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THE COMMUNITY REINVESTMENT ACT: THIRTY YEARS OF ACCOMPLISHMENTS, BUT CHALLENGES REMAIN

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

FEBRUARY 13, 2008

Printed for the use of the Committee on Financial Services

Serial No. 110–90

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THE COMMUNITY REINVESTMENT ACT: THIRTY YEARS OF ACCOMPLISHMENTS, BUT CHALLENGES REMAIN

Wednesday, February 13, 2008

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Waters, Maloney, Velazquez, Watt, Capuano, Clay, Baca, Scott, Green, Cleaver, Sires, Ellison, Klein, Murphy; Bachus, Manzullo, Biggert, Capito, Brown-Waite, and Bachmann.

The CHAIRMAN. The hearing will come to order. Would someone close that door, please? This hearing begins what will be one of the most important initiatives that this committee will be undertaking, and that I hope the whole Congress will undertake. In 1977, before any of us on this committee got here, Congress passed the Community Reinvestment Act under the leadership, at the time, of the Senate Banking Committee chairman, Senator Proxmire. It has worked very well.

I made a point of asking Larry Lindsey, who was the Federal Reserve Governor with responsibility for consumer and regulatory affairs some years ago, but not all that long ago, how he evaluated the Community Reinvestment Act and other consumer protection acts. Particularly, I wanted to ask him if he thought they had interfered with the ability of the institutions covered, the banks, to perform their very important function, the function of intermediation in our financial system, of gathering up relatively small amounts of money from a large number of people and making it available for useful work. He wrote me back a very useful letter, and I forgot to bring it with me.

I will insert it in the record, saying that—and this is Mr. Lindsey, a conservative who had served in Republican Administrations—and his conclusion was that there was no evidence of any harm, that there was no indication that this had in any way interfered with safety and soundness, and that in fact it has done a great deal of good.

We are now looking at this Act 31 years later, and there are two areas where I believe we should be amending it to enhance its effectiveness. First, if you go back to 1977, the Community Reinvest-

ment Act covered most of the institutions that did the kind of activity it was meant to cover.

Thirty-one years later, there has been a great increase in the number and type of institutions that engage in these forms of activities who are not covered by CRA. And so the first question we will address is whether or not, and if so how, to expand the obligations of the Community Reinvestment Act to institutions that now do the kinds of things that banks were doing 31 years ago but either weren't doing them then or didn't exist then. That is a much smaller piece of the relevant action is now covered by CRA that should have been.

Secondly, there are questions about the enforcement of CRA. There have been arguments from some that there has been excessive paperwork, and we are open to listening to that, particularly from some of the smaller institutions. But there is also a concern that many people have, myself included, that there is a limited chance to enforce CRA.

CRA ratings come into play when there is a change in ownership of the bank, but that shouldn't be the only time in which that happens. There ought to be, I believe, some forms of enforcement, and not just enforcement in the negative sense, but reward for those institutions that have done well. There are also questions about whether or not the range of activities covered, and for which entities get credit, should be expanded.

So that's the topic. It's a serious one to me. I think the Community Reinvestment Act is a very important operation of our overall system. The urban areas in particular are concerned about it, and this hearing begins what will be a fairly thorough study, and I am hoping that we will begin the legislative process. We may not be able to complete it this year. It is February of the second year of a term, and we had other things to accomplish. But this is the beginning of a serious legislative process.

Finally, I just want to apologize. At 12:30, I will have to go to a meeting that the Speaker has asked me to attend, and at 1:15, I leave for the White House to be at the signing of the stimulus bill, and I will therefore be leaving the hearing in about 2½ hours, and we have a long panel. But I do want to assure people that we are monitoring this very closely, and those who will be testifying later are not going to be speaking to a bunch of vacant chairs. We give this a great deal of serious consideration.

It's a busy week. We're only in for a couple of days this week, and the attendance does not reflect the interest, I can assure you. And with that, I'm glad to call on the ranking member of the Subcommittee on Housing and Community Opportunity, the gentlewoman from West Virginia, Mrs. Capito.

Mrs. CAPITO. Thank you, Mr. Chairman, and I want to thank all of the folks who have come in through this difficult weather to testify today on an important issue. The ranking member of the full committee extends his apologies for not being here and has asked me to come in his stead and offer the statement.

No government mandate should continue in perpetuity without congressional oversight, and CRA is no exception. The banking industry and our credit markets have changed dramatically, we all know, since CRA was first enacted in 1977. American innovation,

along with increased industry competition, has created credit opportunities today that were unimaginable years ago. These market forces have prompted some to question whether significant regulatory burdens imposed by CRA, particularly on small community banks, have come to outweigh any benefits the law was originally intended to confer upon underserved communities.

The evidence suggests that deregulation and technological advances have spurred new lending to once underserved communities over the past 3 decades. For example, a 2000 study by an economist at the Dallas Federal Reserve Bank found that CRA covered lenders as a group devoted about the same proportion of their home purchase loans to low-income neighborhoods from year to year. Even though those institutions were subject to CRA, their lending in low-income communities grew no faster than other types of lending. In other words, CRA may not be necessary to ensure that all segments of our economy enjoy access to credit.

There are some who argue that CRA should be extended to credit unions and other segments of the financial services industry that currently fall outside the law's coverage. Indeed, rather than expanding the regulatory dragnet, our focus must be on providing appropriate regulatory relief to our financial institutions so they're free to serve the needs of their communities unshackled by outdated regulatory mandates and bureaucratic red tape.

It is for that reason that I look forward to working with my colleagues on both sides of the aisles to develop an appropriate regulatory relief package that Congress can act on this year. The bill we passed last year was a good first step, but much remains to be done if we are serious about maintaining a strong community banking sector in this country.

Thank you again, Mr. Chairman, for holding this important hearing. Although we may have some philosophical differences—imagine that—we agree on the need for this committee to fulfill its oversight responsibility to review the law's implementation and the effect it has had on depository institutions, underserved communities, and our economy.

Let me again thank the witnesses for their testimony. I look forward to the hearing. Thank you.

The CHAIRMAN. I thank the gentlewoman. And I would just comment, if you have no objection, that I appreciate seriously her reference to philosophical differences. There is an understandable unhappiness that some people have with disagreement that appears to be for its own sake. But the notion that legitimate philosophical differences among elected officials shouldn't be expressed has started to bug me. I will confess all this talk about being post-partisan seems to me to devalue democracy. I'm beginning to suffer from post-partisan depression here.

[Laughter]

The CHAIRMAN. Because I don't want to see legitimate issues that ought to be discussed somehow subordinated or that discussion devalued. And I am very proud of the fact that under my predecessor, Mike Oxley, and now, I think we have been a model of how you can have legitimate philosophical debate without in any way impinging on our ability to work together in some other areas. So I thank the gentlewoman for saying that. And we're going to con-

tinue to be a place where we will be partisan sometimes and bipartisan other times without either one eating into the legitimate area of the other.

The gentleman from Texas.

Mr. GREEN. I thank you, Mr. Chairman. I thank you and the ranking member. I concur with you that honorable people can have honorable disagreements. I am so proud to be here this morning with the CRA being a topic of discussion.

I had the good fortune of being president of a branch of the NAACP, and I have a firsthand understanding of how the CRA can be of great benefit in terms of helping financial institutions to go into areas that they may not have had a real good look at. It has been a great benefit to organizations like the NAACP, community-based organizations, and I am hopeful that we will be able to make sure that it continues to help and aid in the communities that are underserved.

I, unfortunately, will have to leave. I have a Homeland Security meeting. Secretary Chertoff is before the Homeland Security Committee that I sit on, and I also have a piece of legislation on the Floor of the House. But I assure you, I will be monitoring the hearing, and I am eager to do what I can to make sure that the CRA continues to be of benefit to underserved communities.

Thank you, Mr. Chairman, and I yield back the balance of my time.

The CHAIRMAN. Next, we will hear from the gentlewoman from California, who as chairwoman of the Housing and Community Opportunity Subcommittee has, of course, a great interest and involvement in these areas. Ms. Waters.

Ms. WATERS. Thank you very much, Mr. Chairman. I will be brief, because I know we have three large witness panels to hear from and may be interrupted by votes. So let me start by saying that I consider the Community Reinvestment Act to be one of the most significant pieces of legislation of the 3 decades that have elapsed since its enactment.

I, too, well remember the days of redlining where minorities simply could not get access to the capital they needed to purchase homes and start businesses. Indeed, when I entered the California Assembly in 1976, just prior to congressional passage of CRA, these practices were in full force.

The impact of CRA on investments in underserved communities by covered financial institutions has become enormous. Its effect has been documented by studies like the one conducted by Harvard's Joint Center on Housing Studies, which showed that CRA encouraged financial institutions subject to its reach to originate a higher proportion of loans to lower-income people and communities than they would have if the law did not exist.

Recently, Federal Reserve Chairman Bernanke himself acknowledged that CRA has helped institutions discover and enter new markets that were previously underserved or entirely ignored.

But I don't need academics or others to credentialize CRA. I have seen its impact with my own eyes in the communities I have represented in the California State legislature and here in Congress. To those who suggest that CRA has unnecessarily distorted the market and that increased access to credit by low-income and mi-

nority communities would have happened on the same timetable without it, I say that's not true. Without CRA, we still would be sitting here wringing our hands about what to do to get sound credit flowing into underserved communities.

