Center for Community Change

(40)

July 17, 2000

Communications Division
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20019
ATTENTION: DOCKET NO. 00-11

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th and C Streets, NW
Washington, DC 20551
RE: DOCKET NO. R-1069

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
ATTENTION: COMMENTS/OES

Manager, Dissemination Branch
Information Management & Services Division
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
ATTENTION: DOCKET NO. 2000-44

RE: COMMENTS ON THE PROPOSED "CRA SUNSHINE" REGULATIONS

Dear Madam/Sir:

These comments are submitted on behalf of the Center for Community Change ("CCC" or "the Center"). The Center is a national, non-profit organization that provides technical support to grassroots community groups on low income and minority communities, in both urban and rural areas, across the country. For more than two decades, the Center's work has included helping groups assess the credit needs in their communities, evaluate the performance of local lenders in responding to those needs, and developing and implementing reinvestment strategies. The Community Reinvestment Act (CRA) has been a critical tool for the local organizations with which the Center works.

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In addition to its technical assistance work, the Center also plays a role in public policy, particularly with respect to legislative and regulatory proposals that would affect the efforts of grassroots organizations in their local communities. The Center was an active participant in the legislative debate on the Gramm-Leach-Bliley Financial Services Modernization Act, including the so-called "CRA Sunshine" provision, which provided the impetus for these proposed regulations.

The legislative sponsors of the "Sunshine" provision argued vociferously that it was needed because CRA was being used as a tool of coercion by community groups against banks. The alleged result was that institutions were being forced to make cash payments of various sorts, against their will and against their better business judgment, in order to receive satisfactory or better CRA ratings or to have their applications for deposit facilities approved by the federal banking regulators.

This argument is not supported by the reality of the way CRA is – now and historically – implemented and enforced by the federal banking regulators. Of the thousands of institutions subject to the law, only a handful (2-3%) receive less than satisfactory ratings. Applications for deposit facilities filed by banks and thrifts are routinely approved, generally within the allotted timeframes and with no CRA-related conditions attached, regardless of the comments filed by community groups, public officials, and others about the CRA performance of the institutions involved.

Perhaps even more important, while the legislative sponsors of this provision alleged improper coercive use of the Community Reinvestment Act, the fact of the matter is that they never provided a shred of evidence to support this allegation. They may have prevailed in the legislative process, but they did not prove their point. Nonetheless, this provision is likely to have an extremely detrimental effect on the revitalization efforts of urban and rural communities all across the country. CRA has stimulated partnerships between banks and community-based organizations, small businesses, public officials and others that have opened up access to mainstream financial services, helped thousands of people become homeowners, provided countless jobs, and improved the quality of life in many communities. Its simplicity and flexibility have been some of CRA's best features. Attaching onerous disclosure and reporting requirements to this law will have a crippling effect. In developing regulations to implement this provision, the agencies should keep in mind the fact that it addresses a problem that does not exist, yet may do tremendous damage to a law that has been, in many respects, a great success.

The Center's specific comments on the regulations follow.

1. Definition of covered agreement

    a. **Meaning of "material impact."** The statute sets out a series of factors to apply in determining whether or not a particular arrangement is a "CRA agreement" for the purposes of the statute and regulations. It must be in writing, include as a party an insured depository institution or its affiliate, involve monetary consideration above specified levels, and be made "in

fulfillment of CRA." Certain exclusions are also provided. The term "in fulfillment of CRA" is defined in Sec. 711(e)(2) as "a list of factors that the appropriate Federal banking agency determines have a material impact on the agency's decision –

(A) to approve or disapprove an application for a deposit facility...; or

(B) to assign a rating to an insured depository institution under section 807 of the Community Reinvestment Act of 1977.

The agencies are directed to enumerate a list of the factors that they would consider relevant in evaluating the performance of a bank or thrift under CRA. However, it is important to distinguish between the factors that are relevant and the level of activity relating to any factor that would have a *material impact* on the institution's CRA rating or on a decision to grant or deny an application for a deposit facility.

The agencies have stated clearly the factors that they rely upon to make decisions about applications covered by CRA, and the role that commitments for future action will play in their decision-making process. As far back as 1989, they noted publicly their expectation that "applicants should address their CRA responsibilities and have the necessary policies in place and working well before they file an application." (See "Statement of the Federal Financial Supervisory Agencies Regarding the Community Reinvestment Act," March 21, 1989, p.18.) The same policy statement says that "commitments made in the applications process cannot be used to overcome a seriously deficient record of CRA performance." Thus, it is a bank's ongoing performance that is important, not commitments that may be made at the last moment when an application is pending. Such commitments would not have a material impact on the decision to grant or deny the application.

