cfed
expanding economic opportunity

August 31, 2010

Lee T. Bowman
Chief of Community Affairs Section
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
comments@fdic.gov

Re: RIN 3064–AD60, Community Reinvestment Act Regulation

Dear Mr. Bowman:

The Corporation for Enterprise Development (CFED) is a national, nonpartisan nonprofit organization that works to expand economic opportunity to all Americans by promoting asset-building efforts that expand access to education, entrepreneurship, homeownership, retirement and emergencies. CFED is grateful to have this opportunity to comment on how regulation of the Community Reinvestment Act could be improved.

Since its enactment in 1977, the Community Reinvestment Act (CRA) has required banks to serve everyone who lives in the markets where they do business by providing access to basic banking services and credit products consistent with safe and sound lending practices. The CRA has enabled underserved segments of the population, particularly low- and moderate-income (LMI) households and neighborhoods, to benefit from home mortgage, small business and community development loans made by banks and thrifts for CRA credit. According to an analysis conducted by the National Community Reinvestment Coalition (NCRC) of data from the Federal Financial Institutions Examination Council, CRA has spurred more than one trillion dollars of lending and investment in America's low- and moderate-income neighborhoods.[1]

The CRA's success is a result of carefully tailored legislation and regulation to address and modify specific market behaviors, such as collecting deposits in one market while declining to invest any capital in that market. In the 1970s, most Americans' primary point of access to the financial services industry was through a local branch of a bank or thrift, where they deposited

[1] National Community Reinvestment Coalition (2010). Testimony of John Taylor before the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation regarding the Community Reinvestment Act; RIN 3064-AD60. Federal Deposit Insurance Corporation; Arlington, Virginia.

their paychecks, paid their bills and saved money. Today, retail banking is increasingly less dependent on local branches, due to the rise of the Internet and the diversification of financial services providers and products. CRA regulation, however, has failed to keep pace with changes in how, where and even whether depository institutions interact with and provide products and services to individuals.

Over the past 10 to 15 years, regulatory arbitrage, rapid and sweeping changes in the financial services sector and industry-wide consolidation weakened CRA examinations and enforcement. Given those factors, now is the time to revisit CRA regulations and adjust them so that the law continues to effectively ensure that financial institutions are meeting the needs of the communities in which they do business.

Necessary regulatory revisions fall into three basic areas: expanding CRA coverage, reforming the CRA examination and rating process and facilitating improvements in underperforming institutions' future performance. Expanding CRA coverage includes requiring all affiliated lenders of banks and thrifts to be included on CRA exams and reforming the definition of assessment areas so that a greater share of the market is examined. Improving the CRA examination and rating process requires updating the assessment criteria on the service test and the lending test, improving the CRA examination rating scale and countering grade inflation. Regulators can better facilitate improvements by banks that receive poor CRA ratings by revising the penalties for failing grades and working more cooperatively with communities and community organizations.

It is important to note that additional CRA reforms are outside of the scope of the regulatory agencies and must be enacted through legislation. They are, however, equally important to the continued success of the CRA and are thus worth mentioning briefly. CRA should, for example, apply to additional companies that sell financial products and services but are not federally insured depository institutions, such as independent mortgage lenders and brokers and insurance companies that offer mortgage and home products. Similarly, the exemption of credit unions from CRA obligations and examinations should be eliminated. The National Credit Union Administration should have legislative authority and the obligation to promulgate CRA regulations and rules in cooperation with the other federal regulatory agencies, conduct CRA examinations, issue ratings and generally enforce CRA compliance by federal credit unions.

CFED is recommending regulatory adjustments to the CRA precisely because it has been such an effective piece of legislation. We believe that implementation of the CRA must adapt to new financial market structures and business models in order to guarantee its future success. The most recent major revision to the CRA took place in 1995; since then, the Internet, securitization, and the Graham-Leach-Bliley Act have transformed the landscape of consumer banking and lending in the United States—to say nothing of the impact of the recent global financial crisis. The specific regulatory reforms discussed throughout the following pages will enable the CRA to continue to be among the most effective tools to ensure that all Americans, regardless of income or wealth, are able to access the basic banking services and credit products necessary to fully participate in the economic life of the country.