I'm thankful that today rather than having to fend off an attempt to gut CRA, the kind of battle which I'm afraid occurred with some frequency in congressional sessions from 1994 until now, we can instead begin the process of carefully analyzing how to improve the program. And I think one of the first things we need to think about seriously is extending its reach.

I earlier emphasized the importance of CRA in extending sound credit into underserved communities, because rigorous analysis of recent HMDA data reveals that CRA-covered institutions were less likely to originate the kind of high-cost loans that fuel foreclosures and more likely to retain loans in their portfolio rather than risking the risk of default into the secondary market. The result has been lower foreclosure rates in places with high concentrations of bank branches.

The problem is that today CRA covers less of the credit market than it ever has, thanks to the evolution of the financial services industry and technology. For example, less than a third of all home loans are subject to CRA review. This is in part due to the entry of nondepository and often underregulated institutions into the mortgage and other credit markets too often to disastrous effect. It is also due in part to CRA's outdated notion of an assessment area which harks back to 1977 when we all had to go into an actual bank branch to carry out a financial institution. There were no ATMs outside even, if you can imagine that.

Today CRA-covered entities make many loans that escape CRA review because they are originated in communities in which the financial institutions maintain no physical presence. I look forward to hearing from witnesses about how we can update CRA so that it can provide some assurance of safe and sound lending practices for a larger share of the market.

Similarly, I'm interested in expanding the CRA enforcement tool box beyond just acting to slow a merger, acquisition or application to open a new branch. These opportunities are becoming fewer and farther between as the financial services industry consolidates and the need for new branches wanes in the face of advancing technology, and enforcement is completely absent when an institution has no ambitions to expand. This is unwise.

Again, I thank you, Chairman Frank, for holding this hearing and look forward to hearing the witnesses' perspectives on improving this linchpin of our financial regulatory structure.

The CHAIRMAN. I thank the gentlewoman. Are there any further requests? If not, we will go to our panel. We have three panels here: The first consists of representatives of the regulatory agencies; the second consists of various advocacy groups on one side or the other; and the third consists of people who are in the business of either lending or borrowing for these purposes.

So we will begin with Sandra Braunstein, who is the Director of the Division of Consumer and Community Affairs of the Federal Reserve Board.

Ms. Braunstein.

STATEMENT OF SANDRA F. BRAUNSTEIN, DIRECTOR, DIVISION OF CONSUMER AND COMMUNITY AFFAIRS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Ms. BRAUNSTEIN. Thank you. Chairman Frank, Congresswoman Capito, and members of the committee, thank you for the opportunity to discuss the Community Reinvestment Act or CRA.

I have been active in community development in a variety of positions in the government, private, and nonprofit sectors for the past 30 years. From my experience, I know that CRA is an important law for households and communities big and small, rural and urban. Commensurate with the CRA's importance, the Board implements the law through a separate Division for Consumer and Community Affairs, which I direct, and through separate CRA examinations conducted by reserve bank examiners specially trained in CRA and consumer compliance.

The Board has had a separate consumer compliance and CRA examination program since the late 1970's. Our implementation of CRA is guided by the long-standing statutory principle that insured depository institutions must serve the convenience and needs of the communities in which they are chartered. CRA requires the agencies to encourage institutions to help meet the credit needs of their local communities and to do so in a safe and sound manner.

The law gives the agencies considerable discretion and flexibility to fashion rules, programs, and procedures. This flexibility has enabled the agencies to modify their CRA regulations over time to respond to changes in communities and markets. At the same time, the agencies have duly respected, as they must, the boundaries on their authority, both expressed and implied by the Act.

CRA examinations are at the core of our efforts to encourage State member banks to help meet the credit needs of their communities. Examiners look especially closely at an institution's record of serving low- and moderate-income households and communities. This record is a big factor in an institution's rating. The examiners evaluate this record in the context of all relevant factors, such as a bank's capacity and constraints and local economic conditions. These factors are important, because under CRA statue and regulations, insured depository institutions must meet the credit needs of their communities only through activities that are safe and sound.

Research conducted over the years has generally suggested that CRA has helped to ensure that consumers and communities have access to financial services and products from their local depositories. The law and regulations are a catalyst for depository institutions to become involved in lending and community development projects that may not have been completed without their involvement.

As successful as it has been, CRA does face challenges. The 30 years since the CRA's enactment have been marked by major structural changes in the banking and financial services markets. Banks have significantly expanded their role in the broader financial services industry. At the same time, nonbank financial institutions have increasingly offered traditional banking services, including a full range of credit products.

With these trends, competition in the marketplace has increased, and the lines between banks and nonbanks have blurred. These

changes have created challenges for the implementation of CRA. One challenge is that many financial transactions are now being offered by nonbank service providers and other types of nondepository financial entities which are not covered by CRA.

Insured banks and thrifts remain the primary conduit for many financial services, including the full range of deposit accounts. However, Federal Reserve surveys of small business and consumers document the increasing tendency of small businesses and households to use nondepository financial institutions. Some have suggested that these institutions should be covered by CRA. Such an expansion of CRA would require a searching reevaluation of CRA's conceptual underpinnings.

CRA is based on a fundamental quid pro quo. The banks and thrifts covered by CRA receive special benefits, such as deposit insurance. In exchange for these benefits, banks are expected to help meet the credit needs of their local communities. By definition, this conceptual underpinning of the statute does not apply where nondepository financial institutions are concerned.

Covering such institutions would seem to require that the Congress articulate a new conceptual foundation to guide it in deciding such difficult questions as the type of entities to cover, the scope of the responsibilities, how to evaluate them, and which Federal agency or agencies to vest with these duties.

I appreciate this opportunity to appear before the committee and welcome any questions you may have.

[The prepared statement of Ms. Braunstein can be found on page 98 of the appendix.]

The CHAIRMAN. Thank you, Ms. Braunstein.

Next we have Sandra Thompson, who is the Director of the Division of Supervision and Consumer Protection at the Federal Deposit Insurance Corporation.

STATEMENT OF SANDRA L. THOMPSON, DIRECTOR, DIVISION OF SUPERVISION AND CONSUMER PROTECTION, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. THOMPSON. Chairman Frank, Congresswoman Capito, and members of the committee, thank you for the opportunity to testify today on behalf of the FDIC regarding the Community Reinvestment Act. CRA was landmark legislation, and its effect has been significant in enhancing credit opportunities nationwide.

Before CRA was enacted in 1977, there were severe shortages of credit available to low- and moderate-income neighborhoods, as well as concerns about redlining and discrimination. CRA was intended to expand access to credit and reduce discriminatory credit practices. Consistent with safe and sound operations, CRA assigns federally insured financial institutions a continuing and affirmative obligation to help meet the credit needs of their entire communities, including low- and moderate-income neighborhoods.

CRA is a flexible tool for regulators, because it contains broad goals without detailed requirements about how to achieve them. With its focus on the needs of the community as opposed to specific products or services, it allows bankers to alter their offerings in response to changing credit demands.

Studies have shown that banks can meet their lending obligations to their entire community, including low- and moderate-income borrowers, in a safe and sound manner that is also profitable. Yet there continue to be areas where CRA could have an important impact. Financial needs today in low- and moderate-income communities include basic banking services, savings programs, affordable small dollar loans, and foreclosure prevention programs. CRA's flexibility ensures that it will continue to enhance the ability of all consumers to access and benefit from our banking system.

Today, the FDIC is promoting the use of CRA to encourage solutions to several key consumer financial concerns, specifically, encouraging alternatives for homeowners facing mortgage foreclosures, meeting the need for affordable, small dollar loans, and addressing the exceptionally high cost of credit and the need for basic banking services in many underserved communities.

For example, in April of this year, the Federal financial regulatory agencies issued guidance encouraging financial institutions to consider prudent workout arrangements to keep borrowers in their homes, and made clear that there may be favorable CRA consideration for programs to transition low- and moderate-income borrowers from higher cost loans to lower cost loans, provided that the loans are made in a safe and sound manner. And the agencies have proposed revisions to several CRA Q&As to encourage institutions to work with homeowners who are facing foreclosures.

Patterns evident in the new HMDA data on higher priced home mortgage loans underscore questions about the scope of CRA and the way we evaluate the credit services provided by banks. While credit has become more available, a smaller percentage is subject to CRA evaluation, as nonbanks increase their share of mortgage originations. In addition, the HMDA data has highlighted the importance of focusing attention on not just whether loans are being made, but also at what price and by whom, particularly with regard to minority borrowers.

In conclusion, while CRA's current emphasis on lending has served important needs, the financial services industry and consumers have changed in recent years. CRA's flexibility will ensure that it addresses the changing credit demands of consumers and their access to banking services.

Thank you for the opportunity to testify today, and I look forward to answering questions.

[The prepared statement of Ms. Thompson can be found on page 213 of the appendix.]

STATEMENT OF ANN JAEDICKE, DEPUTY COMPTROLLER FOR COMPLIANCE POLICY, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Ms. JAEDICKE. Chairman Frank, Ranking Member Bachus, Congresswoman Capito, and members of the committee, I am Ann Jaedicke, Deputy Comptroller for Compliance Policy at the Office of the Comptroller to the Currency. I am pleased to appear before you today to discuss the Community Reinvestment Act and the effectiveness of this law over the last 3 decades.

CRA emerged as a seemingly simple concept. Banks that take deposits from the local community where they are chartered have an

obligation to help meet the credit needs of that community, and CRA had a simple but powerful goal: to stop redlining. The law has had its measure of criticism, to be sure, but in my view it is working. It has proven to be a powerful tool that has brought real change and improved conditions in underserved and economically depressed communities.

