance*. Though they do not *guarantee* true community participation, CBAs can be a powerful tool to formalize the terms of engagement between banks and affected communities — and have the potential to obligate banks to establish more participatory practices.

Spotlight

Special Purpose Credit Programs

Special Purpose Credit Programs (SPCPs) were established by the Equal Credit Opportunity Act (ECOA). They allow lenders to design and deliver loans to specific groups of people with common characteristics, including those with protected class status. For example, a bank could design a home mortgage product for Black/African-American families with favorable terms or pricing or more flexible approval requirements. Many banks are wary of using SPCPs because of the perceived lack of clarity in the guidance and concerns that if they make loans only for a particular group of people, they open themselves up to the risk of fair lending violations. However, the regulation and various advisory opinions issued by many relevant agencies (including the Consumer Financial Protection Bureau (CFPB), Housing and Urban Development (HUD), Federal Deposit Insurance Corporation (FDIC), and Federal Reserve Board (FRB)) have all provided extensive instruction on how to establish a sound SPCP and have given many assurances that banks that follow the instructions would not be found in violation of ECOA. This is further validated by the fact that dozens of banks have successfully offered SPCPs for many years, without regulatory reprimand or fair lending violation findings.

SPCPs represent an underexplored avenue to bring more community participation into bank activities. In particular, they allow banks to bring communities in for relevant programs and specific lending areas, rather than designing governance mechanisms at the entire bank level. Because of this, they may be well-suited for an initial foray into Participatory Investment. For example, an SPCP intended to serve BIPOC-owned small businesses could be designed by an advisory council of local BIPOC-owned small business owners, representatives from regional BIPOC chambers of commerce, and people from local economic development nonprofits. Incorporating PI processes could include setting clear expectations of accountability to the advisory council on the program's performance/impact; providing remuneration for the council members' efforts and input; and soliciting regular feedback from the council.

Further Areas of Inquiry

- What internal processes will lead to transformation? What barriers should be removed?
- Which organizations exist (nationally or in your financial institution's region) to support your bank's transition from traditional banking norms to those that center governance and input from the community?
- When community participation is seen as a "need-to-have" rather than a "nice-to-have," how do internal and external pressures to maximize profit shift as part of an effort to accommodate PI?

Deepening Current Bank Practices around Community Engagement

Overview

One of the greatest needs for banks is a specific protocol around the act of reaching out to and interfacing with community stakeholders, be they customers, businesses, grassroots organizations, or individual community members. These findings and recommendations surface the need to grapple with historic power inequities between banks and low-income communities.

Findings and Recommendations

Banking practitioners in general need and want to form more-meaningful relationships with the communities they serve. But many practitioners may not know how to engage with communities beyond customer outreach. Participatory Investment and meaningful racial equity efforts go beyond increasing loan dollars to communities of color and low-income communities; they place the community members themselves at the center of decision making. Engagement can be related to lending as well as other activities.

Grassroots organizations are ones with a broad local membership and direct accountability mechanisms. *Grasstops* organizations tend to be less connected to the local community and act as intermediary influencers in policy and political processes.

Base Level Recommendations

- Survey banking staff on their experience with and need for ways to build relationships with the communities the bank seeks to serve.
- Ensure that staff working on Participatory Investment efforts are evaluated on and compensated for this work as part of their job description.
- Examine all existing bank customer outreach activities for opportunities to add meaningful design and governance roles for grassroots stakeholders.
- Make sure that Participatory Investment efforts are not seen primarily as an opportunity to advertise services to potential clients (a "customer engagement" mindset); instead, target and engage the communities in most need, regardless of their potential to become clients (a "community engagement" mindset).
- Start with listening. As bank staff build or strengthen relationships to support Participatory Investment approaches and projects, they can ask and learn both 1) what types of services, products, and facilities are needed by the community, and 2) what community-driven efforts, if any, are already in the works to fund and develop solutions. From there, the bank can learn whether and how it can offer support.

Deeper Recommendations

- Designate at least one employee dedicated to community engagement who is on or has direct access to the bank leadership team.
- Create a Participatory Investment team that cuts across all bank departments.
- Involve existing community partners in the evaluation of existing programs and processes.
- Provide pro bono consulting to help grassroots organizations build knowledge of banking and explore ways of engaging with capital.

Banks are still generally seen as untrustworthy within low-income communities and communities of color. This can be changed.