EXPAND CRA COVERAGE

APPLY CRA TO ALL LENDING AFFILIATES OF CRA-COVERED BANKS AND THRIFTS

The umbrella of CRA coverage should be expanded so that all lending affiliates of CRA-covered banks and thrifts are considered on CRA exams. Currently, banks are allowed to choose whether or not an affiliate or subsidiary company, such as a mortgage lender or brokerage, will be included on its CRA exam. In 1980, shortly after the CRA became law, more than 70 percent of home mortgages were originated by deposit-taking banks and thrifts;[2] the role of nonbank affiliate lenders was relatively small. Today, however, retail banks and thrifts account for 30 to 40 percent of home mortgage originations[3] and the role of nonbank affiliates has grown exponentially. By 2006, 20 percent of a financial institution's activity within an assessment area was undertaken by an affiliate whose performance was evaluated by the choice of the institution itself, rather than the regulator.[4] This severely limits the reach of the CRA and makes it difficult for regulators, researchers and policy makers to accurately assess the degree to which lenders are meeting the needs of financially underserved or vulnerable populations. Regulators should use their rulemaking authority to require all the affiliated and subordinate lenders of CRA-covered banks and thrifts to be subject to review during the parent company's CRA examination.

REFORM ASSESSMENT AREAS

The proxy by which regulators determine the communities in which CRA-covered banks and thrifts do business is the local branch. In the 1970s, this was a wholly appropriate indicator. In 2010, it is no longer useful. Today, Internet banks and credit card banks that have no local branches compete with national banks that have extensive branch networks throughout the country, as well as local and regional banks with branches clustered in small, defined geographic areas. Customers access their accounts, apply for loans and conduct transactions not just within branches, but from home and work via the Internet and elsewhere via mobile phones and ATMs.

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[2] Essene, Ren S. & Apgar, William C. (2009). "The Thirtieth Anniversary of the CRA: Restructuring the CRA to Address the Mortgage Finance Revolution." In *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act* (12-29). The Federal Reserve Banks of Boston and San Francisco.

[3] Gottschal, Bruce, Rochelle Nawrocki Gorey, Angie Marks, William Apgar, and Mark Duda. 2004. "Preserving Homeownership: Community Development Implications of the New Mortgage Market." Neighborhood Housing Services of Chicago.

[4] Laderman, Elizabeth & Reid, Carolina (2009). "CRA Lending and the Subprime Meltdown." In *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act* (115-33). The Federal Reserve Banks of Boston and San Francisco.

It is not only important to reform the definitions of assessment areas because they have gradually captured less and less of banks' total lending activities but also because research indicates that a bank's behavior outside of its assessment areas is measurably different than its behavior within its assessment areas. Essene and Apgar find that between 1993 and 2006, in-assessment area lending by CRA-covered banks fell from 41 percent to 26 percent of their total lending, while out of-assessment area lending by those banks increased by 187 percent.[5] Furthermore, while CRA-covered banks operating in their assessment areas were responsible for only nine percent of all high-cost loans made to low-income borrowers in low-income neighborhoods, CRA-covered banks operating outside of their assessment areas were responsible for 37 percent of those loans.[6] Given that banks make more expensive loans to LMI consumers outside of their assessment areas than within them, it is important to reform assessment areas so that they encompass a greater share of banks' total lending activities.

Geographic assessment areas would better reflect the areas in which banks are actually doing business if they were defined by location of loan originations rather than location of bank branches. Various advocates for LMI communities have suggested that an assessment area be defined as any of the metropolitan statistical areas (MSAs) or the collected non-metropolitan areas of each state. Loans made in Hawaii, for example, would either fall into the Honolulu MSA assessment area or the non-metropolitan Hawaii assessment area. MSAs are used by numerous federal programs as the geographic unit for describing demographics and other statistics. The U.S. Bureau of the Census, for example, tracks income distributions and establishes income trends within MSAs. A household's or census tract's median income is compared to the MSA's median income to gauge eligibility for programs such as Community Development Block Grants and Head Start. The Home Mortgage Disclosure Act (HMDA) data is also collected and reported at the MSA level. Designating all the area of each state that are not contained within an MSA as its non-metropolitan assessment area ensures that banks' activities in rural areas will be scrutinized during CRA exams.

