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Regulation Comments  
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To Whom It May Concern:

I am writing from Woodstock Institute to comment on the Office of Thrift Supervision's (OTS) proposed changes (No. 2004-53) to their regulation of the Community Reinvestment Act (CRA). Woodstock Institute is a Chicago-based research and policy organization that for over 30 years has worked to promote economic development in lower-income and minority communities. The OTS proposal is a damaging attack on the effectiveness of CRA and continues the OTS's ongoing assault on regulations that promote investment in underserved communities and protect consumers.

Since its passage in 1977, the Community Reinvestment Act has been a critical tool in promoting economic development in low- and moderate-income (LMI) communities. Research has shown that CRA-regulated mortgage lenders have substantially increased their lending presence to low- and moderate-income communities and borrowers. Community development investments and loans from CRA-regulated institutions have facilitated the rapid growth of the community development financial institution (CDFI) industry. CDFIs have been critical in developing affordable housing and promoting small business development in lower-income areas. CRA has encouraged banks and thrifts to expand their branch networks into LMI communities and develop flexible deposit accounts to serve these markets. CRA has also been critical in encouraging banks and thrifts to form community development partnerships with community organizations.

The OTS proposal has two key components that would dramatically weaken the effectiveness of CRA. The first would change the way that a "large" institution's CRA rating is assigned and the second would broaden the definition of "community development" to include activities that do not benefit low- and moderate-income households and communities. Currently, a large institution's final CRA rating is based on weighted consideration of its performance in providing lending, investments, and services to low- and moderate-income (LMI) households and communities. An institution's performance on the lending portion of its CRA examination is 50 percent of its final score, while services and investments are each given 25 percent weight in the final grade. The current OTS proposal would alter this framework by allowing large thrifts to essentially opt out of providing services and investments to LMI markets. These institutions could choose to have lending count for between 50 and 100 percent of their final CRA rating thus minimizing or completely excluding consideration of community development investments and services.

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The second part of the OTS proposal would change the definition of "community development" to include "community services targeted to individuals in rural areas, and activities that revitalize or stabilize rural areas" regardless of the impact to low- and moderate-income people or communities. This would allow thrifts to get CRA credit for participating in activities such as luxury housing development or golf course financing as long as it can be shown that these activities "revitalize or stabilize" rural areas.

The OTS proposal will seriously harm lower-income communities in a number of ways:

- **It effectively removes oversight from thrifts' community development investments and services.** The effectiveness of the current CRA regulation lies in the fact that it is a standardized framework that examiners use to evaluate an institution's community reinvestment performance. All institutions are measured for their lending, investments, and services performance. If it is weak in an area, an institution must improve or receive a poor CRA grade on that portion of the evaluation. Flexibility in the current CRA regulation lies in the performance context established for each financial institution. This takes into account market conditions of an institution's service area and an institution's business focus. The OTS proposal would not require an institution to improve if it has unsatisfactory levels of community development services or investments. Rather, it would allow that institution to opt out of those portions of the evaluation.
- **Large institutions have substantial room for improvement.** The OTS is proposing changes to its CRA regulation that would weaken the evaluation of "large" institutions when there is actually a need for stronger oversight. For example, a recent Woodstock Institute analysis of the 2004 distribution of full service bank branches in the Chicago area, indicates that large institutions (over \$1 billion) have a lower share of their full service offices in LMI communities than institutions of other sizes (see Table 1). Making the services test optional for large institutions will only serve to widen this gap. The service test is critical in encouraging large banks to locate in LMI areas and develop products appropriate for those markets. It should be more strictly enforced, not made optional.

**Table 1. Distribution of Full Service Bank Offices in the Chicago Six-County Area by Assets Size of Institution, 2004<sup>1</sup>**

	Over \$1 Billion	\$1 Billion to \$250 Million	Less than \$250 Million	Total
All Offices	1,578	378	302	2,258
LMI Offices	235	59	72	366
LMI Share	14.9%	15.6%	23.8%	16.2%

<sup>1</sup>Data from 2004 FDIC Summary of Deposits. The Chicago Six-County area includes: Cook, Dupage, Kane, Lake, McHenry, and Will Counties.