Base Level Recommendations

- Make an explicit commitment to Participatory Investment that guides and enables community-facing staff to take the time to build long-term, deeper relationships with community members without the pressure of converting them immediately into clients. The commitment can be codified in the banks' mission, vision, values, operating principles, or similar documents; it can also be shared in a public statement, similar to diversity, equity, and inclusion commitments, for public accountability.
- Build on pre-existing relationships that the bank already has with community-based organizations or coalitions to build trust with others who may be more skeptical at first.
- Create "open houses," listening sessions, or other open opportunities for community members to meet with bank staff and board members and discuss the issues they feel could be addressed by the bank. Actively invite major community players, such as business associations, housing rights organizations, racial justice and climate justice organizations, etc.
- Share the bank's CRA score with the communities served and highlight any PI elements; this can help build trust, as communities often have a hard time finding CRA information.
- Banks with large geographic footprints may lack the deep, place-based relationships that are necessary. Such banks can partner with local lenders, CDFIs, or nonprofit organizations to lead engagement and leverage their relationships.

When engaging communities at the bank or at the program level, power dynamics show up. Community residents and leaders often bring personal and cultural trauma around finance to these interactions, and they may not have much familiarity with terminology or reasoning for why banks make decisions as they do. Additionally, banks and other financial institutions run the risk of wasting valuable community voice and community time, if the engagement is long, unfocused, or unpaid.

Base Level Recommendations

- Provide resources and training for bank staff and board on personal and cultural trauma and finance. See Appendix B for resources to get started.
- Community members should be engaged for their experience, they should be compensated, and they should be engaged only on topics or programs that the bank is willing to change, as community representatives are often asked for input only to have their input ignored or not meaningfully reflected in final outcomes.
- Be mindful of "engagement fatigue" and ensure that community engagement does not burden community members with requests that are too frequent or too taxing.
- Make clear within the bank and with the community why their voice is being sought and the value they will get from participation. Build an internal accountability mechanism to ensure the bank delivers on these commitments.
- Establish clearly with community representatives what decisions they are making themselves, what is in collaboration with bank staff, and what is outside of their purview.
- Ground all new projects designated for community input through pre-launch engagements with grassroots and community organizations as early as possible.
- Authentically listen and seek input from the community; avoid leading with pre-ordained ideas. Community members should expect that their ideas are seriously considered once shared.
- If community members will be asked to make financial decisions, provide training on underwriting and other relevant financial education and give time for on-ramping to the banking process.

When seeking community engagement, banks often partner with larger organizations and foundations that have long-standing relationships with community development players. While this is not necessarily bad on its face, these larger organizations tend to be whiter and are often further removed from the communities most in need than smaller grassroots organizations.

Base Level Recommendation

- Engage clients and borrowers to determine trusted grassroots organizations and individuals, such as tenant associations, social justice organizations, individual residents, and small business owners. Prioritize these over larger organizations (even nonprofit organizations) and business associations.
- Let a mix of these early, trusted community stakeholders define which other groups should be prioritized for participation.

Adopting New Governance Structures and Program Engagement Mechanisms

Overview

The most direct way for a bank to enact Participatory Investment is by adding a layer of governance for communities to guide the bank's own financial activity (as opposed to investing in other entities that feature elements of community control). The particular nature of banks provides several opportunities to add such a layer; these opportunities and how they can be implemented are discussed below. To view these recommendations organized by key bank departments and processes, see Appendix A.

Findings and Recommendations

The legal purpose and corporate structure of a bank can be set to enable Participatory Investment. Banks that are explicitly purpose driven and/or community oriented can implement choices that benefit the community — like Participatory Investment practices — even if those choices could result in lower profits. Note that these changes enable, but may not fully ensure community participation in decision-making. Other practices in this paper should be used to implement the intentions set by these changes in purpose and structure.

Base Level Recommendations

- Banks can write or rewrite language in their articles of incorporation to require community voice in governance and community benefit as an outcome.
- Increase community representation on the bank's board, even if the bank is a CDFI and already meets the community accountability requirements for CDFI certification.