Banks and thrifts that have secured significant market share in an assessment area should be evaluated on CRA performance in that assessment area. The appropriate definition of significant market share is a matter of debate. NCRC[7] and the Woodstock Institute,[8] for example, recommend that the threshold be set at 0.5 percent, while the Opportunity Finance Network (OFN) recommends a 5.0 percent threshold.[9] CFED recommends that significant

[5] Essene & Apgar (2009).
[6] Park, Kevin (2008). Subprime Lending and the Community Reinvestment Act. Research Note N08-2. Joint Center for Housing Studies, Harvard University.
[7] National Community Reinvestment Coalition (2010).
[8] Woodstock Institute. Testimony of Dory Rand before the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation regarding the Community Reinvestment Act; R-1386. Federal Reserve Bank of Chicago; Chicago, Illinois.
[9] Opportunity Finance Network (2010). Testimony of Mark Pinksy before the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, the Office of the Comptroller of the Currency and the Federal

market share be defined as 5.0 percent of all mortgage and small business lending within an assessment area.

REFORM CRA EXAMINATIONS AND RATINGS

REFORM EXAMINATION ASSESSMENT CRITERIA

The CRA examination's service test is currently so narrowly drawn that banks lack the incentive to provide a number of products and services that would substantially benefit LMI households and communities. The service test primarily measures the equality of access that banks provide in LMI areas versus middle- and upper-income areas in the form of branch locations, hours of operation and presence of deposit-taking ATMs. This is not an adequate gauge of the level of service provided by a bank to LMI households and neighborhoods.

The service test's assessment criteria should be expanded to include measures such as demographic characteristics of account holders—age, race, ethnicity and gender, the percentage of bank revenues generated by fees and the variety of basic banking services available. The design and delivery of fair and affordable basic banking services should favorably impact a bank's service test. Such products and services include access to low- or no-fee savings and transactional accounts, low- or no-minimum balance accounts, tax-preferred wealth-building accounts such as Individual Development Accounts (IDAs), Individual Retirement Accounts (IRAs) and Coverdell Education Savings Accounts (ESAs) and savings bonds.

Community development services should also be measured through the service test. Banks' partnerships with community development organizations operating within their assessment areas enhance the quantity and quality of services available to LMI communities. Specific community development services that should receive recognition on the service test include offering Individual Development Accounts, partnering with local IDA sponsors to provide matching funds, funding and/or staffing Volunteer Income Tax Assistance (VITA) sites, funding and/or staffing of technical assistance delivery programs such as financial education courses that serve LMI, minority and women entrepreneurs and offering financial education courses to customers and community members.

Finally, banks should receive positive consideration on the investment test for certain qualified investments outside of their assessment areas. Specifically, banks' investments in multi-regional community development intermediaries including nonprofit Community Development Financial Institutions (CDFI) should be eligible investments, because their tax exempt status and certification from the CDFI Fund of the U.S. Department of the Treasury ensure that such loan funds invest capital in businesses owned by LMI entrepreneurs and in community development projects in underserved areas.

Deposit Insurance Corporation regarding the Community Reinvestment Act; R-1386. Federal Reserve Bank of Chicago; Chicago, Illinois.

Currently, loans made to CDFIs are counted on the lending test, which is weighted to most heavily consider home mortgage and small business lending. Community development lending is inappropriately marginalized. Moreover, the lending test is not the most appropriate test through which to account for banks' loans to CDFIs and similar nonprofit loan funds, because so many of these loans are structured for a set term with the option to renew; in effect, many such loans function more like long-term investments. Because the CDFI industry has been able to deliver close to market rate returns on investments are that too high-risk for mainstream financial institutions, community development loan funds are appealing investments for banks that have community reinvestment obligations. Furthermore, given the industry's demonstrated capacity to mitigate risk through providing technical assistance, training and flexible terms, CDFIs should be recognized as an appropriate alternative on the investment test.

Investments in projects initiated by community development corporations should receive positive consideration as well, though the lending test is likely the most appropriate tool through which to assess such activities.

REFORM EXAMINATION RATINGS

At present, each CRA-covered bank receives one of four possible ratings on its CRA examination: Outstanding, Satisfactory, Needs to Improve and Substantial Non-compliance. CFED recommends replacing the satisfactory rating with two additional options: High-satisfactory and Low-satisfactory. Greater differentiation of the passing ratings would encourage CRA examiners to reserve Outstanding ratings only for the most consistently high performing banks. It would also make it much less likely that a bank that received an Outstanding on one test but a Needs to Improve on another test would earn the highest overall rating.

