Evans, Sandra E

From: Carol Wayman [cwayman@ncced.org]
Sent: Monday, October 15, 2001 1:05 PM
To: Attn: Docket No. 2001-49 Chief Counsel's Off
Subject: Comments on CRA Review

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Carol Wayman
NCCED 1030 15th Street, NW Suite 325
Washington, DC 20005

October 15, 2001

Attn: Docket No. 2001-49 Chief Counsel's Off
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Dear Attn: Docket No. 2001-49:

To Whom it May Concern:

As community developers, it would be impossible to over-estimate the importance of the Community Reinvestment Act. The National Congress for Community Economic Development represents people who work to revitalize low- income communities, especially those in rural areas, older suburbs, and inner cities. We work on behalf of the nation's 3,600 community development corporations (CDCs). We are a membership organization with a democratically elected board of representatives and our comments reflect feedback from surveys and discussions with our membership.

It is still true that African American, Latino, Native American, and Asian Pacific American citizens lag behind their white counterparts in accessing mortgage and home equity loans, small business loans, and more sophisticated commercial products. In fact, the community development industry was partly created to compensate for the lack of commercial capital due to redlining and discrimination in the banking industry. Over time, our relationship with financial institutions has greatly improved.

NCCED's 1999 Census of the CDC Industry reported that 49% of CDCs in this country receive more than $50,000 in loans, investments, and grants from banks. Without Bank partnerships, CDCs would not have been able to develop 550,000 units, nearly one-third of the nation's assisted housing. Nor would CDCs be able to provide $1.9 billion in loans. Financial institutions are key players in helping us develop more than 71 million square feet of commercial and industrial space and bring 247,000 private sector jobs to our communities to benefit our residents. Banks, thrifts, and credit unions are our partners in programs such as the Affordable Housing Program, Community Investment Cash Advance program, and others implemented by GSEs such as the Federal Home Loan Bank.

Thus, it should be no surprise to you to know that expansion and enforcement of the CRA is the highest policy priority of the nation's 3,600 community development corporations.

We believe these increased bank investment numbers are the results of the positive changes to the CRA regulation in 1995. The Department of Treasury's study on CRA found that lending to low- and moderate-income communities is higher in communities in which banks have their CRA assessment areas than in communities in which banks are not examined under CRA. It is because of the critical nature of banks in our communities, that the expansion and enforcement of the CRA is the highest policy priority of our member community development corporations.

Overall Perspective

Our primary concern is that the CRA continues to result in greater participation of financial institutions in the activities of low-income rural and urban communities. We want to strengthen and expand CRA. While some of our members report greater access to financial services since 1995, more report increased difficulty. Those reporting problems are struggling with bank mergers that have left their communities with fewer resources and less of a focus on community development. This problem has been particularly acute in rural areas and smaller towns in the Midwest.

We believe that the Community Reinvestment Act (CRA) has been instrumental in increasing lending and investing to our community and many others around the country. The regulatory changes to CRA during 1995 strengthened the law by emphasizing a bank's performance in providing services and in making loans and investments. The federal banking agencies must now update the CRA regulations in order to further reinvestment in low- and moderate-income communities as well as underserved minority communities.

To preserve the progress in community reinvestment, the federal banking agencies must update CRA to take into account the revolutionary changes in the financial industry. The Gramm-Leach-Bliley Act of 1999 allowed mergers among banks, insurance companies, and securities firms. Banks and thrifts with insurance company affiliates are now aggressively training insurance brokers to make loans. Securities affiliates of banks offer mutual funds with checking accounts. Mortgage company affiliates of banks continue to make a significant portion of the total loans, often issuing more than half of a bank's loans.

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The CRA regulation now allows banks to choose whether the lending, investing, or service activities of their affiliates will be considered on CRA exams. NCCED strongly urges the regulatory agencies to mandate that all lending and banking activities of non-depository affiliates must be included on CRA exams. This change would most accurately assess the CRA performance of banks that are spreading their lending activity to all parts of their company, including mortgage brokers, insurance agents, and other non-traditional loan officers. Ending the optional treatment of affiliates also stops the manipulation of CRA exams and makes exams more consistent in their scope. Currently, banks can elect not to include affiliates on CRA exams if including them will hurt their CRA ratings because they make predatory loans or serve primarily affluent customers.

