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October 17, 2001

**By Regular Mail and Electronic Mail**



Communications Division  
Public Information Room  
Mailstop 1-5  
Office of the Comptroller of the Currency  
250 E Street, SW, Third Floor  
Washington, DC 20219

Mr. Robert E. Feldman  
Executive Secretary  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, NW  
Washington, DC 20429

Attention: Docket No. 01-16

Attention: Comments/OES

Ms. Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve  
System  
20<sup>th</sup> and C Streets, NW  
Washington, DC 20551

Regulation Comments  
Chief Counsel's Office  
Office of Thrift Supervision  
1700 G Street, NW  
Washington, DC 20552

Attention: Docket No. R-1112

Attention: Docket No. 2001-49

RE: Joint Advance Notice of Proposed Rulemaking, *Community Reinvestment Act Regulations*

Dear Sirs and Mesdames:

The Federal Home Loan Mortgage Corporation ("Freddie Mac") appreciates the opportunity to provide comments on the joint advance notice of proposed rulemaking by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (collectively, the "Agencies") entitled, the *Community Reinvestment Act Regulations* ("the ANPR").<sup>1</sup>

Freddie Mac is a shareholder-owned corporation chartered by Congress in 1970 to create a continuous flow of funds to mortgage lenders in support of homeownership and rental housing. With the financing of more than 25 million home mortgages, Freddie Mac continues to fulfill our public mission by making low-cost mortgage money more available for America's families. Our continuing success results from our commitment to provide access to mortgage credit at all times, our access to worldwide capital

<sup>1</sup> 66 Fed. Reg. 37602 (July 19, 2001).

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markets to meet the housing finance needs of America's families at the lowest possible cost and our continued efforts to reduce costs and improve the mortgage finance system.

## I. GENERAL STATEMENT OF INTEREST

The ANPR "marks the beginning of [the agencies'] assessment of the effectiveness of the [Community Reinvestment Act (CRA)] regulations in achieving their original goals of (1) emphasizing in examinations an institution's actual performance in, rather than its process for, addressing CRA responsibilities; (2) promoting consistency in evaluations; and (3) eliminating unnecessary burden."<sup>2</sup> Freddie Mac looks forward to engaging in discussions with the agencies regarding lending and investment practices designed to address the credit needs of low- and moderate-income individuals and geographies in a safe and sound manner.

One of Freddie Mac's purposes is to "promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing."<sup>3</sup> Freddie Mac purchases affordable mortgage portfolios originated by insured depository institutions as part of our affirmative obligation to facilitate the financing of affordable housing for low- and moderate-income families. Historically, many depositories have held affordable mortgage portfolios on their balance sheets in whole-loan form due to limitations that made these loans difficult to sell into the secondary market. To help overcome these limitations, Freddie Mac has developed credit enhancements that offer depositories the means to profitably sell these loans to us for cash, through securities swap executions, and in conjunction with Real Estate Mortgage Investment Conduit (REMIC) transactions. These transactions provide depositories with immediate liquidity and enable them to undertake additional targeted affordable lending activity.

Mortgage-backed securities (MBS) have become a popular vehicle for financial institutions to invest in their communities. Mortgage securities play a crucial role in housing finance, making financing available to home buyers at lower costs and ensuring that funds are available throughout the country. The MBS market is enormous, with the volume of outstanding MBS exceeding \$3.8 trillion. Investors include corporations, banks and thrifts, insurance companies and pension funds. MBS are popular because they provide a number of benefits to investors including liquidity, yield and capital management flexibility. Standard MBS also provide issuers and investors with the benefit of geographic diversity, which reduces the credit risk of the security.

Over the years, Freddie Mac has developed extensive experience in assisting depositories in meeting their CRA objectives. Freddie Mac provides depositories with

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<sup>2</sup> 66 Fed. Reg. 37,603.

<sup>3</sup> 12 U.S.C. at Note to 1451 (b)(4) (1992).

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expert assistance in structuring securities that help them achieve their CRA lending and investment goals through the securitization of flow and portfolio mortgage loans and the provision of targeted MBS and Collateralized Mortgage Obligations (CMO). Given our level of activity in this market, we have observed growth opportunities and limiting constraints operating in the CRA securities market, in part reflecting the regulatory incentives and limits that the agencies' CRA regulations create.

