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April 29, 2004

Regulation Comments, Attention: No. 2004-04
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street NW
Washington DC 20552

To Whom It May Concern::

The 18,000 member cities of the National League of Cities (NLC) appreciate the opportunity to comment on proposed regulations entitled *Community Reinvestment Act Regulations, 69 Fed. Reg. 5729 (Feb. 6, 2004).* The notice of proposed rulemaking was issued jointly by the Office of the Comptroller of Currency (OCC), the Board of Governors of the Federal Reserve (Board), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision, Treasury (OTS), hereafter referred to collectively as "the agencies."

I. NLC's 2004 National Municipal Policy Calls for Strong Agency Enforcement of the Community Reinvestment Act (CRA) and Other Predatory Lending Laws.

NLC believes that financial institutions strongly influence current and future capital investments and economic development throughout local economic regions. They play a critical role in the development and long-term economic health of our communities. Without reasonably equal and fair access to capital, many low- and moderate-income groups and communities would continue to under perform economically. For this reason, the federal government must remain an active player in influencing the direction of the financial industry's lending practices. The federal government can only play this role through appropriate regulation and oversight. This oversight must include all financial institutions including commercial banks, mortgage lenders, savings and loan institutions, mutual savings banks, credit unions, and industrial banks.

II. The Purpose of the CRA is to Ensure Financial Institutions Meet the Deposit and Credit Needs and Convenience of Low- and Moderate-Income Communities.

The Community Reinvestment Act (CRA)[1] and its implementing regulations have been particularly useful tools in maintaining this oversight. CRA has been instrumental in increasing access to homeownership, boosting economic development, and expanding small businesses in the nation's minority, immigrant, and low- and moderate-income communities. It has had the effect of creating productive investment in cities and reducing urban blight. The federal government must remain committed to the intent and application of this important law. For this

y Reinvestment Act of 1977, 12 U.S.C. 2901 *et. seq.*

reason, NLC supports vigorous enforcement of the CRA. Moreover, NLC will oppose any federal efforts to weaken or eliminate the CRA, or efforts to create safe harbors for financial institutions.

In enacting the CRA, Congress found that "regulated financial institutions are required by law to demonstrate that their deposit facilities serve *the convenience and needs* of the community in which they are chartered to do business."[2] (*Emphasis added*). The convenience and needs of communities includes "the need for credit services as well as deposit services." [3] Therefore, Congress concluded the purpose of the CRA was to require the agencies to use their regulatory authority when examining financial institutions, "to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions."[4]

As will be discussed later in this comment, many of the proposed regulatory changes appear to be inconsistent with the purposes of the Act. Instead of enhancing the agencies' ability to oversee and ensure that regulated institutions demonstrate that they serve the "convenience and needs" of the communities in which they are chartered, the proposed regulations weaken that ability by lessening CRA reporting requirements for over 1,100 financial institutions. Additionally, the proposed regulations weaken screens against predatory lending by failing to take into account all instances of predatory lending.

III. NLC Opposes The Proposed Rule Change Because It Undermines the Intent of the Community Reinvestment Act and Fails to Update Exam Procedures.

NLC opposes the proposed rule change for three reasons. First, the rule increasing the asset threshold definition for a small institution would allow too many financial institutions to escape the most stringent and appropriate CRA review. Second, the proposed changes in the predatory lending standard would have the counter-productive effect of perpetuating abusive lending practices. Third, the proposed changes represent a missed opportunity for the agencies to update CRA exam procedures.

A. Increasing the Asset Threshold for the Definition Would Allow Too Many Financial Institutions to Escape Appropriate CRA Review.

The proposed rule would change the definition of "small institution" to mean financial institutions with less than $500 million in total assets, without regard to the assets of any holding company. The previous definition for a "small institution" was any financial institution with less than $250 million in assets.[5] The former definition also took into account the assets of a financial institution's holding company (i.e., the institution would be subject to CRA examination if its holding company had more than $1 billion in assets).

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[2] 12 U.S.C.S. § 2901(a)(1)
[3] 12 U.S.C.S. § 2901(a)(2)
[4] 12 U.S.C.S. § 2901(b)
[5] Community Reinvestment Act Regulations, Joint Notice of Proposed Rulemaking, 69 Fed. Reg. 5729, 5731 (Feb. 6, 2004).

Under the current CRA regulations, the agencies rate large banks by performance evaluations that scrutinize these banks' level of lending, investing, and services to low- and moderate-income communities. The proposed changes will eliminate the investment and service parts of the CRA exam for banks and thrifts with assets between $250 and $500 million. There are currently 1,111 banks and financial institutions, accounting for more than $387 billion in assets, that fall into this category.