In addition to expanding the CRA examinations rating scale, regulatory agencies should also actively combat grade inflation. According to one advocacy group, in 1990, the first year that CRA ratings were made publicly available, nearly 10 percent of CRA-covered banks and thrifts failed their CRA exams. The failure rate declined steadily to about three percent in 1995, but has essentially held steady between one and two percent for the past 15 years.[10] During the housing boom and proliferation of high-cost, risky mortgage lending, the failure rate did not increase, despite the fact that banks were increasingly making high-cost loans—rather than standard 30-year-mortgages—to LMI borrowers and in LMI communities.[11]

Grade inflation is best addressed through improved examiner training and curtailing the use of limited-scope examinations. Former OTS director Ellen Seidman has written about this issue and recommends that examiners be provided with more substantive professional development

[10] CRA Manual (2007). National Community Reinvestment Coalition.
[11] CRA Manual (2007).

training opportunities on a regular basis.[12] She also faults limited-scope examinations, which are performed in a large bank's lowest-activity assessment areas, for contributing to grade inflation, as they consider only the quantity of community development activities.[13] CFED concurs with Ms. Seidman's recommendation that all assessment areas are evaluated for both quality and quantity.

FACILITATE IMPROVED CRA PERFORMANCE

IMPLEMENT EFFECTIVE CONSEQUENCES FOR FAILED EXAMINATIONS

When a bank fails its CRA examination, there are no immediate consequences. Neither fines nor sanctions are levied; the regulator may or may not require the bank to submit a CRA improvement plan. The CRA's key enforcement mechanism is to deny banks that have failed their exams the permission to proceed with mergers and acquisitions or to deny approval to offer new services or enter new markets.[14] This has never been an especially effective enforcement mechanism. By 1987, ten years after the passage of the CRA, regulators had denied eight merger applications, out of 40,000 submitted, based on failed CRA exams.[15] Moreover, the past 30 years have seen intense consolidation within the financial services industry.[16] Particularly in the wake of the financial crisis, far fewer mergers are anticipated to take place in the future. For those reasons, a more proactive enforcement regime should be developed. CFED recommends that any bank that receives a rating of Unsatisfactory or Substantial Non-compliance be required to submit improvement plans to its regulator and make the plans available for public comment. Subsequent CRA examinations would conduct the lending, investment and service tests and also evaluate the bank's success in implementing the improvement plans.

ENHANCE PUBLIC OUTREACH PROGRAMS

Since the 1990s, when CRA agreements between banks and community organizations peaked, resulting in the commitment of billions of dollars for specific community development activities, cooperation between the regulatory agencies and community organizations has

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[12] Seidman, Ellen (2010). "Improving CRA for Communtiy Developmetn: Geographic and other Considerations." Testimony before the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation regarding the Community Reinvestment Act; R-1386. Federal Reserve Bank of Chicago; Chicago, Illinois.
[13] Seidman, Ellen (2010).
[14] Quercia, Roberto, Ratcliffe, Janneke & Stegman, Michael A. (2009). "The Community Reinvestment Act: Outstanding and Needs to Improve." In *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act* (47-58). The Federal Reserve Banks of Boston and San Francisco.
[15] Essene & Apgar (2009).
[16] Essene & Apgar (2009).

waned. The agencies should invest more time and effort in cultivating relationships with communities in order to better understand the community needs that the CRA seeks to meet.

The regulatory agencies should make it easier for consumers to learn how banks are performing with regard to the CRA and to compare the CRA performance of lenders in their areas. Each agency has dedicated pages on its website that address CRA, but none of the agencies has established an easy web-based way for consumers to contact regulators about specific CRA concerns. A simple solution would be to create an interagency CRA-focused website with a form through which an individual could input her name, email address and phone number, ZIP code, and a question or comment related to a bank's activities in her area. Such a form could be automatically routed to the proper team of examiners once it is submitted through the website.

A web-based CRA performance comparison tool would also facilitate public engagement with the regulators. A website that populated a chart based on a user's ZIP code with a comparison of, for example, the CRA ratings of the top five national bank lenders (by loan volume) in the user's assessment area and the top ten regional and local banks would make it easy for interested community residents, community organizations and local governments to understand which banks provided the best service to the community. The chart could include a summary of recent projects the bank supported in the assessment area and the date of the last exam. This type of community outreach is low-cost and has the potential to produce significant returns in the form of public engagement.

We appreciate the opportunity to comment on the FDIC's Community Reinvestment Act regulation, and look forward to being a resource to the agency as it continues implement and enforce CRA.

Sincerely,

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