We are specifically focused on expanding affordable housing financing through the development of a more market-oriented treatment of the "qualified investment" test in the CRA regulations. We believe that such development can spur investor demand and thus, increase affordable housing lending to benefit low- and moderate-income individuals. In the past we have observed that, for reasons relating to safety and soundness and regulatory capital management, insured depository institutions have a strong incentive to invest in highly rated, low risk and liquid securities that help meet the credit needs of the institution's assessment area or a broader statewide or regional area. We build upon this previous observation, and as a result, offer for agency consideration our views on how the CRA regulations could enhance certain institutions' abilities to meet the credit needs of low- and moderate-income individuals and neighborhoods.

The agencies have determined that investments in MBS designed primarily to finance community development generally are considered qualified investments.<sup>4</sup> We agree with the agencies in recognizing the CRA value of these MBS investments in spurring additional low- and moderate-income lending.

## II. OVERVIEW OF COMMENTS

Freddie Mac submits the following comments on the ANPR:

1. We recommend that the agencies study the result of the current treatment of qualified investments for certain institutions that offer product lines on a national basis and consider whether further flexibility is warranted. These institutions include wholesale and limited purpose institutions, institutions that use the Internet almost exclusively to gather deposits and deliver services, and large retail institutions with a national presence.

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<sup>4</sup> See Community Reinvestment Act Interagency Questions and Answers Regarding Community Reinvestment, 66 Fed. Reg. 36,629 (July 12, 2001) (Q and A 2 addressing the meaning of "qualified investments" under 12 C.F.R. §§ 25.12(s), 228.12(s), 345.12(s), and 563(e).12(r)). See also OCC Interpretive Letter No. 794 (August 11, 1997) (specifically holding that Fannie Mae, Freddie Mac and Ginnie Mae MBS are qualified investments if composed of mortgages meeting CRA guidelines).

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2. We recommend that the agencies retain the current treatment of loan originations and loan purchases under the Lending test because such treatment effectively advances CRA purposes.
3. We recommend that the agencies consider the benefits of allowing institutions to voluntarily opt to apply the Lending test to MBS purchases that are backed by loans to low- and moderate-income individuals.

### III. FREDDIE MAC'S COMMENTS ON THE ANPR

- A. *The agencies should consider studying the benefits of developing a more flexible approach to the treatment of qualified investments for institutions that offer product lines on a national basis.*

In the Preamble to the final CRA rule, the agencies noted that many commenters maintained that the limitations placed on considering activities outside of an institution's delineated assessment area were too restrictive and did not account for the broader business strategies and operations of wholesale and limited purpose institutions, which often serve communities on a nationwide basis. As a result of those articulated concerns, the final rule removed the specific limitation that community development activities outside an institution's assessment area be considered in an amount only up to the amount of activities within the institution's assessment area.<sup>5</sup> Thus, wholesale and limited purpose institutions may receive positive consideration for community development loans and qualified investments wherever they are located, so long as the institutions otherwise have adequately addressed the credit needs in their assessment area. During this consideration, the agencies further opined that, unlike other institutions, wholesale and limited purpose institutions typically draw their resources from, and serve areas well beyond, their immediate communities.<sup>6</sup>

We believe this is an appropriate time for the agencies to revisit the current limitations on both geographic limits on qualified investments and the types of institutions that are eligible to receive credit for qualified investments benefiting areas outside of a given assessment area. The agencies have several years of experience interpreting the CRA regulations. The trend in financial services is for large regional banks or thrifts to be absorbed within depositories having a market presence that is virtually throughout the nation. This trend suggests that today there

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<sup>5</sup> Under the current regulatory scheme, the agencies consider the qualified investments of wholesale and limited purpose institutions that benefit areas outside the institution's assessment area(s) only if and to the extent the institution has adequately addressed the needs of its assessment area(s). 12 C.F.R. §§ 25.41(e)(2), 228.25(e)(2), 345.25(e)(2), and 563(c).25(e)(2).

