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October 17, 2001

Communications Division
Public Information Room
Mailstop 1-5
Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, D.C. 20219
[Docket No. 01-16]

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
[Docket No. R-1112]

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments/OES
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552
[Attention Docket No. 2001-49]

**Re: Joint advance notice of proposed rulemaking
Community Reinvestment Act (CRA) Regulations
66 Fed. Reg. 37602 (July 19, 2001)**

Dear Sir or Madam:

Fannie Mae welcomes this opportunity to comment on the joint advance notice of proposed rulemaking ("ANPR") regarding the Community Reinvestment Act ("CRA") regulations issued by Office of the Comptroller of the Currency, the Board of Governors

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of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (collectively the "Regulators").

Fannie Mae is a congressionally chartered, shareholder-owned company whose sole business is to support residential housing by making a market in residential loans for both single family and multifamily mortgages. Fannie Mae is both the largest American investor in mortgages, and a major issuer of mortgage-backed securities ("MBS") secured by properties for low-, moderate-, and middle-income families. By statute, Fannie Mae is required to take affirmative steps to help insured depository institutions meet their CRA obligations. 12 U.S.C. 4565(3)(B). In furtherance of this obligation and our affordable housing mission, Fannie Mae conducts a significant amount of affordable housing business with financial institutions covered by the CRA.

Based on our experience working with primary market lenders, we believe the Regulators have the opportunity to increase the effectiveness of CRA, while reducing the costs of the regulations on lending institutions and ultimately on borrowers. We recommend three types of changes to support these goals. First, the Regulators should consider changes in the regulations that provide lending institutions with increased flexibility in the strategies that these institutions use to meet CRA objectives. Second, the new rules should seek to encourage and reward lender innovation and effort without penalizing lenders who do basic and important activities well. And, third, Regulators should consider changes that reduce lender uncertainties regarding compliance and interpretation of the rules.

Many positive contributions have been made in expanding the availability of credit, investment, and services for low- and moderate-income ("LMI") borrowers and LMI communities because of CRA. Any changes to the current structure should not undermine the ability to build on these contributions but rather should increase competition, foster innovation, and expand affordable housing opportunity consistent with the spirit of CRA.

I. Increasing Lender Flexibility in Meeting CRA Objectives

The current CRA regulations recognize that lending institutions can serve their communities in a variety of ways – through lending, through investments, and through the quality and range of services provided. Many large institutions have the ability to engage in effective activities in all three areas simultaneously. And, many of these institutions provide a mix of large scale and customized solutions to a community. Other smaller institutions evaluated under the large bank test may find it harder to develop strong programs in all three areas. Likewise, the unique characteristics of an institution and its market may allow this type of institution to specialize in activities that fully satisfy one of the three tests, but not all three. In particular, lender partners have told us it is sometimes difficult to find investment opportunities that meet CRA requirements, while meeting the financial requirements of shareholders and safety and soundness requirements of Regulators.

No one institution can meet all of the different types of needs in a community. Therefore, diversity of business objectives is a bonus for the CRA and communities. The contributions made by various institutions, with their disparate but complementary business strategies, can better assure that a community will have most of its needs met. The CRA regulations already acknowledge that lending is but one way in which an institution can help revitalize a community. Recognition that different institutions will emphasize different contributions is a natural extension of this concept. CRA evaluations should consider the impact on a community rather than assure that each lender contributes in the same way. This recognition of the importance of diversity is key, so that lenders can feel comfortable in supporting new tools and investment opportunities such as the New Markets Tax Credits and the Single Family Tax Credits. We believe that there are ways in which compliance with the CRA regulations could better recognize this diversity across markets and across lending institutions by allowing more flexibility in the acceptable paths by which institutions can achieve at least a satisfactory rating.

In addition to meeting the needs of a community, financial institutions need to tailor their CRA activities to align with their business strategies and to produce a sustainable and profitable business plan. The infusion of capital into LMI neighborhoods encouraged by CRA since its inception in 1977, has been possible, in large part, because it is good business for underserved consumers, underserved neighborhoods, and lenders. As a business proposition, CRA lending and investments must be profitable to be sustainable over the long term. In our work with our lender partners, they share with us their frustration regarding below market rate lending and investment. Below market rate lending and investments are not sustainable as large scale, long-term programs if those activities preclude a bank or thrift from covering its costs, risks and rate of return.

a. Treatment of MBS and Loan Purchases

In focusing on the impact to the community and not only on the method used to serve the community, the Regulators should consider lending and investment activities that promote the availability of capital for LMI households and communities. Continued favorable treatment of MBS investments and loan purchases in the CRA rules are examples of ways in which the regulations can advance flexibility for lenders seeking to meet their CRA obligations, while encouraging the flow of capital to these borrowers. The purchase of affordable housing loans and investment in MBS are essential for a vibrant affordable housing market.

