NLWJC - Kagan
DPC - Box 057 - Folder-018

Urban Policy - Community Reinvestment Act

Urban - community
reinvestment act

March 1, 1999

MEMORANDUM FOR THE PRESIDENT

CC: THE VICE PRESIDENT

FROM: ROBERT RUBIN
GENE SPERLING
BRUCE REED
LARRY STEIN

SUBJECT: Financial Services Legislation

ACTION-FORCING EVENT: On March 4, the House and Senate Banking Committees are both scheduled to mark up major financial services legislation. The House bill, developed by Chairman Leach and Ranking Democrat LaFalce, is generally acceptable. But the Senate bill being developed by Chairman Gramm is seriously flawed. While we expect to see another draft of the Gramm bill later today, the most recent draft would remove outmoded barriers to affiliations among different types of financial services firms, but it would also: (1) weaken the effect of the Community Reinvestment Act (CRA); (2) erode the national bank charter and the Administration's role in financial services policymaking; (3) provide inadequate consumer protections; and (4) provide increased leeway for affiliations between banks and nonfinancial firms.

RECOMMENDED ACTION: That you or John Podesta on your behalf sign the attached letter stating that you would veto the Senate bill in its current form (Attachment A).

Agree ____ Disagree _____ Discuss ____

BACKGROUND: Both Houses of Congress are currently considering legislation to permit the full range of financial services firms—including banks, securities firms, and insurance companies—to affiliate with one another. This memorandum describes the current status of such "financial modernization" legislation and outlines a strategy for countering the most objectionable features of the Senate bill.

Attachment B provides a more detailed discussion of the issues in question.

In General

The 1933 Glass-Steagall Act generally prohibits affiliation between banks and securities firms. The Bank Holding Company Act of 1956 generally prohibits affiliation between banks and insurance companies. Large financial services firms strongly support removing these barriers to affiliation, although consumer and community groups generally see little benefit in such changes.

Repealing barriers to affiliation among financial services firms has the potential for giving consumers greater choice and lower costs. However desirable the general goal of financial modernization, it does not warrant accepting a seriously flawed bill. Financial modernization is already occurring in the marketplace, and will continue even without legislation.

Over the years, efforts to enact financial modernization legislation have repeatedly failed in the face of infighting among different types of financial services firms. By the end of the last Congress, however, a financial modernization bill known as H.R. 10 had received broad support from the banking, securities, and insurance industries. The bill passed the House but died on the Senate floor for two reasons. First, Senators Gramm and Shelby opposed what they characterized as an expansion of the Community Reinvestment Act. Second, the Administration objected that the bill would have undercut its role in financial services policymaking and had the effect of weakening CRA.

Status of Legislation

As this Congress turns to financial modernization legislation, the inter-industry consensus on the need for such legislation remains intact. Both the Banking Committees are scheduled to mark up financial modernization bills on March 4. Given that early start and the momentum for some sort of legislation, the prospects for passage of legislation are stronger than in the last Congress, though still uncertain.

- ***House.*** The Leach-LaFalce bill has been developing along very constructive lines, and we anticipate that it will merit our support. As discussed in Attachment B, the bill accomplishes the basic work of financial modernization—allowing affiliations among different types of financial services firms—and does so consistent with our views on the Community Reinvestment Act, banking structure, and other issues. The House Leadership is by all accounts committed to moving some sort of financial modernization bill. The House Commerce Committee, however, may seek changes that could be unacceptable.

- ***Senate.*** Chairman Gramm is scheduled to release a committee print on March 1. As further described in Attachment B, Gramm's recent draft bill runs counter to our views on CRA, banking structure, consumer protection and promoting a separation between depository institutions and commercial firms. Senator Sarbanes, the Ranking Democrat, is working with the Treasury to unite Banking Committee Democrats behind an alternative bill that will have much in common with the Leach-LaFalce bill. The Committee is likely to approve the Gramm bill on a straight party-line vote.

CRA: The current version of the Leach-LaFalce compromise requires a bank to have and maintain a satisfactory CRA record in order to engage in newly authorized non-banking activities—a requirement not included in the Administration's 1997 bill, but which we have since argued is essential to maintaining the vitality of CRA. The draft Gramm bill contains no such "have and maintain" requirement, and includes two amendments that would seriously undermine CRA.
Some House Democrats may seek to go on the offensive by proposing to expand CRA. For example, Representative LaFalce may offer an amendment to make explicit that public comment on an institution's CRA record must be considered in applications for newly authorized activities, an amendment we could support. Last year, Representative LaFalce introduced an amendment requiring financial institutions to report on their progress in meeting publicly announced "commitments" under CRA; currently no such reporting occurs. Other House committee Democrats may offer amendments to extend the reach of CRA to insurance companies and securities firms.

