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Ranking Season: Combating Commercial Banks' Systemic Discrimination of Consumers

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The recent disbursement of COVID-19 pandemic-related federal relief funds to businesses and individuals under the CARES Act exposed significant problems in the U.S. system of money and payments. U.S. banks' wealth maximization objectives clashed with the federal government's goals of diversity, equity, and inclusion (DEI). The discriminatory, self-interested behavior of banks, which essentially served as the federal government's long arm in these transactions, worsened the pandemic-induced economic crisis for many, especially women and minorities, and intensified racial injustice. The U.S. government's inability in 2020 to successfully execute its stimulus plan and give all its intended recipients the benefits it had designated due to the role played by banks begs the question: Should U.S. banks be subject to any legal obligations when they help the government execute its fiscal goals? This article argues that U.S. banks should help advance the federal government's fiscal policy, including the DEI social agenda, especially during critical junctures such as the economic crisis instigated by COVID-19, and proposes an agency theory approach to mandate the implementation of government social policy goals among commercial banks via a CAMELS rating-like system that includes social goals, such as DEI. This DEI rating system would create public consequences for noncomplying banks, including depositors withdrawing their funds from lower-rated banks and redepositing them in top-rated banks, resulting in higher-rated DEI banks overtaking lower-rated banks. This DEI rating system will also provide an incentive for banks to compete for more diversity and inclusion, which would solve many of the systemic discrimination-related issues that led to economic inequality and intensified the 2020–2021 crisis. Lastly, DEI-based scores could help prevent banks from finding themselves on the losing side of

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the growing public banking movement in the United States, enabling banks to reposition themselves and avoid future radical changes in the banking industry.

Introduction

The Federal Reserve (Fed) performs several key functions to promote a strong U.S. economy and financial system. Among these functions are "conducting monetary policy, promoting financial system stability, supervising and regulating financial institutions and activities, fostering payment and settlement system safety and efficiency, and promoting consumer protection and community development."[1] Commercial banks are the conduit for the monetary policies of the Fed.[2] In that capacity, banks play a critical role in our society and are unique in that they are subject to strict regulation, supervisory oversight, and monitoring to ensure the proper implementation of the Fed's monetary policy. Regulation includes a time-tested reward and punishment system, which examines the financial soundness of banks and ensures that they adhere to certain conservatisms in their business[3] while implementing the Fed's monetary policy goals. This article, however, focuses on a less-discussed aspect of the role of commercial banks in the United States, their role in advancing the government's fiscal policy.[4]

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[1]Bd. Governors Fed. Rsrv. Sys., *Feature Publications*, https://www.federalreserve.gov/publications/general.htm (last visited Sep. 27, 2021).

[2]*See*, *e.g*., Keith R. Fisher, *Reweaving the Safety Net*: *Bank Diversification into Securities and Insurance Activities*, 27 Wake Forest L. Rev. 123, 261 (1992) (discussing the role of commercial banks in today's developed capital markets and stating that the "textbook function of banks, to act as a conduit through which the Federal Reserve implements its monetary policy….").

[3]*See*, *e.g*., Elizabeth W. Cooper, *Monitoring and Governance of Private Banks*, 49 Q. Rev. Econ. & Fin. 253, 253 (2009); *see generally* Timothy W. Koch & S. Scott MacDonald, Bank Management Chpt. 11 (8th ed. 2015).

[4]Thomas J. Schoenbaum, *The Global Financial Crisis and Its Impact on World Trade and the World Economy*: *An Overview*, 41 Unif. Com. Code L.J. 375, 401 (2009) (discussing how, as part of governments' fiscal agenda, "[m]any nations have enacted or will pass gigantic fiscal stimulus packages to revive domestic demand … . In the United States, the center of the [2008 financial] crisis, Congress enacted the American Recovery and Reinvestment Act of 2009, a massive $787 billion economic stimulus package of government spending and tax cuts" to advance the Government's fiscal policy). The Biden administration, in particular, has committed to advancing social goals, emphasizing DEI. Emily Glazer, *Companies Brace Themselves for New ESG Regulations Under Biden*, Wall St. J. (Jan. 18, 2021), https://www.wsj.com/articles/companies-brace-themselves-for-new-esg-regulations-under-biden-11610719200.

The banks' unique role includes acting as the main channel for transferring government funds to consumers, aiding populations and communities in need, and helping financially weaker groups.[5] Banks also play a role in money creation and distribution,[6] and appreciating this unique importance, some commentators have suggested that banking regulation should be understood as a subcategory of infrastructure regulation.[7]

There is no doubt that commercial banks do serve as the conduit for the government's fiscal policy, as they are the main conductor for funneling money to and from the government. For instance, the government relies on commercial banks when it direct-deposits taxpayers' refunds

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[5]The U.S. government manages programs such as TANF, SNAP, and others. *See infra* Section II. B. 1. Similarly, the U.S. Community Reinvestment Act, 12 U.S.C. §§ 2901 *et seq.*, puts government financial regulators in the position of needing to grade banks and other financial institutions based on their extension of credit and funds to specific types of borrowers, especially low-income borrowers who wish to purchase homes. This fiscal agenda was especially notable in President Bill Clinton's "National Homeownership Strategy," which pushed for particular home ownership rates, and President George W. Bush's "ownership society," which increased the number of homeowners, particularly for low-income individuals. Thomas J. Schoenbaum, *Saving the Global Financial System*: *International Financial Reforms and United States Financial Reform*, *Will They Do the Job*?, 43 UNIF. COM. CODE L.J. 479 (2010) (mentioning U.S. DEP'T OF HOUS. AND URB. DEV., HOMEOWNERSHIP AND ITS BENEFITS; URBAN POLICY BRIEF NO. 2 (Aug. 1995); Zachary Karabell, *The End of the Ownership Society*, NEWSWEEK (Oct. 10, 2008), https://www.newsweek.com/end-ownership-society-92195).

[6]*See* Morgan Ricks, *Money as Infrastructure*, 2018 COLUM. BUS. L. REV. 757, 758–59 (2018) [hereinafter *Money as Infrastructure*] (explaining that "[t]wo competing paradigms have long dominated understandings of banking and its regulation. One paradigm sees banking first and foremost as a species of financial intermediation. Under this intermediation paradigm … banks are understood to be primarily in the business of 'taking funds' from depositors and then 'lending them out.' … The other paradigm can be called the money paradigm. It views banks as distinctly monetary institutions … Rather than seeing banks as taking funds that are then lent out, the money paradigm sees banks primarily as issuers of 'funds.'… On this view, banks are an integral part of the overall monetary framework, a status that justifies a unique relationship with the state. The two paradigms are not strictly incompatible; most banking experts would probably find truth in both of them.") (emphasis omitted).

[7]*See, e.g.*, Robert C. Hockett & Saule T. Omarova, *The Finance Franchise*, 102 CORNELL L. REV. 1143 (2017) (offering an in-depth theoretical account of the fundamental hybridity of modern banking as a public-private enterprise); and *Money as Infrastructure*, *supra* note 6 (contrasting the "intermediation paradigm" of banking and the "money paradigm."). *See generally* CHRISTINE DESAN, MAKING MONEY: COIN, CURRENCY, AND THE COMING OF CAPITALISM (2014) (describing how money evolved and suggesting that it is an institution engineered by political communities to mark and mobilize resources).

into their bank accounts or sends checks to be cashed at their banks.[8] But despite the banks' importance in implementing the government's fiscal policy, there is no system that ensures or assesses the banks' operations in that context, rewards them when money reaches the government's intended recipients in an equal and equitable fashion, or reprimands the banks for failing to advance the government's intended fiscal goals.

This article argues that such a system is needed more than ever before. Recent years' frustration with the economic system due to growing inequality intensified following the government's disbursement of the Coronavirus Aid, Relief, and Economic Security (CARES Act)[9] stimulus package to COVID-19-affected populations that was distributed in an unequal and unequitable manner, largely because of the banks' business choices.[10] The banks simply failed in advancing the goals of the stimulus package, as intended by the government,[11] partly because they had no incentives to do so. The lack of fiduciary duty placed on banks contributed to their inability to be flexible with those facing financial difficulties.[12]

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[8]*See, e.g.*, *Choose Direct Deposit for the Fastest Way to Receive Your Refund*, Internal Revenue Serv. (Feb. 28, 2020), https://www.irs.gov/newsroom/choose-direct-deposit-for-the-fastest-way-to-receive-your-refund ("The fastest way to get your tax refund is to file your return electronically and have your refund deposited directly into your bank account.").

[9]The CARES Act was signed into law several weeks after the COVID-19 pandemic put a halt to most aspects of American life. *See* CARES Act, Pub. L. No. 116-136, § 2102(a)(3), 134 Stat. 281, 313–14 (2020); *Covid-19 Economic Relief*, U.S. Dep't of Treasury, https://home.treasury.gov/policy-issues/cares.

[10]*See, e.g.*, Pamela Foohey, Dalié Jiménez & Christopher K. Odinet, *The Debt Collection Pandemic*, 101 Cal. L. Rev. Online 222 (2020) (discussing the poorer and most in-financial-need populations that had creditors and debt collectors take their CARES Act distributed funds from their bank accounts).

[11]*See* Nizan Geslevich Packin, *In Too-Big-to-Fail We Trust*: *Ethics and Banking in the Era of COVID-19*, 2020 Wis. L. Rev. Forward 101 (2020) [hereinafter *Ethics and Banking*] (explaining that "[t]he government needed and trusted the big banks to provide liquidity by distributing funds to individuals and small businesses, but the banks failed in doing so. Instead, the banks prioritized profit-making … on the expense of those who needed liquidity most. In the process, the banks discriminated against minorities, women, and other underserved populations.").

[12]*See, e.g.*, Isabel Peres, Note, *The Evolution of Banking*: *A Flexible Fiduciary Duties Approach Will Help Better Protect Mobile Banking Consumers*, 2015 U. Ill. J.L., Tech. & Pol'y 211–14, 226; *Ethics and Banking*, *supra* note 11, at 1050.

Some banks used widely known loopholes[13] to collect the government's payments in customers' bank accounts[14] if payees owed outstanding loans or other payments to the bank.[15] Alarmed by this, scholars,[16] journalists,[17] and politicians[18] expressed concerns about this practice. Similarly, several states' attorney generals,[19] governors,[20] and even various courts tried to address the

[13]The Bureau of Fiscal Service (BFS), formerly Financial Management Service (FMS), is a bureau of the Treasury Department that is responsible for collecting all nontax debts and discusses issues such as banks' loopholes in connection with the distribution of government funds. *See* IRM 5.21.6.7 (Feb. 18, 2016).

[14]Within a couple of weeks after enactment of the CARES Act, Treasury, through its BFS and the Internal Revenue Service (IRS), was responsible for the distribution of more than 81 million payments at a value of more than $147 billion via electronic transfers to recipients' bank accounts. CARES Act, § 2201, 134 Stat. at 335–40. *See* U.S. Gov't Accountability Off., GAO-20-625, Covid-19: Opportunities to Improve Federal Response and Recovery Efforts, Report to the Congress (2020).

[15]*See* Pamela Foohey, Dalié Jiménez & Christopher K. Odinet, *CARES Act Gimmick*: *How Not to Give People Money During a Pandemic and What to Do Instead*, 2020 U. Ill. L. Rev. Online 81, 82 (2020) (describing how the Treasury failed to code the payments in a certain way before sending them, which enabled banks to hold onto customer's relief payments if their accounts were overdrawn when the money was deposited).

[16]*Id.*

[17]*See* Kiah Collier & Ren Larson, *Coronavirus Put Her Out of Work, Then Debt Collectors Froze Her Savings Account*, Tex. Trib. (Apr. 22, 2020), https://www.texastribune.org/2020/04/22/texas-coronavirus-debt-collectors/ (discussing how predatory debt collectors raided bank accounts as soon as the federal government began to deliver stimulus payments and how more protections for bank account garnishments are needed).

[18]*See, e.g.*, Emily Stewart, *Exclusive*: *Elizabeth Warren and Sherrod Brown's Plan to Protect Consumers from Financial Ruin*, Vox (Apr. 21, 2020), https://www.vox.com/policy-and-politics/2020/4/21/21229412/elizabeth-warren-sherrod-brown-cares-act-consumer-proposals (detailing how banks and loan sharks could seize the stimulus check money before it landed in consumers' accounts).

[19]*See, e.g.*, 940 Mass. Code Regs. 35.00 (2020); Dave Yost, Ohio Att'y Gen., Notice of Applicability of State Law Exemption to Payments Under the Federal CARES Act (Apr. 13, 2020), www.ohioattorneygeneral.gov%2FFiles%2FBriefing-Room%2FNews-Releases%2FSTATE_LAW_EXEMPTION_FOR_WEB.aspx&clen=129414&chunk=true; and N.Y. State Off. Att'y Gen., Guidance on CARES Act Payments (2020), https://ag.ny.gov/sites/default/files/cares_act_guidance.pdf.

[20]*See, e.g.*, Ill. Exec. Order No. 2020-25 (Apr. 14, 2020); Wash. Exec. Order No. 20-49 (Apr. 14, 2020); and Cal. Exec. Order No. N-57-20 (Apr. 23, 2020).

problem to help consumers,[21] stressing that the government intended for banks to distribute the funds to consumers who truly needed them.[22]

This article explores banks' role in advancing the government's fiscal policy and social agenda as banks clearly serve as the conduit for the government's fiscal policy. Within that context, this article discusses ethics in banking[23] and focuses on the recent rise of corporate environmental, social, and governance (ESG) goals,[24] which also include diversity, equity, and inclusion (DEI). The article especially focuses on DEI in banking and explains why the trend cannot, by itself, be enough to successfully align the interests of banks, which seek to maximize their shareholders' wealth,[25] with the government's social policy goals.[26] Even if banks would choose to

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[21]*See*, *e.g.*, Tenth Emergency Order Regarding the COVID-19 State of Disaster, Misc. Docket No. 20-9054 (Tex. 2020); *In re* Petition to the Indiana Supreme Court to Engage in Emergency Rulemaking to Protect CARES Act Stimulus Payments from Attachment or Garnishment from Creditors, Nos. 20S-MS-258, 20S-CB-123 (Ind. 2020).

[22]*Court Halts Debt Collection During Crisis*, DOMINION POST (Apr. 17, 2020), https://www.dominionpost.com/2020/04/17/court-halts-debt-collection-during-crisis (discussing court orders to protect individual stimulus payments—the federal pandemic survival funds—from being seized).

[23]Other scholarship focuses primarily on ethics in banking. *See*, *e.g.*, *Ethics and Banking*, *supra* note 11 (suggesting solutions to ensure that banks behave more ethically toward their customers.)

[24]*See* Thomas Lee Hazen, *Corporate and Securities Law Impact on Social Responsibility and Corporate Purpose*, 62 B.C.L. REV. 851, 853–54 (2021) (stating that "[t]he corporate social responsibility (CSR) movement wants companies to consider the societal impact of their operations); *See also* Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s)*: *Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243 (2020) (focusing on an overlooked dimension of the ESG-based competition among major institutions—the effort to attract Millennial assets, given research, which indicates that Millennial investors are more likely to invest based on ESG considerations than are others); Ann M. Lipton, *Not Everything Is About Investors*: *The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. ON REG. BULL. 499, 527 (2020) (Some commentators believe that when it comes to the social impact of corporate activity, the informational needs of investors and the public are not that different. "Sustainability" metrics are material to investors' evaluation of long-term financial performance as such practices contribute to corporate health and help generate goodwill, which translates into better sales, hiring, economic signaling, and compliance operations.)

[25]Banks' compensation structures have also produced incentives for excessive risk-taking. *See generally* Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L.J. 247 (2010).

[26]*See*, *e.g.*, Brian Knight, Opinion, *The Fed's Loan Relief Must Be Non-political*, WALL ST. J. (Apr. 12, 2020), https://www.wsj.com/articles/the-feds-loan-relief-must-be-non-political-11586712221 (analyzing the 2020 government plan).

advance some ESG-based goals, and specifically DEI, they would do so in conjunction with pursuing their own strategic objectives,[27] which could mean doing so only if such a course of action would result in business rewards for the banks.[28] Likewise, without clear standards and laws, banks' attempts to step up their ESG-based operations are likely to be non-transparent, vague,[29] and mainly public relations–driven initiatives that do not necessarily reflect their genuine business interests and practices.[30]

Focusing on commercial banks' role in advancing the government's fiscal agenda, and particularly DEI-related goals, this article offers an agency theory–based approach, requiring banks to advance the government's fiscal agenda, as its semi-agents. This approach is explained by analyzing the banks' (i) compensation for serving the government as its semi-agents, (ii) unique role in and contribution to the U.S. financial

[27]Fitch Ratings has determined that ESG ranking is relevant for the credit scoring of only specific types of corporate entities. *See Fitch Ratings Launches ESG Relevance Scores to Show Impact of ESG on Credit*, Fitch Ratings (Jan. 7, 2019), https://www.fitchratings.com/site/pr/10058528.