This hearing offers an excellent opportunity to reflect on the CRA and to exchange ideas about the challenges we face going forward. To further this discussion we offer the following perspectives:

First, the CRA has proven to be a remarkably effective and resilient piece of legislation, and has provided the Federal banking agencies with the flexibility we need to respond to changing circumstances.

Second, the CRA has acted as an incentive for insured depository institutions to provide billions of dollars in loans, investments, and services in communities across the country.

And third, CRA lending and investments have proven to be safe, sound, and generally profitable.

Yesterday, Comptroller Dugan gave a speech before the National Association of Affordable Housing Lenders. He described three recommendations related to CRA, and I'd like to recount them here today. First is the need for legislation to restore national bank public welfare investment authority. The Federal law that authorizes national banks to make public welfare investments was amended over a year ago. While the amendments increase the amount of investments permissible for national banks, they simultaneously decrease the types of investments that may be made. Comptroller Dugan has been very appreciative of your leadership, Chairman Frank, and of yours, Representative Bachus, in achieving bipartisan passage by the House of Representatives of H.R. 1066. H.R. 1066 would restore the broader preexisting public welfare investment standard. A comparable bill recently has been introduced in the Senate, and the OCC urges that the public welfare investment authority of national banks be restored by enacting legislation like H.R. 1066.

Second, yesterday the Comptroller proposed an important CRA regulatory initiative to assist communities that are being hard-hit by the rising tide of mortgage foreclosures. The Comptroller urged that the Federal banking agencies provide a CRA incentive for additional mortgage relief in middle-income communities significantly affected by the subprime mortgage turmoil. He called for the development of a targeted amendment to the inner agency CRA regulations. This amendment would provide a CRA incentive for community development investments that revitalized and stabilized middle-income urban and suburban communities that are distressed due to unprecedented foreclosures. With this change, the banking agencies could give CRA consideration for, and thereby encourage, loans, services, and investments in more communities suffering the consequences of foreclosures. We believe that we should be able to make this change by revising the definition of community development in the CRA rules.

Finally, in the 30 years since CRA was enacted, the financial services industry has changed. While insured depository institutions previously may have provided most financial transactions of

the type that are evaluated under CRA, now many non-bank companies provide such financial products and services. In light of these developments a legitimate question may be raised: What are the public policy reasons for continuing to restrict the application of CRA to insured depository institutions? As the Comptroller said yesterday, the time may be right to evaluate whether a legislative determination, made over 30 years ago about the scope and coverage of CRA continues to be appropriate given the significant changes in our financial market.

Thank you, Mr. Chairman, for the opportunity to appear before you today. I would be pleased to answer any questions you might have.

[The prepared statement of Ms. Jaedicke can be found on page 127 of the appendix.]

The CHAIRMAN. We will take this next witness, then we will go to vote, and we will come back.

Please, Ms. Yakimov.

STATEMENT OF MONTRICE GODARD YAKIMOV, MANAGING DIRECTOR, COMPLIANCE AND CONSUMER PROTECTION, OFFICE OF THRIFT SUPERVISION

Ms. YAKIMOV. Thank you. Good morning, Chairman Frank, Ranking Member Bachus, Congresswoman Capito, and members of the committee. My name is Montrice Godard Yakimov, and I am the Managing Director for Compliance and Consumer Protection at the Office of Thrift Supervision. I thank you for the opportunity to testify on behalf of the OTS to commemorate the 30th anniversary of the Community Reinvestment Act, reflecting on its array of accomplishments and exploring how to move forward positively into the next 30 years. I'm pleased to help celebrate the role CRA has played to encourage regulated institutions to meet the credit needs of their communities. I have submitted a full statement for the record, so this morning, I will just highlight a few points.

First, OTS strongly believes that CRA has played a significant and positive role and has helped the thrift industry meet the needs of low- and moderate-income households. One example is community development lending by savings associations, which increased from about $2 billion in 1996 to nearly $10.5 billion a decade later in 2006. CRA's focus on community development has been one important reason.

OTS-regulated institutions also continue to make sizeable amounts of CRA eligible investments, approximately $899 million by our large institutions in 2006 and 2007 alone. Savings associations also play a leadership role in originating multi-family loans, a key vehicle for affordable housing. In September 2007, OTS-regulated savings associations had about 4 percent of their assets in multi-family loans, where commercial banks had about 1 percent of their assets in such loans. CRA has contributed significantly to the rise in small business lending, an important driver in the economic empowerment of low- and moderate-income neighborhoods. In 1996, OTS-supervised institutions originated about 36,000 small business loans totaling about $3.5 billion. A decade later, savings associations were originating about 5 million small business loans totaling about $29 billion.

The second point I'd like to note is OTS's interest in legislation that will empower savings associations to further contribute to community and economic development. OTS Director Reich has made recommendations to expand the ability of OTS-supervised institutions to engage in small business and commercial lending. This increase would not only strengthen OTS-regulated institutions by further diversifying their business signs, but would also increase the availability of credit in local communities. Small business and commercial lending are keys to economic growth and recovery, particularly in low- and moderate-income areas. Earlier versions of this proposal were part of legislation passed by the House in both the 108th and 109th Congresses, and we are hoping for favorable consideration by this body again.

Third, I'd like to point out two important CRA developments in 2007 that deserve mention. The first came in March when OTS published a final CRA rule, bringing our regulations back into alignment with the regulations of the other Federal banking agencies. These changes support the core principal and policy objectives of CRA and facilitate more consistent and effective evaluations of the CRA performance of banks and thrifts operating within the same market areas. The second took place in July 2007, when the OTS and the other Federal banking agencies issued for comment proposed questions and answers to clarify the types of foreclosure prevention activities eligible for CRA favorable consideration. For example, credit counseling to assist low- and moderate-income borrowers in avoiding foreclosure would receive CRA favorable consideration, as would loan programs to help low- and moderate-income homeowners facing foreclosures.

There is one issue I would like to mention that underscores the commitment OTS has to consumer protection, and that is an advance notice of proposed rulemaking relating to unfair or deceptive acts or practices. The ANPR sought public comment on a proposal that OTS might consider in determining whether and to what extent additional regulation is needed to ensure that customers of OTS-regulated entities are treated fairly. We intend to move forward with the proposed rulemaking to establish a clear set of rules and standards for thrift institutions in this area.

In conclusion, OTS can measure attention to the important role the Community Reinvestment Act has played over time and ways positive gains can be expanded. We stand ready to work with you and to serve as a resource in this exploration. I'd like to thank you again for inviting me here today, and I look forward to responding to your questions.

[The prepared statement of Ms. Yakimov can be found on page 252 of the appendix.]

The CHAIRMAN. Thank you. We are going to break, but let me just make an announcement. There is a fight going on that is going to spill over here; there is a dispute about the decision of whether or not to take up the Foreign Intelligence Security Act. There may be procedural votes all day, so we may not be able to finish this hearing. I wanted to say this: Those witnesses who came at some expense, I have instructed the staff to find ways that we can reimburse them. As it is, we may have to ask some of the witnesses to return. If we do, we will provide travel expenses. This is an impor-

tant hearing. I regret the fact that it is going to get interrupted, but there may be a pattern of procedural votes that will keep us from doing much. Our Attention Deficit Disorder, which is inherent in our work, may be exacerbated by exogenous factors in this particular case. So we are going to break now, but we will be back.

I do just want to note that the public welfare bill that was referenced, the House has again passed it, and we are hoping that the Senate will. We do agree that this is very important. We were told by various advocacy groups. So the House has passed that bill, and we're hoping the Senate will do the same. We will return as soon as we can.

[Recess]

The CHAIRMAN. Mr. Bachus made a very good suggestion. If this keeps up, he and I will stay through the next set of votes—it is only the one vote—and some other Members—we are going to try to keep this going. We apologize. So we will now finish the panel with our representative from the States, Howard Pitkin, who is the commissioner of the Connecticut Department of Banking.

Commissioner, please go ahead.

STATEMENT OF HOWARD F. PITKIN, COMMISSIONER, CONNECTICUT DEPARTMENT OF BANKING

Mr. PITKIN. Good morning, Chairman Frank, Ranking Member Bachus, and distinguished members of the committee. My name is Howard Pitkin, and I am pleased to be here today on behalf of the Connecticut Department of Banking to discuss the Community Reinvestment Act at work in Connecticut and other States. I also appear today as a member of the Conference of State Bank Supervisors and the National Association of State Credit Union Supervisors. As you know, these are the professional associations of State officials that regulate the banking and credit union industries.

The Community Reinvestment Act has provided access to lending and investing programs by highlighting a need for community investment and development initiatives. The very nature of CRA is the expectation that banks and credit unions will seek out loans and investments that promote community development. The people of Connecticut have realized the benefit of this law through banks and credit unions' participation in construction loans for affordable housing, low- and moderate-income mortgages, loans to small business and consumer and automobile lending. In pursuit of their CRA goals, these institutions have provided funds for the education of our children and made vital contributions to community-based organizations. Most importantly, the officers and employees of the banks and the credit unions are leaders within their communities.