This change of definition would translate into considerably less access to banking services and capital for underserved communities. For example, CRA exams for the newly defined small financial institutions would no longer consider investment in Low Income Housing Tax Credits (LIHTC)[6] as a factor in approving applications for certification. Congress created the LIHTC program with the Tax Reform Act of 1986 as an alternate method of funding housing for low- and moderate-income households. Developers and investors must use the tax credits for new construction, rehabilitation, or acquisition and rehabilitation of rental housing.[7] Consequently, the LIHTC has been a major source of capital and leverage for loans for affordable housing projects.

Under the proposed rule, many of these newly defined small banks would have diminished incentive to make loans, especially those leveraged with LIHTC monies, for affordable housing developments located in low- and moderate-income communities. This is because the proposed rule eliminates the investment test element of CRA evaluation for a significant number of financial institutions. Without such scrutiny, these institutions are less likely to make investments in projects leveraged by LIHTC. Again, the Act mandates "each appropriate Federal financial supervisory agency . . . use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions."[8] The agencies have made no argument that applying the investment test to institutions with less than $500 million in assets would jeopardize the safety and soundness of their operations. Moreover, they have made no compelling argument that would lead one to believe these institutions would continue to make investments meeting the credit needs of low- and moderate-income communities. Therefore, the proposed rule change is inconsistent with the intent of the Act.

Additionally, under the proposed rule, the agencies would no longer scrutinize whether the newly defined small financial institutions provide bank branches, checking accounts, Individual Development Accounts (IDA), or debit card services to low- and moderate-income individuals or communities. This is because the service test element of the CRA evaluation is eliminated for these institutions. As the agencies point out, "the service test takes into account the degree to which services are tailored to meet the needs of low- and moderate income geographies, whether as "mainstream" retail banking services or community development services."[9] Without the application of the service test to these newly defined smaller institutions, the agencies have failed to explain how they will hold these institutions accountable, in the

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[6] 42 U.S.C.S. § 256, *et. seq.*
[7] About the Low Income Housing Tax Credit, Danter Company, http://www.danter.com/taxcredit/about.htm
[8] 42 U.S.C.S. §2901(b)
[9] 69 Fed. Reg. at 5734. *See also,* 12 C.F.R. §25.24 (d)(1)-(4)

manner intended by Congress, for their obligation to "demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business."[10] For this reason also, the proposed rule is inconsistent with the intent of the Act.

B. The Proposed Change in the Predatory Lending Standard Would Perpetuate Abusive Lending Practices By Failing to Curb Several Other Forms of Abusive Lending.

The proposed rule will also change CRA evaluations of predatory lending practices. Specifically, under the new rule, if certain specific evidence is found showing a financial institution or any of its affiliates, in approving or denying loan applications, "engaged in discriminatory, illegal, or abusive credit practices in connection with certain loans,"[11] such evidence can adversely affect the evaluation of that institution's CRA evaluation. The agencies contend that this change in the regulation would "better address abusive lending practices."[12]

NLC believes the agencies have provided little basis for this contention. NLC is concerned that the proposed anti-predatory lending screen will actually perpetuate abusive lending practices by shielding banks from the consequences of abusive lending. The agencies have proposed a standard that evaluates lending based on foreclosure value alone.[13] In other words, a bank's performance evaluation will only be down-graded if evidence is found connecting the bank's home mortgage and secured consumer loans to "a pattern or practice of lending based predominately on the foreclosure or liquidation value of the collateral by the bank (or affiliate, as applicable). . . ."[14] This is assuming the agencies also determine the borrowers in question cannot be expected to make the payments under the terms of the loan.[15] NLC believes this asset-based standard falls short of curbing abusive lending practices because it fails to cover many other instances of predatory lending. For example, under the proposed rule, abusive lending practices would not result in lower CRA ratings in situations where the practice strips equity without leading to delinquency or foreclosure. This generally happens when a borrower has sufficient income to pay on the terms of the note, but where the terms also contain excessive fees or unnecessary products (such as disability insurance) that make it difficult for the borrower to build equity and wealth in the collateral.