[28]*See, e.g.*, Rodolphe Durand et al., *Do Investors Actually Value Sustainability Indices? Replication, Development, and New Evidence on CSR Visibility*, 40 Strategic Mgmt. J. 1471 (2019) (suggesting that even if more data about corporate entities' social performance becomes publicly available, these entities' stock prices might stay the same and not reflect the change.)

[29]Commentators have urged the SEC to set clear and proper disclosure standards under the federal securities laws. Some have argued that there are environmental and social factors that meet the definition of financial materiality and should be disclosed under securities disclosure laws. *See, e.g.*, Ruth Jebe, *The Convergence of Financial and ESG Materiality: Taking Sustainability Mainstream*, 56 Am. Bus. L.J. 645, 645 (2019) (critiquing the SEC's failure to act on sustainability). Agreeing with the importance of ESG factors, but believing these factors are currently not required to be disclosed, others have argued that the materiality standard should be expanded. *See, e.g.*, Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 Geo. L.J. 923, 929 (2019) (suggesting that the SEC adopt principles-based sustainability disclosures).

[30]*See* Lucian A. Bebchuk & Roberto Tallarita, *Stakeholder Talk Proves Empty Again*, Wall St. J. (Aug. 18, 2021), https://www.wsj.com/articles/stakeholder-capitalism-esg-business-roundtable-diversity-and-inclusion-green-washing-11629313759 (concluding that most signatory companies to a group commitment to deliver value to all stakeholders did not intend their endorsement to be followed by changes in how they treat stakeholders); Asjylyn Loder, *Funds Don't Always Vote for Policies They Publicly Back*, Wall St. J. (Apr. 2, 2019), https://www.wsj.com/articles/funds-dont-always-vote-for-policies-they-publicly-back-11554206401 (describing how even socially responsible investing funds' stated intentions do not necessarily translate into their voting records).

system, and (iii) involvement in the government's existing fiscal policy and social programs.

Building on this agency theory–based approach, this article suggests adopting a regulatory solution that will entail a public criticism component in a CAMELS rating–like system. The CAMELS rating, which has successfully rated commercial banks in the United States for nearly forty years, looks at the safety and soundness of banks.[31] The suggested new Social Policy Rating System (SPRS) that this article conceptualizes and advocates for will measure how banks' actions ensure the safety and soundness of the societies in which they operate. Therefore, just as banks must help carry out the Fed's monetary policy, even while ensuring their financial safety and soundness by measuring up to their CAMELS ratings, they would have to help carry out the government's fiscal policy directives, while ensuring their socially responsible behavior by measuring up to the SPRS. Yet, unlike the CAMELS rating, the SPRS will be publicly available for successfully incorporating the public criticism component, by publicly ranking banks based on their social consciousness and devotion to DEI. Such an agency theory–based approach would encourage banks to enhance economic inclusion, factor DEI issues into their business operations, and ensure that the neediest will not be victimized, especially during times of crisis. This approach could also help prevent banks from finding themselves on the losing side of the growing movement toward public banking in the United States, enabling banks to reposition themselves and avoid future radical changes in the banking industry.

This article is organized as follows: Section I examines the legal connection between banks and economic inclusion, describes the ESG and DEI trends, explains why solely relying on these trends is unlikely to solve DEI problems in banking, and discusses the movement toward public banks in the United States. Section II introduces an agency theory–based approach according to which banks should advance, as semi-agents of the U.S. government, the government's fiscal agenda. Section III outlines the SPRS that would measure banks' socially

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[31]The Federal Financial Institutions Examination Council (FFIEC), which is made up of several government agencies, has created (and since then revised) the Uniform Financial Institutions Rating System (UFIRS) that is commonly known as the CAMELS rating system. Federal Financial Institutions Examination Council Act of 1978, Pub. L. No. 95-630, 92 Stat. 364 (1978).

responsible behavior while advancing the government's fiscal agenda. Finally, the article concludes by stressing the importance of aligning the banks' interest with those of the government, emphasizing social welfare, inclusion, and community building, and calling for the adoption of a top-down approach to incentivize banks.

I. Banks and Economic Inclusion

Depository institutions are among the most regulated of all businesses in the United States, by federal and state law.[32] Financial legislation, however, is typically limited in its nature. This is partly because there is a long history of financial regulation following crises. In the United States, the Fed was created to ensure that panics like the one of 1907 could be contained.[33] The Great Depression of 1929–1933 led to the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934.[34] The Sarbanes-Oxley Act of 2002 was primarily a result of the Enron scandal.[35] The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was a result of the 2007–2008 financial crisis.[36] Finally, the COVID-19 pandemic has brought its share of requirements for financial legislation and showcased the need for legislation to ensure that fiscal payments reach their intended recipients.[37] Laws such as the

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[32]*See*, *e.g.*, Elizabeth F. Brown & Edward F. Buckley, *A Preliminary Look at State Structures for Regulating Financial Services*, 87 U. Cin. L. Rev. 891, 919 (2018) (explaining how unlike insurance-industry players, "depository institutions … are regulated by both the federal and state governments").

[33]*See*, *e.g.*, Roger W. Spencer & John H. Huston, The Federal Reserve and the Bull Markets 1–6 (2006) (describing the passage of the 1913 Federal Reserve Act and the first president of the Federal Reserve Bank of New York).

[34]*See* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 547 U.S. 71, 78 (2006) ("In response to the sudden and disastrous collapse in prices of listed stocks in 1929, and the Great Depression that followed, Congress enacted the Securities Act of 1933 (1933 Act), 48 Stat. 74, and the Securities Exchange Act of 1934 (1934 Act).").

[35]*See*, *e.g.*, Digit. Realty Tr., Inc. v. Somers, 138 S. Ct. 767, 769 (2018) ("Endeavoring to root out corporate fraud, Congress passed the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley).").

[36]*Id*. at 773. (Passed after the 2008 financial crisis, Dodd-Frank aimed to promote the United States' financial stability by enhancing accountability and transparency standards and responding to perceived shortcomings in financial regulation.).

[37]*See Ethics and Banking*, *supra* note 11, at 1044–46.

Consumer Credit Protection Act of 1968 (CCPA), the Equal Credit Opportunity Act (ECOA),[38] and the Community Reinvestment Act of 1979 (CRA),[39] which were specifically created to overcome aspects of consistent discrimination, have not proved effective in solving broader economic inequality–related needs, including urgent ones such as those demonstrated during the COVID-19 pandemic–induced economic crisis.

This regulatory ineffectiveness is a problem. Financial and economic inequality–related issues are among the market failures that regulation is typically meant to fix, along with ensuring that any unfair practices that hurt certain populations and communities are discouraged.[40] In the financial markets, specifically, there are five fundamental reasons for regulation: (i) to ensure their safety and soundness, (ii) to provide an efficient and competitive financial system, (iii) to provide monetary stability, (iv) to maintain the integrity of the nation's payments system, and (v) to protect consumers from abuses by credit-granting institutions.[41] The last two reasons were compromised in the recent past after it became clear that without proper regulation, sections of the population can be harmed by lenders' discriminatory behavior or excluded from certain financial services. Notable among laws that seek to address this is the CCPA, which created protections for consumers from financial institutions such as banks and credit card com-

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[38]ECOA makes it unlawful for "any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction," on the basis of sex, marital status, and other designated characteristics. 15 U.S.C. § 1691(a)(1) (2021).

[39]Housing and Community Development Act of 1977, Pub. L. No. 95-128, § 801, 91 Stat. 1111, 1147 (codified as amended at 12 U.S.C. §§ 2901–05); Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). For an overview of CRA, *see* Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act*: *An Economic Analysis*, 79 Va. L. Rev. 291 (1993); Kathleen C. Engel & Patricia A. McCoy, *The CRA Implications of Predatory Lending*, 29 Fordham Urb. L.J. 1571 (2002).

[40]*See, e.g.*, Steven L. Schwarcz, *Regulating Financial Change*: *A Functional Approach*, 100 Minn. L. Rev. 1441, 1451 (2016) ("In general, markets are efficient absent market failures; hence the purpose of financial regulation should be to correct market failures."); Charles W. Murdock, *The Future of Insider Trading After Salman*: *Perpetuation of a Flawed Analysis or a Return to Basics*, 70 Hastings L.J. 1547, 1610 (2019) (explaining how the purpose of securities regulation is to ensure a level playing field).

[41]Koch & MacDonald, *supra* note 3, at 31–32.

panies.[42] Similarly, the ECOA forces lenders not to discriminate based on race, gender, marital status, age, or national origin. These two acts, along with the CRA, redefined banking and showcased the government's interest in promoting social welfare and inclusiveness.[43] The CRA, especially instrumental in this,[44] was created with the intention of preventing redlining, a practice of not lending to people in a particular geographic area.[45]

While the passage of the CRA was motivated by evidence of redlining and disinvestment of bank deposits in certain areas,[46] some

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[42]G. Marcus Cole, *Rational Consumer Ignorance: When and Why Consumers Should Agree to Form Contracts Without Even Reading Them*, 11 J.L. ECON. & POL'Y 413, 462 n.8 (2015) ("The Truth in Lending Act of Title I of the Consumer Credit Protection Act of 1968, 15 U.S.C. § 1601 *et seq.*, requires disclosures of basic parameters of any extension of credit by a lender to a consumer. The regulations implementing the statute, known as 'Regulation Z,' are codified at 12 C.F.R. 226."). *See also FDIC Law, Regulations, Related Acts*, FED. DEPOSIT INS. CORP., https://www.fdic.gov/regulations/laws/rules/6500-200.html for more details on consumer protection.

[43]*See* Sarah Bloom Raskin, Member, Bd. of Governors of the Fed. Rsrv. Sys., Remarks at a New America Foundation Forum: Economic and Financial Inclusion in 2011: What It Means for Americans and Our Economic Recovery (June 29, 2011) (detailing why broad inclusion matters to economic recovery). Raskin stated that

> [i]n the financial and regulatory world, "economic inclusion" refers to efforts to expand public access to, and participation in, mainstream financial services. This effective inclusion in the financial marketplace depends upon a strong regulatory framework, active market participation, and an expansion in public financial literacy. For the sake of clarity, I will call this meaning "financial inclusion," and proceed on the assumption that it is indispensably important to effective navigation of the twists and turns of life in the American economy.

Id. at 2.

[44]*See* Michael S. Barr, *Credit Where It Counts: The Community Reinvestment Act and Its Critics*, 80 N.Y.U. L. REV. 513 (2005) (describing its success "in expanding access to home mortgage lending").

[45]*See, e.g.*, Marion A. Cowell, Jr. & Monty D. Hagler, *The Community Reinvestment Act in the Decade of Bank Consolidation*, 27 WAKE FOREST L. REV. 83 (1992) (explaining the remarkable transformation it has gone through, shifting "from a seldom-employed, regulatory formality to a powerful tool wielded by community groups and financial regulators").

[46]Focusing on this disinvestment issue, Senator William Proxmire, a sponsor of the law, explained that redlining happens when "banks and savings and loans will take their deposits from a community and instead of reinvesting them in that community, they will … actually or figuratively draw a red line on a map around the areas of their city, … sometimes in the older neighborhoods, sometimes ethnic and sometimes black, but often encompassing a great area of their neighborhood." *See* Charles L. Nier, III, *Perpetuation of Segregation: Toward a New Historical and Legal Interpretation of Redlining Under the Fair Housing Act*, 32 J. MARSHALL L. REV. 617, 633 (1999) (citing 123 Cong. Rec. 17,630 (1977) (statement of Sen. Proxmire)).

commentators believed that the CRA could do more than just fix geographic credit imbalances and actively prevent racial discrimination in credit markets.[47] After all, minorities typically live in low- and moderate-income (LMI) neighborhoods,[48] and ensuring fair access to credit for residents of such areas means ensuring fair access to credit for minorities. Therefore, by mandating that banks make credit available in areas where they might not do so otherwise, the CRA has had (even if indirectly) some positive effects.[49] Yet, race, gender, and other anti-discriminatory and fairness-related goals are not explicitly mentioned in the CRA. The CRA's strong economic foundation and justifying principles are based on "the government's (implicit) desire to maximize some measure of social welfare in the aggregate while increasing the social welfare of LMI areas through the socially optimal allocation of credit."[50] These principles are useful for this article's agency theory–based approach regarding commercial banks' role in advancing the government's fiscal agenda. But in terms of regulation, the CRA, much like the CCPA and ECOA, is not enough. We need a broader-ranging, explicit, incentivizing regulation to make banks advance the government's fiscal agenda. Any regulatory design must, therefore, focus on the promotion of DEI in banking services, especially given the misalignment between the government's and banks' interests. While extreme times of economic inequality and distress like 2020–2021 are uncommon, they require the government to go to abnormal lengths to try to protect disadvantaged populations. Otherwise, they will be marginalized by the banks, as was

[47]Keith N. Hylton & Vincent D. Rougeau, *Lending Discrimination: Economic Theory, Econometric Evidence, and the Community Reinvestment Act*, 85 GEO. L.J. 237, 246 (1996) ("[I]n spite of its title and its general language about meeting the needs of the community, it is well known that the CRA is aimed at eliminating a pattern that seems to be racially discriminatory. The statute is framed in nonracial terms, but interpretations by regulators and legislators consistently refer to minority groups.").

[48]Christopher A. Richardson, *The Community Reinvestment Act and the Economics of Regulatory Policy*, 29 FORDHAM URB. L.J. 1607, 1613 (2002) [hereinafter: *The CRA*] (describing the CRA as the regulators' attempt to shape the economic and social condition of communities by modifying the economic policies of depository institutions, and how the law's supporters believe it provides more access to credit in LMI neighborhoods).

[49]*Id.*

[50]*Id.* at 1614.

the case during the COVID-19 pandemic, due to legal business practices.[51]

The following sections discuss the development of three key DEI-related areas in banking: (i) financial institutions' social goals–driven agenda; (ii) the conduct risk concept, as part of banks' risk management protocols; and (iii) the rise of the public banks trend in the United States.

A. The 'S' in ESG: Diversity, Equity, and Inclusion and a Social Agenda in Banking

The inequality, exclusion, and social-related problems demonstrated in the execution of the government's response to the COVID-19 pandemic–induced economic crisis were not surprising. American financial regulation is simply not broad or incentivizing enough to make banks advance financial inclusion and the government's social agenda. Laws such as the CRA, however, did raise some social awareness among bankers and even nudged some financial institutions to choose to contribute toward certain social goals on a voluntary basis. For example, based on the CRA's concept of fair access to credit,[52] some banks have been undertaking more risky lending,[53] facilitating some communities' development.[54] On the profitability side, studies have shown that "a

[51]For example, relief checks directly deposited into taxpayers' accounts were garnished by banks before customers could access them. *See*, *e.g.*, CARES Act § 2201; GAO-20-625; Foohey et al., *supra* note 15. Additionally, banks prioritized larger customers over women and minorities in the government's Payment Protection Program (PPP) loans. *See* Emily Flitter & Stacy Cowley, *Banks Steered Richest Clients to Federal Aid*, N.Y. Times (New York), Apr. 23, 2020, at A1. Lastly, the processing of PPP loans was limited, primarily by banks' capacity to quickly process applications, and banks preferred their pre-existing clients. *See Ethics and Banking*, *supra* note 11, at 1055–56.

[52]*See* News Release, Off. of the Comptroller of the Currency, Comptroller Statement Regarding Wells Fargo Fair Lending Settlement No. 2012-107 (July 12, 2012) (The OCC "is committed to assuring that national banks and federal savings associations provide fair access to credit and treat every customer fairly. Every person who applies for a loan should be evaluated on the basis of objective credit factors, and not the color of their skin. The practice of steering minority borrowers into higher-priced subprime loans is not just unacceptable, but illegal.").

[53]*See generally* Sumit Agarwal, Effi Benmelech, Nittai Bergman & Amit Seru, *Did the Community Reinvestment Act (CRA) Lead to Risky Lending?* (Chi. Unbound, Kreisman Working Papers on Hous. L. and Pol'y, Paper No. 8 (2012)).