Our banks and credit unions have found CRA to be profitable, and the statistical analysis necessary to define a community's credit needs are an important part of the strategic plan—the lending, business development, and developing deposit account relationships. Connecticut's Community Reinvestment Act was enacted on July 1, 1990. The State statute uses Federal law as a model, but also requires each Connecticut bank to publish a State Community Reinvestment Act notice announcing the public access to the bank's performance evaluation and clearly stating how to send written comments to the banking commissioner. Since July 1, 2001, Con-

necticut has enforced similar requirements for State-chartered community credit unions. These are credit unions that have assets of $10 million or more and draw their members from a well-defined community, neighborhood, or rural area.

Connecticut State-chartered banks have had a long-standing record of compliance with both State and Federal CRAs. Since 1999, no State-chartered Connecticut bank has a CRA rating below satisfactory. Since February 2005, Connecticut has administered an offsite program for monitoring banks' CRA compliance. We develop a profile for each bank and require an update on an annual basis. We incorporate information from each bank's Federal CRA examination into this profile, along with additional statistical analysis using the Home Mortgage Disclosure Act data and a software tool that analyzes lending statistics. Examiners also use peer information to compare bank performance with other competitors in the market place.

We found this process to be very effective in monitoring CRA performance and making sure it remains a priority for our institutions. I have the power to deny or set conditions on many types of applications based on CRA performance. We found that this off-site CRA monitoring system not only reduces regulatory burden on our institutions, but also gives accurate and up-to-date information about lending performance and trends. In addition, the offsite program does not restrict the department's authority to conduct an onsite examination if we deem it necessary.

Connecticut and Massachusetts have implemented CRA requirements for credit unions. We use the same rating scale we use for banks. We look at several factors similar to the factors we use to asses the community reinvestment practices of our State-chartered banks, but taking into account credit unions unique structure and mission. Connecticut posts CRA rating for the banks and credit unions on our Web site and reports institutions that have a CRA rating of "needs to improve" or "substantial noncompliance" to the State treasurer. No bank or credit union included on that list can receive public deposits.

The Community Reinvestment Act has been, in my opinion, a unique law requiring banks—and in our State, credit unions—to identify and serve the credit needs of their communities. They need to do that to be profitable. Six States plus the District of Columbia have enacted their own CRA laws. Some States have gone beyond the provisions of Federal law by expanding the application of their CRA statutes, what qualifies for CRA credit, or how CRA is enforced. Other States have simply mirrored the Federal statute, giving them the opportunity to enforce the Federal statute through their own laws.

If Congress or the Federal regulators are considering changes to CRA, I suggest these changes may include consideration of fewer restrictions on the type of or dollar thresholds for investments. We should continue to encourage and foster community focused lending and investing, a building block in the foundation of community banking and credit union activity.

Thank you for your time this morning and for inviting me to be here with you today to celebrate 30 years of accomplishments with the Community Reinvestment Act.

[The prepared statement of Mr. Pitkin can be found on page 158 of the appendix.]

The CHAIRMAN. Thank you. Let me begin with Ms. Jaedicke. I know that Comptroller Dugan has proposed an expansion to give CRA credit to communities that have been victimized by the foreclosure issue when they would be above the general income level. The question I have is, would it be possible to do that for a time-limited period? That is, we understand the disruption for now, but how would you frame that so that 10 years from now, we will not still be giving CRA credit for investing in the type of communities that were not ordinarily thought of as CRA targets?

Ms. JAEDICKE. Our proposal is to make a change to the definition of community development within the regulation. And we can put a sunset provision on it or a time limit on it, if—

The CHAIRMAN. I know that you would do that. Again, we do understand that there are communities that are being hit by this, but I think I would ask you to ask the Comptroller to consider that—some kind of sunset, because otherwise we hope that we will be able to resolve some of these issues. It's a useful initiative, but I think it shouldn't be a forever one. So that would be very helpful.

Let me ask Mr. Pitkin. You mentioned that Connecticut and Massachusetts have covered credit unions. Now we have this issue—and in fact I will put in the record now, without objection, a letter from the National Association of Federal Credit Unions, and also a study by the law firm of Traiger and Hinckley on the Community Reinvestment Act. They title their study, "A Welcome Anomaly in the Foreclosure Crisis: Indications that the CRA deterred irresponsible lending in the 15 most populous U.S. metropolitan areas." And we will make that part of the record.

But let me ask, what has been the experience—are the credit unions in Connecticut unhappy? How long has it been in place and have they found it to be burdensome? I mean, their argument is, "Well, we do this sort of thing anyway." And many of them do. We do have the issue of some of the larger, less geographically based, but when did it go into effect and what has been the experience, and is there any effort by the credit unions now in Connecticut to repeal that coverage?

Mr. PITKIN. Mr. Chairman, there is—our law passed in 2001 for community-type credit unions, and there has been no adverse reaction from the industry. We all felt that credit unions have a story to tell, and don't often have a chance to tell it. While they lend to a delineated community field of membership, they also take part in community development activities and investment within their communities, and it's significant. And we have had good experience with our industry; they have cooperated, and in the spirit of the law they have served the credit needs of their communities.

The CHAIRMAN. You said, "community credit unions," meaning those that are geographically based as opposed to others?

Mr. PITKIN. Yes, Mr. Chairman. They generally have, in Connecticut, a county or two. The larger ones can serve up to three counties. We have not yet given a charter for a statewide—

The CHAIRMAN. Oh. All right. So you have that?

Mr. PITKIN. Right. Right.

The CHAIRMAN. And I mention that because—and I understand people don't like to feel that if they haven't done anything wrong, they should be treated as if they might. And I would hope people—and say we don't regard this as punitive when we talk about expanding CRA. We think it is a useful tool, and as you said in some cases, I would say to people, "If you're doing the right thing anyway, you'll get better recognition for it. So we appreciate that."

Let me ask you, if any of the panel members now—and I understand it's a congressional decision to us. I appreciate the spirited testimony in every case—let's be clear: there is a consensus, I think, that CRA has worked well, and that in the last 31 years there have been changes in the industry. I think it's fair to say this: If CRA were passed for the first time today it would have a wider footprint than the one it had in 1977. That is a decision we have to make.

Let me ask all of you now and in the future—and you raised this question—how do we deal with—there are a couple of issues. One is a conceptual. You know the quid pro quo. Well, I think we can deal with that one. There is no financial institution operating in America today that doesn't get some benefits from the relationship with the government.

But beyond the issue is where the institution in question does not have a geographic footprint. What would a CRA set of requirements look like? Does anyone want to respond to that now? But that is something I would ask all of you, in writing, to advise us. And I understand—we're not asking you to endorse the broadening, but if we were to broaden this to cover lending institutions that don't have a geographic footprint, how would you formulate the requirements? Do any of the witnesses want to try that now?

Yes, Ms. Thompson?

Ms. THOMPSON. Well, I would certainly include the public evaluation concept, because I think that is critical to make sure that the public is very aware and informed of an entity's performance with regard to CRA. And I'd also try to figure out a mechanism for enforcement. That is a key issue.

The CHAIRMAN. But also the question is, what would we be enforcing? And what is their obligation, if it is not a geographic one?

Ms. THOMPSON. If it's not a geographic obligation, you would have to define the customer base. Who are you lending to? And make sure that whatever parameters you put in place are enforcing responsible lending. Because what we found, again, is that CRA answered one question, and that was access to credit. There are other questions, such as cost of credit. And you're finding that so many people have been told, "no," that when they get the "yes" answer, they don't ask the detailed questions.

The CHAIRMAN. I appreciate that. The gentleman from Alabama.

Mr. BACHUS. Thank you. A lot of my complaints from our small community banks are about the compliance cost of CRA. Can you give me an idea about what is the compliance cost? Have there been any studies or any figures on what the compliance cost is? And of all regulations, is it the most expensive?

Ms. YAKIMOV. Congressman Bachus, what we have heard from institutions is as it had experience with the Community Reinvestment Act some 31 years, the complaints we have heard about costs

there have subsided over time. Frankly, institutions have pointed to compliance costs associated with the Bank Secrecy Act, in fact, anti-money laundering as one of their key areas. That is on top of their wish list in terms of some regulatory rule.

Mr. BACHUS. Well, actually, you're right. It used to be CRA, but I think it is Bank Secrecy Act now. So that is good.

Ms. BRAUNSTEIN. Congressman? I just wanted to say that, certainly, as the agencies, all of us have always been aware of the fact that there have been issues around compliance costs and we tried to address those in developing categories of compliance for CRA. You know, we have a small bank category, and we most recently developed an intermediate small bank category, and then a large bank category.

And that was to help address some of those issues, as well as the Congress put in place a few years back a dictated schedule for examinations to help relieve some of the compliance burdens. So I think that these matters have been, you know, somewhat addressed over time.

Mr. BACHUS. You know, I would agree. I think categorizing the banks has helped in exempting some of the smaller banks. In light of market changes over the last 30 years, what particularly, maybe the growth, you know. At one time, banks couldn't expand across State lines. Now we have money center banks, some banks that have 8 and 10 percent of the total market in the country.

Would you revise CRA in light of market changes? And, if you did, what would those revisions be? I notice the Comptroller of the Currency recently said that maybe in light of market changes, the CRA ought to be retooled. What would some of those changes be? I'll just start.

Mr. PITKIN. If I could, again. Congressman, I think the view that non-bank lenders should be included in CRA. At the State level we license thousands of those companies. And the Commonwealth of Massachusetts has recently passed a law which includes them under CRA and is staffing right now to include non-bank lenders in their examination program.

