NATIONAL ASSOCIATION OF AFFORDABLE HOUSING LENDERS

CRA Reg Reform

QUESTIONS	NAAHL
GEOGRAPHIC COVERAGE *What are the best approaches to evaluating the geographic scope of depository institution lending, investment and/or deposit-taking activities under CRA? Should geographic scope differ for institutions that are traditional branch-based retail Institutions compared to institutions with limited or no physical deposit-taking facilities? Should it differ for small local institutions compared to institutions with a nationwide customer base? If so, how? As the financial services industry continues to evolve and use new technologies to serve customers, how should the agencies adapt their CRA evaluations of urban and rural communities?* ***<u>Assessment Areas</u>*** ***We believe that maintaining the current Assessment Areas for lending (mortgage, small business) and services to communities where an insured depository has a retail footprint and employees still makes sense. However, critical opportunities and possibly unmet needs for Community Development lending and investing are often outside of Assessment Areas. Community advocates and practitioners alike complain of "reverse redlining" under the current rules. Lenders and equity investors complain of too much big bank money chasing too few Low Income Housing Tax Credit program (LIHTC) deals in just a few large metropolitan markets, competing in a race to the bottom that only benefits developers.*** ***If an institution receives at least a "Satisfactory" rating in its prior statewide CRA evaluation, the presumption should be that the bank will receive full credit in its next exam for all Community Development lending and investments in its state and any regional area where it has at least one assessment area.***	**It is important to maintain the focus of CRA on LMI borrowers and neighborhoods** in local markets where financial institutions have a physical presence. With such a presence, banks have staff who can perform the work needed to serve these difficult-to reach populations with appropriate products, work at the local level to affect public policy which is needed to support community development, and adequately assess risk which requires local knowledge. Broadening CRA's objectives to address a wide range of social and economic problems and expanding the geographic reach beyond where banks can effectively engage in CRA activities would stretch resources and risk diluting some of the most positive impacts of the law. Changes in the financial services industry include a growing number of institutions with little to no local interface with deposit customers. We believe those institutions should be examined under the Community Development Test with consideration for CD loans, investments and services that occur across the entire country. This would facilitate getting capital into under-served markets such as rural communities and small cities that have seen the number of locally-chartered banks decline. It would also support regional and national funds which are an efficient and effective method for getting capital into under-served markets.
ACCESS TO BANKING SERVICES *How should access to financial services be considered under CRA? What changes would encourage financial institutions to expand access to unbanked and under-banked consumers in a safe and sound manner and to promote affordable, safe*	We believe this is an area that needs greater focus in the CRA examination. **Identifying a certain activity as counting under the CRA examination is only a first step to gaining attention from banks. What matters is the weighting given,** meaning how much it impacts the ratings. Activities to reach the under-served count, but receive little weight.

transaction and savings accounts? Should the agencies revise CRA to include additional regulatory incentives to provide access to services for historically underserved and distressed areas?	In some examinations, most of the Service Test rating is based on the distribution of branches in LMI census tracts regardless of whether those areas are under-banked and whether it would be a wise business decision for a bank to open new branches in those markets. **CRA evaluations need to have greater emphasis on unmet need and business viability with consideration of both risk and return.** We believe such a framework for evaluation is critical to sustainable community investment. Currently, the regulatory emphasis is on full-service banks with substantially diminished CRA consideration for modified levels of service. <u>Building full-service de novo branches is a high-cost endeavor.</u> Because many under-banked markets do not have the deposit or transaction volume needed to support a full-service branch, the result is that those communities are under-served. <u>We recommend that the agencies encourage banks to provide a level of service that results in an economically viable business activity and is targeted to the needs of the specific community without penalty for not providing the full set of services found in other branches.</u> Some advocate that only full-service branches in LMI communities should receive full CRA consideration. The reality is that starting with a smaller scale branch, providing some deposit products with referral capabilities for additional products and financial education classes, will encourage banks to enter these markets. This would enable banks to test whether the level of business supports expansion to the full-service level.
COMMUNITY DEVELOPMENT *What are the opportunities to better encourage community development loans, investments and services to support projects that have a significant impact on a neighborhood? Should the agencies consider revisions to the Community Development Test or to the definition of community development? How could the rules most effectively balance support for community development organizations of different sizes, varying geographic scope, and in diverse rural and urban communities? How might they balance incentives for meeting local needs as well as the needs of very distressed areas or those with emergency conditions?* ***<u>Measuring the Quantitative and Qualitative Impact of Community Development Activities</u>***	**NAAHL strongly supports expanding the consideration and weighting of community development in the evaluation.** When the rule was written in 1995, there was a need to emphasize what we now consider "outputs'" or quantitative assessment; for example, the distribution of mortgage and small business loans and the volume of community development investment. We have evolved beyond that as banks have since expanded their understanding of how to make safe and sound loans to LMI populations and neighborhoods. This is not to say that all need has been met, but most likely the great majority that are credit-worthy have been met with limited additional opportunity. **In conjunction with increasing focus on community development, we recommend the agencies reduce emphasis on the quantitative methodology of comparing activity to demographic benchmarks without serious consideration of need, risk and profitability.**

To incentivize Community Development, the agencies should revise the weights accorded the CRA exam tests.