[54]Michael S. Barr, *Credit Where It Counts*: *The Community Reinvestment Act and Its Critics*, 80 N.Y.U. L. Rev. 513, 614–15, 649–51 (2005).

number of large bank[s] have substantially broadened the distances at which they are willing to extend commercial loans, but there is … evidence … that this has occurred primarily at the high side of the distribution of lending distances."[55] But such banks' efforts have mainly taken place when they aligned with the banks' business interests, and more on a group level.

In addition to the CRA, the CCPA and ECOA, which had a positive effect on fighting discriminatory practices and expanding financial inclusion, also had an impact on banking business norms. Specifically, in recent years, market forces drove corporations, including financial institutions, to pay more attention to corporate social responsibility and ESG-related campaigns,[56] which include addressing broad stakeholder interests.[57] Similarly, institutional investors also made wide-ranging commitments to social responsibility,[58] referencing studies that argue that these factors provide useful data about financial strengths and weaknesses of businesses.[59]

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[55]Kenneth P. Brevoort & Timothy H. Hannan, *Commercial Lending and Distance*: *Evidence from Community Reinvestment Act Data*, 38 J. Money, Credit, & Banking 1991, 1991 (2006).

[56]ESG is no longer considered a niche area. *See generally* Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 Vand. L. Rev. 1401 (2020); George S. Georgiev, *The Human Capital Management Movement in U.S. Corporate Law*, 95 Tul. L. Rev. 639, 675 (2021) (describing how "a significant number of companies now include ESG metrics in the incentive compensation plans for corporate executives"); Dana Brakman Reiser & Anne Tucker, *Buyer Beware*: *Variation and Opacity in ESG and ESG Index Fund*s, 41 Cardozo L. Rev. 1921, 1924 (2020) [hereinafter *Buyer Beware*] (stating that in 2019, global ESG assets under management reached $30 trillion); Matt Turner, *Here Is the Letter the World's Largest Investor, BlackRock CEO Larry Fink, Just Sent to CEOs Everywhere*, Bus. Insider (Feb. 2, 2016), http://www.businessinsider.com/blackrock-ceo-larry-fink-letter-to-sp-500-ceos-2016-2 (describing the letter sent by the CEO of BlackRock to the CEOs of the S&P 500 companies regarding how addressing ESG issues signals operational excellence).

[57]*See*, *e.g.*, Paul B. Miller, *Rethinking Corporate Purpose … But Not as One Might Expect*, CLS Blue Sky Blog (Dec. 23, 2020), https://clsbluesky.law.columbia.edu/2020/12/23/rethinking-corporate-purpose-but-not-as-one-might-expect ("Corporate purpose is having a moment… Directors, officers, institutional investors, and others have been buffeted by a new enthusiasm for SRI, Social Impact, and ESG.").

[58]Samuel G. Liss, *Addressing ESG in 2021*: *Who Is in Charge?*, CLS Blue Sky Blog (Jan. 29, 2021) [hereinafter *Who Is in Charge?*], https://clsbluesky.law.columbia.edu/2021/01/29/addressing-esg-in-2021-who-is-in-charge/.

[59]*See*, *e.g.*, Robert G. Eccles, Ioannis Ioannou & George Serafeim, *The Impact of Corporate Sustainability on Organizational Processes and Performance*, 60 Mgmt. Sci. 2835 (2014) (examining the effect of sustainability policies on 180 American business entities over an eighteen-year time frame, and finding that high sustainability entities outperformed the low sustainability ones).

As part of the ESG trend, corporations and banks started publishing extensive reports showcasing their efforts. Yet, the increase in volume of disclosures of corporations' commitment to such goals does not serve as an indicator of their commitments' quality or level, especially in a voluntary disclosure regime. After all, as one BlackRock executive phrased it, it is questionable if "the answer to the market's failure to serve the long-term public interest is, of course, more market."[60]

Realizing this, commentators called for the creation of mechanisms to ensure that corporate disclosures are made in a consistent and accurate way that reflects real contributions, and to integrate such disclosures into the presentation of fundamental business performance.[61] In the United States, the Securities and Exchange Commission (SEC) did not act on social agenda items or offer disclosure rules to provide for more transparency, integrity, and consistency on such matters until early 2021.[62] However, it is not likely

[60]Robert Armstrong, *The ESG Investing Industry Is Dangerous*, FIN. TIMES (Aug. 24, 2021), https://www.ft.com/content/ec02fd5d-e8bd-45bd-b015-a5799ae820cf?desktop=true&segmentId=7c8f09b9-9b61-4fbb-9430-9208a9e233c8#myft:notification:daily-email:content; *see* Press Release, World Econ. F., Measuring Stakeholder Capitalism: World's Largest Companies Support Developing Core Set of Universal ESG Disclosures (Jan. 22, 2020), https://www.weforum.org/press/2020/01/measuring-stakeholder-capitalism-world-s-largest-companies-support-developing-core-set-of-universal-esg-disclosures; *see also* Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, §§1001–10, 92 Stat. 3641, 3694–96. *But see* Paul Rissman & Diana Kearney, *Rise of the Shadow ESG Regulators*: *Investment Advisers*, *Sustainability Accounting*, *and Their Effects on Corporate Social Responsibility*, 49 ENV'T L. REP. 10155 (2019) (explaining how disclosures, even if voluntary, could still improve in the United States in the future once the Sustainability Accounting Standards Board will finalize its financially material social and environmental reporting standards). Realizing these issues, the Big Four accounting firms along with other corporate members of the World Economic Forum have pledged to work on the development of metrics for corporate reporting on ESG issues. Press Release, World Econ. F., Measuring Shareholder Capitalism *supra*.

[61]Betty Moy Huber & Michael Comstock, *ESG Reports and Ratings*: *What They Are*, *Why They Matter*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 27, 2017), https://corpgov.law.harvard.edu/2017/07/27/esg-reports-and-ratings-what-they-are-why-they-matter/ (explaining that many business entities are being evaluated and rated on their ESG performance by third parties, yet the rating methodology and scope coverage vary).

[62]*See* Liss, *supra* note 58. The SEC, however, focused on a narrow social agenda type of work when it published a Request for Comments on Climate Disclosures and announced the creation of a Climate and ESG Task Force in 2021. Until then, the most positive response to questions about the public debate on social agenda items has been the former SEC Chair's request for guidance from the SEC's Investor Advisory Committee as to what investors would like to see in terms of ESG disclosures. Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, Remarks at Meeting of the Investor Advisory Committee (Nov. 7, 2019), https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-110719.

that requiring increased transparency by itself would be enough to guarantee the authenticity and volume of the activities corporations disclose, or provide a sufficient incentive for banks to meticulously implement the government's fiscal agenda. Indeed, at the end of the day, each bank would pursue its own strategic and financial motives and attempt to maximize profits. A good example of how corporate entities do that was an August 2019 Business Roundtable statement, meant to reflect the biggest corporate entities' move from serving shareholders to serving stakeholders.[63] The statement announced that the "Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans,'" but the sincerity of that statement was challenged when, a couple of years later, almost no corporations out of the 184 global entities whose leaders had signed or endorsed the statement actually got it approved by their Board of Directors.[64]

[63]For more on the Maximizing Shareholder Wealth Theory *see*, *e.g*., Milton Friedman, *A Friedman Doctrine – The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 32; Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) (reaffirming the shareholder primacy model); Lisa M. Fairfax, *The Rhetoric of Corporate Law*: *The Impact of Stakeholder Rhetoric on Corporate Norms*, 31 J. CORP. L. 675, 682–83 (2006) ("Articulated in this fashion, the shareholder primacy model seemingly disfavors corporate efforts to attend to community interests or otherwise engage in socially responsible behavior."); Simons v. Cogan, 549 A.2d 300, 304 (Del. 1988) (holding that directors owe no duty to debenture holders); Katz v. Oak Indus. Inc., 508 A.2d 873, 879 (Del. Ch. 1986) (finding it is appropriate, if not legally binding, for corporations to maximize their shareholders' interests at the expense of other groups' concerns). Differently, for more on the Stakeholder Theory, *see*, *e.g*., Eric W. Orts, *Beyond Shareholders*: *Interpreting Corporate Constituency Statute*s, 61 GEO. WASH. L. REV. 14, 24 (1992); Ian B. Lee, *Fairness and Insider Trading*, 2002 COLUM. BUS. L. REV. 119, 121 (stating that the moral value of fairness has a place in corporate law); Kathleen Hale, Note, *Corporate Law and Stakeholders*: *Moving Beyond Stakeholder Statutes*, 45 ARIZ. L. REV. 823 (2003); Lisa Fairfax, *Easier Said Than Done? A Corporate Law Theory for Actualizing Social Responsibility Rhetoric*, 59 FLA. L. REV. 771 (2007); Anthony Bisconti, Comment, *The Double Bottom Line*: *Can Constituency Statutes Protect Socially Responsible Corporations Stuck in* Revlon *Land?*, 42 LOY. L.A.L. REV. 765 (2009); Douglas G. Baird & M. Todd Henderson, *Other People's Money*, 60 STAN. L. REV. 1309 (2008). Moreover, it has been inferred that there is a genre of stakeholder theories, and not one basic theory. *See* R. Edward Freeman, *The Politics of Stakeholder Theory*: *Some Future Directions*, 4 BUS. ETHICS Q. 409 (1994).

[64]Lucian Bebchuk & Roberto Tallarita, *'Stakeholder' Capitalism Seems Mostly for Show*, WALL ST. J. (Aug. 6, 2020), https://www.wsj.com/articles/stakeholder-capitalism-seems-mostly-for-show-11596755220.

As more commentators and regulators focus their attention on the social category in ESG,[65] it clearly emerges as a top shared topic for shareholders wanting to achieve positive change.[66] The social category includes issues such as social inequities and injustice, racial equality, gender and diversity policies, community relations, human rights, and even labor conditions.[67] The social category is also the

[65]*See, e.g.*, FED. DEPOSIT INS. CORP., 2021–23 DIVERSITY, EQUITY, AND INCLUSION STRATEGIC PLAN, www.fdic.gov/about/diversity/pdf/dei2021.pdf (describing the Federal Deposit Insurance Corporation's (FDIC's) DEI-related plans, and outlining its intensions regarding how to ensure that its decision making reflects and respects the diversity in the United States, supports diversity in financial institutions, and builds a culture that enhances, values, and capitalizes on diversity); John Reosti, *FDIC Creates Investment Fund to Support Minority Banks, CDFIs*, AM. BANKER (Sept. 16, 2021), https://www.americanbanker.com/news/fdic-creates-investment-fund-to-support-minority-banks-CDFIS (describing the FDIC's launch of the Mission-Driven Bank Fund, which is part of its effort to match private investors with minority-owned banks and community development financial institutions that need capital); Laura Reiley, *New Federal Study Shows Safety Net Helped Prevent Widespread Hunger During the Pandemic*, WASH. POST (Sep. 8, 2021), https://www.washingtonpost.com/business/2021/09/08/usda-food-insecurity-report/ (describing how spending on Agriculture Department domestic food aid reached a historic high in 2020 that enabled many American families to keep enough food on the table).

[66]In some ways, this is similar to the approach toward the environmental agenda. *See* Julia Haake, *Stewardship Excellence*: *ESG Engagement in 2021*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 26, 2021), https://corpgov.law.harvard.edu/2021/07/26/stewardship-excellence-esg-engagement-in-2021. President Biden also emphasized the importance of this agenda in an Executive Order on Climate-Related Financial Risk. Exec. Order No. 14,030, 86 Fed. Reg. 27,967 (May 20, 2021). The Executive Order includes directives that call various federal regulators to take actions to address climate-related financial risk. *Id. See* Margaret E. Tahyar, Randall D. Guynn & Betty Moy Huber, *Private Sector Implications of Biden's Executive Order on Climate-Related Financial Risk*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 10, 2021), https://corpgov.law.harvard.edu/2021/06/10/private-sector-implications-of-bidens-executive-order-on-climate-related-financial-risk/#1.

[67]*See, e.g.*, Chris Arnold, *Trump Regulator's Rule Would Force Banks to Lend to Gun-Makers and Oil Drillers*, NAT'L PUB. RADIO (Jan. 11, 2021) *[hereinafter Force Banks to Lend]*, https://www.npr.org/2021/01/11/954945486/trump-regulators-rule-would-force-banks-to-lend-to-gun-makers-and-oil-drillers (quoting John Court, the head of regulatory affairs at the Bank Policy Institute, which represents the biggest banks in the country); Susan N. Gary, *Best Interests in the Long Term*: *Fiduciary Duties and ESG Integration*, 90 U. COLO. L. REV. 731, 734 (2019).

most difficult element of the three ESG areas for businesses to integrate.[68]

Public figures emphasize the importance of correcting inequities and injustice, arguing that society must prioritize DEI as key goals.[69] Among high-profile legal initiatives that advance diversity and inclusion is the recently passed NASDAQ board diversity rules, which the SEC voted to approve on August 6, 2021, through a "comply or disclose" framework to enhance transparency of board diversity statistics.[70] Based on this new rule, NASDAQ-listed companies need to bring their boards into compliance by including on them diverse board members and disclose annually their board-level diversity data in a standardized matrix according to the directors' self-identified gender, race, and LGBTQ status.[71] Similarly, a California law

[68]*See* Marc S. Gerber et al., *ESG*: *Key Trends in 2020 and Expectations for 2021*, Skadden, Arps, Slate, Meagher & Flom LLP (Feb. 1, 2021), https://www.skadden.com/insights/publications/2021/02/esg-key-trends-in-2020-and-expectations-2021 ("A recent corporate secretary survey reported that nearly 75% of respondents named social factors as the most difficult element of the three areas for companies to integrate, the second half of 2020 continued to highlight the 'S' in ESG. Demands for greater gender and racial diversity at management and board levels resulted in many large U.S. corporations pledging to report on their diversity, equity and inclusion (DEI) figures in an effort to increase transparency, and many companies working to improve their board diversity in the midst of the Black Lives Matter movement.").

[69]*See*, *e.g.*, Mehrsa Baradaran, *Rethinking Financial Inclusion*: *Designing an Equitable Financial System with Public Policy* (Apr. 2020) (working paper), https://rooseveltinstitute.org/rethinking-financial-inclusion-equitable-financial-system-public-policy/ (discussing the financial inclusion as a key social goal). In many ways, the social push for inclusion and diversity is not surprising. Indeed, the famous claim from *Regents of Univ. of Cal. v. Bakke* that "[p]eople do not learn very much when they are surrounded only by the likes of themselves," is an inherently empirical one. 438 U.S. 265, 312 n.48 (1978) (internal quotation marks omitted) (upholding a school's use of "affirmative action" to accept more minority applicants).

[70]Comm'r Hester M. Peirce, Statement on the Comm'n's Order Approving Proposed Rule Changes, as Modified by Amendments No. 1, to Adopt Listing Rules Related to Bd. Diversity submitted by the Nasdaq Stock Mkt. LLC (Aug. 6, 2021) at n.3, https://www.sec.gov/news/public-statement/peirce-nasdaq-diversity-statement-080621; Comm'r Allison Herren Lee & Comm'r Caroline A. Crenshaw, Statement on Nasdaq's Diversity Proposal – A Positive First Step for Investors (Aug. 6, 2021), https://www.sec.gov/news/public-statement/statement-nasdaq-diversity-080621?utm_medium=email&utm_source=govdelivery; Chair Gary Gensler, Statement on the Comm'n's Approval of Nasdaq's Proposal for Disclosure about Bd. Diversity and Proposal for Bd. Recruiting Serv. (Aug. 6, 2021), https://www.sec.gov/news/public-statement/gensler-statement-nasdaq-proposal-disclosure-board-diversity-080621 (explaining that this is done through a "comply or disclose" framework).

[71]Comm'r Peirce, *supra* note 70; Comm'rs Lee & Crenshaw, *supra* note 70; Chair Gensler, *supra* note 70.

mandates that all public businesses with executive offices in California have at least one woman on their boards,[72] and another law mandates racial and sexual-orientation diversity.[73] Likewise, a few years earlier, focusing on racial equality, the SEC mandated that businesses disclose if they consider diversity as a factor in selecting their board members.[74]

However, the need for more diversity in the financial industry remains an issue,[75] and financial institutions need to focus on DEI. Indeed, in the Black Lives Matter (BLM)[76] era, it has become clear that wide-ranging

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[72]S.B. 826, 2018 Leg., 2017–2018 Sess. (Cal. 2018). The legislation also applies to entities that are organized under different state laws, if their securities are listed on a major public stock exchange, and whose principal executive office is in California. *See id.* § 2(a). Moreover, the number of female directors is expected to continue to rise, as the law requires that starting from the end of 2021, boards with five board members would have at least two women directors, and boards that have six or more directors would have at least three women on board. *See* §§ 2(b)(1)–(2). Noncompliant entities could be fined. *See* § 2(e)(1).