Spotlight

Board Community Representation at VCLF

Vermont Community Loan Fund (VCLF) provides one such example. Their board and staff knew that they wanted to be a force for racial justice and in 2020 realized they needed to be more impactful, targeted, and intentional in their work for racial justice. Specifically, they wanted to recruit a diverse board with the skills to lead and represent a broad geographic and stakeholder perspective that includes representation from communities of color. Being a CDFI, VCLF's board of directors already met community accountability requirements; however, VCLF wanted to go beyond this minimum and ensure that BIPOC communities in Vermont were represented in their governance. Among other strategies, they sought board members who were involved with other racial justice organizations in the community.

Deeper Recommendations

- Banks can be incorporated as nonprofits, benefit corporations, cooperatives (such as *Reading Cooperative Bank*), or Purpose Trust structures, which opens opportunities for centering mission over profit. Mutual banks are another example of how a bank's structure can support de-emphasizing profit in favor of community benefit (such as in the case of *Ponce Bank*, a CDFI that was established as a mutual bank).
- Consider innovative ways to share bank profits with depositors or community members as a whole, inspired by consumer cooperatives and credit union dividends. For an example of how dividends are distributed by a cooperative, check out the description *Farm Credit Services of America* provides on its model. Another example comes from National Cooperative Bank, which shares annual dividends in the form of discounts on borrowers' interest payments.

Governance is not static and can be deepened over time, starting with community stakeholder participation in bank practices and relationships at easier entry points.

Base Level Recommendations

- When developing community engagement programs, start with the easiest entry point that still feels transformative for where your organization is currently.
- Provide community partners with the opportunity to participate as observers or advisors to committees that do not disclose sensitive information, such as product committees.
- Ensure that board leadership is diverse and board members of all backgrounds and identities have full decision-making power and participation.
- Incorporate community engagement practices in your staffing and recruitment processes for bank staff. Hire staff from the prioritized community with the explicit mandate of engaging with the community.
- Conduct an annual review of existing governance mechanisms to evaluate the depth of power that community stakeholders have over bank and lending practices.
- Make a plan for how community governance will deepen over time, either by expanding into new bank activity or within initial programs.

Community governance is deeper when community members are not just invited to participate in mechanisms established by the bank, but when they're able to design key features and goals of the program or project.

Base Level Recommendation

- Before starting new programs, even ones in which the bank plans to have ongoing community governance roles, invite grassroots stakeholders in to design the program from the outset.

It is possible to develop community governance over specific lending areas (e.g., real estate lending) or specific programs (e.g., a lending program for entrepreneurs of color).

Deeper Recommendations

- Create a committee of borrowers to make meaningful decisions about bank lending practices, such as setting interest rates for future lending, starting with easy entry points.
- Explore the creation of a Community Advisory or Loan Committee that can make decisions on bank lending across a range of factors. For example, the *Olamina Fund* has a community advisory committee with veto power over potential investments; Native Women Lead, Mortar, and ConnectUp! (all partners in Common Future's *character-based lending fund*) base underwriting on relationships with community, rather than relying on traditional credit criteria such as credit scores.
- Consider using Special Purpose Credit Programs in commercial or consumer lending as vehicles for specific Participatory Investment initiatives (see the *Tool Spotlight on page 12*). Create a community committee or other entity that can pair with the program to achieve a specific set of goals defined by the community.
- In consumer lending, consider creating lending programs that bring in trusted community partners for deal sourcing and evaluation. While housed in the bank, these programs can rely on community organizations and specialized place-based lenders with deeper ties to the communities to source borrowers and evaluate them on trust-based terms (as seen with the La Montañita FUND and Co-Op Capital, two separate programs housed under Nusenda Credit Union in New Mexico).

Spotlight

Example of Direct Participatory Investment Through Community Partnership

La Montañita Co-Op is a community-owned natural food market based in Albuquerque, NM. The Co-Op operates a member-funded microloan program called the La Montañita FUND, which is administered by *Nusenda Credit Union*, also based in New Mexico. The program aims to "grow the local food systems and strengthen the local economy" by supporting cooperatively run farms, ranches, other food businesses, and non-food businesses. Prospective borrowers are reviewed and approved by La Montañita's loan advisory committee, which consists of La Montañita staff and volunteers from the community.

Loans are collateralized by funds raised from La Montañita Co-op members (who are the consumer-owners of the food market), who purchase interests in the La Montañita FUND. Funds from those purchases are deposited in an account at Nusenda, which administers the loans, for use as collateral for loans. This unique partnership is an example of a financial institution outsourcing the loan review (despite administering the loans itself) to grassroots organizations and people with deeper ties to the community than the credit union itself while leveraging the financial institution's loan administration strengths.