Near-Term Strategy

Our near-term goal is to assist Leach and LaFalce in moving their bill forward, while doing everything possible to block the Gramm bill. This strategy has four advantages. First, we would help advance the better of the two bills. Second, we would take a strong stand against weakening CRA. Third, we would help unite Senate Democrats against the Gramm bill. Fourth, we would be taking a visible stand against a bad "financial modernization" bill, while simultaneously supporting a good bill.

To further this strategy, we recommend that you --as requested by Senator Sarbanes -- or John Podesta on your behalf send a short letter stating that you would veto the Gramm bill if it were presented to you in its current form. The proposed letter would cite two reasons from last Congress: The bill's weakening of the effect of CRA, and the bill's flawed banking structure issues. It would also cite two new reasons: the bill's inadequate consumer protections (notably the failure to provide adequate investor-protection safeguards on the sale of securities to bank customers), and its extensive expansion of non-financial firms' ability to affiliate with banks.

Secretary Rubin would send a letter setting forth a fuller explanation of our reasons for opposing the Gramm bill. He would also send a letter supporting the

Leach-LaFalce bill.

Finally, your advisors are discussing the merits of various CRA proposals and how we should respond to amendments that would enhance enforcement of CRA, such as the LaFalce amendments. Some think that supporting something along these lines could strengthen our hand in negotiations later on; moreover, as we provide the industry with new opportunities, they argue, we should insist on some new responsibilities. However, some of these amendments would present an uncomfortable vote for moderate Democrats, have slim prospects for passage, and could possibly jeopardize the CRA provisions already in the House bill.

Attachments

ATTACHMENT A: PROPOSED LETTER TO CHAIRMAN GRAMM

Dear Mr. Chairman:

This Administration has been a strong proponent of financial legislation that would reduce costs and increase access to financial services for consumers, businesses and communities. Nevertheless, we cannot support the "Financial Services Modernization Act of 1999" now pending before your Committee.

In its current form, the bill would undermine the effectiveness of the Community Reinvestment Act, a law that has helped to build homes, create jobs, and restore hope in communities across America. The CRA is working, and we must preserve its vitality as we write the financial constitution for the 21st Century. The bill would deny financial services firms the freedom to organize themselves in the way that best serves their customers, and prohibit a structure with proven advantages for safety and soundness. The bill would also provide inadequate consumer protections. Finally, the bill would expand the ability of depository institutions and non-financial firms to affiliate, at a time when experience around the world counsels caution in this area.

The President [I] agree[s] with you that reform of the laws governing our nation's financial services industry would promote the public interest. However, he

[I] will veto the bill if it is presented to him [me] in its current form.

Sincerely,

ATTACHMENT B: KEY ISSUES

1. Community Reinvestment Act

Current Law. CRA requires a bank to serve the convenience and needs of all communities in which it operates. Although banks are examined periodically for CRA compliance, enforcement comes only when a bank files an application to merge with another bank or open a new branch. The regulator must then consider the bank's CRA record in evaluating the bank's application, and the public has an opportunity to comment on the application. A bank's CRA record is not *currently* scrutinized in connection with applications to affiliate with non-banking companies.

Early in your Administration, and at your request, the banking regulators revised the regulations implementing CRA to focus on performance, not paperwork. They now base CRA ratings on a three-pronged test: lending, services, and investments. Regulators also revised and streamlined the examination process, particularly for smaller institutions.

Conditioning Authority to Conduct New Non-banking Activities on Banks Having a Satisfactory CRA Record. We have argued that financial modernization legislation must preserve the relevance of CRA for the 21st century, and must not weaken the effect of CRA. CRA's relevance should be maintained by conditioning authority to conduct new non-banking activities on banks having a satisfactory CRA record. Although the Administration's 1997 bill did not impose a link between CRA and non-banking activities, we have insisted in this Congress that a bank both *have* and *maintain* an adequate CRA record as a condition of engaging in newly authorized non-bank activities. This would provide additional means for enforcing existing CRA obligations. Noncompliance would result in submission of a compliance plan (and ultimately, albeit unlikely, forced divestiture).

The Leach-LaFalce compromise requires the bank to have *and* maintain a satisfactory CRA rating, though amendments (including by Leach himself) are possible. Secretary Rubin has testified that if we wish to preserve the relevance of CRA, at a time when the relative importance of bank mergers may decline and non-bank financial activities are becoming increasingly important, authority to engage in newly authorized non-bank financial activities must be conditioned on satisfactory CRA performance.

Gramm's draft bill imposed no such condition. Gramm views such a requirement as an unprecedented expansion of CRA to non-bank activities, and has told the Secretary that he would prefer no bill to a bill with such a condition. We have argued, though, that the financial services system of the future may include rather fewer banking applications (and therefore fewer opportunities for enforcement of CRA) and more non-banking activities (where an ongoing requirement of a satisfactory CRA record would be a meaningful incentive for compliance). Thus a bill that is silent on CRA (and thus supposedly neutral) would, in our view, tend to weaken the effect of CRA, and we would oppose such a bill.