The purchase of CRA-targeted MBS particularly benefits LMI communities by freeing up capital that allows financial institutions to make additional loans to LMI communities and individuals. Securitizing loans converts them into liquid instruments that have a much broader investor base. Securitization not only expands the available capital for communities, but also allows institutions to amass capital quickly when new community investment opportunities present themselves. The ability of institutions to provide higher volumes of low-cost mortgage products is significantly enhanced when securitization is an option.

Accordingly, we would ask that the Regulators reconsider their position on investment test credit for institutions investing in MBS backed primarily or exclusively by loans for which the institution received consideration under the lending test. Providing CRA credit for investments in securities that are backed by loans also receiving credit under separate CRA evaluation tests should not be deemed as "double counting". A consistent interpretation to permit "swap and hold" transactions would enable a wide range of securitization alternatives for all CRA-regulated institutions. Because these securitization alternatives would "count" for all institutions, and the standards are relative for peer institutions, investment test standards would not be lowered in any way. For additional detail on this, we would refer you to the comment letter we provided on the Q&A on this topic in 1999 (copy attached).

Purchases of loans likewise have the effect of increasing the amount of capital the originating lender has available for reinvestment in a community. Because of the important role that both the origination and the purchase of loans play in LMI communities, we believe that the Regulators should continue to award equal lending test credit for loan purchases and originations.

b. Expanded Qualifications for Community Development Investments

Another opportunity for increasing flexibility is to allow institutions to gain consideration for community development activities outside of their assessment areas when they have adequately met the needs of their communities. While investments outside of an institution's assessment area should not be a requirement, reducing the restrictions on getting CRA credit for activities outside an institution's assessment area would increase the free flow of capital to LMI communities, in particular, those rural areas that are not heavily-served by the banking industry. This change makes considerable sense to us: the lending or investment is meeting the spirit and objectives of the statute.

In addition to expanding the geographic scope of community development activities that qualify, the Regulators should expand the definition of community development to include additional activities such as responding to unusual devastating circumstances. We were pleased to hear that the Regulators announced that they will give favorable CRA consideration to institutions that invest, lend, or provide services toward economic development in the lower Manhattan area for rebuilding related to the September 11th terrorist attacks, regardless of the median income of the area. We further recommend that the scope of this consideration be extended generally to cover all areas devastated by natural disasters or by acts of terrorism or war.

c. Clarity on Strategic Plan Approval Process

One additional way in which institutions can be encouraged to be effective in serving LMI individuals and communities is to improve the strategic plan approval process. Our experience suggests that when partners have clarity about their goals and the consequences of their actions, the output is far more effective. Predefining a strategy and set of goals can allow institutions greater freedom to take on much-needed innovative

work. As conceived, the strategic plan option provides another potential source of flexibility through which a lender can meet the intent of the CRA. However, we have learned from institutions that they may not use this option because of the complexities and burdens associated with getting a plan approved by the Regulators. In approving strategic plans, the Regulators should be guided by the same basic principles upon which we suggest they focus to improve the current regulations -- increasing flexibility, rewarding innovation without penalizing basic lending activities, and reducing uncertainty.

Effective service to a community is a win-win situation. Communities gain more cost-effective products because capital is invested in communities rather than regulatory systems. Lenders also win because they can fulfill their responsibilities in a manner that recognizes their business reality. Ultimately, the winners are the families that are helped to find a home, become homeowners or live in redeveloped neighborhoods that create a better place to live for their children.

II. Encouraging Innovation and Effort without Penalizing Good Works

We have heard from many of our partners that the current regulations and the examination process do not appropriately recognize CRA-eligible activities that require more time and effort or require an institution to take on higher level of risks. Building in a greater recognition of this extra effort/extra risk-taking makes sense to us as a way to encourage innovation and effort. While it is difficult for examiners to evaluate innovative and complex initiatives, the examination process could benefit from a mechanism that augments quantitative CRA measures with an extra recognition for qualitative features of an institution's activities. In giving increased recognition to the qualitative measures of the CRA examination process, the Regulators should not abandon the certainty and clarity that also comes with a quantitative process.