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- **The use of purchased loans would allow large thrifts to have no direct presence in LMI markets.** Under the OTS proposal, institutions could have 100 percent of their CRA rating based on lending. This is highly problematic because current CRA regulations do not require institutions to perform any direct lending in LMI communities to receive CRA credit. Rather, for CRA purposes, loans that are purchased from third parties are given equal consideration to directly originated loans. These purchased loans, however, require virtually no effort on the part of the acquiring lender and allow institutions to get CRA credit while having no direct presence in LMI communities. Additionally, there is no quality control that institutions are required to perform on purchased loans other than basic safety and soundness considerations. Indeed, it is well known in the industry that the same group of purchased loans may be bought several times by numerous financial institutions to "boost" their CRA performance. These purchased loans may contain abusive terms such as excessive yield spread premiums or onerous prepayment penalties. By making the services test optional and giving purchased loans equal consideration to directly originated loans, the OTS proposal would not require a large thrift to have any direct presence in LMI markets to receive an "outstanding" or "satisfactory" CRA rating.
- **Rural development component will subvert the original intent of CRA.** The intent of CRA is to ensure that depository institutions meet the credit needs of the communities in which they are chartered including low- and moderate-income areas. By changing the definition of "community development" to include activities that "revitalize and stabilize" rural areas regardless of their impact on LMI households or communities, the OTS would divert community development resources to projects in rural areas such as luxury housing, strip malls, or golf courses, that do not benefit LMI markets. Additionally, this provision gives CRA incentive to thrifts to engage in projects on the fringe of metropolitan areas that encourage and contribute to urban sprawl.

The OTS proposal sets up a circumstance where a large thrift could receive an "outstanding" or "satisfactory" on a CRA evaluation with virtually no direct presence in LMI communities. A thrift could have a large branch network with few or no branches in LMI communities, but choose not to have its level of community development services considered on a CRA examination. The thrift could make no investments in affordable housing or business development or refuse to make grants or investments to organizations that promote economic development in LMI communities, yet not have their community development investments considered on their CRA examination. The thrift could make few or no direct loans to LMI communities or borrowers, but purchase LMI loans from a third party. These loans could be years old, contain abusive prepayment penalties, or have large yield-spread premiums. This thrift could also provide a "community development" loan for a golf course that "revitalizes" a "rural" community on the fringe of a large metropolitan area. Despite virtually no presence in LMI markets, this institution could be considered "outstanding" under the OTS proposal.

The current CRA regulation is an effective tool for the proper implementation of the Community Reinvestment Act. The basic well-being of communities across America depends on proper CRA implementation. Lower-income communities are particularly dependent on this law. We know from decades of research and on-the-ground experience that CRA has been critical in bringing affordable housing, small businesses, retail shopping, and social service organizations such as child care centers to

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underserved communities. These necessities are crucial to a family's ability to enter and bring their children into the American mainstream. It would be a tragic mistake if a government body deliberately robbed ordinary families of their chances of raising their children in decent, supportive communities.

The current OTS proposal is only the most recent attack by the agency on laws and regulations that promote community development and protect consumers. In summer 2004, the OTS unilaterally broke away from other bank regulators to raise the asset threshold for small institutions subject to streamlined CRA evaluations from any institution with less than \$250 million in assets and not part of a holding company over \$1 billion in assets to any institution with less than \$1 billion in assets. This dramatically reduced the number of institutions covered by comprehensive, "large" institution CRA examinations. In January 2003, the OTS was the first agency to announce that federally chartered thrifts were not required to comply with state laws regulating high-cost, predatory lending, and, in October 2004, the OTS took federal preemption a step further, issuing a legal opinion stating that third party agents (such as mortgage brokers) of federally chartered thrifts were not subject to state licensing and consumer protection regulations. This dramatically weakened protections for consumers in states that have strong anti-predatory lending legislation in place. When considered with the current proposal to weaken CRA, the OTS's recent pattern of behavior can be considered nothing less than a direct attack on low- and moderate-income households and their ability to take part in the full economic life of the nation with the guarantee of reasonable access to safe and sound financial products that contain fair terms and conditions. The OTS, in its recent actions, is acting like a financial industry lobbyist, not a public servant whose mission is both to strengthen the industry and protect the public.

The current OTS proposal would return CRA to the pre-1990s era when it was ineffectively enforced and had a negligible impact on improving access to financial services in low- and moderate-income communities. The proposal will substantially weaken CRA and hurt community development efforts in low- and moderate-income neighborhoods. It will not require institutions to improve if they have poor levels of community development services and investments and will allow institutions to receive outstanding CRA ratings while having no direct presence in low- and moderate-income markets. We ask that the OTS withdraws all aspects of this proposal.

Sincerely,



Geoff Smith  
Project Director

GS/bab

cc: Julie Williams, OCC  
Donald Powell, FDIC  
Jennifer Johnson, Federal Reserve Board