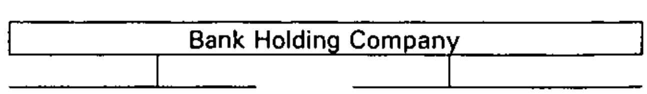
Gramm's Safe Harbor Amendment. Gramm has proposed a safe harbor for applications now subject to CRA. A satisfactory CRA rating at a bank's most recent examination would conclusively establish the bank's CRA performance, unless a public comment provides substantial verifiable information to the contrary. A regulatory agency could not review the bank's CRA record unless there were an adverse public comment meeting the test—even if the previous examination were old or otherwise stale. And Gramm would create a rebuttable presumption favoring approval of the application. In so doing, he would place a significant burden of proof on consumer and community organizations that generally have less access than the bank to relevant information. He would also, in effect, force community groups to stretch their limited resources to comment on many examinations, instead of focusing those resources on major applications (e.g., for mergers or acquisitions). Secretary Rubin has testified that such a safe harbor would tend to eviscerate the effectiveness of CRA, and the Administration has repeatedly threatened vetoes of bills containing safe harbors provisions.

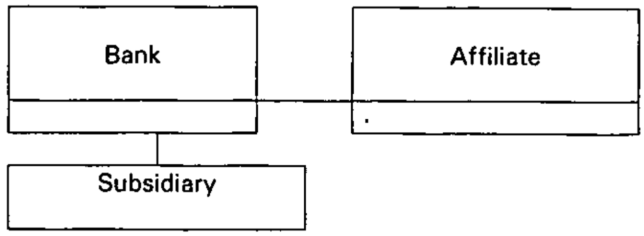
Gramm's Anti-extortion Amendment. Gramm has also proposed a so-called "anti-extortion" provision which may be dropped from the bill. We strongly oppose extortion. Yet laws punishing extortion, bribery, and false statements already protect against misuse of the CRA process. Gramm's broad and vague proposal would criminalize normal, legitimate arms length transactions and cooperation between banks and community groups (e.g., bank grants to support community groups' home ownership counseling programs)—the very sort of activity CRA seeks to foster.

It is important to note that if we should end up opposing a bill, for whatever reason, CRA will be the issue best able to unite Democrats behind us.

2. Allowing Firms the Choice of Operating through Subsidiaries as Well as Affiliates.

Since 1995, the Treasury has advocated giving financial services firms that include banks the option of conducting newly authorized financial activities (e.g., securities underwriting) in through a subsidiary or an affiliate.





The Fed, by contrast, has insisted that new activities be allowed only in Fed-regulated affiliates.

We have emphasized four points to Members of Congress:

- Absent a demonstrable public interest to the contrary, financial services firms should have the same freedom as other businesses to organize themselves in the way that best serves their customers.

- The subsidiary approach has strong safety and soundness advantages. If the subsidiary prospers and the bank falters, the bank's interest in the subsidiary can be sold to help replenish the bank's capital—or reduce any loss to the FDIC. Yet if the bank prospers and the subsidiary falters, the bank faces no greater risk than if an affiliate faltered. Four past and present Chairmen of the FDIC have strongly agreed with this point, arguing that the subsidiary offers better protection to the FDIC and the taxpayer.

- Banks with new financial activities in subsidiaries will have more earning assets, and thus will be stronger and better able to serve their communities under CRA.

- The subsidiary/affiliate option would also help preserve the current balance among the regulatory agencies by giving both Treasury/OCC and the Fed a role in supervising new financial activities. In so doing, it would help safeguard the role of the President and the Executive Branch in financial services policy making.

These efforts appear to be bearing fruit. On the House side, the Leach/LaFalce compromise includes the subsidiary option, and permits subsidiaries to conduct all financial activities except insurance underwriting. On the Senate side, Chairman Gramm's discussion draft would allow the subsidiary option only to banks with less than $1 billion in assets—an approach that Secretary Rubin has labeled a non-starter. We understand, however, that several Banking Committee Republicans (Bennett, Grams, Shelby) strongly support our position (and may well be joined by Hagel and Mack). Among the Democrats, Senator Sarbanes, formerly a critic of the subsidiary option, will include the Leach-LaFalce subsidiary in the Democratic substitute.

3. Consumer Protection

We believe that financial modernization legislation should contain appropriate consumer protections, including safeguards relating to the sale of non-banking products to bank customers (e.g., suitability and disclosure requirements). The Leach-LaFalce bill contains such protections. Yet the Gramm bill, although it would significantly expand the potential for affiliations between banks and securities firms, fails to provide adequate investor protections in connection with the sale of securities to bank customers.