In our partnerships throughout the country -- whether through our Regional Offices, Partnership Offices, or on an institutional basis -- we have been fortunate to receive wise counsel from many partner-advisers. One recurring theme that resonates for us is the recommendation to be responsive to the particular needs that each community faces. Needs vary, as each community faces different challenges. In many instances, these needs can be met with products that are developed and delivered to scale. This is important work, deserving CRA credit. There are other instances, however, where the needs of a community can be met only with innovative solutions that require significant time and resource commitments by lenders, and will not deliver high volumes of loans or investments. There are many examples that illustrate this point including housing for people with special needs, developing community-by-community solutions to leverage public funds earmarked to improve the affordability of homeownership, conventional lending to Native Americans, and creating programs to help the victims of predatory lending.

Transactions focused on providing rental housing for very-low income people with special needs are highly complex for lenders and the loan dollars are very small. Project

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costs can be extremely high and vastly higher than the resulting permanent loan amounts because the rents are so low. The focus on volume in CRA is a deterrent for institutions to focus time and attention on these transactions.

Likewise, on the homeownership side, many institutions participate in a plethora of local government or nonprofit loan funds targeted to provide down payment and/or closing cost assistance to eligible families. Every initiative requires individual review and administration by lending institutions as well as customized processing, underwriting, etc. These tailored activities clearly add substantial burden and cost for the lender, while most often generating very few loans.

Providing conventional loans to Native Americans on tribal lands has been a challenging but very rewarding endeavor for lenders. Lending on tribal lands presents a unique set of challenges because Native American tribes operate as sovereign entities, the land is held in trust by the U.S. Government, and the land cannot be transferred out of tribal control. Lenders working with tribal officials have spent considerable resources developing the financial and legal infrastructure necessary to support mortgage lending on tribal lands. The successes to date have come after years of consulting and issues resolution with the tribal governments. Since 1998, Fannie Mae, for example, has invested \$92 million in conventional loans on tribal lands. While these numbers may seem small, these investments are significant contributions to the stability and cohesiveness of the tribal communities.

In addition, some tribes also seek to assist Native Americans with housing off tribal lands so that they can live close to employment centers and avoid remaining isolated on reservations. One large California thrift developed a product leveraging Federal funding through NAHASDA to allow tribal housing authorities to buy individual properties and offer a lease/purchase arrangement to tribal members. The institution took on the work of developing the funding and loan structures, as the tribes did not have the experience to structure the product themselves. This work took years of time and effort and has generated a handful of loans – clearly an initiative that addresses a key underserved community that should be rewarded under CRA.

One final example that illustrates the importance of encouraging and rewarding innovative work by lenders is the work being done to help victims of predatory lending. Through individually tailored initiatives, borrowers are refinanced into loans they can afford to repay. To be successful, these efforts require collaboration among lenders, nonprofits, and legal service providers. The team must not only design the criteria for who will be served through the effort, but they must also spend intense and long hours – after the effort is announced – reviewing and assessing the borrower's credit profile. We have seen firsthand in New York City, the tremendous effort by lenders (and others) to design and implement an effective effort to help the victims of abusive lending. Due to the complexity of the issues, the work in New York City took several months to design and launch. The project has been in operation for 12 months. During that time period, the group has approved \$1 million in loans. While these volume numbers are not high, the

impact on the families, and the message it sends to those communities is exactly the kind of impact the CRA is intended to produce.

III. Providing clear and consistent guidance to financial institutions

Encouraging innovation and flexibility does not mean that the CRA regulations should not have standards. Lenders will still need to be evaluated in the context of information about their business strategies, their communities, their competitors, and their peers. While the current regulations have provided consistency for certain activities, in other respects the rules are lacking. The Regulators should reduce the uncertainty about compliance and CRA ratings where possible. Uncertainty in these areas discourages lenders in engaging in activities that could be beneficial for LMI consumers and communities.

a. Defining Affordable Housing

One way to ensure that guidance is clear and consistent would be to standardize and simplify data requirements where possible. For example, under the current regulations, there is tremendous uncertainty regarding whether a multifamily project qualifies as an affordable housing project.