The 1989 Policy Statement also addressed the elements that banks should consider in designing a program to achieve satisfactory performance under CRA. Although the CRA regulations have changed, the elements described in the Statement have remained relevant for successful efforts under CRA. In this context, as in the context of applications, the regulators stated that, while they support "special or pilot lending programs earmarked for low- and moderate-income neighborhoods, consistent with safe and sound lending practices, the scope of any such program is properly addressed by the financial institution itself, taking into account its own expertise and financial capabilities. This is particularly true of any targeted goals established for such a program, which may represent a statement of the institution's expectations of services to be provided based upon actual loan demand, market conditions, and other factors." In other words, it has been the regulators' view that the bank has the discretion and responsibility to decide what and how much activity to engage in for CRA purposes, not outside parties.

Both in the 1989 Policy Statement and in their actions in the intervening years, the agencies have made it extremely clear that they neither require nor expect banks to enter into agreements with community groups or anyone else in conjunction with CRA-covered applications, that such agreements are not necessary to achieve a satisfactory CRA rating, and that they do not review performance under such agreements either in connection with applications or as part of the CRA examination process.

Thus, it is clear that individual CRA agreements cannot and do not have a material impact on the agencies' decisions on applications or on CRA ratings. These regulations should properly be constructed to exclude any agreement entered into by a bank or its affiliate unless the absence of that agreement would result in an application being denied or receiving a conditional approval, or the bank receiving a lower CRA rating.

b. **Definition of "CRA contact."** If the agencies are unwilling to define material impact in a manner consistent with their actual regulatory practice, then the definition of "CRA contact" becomes the single most critical factor in determining what is or is not a covered CRA agreement. In this context, the term "CRA contact" refers to the language in Sec. 711(e)(1)(B)(iii), excluding from the definition of a CRA agreement any agreement with a 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."

Constructing a definition of "CRA contact" poses a number of significant challenges. To be workable, it must provide certainty to the parties, which means it must be relatively simple and straightforward. Otherwise, both lenders and others may avoid entering into useful and constructive partnerships because they cannot be sure whether or not such partnerships will subject them to disclosure and reporting requirements.

The definition must also avoid creating situations where parties may "game the system" and time their contacts explicitly to avoid coming under the provisions of the regulation, or deliberately avoid referring directly to CRA or the bank's record of performance in contacts that would otherwise clearly be classified as CRA contacts. Further, it must avoid creating disincentives for members of the public to raise their concerns about banks' performance under CRA or participate in the regulatory process. Public involvement has been an essential element in the agencies' ability to carry out their CRA enforcement duties effectively. It has also been essential in focusing banks' attention on problem areas in their performance and in helping banks develop effective programs to meet community credit needs. Any definition of CRA contact that creates a disincentive for the public to speak up, or for banks to enter into partnerships with people or organizations that do, will severely undermine the effectiveness of the CRA. It will undo two decades' worth of progress in addressing some of the most pressing and persistent problems facing our country.

Finally, the effort to delimit a timeframe within which contacts would be deemed "CRA contacts," as has been suggested in the draft regulations, fails to accurately reflect the time periods that are relevant for evaluating a bank's performance, either for assigning a CRA rating or deciding on an application. In terms of ratings, the relevant period is the entire time between the previous exam and the current examination, not simply the time between when the exam schedule is published and the examination actually takes place. Any contact that occurs within this period may have an impact on the bank's rating.

The bank's most recent evaluation and rating, in turn, are the single most critical CRA-related factor in decisions on applications. Thus, once again the relevant time period is much longer than the proposed standard of the time during which an application is pending with one of the federal banking regulators. For that matter, a contact that takes place between the time an acquisition is announced and an application is actually filed, or while a bank is contemplating an acquisition that has yet to be announced publicly, is likely to have as much impact as one that occurs after the application has actually been filed. A definition that distinguishes between these situations is arbitrary and unfair.

It is the Center's view that there is no way to narrow the definition of a CRA contact that is simple, fair and effective. Thus, the better alternative is for the agencies to develop a broad definition for a "CRA contact," one that encompasses any partnerships a bank enters into that would be considered as part of its CRA performance. This approach would recognize that banks consider CRA in a broad range of situations, large scale and small scale, when a application or exam is upcoming and when none is pending. It is an integral part of the banking business, and is a factor that enters into a wide variety of business decisions. It is virtually impossible to draw a line and single out any subset of these decisions and say that they are somehow significantly different in a way that deserves different regulatory treatment.