4. Banking and Commerce

Considerable controversy has arisen recently over proposals to "mix banking and commerce", i.e., to allow depository institutions to affiliate with non-financial firms.
Secretary Rubin has expressed serious reservations about allowing affiliations of depository institutions and non-financial firms. Experience in Asia raises concerns that mixing banking and commerce can lead to inefficient allocation of resources and exposure of the banking system to risk. Chairman Greenspan has expressed similar sentiments, arguing that we should assess the effect of allowing full affiliation among financial firms before allowing affiliations with non-financial firms. Senator Sarbanes strongly opposes mixing banking and commerce. Assistance on the subsidiary issue was conditioned on our support on this issue. Chairman Leach also opposes mixing banking and commerce.

The draft Gramm bill proposed a significant expansion of banking and commerce. For example, under the Gramm draft, a large banking organization could own a mid-sized commercial firm, and a large commercial firm could own a small bank. Also, any commercial firm would be permitted to own a savings association (thrift) of any size, as under the current "unitary thrift holding company" law.

The Leach-LaFalce bill contains what may be an acceptable compromise. New commercial affiliations would not be permitted, and the unitary thrift holding company would be prohibited going forward (with existing ownership grandfathered). The compromise depends, though, on a slightly broader definition of permissible financial activities, which we will need to negotiate.

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Paul J. Weinstein Jr.
06/25/98 03:35:11 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP

cc:
Subject: Three Questions -Reply

Some good new and some mediocre from Treasury on several issues I have been working on. They are working hard on getting Child Care in on the Low Income Housing Tax Credit piece, but they are taking the easy route off on EFT, making it an almost completely voluntary program.

--------------------- Forwarded by Paul J. Weinstein Jr./OPD/EOP on 06/25/98 03:37 PM ---------------------------

"BARRM%DOM3.DOPO6" <Michael.Barr @ MS01.DO.treas.sprint.com>
06/25/98 12:40:22 PM

Record Type: Record

To: Paul J. Weinstein Jr./OPD/EOP

cc: "kelloggc%DOM3.DOPO6" <CLIFF.KELLOGG @ MS01.DO.treas.sprint.com>
Subject: Three Questions -Reply

Date: 06/25/1998 12:35 pm (Thursday)
From: Michael Barr
To: EX.MAIL("Paul_J._Weinstein_Jr@opd.eop.gov")
CC: kelloggc
Subject: Three Questions -Reply

Paul, sorry that Cliff and I missed your meeting. We were quadriple booked. Please give me a call to let me know how things went.

On your CDFI question:

The Fund has held two rounds of CDFI awards totaling $80 million, to 81 CDFIs. The third round applications have been received, and awards will be made before the end of September.

The Fund has held two rounds of BEA awards totaling $30 million to 92 institutions. The third round applications have been received, and awards will be made before the end of September.

The Fund has also held one Presidential Awards for Micro-Enteprise round. The second round is underway, and awards will be made before the end of calendar year 1998.

The Fund has also launched a $5m technical assistance round, focused on building the capacity of smaller, newer CDFIs, with awards to be made before the end of September. The Fund will soon launch a $15m training procurement, focused on building the capacity of the field to provide t.a. to CDFIs, with decisions before the end of September.

The Fund will spend approx. $92m by the end of the fiscal year, leaving approx. $18m to carryover to FY 1999 (no funds will lapse), to begin funding program rounds that will be obligated in FY 99.

The Appropriations subcommittees have both issued chairman's marks. The Senate at $55m; House at $80m. They will not complete their work until likely in September, as part of a larger budget package.

On your Fair Lending question:

We sent in our joint letters on Reg. B and Reg. C. The Fed. received hundreds of comment letters. Our position was supported by large banks, community and consumer groups; our position was opposed by a number of smaller banks. The Fed. is unlikely to issue a proposed rule until this fall at the earliest. We continue to monitor this closely.

On low income housing tax credit:

In the Senate, there are 57 cosponsors. The House has 239. We tried to get the credit put on the IRS restructuring bill, but failed. We'll try again on the next likely vehicle, an extenders bill later this summer. Also, we have agreement on child care facilities being eligible for credits.

On EFT '99:

We will issue a press release today on the EFT '99 regulation governing waivers, basically saying we're treating this as a near voluntary program. We expect to issue the regulation in July. On the ETA accounts, which is where we might be doing some good that we'd like to play up, we expect to issue a proposed account structure in July.

On CRA:

We expect a heated fight on our CRA-lite credit union provisions and on a likely Shelby CRA small bank exemption amendment. We've been strategizing to be sure we're ready for such a fight.

On IDAs:

I'd still like to see Treasury administer this program, so that we can link it with financial institutions policy, EFT '99, CDFI and our saving agenda. Please weigh in.