All of the States are adopting examination guidelines to do the same thing. In addition, the National Mortgage Licensing System is being formed by CSBS, NACA, and Armor. And I think that will be a major step forward in consumer protection. So my feeling on non-bank lenders is, let's let Massachusetts be the laboratory and watch how they make out doing it, and I think then take another step forward.

Mr. BACHUS. I know that probably would be problematic for some of us, but I appreciate that suggestion.

Anyone else? Seems like you've thrown a chill over the rest of the panel.

Mr. PITKIN. Well, I certainly don't mean to. The chairman encouraged differences of opinion, so.

Mr. BACHUS. Anyone else?

Ms. JAEDICKE. The Comptroller made the proposal yesterday as part of a speech that he made, and I would say that we haven't worked out the details or the specifics about how expanding CRA might work. But we would be happy to work with other thought leaders in this area to see what might be done.

Mr. BACHUS. Was he talking about expanding it or revising it?

Ms. JAEDICKE. Well, he was really speaking to the changes in the financial services industry today—the fact that financial products are being offered by a lot of non-depository institutions, particularly mortgages. I think we're all witnessing that.

Mr. BACHUS. So the same thing the Commissioner was talking about, Commissioner Pitkin?

Ms. JAEDICKE. Right.

Mr. BACHUS. Okay.

Ms. JAEDICKE. So we simply raised the question of, should there be a broader coverage of CRA?

Mr. BACHUS. I see. How about for those institutions that are now covered. Any changes there, or no?

Ms. THOMPSON. Well, one of the things that we have been looking at is how to bring underserved people into the banking sector and alleviate some of the high costs of products, like payday loans. We are advocating small dollar loans in the banking system. So, you want to bring people in and you want to make sure that the banking services that they get are going to receive some sort of credit. And we want to make sure that CRA is expansive enough, and we believe it is, to include basic banking services and products, as well as positive consideration for institutions that are currently offering those services and products.

Mr. BACHUS. Thank you.

Ms. BRAUNSTEIN. I would just say that one of the things that has made CRA so successful is the flexibility that was built into the statute from the beginning, which has allowed us to address credit needs and changes in markets as they have occurred.

So I think that there are a number of things that we could discuss and those discussions are worth having. But something to keep in mind is the flexibility that is currently in the statute, and retaining that.

The CHAIRMAN. Thank you. Ms. Yakimov.

Ms. YAKIMOV. Chairman Frank, I would offer that OTS has had some experience with non-traditional thrifts—thrifts that operate outside of a traditional branch network that raise a significant amount of deposits through the Internet and other means—and there may be some lessons learned through our experience with examining those institutions with CRA that might be helpful.

Looking first at how they satisfy their obligations within the assessment area, that meets the threshold looking outside, particularly with community development lending. So we would offer ourselves as a resource in that area.

The CHAIRMAN. That would be very helpful if you would give us that result. I would just say with regard to, I think it was Ms. Thompson's point, yes, we feel very strongly, and I know a lot of members in this committee feel that getting into the banking system is very important.

Ms. Waters has had the lifeline banking issue. Others, Mr. Hinojosa and Ms. Biggert, have been worried about financial literacy, where the banks have been helpful with regard to check cashing, payday lending, remittances.

I know people pay a much higher set of transaction costs than we do, and we want to keep mentioning that banks and credit

unions are great assets for people here. In particular, we did take an initiative that the regulators responded to favorably; and, I think, the remittance services are now you get CRA credit for remittance services, and that has been very helpful in bringing down that cost. So we do intend to move on that.

The gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman.

I perhaps want to be a little bit more direct with the panel than Mr. Bachus was on this issue of coverage of non-insured institutions under the CRA. When we did Gramm-Leach-Bliley, there was a proposal put forward at that time, an amendment offered at least to the bill, that would have expanded CRA to other parts of the financial institutions that would have given more flexibility for banks and lenders to be involved.

Obviously, the rationale or the argument against it was that insured depository institutions received an implied subsidy, and historically have had an implied obligation therefore to their communities in exchange for that. A lot of non-insured institutions were basically doing a lot of banking activities—the same activities as insured depository institutions at that time—and Gramm-Leach-Bliley allowed that to happen even more, and expansion of activities substantially across line securities into banks, banks into securities, insurance.

So the question I would ask is, number one, what are the institutions that we ought to be looking at? I guess I have heard each of you implicitly endorse the notion that CRA ought to be expanded. And I understand regulators don't have the authority to do that. We have to do it as Congress. We could use the same language if we expanded the coverage.

So I'm going to assume that each one of the regulators thinks that is at least something we ought to be exploring and looking at. And if you were going to do that, to what financial entities would you be talking about doing or at least considering doing? Ms. Thompson, if you want to go first, that would be great.

Ms. THOMPSON. Yes. One category I would consider would be the mortgage lenders, in terms of non-depository institutions.

Mr. WATT. Okay, so we have mortgage lenders on the table. Tell me who else. And I'm going to cut you off. I know we can talk about the rationale for each. I just want to get the laundry list on the table here, and, if we have time, we can talk about the rationale for including or excluding them.

But what is the laundry list? Mortgage lenders; who has another one? Do you have another one, Ms. Thompson? I didn't mean to cut you off if you had another one. I just didn't want you to spend all my time telling me what the rationale for mortgage lenders was.

Ms. THOMPSON. Congressman, I respect fully when asked to look at a category of high-cost service providers and mortgage lenders, because of the current crisis, leads that charge. And, if you recall, we were here in October and we specifically talked about HMDA data and the pricing differentials between non-bank lenders and bank lenders.

So that was the reason I would discuss that. But I really categorize high-cost service providers.

Mr. WATT. And who does that include? Mortgage lenders, who else?

Ms. THOMPSON. Let's see: check cashers; payday lenders.

Mr. WATT. You're saying we should include check cashers and payday lenders under CRA? That before I would get to insurance companies or securities dealers, I would be looking at check-cashers first?

Ms. THOMPSON. Well, under CRA, we are looking at low- and moderate-income, generally speaking. And for securities, I know there are suitability requirements that apply to the purchase of most investments and most securities. So I'm thinking about the least educated, most vulnerable group of people who are paying more for products and services than other categories.

Mr. WATT. Okay. Payday lenders, check cashers, mortgage lenders. Who else? You all are falling silent on me out there.

Mr. PITKIN. Well, Congressman, being from Connecticut, I—

Mr. WATT. Who do you all include?

Mr. PITKIN. We include banks and credit unions.

Mr. WATT. Credit unions?

Mr. PITKIN. Under CRA.

Mr. WATT. Okay.

Mr. PITKIN. I think that we have two different industries here with mortgage lenders and brokers and originators. It is a Commission-driven industry and banks are concerned. When they write a mortgage with safety and soundness, it is a completely different approach to a mortgage.

But mortgage brokers, lenders and originators report under HMDA and we can tell exactly where they're lending, who has made the most loans in Connecticut, where they have lent, and how many are high cost.

Mr. WATT. Well, I presume, we could make anybody who has a CRA requirement report on what they were doing in the community in one way or another. I still don't have any takers on securities.

That's all right—I have a reluctant. I'll yield back.

The CHAIRMAN. I would say that of the things Mr. Pitkin suggested to me, one of the sort of conceptually obvious things would be to have CRA and HMDA tracked together. Because you were referring to entities that were covered by HMDA, but not CRA, and that would be one area where we're doing it.

The other I wasn't sure, Mr. Pitkin, when you started to say as someone from Connecticut whether you were going to volunteer hedge funds to be under CRA, but we'll pass on that one. But I do think at this point the HMDA tracking does seem to be. We will be talking about some of the others as well.

The gentlewoman from Florida, Ms. Brown-Waite, I'm told is next.

Ms. BROWN-WAITE. I thank the gentleman.

And like many other members of the committee, I serve on another committee, which is why I wasn't here for the opening statements and for the testimony of the panel. It is certainly not for lack of interest, and I thank you all for being here.

If the CRA was enacted about 30 years ago in response to perceived redlining, are any of you aware of any institution that pur-

posefully avoids doing business in particular neighborhoods or with particular customers, solely because of race? And, if so, wouldn't it better to absolutely insist on the enforcement of anti-discrimination laws rather than force banks to make loans?

And, you know, there is another form of redlining that is going on right now in my home State, Mr. Chairman. I don't know if you are aware of it. And that is when you live in certain areas, and there are sinkholes, you are not going to get insurance, even though your house does not have a sinkhole. You probably aren't going to get a mortgage for it.

So there absolutely is existing redlining for purposes other than originally that the CRA was created for. And I would just like to have a response as to whether or not today when we have both Federal and State anti-discrimination laws, if CRA should be continued.

Ms. YAKIMOV. I would offer, we have a host of tools to deal with any discrimination with respect to violations of the Equal Credit Opportunity Act, and the Fair Housing Act. And if we identified an institution that has fair lending violations, violations of such laws, it has an adverse impact on the CRA rating.

So, in that sense, fair lending and CRA work together. But we would certainly not tolerate an institution that we identified purposely avoiding making loans on a prohibited basis, such as race as you described.

Mr. PITKIN. Congresswoman, I think that what we have noticed in analyzing our subprime lending and high-cost lending in Connecticut is that the reverse really has happened where the high cost loans were contained, mainly in our inner cities. And it is a real problem when you target people who use English as a second language, or who might not be as financially savvy as most.