CRA exams will continue to allow abusive lending practices if the proposed predatory lending standard does not expressly address problems associated with fee packing, high prepayment penalties, loan flipping, mandatory arbitration, and other abuses. In addition, an anti-predatory standard must apply to all loans made by the bank and all of its affiliates, not just real-estate secured loans issued by the bank in its “assessment area” as proposed by the agencies. By shielding banks from the consequences of abusive lending, the proposed standard will frustrate CRA’s statutory requirement that banks serve the convenience and needs of low- and

[10] 12 U.S.C.S. § 2901(a)(1)
[11] Community Reinvestment Act Regulations, 69 Fed. Reg. 5729 at 5729
[12] Ibid.
[13] *See* 69 Fed. Reg. at 5744, 5745, 5746. (*e.g.,* §25.28(c)(1)(ii)).
[14] Ibid.
[15] Ibid.

moderate-income communities. Therefore, the rule is not consistent with the purposes of the Act.

C. The Agencies Have Missed an Opportunity to Update Exam Procedures.

NLC is concerned that the agencies missed an opportunity to close certain loopholes in the current CRA regulations. For example, under the proposed rule, banks will still be able to include or exclude affiliates at their option. Consequently, regulated financial institutions will be able to exclude from CRA review those affiliates that do not serve low- and moderate-income borrowers. Worse, these institutions may continue to exclude from review those affiliates that engage in predatory lending practices. The result is that many underserved communities and individuals will not benefit from the intended protections of the Act. This situation can only be remedied if the federal agencies require banks to subject all their affiliates to CRA review.

Finally, NLC is concerned that the proposed rule does not address the current need to update assessment areas so that geographic areas beyond bank branches are included. Today, it is not uncommon for many banks to have a considerable number of loans within their portfolios with borrowers outside the geographic territory of their branches. Under current rules, the agencies do not scrutinize through CRA exams non-branch lending activities. This situation fosters an environment that allows many financial institutions to continue predatory lending practices without the specter of regulatory penalty consequences.

IV. Provisions to Enhance Data Disclosure are Important Steps Toward Improving Consumer Ability to Evaluate Bank Service to Low- and Moderate-Income Communities.

The agencies propose to change the regulatory structure of CRA related to data disclosure in an effort to enhance "data disclosed in CRA public evaluations and CRA disclosure statements."[16] Specifically, the agencies will publicly report the specific census tract location of small businesses receiving loans in addition to the current items in the CRA small business data for each depository institution.[17] The agencies also propose to report separately on CRA exams purchases from loan originations.[18] Moreover, they will begin reporting separately high cost lending (per the new Home Mortgage Data Act (HMDA) data requirements starting with the 2004 data).[19] NLC believes these changes will improve the ability of consumers to determine if banks are serving traditionally neglected neighborhoods with small business loans.

Still, NLC believes these changes do not go far enough because the federal agencies do not propose to utilize the data enhancements in order to make CRA exams more rigorous. To make these changes truly useful, the agencies must not merely report the new data on CRA exams, but must also use the new data to give less weight on CRA exams to high cost loans verses prime loans and assign less weight for purchases verses loan originations.

[16] 69 Fed. Reg. at 5744, 5745, 5746
[17] Ibid.
[18] Ibid.
[19] Ibid.

V. Conclusion.

NLC opposes exceptions or loopholes that allow financial institutions to "opt-out" of complying with the comprehensive three-part evaluation of CRA. The provisions contained in the proposed rule streamlining exams for certain institutions and modifying anti-predatory lending standards are contrary NLC policy. NLC believes the proposals significantly threaten the CRA's statutory purpose of encouraging financial institutions to serve the needs and convenience of underserved individuals and communities.

NLC urges the agencies to include local branches and subsidiaries in CRA examinations and ratings; conduct CRA reviews on a community basis; and apply and standardize uniform CRA evaluation ratings and procedures to all lending and other financial institutions.

Conceptually, NLC views the proposed data enhancements as one step in the right direction. However, those enhancements do not begin to make up for the significant harm caused by the other proposals contained in the rule. Moreover, such data enhancements would be much more meaningful if the agencies updated procedures regarding assessment areas, affiliates, and the treatment of high cost loans and purchases on CRA exams.

Because the proposed rule weakens CRA regulatory oversight of many financial institutions, NLC opposes the joint rule and asks the agencies to consider withdrawing it. NLC, however, looks forward to working with the agencies in the future to develop new CRA regulatory structures that better and more efficiently address the needs of the financial services industry and the communities they serve.

Again, thank you for this opportunity to comment. Please feel free to contact Jon P. Heroux, Senior Legislative Counsel, at (202) 626-3025 or heroux@nlc.org for further input or questions.

Sincerely,

Don Borut
Executive Director

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