>>> EX.MAIL."Paul_J._Weinstein_Jr@opd.eop.gov" 06/25/98 11:33am
>>>
RFC-822-Headers:
X-Lotus-Fromdomain: EOP
Mime-Version: 1.0
Content-Type: text/plain; charset=us-ascii

Elena: Good article on CDFIs Mw

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in which the EU will seek to stop proliferation of weapons of mass destruction; will press Iran to sign anti-terrorism conventions; and will refrain from retaliating against American firms. Clearly, American energy firms would love to get involved in Iran; but it seems clear that the Europeans, plus Russia and Malaysia, are getting waivers from the rigours of a sanctions law that will remain.

Besides, the administration can hardly take domestic support for granted. Congress, which has imposed sanctions no fewer than 61 times in the past few years on regimes that offend it, can hardly be expected to deal more gently with Iran. First, this is an election year. Second, Iran has been demonised (often with reason) as an exporter of terrorism, an avowed enemy of Israel and an aspirant to acquire nuclear and other weapons of mass destruction: witness, say the suspicious, the Bushehr nuclear reactor being built with Russian help on the Gulf coast.

On June 23rd, President Clinton announced that he was vetoing legislation which would impose sanctions on suppliers of missile technology to Iran. The president's argument was that the bill would "make it more difficult" to deal with Russia on a range of issues, and does not reflect the progress made by Russia "to sever links between Russian entities and Iran's ballistic missile programme". Mr Clinton may be right, but the fact is that the bill was passed in the House by 392 votes to 22 and in the Senate by 90 votes to 4. If he wants his veto to stick, he will have to produce convincing evidence that he has found a better way to a better Iran. And, as he knows only too well, drawing maps in the Middle East is far from easy. ■

Community development finance

Banking on the poor

NORTH PHILADELPHIA

The Clinton administration has poured millions of dollars into community financial institutions. Has it been money well spent?

ACROSS the street from a disused factory in the heart of North Philadelphia, a few blocks from some of the worst urban decay in America, is a sight to make Bill Clinton's heart beat a little faster. Sprawled contentedly on plastic mats and covered with light blankets, more than 100 children are taking their midday nap. Bright yellow partitions divide them into different age groups. The infants have cots; the pre-schoolers share a computer. A milk-cooler hums in the corridor; there is no television in the place.

This is the North Broad Street branch of the Allegheny Child Care Academy, a sparkling new day-care centre for 130 children, 97% of whose mothers are on welfare-to-work programmes. It is one of six new commercial child-care centres in Philadelphia, owned by an entrepreneur from Pittsburgh (where there are more such centres), and financed by venture capitalists together with the Delaware Valley Reinvestment Fund, Philadelphia's biggest community development financial institution (CDFI).

CDFIs are the latest fashion in America's efforts to fight rural and urban poverty. In 1992 candidate Clinton vowed to spend $1 billion creating 100 community lenders. In office, he decided a better approach was to finance existing as well as new CDFIs. Bipartisan legislation in 1994 created the CDFI fund, housed in the Treasury Department, with an authorisation to spend $382m over four years on CDFIs and on banks that invested in them.

The ugly acronym covers a swarm of different institutions—including community credit unions, loan funds and microfinance funds—whose goal is to provide credit and capital to poor people who lack access to conventional financial services, such as banks. These institutions are generally unregulated, and are often non-profit organisations whose origins lie with church groups. Private investors, foundations, banks—and now the federal government—lend the CDFIs money at below-market rates, or put in grant or equity finance, which is then invested. Most CDFIs have concentrated on financing low-income housing; others provide consumer credit (see box) or, increasingly, invest in businesses in poor districts.

Dollars wanted

Delaware Valley is one of the larger and more dynamic CDFIs. Run by Jeremy Nowak, an indefatigable former community organiser, with the help of several graduates from Wharton business school, it has become an important force in Philadelphia's poorer communities. Since 1985 it has invested more than $90m, leveraging a further $250m, which has financed 3,000 units of low-income housing and created (or preserved) 5,000 jobs. The investment in Allegheny Child Care comes from its new venture-capital fund.

Few CDFIs are as big as that but—after chugging along for decades—these unconventional financiers have boomed in the 1990s, thanks in large part to the publicity generated by the Clinton administration. Since they mostly escape regulation, no one knows exactly how many CDFIs there are or how much money they control. Mark Pinsky, head of the National Community Capital Association, the biggest association of CFDIs, reckons there are about 350 such organisations in the country, with between $2 billion and $3 billion in capital available for lending. His own members' capital has grown by almost 40% a year during the 1990s.