- ***There is a longstanding need to re-emphasize Community Development. For more than a decade, NAAHL has strongly recommended a Community Development Test option for insured depositories with expertise in this work. For those that opt to be evaluated under this test, Community Development loans and qualified investments would constitute 50% of their rating. The Lending and Services' tests would each then represent 25% of the CRA rating.***

- ***<u>Greater Consideration for All Community Development</u> If an insured depository does not take the Community Development Test option, it should still receive greater quantitative and qualitative considerations for Community Development loans in its Lending evaluation.***

- ***<u>Qualitative Factors Remain Undervalued</u> Factors like complexity, innovation, and leadership have been difficult to document for examiners with little or no background in Community Development. Examiners need both training in contemporary Community Development and agency encouragement to simplify greatly what has become an overly complex regimen of CRA evaluations.***

  Currently, banks qualify their investments in terms of affordable housing, economic development, neighborhood revitalization/stabilization, and Community Development services. In addition to giving credit for how many of these Community Development objectives an investment or loan hits, the bank should also receive credit for:
  - ***The <u>number</u> of Community Development transactions rather than the dollar volume because smaller (under $3 million) dollar loans have high impact on rural and other distressed areas.***
  - ***The neighborhood impact, complexity, and responsiveness of the transactions to meeting the needs of underserved areas.***

- ***To provide some certainty of favorable consideration of***

Increasing emphasis on the quantitative versus the qualitative impacts of CRA activities has focused institutions on activities that are costly, do not yield meaningful benefits for LMI communities, and undermine the reputation of CRA. Further, it has undercut support for CDFIs, an industry that is able to reach and provide services that would be impractical for regulated banks to address directly. It is important to provide more flexibility and greater weight to high-impact activities so that banks will be encouraged to reach deeply into underserved areas.

We also believe that the regulation should be flexible to adapt to the policy priorities at the local level. For example, full CRA consideration for financing mixed-income housing could stimulate increased interest among banks at a time when local governments have seen the negative effects of segregating LMI populations and so are placing a high priority on a mix of incomes in a development. The evaluation should also take into account both the complexity and impact of CD activities. Because of the current emphasis on quantity versus quality, banks are incented to finance the larger, least time-consuming transactions leaving the smaller, high-impact developments with few to no financing options.

• **We recommend that all insured institutions have the option of a Community Development Test**, providing flexibility in the provision of Community Development lending, investment and services so long as the institution undertakes meaningful activities in at least two of the three categories. Community Development encompasses those activities of a financial nature or otherwise, which have the effect of improving the life condition of LMI individuals, or of stabilizing and revitalizing the communities in which they live or work. By providing for a Community Development Test, institutions would gain more consideration for the hardest and most labor-intensive work.

• There should be **full consideration of banks' investments in multi-investor funds outside their assessment areas.** For more than 30 years, these funds have provided important financing for Community Development. They diversify the risk of lending and investing in affordable housing.

1. Some examiners are <u>discounting banks' investments in funds that benefit a large regional area</u> on the basis that the benefit to a bank's assessment areas may be diffused and therefore 'unresponsive' to the needs of the communities in the bank's assessment areas. This practice undermines CRA as an incentive for investing in debt and equity funds and leaves many markets under-served.
2. Some banks are receiving <u>diminished consideration for investing in multi-investor funds,</u> regardless of their value in addressing community needs. Since they cannot predict how great the discount will be when they decide whether to participate, <u>the banks cannot reliably factor CRA into their financing decision</u>. Banks are reporting deep discounting of participation in nationwide, regional, statewide, and even metropolitan area funds years after investment decisions are made.
3. In order to be workable, <u>multi-investor funds must be large enough to accommodate numerous participants, diversify investment risks, and be administratively efficient</u>. The current guidance does not provide banks with adequate assurance about receiving substantive credit in two regards. First, the use of a 'multi-state' region is vague. Second, <u>the threshold requirement that a bank must be meeting the Community Development needs of each of its assessment areas before it can receive recognition for regional benefit is also vague and subject to varying viewpoints</u>. **To address this problem, we recommend that the country be divided into four quadrants and banks be given credit for their entire investment in a fund so long as at least one of**

Community Development activity, some propose having regulators and/or academics develop needs' assessments for a state's Community Development. NAAHL does not support third party assessments.

