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United States Senate
COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

July 14, 2000

The Honorable Ellen S. Seidman
Director
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552

Dear Director Seidman:

The Office Thrift Supervision has recently offered for comment proposed regulations to implement section 711 of the Gramm-Leach-Bliley Act, "CRA Sunshine Requirements." At my request, the legal staff of the Senate Committee on Banking, Housing, and Urban Affairs conducted a careful and comprehensive evaluation of the proposed regulations in light of the plain language of the statute and the legislative history. I am attaching for your consideration a copy of Committee Counsels' memorandum on that evaluation.

The memorandum presents a troubling set of findings. It highlights six particular areas which, when taken together, would seem to render the provisions of section 711 totally ineffective in meeting the purposes for which Congress adopted them. Moreover, the fault does not seem to lie with the legislation, but rather with the proposed regulations, which the legal staff finds to be either contrary to the statute or providing avenues for parties to avoid compliance with the statute's requirements.

Inasmuch as I know that you join with me in support of the purposes of section 711 and as a matter of practice are careful to exercise great care to give force to the acts of Congress, I wanted to share the memorandum with you. I would appreciate any comments that you might have on the analysis. If we are to bring the people who actually live in the communities into the Community Reinvestment Act process, and give them the power to know and monitor what is said and done in the name of their interests, these regulations must not be allowed to go forward until these defects are corrected.

Yours respectfully,

PHIL GRAMM
Chairman

MEMORANDUM TO THE CHAIRMAN

Committee on Banking, Housing, and Urban Affairs

United States Senate

From: Linda L. Lord, Chief Counsel
Dina Ellis, Counsel

July 13, 2000

THE PROPOSED INTER-AGENCY REGULATION IMPLEMENTING SECTION 711 OF THE GRAMM-LEACH-BLILEY ACT (CRA SUNSHINE REQUIREMENTS)

Issue

On May 10, the Federal banking agencies proposed for comment regulations implementing Section 711 of the Gramm-Leach-Bliley Act (Public Law 106-102). Section 711 adds a new Section 48 to the Federal Deposit Insurance Act, embodying the "CRA Sunshine Requirements." We have carefully reviewed these proposed regulations, carefully comparing them with the statute and the legislative history. In our view, several of the interpretations of this provision in the proposed regulations would create significant loopholes, resulting in potential serious evasions of the law. In addition, the manner or context in which issues are presented in the proposed regulations suggests the potential for other unauthorized dilutive interpretations of the law.

Background

Section 711 creates a new Section 48 of the Federal Deposit Insurance Act (12 USC 1831y). Generally, Section 711 requires disclosure and annual reporting of written contracts, arrangements, and understandings entered into by an insured depository institution or affiliate and a nongovernmental entity or person "pursuant to or in connection with the fulfillment of the

Community Reinvestment Act" where the insured depository institution or affiliate provides cash payments or other consideration with an aggregate value of more than $10,000 in any year, or loans with an aggregate value of more than $50,000 in any year. For purposes of this memorandum, such agreements are referred to as "covered agreements."

Specific Concerns

1. The proposal would exclude from the definition of a covered agreement a unilateral pledge by an insured depository institution or affiliate to contribute funds for community development. The proposed exclusion of unilateral pledges from covered agreements creates a significant loophole to the disclosure and reporting requirements of the law. Under the law, a covered agreement can take the form of "any written contract, written arrangement, or *other written understanding*."[1] For example, Bank A, which has experienced CRA protests in the past, and intends to grow by further acquisitions, may decide to pledge $100,000 to CRA Group X. The pledge may be memorialized in written form. The proposed regulation would exclude that pledge from qualifying as a covered agreement. That would be incorrect. The unilateral pledge may, in fact, be a written understanding. Bank A's decision to make the unilateral pledge may be the result of its desire, based upon its past experiences, to prevent CRA Group X from protesting future acquisitions and delaying the completion of those transactions. Any decision simply to exclude unilateral pledges from the CRA sunshine requirements creates a significant loophole and would violate Section 48(h)(1) of the Federal Deposit Insurance Act, which directs that the regulations be "reasonably designed to *ensure and monitor* compliance with the requirements of [section 48]."[2] (Emphasis provided.) Instead, it would be a blueprint for CRA participants to replace a signed agreement with a written pledge sealed with a knowing wink.