Measured against a $23 trillion financial services industry, these numbers are paltry. But in an era of bank consolidation and dramatic change in federal social assistance, CDFIs do an important job in providing finance for projects in poor areas. That, at least, is the opinion of Mr Clinton and his treasury secretary, Robert Rubin. And, in theory, federal financing for CDFIs makes a lot of sense. Instead of creating big new government programmes and projects, federal money tops up private channels. This cuts bureaucracy and waste, and can ensure (though not infallibly) that public capital is efficiently allocated among the deserving.

Unfortunately, the CFDI fund's reputation in Washington is less sparkling. A big share of its first funding round in 1996 went to organisations connected with South Shore Bank, a community lender (though also a fully regulated bank) with close ties to Hillary Clinton. Spencer Bachus, a Republican congressman who leads the congressional subcommittee that oversees the fund, smelt a political rat and quickly began to investigate.

His findings, first publicised last year and formally published this month, do not make pretty reading. Although there is no real evidence of politically motivated lending (and in the industry few quibble with the choice of institutions that received money), the CDFI fund in its early years was wasteful, politically naive and, at times, incompetent. Too much money was spent on high-powered consultants; there were inadequate records of why particular CDFIS were financed; and, most egregiously, senior CDFI people tried to cover their tracks by adding (undated) memos to their files just before congressional staffers came to look at them.

All this has now changed. The CDFI fund is under new management and is working hard to sort itself out. So far, it has invested \$77.6m in 81 CDFIS and \$30m in 92 banks that lend to them, and is currently assessing 245 applications for this year (it will hand out about \$40m). Although its reputation is tarnished, particularly among some Republicans, the fund will almost certainly get its appropriation from Congress this year, though probably not as much as the administration would like. (It has received \$225m since 1995 and is asking for \$125m this year; much meaner proposals are now being mooted in various congressional committees.)

A bit less cash might not be such a bad thing. One of the biggest dangers CDFIS face is excessively rapid growth. Delaware Valley has doubled its lending in the past two years. Many others are growing at similar rates. Mr Pinsky hopes that CDFIS can become a \$25 billion industry within a decade. For small CDFIS, in particular, such massive expansion can be dangerous. Investing in poor areas is a time-consuming, labour-intensive business, and most CDFIS are small players. Many have never been through a recession. As with all banks, too much easy money too quickly will soon spell bad investments.

Another risk is that CDFIS may become caught up in a knot of federal regulations. Some oversight is necessary, to make sure public money is not misused. But the CDFIS' strength today lies in their diversity and independence. It would be a pity if they became just another government programme for the poor.

Perhaps the biggest danger is dashed expectations. Listen to Mr Clinton enthusing about community banks, and it is easy to see them as a Great New Panacea for distressed communities. They are not. They are small, if promising, helpers. As the financial-services industry consolidates, they have the potential—if properly managed—to play a more important role. But they are not a miraculous answer to one of America's most intractable problems.

Credit in the hollows

BEREA, KENTUCKY

IN DENIM dungarees and a blue baseball cap, with well-worn work boots on his feet, Steve Neeley is as solid as the Appalachian hills among which he lives. He drives a pick-up truck, lives in a 70-foot mobile home with his 11-year-old daughter, and works for \$6.40 an hour at a woodcraft plant in Jackson County.

He is also one of the most stalwart members of the Central Appalachian People's Federal Credit Union (APFCU), a financial institution set up to serve the poor of Appalachia. Over the years Mr Neeley reckons he has borrowed \$10,000 from the credit union: his most recent loan, for \$350, was to repair his tractor and buy a side of beef for the freezer.

The APFCU, which received \$575,000 from the CDFI fund in 1997, is the only credit union specifically designed to help Appalachia's poor. It provides consumer and some mortgage lending to one of America's most distressed rural areas. Jackson County, where Mr Neeley lives, has a 38% poverty rate. Its typical family income is less than half the national average. Almost half of the credit union's members earn less than \$1,000 gross a month; 12% earn less than \$500. The average loan in 1997 was just over \$4,000 (usually to pay for a car), but many are much smaller. Jim Roland, head of the credit union's Jackson County branch, recently lent a couple \$115 to pay their electricity bill.

Making loans of this size to poor people is an expensive and risky business. The credit union writes off about 1.4% of its loans a year, a much higher rate than the industry's average (though not so much higher than the write-off on, say, credit cards). Its administrative costs and spreads are bigger than those of ordinary banks. But it reaches people whom those banks largely ignore, teaching them about managing money, encouraging them to save, and keeping them from falling for the loan sharks and finance companies that are often the only other source of credit. In Appalachia, that is no mean achievement.

The APFCU can pay her bills

Boll-weevil trouble

Jes' a-lookin' for a home

BORDELONVILLE, LOUISIANA

IN THE rain-thirsty cotton fields of central Louisiana, a series of green plastic cones, hoisted on poles, stand among this season's newly planted shoots. They are traps, marking the sites where state officials check the progress of their latest pest-control programme: a chemical massacre of the boll weevil. If all goes well, the traps will also mark the end of an era: the final defeat of the mightiest insect around.