Source: *https://lamontanita.coop/fund/borrow/*

Further Areas of Inquiry

- Do the recommendations above cover the potential range of community governing entities that are possible for your bank?
- Should community governance at your bank be considered at the product level, program level, or process level?

Adding Indirect and Adjacent Forms of Participatory Investment to Impact Thesis

Overview

In contrast with adding direct governance at the bank level, banks can support the ecosystem of Participatory Investment by supporting other projects, such as capital intermediaries and development projects, that are deploying capital with a process of community governance. They can also invest in community-owned initiatives and entities, like cooperatives, that are aligned with the power-building approach of Participatory Investment.

Below are our findings and recommendations to help banks use their loan dollars to support activities that are indirect or adjacent to Participatory Investment.

Findings and Recommendations

Banks have a significant ability to support shared ownership in business (especially worker-owned cooperatives), in housing and real estate (housing cooperatives, Community Land Trusts), and in other financial institutions (e.g., democratic community investment funds). This is a layer of impact that can strengthen goals of racial equity, power building, and wealth building.

Base Level Recommendations

- Dedicate a minimum percentage of business, housing, and real estate lending to entities with shared ownership, such as worker cooperatives and community land trusts.
- Seek out Participatory Investment real estate projects and provide financial support, such as bridge loans for land purchases, permanent and acquisition loans, or letters of credit. Banks can even purchase tax credits (for example, New Markets Tax Credit) from CDFIs to indirectly capitalize projects with strong PI elements.
- Seek out democratic and participatory financial intermediaries to support by purchasing investment notes or direct public offerings, or by providing interest rate subsidies for their funds.

Banks can support more risk-tolerant lenders such as CDFIs and community lenders to do Participatory Investment themselves.

Base Level Recommendations

- Purchase loans off CDFIs' balance sheets to provide them more liquidity to do Participatory Investment themselves.
- Create a plan to document and learn from PI partners how to develop internal Participatory Investment programs and practices over time.

Deeper Recommendation

- Coordinate and co-invest with other financial intermediaries that are operating with Participatory Investment approaches, and take a more subordinate position to de-risk their investments.

A bank's existing capital products may not align with community needs in terms of time horizon and other deal terms. Banks can adjust their terms to better align with the needs of the communities they serve.

Base Level Recommendation

- Provide capital on terms compatible with uses, including the duration of an investment, the type of capital, and the terms the project needs (for example, avoid lending short-term to an intermediary that is expected to make longer-term loans).

Some emerging grassroots efforts need bank and CDFI partners to underwrite loans and provide other back-end financial services.

Deeper Recommendation

- Proactively look out for emerging PI efforts from the community and explore potential partnerships around those projects.

Banks do not have access to potential Indirect PI deals that they could participate in.

Base Level Recommendation

- Share widely with aligned banks the opportunities that you encounter.
- Socialize success stories of investments into Indirect PI deals through bank networks and affinity groups.

Further Areas of Inquiry

- Does your bank's highest levels of leadership acknowledge this as an important impact approach to adopt? Where else does that leadership exist in the organization?
- What support is there for your bank to take time to learn about broader movements to build a more equitable economy, including economic democracy and the solidarity economy?

Leveraging Institutional Power to Support the Field

Overview

Banks have the ability not only to change their own behavior, but also to impact the industry at large. All trends in community development finance and mission-driven investment start with a critical mass of actors innovating on their own and then sharing their experiences for the field to learn from. Additionally, banks wield cultural and political power outside of their financing capabilities. These assets can and should be wielded in the effort to expand Participatory Investment to new areas of banking.

Note: These recommendations are also highly salient for field builders, industry networks, and researchers.

Findings and Recommendations

Banks that are proponents of PI can be advocates for regulatory shifts to drive PI in the sector. Transform Finance's 2022 Comment on the CRA's Notice of Proposed Rulemaking offers an example of the type of advocacy a bank could pursue.