2. The proposal would exclude from the definition of a covered agreement a commitment by an insured depository institution or affiliate to make CRA loans over a period of time. Section 48(e)(1)(B)(ii) of the Federal Deposit Insurance Act[3] generally excludes from a covered agreement: (1) mortgage loans; (2) a *specific* contract or commitment for a loan to individuals, businesses, farms or other entities, if the funds are loaned at rates not substantially below market rates and if the purpose of the loan or extension of credit does not include any relending of the borrowed funds; and (3) an agreement with a nongovernmental party who has not commented on, testified about, or discussed the Community Reinvestment Act of 1977 with the institution. If Bank B makes a general commitment to CRA Group X that it will make $1 million in community development loans over a 3-year period, that general commitment is *not* excluded from the disclosure provisions of Section

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[1] 12 USC 1831y(e)(1)(A).

[2] 12 USC 1831y(h)(1).

[3] 12 USC 1831y(e)(1)(B)(ii).

48. The term "specific" within subsection 48(e)(1)(B)(ii) clearly modifies the terms "contract" and "commitment." Any decision simply to exclude general commitments from the CRA sunshine requirements would exclude some of the very agreements intended to be covered by the statute and clearly comprehended by the terms of the law.

3. <u>The proposal would exclude certain other agreements as a result of an inappropriately narrow interpretation of a "CRA contact."</u> The proposal seeks comment on whether qualifying CRA contacts should be those limited to a certain time frame prior to or following the execution of a covered agreement. Section 48(e)(1)(B)(iii) of the Federal Deposit Insurance Act[4] excludes from covered agreements "any agreement entered into by an insured depository institution or affiliate with a nongovernmental entity or person *who has not commented on, testified about, or discussed with the institution, or otherwise contacted the institution, concerning the Community Reinvestment Act of 1977.*" (Emphasis provided.) Specifically, the proposed regulation asks whether there should be a "temporal relationship" between a CRA contact and the time when an agreement is made. For example, if CRA Group X discussed the CRA with Bank C two years ago, has not discussed the CRA with the Bank since that time, and then receives a $100,000 grant from the Bank, the proposal suggests that the exclusion would apply. The law does not provide any such "temporal relationship."

Moreover, the proposed regulation suggests that CRA contacts be limited to those where CRA-related comments or testimony are given to a government agency, or discussions with an insured depository institution or affiliate relate to providing (or refraining from providing) such comments or testimony to a government agency. If this interpretation were adopted, CRA Group X could simply not provide testimony or comments to a government agency and avoid the types of discussions with Bank D constituting a CRA contact under the proposed regulation. Instead, CRA Group X would engage in other types of CRA contacts with Bank D, or encourage, motivate, or direct third parties to make the "qualifying" CRA contacts with a government agency or the Bank, or reserve its CRA comments to discussions in public fora, letters to shareholders, public demonstrations or protests, or any of a variety of other avenues, all legitimate avenues of communication, but all of which are comprehended in the statute but potentially excluded by the proposed regulation. A subsequent agreement for funds would be CRA related, but could escape the reporting requirements under the law. This result significantly narrows the scope of the sunshine requirements, and paves the way for CRA groups to engage in many types of CRA contacts without ever becoming subject to the law's reporting requirements.

4. <u>The proposal would create disparities in required disclosures based upon whether there were "specific" or "general" application of funds received from an insured depository institution.</u> With respect to funds from a financial institution that are allocated for a "specific purpose," the proposal states that a CRA group need only disclose the purpose for which the funds were received and the amount used for the specific purpose. For example, under the proposed regulation, if CRA Group

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[4] 12 USC 1831y(e)(1)(B)(iii).