When it comes to destruction, nothing compares to the weevil, which hopped from Mexico to Texas in 1892, and into Louisiana soon after that. With its protruding snout and stunted wings, the boll weevil looks part beetle, part aardvark, and has no natural enemies in the American South. As it worked its way slowly across the region, ravaging cotton fields and ruining cotton farmers, it radically changed the economy.

It brought a diversification of crops, helped the study of pesticides, and speeded the northward migration of black farm workers. Cotton, though hurt, survived: it is still one of Louisiana's chief agricultural products, second in value only to timber. But many farmers long ago converted their fields to safer, less lucrative crops, such as soyabeans and corn. And, thanks to the weevil, the 5,000 state farmers who still produce cotton must drench their fields with chemicals up to 20 times each year.

For decades, the federal government has studied the boll weevil, hoping to destroy it. In the late 1970s, researchers unveiled a five-year programme that actually seems to work. It has the ambitious title of Boll Weevil Eradication. Its weapon is a

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STATEMENT OF ADMINISTRATION POLICY

TO: JACK LEW
SYLVIA MATHEWS
JOHN PODESTA
MARIA ECHAVESTE
LARRY STEIN
ELENA KAGAN
BRODERICK JOHNSON
GENE SPERLING
SARAH ROSEN
CHUCK KIEFFER
ELIZABETH GORE
CHUCK KONIGSBERG

DATE: 8/6/98

FROM: Kate Donovan, OMB Legislative Affairs

RE: FOR YOUR CLEARANCE -- Draft Treasury Letter on HR 4364 - Depository Institution Regulatory Streamlining Act of 1998

POSITION: SECRETARY OF TREASURY VETO RECOMMENDATION ON THE BILL IN ITS CURRENT FORM.

BACKGROUND: HR 4363 was marked up by a House Banking subcommittee on 8/4/98. The subcommittee amended the bill to include a provision that would exempt small banks from the Community Reinvestment Act.

On 7/22/98, a SAP was released on HR 1151, Credit Union Membership Access Act with the position: "The full Senate should reject amendments ... such as the amendment that would substantially weaken the CRA by exempting certain banks from the Act's requirements. If HR 1151 were presented to the President with such an amendment, the Secretary of the Treasury would recommend that the President veto the bill."

TIMING: Treasury aims to release before the House recesses for the month. Please review & provide comments/clearance as soon as possible to Kate Donovan at 5-4790. Thanks.

DRAFT

The Honorable James A. Leach
Chairman
Committee on Banking and Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I am writing to voice the Administration's strong opposition to H.R. 4364, the Depository Institutions Regulatory Streamlining Act of 1998, as approved by the Subcommittee on Financial Institutions and Consumer Credit on August 4. If the bill were to be presented to the President in its current form, I would recommend that he veto it.

As you know, the Administration strongly supports regulatory reform and has taken numerous steps over the past five years to reduce the costs and improve the quality of depository institution regulation. But we cannot accept the bill in its current form.

Section 313 of the bill would exempt over 85 percent of the nation's banks and thrifts from the Community Reinvestment Act. The CRA provides incentives for depository institutions to serve all of our communities. The federal banking agencies rewrote their CRA rules in 1993-94 to emphasize performance – not paperwork – and thereby eliminate burdens associated with the old CRA rules. Eighty-one percent of banks and thrifts have a streamlined examination with no reporting requirements beyond those otherwise applicable and virtually no documentation of performance beyond what the institutions would otherwise do in the ordinary course of business. Section 313 ignores this progress and – in the name of alleviating the former paperwork problem – would exempt most depository institutions from a statute that plays an important role in helping revitalize distressed communities, both urban and rural.

Section 101 would permit the Federal Reserve to pay interest on reserves maintained at Federal Reserve Banks. The Office of Management and Budget has estimated that paying interest on reserves would cost taxpayers $800 million over the period 1999-2003. Section 103 purports to pay for such a cost by drawing down the Federal Reserve System's retained earnings. Yet from the standpoint of protecting the taxpayers, this budgetary device is transparently fictitious: the retained earnings essentially belong to the taxpayers, and spending those retained earnings (instead of appropriated funds) saves the taxpayers nothing. In principle, we support paying interest on reserves. But given the many high-priority claims on scarce budget resources, the high cost of paying interest on reserves, and the failure to identify an acceptable offset, we must object to section 101.

We have other concerns about the bill, which we will detail in a subsequent letter.

Sincerely,

RER

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

July 22, 1998
(Senate)

STATEMENT OF ADMINISTRATION POLICY

(THIS STATEMENT HAS BEEN COORDINATED BY OMB WITH THE CONCERNED AGENCIES.)