Large Retail Institutions: Lending, Investment, and Service Tests:

We strongly support the continuation of the three tests for CRA Investment. We believe that quantitative measures (investments) should continue to be a significant emphasis in the regulations. We urge you to prioritize outcomes over process. Bankers live and die by the numbers, and CRA should be no exception.

This is not to say that only quantitative measurements matter. Improvements are needed. Measuring lending volume alone is not enough.

Examiners should distinguish between different types and costs of lending. Measurements should incorporate the qualitative differences in lending, investment, and service activities. For example, examiners should analyze a bank's lending for costs and abusive terms or consider the number of loans, not just the total amount. There is a role for qualitative measures to be applied to the lending and other two tests. The rules already permit this, but perhaps additional guidance should be provided to examiners to ensure that they take into account factors other than loan volume in situations in which a lender demonstrates over-saturation of a particular product. For example, if a lender is able to substantiate that there are too many loans chasing too few borrowers in a particular market, greater weight should be given to activities in that location that serve needs that are not being well met.

However, qualitative factors must not be used to raise what would otherwise be a failing grade or even a low-satisfactory grade for any of the three tests (i.e., qualitative factors should be used only to raise a grade from high-satisfactory to an outstanding level).

There should also be increased attention given to assuring that depositories maintain some minimal level of investment and service performance. No bank should receive an overall Satisfactory rating if it receives a Substantial Noncompliance rating on any component test or if it receives a Needs to Improve rating on more than one test. Certainly, if a Bank is "substantially non-compliant" in any area, it should not receive an overall rating of satisfactory. We believe that there are insufficient consequences for a bank performing poorly on the investment and service tests. No bank should receive an Outstanding rating if it receives A Needs to Improve rating on any component test. The requirement that a bank must receive at least a Low Satisfactory on the lending test to receive an overall Satisfactory should be retained. We would like to see consistent ratings among the various criteria in the ANPR.

The Lending Test

It is vitally important that the lending test continues to be a key component of CRA performance evaluations. The location, distribution, volume, and quality of an institution's residential, small business, and consumer lending are all of primary concern. Why? Because lending is consistent with both the legislative history perspective and the continuing mainstream credit needs. There is ample evidence of continuing problems in access to retail credit, particularly in lower-income and minority communities. The explosion of predatory lending, the continued evidence of discrimination and redlining in both the mortgage and small business lending markets, and the growth of the payday lending industry all point to the need for continued CRA regulation of mainstream lending products. The Department of Treasury's Study on CRA has found that the movement to performance-based measures in CRA evaluations has led to some improvements in home loan markets - especially for home purchase loans.

Notwithstanding the importance of maintaining the overall importance of the lending test, there are a number of issues that the agencies should address in regulatory review. First, originations should be evaluated separately from purchased loans, especially when loans are purchased from other lenders (rather than mortgage brokers). Origination should be given more weight than purchases, especially if the purchases are of seasoned loans. While providing liquidity may provide an important function, especially for nonconforming products, the emphasis on origination is required to ensure a healthy market with substantial number of originators.

Second, geographic distribution criteria should include race of neighborhood as well as income level. The CRA statute provides that examiners assess an institution's record of meeting the credit needs of the entire community. Many geographic lending disparities are more pronounced by race of neighborhood than by income. For example, The Woodstock Institute has found that in Chicago, the market share of refinancing loans of sub-prime lenders in middle-income African American neighborhoods is more than four times that made in middle-income white neighborhoods. Geographic data should also include rural areas.

Third, the regulations should direct examiners to evaluate the quality as well as the quantity of an institution's lending. The regulations should call for an examination of sub-prime loans for predatory features, including

* excessive up-front fees (more than four percent of the total loan amount), * heavy prepayment penalties (more than 2 percent of the principal), single premium credit insurance, * mandatory arbitration,

or
* back-end debt to income rations above 50 percent.

Lenders that make a significant number of these loans should receive no higher than a Needs to Improve lending test rating. The origination or purchase of any loans (mortgage or consumer) that violate different types of neighborhoods (by income level and racial composition) and the different products' market shares in different types of neighborhoods (by income and race). Any lender significantly engaged in payday or auto title lending at or above standard and industry rates (above 20 percent APR), should receive no higher than a Needs to Improve on the lending test. Also, additional weight should be given to those having programs in place to "refer-up" borrowers who come in through their subprime affiliates but qualify for prime credit.