<sup>6</sup> 60 Fed. Reg. 22155, 22161 (May 4, 1995). The Preamble may be found at: <http://www.fdic.gov/regulations/community/community/crapreamb.txt>

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likely are many more large, well-capitalized institutions for which binding geographic limitations on investments may inhibit competitive allocation of CRA-earmarked investment funds than were in existence when major CRA regulatory revisions were last effected.

We would like to join the agencies in researching and studying these sets of issues to determine whether we can design regulatory policies that meet the needs of each local neighborhood while spurring a greater overall investment of low-cost capital in underserved communities throughout the nation. For example, we suggest that the agencies consider whether it would be desirable to remove the temporal precondition operating on wholesale and limited purpose institution qualified investments, under which the agencies only consider benefits occurring outside of the assessment area after consideration has been given to benefits occurring inside the assessment area. Permitting wholesale and limited purpose institutions to pursue both strategies with equal weighting may be appropriate in some geographic areas that have a high concentration of special purpose institutions and a relatively low need for targeted local investment funds.

Additionally, we believe it would be appropriate for the agencies to consider broadening the list of institutions that can meet CRA obligations through qualified investments outside of a delineated assessment area. Under the current regulatory scheme, as long as a retail institution has adequately addressed the community development needs of its assessment area, it will also receive consideration for community development activities that benefit geographies or individuals located somewhere within a broader statewide or regional area that includes the institution's assessment area, even if those activities do not directly benefit its assessment area.<sup>7</sup> The rule, in effect, limits all retail institutions to only those qualified investments that have some linkage to the local assessment area. We believe this probably discourages large retail institutions from pursuing a more active approach to geographically dispersed qualified investments, such as CRA-eligible MBS.

We would like to join with the agencies to examine whether or under what circumstances greater flexibility can be obtained with regard to the treatment of qualified investments for retail institutions. One approach to consider during the examination review process is the applicability of the wholesale and limited purpose institutions scheme in which benefit areas outside the institution's assessment area are considered if the institution has adequately addressed the needs of its assessment area.<sup>8</sup> (Further refinements of this standard may be appropriate, particularly if the

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<sup>7</sup> See Community Reinvestment Act Interagency Questions and Answers Regarding Community Reinvestment, 66 Fed. Reg. 36,627 (July 12, 2001) (Q and A 6 addressing the meaning of the term "regional area" under 12 C.F.R. §§ 25.12(i), 228.12(i), 345.12(i), and 563(e).12(h)).

<sup>8</sup> This is the same basic scheme used under the Lending test for loans, other than community development loans, made outside of a retail institution's assessment area. Consideration is given for

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agencies take stock of experience with respect to wholesale and limited purpose institutions). We further believe these issues merit further study and analysis because many institutions, including smaller and medium sized banks that are particularly challenged, have expressed concern about their inability to find qualified investments.<sup>9</sup>

Broadening the universe of depositories that can look outside of a specific geographic area for qualified investments will greatly enhance the value of these investments in the marketplace. Today, many qualified investments such as a MBS backed by low-income loans provide qualified investment credit only for a narrow group of investing depositories. This is because the qualified investment regulations require many depositories to look to the underlying mortgages and determine whether the mortgages have a sufficient geographic nexus with the institution's assessment area. This lowers the value of the security in the marketplace, because few other institutions would bid a premium price for the security as a qualified investment. The value of securities often depends on the "liquidation" value of the security (*i.e.*, its market price on any given date).

By broadening the group of institutions that could obtain CRA credit *vis-à-vis* for secondary market purchases of MBS or other investments benefiting low-income neighborhoods or borrowers, the agencies will promote a ready market for these securities, increasing their value and creating greater financial rewards for lenders making eligible CRA loans. Our preliminary review suggests that enhancing qualified investment eligibility by providing geographic flexibility may spur a surge in the value of CRA MBS, driving lenders to seek to make loans to low- and moderate-income individuals and in underserved neighborhoods. This market impetus would greatly benefit the intended beneficiaries of the Community Reinvestment Act.