H.R. 1151 - Credit Union Membership Access Act
(Latourette (R) OH, Kanjorski (D) PA and 206 cosponsors)

The Administration strongly supports Senate passage of H.R. 1151, as approved by the Senate Banking Committee, without extraneous or controversial amendments. The full Senate should reject amendments rejected at the Banking Committee mark-up, such as the amendment that would substantially weaken the Community Reinvestment Act by exempting certain banks from the Act's requirements. If H.R. 1151 were presented to the President with such an amendment, the Secretary of the Treasury would recommend that the President veto the bill.

The Senate Banking Committee version reflects a careful balancing of important goals: (1) protecting existing credit union members and membership groups; (2) removing uncertainty created by the Supreme Court's AT&T decision; (3) facilitating credit union expansion beyond core membership groups in appropriate circumstances, such as when necessary to meet the needs of underserved areas; (4) reforming credit union safety and soundness safeguards, by instituting capital standards and a risk-based capital requirement, as well as further strengthening the Share Insurance Fund; and (5) reaffirming and reinforcing credit unions' mission of serving persons of modest means. The Administration strongly opposes any efforts to upset this balance by stripping the bill of any of these important provisions.

Specifically, Section 204 would require periodic review of each Federally-insured credit union's record of meeting the needs of such persons within its membership. This requirement is flexible, tailored to credit unions, and will impose no unreasonable burden. It rests on the Congressionally mandated mission of credit unions and on the benefits of Federal deposit insurance. Inclusion of Section 204 is particularly important to keeping credit unions focused on their public mission in view of how the bill liberalizes the common bond requirement.

In addition, the Administration sees no safety and soundness basis for an amendment that would limit the ability of credit unions to make business loans to their members. Existing safeguards, coupled with the new capital and other reforms in the bill, are sufficient to protect against any safety and soundness risk from member business lending.

Pay-As-You-Go-Scoring

H.R. 1151 would affect direct spending and receipts; therefore it is subject to the pay-as-you-go requirements of the Omnibus Budget Reconciliation Act of 1990. The Administration's preliminary estimate is that H.R. 1151 would have a net budget cost of zero.

* * * * * * *

Urban - Com Reinv Act

NEW COMMUNITY REINVESTMENT ACT NUMBERS

According to the National Community Reinvestment Coalition (NCRC), the private sector has pledged more than $1 trillion going forward in loans to distressed communities – and more than 95 percent of these financial commitments have been made since 1992.

- There have been 23 times more financial commitments to distressed communities from banks in the past 5½ years than in the previous 15 years combined.

- Lending commitments under the CRA have increased 69-fold from the pre-1993 era -- from an average of $2.6 billion per year between 1977 and 1992 to about $180 billion per year in the past 5½ years.

Financial Commitments To Distressed Communities Under CRA	
1977-1992:	$42.3 billion
1992-1998:	$991.7 billion
Total since 1977:	**$1.034 trillion**
% Since 1992:	**96%**

Financial Commitments To Distressed Communities Under CRA (Average Financial Commitments Per Year)	
1977-1992:	$2.6 billion per year
1992-1998:	$180 billion per year
Past 5 Years vs. Previous 15 Years	**69-Fold Increase**

NOTE: These numbers include financial commitments to distressed communities by financial institutions with merger approvals still pending.

If Only Approved Mergers Are Included:

- Under CRA, \$411 billion in financial commitments have been made to low-income communities with 90 percent -- \$369 billion -- has come since 1992.

Urban policy -
Community Reinvestment
Act

Paul J. Weinstein Jr. 01/29/98 04:59:54 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP

cc: Jose Cerda III/OPD/EOP, Julie A. Fernandes/OPD/EOP, Christa Robinson @ EOP @ LNGTWY
Subject: Gene Ludwig and CRA

In his resignation letter to the President, Gene Ludwig offered the following statistics on the impact of the Administration's 1993 reform of the Community Reinvestment Act (CRA):

"Lending commitments under the CRA have increased 15-fold from the pre-1993 era, from roughly $3 billion a year to $43 billion a year. Thes commitments represent new credit availability for low- and moderate-income urban and rural communities, including loans for housing, small farms and small businesses. At the same time, equity investment by national banks in community development corporations and projects were six times greter in the last four years than during the previous 28 years combined. Home mortgages to African Americans and Hispanic Americans have increased more than 50% over the last four years -- almost three times the rate of increase for the population as a whole. In some chronically underserved communities the change has been even more dramatic....moreover, we have been able to achieve these results while substantially reducing the supervisory and paperwork burdens that the CRA had previously imposed on the banking industry."

This paragraph highlights what I maintain is still our most successful, yet underpublicized community empowerment initiative. It also, in my mind, underscores the need for the President to give a major address which ties what has been a successful strategy to reinvigorate America's cities with his sizable package for urban America in his FY99 budget.