2. Reporting requirements

   a. **Use of IRS Form 990.** The Center strongly supports the proposal to allow non-bank parties to CRA agreements to satisfy their reporting requirements by submitting their federal tax returns (Form 990), financial statements, annual reports, or other documents prepared on a routine basis. This is consistent with the statutory mandate, laid out in Sec. 711 (h)(2)(A) of the Gramm-Leach-Bliley Act, which directs the regulators to "ensure that the regulations...do not impose an undue burden on the parties..." If parties to CRA agreements were required to establish new systems to track their expenditures separately for each funding source, and to create new financial reports simply to satisfy the requirements of the CRA "Sunshine" provision, the result would be extremely expensive, cumbersome, and highly burdensome. Further, the proposed scheme is consistent with the legislative

history as provided in the conference report on S. 900, which states the conferees' concerns that the regulatory burden created by this provision be minimized, and states the intention of the Managers that non-governmental parties to CRA agreements may fulfill their reporting requirements by the submission of their annual audited financial statements or their Federal income tax returns.

b. **Reporting on funds for specific purposes.** The regulations propose a separate reporting requirement for funds provided to non-governmental entities under CRA agreements that are used for purposes other than general operating support. The proposed rule would require parties to show the amount of such funds received in any year and describe the uses to which they were put. However, the distinction between general operating support and specific purpose funds is far from clear, and is likely to create significant confusion among parties to CRA agreements, not to mention considerable numbers of inquiries to the regulators for determinations as to whether particular funds should be considered general operating support or specific purpose funds. Such confusion may lead some to report improperly under the proposed scheme, categorizing specific purpose funds as general support, or vice versa. At best, this might force the parties to redo their reports and file more than once, creating unnecessary burden. At worst, improper reporting arising out of confusion may subject parties to liability if they are deemed to be in willful and material non-compliance with the regulations.

Indeed, one of the examples provided in the preamble to the proposed rule illustrates this point. The example discusses an organization that receives a $50,000 grant from a bank, and decides to apply $5,000 to general operations and use $45,000 to purchase computer equipment. The example states that the organization would file its tax return or comparable document to show how the $5,000 was spent, and provide a separate statement about the $45,000 spent on computers. However, from the perspective of the group, funds that it has the discretion to determine how to spend would certainly be considered general operating support. Thus, community groups would likely expect the full $50,000 to be considered general support. Since expenditures for equipment are reflected on financial statements, including the Form 990, it is not unreasonable to expect groups to view their financial statements as accurately reporting the expenditure on computers. A group making a good faith effort to comply with the requirements might well report the wrong information in this case. Undoubtedly, there are many other situations where two observers would reach different conclusions as to whether particular funds should be considered specific purpose or general purpose.

Since all funds that organizations receive must be reflected in their financial statements, we suggest that the special reporting requirements for specific purpose funds be dropped, and that the Form 990 or comparable document be

permitted as acceptable documentation of the expenditure of any and all funds received by non-governmental organizations under CRA agreements.

c. **Eligibility for consolidated reporting.** The statute directs the regulatory agencies to "establish procedures to allow any nongovernmental entity or person who is a party to a large number of agreements...to make a single or consolidated filing of a report..." on the funds they receive under the agreements. The rule, as proposed, would set five as the number of agreements that would trigger the consolidated filing option. This number is too high. It creates a situation in which parties to between two and four agreements face a greater reporting burden than parties to five or more agreements. This standard will place the greatest reporting burden on smaller organizations, which are likely to have the fewest resources to devote to compliance. CCC recommends that any nongovernmental entity that is party to two or more agreements be eligible for consolidated reporting.

It appears that this area is one in which the agencies believe they have some discretion, as the rule also proposes to extend the option for consolidated reporting to insured depository institutions, for which the statute makes no provision. If discretion can be exercised to benefit lenders, who have far greater resources, it should also be exercised to minimize the burden on small organizations. Allowing groups that are party to two or more agreements to file consolidated reports would be a reasonable way to collect the required information while simultaneously adhering to the statutory mandate to minimize undue burden.

d. **Requirements for reporting when no funds are received.** If a party to an an agreement neither received funds nor made payments under that agreement during a particular year, then that party should not be required to file a report for that year. Since there would be nothing to report, requiring a report to be filed would create needless paperwork and be counter to the statutory requirement to minimize undue burden.

e. **Calendar vs. fiscal year reporting.** If parties to agreements are to be allowed to use existing documents to satisfy their reporting requirements (their Form 990, annual audited financial statements or comparable document), as the Managers of S. 900 intended, they must be allowed to conform the reporting period to their fiscal year. Otherwise, they will be forced to undertake substantial efforts to collect and analyze financial information in ways for which their accounting systems were not set up. If the requirement were to file reports based on calendar years, an organization with a different fiscal year would be forced to go back through part of the previous fiscal year to collect and analyze records, and to essentially conduct a partial audit before the current fiscal year has been completed. This is likely to be an expensive and very time-consuming process, and will create substantial burden.

