KENNETH H. THOMAS, PH.D

www.CRAHandbook.com

6255 CHAPMAN FIELD DRIVE

MIAMI, FLORIDA 33156

Voice (305) 663-0100
Fax (305) 665-2203

MEMO

From: Kenneth H. Thomas, Ph.D.

To: OCC (2014-0021), FRB (OP-1497), and FDIC (2014-0101-0001)

Date: November 10, 2014

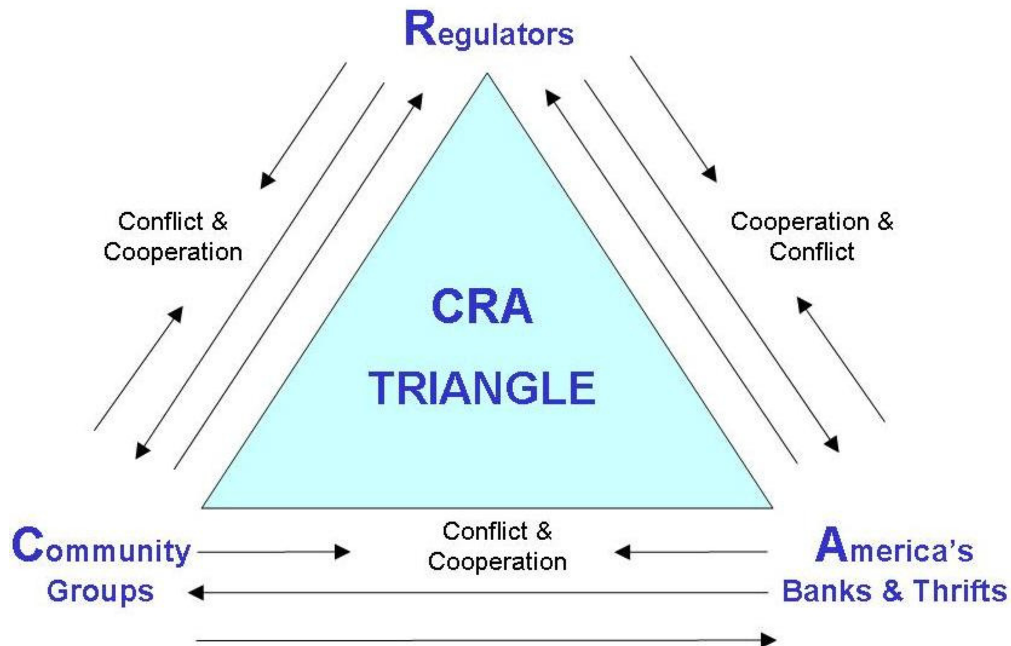
Re: Comments on Proposed Revisions to CRA Interagency Q&As Dated September 10, 2014

This comment is based on my on-going analyses of CRA, some of which has been published in Community Reinvestment Performance (Probus Publishing, 1993) and The CRA Handbook (McGraw Hill, 1998). Also, the 2002 Public Policy Brief on Optimal CRA Reform (www.levy.org) contains further background on my research and recommendations for improved CRA public policy.

The first part of this comment includes general recommendations that will hopefully be considered in the ongoing effort to improve CRA, and the second part of this comment includes specific comments on the subject Q&As.

General Recommendations to Improve CRA

These recommendations are based on my view as to the critical importance of The CRA Triangle in understanding and advancing good CRA public policy:



The CRA Triangle, with its three corners representing Community groups, Regulators, and American banks and thrifts (see graph), emphasizes the importance of the constant dynamic conflict and cooperation among these three corners. This give and take dynamic tension is critical to good CRA public policy, but the systems breaks down if there is excessive conflict or cooperation among these three corners.

With The CRA Triangle in mind, here are some of the most important general recommendations to improve CRA public policy:

1. The regulators themselves need to be more *responsive* to the community, instead of just banks and thrifts acting in this critical capacity. I am specifically referring to the glaring need for the three CRA regulators, namely the FDIC, FED and OCC, to develop a specific timeline and schedule for WHEN a CRA Public Performance Evaluation ("PE") becomes public. I have noted many examples in recent years where either the regulators and/or the subject banks have caused significant delays in the publication of a downgraded CRA rating thus benefiting the bank in many ways (until the next exam is done, usually with an upgraded rating). I commented on 5/1/2012 to the FDIC and the FED in this regard about the downgraded (from Outstanding to Satisfactory) CRA rating of BB&T which was dated 1/22/08 and not made public by the FDIC until an inexplicable 32 months later, four times the length of time their previous two Outstanding PEs were made public. Most recently I have criticized the OCC in this regard regarding the downgraded (from Outstanding to Satisfactory) rating of Bank of America and the FED regarding the pending downgraded (from Satisfactory to Needs to Improve) rating of a very large bank.

2. The entire CRA function (including regulations, examinations, ratings, enforcement, etc.) of the individual regulators should be transferred to the new Consumer Financial Protection Bureau (CFPB) to provide needed uniformity and minimize persistent CRA Grade Inflation which has been documented in my more than two decades of research on CRA. The above problem of subjectivity in the timing of the release of downgraded CRA ratings would likely be eliminated under the CFPB.

3. The previous small lending business data requirements should be reinstated for all banks, since the elimination of data from all but the largest banks limits the usefulness of such data in studying small business lending patterns in local markets, especially non-metropolitan and rural areas where there are few big banks.

4. The regulatory agencies should adapt a High and Low Satisfactory rating for all of its performance matrices and, most importantly, for the overall state and bank ratings. In doing so, we would return to the five rather than four overall CRA ratings that existed prior to July 1, 1990. This would mean both High Satisfactory ("B") and Low or just plain Satisfactory ("C") overall ratings rather than nearly everyone being lumped into a huge 90%+ "satisficing" category. This is the case today for state banks, credit unions, and even licensed mortgage lenders in Massachusetts.