[73]*See* A.B. 979, 2020 Leg., 2019–2020 Sess. (Cal. 2020) (amending Section 301.3 of, and adding Sections 301.4 and 2115.6 to, the Corporations Code, relating to corporations to require businesses headquartered in the state to have at least one director who self-identifies as a Female and also one from what is defined as an Underrepresented Community). *See, e.g.*, Courtney Murray & Eric Talley, *Racial Diversity and Corporate Governance: Assessing California's New Board Diversity Mandate*, CLS BLUE SKY BLOG (Oct. 28, 2020), https://clsbluesky.law.columbia.edu/2020/10/28/racial-diversity-and-corporate-governance-assessing-californias-new-board-diversity-mandate (discussing the "underrepresented communities," a category that includes both racial and LGBTQ status).

[74]*See* 17 C.F.R. § 229.407(c)(2)(vi) (2010) (mandating as part of Regulation S-K the disclosure of how diversity is weighed in the process by which candidates for director positions are considered for nomination); *see also* Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334, 68,343 (Dec. 23, 2009) (mentioning "that there appears to be a meaningful relationship between diverse boards and improved corporate financial performance, and that diverse boards can help companies more effectively recruit talent and retain staff").

[75]*See, e.g.*, Jeanna Smialek, *Why Are There So Few Black Economists at the Fed?*, N.Y. TIMES (Feb. 2, 2021), https://www.nytimes.com/2021/02/02/business/economy/federal-reserve-diversity.html (describing how the lack of diversity is both in the public and private sectors, especially in the financial industry).

[76]For an analysis of how the BLM movement emerged online in 2013 and how it capitalized on social media platforms, *see generally* DEEN FREELON, CHARLTON D. MCILWAIN & MEREDITH D. CLARK, BEYOND THE HASHTAGS (2016). It was founded by three Black women that started it using the hashtag #BlackLivesMatter to draw attention to the long-standing devaluation of African Americans' lives. Katheryn Russell-Brown, *Critical Black Protectionism, Black Lives Matter, and Social Media: Building a Bridge to Social Justice*, 60 HOW. L.J. 367, 401 (2017).

efforts must be made to advance social issues,[77] as exclusion and lack of diversity in societal settings may lead to discriminatory behavior, conflicting with social justice–based efforts.[78] In the years after its founding, the BLM movement grew in response to the increasing public revelations of racial discrimination, which impacts all walks of life, and reached an all-time high after the murder of George Floyd,[79] leading to a public outcry for political, social, and economic responses.[80]

Diversity is important. As stated above, nonhomogeneous groups typically are exposed to more opinions, conflicting thought processes, and different perspectives, all useful when looking for innovative, sophisticated solutions to problems.[81] Persons often reach better results not by relying on the knowledge of narrow elites but from the proverbial

[77]*See*, *e.g.*, the Fed Bank of New York, which published the following statement: "We are dedicated to understanding and finding solutions to the numerous forms of inequality that communities of color experience and working with communities in our District to address deep-seated inequities. We are steadfast in our commitment to work for a more equitable economy and society for all, and will redouble our efforts in pursuit of this essential mission." *About the New York Fed*: *Standing in Unity*, Fed. Rsrv. Bank of N.Y., https://www.newyorkfed.org/aboutthefed (last visited Feb. 14, 2020).

[78]*See* Fed. Deposit Ins. Corp., *supra* note 65, at 5 (explaining how the FDIC has made it a priority to promote the business case for DEI by taking actions).

[79]*See* Larry Buchanan, Quoctrung Bui & Jugal K. Patel, *Black Lives Matter May Be the Largest Movement in U.S. History*, N.Y. Times (July 3, 2020), https://www.nytimes.com/interactive/2020/07/03/us/george-floyd-protests-crowd-size.html.

[80]*See*, *e.g.*, Sarah Chaney Reichenbach, Comment, *CVE and Constitutionality in the Twin Cities*: *How Countering Violent Extremism Threatens the Equal Protection Rights of American Muslims in Minneapolis-St. Paul*, 69 Am. U. L. Rev. 1989, 2017 (2020) ("The brutal killing of George Floyd sparked protests around the globe."); *Protests Across the Globe After George Floyd's Death*, CNN (June 13, 2020), https://www.cnn.com/2020/06/06/world/gallery/intl-george-floyd-protests/index.html (describing how Floyd's killing prompted people, globally, to demonstrate about racial equality).

[81]*See generally* Katherine W. Phillips, *How Diversity Makes Us Smarter*, Sci. Am. (Oct. 2014) (explaining how diversity jolts us into cognitive action in ways that homogeneity cannot); R. George Wright, *Epistemic Peerhood in the Law*, 91 St. John's L. Rev. 663, 692 (2017) (describing how diverse groups foster more openness, innovation, conscientiousness, the examination of more perspectives, and thoughtfulness). For skepticism regarding theories of positive corporate signaling in connection with racial diversity hiring, *see generally* Patrick S. Shin & Mitu Gulati, *Showcasing Diversity*, 89 N.C. L. Rev. 1017 (2011) (suggesting that diversity in corporate governance will not racially reform corporations or open doors for minorities).

"wisdom of crowds,"[82] and by giving weight to different considerations.[83] Thus, when a group includes members of similar backgrounds, many possible solutions to problems might not be suggested.[84] Moreover, in the business setting, racial diversity sends a positive message about businesses and their leadership. Diversity could signal that corporations care about equality and social justice,[85] serve all stakeholders,[86] and are socially upstanding organizations.[87] A good example of such signaling in the commercial banking framework is Citigroup's 2021 commitment to fight racial inequality by hiring four Black-owned firms to distribute a $2.5 billion bond issuance to investors.[88]

Understanding the importance of diversity, some government agencies have also made statements and taken initiatives that resemble Citigroup's. For example, in the summer of 2021, the Federal Deposit Insurance Corporation (FDIC) board of directors approved a statement of policy to enhance the agency's efforts to preserve and promote Minority Depository Institu-

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[82]*See generally* James Surowiecki, The Wisdom of Crowds 31 (2004) (stressing the need for diversity within a crowd in order to guarantee enough variance in approach and thought process).

[83]*See* Wright, *supra* note 81, at 671 n.43 (citing Dražen Prelec, H. Sebastian Seung & John McCoy, *A Solution to the Single-Question Crowd Wisdom Problem*, 541 Nature 532, 533 (2017) (stressing the value of minority judgments)).

[84]Nizan Geslevich Packin, *It's (Not) All About the Money*: *Using Behavioral Economics to Improve Regulation of Risk Management in Financial Institutions*, 15 U. Pa. J. Bus. L. 419, 453 (2013).

[85]*See* Lissa Lamkin Broome & Kimberly D. Krawiec, *Signaling Through Board Diversity*: *Is Anyone Listening?*, 77 U. Cin. L. Rev. 431, 432 (2008); Laura Weiss, *Shareholder Vote Adviser May Oppose Boards Lacking Racial*, *Ethnic Diversity*, CQ Roll Call Corp. Governance Briefing (Oct. 19, 2020) (citing the Institutional Shareholder Services Inc. (ISS) explaining that "[r] ecent social unrest has put racial and ethnic injustices and inequalities at the forefront of many investors' minds and many boards' deliberations.").

[86]*See*, *e.g.*, Lily Zheng, *We're Entering the Age of Corporate Social Justice*, Harvard Bus. Rev. (June 15, 2020), https://hbr.org/2020/06/were-entering-the-age-of-corporate-social-justice.

[87]*See*, *e.g.*, Tristin K. Green, *Race and Sex in Organizing Work*: *"Diversity," Discrimination*, *and Integration*, 59 Emory L.J. 585, 598 (2010) (according to the prevailing business narrative, "[r]ace and sex are relevant primarily as means of serving markets and of signaling commitment to diversity and adherence to egalitarian norms and laws").

[88]*Citi Hires Black-Owned Firms for $2.5 Bln Bond Distribution*, Reuters (Jan. 28, 2021) https://www.reuters.com/article/citigroup-debt-race/citi-hires-black-owned-firms-for-2-5-bln-bond-distribution-idUSL4N2K346H.

tions (MDIs).[89] The statement, which describes the FDIC's actions, focuses on enhancing communication between the FDIC and minority-owned and -managed institutions.[90] However, without regulation to require or at least incentivize banks' commitment to DEI-based goals, banks are not likely to change their business operations and will take only those actions that are aligned with their financial interests.

Society needs such regulation. Lawmakers can regulate to incentivize banks to advance the government's social agenda. Some examples of possible bank actions include requiring banks to choose to make different, or social agenda–based, credit granting decisions. For example, based on the concept of fair access to credit, banks can decide to increase interest rates in connection with certain types of loans offered, or impose tariffs in connection with projects with high external costs, to establish a fairer spread of costs in society. The logic behind this is that if a business operation caused extensive social harm, it would be only fair to expect it to spend more on credit, taking some of the cost off of society as a whole and shifting it onto that business operation.[91]

Additionally, regulators could nudge banks to help society progress on DEI-based goals and reward banks that successfully take these actions. For instance, banks could have policies whereby clients that promote DEI initiatives, or historically underrepresented clients, pay less interest than others would. Alternatively, banks could have companies that lag behind in social awareness in their business operations pay higher interest rates. Likewise, banks could help cultivate ethical business investing. By investing based on ethical principles, ethical banks can advance

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[89]Press Release, FDIC Board Approves New Policy Statement on Minority Depository Institutions, FED. DEPOSIT INS. CORP. (June 15, 2021), https://www.fdic.gov/news/press-releases/2021/pr21052.html. The FDIC's statement outlines two definitions of how FDIC-insured banks and savings associations may qualify for MDI status: a federal insured depository institution where (i) 51 percent or more of its voting stock is owned by minority individuals; or (ii) a majority of its board of directors is minority and the community that the institution serves is predominantly minority. The institution's ownership must be U.S. citizens or permanent legal U.S. residents in order to be counted when determining the minority ownership. *Id*.

[90]*Id*.

[91]This has been suggested in the environmental context. *See*, *e.g.*, Marcel H.A. Jeucken & Jan Jaap Bouma, *The Changing Environment of Banks*, 27 GREENER MGMT. INT'L 21 (1999) (discussing the differentiation of tariffs that could enhance the internalization of environmental costs of market prices and could enable banks to realistically foster sustainability).

socially accountable companies and reprimand persons and businesses that do not conform to these standards. But there is always the possibility that banks would just start adopting specific measures that make them appear ethical, while not adopting others that are of greater impact. Lastly, banks could, hypothetically, choose not to offer credit at all, or refuse transactions with businesses within industries that promote goals they do not support.[92] Such a practice, however, has proven controversial. Believing that banks should not be allowed to restrict credit from legal businesses, and to some extent reinforcing the theory that banks are semi-agents of the government whose role is to facilitate liquidity in the markets, the Trump administration–led Office of the Comptroller of the Currency (OCC) attempted to block such a banking practice in 2021.[93] Several months later, however, the Biden administration put a stop to this initiative that impacted both financial stresses and reputational risks.[94]

B. Conduct Risk

In recent years, bank risk management professionals have discussed the notion that banks' behavior and reputation can impact consumers. Conduct risk is defined as any action of a financial institution or individual that leads to consumer detriment or has an adverse effect on market stability or effective competition.[95] Practitioners interpret the drivers for conduct risk to include societal environmental factors, which are economic developments that have the potential to impact financial markets and in turn the long-term needs of consumers, where firms' ineffective

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[92]Regulating the professional behavior of banks is the most direct and desirable method to address the market failures in the financial industry and enhance ethical practices, but it is extremely challenging. *See, e.g.*, David Zaring, *Regulating Banking Ethics*: *A Toolkit*, 43 SEATTLE U. L. REV. 555 (2020) (discussing the difficulties in making the banking industry, and bankers, more ethical).

[93]*See Force Banks to Lend*, *supra* note 67 (announcing a ban on banks that would deny services to businesses based on whole sectors).

[94]Eric Rosenbaum, *Banking Regulator Pauses Rule That Enraged Wall Street and Climate Investors*, CNBC (Jan. 28) https://www.cnbc.com/2021/01/28/occ-pauses-bank-rule-that-enraged-wall-street-climate-investors-.html (describing how the OCC paused the rule).

[95]*See* Lucas Ocelewicz, James Lewis & Chris Steele, *Conduct Risk*: *Delivering an Effective Framework*, KPMG (Feb. 22, 2021), https://home.kpmg/uk/en/home/insights/2017/09/conduct-risk-delivering-an-effective-framework.html.

response to such pressures leads to poor conduct outcomes.[96] For example, it seems reasonable to argue that the various state courts' decisions regarding the U.S. banks' behavior during the COVID-19 pandemic in connection with stimulus payments[97] could fall under the conduct risk category.

In the United Kingdom, the Financial Conduct Authority, which took over the supervision of consumer protection in 2013, also addresses banks' behavior and has examined conduct risk in its work. In a speech discussing it, Robert Taylor, head of Wealth Management and Private Banking, concluded that he

> would like to see boards and senior management spending as much time on the firm's financial circumstances as they do on client outcomes. It's that understanding of the fact that every decision all of you make has an impact on customers … . I regard it as your responsibility to demonstrate how you and your team have discussed how any of the decisions you make with your team could impact your customers.[98]

The addition of conduct risk to banks' risk management procedures, therefore, could help raise awareness of the needs of customers and the advancement of DEI. For example, if American banks had distributed the stimulus money to businesses that were the government's intended recipients or treated all their potential customers in an equitable and equal manner, there would have been less hostility directed at the banks. This is especially true since U.S. banks have, in many ways, contributed to the financial inequality and failed to advance the government's social agenda.

C. Public Banks

As of 2019, a quarter of the American population was not just discriminated against, but actually excluded from the banking industry, resulting

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[96]*Id.*

[97]For the state courts' decisions during the COVID-19 pandemic, *see* Tenth Emergency Order Regarding the COVID-19 State of Disaster, Misc. Docket No. 20-9054 (Tex. 2020); *In re* Petition to the Indiana Supreme Court to Engage in Emergency Rulemaking to Protect CARES Act Stimulus Payments from Attachment or Garnishment from Creditors, Nos. 20S-MS-258, 20S-CV-123 (Ind. 2020).

[98]*See* Robert Taylor, Head of Wealth Management & Private Banking, Fin. Conduct Auth., Conduct Risk Briefing (Nov. 28, 2014) (emphasis added), https://www.fca.org.uk/news/speeches/conduct-risk-briefing.

in this segment of the population being unbanked or underbanked.[99] These low-income households spent a great deal of time and too much of their income on charges and fees just to be able to use money.[100] Banks could have served some of these populations, but they are not legally mandated to serve everyone.

In recent years, scholars, the media, and lawmakers have discussed the need to increase financial inclusion,[101] referencing this in government agency strategic plans.[102] Financial inclusion also contributed to the rise of financial technology (FinTech), branding it as a market democratizing tool.[103]

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[99]Erin Barry, *25% of US Households Are Either Unbanked or Underbanked*, CNBC (Mar. 9, 2019), https://www.cnbc.com/2019/03/08/25percent-of-us-households-are-either-unbanked-or-underbanked.html.

[100]Off. Inspector Gen., U.S. Postal Serv., Rep. No.: RARC-WP-14-007, Providing Non-bank Financial Services for the Underserved (2014); Mehrsa Baradaran, How the Other Half Banks: Exclusion, Exploitation, and the Threat to Democracy (2015) [hereinafter How the Other Half Banks].