Investment test

The investment test is critical to evaluating an institution's record of helping to meet the credit needs of its entire community and should be retained as a separate test. Eliminating investments as a separate and distinct test could reduce the incentive for banks to provide critical, non-debt related, financial support for community development activities.
Despite the anecdotes sometimes offered, there is no independent evidence to suggest that a separate investment test has deterred, in any substantial way, bank support for local activities. In our view, the exception should not drive the rule. The CRA rules should permit a community development credit to be counted under either the investment or Lending Test in special circumstances, should the institution already have demonstrated it is performing at a satisfactory level for both tests.

Investments are critical to the capacity of nonprofits, community development banks, and others to serve the credit needs of those not well served by regulated depositories. Our members (some of whom are certified Community Development Financial Institutions) are very active in providing loans to those that are not served by conventional institutions.
Investments in these organizations are needed and should be counted under CRA.

Currently, performance evaluations do not distinguish between very different types of investment activity to determine the investment test rating. Grants, deposits in eligible institutions, investments in non-targeted SBICs, and other disparate investments are summed with no explicit weighting or disaggregation. The sum of investments is then compared to a bank's own equity capital. This overly simple analysis does not adequately distinguish between lower- and higher-risk investments, or between higher-return and lower-return investments. The regulations ask examiners to consider the responsiveness to community needs and the extent to which the private market meets a need. Our wish list would have regulations that direct examiners to consider a community's needs more explicitly and distinguish between different types of investments. Each category of investment should be measured relative to a bank's equity capital. Grants should be measured against a bank's recent earnings. All investments in mortgage and asset backed securities should be reviewed for predatory or illegal lending practices. Any investments in securities that are backed by illegal loans should result in a Substantial Noncompliance rating under the investment test.

The Service Test

The separate service test should continue and be weighted as it is now. Clearly, retail deposit and other services are critical to accessing capital of low and moderate income communities. The current regulations recognize the importance of these services. However, placing more emphasis on banking services could be at the expense of needed lending to underserved communities.

The service test should be applied to all institutions that provide retail banking services, without regard to how those services are delivered. Currently, the service test does not assess performance. It uses delivery channels as proxies for ensuring that services are provided to low-income customers. Most institutions provide little or no documentation that the products (1) meet community needs (especially the needs of the unbanked); and (2) are being used. The test provides few incentives for banks to develop and market retail products for lower-income consumers. Service Test criteria are broad and difficult to measure and financial institutions are inconsistently examined. This broad approach is open to multiple interpretations by examiners - which undermines the effectiveness of the service test.

Accordingly, the regulations should require more quantitative measures of alternative and innovative services being offered. In order to receive an Outstanding rating on the Service test, banks should provide lifeline banking products, multiple delivery systems, and alternatives to standard retail accounts. Alternatives to direct service provision could include:

* Providing grants, nonmember deposits and investments to community development credit unions that provide lifeline banking services and products; * Sponsoring financial literacy workshops in cooperation with community partners; and * Supporting financial literacy providers, including consumer credit agencies, job training programs, community colleges, etc.

Predatory practices are not limited to direct lending by the financial institution. Banks are also involved in partnerships with firms such as predatory payday lenders. CRA should be used to discourage banks from engaging in or involvement with check cashers, payday lenders, and other fringe banking institutions that gouge low and moderate-income families and suck out economic resources from economically distressed communities.
Banks should not receive higher than a Needs to Improve rating if they are

involved in alliances that harm lower-income consumers. This should be true even when the fringe banking activity occurs outside the bank's CRA assessment areas, a situation in which the regulators have previously said CRA does not apply.

Definitions of Community Development

The current definition is too broad and biased towards urban areas. In particular, "activities that promote economic development by financing small businesses and farms" is far too general a description of eligible economic development activities under the community development definition. This description can be conceivably applied to almost any loan, investment, or service to any type of small business (which could have as many as 500 employees). Business development activities should meet the following criteria to fall under the definition of community development: 1) affected firms are small business located in low and or moderate income geographies or are minority owned and 2) the activity of the firm is not perceived as deleterious to the community (payday loan stores, liquor stores)

The three component tests should not be consolidated.

Small Institutions

The current definition of small institution should not be liberalized to include more institutions; the thresholds should remain the same or be tightened. The rules already are streamlined for 80 percent of the banks. This is causing a problem in rural areas where the vast majority of banks are barely subject to CRA. Compliance entails only ten hours of work a year for the small banks. This is a very low level of regulatory responsibility for more than four-fifths of the industry.