X received $15,000 for a financial education program, then the group would only need to disclose that it received the $15,000, spent $15,000 for the program, and generally what the program is about, not the details required by the law, such as compensation, administrative expenses, travel, entertainment, consulting and professional fees paid.[5] This would nullify the effect of the statute for a significant class of parties, and, with the regulation serving as a blueprint for evasion, a class that may be expected to grow.

The more detailed or itemized categories of reporting would apply under the proposed regulation only in cases where funds are received for "general" purposes. *This division is not a concept found in the Act.* The provision of law enabling the regulators to prescribe regulations to prevent an undue burden on reporting parties does not justify or otherwise support the creation of disparate reporting requirements. Under this interpretation, CRA Group X would merely arrange to receive funds for a "specific" purpose, requiring minimal disclosure. Yet, it was the clear intent of the sunshine provisions to allow people in communities to know precisely what purposes the CRA commitments are intended to serve and to monitor carefully whether those purposes were being met. This proposed regulation could frustrate that effect of the law.

5. The proposal invites evasions of the dollar thresholds for reporting. The proposed regulation requests comment on how the dollar thresholds in the statute should be applied in situations where an agreement does not have a specific term or does not specify a timetable for disbursement of funds under the agreement. The regulators state, "For example, if an agreement provides that an insured depository institution will make $40,000 in grants over a 5-year period, but does not specify the years in which the grants will be made, should the rule create a presumption that the entire sum is provided in the first year of the agreement or assume that the value is paid in equal yearly installments of $8,000." Under this interpretation, no reporting by the recipient would be required since the threshold for grants mentioned in the statute is $10,000. The law does not, however, allow for evading the reporting requirements by "amortizing" the amounts of the agreement to get the agreement below the *de minimis* limits. This interpretation would create a significant loophole all too easy to exploit by any party seeking to avoid compliance with the law.

6. The proposal allows evasions of disclosure requirements for those years in which funds are not received under a covered agreement. The proposed regulation does not require that the filing of an annual report with respect to a particular covered agreement for any fiscal year during which funds are not received under the covered agreement. For example, if Bank E agrees to invest $100,000 in CRA Group X over 3 years, making the entire payment in the third year, disclosure by CRA Group X would occur only in the third year. Similarly, if the terms of a covered agreement provide for $25,000 payments to CRA Group X for each of 5 years, but CRA Group X structures the payments so that it receives no more than $10,000 in years one and two, there would be no disclosure by CRA Group X for those two years. Such an interpretation would create a significant and easily exploitable

[5] 12 USC 1831y(c).

loophole, one not provided by the statute.

Conclusion

The purpose of section 711 of the Gramm-Leach-Bliley Act generally is to require full disclosure of CRA agreements by both insured depository institutions and recipients of funds pursuant to covered agreements. The elements of a covered agreement include the nature of the parties involved, a written agreement or understanding made pursuant to the CRA, and the satisfaction of stated dollar thresholds.

The specific concerns discussed in this memorandum identify some of the more egregious interpretations of the proposed CRA sunshine regulations. Should these interpretations be adopted in the final rule, enforcement of the CRA sunshine statute will be significantly impaired.

Singly, and in their entirety, the exclusion of unilateral pledges and general commitments from the definition of a covered agreement; the exclusion of other agreements because of CRA contacts lacking a "temporal relationship" to the agreement; the narrowing of qualifying CRA contacts; the creation of disparate reporting requirements based on "specific" or "general" applications of funds; and the manipulation of reporting requirements allowing persons to evade disclosure, provide an ample menu of options for evading the provisions of the law. Our analysis of existing CRA agreements finds not a single example that could not be easily restructured so as to make use of the proposed regulation and avoid any reporting requirements at all. Such a result, unintended though it may be, is contrary to the letter and intent of the statute and clearly is a violation of section 48(h)(1) of the Federal Deposit Insurance Act, which directs that the regulations be "reasonably designed to *ensure and monitor* compliance with the requirements of [section 48]."

The rulemaking power granted to administrative agencies charged with the administration of a Federal statute is not the power to make law or to nullify the law. Rather, it is the responsibility to carry into effect the will of Congress as expressed by the statute. Were the regulatory agencies to implement the regulations with the problems noted above, they would not be meeting that responsibility.