[101]*See*, *e.g*., Emily Guy Birken, *The Costs of Being Unbanked or Underbanked*, Forbes (July 28, 2020), https://www.forbes.com/advisor/banking/costs-of-being-unbanked-or-underbanked/; Mehrsa Baradaran, *Banking on Democracy*, 98 Wash. U. L. Rev. 353, 357 (2020) (explaining the unbanked and underbanked situation and how they "pay a fee or a premium each time they interact with the payments system"); *Inclusive Banking During a Pandemic*: *Using FedAccounts and Digital Tools to Improve Delivery of Stimulus Payments*: *Hearing before the Task Force on Financial Technology of the Committee on Financial Services*, 116th Cong. 30–38 (2020) [hereinafter *Baradaran's Testimony*] (testimony of Mehrsa Baradaran, Professor of Law, University of California Irvine School of Law), https://docs.house.gov/meetings/BA/BA00/20200611/110778/HHRG-116-BA00-Wstate-BaradaranM-20200611.pdf; Off. Inspector Gen., U.S. Postal Serv., *supra* note 100, at 2 (describing how the unbanked and underbanked spend 9.5% of their income on alternative financial services).

[102]*See*, *e.g*., Fed. Deposit Ins. Corp., Economic Inclusion Strategic Plan (2019), chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/viewer.html?pdfurl = https%3A%2F%2Fwww.fdic.gov%2Fconsumers%2Fcommunity%2Fdocuments%2Feisp.pdf&clen=258598; FDIC Advisory Committee on Economic Inclusion (ComE-IN); Notice of Meeting, 86 Fed. Reg. 52,463 (Sept. 21, 2021).

[103]Some argue that FinTech could increase access to financial services. *See*, *e.g*., Exec. Off. of the President, Big Data: A Report on Algorithmic Systems, Opportunity, and Civil Rights 11–12 (2016); Marianne Crowe, Fed. Rsrv. Bank of Bos., Mary Kepler & Cynthia Merritt, Fed. Rsrv. Bank of Atlanta, The US Regulatory Landscape for Mobile Payments (2012) (discussing how mobile technologies can aide financial inclusion); Ravi Menon, Managing Director of the Monetary Authority of Singapore, Fintech for an Inclusive Society and a Sustainable Planet, Remarks at the Singapore FinTech Festival 2020 (Dec. 8, 2020), https://www.bis.org/review/r201210c.htm (explaining his FinTech vision of "every citizen and every enterprise digitally enabled and financially included"); Kiara Taylor, *Does Fintech Actually Contribute to Financial Inclusion?*, Crunchbase (Dec. 17, 2020), https://about.crunchbase.com/blog/does-fintech-actually-contribute-to-financial-inclusion/ ("[P]rogressions in technology have allowed fintech to emerge as a way to break down these barriers and positively impact the world through financial inclusion.").

The focus on the underbanked and unbanked issue led to a growing movement toward public banking.[104] A public bank is one where the banking enterprise is under government control, and either the state, the local municipalities, or the public owns it. North Dakota established a public bank in 1919 that is owned by the state,[105] and recently more states have expressed their interest. California passed a law permitting local governments to start their own public banks,[106]and a New York State Senate bill is looking to do something similar.[107] Lawmakers in various states are considering whether to follow.[108]

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[104]*See*, *e.g*., Sarah Jones, *Why Public Banks Are Suddenly Popular*, New Republic (Aug. 10, 2018), https://newrepublic.com/article/150594/public-banks-suddenly-popular (discussing the public options for banking services); How the Other Half Banks, *supra* note 100, at 210–25 (stressing the importance of people's access to regular bank loans and the importance of U.S. postal banking to help low-income populations); Abbye Atkinson, *Rethinking Credit as Social Provision*, 71 Stan. L. Rev. 1093, 1162 (2019) (showcasing how "access to credit" talk pervades the contemporary conversation); John Crawford, Lev Menand & Morgan Ricks, *FedAccounts*: *Digital Dollars*, 89 Geo. Wash. L. Rev. 113 (2021) (flirting with a central bank digital currency (CBDC) notion, discussing the idea of extending the privilege of central bank accounts via a system of FedAccounts maintained at the Fed); K. Sabeel Rahman, *The New Utilities*: *Private Power*, *Social Infrastructure*, *and the Revival of the Public Utility Concept*, 39 Cardozo L. Rev. 1621, 1657–65 (2018) (putting forward a "public utility" view of banking); and Elaine McArdle, Going Public, Harvard Law Today (July 7, 2021), https://today.law.harvard.edu/going-public/ (describing how Harvard Law School students are working to create a public bank to help minorities and immigrants). Similarly, there have been arguments in favor of creating public options in other financial market aspects, such as the credit-card clearing market. *See* Adam J. Levitin, *Public-Private Competition in Payments*: *The Role of the Federal Reserve* (Georgetown Univ. L. Ctr., Bus., Econ. and Regul. Pol'y Working Paper Series, Paper No. 1420061, 2009), *available at* https://ssrn.com/abstract=1420061.

[105]Will Peischel, *How a Brief Socialist Takeover in North Dakota Gave Residents a Public Bank*, Vox (Oct. 1, 2019), https://www.vox.com/the-highlight/2019/9/24/20872558/california-north-dakota-public-bank.

[106]James F. Peltz, *Public Banks Can Be Formed in California*: *Newsom Signs New Law*, L.A. Times *(Oct. 2, 2019)*, https://www.latimes.com/business/story/2019-10-02/public-banks-can-be-formed-under-bill-signed-by-newsom.

[107]S.B. S5565C, 2019–20 Leg. Sess. (N.Y. 2019) ("Relates to establishing the New York public banking act; authorizes the lending of public credit to public banks and authorizes public ownership of stock in public banks for the purpose of achieving cost savings, strengthening local economies, supporting community economic development, and addressing infrastructure and housing needs for localities.").

[108]*See*, *e.g*., Laura Alix, *Public Banking*: *The Other Winner in 2017 Elections*, Am. Banker (Nov. 13, 2017), https://www.americanbanker.com/news/public-banking-the-other-winner-in-2017-elections (stating that New Jersey's governor, Murphy, "is among a growing number of progressives who support the creation of more public banks"); Michelle Chen, *Why Shouldn't the People Own the Banks?*, The Nation (July 9, 2021), https://www.thenation.com/article/economy/new-york-city-public-bank/ (describing different states' and municipalities' public banking initiatives).

This growing movement should concern commercial banks, as public banks would mean increased competition and potential disintermediation for commercial banks,[109] something that Congresswomen Rashida Tlaib and Alexandria Ocasio-Cortez seek to advance through a new bill in Congress called the Public Banking Act.[110] According to the congresswomen, the COVID-19 pandemic demonstrated the importance of the idea[111] when the disbursement of federal relief funds exposed significant problems in the U.S. money system that are the result of the banks' wealth maximization objectives clashing with the government's DEI goals. As described in this section, three key voluntary-based DEI-related approaches in banking have developed, in an attempt to address the public outcry that this clash caused. These include the rise of ESG and specifically a social goals–driven agenda among financial institutions, the conduct risk concept, and the public banking trend. An additional and potentially more promising avenue is to use an agency theory–based approach to mandate the implementation of government social policy goals among commercial banks, the focus of the next section.

II. The Agency Theory Solution(s)

Commercial banks play an important role in the government's fiscal policy because, as previously mentioned, they are the main channel for the transfer of funds. In the United States, the Fed payments system has proved secure, private, and safe and is considered to be among the most

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[109] *See PBI's Open Letter to Congress*: *A "Critical-Care" Bailout for Main Street in the Face of COVID-19*, Pub. Banking Inst., https://www.publicbankinginstitute.org/2020/04/08/pbis-open-letter-to-congress-a-critical-care-bailout-for-main-street-in-the-face-of-covid-19/ (last visited Sep. 29, 2021) (showcasing how the Public Banking Institute has written open letters to state governors and Congress asking them to take urgent actions to rescue communities from financial catastrophe and to provide for future fiscal health given the COVID-19 crisis).

[110] *See* Public Banking Act of 2020, H.R. 3224, 116th Cong. (2020). Emily Stewart, *Exclusive*: *Rashida Tlaib and AOC Have a Proposal for a Fairer, Greener Financial System—Public Banking*, Vox (Oct. 30, 2020), https://www.vox.com/policy-and-politics/21541113/rashida-tlaib-aoc-public-banking-act (describing why the Congresswomen proposed the new bill); Rashida Talib & Eduardo Suplicy, Opinion, *Prioritizing People to Build Back the Economy*, N.Y. Times (June 30, 2021) https://www.nytimes.com/2021/06/30/opinion/covid-economic-aid-recovery.html (outlining the public banking idea as a robust and inclusive safety net).

[111] Stewart, *supra* note 110 (emphasis added).

trustworthy and reliable systems in the world, although it is exclusionary.[112] In 1913, Congress passed the Federal Reserve Act (FRA)[113] to increase the integrity, efficiency, and equity of U.S. payments.[114] According to the Fed's own statements, it has "a public-interest motivation in seeking to stimulate improvements in the efficiency of the payments system."[115] This motivation mandates that the Fed "provide equitable access and an adequate level of services nationwide."[116]

The Fed supports banks that use and rely on the payments system with the understanding that banks will offer their services to customers, something that many banks have explicitly agreed to do.[117] This is a problem since unless the Fed ensures that services are made available to all consumers, it is de facto failing to fulfill its mandate of providing equitable access nationwide as part of its defined mission to execute the government's fiscal policy.[118] Realizing this, in August 2019, the Fed proposed to build and operate an entirely new payment platform,[119] which would help quickly move the adoption of new, faster payment methods not just

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[112] *See Baradaran's Testimony*, *supra* note 101.

[113] *See* the Federal Reserve Act of 1913, Pub. L. No. 63-43, 38 Stat. 351 (1913) (codified as amended by sections of 12 U.S.C.).

[114] The lawmakers also intended for the Fed to reduce the incidence and severity of major financial crises such as the ones that occurred in the 19th and 20th centuries and in 2008. Steven A. Ramirez, *Depoliticizing Financial Regulation*, 41 Wm. & Mary L. Rev. 503, 531 (2000); Ellis W. Tallman & Jon R. Moen, *Lessons from the Panic of 1907*, 75 Fed. Rsrv. Bank Atlanta Econ. Rev. 2, 2–13 (1990); Edward L. Rubin, *Uniformity, Regulation, and the Federalization of State Law*: *Some Lessons from the Payment System*, 49 Ohio St. L.J. 1251, 1253 (1989) (explaining that before the establishment of the Federal Reserve, common law governed U.S. checking and its dysfunctional payment system); Hal S. Scott, *The Risk Fixers*, 91 Harv. L. Rev. 737, 748 (1978).

[115] *Policies*: *The Federal Reserve in the Payments System*, Bd. Governors Fed. Rsrv. Sys. (Aug. 11, 2020), https://www.federalreserve.gov/paymentsystems/pfs_frpaysys.htm.

[116] *Id*.

[117] *See Baradaran's Testimony*, *supra* note 101.

[118] *Id*. at 38 ("[I]t is up to our democratically elected representatives to update this mission and mandate that the Fed promote efficiency and financial inclusion to the benefit of more Americans.").

[119] *See* Federal Reserve Actions to Support Interbank Settlement of Faster Payments, Notice and Request for Comment, 84 Fed. Reg. 39,297, 322 (Aug. 9, 2019) (asking for public comments on a proposal to develop a new interbank service to support faster, safe, and efficient payments in the United States).

among banks, but among individuals and business entities as well.[120] This new system would "function as a public option—a government program that 'provides an important service at a reasonable cost' and 'coexists … with one or more private options offering the same service'—offered to all financial institutions that participate in the U.S. banking system."[121]

While everyone agrees that promoting the adoption of faster payments in the United States is necessary, critics of this new initiative argue against the legitimacy of a public option as a means toward that goal.[122] Some cite historic arguments dating to the Fed's creation. This is understandable since from its inception, the Fed's status as public central bank produced great political tensions relevant to its proper role within society's basic financial infrastructure.[123] Yet, there is no dispute about two things. First, banks are the main conductors through which money is funneled to and from the government, and are therefore at the service of the government's fiscal policy. Second, banks enjoy unique benefits in our society that result from their role in the broadly defined money supply.[124] Yet, how can the government ensure that banks will advance its fiscal policy goals? The answer we propose is with the use of an agency theory approach. The remainder of this section analyzes this approach and how it should be implemented in the relationship between the federal government and commercial banks. Section A describes agency law and the role of banks in the government's fiscal policy. Section B demonstrates how banks are already promoting and advancing the government's fiscal policy as its agents. Section C explains the compensation that banks receive for serving in their unique role and how that also justifies the expectation that banks would fulfill duties under the agency approach.

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[120]*See* Peter Conti-Brown & David A. Wishnick, *Private Markets, Public Options, and the Payment System*, 37 Yale J. Reg., 380, 400–03 (2020) (presenting "an account of how the Fed has worked, and plans to work, 'at the boundary' of prototypical administrative practice to bring it into existence").

[121]*Id.* at 382–83 (quoting Anne Alstott & Ganesh Sitaraman, The Public Option: How to Expand Freedom, Increase Opportunity, and Promote Equality 2 (2019)).

[122]*Id.*

[123]*Id.*

[124]*Id.*

Finally, Section D offers a comparative analysis of the government's need to rely on banks as its agents.

A. Agency Law and the Role of Banks in the Government's Fiscal Policy

The U.S. government's inability in 2020, to successfully execute its stimulus plan and give all its intended recipients the benefits it had designated for them, due to the role played by banks,[125] begs the question: Should U.S. banks be subject to any legal obligations when they help the government execute its fiscal goals? This article suggests that while the answer to this question might currently be negative, it should be positive, based on agency theory. Essentially, an agency relationship is created when "one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act."[126] Agency relationships are fiduciary relationships, in which the agent owes a fiduciary duty to the principal and is legally required to act in the principal's best interests.[127] Within common law agency, an agent owes the principal fiduciary duties of loyalty in addition to duties of performance.[128] While fiduciary mandates may involve one party administering the financial affairs of another party, fiduciary theory is currently undergoing a renaissance, as in recent years, public law scholars have increasingly offered fiduciary accounts of the state and its officials.[129]

Agency relationships, however, become legally complicated when there are divergent objectives for the principal and the agent.[130] Due to bounded rationality, inadequate foresight, and information asymmetries between the principal and the agent, which can therefore behave in an

[125] *See generally Ethics and Banking*, *supra* note 11.

[126] Restatement (Third) of Agency § 1.01 (Am. L. Inst. 2006).

[127] *Id*. at §1.01 cmt. e (discussing fiduciary character of an agency relationship).

[128] *See, e.g.*, Deborah A. DeMott, *Disloyal Agents*, 58 Ala. L. Rev. 1049, 1049 (2007).

[129] Paul B. Miller & Andrew S. Gold, *Fiduciary Governance*, 57 Wm. & Mary L. Rev. 513, 516–18 (2015) (explaining that "[f]iduciary governance has striking implications for broad swaths of law, from corporate and charities law to administrative and constitutional law").

[130] Simone M. Sepe, *Corporate Agency Problems and Dequity Contracts*, 36 J. Corp. L. 113, 124 (2010) (discussing the three agency problems).

opportunistic way, principals can find it difficult to induce agents to act in the principal's best interests.[131] This was the case between the federal government and U.S. commercial banks, as the disbursement of COVID-19 pandemic-related federal relief funds under the CARES Act demonstrated. Particularly, the U.S. banks' wealth maximization objectives clashed with the federal government's goals of DEI. This worsened the pandemic-induced economic crisis for many, especially women and minorities, and intensified racial injustice.

B. Banks at the Government's Fiscal Policy Service

1. The Government's Social Policy Programs Administered by Banks

Commercial banks serve the government's fiscal policy in two ways important to the promotion of DEI, both as administrators of government social policy programs and as promoters of broader government objectives. The U.S. government directly and indirectly relies on commercial banks, as semi-agents, to help it distribute payments for various social policy programs.

The government's social policy programs' funds are processed primarily through banks, which serve as the main channel for these transfers. Such programs include Temporary Assistance for Needy Families (TANF), administered via block grants to states,[132] and the Special Supplemental Nutrition Program for Women, Infants and Children (WIC) and the Supplemental Nutrition Assistance Program (SNAP), both federal programs that influence millions of Americans[133] and rely on commercial banks. While serving as the government's channel for the transfer of funds through SNAP, commercial banks reap hefty profits when making payments to individuals and businesses, especially in the

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[131]*See, e.g.*, Michael C. Jensen & William H. Meckling, *Theory of the Firm*: *Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) (showing the agency problems that arise when ownership and control are separated).

[132]*See* Ali Safawi & Liz Schott, *To Lessen Hardship, States Should Invest More TANF Dollars in Basic Assistance for Families*, *Center on Budget and Policy Priorities*, CTR. BUDGET & POL'Y PRIORITIES (updated Jan. 12, 2021), https://www.cbpp.org/research/family-income-support/to-lessen-hardship-states-should-invest-more-tanf-dollars-in-basic.