- ***The regulations should not be prescriptive about how a bank and its business model should meet the unique needs of an underserved area in its market. Rather, the banks should decide how to deploy best its capital to help meet the needs of its community given its business strategy.***

While exam practices have seriously undermined banks' confidence in favorable consideration for Community Development activities, the solution lies in simplifying policies and exam practices that align with those policies.

- <u>***Some propose providing certainty of favorable consideration to certain products (e.g., LIHTC) and/or specified intermediaries (certified CDFIs). NAAHL does not support extending the treatment afforded minority and women-owned institutions as additional "protected classes". NAAHL's mission is to increase the flow of private capital to underserved areas, whatever the intermediary or product.***</u>

- <u>***The regulations should not assure favorable consideration for classes of favored lenders or products. Many***</u>

the fund's activities is in a quadrant containing that bank's assessment area.

- There should be **full consideration of Letters of Credit (LC).** The credit risk of an LC is identical to that associated with a conventional loan, the transactions are underwritten through the same methodology as conventional loans, and LCs require the same level of asset management and thus are monitored equally to those of conventional loans. Yet examiners are discouraging banks from providing LCs to local public agencies (LPAs) that would lower agency borrowing costs for construction and renovation of housing affordable to LMI households.

- There should be **full consideration for prior-period investment and loans**. Currently there is diminished consideration for investments, and none for loans. Originating short-term product that is either sold or structured to be retired in the near-term does not represent an equivalent level of commitment as long-term activities that remain on an institution's books.

non-profit lenders do not meet the narrow statutory definition of a Community Development Financial Institution. Others lack the financial resources to attempt certification. Low Income Housing Tax Credits (LIHTCs) are a significant resource, but not the only resource for financing affordable rental housing.	
RATINGS AND INCENTIVES *Is there an opportunity to improve the rules governing CRA ratings to differentiate strong, mediocre, and inadequate CRA performance more consistently and effectively? Are there more effective measures to assess the qualitative elements of an institution's performance? Are there regulatory incentives that could be considered to encourage and recognize those institutions with superior CRA performance?*	**We recommend that the agencies make CRA less complicated and therefore more effective.** The endless conversations and voluminous and growing Q&A's addressing minutiae related to what counts and does not count has grown way out of proportion (in terms of cost and resources) to the value it provides. **We recommend a major simplification be undertaken with application of an 80% correct threshold, rather than the current effort to be 100% correct.** Greater emphasis on impact and addressing need requires a qualitative view: understanding communities at the local level, identifying need, and assessing opportunity and risk. Currently, the performance context in which the bank operates is not used to adjust quantitative scoring systems. The alternative is a burdensome "numbers game" that applies unrealistic benchmarks and ignores key factors such as opportunity, risk and profitability. The result is unintended market distortions ultimately undermining the value and reputation of CRA. The regulation should provide **clear incentives to Outstanding CRA performance**. These could include: 1) **a safe harbor** for regulatory applications or, at a minimum, a

	streamlined application process that relies heavily on the rating; 2) **recognition from the agency head** to the executive leadership of the institution and the public; and 3) **longer periods between exams**.
EFFECT OF EVIDENCE OF DISCRIMINATORY OR OTHER ILLEGAL CREDIT PRACTICES ON CRA PERFORMANCE EVALUATIONS *Currently, the agencies' evaluations of CRA performance are adversely affected by evidence of lending discrimination or other illegal credit practices as outlined in the CRA rules. Are the existing standards adequate? Should the regulations require the agencies to consider violations of additional consumer laws, such as the Truth in Savings Act, the Electronic Fund Transfer Act, and the Fair Credit Reporting Act? Should the regulations be revised to more specifically address how evidence of unsafe and unsound lending practices adversely affects CRA ratings?*	Our overriding theme is to **do no harm**. We believe it is important to maintain the integrity of separate laws. CRA has been effective because of a continuing focus on expanding capital and banking services to LMI households and neighborhoods. Other laws and regulations play important and separate roles in the Federal construct of consumer protection, including fair lending/anti-discrimination, unfair and deceptive practices, and appropriate disclosures. If existing consumer protection enforcement is inadequate, the answer is not to add them to CRA, but rather to enhance their oversight as needed.