Community Development Test: Limited Purpose and Wholesale Institutions.

Our member survey reports that the definitions are not adequate. Some of the "wholesale and limited purpose institutions" should be clearly regarded as retail financial institutions and subject to the full CRA examination.

Strategic Plan Option

Our members agree that the Strategic Plan option is not currently viable and needs reform, if not elimination. Some argue that it is essentially an abandonment of the agencies' responsibilities to implement and enforce CRA in a consistent fashion. The absence of any substantive guidelines for this option essentially enables banks to develop their own rating system with little or no regulatory oversight. Unless the system is rigorously reviewed to be a credible and fair evaluation scheme, it will simply assure an Outstanding rating. Goals can be set at such low levels that institutions could not realistically fail to meet them. Few banks have chosen the plan option either because some of the agencies have rejected plans that were clearly designed to assure an Outstanding rating, or because other uncertainties exist with the process

Assessment Areas

The method for defining assessment areas must be revised to encompass the way increasing numbers of banks operate in today's environment. Contemporary banking has changed dramatically and this needs to be reflected in the assessment areas. If financial institutions have some or all of their activity based outside of a branch network and those institutions are examined solely on the basis of the area around a branch, a central computer, or a home office, the spirit of the CRA statute is ignored. The regulations should focus on who is and who is not being served, not on how they are served or the geographical locus of a particular method of delivering service. The agencies should expand their current practice by allowing institutions to delineate assessment areas not only where they have their main office, branches, and deposit taking ATMs, but also where they take a significant portion of their deposits or make a significant portion of their loans.

The CRA regulations should be revised so that banks would be required to delineate assessment areas not only where they have a physical presence, but also in areas in which they obtain a substantial amount of deposits or make substantial numbers of loans. Thus, a mega-bank that collects deposits via internet banking would be required to include as an assessment area those parts of the country where it obtained substantial deposits or had a substantial market share for lending. The same would be true for internet banks, and for insurance companies, or auto manufacturers and other types of commercial firms that owned a local bank for the purposes of selling financial services to a broader area than the one in which the physical institution happens to be situated.

Yet, the assessment area concept should not be eliminated, as some have suggested. The assessment area approach maintains the connection of banks to their local communities, which has been a key concept for CRA all along.

Affiliates

Banks should not be permitted to pick and choose among affiliates' records. CRA regulations should be clarified to permit a bank to choose either to have the records of all affiliates included in determining CRA performance or none. Such a clarification would prevent a bank from choosing to include the record of its prime affiliates, but not that of its subprime mortgage lending affiliate.

Public Data

The public disclosure of meaningful data is essential to making the CRA process work for communities. Unfortunately, the data reported for CRA purposes do not achieve what should be its primary objective - giving the public the necessary information to compare for itself the performance

of
local banks.

Accordingly, we suggest several revisions to current CRA loan disclosure requirements:

Small business data should be reported in a format more comparable to the format used for reporting mortgage loans under the Home Mortgage Disclosure Act (i.e., applications, approvals and denials, withdrawn, incomplete). Further, the Federal Reserve Board should finalize the proposal that it has pending that would enable banks to report on the race and gender of the small business owner obtaining a loan. Community development loan data should be reported on a census tract basis (currently, it is only reported in the aggregate). Also, the purpose of the community development loan should be reported by category (i.e., housing, economic development, etc.). The CRA exam report should analyze prime and subprime loans separately (such a revision to HMDA that would require lenders to report on their subprime mortgage loan activity is currently pending with the Fed). Qualified investments should be counted under the Investment Test be reported by category and amount. Data on mortgage lending outside metropolitan areas, reported by large banks, should be made much more readily accessible to the public. More detailed reporting on specific activities counted under the Service Test (i.e., information about the number of basic banking account services, the extent to which alternative banking services are provided, etc.).

Conclusion

In closing, the regulations should not be changed to consolidate the lending, service, and investment tests. The three component tests are vital to ensuring adequate examination of bank performance. Mainstream direct lending and service activity has always been at the heart of the CRA and should be a major focus of the examinations. Capital access is the life-blood of community development. We think bank activity in low-income communities and with minority residents is in the mutual self interest of the financial industry and the nation.

Sincerely,

Carol Wayman