[133]*See generally* Regina T. Cucurullo, *The Special Supplemental Nutrition Program for Women, Infants and Children (WIC) and the Supplemental Nutrition Assistance Program (SNAP)*: *Comparing Policies and Suggesting Changes*, 8 J. FOOD L. & POL'Y 257, 258 (2012).

era of electronic benefits transfer (EBT) cards.[134] Commentators have suggested that some banks charged with administering the transfer payments associated with SNAP may have abused their power.[135] The Medicaid program[136] is also administered with the assistance of banks, as certain states mandate that program participants have checking accounts to receive benefits. Additionally, banks require documentation to perform financial eligibility checks.[137] Medicaid is funded jointly by the federal government and the state governments. Social Security Disability Insurance (SSDI) has a limited yet notable involvement of commercial banks in the administration of the program: checking accounts are mandatory, and the implementation process includes a review of bank accounts.[138]

Similarly, bank checks or direct deposits are primarily used in the payment of refunds of tax payments. When the government pays its citizens for any reason, direct deposit into banks and bank checks are the mechanisms almost always used. Moreover, those working with banks can also profit from the banks' involvement. For example, in the United States, under the federal Earned Income Tax Credit (EITC), credits are given as direct transfers deposited into recipients' accounts. Some EITC tax preparers open bank accounts for clients as a method of allowing the recipient to borrow against the future credit for the sake of paying the filing. These schemes are at a high interest rate and are criticized by

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[134] Virginia Eubanks, *How Big Banks Are Cashing In on Food Stamps*, AM. PROSPECT (Feb. 14, 2014), https://prospect.org/power/big-banks-cashing-food-stamps/ (detailing how distributing government benefits "is a lucrative industry … . J.P. Morgan Chase, which currently controls EBT contracts in 21 states, Guam, and the Virgin Islands, made more than half a billion dollars between 2004 and 2012 providing government benefits to U.S. citizens.").

[135] *Id.*

[136] Medicaid was enacted as Title XIX of the Social Security Act. Social Security Amendments of 1965, ch. 7, art. 121, §§ 1901–09, 79 Stat. 286, 343–53 (codified as amended at 42 U.S.C. § 1396 *et seq.*).

[137] N.J. DEP'T HUM. SERV., WHAT MEDICAID APPLICANTS NEED TO TELL A BANK WHEN ESTABLISHING A QUALIFIED INCOME TRUST, https://www.state.nj.us/humanservices/dmahs/clients/What_medicaid_applicants_need_to_tell_Bank_when_establishing_QIT.pdf.

[138] *See Social Security Direct Deposit*, SOC. SEC. ADMIN., https://www.ssa.gov/deposit/ (last visited Feb. 14, 2020); *Reducing Improper Payments*, SOC. SEC. ADMIN., https://www.ssa.gov/improperpayments/afi.html (last visited Feb. 14, 2020).

the OCC.[139] Tax preparation has become expensive and quite the operation, with more than one million preparers getting paid to do this work.[140] Most of this industry is focused on low-income individuals who are less educated and likely to receive refunds, which makes them desired targets.[141] In 2013, about fifteen million EITC households paid approximately $1 billion in tax preparation fees.[142] A popular technique is Refund Anticipation Checks (RACs), which includes a temporary bank account that tax preparers open on their customers' behalf to receive refund deposits from the IRS.[143] Then, after the refunds are issued, the accounts are closed and the customers receive refunds by check or pre-paid debit card.[144] One commentator noted this about RACs:

> While marketed for their convenience and speed, RACs, which typically cost $30 to $50, are actually no faster that [sic] the regular IRS refund process, which is generally quite expeditious—90 percent of refunds are issued within three weeks, and e-filers who select direct deposit can get theirs in as few as ten days. Instead, their primary function is to serve, effectively, as short-terms loan [sic] for clients who lack the cash to pay the tax prep fee, which is taken off the top when the refund is deposited.[145]

2. Promoting the Government's Interests

There are other situations, beyond these social policy programs, where the U.S. government, as a semi-principal, may rely on commercial banks, as semi-agents, to help advance its social agenda. The government's intentions, however, might conflict with the preferences of its semi-agents, the banks, which are private-sector participants that seek to maximize their profits. Banks, however, should be subject to certain duties under agency law. Specifically, agency relationships are fiduciary

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[139] *See* Off. of the Comptroller of the Currency, Leveraging Earned Income Tax Credits to Reach New Bank Customers (2018).

[140] Michael Cassidy, *How Can the EITC Be Improved?*, The Century Found. (Apr. 13, 2015), https://tcf.org/content/commentary/how-can-the-eitc-be-improved/?session=1.

[141] *Id.*

[142] *Id.*

[143] *Id.*

[144] *Id.*

[145] *Id.*

relationships, which means that banks should be legally required to act in the best interests of their semi-principal, the government, and owe fiduciary duties of loyalty and performance.

For example, the attempt of the OCC, which regulates and supervises banks and thrift institutions, to forbid banks from refusing to offer services to industries engaged in legitimate business activities was a clear act in which the government, as a semi-principal, sought to advance its fiscal agenda via its semi-agent's action.[146] The Trump administration OCC wanted to enable the ongoing flow and supply of funds to businesses of all industries, especially to specific industry categories that it found legitimate but that many commercial banks did not. The OCC proposal, therefore, mandated that banks would conduct a risk assessment of each potential customer, and solely based on that decide whether to give that customer services or not.[147] The OCC centered much of its discussion on the practices of bank lending, but the proposal related to a potential change regarding how national banks would give business customers financial service. The proposal was perceived as restricting banks' ability to regulate their own politics of risk management and corporate speech.[148] The OCC argued that it would be unethical for banks not to lend to companies such as producers of oil and gas, carbon-intensive manufacturers, family planning facilities, or weapons manufacturers.[149] This argument makes sense when interpreted under an agency law approach. The OCC basically stated that since, according to federal legislation, its mission is to ensure fair access to financial services, and fair treatment of customers, national banks as the government's semi-agents must advance this goal and give all businesses access to financial services, based on their own characteristics, without discrimination.

[146]Fair Access to Financial Services, 85 Fed. Reg. 75261 (Nov. 25, 2020) (to be codified at 12 C.F.R pt. 55).

[147]*Id.*

[148]Ellen Traupman Berge et al., *OCC Proposal Would Prohibit Banks from Denying Services to Entire Industry Categories*, Venable (Nov. 24, 2020), https://www.venable.com/insights/publications/2020/11/occ-proposal-would-prohibit-banks-from-denying.

[149]*Id.*

C. Compensating Banks for Serving as Agents

In addition to serving as the government's long arm to distribute funds under various types of social policy programs, banks also serve a unique purpose that makes sense under an agency law approach. Banks are corporations that operate primarily for the benefit of their stockholders, just as other corporations do. Their role in the modern economy, however, is more significant than any other industry's. As such, banks are regulated more than most industries and receive more government help when the quality of their assets (loans) deteriorates.[150] Indeed,

> [i]f a bank's risky positions are profitable, stockholders and managers reap the benefits. However, if a bank fails, the FDIC must pay insured depositors, typically at a loss to the insurance fund. The primary benefit of insured deposits is that depository institutions gain access to relatively inexpensive funds that they can lend to businesses, individuals and government units.[151]

Essentially, banks get a unique opportunity. If they lend their depositors' money and make a profit, their managers and stockholders benefit. If they lose or go bankrupt, the FDIC will refund the depositors. Banks have very low equity-to-assets ratios because their income is strictly dependent on the spread between interest received and interest paid minus expenses.[152] Technically, banks may be viewed as serving a public role to identify and invest society's savings in an efficient and profitable way. There have been several studies in the empirical literature about the uniqueness of banks and the role they play in modern society.

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[150] *See generally* KOCH & MACDONALD, *supra* note 3, at Ch. 2.

[151] *Id.*

[152] Emilios Avgouleas & Jay Cullen, *Excessive Leverage and Bankers' Pay*: *Governance and Financial Stability Costs of a Symbiotic Relationship*, 21 COLUM. J. EUR. L. 1, 2 n.1 (2014) (quoting the EUR. BANKING FED'N, BANK LEVERAGE AND ITS ECONOMIC IMPLICATIONS 4 (2010)) (providing the following description of bank leverage and of its potential uses: "[W]henever a bank's assets exceed its equity base, that bank is considered 'leveraged'. The more assets a bank borrows with the view to enhancing its returns, the higher is that bank's leverage. By leveraging, a bank bets that the interest paid on the borrowed capital will be smaller than the return generated, thus improving the bank's performance. If leverage is employed successfully, the difference between the cost of capital, and the return on capital employed, will be attributable to the principal as an economic profit … . Commercial banks make a profit on the interest earned on its borrowed funds through lending spreads, and on commissions charged for services. However, to amplify its income and capacity to lend, it can also choose to leverage, i.e. borrow more money on its own account (e.g. from governments or other financial institutions) and then lend it to other parties at a higher interest rate.").

For example, examining the uniqueness of commercial banks, Professor John Wood from the University of Pennsylvania concluded that "banks have a greater capacity for causing changes not only in total credit extended by intermediaries, but also in the price level and, where wage rigidities exist, employment and output."[153] While his study is on the differences between commercial banks and other financial intermediaries, his conclusion underlines the significance of commercial banks in the functioning of a modern economy, as they can impact price level, employment, and output in conditions of wage rigidities.[154]

As mentioned earlier, banks are the main conduit for the implementation of the Fed's monetary policy, and banks achieve this with three main tools:[155] (i) open market operations that purchase and sell Treasury securities, (ii) the discount rate, which is the rate charged by Fed banks on loans to financial institutions in their district, and (iii) the reserve requirement, which is the minimum amount of reserve assets that depository institutions must maintain by law to back transaction deposit accounts that are part of a bank's liabilities. Banks as depository institutions have both advantages and disadvantages stemming from this scenario. On the one hand, banks have access to the discount window, while on the other hand they must follow the Fed's reserve requirements. As such, commercial banks are subject to heightened regulation. Since open market operations are essentially a way of controlling the money supply and interest rates, a commercial bank's profit margins depend directly on Fed policy. In this manner, a bank becomes a public face for the Fed in an indirect way. Banks can, therefore, be viewed as the Fed's agents for carrying out policies for the general well-being of the economy, and the banks are compensated for fulfilling this vital role.

Acknowledging the advantages that banks enjoy and recognizing the importance of expansive banking services, there has been growing support for making banking services more inclusive.[156] Among the scholars

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[153] *See generally*, John H. Wood, *Two Notes on the Uniqueness of Commercial Banks*, 25 J. Fin. 99, 108 (1970).

[154] *Id*.

[155] *See* Anthony Saunders & Marcia Millon Cornett, Financial Markets and Institutions Ch. 4 (7th ed. 2019) (discussing the Fed System).

[156] *See* Jones, *supra* note 104; Atkinson, *supra* note 104; Baradaran, *supra* note 104; Crawford et al., *supra* note 104; Rahman, *supra* note 104; McArdle, *supra* note 104; Levitin, *supra* note 104.

promoting these initiatives are Professors John Crawford, Lev Menand, and Morgan Ricks, who argue that one of "the perks of being a bank is the privilege of holding an account with the central bank. Unavailable to individuals and nonbank businesses, central bank accounts pay higher interest than ordinary bank accounts."[157] Acknowledging this perk, they argue "that restricting central bank accounts to an exclusive clientele (banks) is no longer justifiable on policy grounds if indeed it ever was."[158] They, therefore, propose giving the general public the option to directly hold accounts at the central bank, referring to these as "FedAccounts."[159] This idea, if it ever becomes a reality, would be far from ideal for commercial banks. Once individuals, businesses, and institutions have such FedAccounts, the government would no longer need to rely on banks as its semi-agents. FedAccounts would enable the government to directly remit payments to individual accounts whenever it needs to do so, something that could theoretically cause a run on the bank. Similarly, individuals could and would use their FedAccounts to prevent situations in which their payments sent to them from the government would be seized by banks.

Alternatively, as some scholars have suggested, the government could rely on the U.S. Postal Service (USPS), which is an independent agency of the executive branch of the federal government, to promote USPS banking.[160] Under this alternative scenario, there is no question that the USPS would be subject to government's policy goals as its agent.[161]

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[157] *See* Morgan Ricks, John Crawford & Lev Menand, *A Public Option for Bank Accounts (Or Central Banking for All)*, Harv. L. Sch. F. Corp. Governance (June 22, 2018), https://corpgov.law.harvard.edu/2018/06/22/a-public-option-for-bank-accounts-or-central-banking-for-all/.

[158] *Id*.

[159] Crawford, Menand & Ricks, *supra* note 104.

[160] *See* Mehrsa Baradaran, *It's Time for Postal Banking*, 127 Harv. L. Rev. F. 165, 166 (2014); Mehrsa Baradaran, Opinion, *The Post Office Banks on the Poor*, N.Y. Times (Feb. 7, 2014), https://www.nytimes.com/2014/02/08/opinion/the-post-office-banks-on-the-poor.html; Randall K. Johnson, *How the United States Postal Service (USPS) Could Encourage More Local Economic Developmen*t, 92 Chi.-Kent L. Rev. 593 (2017).

[161] Julie Tsirkin & Phil McCausland, *Can a Post Office Be a Bank? New Services Test a Progressive Priority,* NBCNews (Oct. 4, 2021) https://www.nbcnews.com/politics/politics-news/return-postal-banking-postal-service-tests-new-financial-services-rcna2502.

D. Governments' Reliance on Banks During the COVID-19 Crisis: A Global Perspective

The U.S. government was not unique in its need to rely on agents to advance its fiscal goals during the COVID-19 pandemic. Many governments offered economic stimulus packages through banks via direct one-time payment transfers.[162] The U.S. government's reliance on commercial banks, however, was rather complex. The relatively large number of American banks reflects a decentralized, state unit banking structure with various regional constraints.[163] A significant drawback of the U.S. banking system is, however, the unit banking system and the prohibition of nationwide banking.[164] Therefore, in the stimulus packages context, the decentralized banking system, which includes thousands of banks,[165] meant that the government's assistance to businesses was dependent on not only the largest banks but also many smaller ones.[166] This proved to be problematic.[167] Moreover, the Fed, which typically deals with monetary policy issues, had to

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[162]Trevor Sutton, Jordan Link & Anna Lipscomb, Lessons for the United States From International Economic Responses to the Coronavirus, Ctr. for Am. Progress (March 26, 2020, 11:26 A.M.), https://www.americanprogress.org/issues/security/news/2020/03/26/482287/lessons-united-states-international-economic-responses-coronavirus/.

[163]Art Alcausin Hall, *International Banking Regulation into the 21st Century*: *Flirting with Revolution*, 21 N.Y.L. Sch. J. Int'l & Comp. L. 41, 47 (2001).

[164]*See* Geoffrey P. Miller, *Legal Restrictions on Bank Consolidation*: *An Economic Analysis*, 77 Iowa L. Rev. 1083, 1121–22 (1992) ("[T]he remarkable contrast between the United States banking industry and the industries of all other major industrialized nations suggests rather powerfully that our 'decentralized' banking structure may not be the most efficient method for delivering banking services in an increasingly global financial marketplace.").

[165]Eric J. Gouvin, *Cross-Border Bank Branching Under the NAFTA*: *Public Choice and the Law of Corporate Groups*, 13 Conn. J. Int'l L. 257, 260 (1999) (providing possible explanations for the multitude of banks in the United States).

[166]*See* Robert F. Roach, *Bank Mergers and the Antitrust Laws*: *The Case for Dual State and Federal Enforcement*, 36 Wm. & Mary. L. Rev. 95, 118 (1994) (explaining how the decentralized banking system enjoyed in the United States today was established by the passage of banking laws in the 1800s); Arthur E. Wilmarth, Jr., *The Expansion of State Bank Powers*, *The Federal Response*, *and the Case for Preserving the Dual Banking System*, 58 Fordham L. Rev. 1133, 1153 (1990) (analyzing the laws that created the growth of decentralized banking in the United States).

