August 5, 2022
The Honorable Jerome Powell
Chairman
Board of Governors of the Federal Reserve System
Attention: Ann E. Misback, Secretary
20th Street and Constitution Ave. NW
Washington, DC 20551
RE: Community Reinvestment Act, Notice of Proposed Rulemaking, Docket Number R-1769, RIN 7100-AG29

The Honorable Michael Hsu
Comptroller
Office of the Comptroller of the Currency
Attention: Comment Processing
Chief Counsel's Office
400 7th Street SW, Suite 3E–218
Washington, DC 20219
RE: OCC Docket ID OCC–2022–0002

The Honorable Martin Gruenberg
Acting Chair
Federal Deposit Insurance Corporation
Attention: James P. Sheesley, Assistant Executive Secretary
550 17th Street NW
Washington, DC 20429
Attention: Comments RIN 3064–AF81

Dear Chairman Powell, Comptroller Hsu, and Acting Chair Gruenberg:

I am writing to comment on the Joint Notice of Proposed Rulemaking (NPR) entitled Community Reinvestment Act (CRA), which was issued jointly by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation on May 5, 2022.

My name is Mark A. Willis. The opinions expressed here are my own. I am currently a Senior Policy Fellow at the NYU Furman Center where I work mainly on community development (including the Community Reinvestment Act), affordable housing, housing finance, and tax policy. I previously headed community development for Chase/JP Morgan Chase, initially as the founding president of the Community Development Corporation at Chase Manhattan Bank and 19 years later leaving JPMorgan Chase as executive vice president for Community Development. Among my duties during those years I had direct responsibilities for the bank's CRA activities/compliance. Building on that experience I have continued to this day to write and lecture extensively on CRA and proposals for reform. Of my writings, two publications of note are my 2009 paper ("It's the Rating, Stupid: A Banker's Perspective on the CRA") in *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act*, a joint publication of the Boston and San Francisco Federal Reserve Banks (https://www.frbsf.org/community-development/files/revisiting_cra.pdf) and, "Updating CRA Geography: It's Not Just About Assessment Areas" (https://penniur.upenn.edu/uploads/media/Mark_Willis_10-1.pdf) which was published in

Housing Policy Debate and where I directly tackled the issue of evaluating CRA performance for internet banking.

I first would like to thank the three bank regulators—the OCC, the FDIC, and the Board—and their staffs for their leadership in updating the CRA regulations. Having a single set of regulations adopted by all three bank regulators is fundamental to the effectiveness of the CRA. The length of the NPR is a testament to the difficulty of the task you undertook. So, it should come as no surprise that the discussions and analyses that the NPR has prompted has further demonstrated how complicated it is to deal with such a complex and diverse industry operating in a world of widely varying local conditions. While clarity, consistency, and transparency are worthwhile guiding principles, the regulations also need to accommodate all that diversity and variation. It is simply not possible to accommodate all those differences with mathematical formulae. Hence the continued importance of building Performance Context (bank capacity and strategy and local market conditions) directly into all four tests.

Rather than respond specifically to each of the questions in the NPR (I leave that task to others more currently involved at the ground level), I have chosen to comment on two big picture issues—Geography for Evaluating CRA Performance and Motivating a Race to the Top. I also share a select number of brief, additional comments which I think could have an outsized impact on how well banks can do in helping LMI individuals and communities to thrive.

Geography for Evaluating CRA Performance

One area where stakeholders are in broad agreement is that the regulations need to be "modernized" to provide guidance on how to evaluate the CRA-related business done by banks in geographies outside of their branch networks and to allow CRA credit more broadly for community development activities in so-called CRA deserts. The NPR provides just such a framework. This framework is clear and offers a consistent way to evaluate large banks (and with modifications, intermediate banks) that can be uniformly applied to the whole range of bank business strategies ranging from a focus just on customers within a branch network, to forgoing branches while serving customers across a broad geography, and variations on a "hybrid" approach between the two extremes.

The proposed framework makes useful and practical distinctions across the geographies in which a bank may do business. The NPR retains a focus on evaluating a bank's CRA performance within any existing branch network by requiring the designation of Facility-Based Assessment Areas (FBAAs) where banks have a main office or branches. For markets where large banks provide retail loans beyond their FBAAs, the NPR adds two new types of geographies for evaluating the retail lending performance for major product lines: 1) Retail Lending Assessment Areas (RLAAs) where there are concentrations of loans (the NPR proposes thresholds of 100 home mortgages or 250 small business loans) and 2) an Outside Assessment Area (OAA) that encompasses all the other geographies where a bank makes retail loans.