Base Level Recommendations

- Advocate for strengthening of CRA requirements around Participatory Investment factors.
- Suggest the implementation of Participatory Investment approaches as a remedy for fair lending violations.
- Advocate for the CDFI Fund certification process to include Participatory Investment methods as a requirement.
- Push for stricter guidance on the CDFI Fund's requirements that board members be accountable to the communities they serve, such as a requirement of representation from grassroots rather than larger "grasstops" organizations, or a provision that the bank consults with community partners on who is elected to the board.
- Advocate to the U.S. Treasury to make PI a requirement for funding from other federal sources, such as the Emergency Capital Investment Program.
- Identify state and federal regulatory entities, programs, funding sources, and tax incentives — such as the U.S. Treasury's State Small Business Credit Initiative (SSBCI) and its allocations to Socially and Economically Disadvantaged Individual (SEDI)-owned businesses — that could be petitioned to make it easier to adopt PI strategies.
- Proactively advocate for PI in any spaces where the bank has power and efficacy in policy change.

There is a need for peer-to-peer sharing among banks on their experiences with Participatory Investment.

Base Level Recommendations

- Track the effectiveness and impact of the bank's PI efforts in terms of social equity, bank revenue and growth, and other intended outcomes.
- Share the bank's Participatory Investment findings and successes through industry publications or through platforms such as the Federal Reserve's Investment Connection.
- Encourage standards creators and field builders to more deeply incorporate Participatory Investment approaches in widely used standards like Global Alliance for Banking on Values (GABV), United Nations Environment Programme Finance Initiative (UNEP-FI), and the B Corps' B Impact Assessment. All of these already contain some elements of PI (such as B Lab's *stakeholder capitalism or stakeholder economy* thesis), which further validates the importance of PI in the future of banking.

Further Areas of Inquiry

- Does the bank generally engage in regulatory reform? If so, what existing processes can be used to help ensure regulations and policy support more Participatory Investment? What process of regulatory change can banks themselves accelerate?
- What current windows exist for commenting on rule changes, such as the CRA amendment process?

Appendices

Appendix A

Implementing Participatory Investment Elements Across Departments and Business Operations

General Guidelines and a Checklist

As we have tried to illustrate in this guide, PI principles and methods can be applied in various ways and to various depths. Banks can explore ways to apply them by looking at each major area of the bank's governance, operations, and loan program design and delivery. Below are some general guidelines for PI roles and a checklist of major opportunity areas to explore.

General Guidelines

Expertise – Representatives of the priority communities are the subject matter experts on the needs, assets, and experience of applicants and borrowers, including reflections on fairness and adherence to values; participation should be designed to utilize this expertise. Participants may or may not also become experts in a relevant banking area; the bank could provide training in areas which they think would be helpful. Being explicit about these areas of expertise will help banks ensure that the ideation and decision-making processes are clear and effective.

For example, participants may not be familiar with loan-to-value ratios (LTV) initially, but they can provide insights into the likelihood that applicants would have access to cash that would reduce the loan amount. They could also get information on LTV in order to weigh in on what LTV requirements are reasonable for different loan types.

Compensation – As subject matter experts sharing their time and expertise, participants should be compensated at the appropriate market rate for such consulting services.

Mechanisms – As you look at each of the areas in the checklist table below, consider these common mechanisms to incorporate the voice and vote of your priority communities. Ideally the bank would start with the most meaningful participatory mechanism possible at that moment, and continue to move to more meaningful mechanisms over time (moving up this list from non-voting and temporary to voting, permanent, and staff/board positions).

- Recruit to board
- Hire into executive leadership team
- Hire into various staff positions
- Include on voting committee (permanent/long-term)
- Include on non-voting advisory committee (permanent/long-term)
- Voting task force (short-term)
- Non-voting advisory task force (short-term)
- Focus groups

Checklist – Areas to Explore for Community Participation

This table can help your bank think through how it might institute participatory processes as well as consider some decisions and design features that might result from these processes.