[167]*See*, *e.g*., Todd H. Baker, *Congress Was Wrong to Leave PPP Disbursement Up to Banks*, Am. Banker (Apr. 28, 2020), https://www.americanbanker.com/opinion/congress-was-wrong-to-leave-ppp-disbursement-up-to-banks (explaining that the United States' reliance "on lender intermediaries means that assistance must come in the form of 'loans' rather than direct support payments. It also exposes how frequently the government's policy goals conflict with lenders' economic goals and incentives.").

focus on credit distribution among different groups in society[168] even though this is not something typically within its domain.[169] The government sought to execute this distribution by partnering with commercial banks; however, banks are profit-maximizing institutions, so their priorities in executing this distribution were contrary to the government's.[170]

Using an agency law theory to define the relationship between the government and banks helps align their interests as the principal and agents. For example, in the context of managers representing shareholders, stock options given to managers have become the standard across industries to ensure that managers work in shareholders' best interests.[171] Likewise, to reduce agency costs, legal doctrines evolved regarding governance structures and remuneration policies that enable the monitoring and assessment of agents' behavior.[172]

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[168]Kathryn Judge, *Guarantor of Last Resort*, 97 Tex. L. Rev. 707, 721–27 (2019) (discussing central bank independence.)

[169]*See*, *e.g.*, Nadav Orian Peer, *Negotiating the Lender of Last Resort*: *The 1913 Federal Reserve Act as a Debate over Credit Distribution*, 15 N.Y.U. J.L. & Bus. 367, 367 (2019) ("Less famously, lender-of-last-resort powers also influence the distribution of credit among different groups in society and therefore have high stakes for economic inequality.").

[170]In 2006, during testimony before the Senate Committee on Banking, Housing, and Urban Affairs, Governor Susan Schmidt Bies of the Fed discussed this "natural tension between the private interests of banks in maximizing shareholder profits" and the public interest. *See An Update on the New Basel Capital Accord*: *Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 109th Cong. 194 (2006) (statement of Susan S. Bies, Governor, Federal Reserve Board of Governors, Federal Reserve).

[171]*See*, *e.g.*, James Tobin, *Galbraith Redux*, 83 Yale L.J. 1291, 1297 (1974) (describing how "[i]ncentive compensation of executives generally is geared to profit performance and share values"); Kelli A. Alces, *The Equity Trustee*, 42 Ariz. St. L.J. 717, 773 n.170 (2010) (quoting Randall S. Thomas & Kenneth J. Martin, *The Effect of Shareholder Proposals on Executive Compensation*, 67 U. Cin. L. Rev. 1021, 1081 n.40 (1999)) ("[T]he conflict between managers and shareholders [sic] interests can be mitigated through the use of incentive compensation packages which align the incentives."). It should be noted, however, that scholars from both the Stakeholder Theory and the Maximizing Shareholder Wealth Theory have criticized incentive compensation and stock option regimes. *See, e.g.*, Lucian Bebchuk & Jesse Fried, Pay Without Performance: The Unfulfilled Promise of Executive Compensation 198 (2004) (arguing that shareholders should have bigger roles in setting executive compensation).

[172]*See*, *e.g.*, Lex Donaldson & James H. Davis, *Stewardship Theory or Agency Theory*: *CEO Governance and Shareholder Returns*, 16 Austl. J. Mgmt. 49, 50 (1991) (arguing that agency theory claims that shareholder interests require protection by separation of incumbency of roles of board chair and CEO, and that differently, stewardship theory argues shareholder interests are maximized by shared incumbency of these roles).

Currently, in terms of carrying out its fiscal policy, the U.S. government is merely asking and trusting banks to do what it expects them to do. The government clearly aims to provide money to those who need it the most,[173] whereas banks do not. Economic equality,[174] or financial inclusion,[175] have never been a top priority for commercial banks. Therefore, it is no surprise that banks did not, and probably could not, distribute funds in the manner that Congress had intended. By using an agency law approach, this could change, and commercial banks, as semi-agents, would be required to advance the government's fiscal agenda and be subject to fiduciary duties of loyalty and performance. To guarantee effective compliance of banks in their role as the government's semi-agents, Section III suggests creating and using a Social Policy Rating System (SPRS) to help assess banks' performance.

III. Piggyback Riding the CAMELS Rating System

There is already a system that monitors and assesses banks' performance. The Federal Financial Institutions Examination Council (FFIEC) adopted the Uniform Financial Institutions Rating System (UFIRS) as a method to evaluate and rate banks' financial soundness.[176]

> Section 10(d) of the Federal Deposit Insurance Act (FDI Act) generally requires the appropriate federal banking agency for an insured depository institution to conduct a full-scope, on-site examination at least once every

[173] *See supra* notes 133–39 and accompanying text (discussing SNAP and the other programs).

[174] *See, e.g.*, How the Other Half Banks, *supra* note 100, at 210–25 (emphasizing the importance of access to banks and explaining how the revival of U.S. postal banking could help low-income populations); Jacob Hale Russell, *Misbehavioral Law and Economics*, 51 U. Mich. J.L. Reform 549, 562–64 (2018) (explaining the costs and benefits of payday loans); Abbye Atkinson, *Rethinking Credit as Social Provision*, 71 Stan. L. Rev. 1093, 1162 (2019) (explaining how "access to credit" talk pervades the contemporary conversation regarding financial rights and equality for low-income populations).

[175] *See* Raskin, *supra* note 43 (detailing why broad inclusion matters to economic recovery); Aaron Chou, Note, *What's in the "Black Box"? Balancing Financial Inclusion and Privacy in Digital Consumer Lending*, 69 Duke L.J. 1183, 1194 (2020) (detailing how the Obama administration announced that FinTech "could have a large role to play in increasing access to credit for underserved, unbanked").

[176] For the latest revision, see Uniform Financial Institutions Rating System, 61 Fed. Reg. 67,021 (Dec. 19, 1996).

> 12 months … for insured depository institutions that meet certain criteria, including the requirement that the insured depository institution must have total assets below a specified size limit.[177]

Once the examination concludes, examination staff analyzes the results and converts those into findings that are used as the basis for rating the condition of insured depository institutions under the UFIRS.[178]

The UFIRS is commonly referred to as the CAMELS rating system, an acronym for its six evaluation components: Capital Adequacy, Asset Quality, Management Quality, Earnings, Liquidity, and Sensitivity to Market Risk.[179] The CAMELS rating has been copied and used in studies and in other countries,[180] yet reports on the effectiveness of the system are still mixed, especially given the system's nonpublic nature, as explained below.[181]

A. The CAMELS Rating System

Federal regulators conduct examinations[182] of all state and federal FDIC-insured banks and rely on state regulators for massive volumes of

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[177]*See* Section 10(b) and 10(d) of the Federal Deposit Insurance Act, 12 U.S.C. § 1820 (d) (2021). *See also* 83 Fed. Reg. 67033 (Dec. 28, 2018).

[178]More information on the FDIC bank examinations' conduct and logics can be found in the Bd. Governors Fed. Rsrv. Sys., Div. Supervision & Reg., Commercial Bank Examination Manual 3 (2020), https://www.federalreserve.gov/publications/files/cbem.pdf. Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, §§1001–10, 92 Stat. 3641, 3694–96 (1978).

[179]For a quick review of ratings, which was adopted on November 13, 1979, *see* Saunders & Cornett, *supra* note 155. For a complete risk manual on how the FDIC uses the rating system, *see* Fed. Deposit Ins. Corp., Risk Management Manual of Examination Policies (2021), https://www.fdic.gov/regulations/safety/manual/index.html.

[180]*See, e.g.*, Mihir Dash & Annyesha Das, *A CAMELS Analysis of the Indian Banking Industry* (2009), *available at* https://ssrn.com/abstract=1666900; Alexis Derviz & Jiří Podpiera, *Predicting Bank CAMELS and S&P Ratings*: *The Case of the Czech Republic*, 44 Emerging Mkts. Fin. & Trade 117 (2008).

[181]*See, e.g.*, Hannah Lang, *Banks Want a Camels Overhaul, but Chiming In Is Risky*, Am. Banker (Nov. 11, 2019), https://www.americanbanker.com/news/banks-want-a-camels-overhaul-but-chiming-in-is-risky (explaining how many in the industry were happy about the regulators' interest in improving the CAMELS rating system, but they may shy from commenting publicly about this).

[182]For information on the examination process from the perspective of the FDIC, *see generally, Bank Examinations*, Fed. Deposit Ins. Corp., https://www.fdic.gov/regulations/examinations (last updated Sept. 13, 2021).

financial data.[183] The examiners review the data of commercial banks on an ongoing basis with the purpose of determining banks' "safety and soundness."[184] The national examiners collect the examination information and create what is referred to as a "CAMELS" rating that evaluates objective factors and subjective information about management capabilities, to guarantee "safety and soundness."[185]

Over the years, the CAMELS rating has been used as an internal supervisory tool that evaluates on a uniform basis and identifies those institutions that require special attention. The rating was implemented following the Fed's recommendation.[186] A rating of 1 is given to the best institutions while a rating of 5 is reserved for the worst. For example, a 4 rating could mean that a bank is in a troubled condition and faces critical problems, which could result in its liquidation.[187]

Commercial banks aspire to get a higher rating for reasons similar to individuals seeking a higher credit rating: to improve one's standing in the market and increase one's ability to make financial decisions. In the case of banks, a higher rating is reflected in greater independence of action and less regulator interference. There is empirical literature that argues for and against CAMELS ratings not being kept secret. Advocating for the ratings to be publicly disclosed, some scholars have argued that

[183]Edwin Adrian Bogert, Comment, *Anti-Federalist Banking Policy Under Dodd-Frank*: *The Case for the Liberal Pre-emption of State Banking Law*, 6 U. Pa. J.L. & Pub. Aff. 309, 332 (2020) (stating that "[a]nother important check that states can rely on in order to establish their preferred consumer protection regime is the highly integrated nature of our banking regulatory system. In fact, federal regulators, and especially FDIC supervisors, who conduct regular 'examinations' of all state and federal FDIC insured banks rely on state regulators for large amounts of financial information").

[184]Bd. Governors Fed. Rsrv. Sys., Div. Supervision & Reg., *supra* note 178 (explaining safety and soundness examinations to be "including assessing risk-management systems and financial condition as well as determining compliance with laws and regulations").

[185]For more on the Uniform Financial Institutions Rating System and the consequences of adverse CAMELS ratings, *see* Julie Andersen Hill, *When Bank Examiners Get It Wrong*: *Financial Institution Appeals of Material Supervisory Determinations*, 92 Wash. U. L. Rev. 1101, 1107–11 (2015) and accompanying footnotes.

[186]*See* Bd. of Governors of the Fed. Rsrv. Sys., SR 96-38, *supra* note 178, at Attachment (providing an in- depth analysis of UFIRS).

[187]*See* First Nat'l Bank & Trust v. Dep't of Treasury, 63 F.3d 894, 896 n.4 (9th Cir. 1995) (explaining the CAMEL system).

> [s]ocial benefits to public disclosure include a reduction in adverse selection, moral hazard, contagion problems, and transactions costs. Disclosure may also reduce inappropriate behavior on the part of the institution. Conversely, disclosure of CAMELS ratings also identifies institutions on the "problem" institution list, potentially leading to panic and liquidity problems that endanger financial system stability.[188]

Institutions with superior ratings would probably prefer disclosure, but since regulators want to avoid bank panics, they have chosen not to reveal the ratings.[189]

The CAMELS ratings are significant to depository institutions because they impact the premium that must be paid for deposit insurance, modify the relative possibility of getting penalized and sustaining sanctions from financial regulatory supervisors, and impact banks' capabilities to expand or employ leadership personnel. Moreover, adverse CAMELS ratings are customarily not entitled to judicial review.[190] Rather, these ratings are subject to limited internal appeals procedures, although sometimes banks will not appeal a rating since the consequence of receiving a significantly adverse CAMELS rating may be swift involuntary receivership by the FDIC and liquidation.[191]

Additionally, the Board of Governors of the Federal Reserve System (FRB) and the FDIC also conduct examinations of specific specialty fields, outside of the CAMELS ratings, for which they assign unique ratings to financial institutions. Such specific specialty fields include asset management/trust,[192] information technology,[193] and government

[188] *See*, *e.g.*, SingRu Hoe, Srinivas Nippani & John David Diltz, *Should CAMELS Ratings Be Publicly Disclosed?*, 37 Econ. Bull. 1567, 1567 (2017).

[189] CAMELS ratings are confidential supervisory information per 12 C.F.R. § 309.5(g)(8) (2016); 12 C.F.R. § 309.6 (2011); 12 C.F.R. § 327.4(d) (2016).

[190] *See* Hill, *supra* note 185, at 1115–60 (discussing the history and nature of OCC, Federal Reserve, FDIC, and NCUA material supervisory determinations appeals processes).

[191] *But see* Builders Bank v. Fed. Deposit Ins. Corp., 846 F.3d 272 (7th Cir. 2017) (holding that CAMELS ratings are not beyond judicial review); Nikhil Gore, *Seventh Circuit Holds Open a Narrow Path for Challenging Bank Supervisory Ratings*, Covington (Feb. 12, 2017), https://www.covfinancialservices.com/2017/02/seventh-circuit-holds-open-a-narrow-path-for-challenging-bank-supervisory-ratings/ (discussing the promise that Builders Bank holds for the judicial review of CAMELS ratings).

[192] Uniform Interagency Trust Rating System, 63 Fed. Reg. 54,704, 54,711 (Oct. 13, 1998).

[193] Uniform Rating System for Information Technology, 64 Fed. Reg. 3,109 (Jan. 20, 1999).

securities dealers or clearing agencies.[194] The agencies assign unique ratings to financial institutions for these specialty areas, which indicates that the agencies perceive them as important. Yet, DEI is no less important than these other assessed categories. To correct this problem, this article suggests creating another system, the SPRS, which would be publicly available and rate banks based on their social consciousness and their level of performance with respect to socially desired goals. The rest of this section describes the components of the SPRS. Section B details how the SPRS would promote DEI. Section C discusses the need for the SPRS to be a publicly available rating system. Finally, Section D explains why the SPRS implementation should be based on both carrots and sticks to incentivize higher levels of social performance and, therefore, higher ratings.

B. Promoting DEI

In the last few years, more and more commentators have argued that there is value in prioritizing DEI in society, including racial and gender diversity and inclusion.[195] Some lawmakers have taken steps to attempt to increase DEI, but most lawmakers have not done so with regard to banking.[196] Given the difficulties of implementing this objective in the banking industry, regulators need a new CAMELS-like SPRS to help advance the government's social policy objectives.

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[194] 17 C.F.R. § 450.3 (2014).

[195] *See*, *e.g.*, Joan MacLeod Heminway, *Women in the Crowd of Corporate Directors*: *Following*, *Walking Alone*, *and Meaningfully Contributing*, 21 Wm. & Mary J. Women & L. 59 (2014) (focusing on diversity and inclusion in corporate governance and exploring advantages resulting from gender diversity, inter alia, in board decision making); Darren Rosenblum, *When Does Sex Diversity on Boards Benefit Firms?*, 20 U. Pa. J. Bus. L. 429, 484 (2017) (describing benefits of gender diversity); Lauren Hirsch, *The Business Case for Boardroom Diversity*, N. Y. Times (Jan. 23, 2021), https://www.nytimes.com/2021/01/23/business/dealbook/diversity-board-directors.html (explaining how "[w]hen big banks see a benefit in helping companies recruit more diverse directors, it's a sign that there are not just morals at play—there is money at stake, too"); Anjan Pathak, *Importance of Diversity and Inclusion for Business Growth*, Entrepreneur (Sept. 10, 2021), https://www.entrepreneur.com/article/384828 (stating that "[d]iversity and inclusion are important assets for any organization's growth and success").

[196] *See generally* Joan MacLeod Heminway, *Me*, *Too and #MeToo*: *Women in Congress and the Boardroom*, 87 Geo. Wash. L. Rev. 1079 (2019) (examining possible gender effects of the #MeToo movement on boardroom composition in relation to the possible gender effects of the #MeToo movement).

Specifically, the SPRS could help advance DEI by addressing three key problems. First, banks discriminate against women and minority business owners by prioritizing larger customers. This was demonstrated in the processing of the PPP loans during the COVID-19 pandemic. This proved detrimental to the interests of nearly thirty million small businesses that employ sixty million people. The problem appeared in this form: Assume that a bank enjoys a long-term relationship with its larger customers, and this ensures a steady income that provides regular revenue for banks. The bank would be unwilling to let go of an opportunity to maintain revenue from these long-term customers, especially when things appear bleak on the economic front. As such, a bank can use its discretionary power to prioritize larger customers. Unfortunately, the interest of the U.S. government is different here, that is, to ensure that everyone is entitled to benefit from the government's program. The PPP loan's main goal was to ensure paycheck replacements during COVID-19 for employers, not to ensure banks could maintain their relationships with their large customers. Just as there is a legal lending limit to how much a bank can lend to a single borrower, there should be a legal repercussion for giving more than a percentage of total funds received by a bank in PPP loans to a particular borrower. The SPRS could look at how many paychecks were protected by each bank's lending practices. The percentage of compliance and noncompliance could be part of a bank's SPRS rating.[197] Likewise, banks should meet a minimum threshold of lending to women and minority business owners as this would force them to emphasize diversity in their distribution.