These geographic distinctions make possible a nuanced approach to evaluating CRA performance. While all four of the performance tests (Retail Lending, Retail Services and Products, Community Development Financing, and Community Development Services) are applied in FBAAs, only the Retail Lending Test applies to RLAAs and OAAs. Community development is evaluated at the FBAA level, but not separately for RLAA and OAA geographies. Rather, to allow banks to receive full CRA credit for community development activities wherever they are made, community development is only additionally evaluated just at the state/metro and institution levels where the regulators are required to produce CRA ratings based on evaluations of both retail and community development performance within the relevant geographic boundaries.

While the proposed framework allows for distinctions as to where and how banks make their products and services available, it is too limiting in the way it evaluates retail lending performance in RLAAs and the OAAs. For these geographies, qualitative factors need to be integrated into the evaluation as they bear directly on the ability and opportunity of a bank to serve each of those markets. While bank metrics and community and market benchmarks are important pieces of information, basing conclusions exclusively on quantitative formulas that replicate the same fixed criteria for setting thresholds as used for FBAAs can have unintended consequences to the detriment of both banks and the communities that may no longer be served.

In particular, the evaluations of RLAAs and OAAs need to take account of Performance Context which includes a bank's strategy and capacity in a locality, as well as the market opportunity in that locality given the competitive environment from non-bank mortgage providers and local banks with a physical presence. Serving geographies remotely can present unique challenges even when offering an array of special products that are responsive to the needs of LMI communities and small businesses. The competition from local branch-based banks for these market segments may be particularly intense as they seek to enhance their own CRA ratings in that geography.

Without taking into account these types of factors, the Retail Lending Test on its own may result in many RLAAs failing to achieve even a Low Satisfactory and potentially failing the proposed test that at least 80% of the AAs need to be at least Low Satisfactory. In addition to this potential for receiving inappropriately low ratings for their efforts in RLAAs, banks will not always know which localities will be evaluated as RLAAs until loan counts exceed the minimum thresholds. And the mix of products that will be evaluated in the RLAA may also not be known in advance (the answer to Question 44 should be to evaluate only those products that meet the minimum thresholds.) To manage this uncertainty, banks may limit their reach to only those geographies where volume will be sufficient volume to warrant a focused CRA effort. In this light, and especially if RLAA product line evaluations remain strictly quantitative, the answer to Question 140 is that the required minimum percentage of assessment areas in which a bank must achieve at least a Low Satisfactory be limited exclusively to FBAAs.

In summary, designating RLAAs and OAAs creates a sensible framework for evaluating CRA retail lending performance outside of FBAAs, but it is inappropriate to apply a purely quantitative Retail Lending Test where banks do not have branches. Exclusive use of a quantitative Retail Lending Test in RLAAs and OAAs may put banks in the uncomfortable position of having to limit which markets to serve, a dilemma that could be particularly acute for markets where a bank has a small market share and strong CRA competition from local banks. The Retail Lending Test for RLAAs and OAAs needs to incorporate qualitative factors as happens at the FBAA level where Performance Context and other factors are taken into account as part of the four-test analysis. Without such changes for evaluating the CRA performance at the RLAA (and OAA) level, the minimum threshold for the percent of AAs to achieve at least a Low Satisfactory should apply only to FBAAs.

<u>Motivating a Race to the Top</u>

The revised regulations need to encourage a self-reinforcing "race to the top" where banks are continually motivated to compete with each other to have a positive impact on low- and moderate-income communities, as evidence by an Outstanding CRA rating. A key to sustaining such a "virtuous circle" is for banks to see value in a scoring system that allows an Outstanding rating to be achievable. Unfortunately, the NPR as currently drafted, with its disproportionate emphasis on "retail" and its unreasonably high market benchmarks for the Retail Lending Test, makes it all but impossible to achieve

an overall rating of Outstanding. This diminishes the incentive to do more; the opposite of what you intend and all of the stakeholders seek.

Without the carrot of an overall ratings of Outstanding and knowing that the best they can do is achieve a Satisfactory rating, banks would unlikely be motivated to strive as hard as they do under the current regulations on any of the four tests. If this should happen, banks may allow their efforts to slip and a gradual decline in CRA performance could easily set in as the market-based benchmarks begin to ratchet down. Over time this would likely allow banks to achieve a Satisfactory with less and less effort.