They want their share of the American dream just like all of us. And I think in a lot of cases, because of piling loans into those areas of our State, for instance, the City of Bridgeport has 5,000 subprime loans contained in it; the City of New Haven has 4,000. And I think it is going to be a long time working this problem out.

Ms. BROWN-WAITE. Thank you, Mr. Chairman. If no one else is going to respond, I will yield back.

The CHAIRMAN. The gentlewoman from New York.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Braunstein, last month during a roundtable I held in my congressional district in Brooklyn, New York, on solutions to the mortgage crisis, participants suggested expanding the coverage of CRA to non-banks and other financial entities as a solution to curb predatory lending. You suggest that changes in the financial sector warrant this expansion, but caution also about some of the issues that may arise as a consequence. Can you expand on those issues and tell us how the Federal Reserve plans to address them?

Ms. BRAUNSTEIN. Yes, thank you. Actually, the expansion of CRA to entities other than depository institutions would really be a matter for Congress to decide. It is not something the Federal Reserve or any of the other agencies could undertake themselves. And what I was pointing out was that in that decision we certainly are quite happy and willing to work with you and discuss these issues with

you. But there was a strong kind of underpinning for the original CRA that was a quid pro quo in terms of deposit insurance.

And it seems that certainly changes in the financial services markets have warranted relooking at this. But there needs to be some kind of strong underpinning for any kind of CRA requirements that are put on other organizations, and that would definitely be worth a conversation.

Ms. VELAZQUEZ. Okay. Thank you. I would like to address this question to any of the witnesses.

In his testimony on behalf of the American Bankers Association, Mr. Barnes mentions that 98 percent of all banks and savings associations receive a CRA rating of satisfactory or both as a positive step. Some of us may see it differently, particularly where something like this may be called grade inflation.

Can you explain why this is the case, particularly, when we have seen the effects of the subprime lending crisis in minority neighborhoods across the country and especially within my district?

Ms. BRAUNSTEIN. Well one of the things I think we've all seen is that a large majority of the loans that were made of the subprime variety, especially the ones that are causing the problems, were not made by depository institutions which were covered by CRA. And that has been one of the issues and one of the reasons for the discussion of the expansion. And CRA has a very strong component of safety and soundness.

And so banks would have discouraged our banks from competing in this communities, in those products, because those were not often safe and sound products, and there was a lot of loose underwriting.

Ms. VELAZQUEZ. Wouldn't that be a good argument to expand CRA to non-banking institutions?

Ms. BRAUNSTEIN. Possibly, yes. Yes. And in terms of the grades, I would just say that CRA has been around for over 30 years and that most banks are quite familiar with the Act and what is required of the regulations. And so, in some ways, it is not surprising that banks have learned how to, you know, get good CRA grades and are doing the right things. And we have seen that CRA has been very successful on a number of fronts.

Ms. VELAZQUEZ. Thank you. And, yes?

Ms. YAKIMOV. I would add to that, that I think you have to look at not just the ratings breakdown but also the data, the numbers. The volume of small business loans, the volume of community development loans, and that completes the picture. At least it fills out the picture, so to the extent that institutions have had 30 years of experience, we saw when we came out with the new BSA exam manual, initially new procedures violations were at a level over time we've seen some of those ratchet down. So I think you have to look at not just the ratings, but also the picture behind it. What are institutions doing to support all their communities?

Ms. VELAZQUEZ. Thank you.

The CHAIRMAN. The gentlewoman from Illinois, Mrs. Biggert, the ranking member of the Subcommittee on Financial Institutions and Consumer Credit.

Mrs. BIGGERT. Thank you, Mr. Chairman. In 1992, Grant Thornton reported that CRA compliance was the single most expensive

regulatory burden placed on community banks, and over the past 15 years, the Federal banking agencies have successfully reduced the unnecessary and unproductive paperwork burden imposed on community banks. I think that the agencies are to be commended for their efforts in this area, but is there more that can be done to relieve the administrative burden of compliance?

Ms. BRAUNSTEIN. Well, one thing, Congresswoman, that the agencies did recommend in the report to Congress on regulatory burden is repeal of the CRA Sunshine Act; I have to say that I think we are all in agreement that hasn't really produced much in the way of benefits, and it is a paperwork burden to financial institutions. So that is something that Congress could consider.

Mrs. BIGGERT. Anybody else have any comment on that?

[No response]

Mrs. BIGGERT. Well, then maybe—and I'm sorry. I don't know if these have been asked or not, but how much time do regulators spend in a bank doing the CRA examination?

Mr. PITKIN. Well, Congresswoman, we in Connecticut do ours offsite, and we take into consideration the Federal examination that is done, but we have a profile of each of our banks. It is very detailed. There is a cottage industry of tools you can use with software to use on the HMDA data to create whatever market area the bank is operating in, and it has worked out very well for us. We update it yearly, and I think that is probably more often than most banks get their CRA exam onsite. We think it is very accurate and very effective in keeping track of banks' compliance with CRA.

Mrs. BIGGERT. So you think there are less burdens now than—

Mr. PITKIN. Yes I do. I do think there are a lot less burdens, and that is the feedback from our institutions.

Mrs. BIGGERT. Would anybody else like to comment?

Ms. THOMPSON. At the FDIC, we supervise about 5,200 banks, and most of them are small community banks, and we typically spend about a week or so on our CRA and compliance exams.

Mrs. BIGGERT. Okay. Thank you. Yes?

Ms. JAEDICKE. For the OCC, I would say it varies dramatically based on the size of the financial institution, and we regulate some financial institutions that are extraordinarily large. But also we regulate a large number of small community banks.

For our community banks, it takes about a week to do a CRA exam, and after Gramm-Leach-Bliley, when the examination schedule was extended, smaller community banks that have an outstanding rating will only receive an exam every 5 years.

So I think the burden has been greatly reduced in terms of the amount of time we spend and the number of exams a bank gets over a certain period of time. For a large bank, it takes a significant amount of time to do a CRA exam, because they may have multiple assessment areas across the United States.

Ms. YAKIMOV. Those institutions that we go into more frequently are those that received a less-than-satisfactory rating, where more active supervision is warranted. So I think we have done a lot to try to reduce, the Congress has done a lot to establish those benchmarks as well.

Mrs. BIGGERT. When a bank receives a less-than-favorable rating, what steps do they take, or how do you work with them to improve that?

Ms. YAKIMOV. We go onsite more frequently. We follow up on issues that were raised during the previous exam and make sure that they are following that, and if necessary, an enforcement action is an outcome.

Mrs. BIGGERT. Thank you. Thank you, Mr. Chairman. I yield back.

Mr. CLEAVER. [presiding] I have just one question, then we will move on to Mr. Sires. In the Community Reinvestment Act, the language, "local community" is all through the legislation. And it has occurred to me that the banking world has changed so dramatically that we don't have much of a local community with regard to banks. I mean, much of their business is now done even through the Internet. The huge banking conglomerates have taken over, so there is no local community. And I'm curious about whether any of you would agree that perhaps we ought to revisit the language, "local community," redefine "local community" in the language, or define it anew.

Mr. PITKIN. Well, Congressman, I think we have talked about doing that in our home State, and I do think that the word "local" can restrict the delineation of a community bank's identity in its community, and that the footprint—in the Northeast, I think we have the phenomenon of a barbell industry. We have small banks, and we have large banks, but we don't have a lot in the middle. And there are consequences to that as far as lending authorities go and also identification in the community.

But I do think that the word "local" should be removed from the law.

Ms. BRAUNSTEIN. We discussed that. The agencies discussed those issues pretty thoroughly when we went through the last revision of CRA, and one of the things that we found is that for most banks, the current definition of assessment area worked pretty well, that even those banks that have a presence on the Internet, generally have some kind of brick-and-mortar presence, and that being able to define a local assessment area seemed to work except in a few cases.

And we made some kinds of alterations to the regulation to allow people—and to the questions and answers—to allow institutions to make investments and lending and have activities outside of those assessment areas as long as they were taking care of their local assessment area.

And it seems to be working, from what we are hearing, it seems to have worked fairly well, but I think it is always worth a conversation, because if we can improve it further, we are certainly willing to do that.

Mr. CLEAVER. Well, some of the large banks may have in a community, in a neighborhood, just a drive-through operation. Is it the bank of that local community?

Ms. BRAUNSTEIN. Yes. If they're taking deposits and offering services, yes.

Mr. CLEAVER. Well, normally those operations, they offer a service, but it's deposit and withdrawal. That's it. I mean, there are no

loan applications taken there. In fact, it's almost—I mean, it's smaller than, you know, a Burger King.

Anyone else?

Ms. JAEDICKE. I'd offer that I think what makes this question difficult is that there are banks that still have a local community, and we still have a significant number of community banks in the United States that operate within a defined, fairly local neighborhood or community.

But we also have many large banks in the United States whose assessment areas span across perhaps several States, or a significant part of the country, which I think is what makes the question difficult.

Mr. CLEAVER. All right. Thank you. Mr. Sires.

Mr. SIRES. Thank you, Mr. Chairman. I just want to get back to the ratings a little bit, because as I read here, it says here that according to the Federal Reserve, 99 percent of the banks and thrifts receive an outstanding or satisfactory rating. That leaves 1 percent. What do you have to do to get an unsatisfactory rating?

Ms. THOMPSON. You have to not lend in your local defined assessment area, and we have had institutions that have been rated nonsatisfactory and needs to improve. But I will tell you that the public input into the process is critical. The financial institutions covet the outstanding and satisfactory ratings and will do what is necessary to achieve those ratings.