Second, banks try to maximize their shareholders' wealth at the expense of the government's social policy.[198] This problem was demonstrated in 2020 when banks were trusted with the relief checks that the U.S. government directly deposited into taxpayers' checking accounts.

[197]For example, part of the rating could be calculated as the total amount received by a bank multiplied by the number of people who received the money divided by the total number of people who are supposed to receive the money. Suppose a bank received $200,000 to distribute, it has 1200 recipients eligible under PPP, and only 600 got the money: the bank would have only 50% of the eligible recipients who received 100% of the money. As such, the bank should be forced to lend to the rest of the 600 recipients from its funds. This forces the banks to be equitable in their distribution.

[198]This means, of course, also at the expense of the banks' business and individual customers.

Yet, because the money was not designated as exempt from garnishment under the CARES Act, many banks froze or seized the funds before consumers received them. In other words, the banks were taking stimulus money from individuals who needed it most to repay bank debt. The government wanted to help taxpayers who could not work because of COVID-19 by assisting them with living expenses, and these checks should have been given in full to the banks' customers.[199] Given the conflict of interest, the creation of a DEI-based SPRS would properly support the implementation of the government's social policy by measuring how much of the funds that banks receive from the government for disbursement under federal legislation (such as the CARES Act) ends up in the intended recipients' hands. Banks can be rated from best (1) to worst (5) in their disbursement of the government's money in an inclusive and broad manner.

Third, there is a problem with the banks' inability to quickly and effectively serve large masses of customers given their lack of desire or ability to invest in expensive digital solutions and infrastructure. During the COVID-19 pandemic, this issue was reflected in the low volume and slow pace at which banks processed PPP loan applications, and this eventually prompted the government to seek the help of FinTech companies.[200] Indeed, most banks used substandard digital solutions to meet the urgent demand, perhaps because many did not want to invest in expensive digital solutions and were not required to do so.[201] Therefore, in the moment of truth during the pandemic banks did the best they could while cutting costs. The SPRS would be able to address this inefficiency by encouraging banks to join a larger system of banks that distribute money. Just as large loans are packaged and syndicated, government-administered payments, such as the PPP payments, could be processed by banks (akin to lead underwriting) with better digital solutions that would take over the disbursement for a fee. The arrangement may be similar to the correspondent banking arrangement. Banks that use this

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[199] *See, e.g.*, *Court Halts Debt Collection During Crisis*, DOMINION POST (Apr. 17, 2020), https://www.dominionpost.com/2020/04/17/court-halts-debt-collection-during-crisis.

[200] *See* Nizan Geslevich Packin, *Let FinTech Help Jumpstart the Economy*, FORBES (April 8, 2020), https://www.forbes.com/sites/nizangpackin/2020/04/08/let-fintech-help-jumpstart-the-economy/?sh=37d331a96c24.

[201] *Id.*

and offer this service to smaller banks should receive points on the SPRS rating. This will ensure that banks that cannot afford to hire extra help to quickly process applications will not be burdened with extra costs. Since most smaller banks have correspondent banking agreements with major banks,[202] such an arrangement should be easier to implement than hiring new employees to help with this task. Based on these three issues, the SPRS could be designed as follows:

An SPRS 1 rating would be given to banks that distribute 90% or above of the money they receive under government programs (such as the CARES Act) as intended by the government. Banks cannot discriminate based on customer size (among institutions), cannot seize funds from customer accounts, and must increase, for example, their temporary staff to ensure that 90% or more of customers receive their intended funds. Banks cannot discriminate based on financial status, race, color, religion, sex, pregnancy, national origin, age, disability, genetic information, or veteran status, or as retaliation against a sexual harassment claim. The banks in this category obtain preference for future fiscal policy programs' allotments of money.

An SPRS 2 rating would be given to banks that distributed 80%–90% of funds as intended and increased their temporary staff to ensure that 80% or more but below 90% of customers received their intended funds.

An SPRS 3 rating would be given to banks that distributed 75%–80% of the funds as intended and increased their temporary staff to ensure that 75% or more but less than 80% of customers received their funds.

Finally, an SPRS 4 rating would be given to banks that performed the worst in the fund distribution and basically did not advance the government's agenda. Banks rated below 3, which withheld funds and prevented amounts from getting into the hands of the most in-need populations, should be excluded from future disbursement efforts. This rating system will ensure that banks self-correct their behavior.

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[202]For more on correspondent banking agreements, see Marcel T. Rosner & Andrew Kang, *Understanding and Regulating Twenty-First Century Payment Systems*: *The Ripple Case Study*, 114 Mich. L. Rev. 649, 656 (2016) (describing how "[a]n international correspondent-banking relationship is a contractual arrangement under which a bank in one jurisdiction (a correspondent) holds deposits, denominated in its native currency, but owned by a bank in another jurisdiction (a respondent)").

C. Publicly Available Ratings

CAMELS ratings are not public records. Official correspondence regarding the ratings is privileged and confidential, and government agencies prohibit disclosure of banks' ratings or any reports of examination without the relevant regulator's permission.[203] Therefore, agencies typically communicate the CAMELS ratings to institutions via formal reports of examination or official agency correspondence, which are agencies' property and are provided to banks confidentially.

The effectiveness of any system depends on the purpose for which it was created and its adaptability to changing circumstances. Unlike CAMELS ratings, the disclosure of which could lead to bank runs, the disclosure of SPRS ratings will not pose any such risk. The purpose of the SPRS is to give bank customers information on how a bank will deal with them in times of crisis. A bank that prioritizes customers ahead of profits would get a higher rating than a bank that would not, and have the SPRS ratings to back it up. The rationale for the public transparency of the rating is somewhat analogous to the legal ability of commercial FDIC member banks, which take deposits, to use the FDIC logo in their advertisements.[204] The ability of banks to present this logo, which states that deposits are "Backed by the Full Faith and Credit of the United States," is meaningful.[205] Publicizing the ratings will incentivize change in bank behavior. Essentially, if commercial banks are given a rating that they have to show on their logo, much like FDIC insurance, banks would be incentivized to serve as agents for the government's objective to ensure equitable program funds distribution. Consistent with banks being able to post a logo of their FDIC assurance, or even their EEOC statements encouraging all applicants to apply for jobs there, a publicly displayed SPRS score will encourage banks to obtain high ratings and will serve the purpose for which these ratings are being advocated.

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[203]Exceptions include the limited circumstances listed in the law (12 U.S.C. §§ 1817(a), 1831(m)) and in the agencies' regulations.

[204]*See* Keith Lewis, *FDIC Seeks Input on Modernizing Bank Advertising*, *Signage Rules*, CQ Roll Call Wash. Banking Briefing, Feb. 21, 2020, at 1 (discussing how banks use the FDIC logo as an advertisement advantage, but financial service providers are only able to do so if they truly are FDIC members).

[205]*See* Adam J. Levitin, *Safe Banking*: *Finance and Democracy*, 83 U. Chi. L. Rev. 357, 386 n.71 (2016) (explaining that the "DIF [deposit insurance fund] is a mutual insurance fund for the banking industry. It is funded by the banks, rather than through congressional appropriations."); *See The Deposit Insurance Fund*, FDIC (Sept 2, 2015), http://perma.cc/U2L5-9CN6.

D. Carrots and Sticks

The public nature of the proposed SPRS, however, is not enough. The SPRS is likely to be dependent on the level of its adoption among commercial banks. Lawmakers should use a mix of both incentives and penalties to reach higher levels of social performance and ratings. Highly compliant banks should be encouraged to obtain carrots, which can include various advantages. One such carrot may be greater access to funds in times of future crisis. Second, top-rated banks may outperform lower-rated banks since there is a possibility that depositors will take their money from lower-rated banks and redeposit it in top-rated banks. This will provide an incentive for self-regulation, whereby banks would compete for better SPRS scores. Indeed, with the passage of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994[206] and the Financial Services Modernization Act of 1999,[207] bank mergers and acquisitions became common. There were 14,400 commercial banks in the United States in January 1984. As of July 2020, there were 4375.[208] Regulators can use this possibility to encourage banks to seek higher SPRS scores.[209] Third, the SPRS would help ensure commercial banks' own long-term survival by ensuring that the public banking movement does not gain momentum, as banks seeking better SPRS scores would probably be

[206]Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, 108 Stat. 2338 (1994) (codified in scattered sections of 12 U.S.C.) dramatically reduces geographic limitations on interstate bank activity, as it "seeks to: (i) encourage economic growth; (ii) increase efficiency of the U.S. banking system; (iii) provide greater protection to the Federal Deposit Insurance Fund; and (iv) benefit consumers through increased lending and availability of banking services across state lines." *See* Grant E. Buerstetta & David E. Runck, *Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994*, 14 ANN. REV. BANKING L. 2 (1995); 140 CONG. REC. S12,927–02 (daily ed. Sept. 14, 1994) (statement of Sen. Bond).

[207]Gramm-Leach-Bliley Act, Pub. L. 106–102, 113 Stat. 1338 (1999) (codified as amended at 15 U.S.C. §§ 6801–09). *See also* Joe Mahon, *Financial Services Modernization Act of 1999, Commonly Called Gramm-Leach-Bliley,* FED. RSRV. HISTORY (Nov. 12, 1999), https://www.federalreservehistory.org/essays/gramm-leach-bliley-act (noting that the Financial Services Modernization Act of 1999 and Gramm-Leach-Bliley Act are one and the same).

[208]*See Commercial Banks in the U.S. (DISCONTINUED)*, FED. RSRV. BANK OF ST. LOUIS (Oct. 7, 2021), https://fred.stlouisfed.org/series/USNUM.

[209]*See generally* Jeremy C. Kress, *Modernizing Bank Merger Review*, 37 YALE J. REG. 435 (2020) (arguing that lawmakers' current approach to evaluating suggested bank mergers is not suited for our modern financial markets, as they have traditionally focused on one main issue—if a bank merger would reduce competition, which is less relevant nowadays—but current bank merger analysis should instead focus on issues that lawmakers have been neglecting, such as if a merger would enhance the public welfare or increase systemic risks).

more amenable to prioritizing their neediest customers when implementing fiscal policies such as the CARES Act.

The government can also reward banks that follow the spirit of its fiscal agenda and not just the letter of it. This could be similar to the incentives that companies create for their top managers using stock options, wherein the employees are entitled to purchase stocks of the company at a predetermined price should they attain some performance goals. Here, the banks that receive funds should be ranked based on their comparative performance, and rewards should be offered to ensure compliance with the principal's intentions. These rewards could take several forms: giving top managers points for their own performance in addition to their bank's performance in the distribution of funds, giving banks greater access to federal government funds in case of large government-sponsored projects, or guaranteeing banks' loans given to foreign buyers whom the government considers a priority whereby the bank's risk is reduced.

Rewards could be accompanied by disincentives such as negative points for managers and banks with regard to their compliance profiles, reducing bank access to federal government funds for government-sponsored projects, and not guaranteeing bank loans provided to foreign buyers. The Federal government's total expenditure is a significant amount.[210] In a study on manager wealth concentration and ownership structure, Professors Sullivan and Spong show how an insider's concentration of wealth in her bank investment affects her incentives to take risk.[211] A similar structure can be put in place to ensure that funds provided by the U.S. government, as a semi-principal, reach the intended recipients by incentivizing a correct distribution of funds.

Finally, while the SPRS's regulatory approach includes carrots and sticks,[212] it mainly advocates the use of carrots. In recent decades,

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[210]*See Government Total Expenditures*, Fed. Rsrv. Bank of St. Louis (Oct. 7, 2021), https://fred.stlouisfed.org/series/W068RCQ027SBEA (showing the government total expenditures in billions of dollars).

[211]*See generally* Richard J. Sullivan & Kenneth R. Spong, *Manager Wealth Concentration, Ownership Structure, and Risk in Commercial Banks*, 16 J. Fin. Intermediation 229 (2007).

[212]*See* Brian Galle, *The Tragedy of the Carrots: Economics and Politics in the Choice of Price Instruments*, 64 Stan. L. Rev. 797, 808 (2012) ("Society can use either carrots or sticks interchangeably to get externality producers to 'internalize' the marginal effects of their decisions on others.").

governments at all levels have demonstrated a preference for the use of incentives to achieve policy goals[213] and found them to be more effective in preventing undesired activities.[214] Specifically, enabling banks to utilize their SPRS scores for public relations purposes, as well as encouraging higher-rated banks with greater access to funds in future crises, clearly relies on carrots more than sticks. While it means that noncomplying banks are not penalized by the regulators, carrots are the right tool, as "[i]ncentives, when properly calibrated and designed, can be incredibly powerful regulatory tools for governing individuals and institutions in the face of complexity."[215]

Conclusion

There is sufficient evidence that shows that the government significantly helped commercial banks to remain in business following the 2008 financial crisis.[216] Some major banks were accused of avarice and irresponsible lending, but the government wanted to ensure that consumers would not lose confidence in commercial banks since the government relies on banks as semi-agents to implement its fiscal agenda. More than a decade after the 2008 financial crisis, the federal government enacted the CARES Act to help the American people during the pandemic and relied on banks to help it execute its plans quickly and efficiently. However, the

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[213]Shi-Ling Hsu, *The Rise and Rise of the One Percent*: *Considering Legal Causes of Wealth Inequality*, 64 Emory L.J. Online 2043, 2065–66 (2015) (explaining that "the carrots frequently take the form of some capital promotion or protection… . Financial regulation, electric utility regulation, and oil and gas subsidies are areas that have played a critical role in economic growth and development, and therefore benefitted from this capital bias. Promoting … these industries is viewed as promoting economic growth and development").

[214]Gerrit De Geest & Giuseppe Dari-Mattiacci, *The Rise of Carrots and the Decline of Sticks*, 80 U. Chi. L. Rev. 341, 345 (2013) (focusing on how "carrots" have become more widely used in recent decades in our society and arguing that "carrots" are superior to "sticks" in the face of complexity, including, particularly in connection with disclosure requirements and financial regulation).

[215]Tom C.W. Lin, *The New Financial Industry*, 65 Ala. L. Rev. 567, 614–615 (2014) (explaining that although "penalties and punishments may be psychologically, politically, and administratively more satisfying following financial misbehavior, incentives may be more effective" in more complex situations).

[216]For a thorough review of financial institutions' role in the crisis, *see* Saunders & Cornett, *supra* note 155.

misalignment between the banks' interest and the federal government's agenda prevented the government's intended financial aid from being as successful as it could have been and in the worst-case scenario increased inequality.

Was it reasonable, however, to expect commercial banks to advance the federal government's fiscal agenda when it conflicted with their strategic business interests? Presently, there is no consensus regarding how significant and broad commercial banks' role should be to advance the government's fiscal policy. However, the CRA, as well as other government social programs, implicitly reflects the idea that banks' unique role in the financial system justifies expecting more from banks. This article argues for an agency theory–based regulatory approach to hold banks as semi-agents of the federal government and using that theory to incentivize banks to advance principles of DEI in the distribution of government funds. This role is especially important during extraordinary economic times, when the government earmarks funds for those most affected by downturns or challenging financial conditions, such as those caused by COVID-19.

Specifically, this article recommends implementing an agency law–based approach and creating a new SPRS that would rank banks' implementation of government social policy, similarly to the CAMELS financial soundness ratings. Banks would be required to report their SPRS scores to their customers just as they display their FDIC insurance status and logo.

In 1776, Adam Smith wrote in his famous *The Wealth of Nations* that "[i]t is not by augmenting the [financial] capital of the country, but by rendering a greater part of that capital active and productive than would otherwise be so, that the most judicious operations of banking can increase the industry of the country."[217] It took several hundred years and several financial crises for society to understand what he meant and the importance of a fair and equitable financial system. Viewing banks as the government's semi-agents in limited circumstances and rating their performance implementing its fiscal policy using the SPRS would help steer banks in the government's desired direction and overcome the conflict of interests between the government and commercial banks.

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[217] Adam Smith, The Wealth of Nations 340 (1776).