3. Disclosure of CRA agreements

a. **Procedures for disclosure.** The procedures that are proposed for disclosure of CRA agreements are reasonably simple and straightforward: lenders will make copies available to their regulators within 30 days and will place copies in their CRA public files; other parties must respond to requests for copies of agreements. It is important that the procedures not be complex, or both banks and non-governmental entities that are parties to agreements may inadvertently fail to comply with the disclosure requirements. Therefore, CCC urges the agencies not to make any changes to these procedures that would make the compliance requirements more complicated.

b. **Reasonable copying and mailing fees.** The provision allowing not just banks, but also non-governmental entities, to charge reasonable fees for copying and mailing agreements to people who request them is important to mitigate the potential burden of disclosure for small organizations with limited resources. The time and expense of copying and mailing multiple documents may be considerable for smaller groups, particularly if they are party to a number of agreements. Organizations should be allowed to recoup this cost, as the regulation proposes to do. CCC fully supports this provision and recommends that it be kept unchanged in the final regulation.

c. **Confidential and proprietary information.** The proposed regulation would allow parties to CRA agreements to withhold from public disclosure those provisions that would be protected under the Freedom of Information Act, which provides considerable protection to information obtained from businesses and individuals, and in particular, records related to the examination, operation or condition of financial institutions subject to federal regulation. However, in the preamble to the proposed regulation, the agencies suggest that, in practice, a lesser standard may apply, and that nearly all provisions of CRA agreements would be subject to public disclosure.

This position poses a potential threat to the "research and development" process that has been such an important product of CRA. Over the years and through partnerships with community groups and otherss, lenders have experimented with a variety of loan products and other banking products and services, modifying underwriting standards, pricing, marketing and other factors to increase the availability and affordability of credit in low and moderate income communities. To the extent that the disclosure requirement decreases lenders' comfort level with experimentation, it will undermine the impact and the purpose of CRA.

Further, the statute explicitly requires the agencies, in promulgating implementing regulations, to ensure that proprietary and confidential information is protected. (See Sec. 711(h)(2)(A)) To carry out this element

of the statutory mandate, the agencies must adopt a broader, rather than a narrower, view of what information should be considered confidential and proprietary.

d. **Duration of disclosure obligation.** The regulation proposes that the obligation to disclose CRA agreements upon request would extend for 12 months after the expiration of the agreement. However, there is no rationale for creating an obligation related to an agreement that extends beyond the existence of the agreement itself, particularly since copies of any agreement would still be available from the regulators. CCC recommends that this provision be amended, and that the public disclosure requirement end with the expiration of the CRA agreement.

e. **Notification about agreements.** Unless the agencies revisit the question of how to define "material impact" with respect to determining which arrangements are "CRA agreements" for the purposes of the statute and this regulation, many individuals and organizations that work with lenders may have "CRA agreements" and not be aware of that fact. Their lack of familiarity with the regulations may expose them, unwittingly, to liability if they fail to disclose and report in conformance with the regulation. The same is not likely to be true for insured depository institutions and their affiliates, which have regular contact with the regulators and many opportunities to become acquainted with the existence and complexities of the regulation. To address this problem, CCC suggests that lenders be required to inform nongovernmental entities when the lender believes that an arrangement into which the parties have entered would be considered a "CRA agreement" subject to disclosure and reporting requirements.

f. **Retroactive application of disclosure requirements.** The statute dictates that agreements entered into after the date of enactment (and before promulgation of these regulations) are subject to the disclosure requirement, although agreements entered for six months after enactment (i.e., before May 12, 2000) are not subject to the annual reporting requirements. The retroactive applicability of the disclosure requirement is not widely understood, and CCC recommends that the agencies undertake an broad effort to publicize this fact. They should encourage banks to notify their nongovernmental partners, and they should communicate directly with community-based organizations and others who may be subject to this provision. In the absence of such a publicity effort , many organizations may find they are in non-compliance and their agreements deemed unenforceable.

In sum, the Center urges the federal banking regulators to develop regulations that are simple and straightforward, so as to create certainty for all involved. Further, we urge the agencies to be very careful not to take steps that would have a chilling effect on the ability or willingness of the public to voice its viewpoints and concerns about local credit needs or banks' performance in helping to meet those needs. To do so would be to strike

a blow at the very core of CRA, the process of dialog that has led to so many important innovations and so many effective partnerships. The ultimate effect would be to halt, or even to reverse, two decades' worth of progress in improving the lives of low and moderate income people in this country.

Thank you for the opportunity to submit these comments. We will be happy to discuss any of these points in more detail.

Sincerely,

Deborah Goldberg
Acting Director
Neighborhood Revitalization Project