Element/Area	Questions, Suggestions, and Examples	Your participation ideas or plans
Needs analysis, product origination, innovation	**Ask: How can we ensure the bank creates products and services that are truly serving the needs of priority community members?** Creating an ongoing process to reach out, build relationships with, and ask the bank's priority communities about their needs will help ensure that each of the bank's products is expressly created for the purpose of serving the community's needs. It can also help the bank decide when it's best to partner with and support community-based financial products rather than create new products. Establishing relationships with grassroots organizations and individual people who are part of your priority community is critical. Making connections through existing community relationships, hosting open houses, and meaningfully supporting and participating in community-led activities can help build these critical relationships. From there, the bank can work to build advisory groups, conduct focus groups, invite community members to join committees, and recruit people to staff and board positions. Note that the initial time and cost invested in establishing these relationships are R&D costs that will be spread across many products, and will likely pay for themselves over time as products meet community needs and relationships expand the customer base. As banks are mandated to meet the needs and convenience of their communities, co-designing with the community helps to ensure that the bank meets its commitments and offers products and services that the community will use.	
Product design and development	**Ask: How can we ensure that our priority community members are involved in the design and development of the product?** When the bank creates new products or modifies existing ones, it can determine the best method to incorporate participation, such as having community members as voting or non-voting members of the product committee, creating a permanent or temporary advisory committee that advises the bank's product committee, or conducting product-specific focus groups. Product pricing, whether determined in the bank's product committee, a separate pricing committee, or elsewhere, should also have community participation. *RSF Social Finance* offers an example of this: borrowers and capital providers discuss and work together to determine interest rates. Engage in discussions to understand and explore risk and pricing from the community member perspective: explore ideas beyond risk-based pricing; consider that loans that perform equally well should cost the same, regardless of original assessment of risk; discuss concepts around sharing both risk and reward, recognizing that borrowers are also taking significant risks and that when the borrower succeeds, so too does the financial institution supporting them.	

Element/Area	Questions, Suggestions, and Examples	Your participation ideas or plans
Source of capital	**Ask: What sources of patient capital can support this program?** You may be able to find capital from funders that align expectations with community needs and with community-focused risk/reward/return expectations. Family foundations, community foundations, impact investors, and some government sources such as CDFI awards and the Emergency Capital Investment Program (ECIP) are good potential sources for capital that do not expect typical market rate returns, but do expect impact returns. This adjusted returns expectation can allow the bank to lower fees and interest rates for loan programs for priority communities and / or help cover the costs and risks of researching, developing, or launching new programs. An example of a loan fund that approached and found investment capital in this way is *Common Future's character-based lending fund*.	
Credit enhancements	**Ask: What credit enhancements might be helpful to launch a new participatory investment product?** As the bank pilots new products or underwriting criteria, it may need credit enhancements to mitigate the riskiness of testing new techniques. The entities likely to offer patient investment capital are also good potential sources for loan loss reserves and guarantees.	
Underwriting and credit decisioning	**Ask: How can we ensure our priority community members are involved in underwriting and credit decisioning?** PI approaches can be incorporated into underwriting and credit decisioning at the portfolio / product design level or at the loan level. Community participation can provide market and borrower (character) information that can sometimes offer better insight about a borrower's ability and propensity to repay than credit scores and histories. Ensuring that appraisals are conducted by people connected to the community can help prevent the racial bias that is often found to undervalue the homes of Black borrowers and other borrowers of color. Examples of incorporating PI approaches to underwriting include: using community-defined underwriting criteria, underwriting that incorporates community-sourced information, or underwriting approaches that ensure that products fit borrowers' needs first, rather than requiring borrowers to fit into bank products.	
Referrals and partnerships for declines	**Ask: How can the bank and priority community members work together to guide and create communications, support, and referral mechanisms for applicants whose applications are declined?** Community members engaged in the loan program development can help ensure that language and approaches are relevant and helpful to applicants from the community, and may offer or be able to vet possible credit building and other technical assistance providers.	
Regulatory adherence and collaboration with regulators	**Ask: How and when will we work with our regulators to share and get feedback on our community participation plans?** Engaging regulators early as you design Participatory Investment approaches can help ensure that they understand the intentions behind the approach and can partner with you as you develop your risk mitigation strategies. In some cases, they may be able to offer ideas from other lenders they've worked with.	