For example, you cannot expand your branches if you have less than a satisfactory designation.

Mr. SIRES. But, Ms. Thompson, I'm just talking about 1 percent. That seems—with all the problems that have been going on with lending and everything else, I would think that percent would be a little higher. How do you rate? You know, I don't understand just 1 percent.

Ms. THOMPSON. Well, in our examination process, we look at the lending that is done in the assessment area, and we also, as part of our compliance examinations and CRA examinations, look at fair lending issues, and we look at the cost of credit. And we look for patterns and practice of discrimination.

But, again, I would note that much of the lending in financial institutions, especially those in low- to moderate-income areas, is done in a safe and sound manner.

Mr. SIRES. And it also says here that the Federal Reserve received, since 1988, 13,500 applications for formation of banks. Then it goes on to say that only eight were denied. I don't know. I mean, that seems kind of low to me.

Ms. BRAUNSTEIN. Well, yes, it does sound very low. But one of the things to consider is that most financial institutions, when they enter into an applications process, they know that they have to have good records in order to complete that process, so they don't come forward unless they are doing the right things.

And there also are cases for which I admit we don't have numbers, we don't track this, but there are cases where financial institutions may come forward who don't have the best records and don't have good records in various affairs, and it may be CRA, and they're discouraged from entering an application. And that would not be captured in those numbers.

But we don't deny, at the Federal Reserve, we're not denying applications for any reason. It's not just CRA. There are a whole host of things that they're rated on, but most banks know that they have to have all their ducks in a row before they come forward with an application.

Mr. SIRES. I'm just wondering if anybody thinks that the rating process is a little lax.

Mr. PITKIN. Congressman, if I could comment, I do think CRA has reached the point of maturity with the banking industry, and I think that the HMDA database is so extensive now that they know where their market is, and to be profitable, they have to serve that market. I can say that we have worked with our Federal counterparts at the Federal Reserve and the FDIC in holding up transactions for banks that didn't have a satisfactory compliance rating or a CRA rating. And it's not in the public interest to allow that rating to stand. It's in the public interest I think to get that bank back between the lines and serving its community. And I think probably that's where we're coming from.

Mr. SIRES. Mr. Chairman, may I have one more question? I see that my district, every time I wake up, I think there is a new bank on the main street. But worse, I see these, all these machines to extract money. They are everywhere; bodegas, pharmacies, I mean, you name it. When you do your review, is that part of it? You know, how does that work? Who reviews that when a bank puts a machine in a bodega or something and they charge you $2 or $3 to take out $20? You know, how does that work? I'm a little naive.

Ms. YAKIMOV. Well, ATMs aren't considered branches for purposes of the Community Reinvestment Act, although we look at the way our institutions provide services in a broad sense. I guess I would offer that Community Reinvestment Act ratings are public, unlike the other ratings that we provide for fair lending and in other areas.

So you may have an institution that—where we have seen issues and concerns that are not public. If there are fair lending violations and concerns, it has an adverse impact on the CRA rating, but wouldn't necessarily take an institution from outstanding to, you know, substantial noncompliance, or from satisfactory all the way down to substantial noncompliance.

So all these things are factored in in terms of our evaluation, but most of these ratings aren't public. And because CRA ratings are public, I think there is even a greater incentive for institutions, they want to get it right. They don't want to be embarrassed. Outside of the implications for approvals for mergers and branches, they don't want an unsatisfactory rating that is public.

Mr. SIRES. How many people do you know, that when they open a bank account, they look at the CRA rating?

Ms. YAKIMOV. Probably none.

Mr. SIRES. Okay. Thank you very much, Mr. Chairman.

The CHAIRMAN. The gentlewoman from California, Ms. Waters.

Ms. WATERS. Thank you very much, Mr. Chairman. Let me thank our panelists for being here today. From the time that I first became involved with CRA, we have been interested in trying to make sure that the ratings make good sense when they get excel-

lent or satisfactory ratings, it's because they have basically complied with the spirit of CRA.

We have been concerned about mergers and bank branches and all of that, and I think enough has been said or perhaps will be said today about the fact that banking services are provided in so many different ways now that increasingly, we're not talking about the same certainly structures that we talked about before.

I am interested in trying to delve into how we could possibly use CRA to deal with our subprime crisis. I have not thought it through, but I certainly would like to do something to encourage those banks, such as Countrywide, who were involved in a lot of the subprime lending, to do workouts and to do modifications and to help people stay in their homes.

I also realize that a lot of this paper is not held by the traditional bank as we have known it. But let me just ask, has anybody given any thought to that?

Ms. BRAUNSTEIN. Well, we did. The agencies issued guidance to the industry encouraging participation in workouts and saying that they would get CRA recognition for doing that. So we have—

Ms. WATERS. Oh, you did?

Ms. BRAUNSTEIN. Yes.

Ms. WATERS. What kind of response did you get?

Ms. BRAUNSTEIN. Well, I don't—I mean, I think that there are a number of institutions that are trying to work towards disclosure—towards, I'm sorry, foreclosure mitigation. I don't know—I mean, we haven't measured a response specifically to our guidance. Our guidance, you know, also came out when other things were happening, before other things happened. After our guidance was out, the HOPE NOW coalition was formed, some other kinds of initiatives have gone on.

Ms. WATERS. Yes. We are still hoping.

Ms. BRAUNSTEIN. So, I don't know if that was—

Ms. WATERS. We are still hoping for the HOPE NOW coalition.

Ms. BRAUNSTEIN. I'm sorry?

Ms. WATERS. We are still hoping that the HOPE NOW coalition will do what it said it would or could do.

Ms. THOMPSON. We are looking for ways to give CRA credit to institutions that are willing to transition borrowers from high-cost loans from some of the subprime exploding ARMs to low-cost loans. And we have also been working with institutions to give them credit for foreclosure prevention mechanisms, to keep the borrowers in their homes.

So we think that CRA can be used in a proactive way. And in July, the agencies issued a number of Q&As that address the subprime issue and foreclosure and loan mitigation specifically.

Ms. WATERS. I don't know if that information has been made available to the committee, or I don't think most of the Members of Congress know that or understand that you have issued guidelines and that you have found a way to give CRA credit for workouts and modifications and loan mitigation. So I certainly would like to have that information, and I would also, Mr. Chairman, would like to, since it only would take into consideration the institutions that are covered by CRA, aside from this kind of look at that, what we could do with the securitization firms and organiza-

tions that are involved with, you know, managing the paper with all of this.

So, thank you. And we will follow up to get additional information about what you have issued and how the CRA credits you are creating work. Thank you very much.

The CHAIRMAN. Those are clearly areas that tie in, because the role of the securitizers has become very significant, the potential legal issue there. That is one of the things we are most focused on.

The gentleman from Minnesota.

Mr. ELLISON. Thank you, Mr. Chairman. Also let me thank all the panelists; it has been a fascinating dialogue this morning. I want to talk to you about the 10 million people who are unbanked in our country, or that is the estimates that I have heard. How is the CRA addressing this unbanked population? Do you get credit for addressing all these people who are basically cash consumers, paying high fees for everything? How do you address the unbanked population?

Ms. THOMPSON. Well, I can—the FDIC has established, through Chairman Bair's leadership, a committee for economic inclusion, and we also have alliances for economic inclusion in nine areas of the country where we formed broad-based coalitions with financial institutions, regulators, and community groups to try to identify unbanked and underbanked people, people who—

Mr. ELLISON. Underbanked.

Ms. THOMPSON. —are not using banking services to the extent that they should, to bring them into the banking system. Chairman Bair has also established a small dollar loan pilot program to try to encourage financial institutions to provide small dollar loans at a reasonable price. We have about 30 banks participating in our pilot program so that we can try to figure out what some of the best practices are so we can fill the gaps in for some of the high-cost credit products.

Mr. ELLISON. How is it going? Have you been able to document whether you have made any progress?

Ms. THOMPSON. We just started our pilot program this year, and we're expecting information coming in from our institutions in the near term.

Mr. ELLISON. Would you be able to send us that?

Ms. THOMPSON. Absolutely.

Mr. ELLISON. Thank you. What about this—I'm curious to know how it is that there could be so many unbanked people, given the existence of CRA. I mean, CRA is all about economic inclusion and bringing people in. Is CRA inadequate to address the needs of the unbanked? Do we need to change the law in some way to create better motivation for banks to reach down into this vast pool of people who are unbanked or underbanked? What do you think about that, Ms. Yakimov?

Ms. YAKIMOV. Well, I think one step the agencies have taken to deal with this issue and bring more people into the financial services mainstream is giving credit for remittances, so institutions that provide that service a good opportunity to reach out to underbanked and unbanked people.

Also the Treasury Department has the Financial Literacy Education Commission. They have had a series of meetings in various

communities, African-American, and Latino communities, to try to understand why there is some reluctance for institutions to take advantage of financial services, how can the system be more attractive. I think those discussions and these meetings—

Mr. ELLISON. Well, you know—

Ms. YAKIMOV. —are really important.

Mr. ELLISON. Excuse me, you know, Ms. Yakimov, it's interesting, because it is kind of a—there are two ways to look at it. You can say well, the banks aren't reaching out to these communities, or you can say these communities don't want to go to banks. You can look at it both ways.