Two aspects of the NPR scoring system risk setting this “vicious circle” in motion: the disproportionate weight given to the Retail Lending Test and the extreme difficulty of achieving an Outstanding rating on that test. Rather than equally rewarding excellent CRA retail and community development efforts, the NPR favors the former. Yet both are important as they each provide critical credit and services to help historically disinvested communities thrive. While branches, home mortgages, and small business loans matter to low- and moderate-income communities, so do community development loans, investment, and services—areas where banks are key players both directly and through such community-based intermediaries as CDFIs.

In determining a bank’s overall rating, the four tests are weighted with Retail Lending at 45%, Retail Services and Products at 15%, Community Development Financing at 30%, and Community Development Services at 10%. As a result, a bank could achieve an overall rating of Outstanding with an Outstanding on the Retail Lending Test and one additional test. However, an Outstanding on the Community Development Financing Test requires the same on *two* additional tests to secure an overall rating of Outstanding.

The fix for this inequitable treatment is simple: equalize the total weights given for the retail tests and the community development tests at 50/50. With this change, an Outstanding on Community Development Financing and at least one of the “services” tests (assuming the weight for the Retail Services and Products Test is at least equal to that for the Community Development Services Test) would allow for an overall rating of Outstanding. (This equal balance between retail and community development is also appropriate for calculating the ratings for Intermediate banks.)

The imperative to weight equally retail and community development is made even stronger given the extreme difficulty of obtaining an Outstanding on the Retail Lending Test as proposed. As Table 9 in the NPR shows, none of the banks with deposits over $50B would meet the new criteria for an Outstanding conclusion on the Retail Lending Test based on their performance between 2017-2019.

The problem here flows from unrealistic market benchmarks for an Outstanding or High Satisfactory conclusion. For a bank to be able to meet the Outstanding threshold of 125% of the market benchmark requires a large share of the other lenders falling short of the market benchmark or at least one or more of the other lenders in the market of collectively comparable size underachieving by a corresponding 25%. Any lender(s) at 75% would, if subject to CRA, be classified as Needs to Improve as their bank metric would be considered a “fail”—not a rating any regulated bank would want to be saddled with and so unlikely to occur. Yet applicability of the market benchmark could be quite common when, for example, the costs of homes are high relative to incomes. In such markets it could be true that banks are working hard to serve the LMI community and that non-banks are also competing hard for market share (While non-bank mortgage lenders are not covered by the CRA statute, they are material competitors in CRA markets and in many markets, they are the dominant competitors.)

Despite such a high level of performance, the banks collectively would only be able to match the overall market benchmark (i.e., 100% of the market benchmark). But that would not result in an Outstanding or even a High Satisfactory (threshold of 110%). Rather it would result in a Low Satisfactory, thereby undermining the intent of revising the regulations and potentially lowering a bank's focus to merely achieving the minimum requirement for a Low Satisfactory or 80 percent of the market benchmark. Similarly, even in cases where the community benchmark prevails because, for example, many mortgage loans in a low- and moderate-income geography come from higher-income borrowers, a bank may get an Outstanding even though the mortgage market for the LMI members of those census tracts may not be being well served.

The complicated methodology for calibrating both the market and community benchmarks does not remedy either directly or indirectly the shortcomings in the structure of the Retail Lending Test. Addressing this problem requires more than just adjusting the benchmarks. As explained above, in a market that is well-served from a CRA perspective, it could well be that meeting the 100% market benchmark would indicate strong performance. While rewarding banks for reaching the industry average may not sound like holding them to a very high standard, the reality is that the benchmark can be a very high standard if the market overall is being well served, or a low standard if a bank can exceed 100% simply because the market is not generally being well served.

More factors, including Performance Context, need to be considered in addition to the bank metrics and community and market benchmarks for evaluating the results of the Retail Lending Test such as data on the degree to which over-income households are accounting for the sales in low- and moderate-income census tracts, or data evidencing a lack of houses for sale that are affordable to low- and/or moderate-income households. None of these data points by themselves can definitively answer the key question: is the market is being well served.

In summary, the revised CRA regulations must guard against the possibility of unintended consequences dampening bank CRA efforts. It is essential to guard against provisions that could lead banks to ratchet their CRA effort down over time, i.e., engage in a "race to the bottom." The regulations should be supportive of a self-reinforcing "race to the top." Some key steps to build this into the regulations would be to give equal weight to retail and community development and to rethink the market benchmarks and/or provide examiners with the data they need to be able to adjust the ratings to take into account how well the market is being served. As part of this broader approach to the Retail Lending Test, I would propose that the benchmark for High Satisfactory be set at 100% and Outstanding be at 110%.