We continue to advocate the point we made in our Q&A comment letter of 1999 (copy attached), that the industry needs a simplified method of determining whether a project is "affordable housing for LMI individuals," thereby meeting the definition of "community development." We agree with the Regulators in their Q&A guidance that projects with an express, bona fide intent of community development (as stated, for example, in a prospectus, loan proposal or community action plan) should receive consideration. But in addition, we continue to support the notion that projects that do not have such explicit "intent" and for which the income of occupants cannot be verified should also be able to receive CRA credit without the need for substantial administrative burden for lenders.

More flexible rules could be very helpful in expanding affordable housing markets. Defining rental housing affordability can be simplified. The Department of Housing and Urban Development (HUD) has considered this issue in detail with respect to Fannie Mae and Freddie Mac's housing goals, and, in our view has established a very effective standard measure and a way to assess housing affordability in the absence of key data such as renter income.¹ We have experience with the application of this standard as it is used by HUD to assess our performance under the housing goals. We would be happy to discuss the operation of this standard and other specific criteria to allow for freer market activity thereby improving market liquidity for affordable multifamily loans. Whether the Regulators adopt the HUD formula set for Fannie Mae and Freddie Mac, or determine a standard of their own, the goal should be to create a usable standard that reasonably

¹ Generally stated, HUD counts as "affordable" units in projects for which the monthly rent is affordable to families with certain percentages of the area median monthly income, calibrated for household size.

satisfies the Regulators' desire to consider projects that predominately house LMI families, without requiring a custom-tailored analysis to be created for every project. Unexpected CRA analysis and documentation requirements that add to the administrative burden of these projects hinder the ability of the multifamily market to tap new capital.

b. Avoiding conflicting standards

In an effort to provide additional clarity to lenders, new CRA regulations should also avoid adding new complexity to the lending process by adding additional concepts or standards that are ill-defined or conflict with other standards that lenders may face in the marketplace. For example, the ANPR posits whether loans, which contain harmful or abusive terms, do not help to meet community credit needs. Regulation in this area poses a significant risk of adding new layers of costly administrative burdens and uncertainty.

Fannie Mae strongly believes that institutions that originate predatory loans that contain abusive or harmful terms should not be rewarded under CRA for those loans. However, in moving forward in this area Regulators should focus on adding clarity to the various standards already imposed on lenders through federal regulations and a growing library of state and local laws and regulations. The plethora of standards defining high-cost loans and abusive lending practices is adding considerable complexity to the legal environment. Additional complexity runs the risk of increasing the cost of credit to all consumers and cutting off access to credit for LMI borrowers.

In looking at how the Regulators can take a leadership role in this area, the Regulators could benefit from looking at the path taken by HUD in its regulation governing Fannie Mae and Freddie Mac's housing goals credit. For the most part, HUD's standards make sense and address the key issues. Following an approach substantially similar to the HUD model would at least allow for a consistent set of standards at the federal level.

c. Examiner consistency

Providing clearer and consistent standards in the regulations will be a step in the right direction in facilitating the availability of capital in underserved communities. Clarity and consistency could be enhanced through incorporating published Q&A guidance into the regulation, to the extent possible. This would help improve the consistent implementation of the CRA regulations throughout and within the Regulators. These standards should be reinforced through enhanced CRA examination procedures and increased examiner training. Credit for activities should not vary depending on who the examiner is or which agency is regulating the institution.

Financial institutions will more readily engage in activities that will benefit LMI individuals and communities as well as create new opportunities if they know that their efforts will be uniformly recognized under the regulations. As an example, the Regulators should codify CRA guidance. The Regulators took an appropriate step in the recently published Q&A to include guidance about high-cost areas. We would recommend that this guidance be incorporated into the regulation so that examiners will

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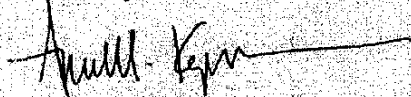
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begin routinely to take into account conditions in high cost areas. In many cities, mayors, housing officials and housing advocates promote mixed-income neighborhoods, and want to attract middle-income residents to their cities. Institutions that lend or invest to support such goals should be assured of CRA credit of this activity.

* * * * *

We recognize that amending the CRA regulations to reward effective service to communities, yet provide clear and consistent standards, is a difficult balance. Nonetheless, we urge you to take on this challenge. Lenders have done much to help revitalize communities under the umbrella of the CRA, yet much more needs to be done. Providing the right regulatory environment to encourage the right behaviors is critical. Thank you for the opportunity to comment on this ANPR. We would be happy to answer any questions you may have regarding our letter.

Sincerely,



Ann Kappler

Enclosure