5. The regulatory agencies and ultimately the CFPB should revisit the "shared branch" proposal and pilot test discussed in The CRA Handbook, and consider expanding this program to unbanked and under-banked markets to promote *physical* access to retail banking services by low-and moderate-income individuals.

6. Banks with Outstanding CRA ratings should be publicly highlighted in separate regulatory releases similar to the current ones on enforcement or similar adverse regulatory actions where banks are criticized. Furthermore, the heads of the agencies (and ultimately the CFPB) should send separate letters to the CEOs of those institutions complementing their Outstanding CRA performance. Good CRA public policy should encourage Outstanding rather than just Satisfactory CRA performance. Since this is not the case now, real CRA reform would mean a *dollar and cents* motivation for Outstanding CRA performance in the form of either *reduced FDIC deposit premiums* and/or a *tax credit*. Conversely, a bank with a failing CRA rating would be penalized, so CRA's teeth would bite into the income statement not just expansion plans. All banks with Outstanding ratings should have an additional year between exams, as is presently the case for small banks. Please see my 4/19/2014 *American Banker* comment titled "Comptroller Curry: How About Some Real CRA Reform?"

7. Any non-profit community group or coalition that represents itself to financial institutions as being associated with CRA or testifying to Congress in this regard must disclose whether any officers or Board members have any direct or indirect associations or relationships with for-profit vendors that sell CRA investments or other products or services to financial institutions. Further, all current and past direct and indirect monetary transactions between the for-profit and non-profit entities must be fully disclosed by both entities as well as to any financial institutions with whom these entities deal. This disclosure about receiving any direct or indirect past, present or planned financial benefits of any type should also apply to non-profit community groups or coalitions making favorable public comments about specific banks. Finally, any non-profit community group or coalition that has been found to be in violation of any conflict of interest provisions by HUD or other federal agencies should likewise be required to disclose this information in any public policy papers, testimony, or similar public pronouncements as well as in contacts with financial institutions with whom they work.

8. We believe that the regulators should provide some *quantitative* guidelines for bankers on how many Qualified Investments (QIs) should be purchased for different Investment Test ratings for large retail banks or for Community Development Investments by Intermediate Small Banks or Special Purpose Banks such as Wholesale and Limited Purpose Banks. While there are other *qualitative* factors which would impact the final rating (e.g., investments in new community development vehicles), I respectfully suggest the following numerical guidelines from The CRA Handbook be considered:

Community Development Investment or Investment Test Rating Guidelines	**QIs to Assets**
Outstanding	1.00% or more
High Satisfactory	.66 - .99%
Low Satisfactory	.26 - .65%
Needs to Improve	.11 - .25%
Substantial Noncompliance	0 - .10%

Source: The CRA Handbook (McGraw Hill, 1998)

9. The "Strategic Plan" option should be eliminated.

Specific Comments on September 10, 2014 Q&As

1. The ongoing CRA "regulatory creep," where CRA is being transformed into a very broad law that aims to cure many social problems must end. This regulatory creep is moving CRA far afield from its original simple mission of helping to meet community credit needs, including low- and moderate-income ones. As pointed out in my 10/24/2014 *American Banker* comment titled "A Simple CRA Is an Effective CRA," it is possible that this significant broadening of CRA has been partly responsible for the recent unfavorable trends in bank lending to small businesses and LMI Americans. With this perspective in mind, the proposed expansion of community development credit for such activities as environmentally friendly "green" activities or broadband access should not be considered, as they are effectively detracting from the real purpose of CRA which is LMI lending.

2. There is no need to change the existing CRA performance standards that place primary emphasis on traditional branches, since electronic delivery systems are already accounted for to the extent they are effective alternatives in providing needed services to low- and moderate-income geographies and individuals. While proponents of "branchless" delivery systems emphasize the increasing portion of electronic transactions being done on-line or via mobile or other devices, they ignore the fact that the original decision as to where to open an account is primarily convenience driven based on the location of branches relatives to places of residence, work, shopping, transportation or other frequently visited areas. The need for a physical branch presence is more important than ever in low- and moderate-income neighborhoods which have seen a disproportionate share of branch closings and where there is a pressing need to decrease the proportion of under-banked and unbanked households.

3. The consideration of CRA credit for *innovativeness* should not only include the innovative nature of individual bank activities as discussed in the Q&A but also the adoption and use by a bank of new community development activities in the marketplace that are competitive with existing ones. For example, if a bank presently receives CRA credit for a community development loan, investment, or service that is purchased or otherwise obtained from an outside source, that bank should receive innovative credit for purchasing or obtaining that same community development activity from a newly formed entity that is competitive with existing ones. In this way the regulators are encouraging the formation of new and competitive community development loan, investment and service providers in the marketplace. Under this approach, a bank would be given CRA innovative credit for such a community development activity that it already is involved in, as long as it is being obtained from a new and competitive provider in the marketplace. In summary, good CRA public policy should not only encourage innovation by banks in their community development activities but also innovation by providers of such activities to increase the overall level and competiveness of such activities.

4. The consideration of CRA credit for *responsiveness* should include input from the CFPB's Complaint Database to help determine which banks are being responsive to retail banking services and which ones are not. For example, if a bank receives a disproportionate high or low share of complaints on a mortgage or other lending product, this information should be considered by bank regulators in their CRA evaluations. While this database only applies to the largest banks covered by the CPFB, these banks have the lion's share of all deposit, lending, and other bank activities.