Additional Comments

These additional comments cover areas where changes could increase the ability of banks to undertake and manage those activities that do the most to expand credit/investment in LMI communities. (As an aside, the absence of race from my comments is not because structural racism is not a reality we need to address, but because I understand the legal and practical issues that including it directly in the evaluation process could cause, potentially undermining all the valuable work that CRA can engender.)

Easing the Way for High Impact CRA Programs

- To support creative ways of helping LMI communities, the pre-certification process needs to provide a fast turnaround (24 hours would be ideal but 30 days might be sufficient), the regulators need to set up a process that can provide feedback that is both timely and reflective of an openness to innovative ideas/approaches. Opportunities to do deals can come and go in short order and a

pattern of conservative decision making can render the availability of this option of little value to those managing CRA programs.

- The inclusion of impact factors is a great way to provide additional motivation/reward for activities (loans, grants, equity investments, technical assistance) that may be smaller in dollar volume or harder to do but have a truly incremental impact on communities and might not otherwise happen at all or at the same scale but for the CRA.
- Relying on the existence of a government program as sufficient to qualify for community development credit is both too restrictive and not restrictive enough. For example, it is too restrictive in the case of NOAH which is an important part of the existing affordable stock and where government cannot on its own provide all the resources to maintain its quality and affordability. Not restrictive enough because of the many government programs that are not necessarily helping LMI communities and the LMI people within them to thrive?
- Banks, like most organizations, manage what they measure. For banks to set reasonable and accurate internal goals require data to be collected and for market and community benchmarks to be known. In this spirit, banks need to know what benchmarks they are expected to achieve in advance of each performance year. Furthermore, the evaluation system should be flexible enough to adjust when there are major changes in the national or local economy that move the benchmarks but can only be known ex post.
- For banks to manage to all the new regulatory changes, a number of which are major and depend on new data, it is important that banks are given enough time to generate the required data and to learn from that data and the benchmarks it produces to set internal goals.

Reallocating coverage under the four tests for large banks

- Coverage under the Retail Lending Test should be simplified to focus primarily, if not exclusively, on closed-end home mortgages (purchase and refinance) and small business (and farm) loans. These are products which have historically been underserved in LMI communities and reversing this is critical for those communities to thrive. Only for banks where the number of these types of loans are de minimis should exceptions be allowed. As for other consumer/retail loans, a bank should have the option with any that are major product lines (more than 50% of retail lending?) to have them examined under a Retail Lending Test to the extent they can be done under the rules laid out in the NPR or through use of a strategic plan. This approach would eliminate mandatory testing of multifamily loans (they are not retail loans, and they are already being evaluated as part of the Community Development Financing Test), of auto loans (which are not wealth building), or other types of closed-end or open-ended mortgages that can still be evaluated for their responsiveness under the Retail Services and Products Test.
- Reallocate to the Retail Services and Products Test and the Community Development Financing Test, the activities evaluated under the Community Development Services Test. Financial literacy (restricted to servicing LMI) and small business technical assistance seem to fit better on the retail side and technical assistance to not-for-profits that are serving their communities fits with grants as part of Community Development Financing. These changes will allow more weight for Community Development Financing—an area where banks play a key role in helping historically underinvested communities to thrive.

Conclusion

Updating the regulations to deal with the internet and to provide more clarity, consistency, and transparency has turned out to be a much more complicated endeavor than might have been expected. The diversity of the industry and of local market conditions presents major challenges for any effort to

reduce evaluation to simple, quantitative formulae (or even not-so-simple ones) and risks unintended consequences. While we can try to guard against those unintended consequences, the reality is that we are unlikely to be able to anticipate them all. In that light it is imperative to commit today to the best of our ability to a process for reviewing the regulations, say 5 years from the full implementation of the new rules. As I have noted previously, a process of more regular review may facilitate making incremental improvements without having to do a major rewrite every couple of decades.

Qualitative judgments cannot be totally eliminated, and the relevance of Performance Context seems as critical as ever as an integral part of each of the four tests for large banks. Obviously, this points out the importance of examiner training and sufficient staffing. The new regulations need to provide sufficient guidance without unnecessary complexity to allow bankers to be able to manage the resources of the bank in a way to have the most impact in helping the people and businesses in low- and moderate-income communities to thrive. Excessive complexity only undermines manageability, not just for the banks but also for the examiners.

I hope that some of the ideas I have laid out will help you find a reasonable balance between quality and quantity, complexity and manageability. We should not miss this opportunity to strengthen the impact that CRA has on communities.

I remain ready to help you in this task in any way I can.