*B. We recommend that the agencies retain the current treatment of loan originations and loan purchases under the Lending test because such treatment effectively advances CRA purposes.*

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loans to low- and moderate-income persons and small business and farm loans outside of an institution's assessment area(s), provided the institution has adequately addressed needs of borrowers within its assessment area(s). See Community Reinvestment Act Interagency Questions and Answers Regarding Community Reinvestment, 66 Fed. Reg. 36,633 (July 12, 2001) (Q and A 4 addressing when examiners will consider loans, other than community development loans, made outside an institution's assessment area(s) under 12 C.F.R. §§ 25.22(b)(2) & (3), 228.22(b)(2) & (3), 345.22(b)(2) & (3), and 563(e).22(b)(2) & (3)).

<sup>9</sup> See, e.g., Burnett, "Qualified Investments: How to Make Investing in Your Communities Really Count!" Volume 10, Number 3, Community Investments Newsletter (Federal Reserve Bank of San Francisco), Summer 1998.

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The agencies evaluate an institution's lending performance by considering, *inter alia*, the number and amount of loans originated or purchased by the institution in its assessment area. The agencies relate in the ANPR that some assert only loan originations should be considered in an institution's evaluation. The agencies further related that some contend loan purchases free up capital to the selling institution, thus enabling it to make additional loans.<sup>10</sup>

Freddie Mac believes that both loan originations and loan purchases make important contributions to advancing CRA objectives and thus should be considered equally under the Lending test. Loan purchases provide liquidity to the market by freeing up capital to the selling institution, thereby enabling it to make additional loans to meet the credit needs of low- and moderate-income individuals and geographies. All things being equal, loan originations and loan purchases should be weighted the same.

Institutions making mortgage originations have a visible role due to their direct involvement in community development with the borrower. Such loan originations, of course, should receive appropriate consideration for such involvement. Similarly, institutions making loan purchases should receive appropriate consideration because of the important role they play in adding liquidity to the market and thus stimulating greater affordable housing lending. Each type of involvement is measurable on an objective basis. Both types of involvement satisfy the goal of providing affordable housing (including multifamily rental housing) for low- and moderate-income individuals and may equally respond to the community development and credit needs of the assessment area. As a result, Freddie Mac supports the agencies' current interpretation of the regulations.

*C. We recommend that the agencies consider the benefits of allowing institutions to voluntarily opt to apply the Lending test to MBS purchases backed by low- and moderate-income loans.*

On a related issue, the agencies ask if purchased loans and purchased asset-backed securities should be captured under the same test, and if so, which test.<sup>11</sup> The regulations currently capture purchased loans under the lending test and purchased asset-backed securities under the investment test. Freddie Mac believes that MBS are appropriately captured under the Investment test and should not be removed from the Investment test.

However, Freddie Mac would urge the agencies to consider granting institutions the option to capture MBS under the Lending test, instead of the Investment test. MBS

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<sup>10</sup> 66 Fed. Reg. at 37,604.

<sup>11</sup> 66 Fed. Reg. at 37,604.

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secured by purchased CRA-eligible loans (similar to the current treatment of purchased loans by the agencies) could be captured under the Lending test. Under this approach an institution would receive Lending test consideration for purchases of MBS that are backed by loans to low- and moderate-income individuals as long as the securities are not backed primarily or exclusively by loans that the same institution originated or purchased.

Considering MBS under the Lending test, at the option of the institution, will encourage financial institutions to actively trade CRA securities. Unlike whole loans, investors can easily buy, sell or borrow against MBS. In addition, the risk-based capital treatment of agency MBS is superior to that for whole loans. Purchasing the same loans in a securitized form serves the same purpose and facilitates additional low- and moderate-income lending by fostering a secondary mortgage market. For the reasons we outlined above, we believe this may produce significant economic benefits for low-income borrowers and neighborhoods.

#### IV. CONCLUSION

Freddie Mac believes that a progressive and flexible approach to interpreting the qualified investment standard for retail institutions and wholesale and limited purpose institutions can help unleash the potential of the qualified investment standard and spur market-based competition in underserved neighborhoods. We submit our comments because we are genuinely interested in engaging in a broad dialogue with the agencies for the purpose of expanding the opportunities to meet the credit needs of low- and moderate-income individuals and geographies in a safe and sound manner.

We appreciate the opportunity to submit comments. If we may be of further assistance, please do not hesitate to contact us.

Yours very truly,



Peter E. Mahoney