Element/Area	Questions, Suggestions, and Examples	Your participation ideas or plans
Loan servicing, portfolio management, and borrower technical assistance	**Ask: How will we work with priority community members to determine the best ways to support borrowers during the loan term?** You can solicit ongoing community feedback and input on the following to design for optimal success for both the borrower and the bank: • Borrower onboarding processes • Ongoing borrower communications such as regular check-ins or reminders as a way of pre-empting problems • Addressing sudden or unavoidable issues with offerings like skip a pay or modifications • Optimizing opportunities to improve and not harm credit • Refinancing for better rates/terms	
Staffing and training	**Ask: How will we ensure our staff understand, value, and can deliver or support programs with a Participatory Investment lens?** Training existing staff on the history of banking in communities, the potential role of banks to support community empowerment, and Participatory Investment approaches will support the design of new programs and encourage staff to be thinking about ways to incorporate these approaches into existing programs. Hiring people to lead Participatory Investment work — a position or department that supports multiple processes — can ensure that this approach is infused throughout the bank and is evaluated and evolved over time.	
Launch, outreach, engagement	**Ask: How will we work with priority community members to design and implement a product launch and outreach plan that best reaches and serves the priority community?** Members of the community will know the best channels and messaging for that community, and can offer existing relationships that instill trust, letting the community know that the bank's intentions and designs are truly working toward community benefit.	
Evaluation	**Ask: How will we engage priority community members in the evaluation of the effectiveness, experience, and impact of the program for intended borrowers and applicants (declined, withdrawn, and approved)?** Priority community members can help determine the channels and questions to ask, and may be able to ensure more participation and elicit the more honest and thorough answers that a trusted relationship would allow.	
General bank governance	**Ask: How can we incorporate Participatory Investment commitments and mechanisms into our bank's governing documents and bodies?** Banks can explore each area of governance to determine where to best codify these commitments. Some possibilities include modifying the articles of incorporation to mandate community benefit, changing the composition of the board and advisory boards, modifying decision making processes and policies, and even major shifts like the bank's corporate type or ownership model.	

Appendix B

Additional Training and Resources

Participatory Investment Report

Organization: *Transform Finance*

Reading materials: *Grassroots Community Engaged Investment*

Video: *Transform Finance's 7-part 2021 series*

History of banking, our economy, and racial inequity

See Beneficial State Foundation's recommended resources *here*.

The power dynamics of capital and economic democracy

Organization: *Center for Economic Democracy*

Reading materials (book): *The Purpose of Capital: Elements of Impact, Financial Flows, and Natural Being* by Jed Emerson

Center for Economic Democracy's "Social Movement Investing: A Guide to Capital Strategies for Community Power" report

Personal and cultural trauma and finance

Organization/Subject Matter Expert: Author and *BlackFem* Founder *Chloe B. McKenzie*

Reading materials: *Movement Generation's Just Transition Work Understanding Racial Trauma's Impact on Financial Literacy*.

Sharing of risk and reward in the provision of capital

Reading materials (Book): *Real Impact* by Morgan Simon

Video: *Transform Finance webinar on risk-return tradeoffs*

Solidarity economy

Organization: *New Economy Coalition*, *Movement Generation*

Reading materials: *Series in Nonprofit Quarterly*

Appendix C

Case Studies and Other Links Provided in This Paper

Participatory Investment Report by Transform Finance:
https://www.transformfinance.org/blog/participatory-investment-report

Underwriting for Racial Justice, a national working group convened by Beneficial State Foundation:
https://beneficialstate.org/urj/

CDFI Fund, a department of the U.S. Treasury that oversees the certification of Community Development Financial Institutions: *https://www.cdfifund.gov/*

Community Benefit Agreements brokered by California Reinvestment Coalition:
https://calreinvest.org/publications/bank-agreements/

Vermont Community Loan Fund, a Vermont-based CDFI: *https://www.investinvermont.org/*

Farm Credit Services of America (FCS) and their cash-back dividend sharing practice:
https://www.fcsamerica.com/about/cooperative-model/cash-back-dividends

Reading Cooperative Bank, a Massachusetts-based cooperative bank: *Reading Cooperative Bank*

Ponce Bank, a New York-based mutual bank that went public:
https://nextcity.org/features/banks-with-no-shareholders-the-curious-case-of-mutual-banks

Common Future's character-based lending program:
https://www.yesmagazine.org/issue/a-new-social-justice/2021/11/15/banking-bipoc-businesses

La Montañita Food Coop in Albuquerque, NM: *https://lamontanita.coop/fund/borrow/*

Nusenda Credit Union in Albuquerque, NM: *https://www.nusenda.org/*

Comment on CRA and Participatory Investment, by Transform Finance:
https://www.transformfinance.org/blog/our-comment-on-cra-and-participatory-investing

U.S. Treasury Department's Emergency Capital Investment Program:
https://home.treasury.gov/policy-issues/coronavirus/assistance-for-small-businesses/emergency-capital-investment-program

B Lab's (the nonprofit behind the B Corp certification) stakeholder economy concept:
https://usca.bcorporation.net/stakeholder-economy/