I tend to think that paying $10 to cash a check for $100 is something most people wouldn't want to do. And if they had a bank, they wouldn't do it. So, if you assume consumers are rational actors in the market, then if you are unbanked, then there is some barrier to being banked. Don't you agree with that?

Ms. YAKIMOV. Well, it's a good point you raise. And the service test is one way that we observe and we measure how our institutions are reaching and providing services in their communities. So, for example, we look at the branch network. We look at where they're located. We look at whether they're located in low- and moderate-income communities. So that's an important tool in the arsenal with respect to CRA.

Mr. ELLISON. Do you think the service test is adequate to really test what we're trying to measure? Because, again, you know, we have a lot of people who are unbanked, so something's not happening right.

Ms. YAKIMOV. This is something I think the agencies need to look at. Director Reich has publicly said how important he believes it is for institutions to serve. Branches provide an anchor.

Mr. ELLISON. Right.

Ms. YAKIMOV. Particularly branches in low- and moderate-income communities, they provide a more cost-effective means to obtain financial services with respect to—vis-a-vis payday lenders and check cashers. So—

Mr. ELLISON. Title loans.

Ms. YAKIMOV. All of that.

Mr. ELLISON. The whole nine—pawn shops.

Ms. YAKIMOV. All of that.

Mr. ELLISON. Yes, these kind of institutions, you know, in many ways, they work to, you know, reinforce poverty. Part of being poor is that you don't get enough, and the other part is that you pay too much. And so access to a bank that can give you an affordable financial product is a very important anti-poverty measure.

Ms. Braunstein, could you talk about how hard it is for people who are unbanked to make it? I mean, what are some of the barriers that they are facing?

Ms. BRAUNSTEIN. I think it is very difficult for people who are unbanked in many ways. Sometimes it—well, it creates problems in terms of the costs that they pay for financial services, number one. It's also more difficult for them to build up any kind of credit record, which is used not just for provision of financial services nowadays, but can be used in other means, getting insurance, other kinds of—in transactions, even sometimes getting employment.

Also, sometimes employers are doing direct deposit now, and so if you don't have a bank account, that can be a barrier for that. Although many employers are going to payroll cards, which, you know, present their own kinds of issues. It is certainly better if people have services, access to or serviced by a financial institution.

Mr. ELLISON. My time is up.

The CHAIRMAN. Thank you. I thank the panel. We will hope to hear from you more as we deal with this. This is, as I said, something we take seriously, and let's get the next panel here. It does look to me now like we are going to be able to finish today. I will be gone, but I will have someone else sit here. So let's move quickly, people.

Do not impede the leaving of the table. Let's sit down. You can shake hands and talk later. A minute may not sound like much to you now, but we are in a real hurry. Just sit down.

I will begin with Ellen Seidman, who is the director of the financial services and education project at the New America Foundation. Ms. Seidman, please go ahead.

Everybody's full statements and material will be submitted for the record, so there will be no further need to request that.

Go ahead.

STATEMENT OF ELLEN SEIDMAN, DIRECTOR, FINANCIAL SERVICES AND EDUCATION PROJECT, NEW AMERICA FOUNDATION

Ms. SEIDMAN. Chairman Frank, and members of the committee, thank you very much for this opportunity to testify today about the effectiveness and the future of the Community Reinvestment Act. You mentioned that I am currently directing the Financial Services and Education Project at the New America Foundation, but from October of 1997 to December of 2001, I was the Director of OTS. And as OTS Director, one of my priorities was to make certain that the institutions we regulated understood the importance of meeting both the letter and the spirit of CRA.

My experience with CRA at OTS, with this New America Project, and also with my job at ShoreBank has taught me several lessons. First, what is measured, like residential loans, is what gets done. Measurement is incredibly important. CRA has focused heavily on residential loans and the kinds of investments that are easily measured.

Second, the regulatory system can be significantly leveraged by information made directly available to the public. Third, CRA has generated a fair amount of innovation. I think this is really important with respect to some of the questions that were being asked earlier. CRA changed the hurdle rate for new products, services, and markets, encouraging banks and thrifts to look for investments and products for which a part of the return was in CRA credit rather than in dollars. Some of those products continue on purely financial terms. In other cases, the institutions understand the value of both CRA and the publicity that comes with it.

Fourth, the implicit requirement that banks enter new markets for which gaining trust, getting business, and making a profit were not familiar has required partnership and collaboration with a wide variety of more community-oriented institutions.

So those are the positive lessons, but there is plenty of room for improvement. Most obviously, as you have discussed, the CRA applies only to banks and thrifts. The myriad of other types of organizations that provide some or all of the same types of financial services to some or all of the people that CRA was designed to assist remain uncovered.

Second, it has become a complex regulatory regime, especially with respect to service and investment. Third, the lack of an explicit enforcement mechanism beyond the merger situation works well in terms of major merger activity, but not as well otherwise. Some States and localities have been effective in adding other incentives such as linked deposits. We need to think of other ways to incent CRA performance.

Fourth, the spatial origin of CRA has had several negative effects. They are described in my testimony, but let me just raise one: notwithstanding that redlining had its origin in racial discrimination, the statute is color-blind, which has limited its impact in many of the communities and populations it was meant to serve.

The language of CRA is focused on communities, and the impetus for its enactment was redlining of entire neighborhoods. Nevertheless, the manner in which financial institutions dealt with people in low- and moderate-income communities, limiting their access to credit, closing branches, and moving out was also part of CRA's origins.

Our current debt crisis makes this a propitious time to consider how the "people" aspect of CRA can be improved. I go into this in much greater detail in my written testimony, but let me just say I think it's time, at least to consider, a totally new paradigm for consumer financial services and one that is just as bold as CRA was 30 years ago; namely, any financial institution that provides an essential consumer product must make that product available in a fair and transparent manner to low- and moderate-income consumers, in all communities, in all broad geographies in which the entity does more than an incidental amount of business in the product. This paradigm would concentrate the attention of business, the public and government on what is important to consumers and would use the market forces generated by consumers with the knowledge and resources to demand high quality financial services to extend the reach of those products and services to the rest of the market.

To bring CRA as applied to banks and thrifts more fully in line with both the modern financial services system and the principles proposed, some changes would be desirable. CRA should cover service to low- and moderate-income consumers everywhere a bank or thrift does a significant amount of business and a covered product. Effective public disclosure regimes should be added to cover essential products beyond residential loans. Any for-profit subsidiary of a holding company that provides any of the essential products should be evaluated in the same manner and at the same time as the largest bank or thrift in the holding company group.

With respect to consumer protection and fair lending responsibilities, the agencies have moved in that direction but they need to become much more firmly embedded in all CRA evaluations, in-

cluding in particular the investment test. And incentives should be established that are external to CRA.

But as we all know, changing the rules for banks and thrifts is not enough, and in fact would make the unlevel playing field even more unlevel. It's essential to extend the responsibility to serve all consumers fairly and equitably to all providers of essential consumer financial services.

One could extend CRA's language and regulatory system to other types of financial institutions, placing examination and enforcement responsibility on their regulators to the extent they have them or on surrogates such as HUD. However, for financial services entities operating under different types of or no regulatory regime, alternative solutions that take maximum advantage of regulatory systems and responsibilities already in place, such as the suitability standard in the securities industry, may be a better solution.

In conclusion, by enacting CRA 30 years ago, the Federal Government challenged the banking industry to help lower income communities and their residents to achieve a better life. Consumers today are expected to take much greater responsibility for their financial health and stability, and many Americans are having a difficult time with this task. The new responsibility paradigm presented here challenges the entire financial services industry, as CRA did banks 30 years ago, to help American consumers to do better.

Thank you.

[The prepared statement of Ms. Seidman can be found on page 167 of the appendix.]

The CHAIRMAN. Thank you.

Next, John Taylor, who is the chief executive officer of the National Community Reinvestment Coalition.

STATEMENT OF JOHN TAYLOR, CHIEF EXECUTIVE OFFICER, NATIONAL COMMUNITY REINVESTMENT COALITION

Mr. TAYLOR. Good afternoon, Chairman Frank, and thank you Representative Waters, Representative Watts, Representative Cleaver, and other members of the Financial Services Committee for the opportunity to offer the remarks of the National Community Reinvestment Coalition.

Mr. Chairman, America, as you know, is in the grips of a foreclosure crisis. It is destroying family wealth, undermining communities, and destabilizing the economy. And the sad and unfortunate reality is that this problem was largely unnecessary and avoidable. The failure to protect consumers in the home loan market from rampant unfair and deceptive mortgage lending practices is the core of the problem that we face today.

Improved coverage and enforcement of the Community Reinvestment Act could have provided much of the needed protection. The overwhelming share of subprime mortgages heading into foreclosures were made or funded by lending institutions that are not subject to CRA. CRA does not apply, for example, to independent mortgage companies, investment banks that securitize these loans, and many mortgage company affiliates of banks.

These non-CRA-covered institutions issue hundreds of thousands of loans annually, without adequate oversight. Their misbehavior has now impacted all Americans regardless of whether they have a subprime loan. In fact, inadequate regulation of the subprime market is negatively impacting all Americans, regardless of whether they even own a home.

Sadly, all signs suggest the worst of both the foreclosure crisis and the slumping economy remains ahead of us. In addition to the need to expand CRA's coverage to other institutions, we must also improve the system of regulatory enforcement of this law. Regulators count less and less of the bank's geographic areas in doing their CRA assessment of banks. They have less frequent examinations under this law, and the grading system for assessing a bank's CRA performance has increasingly become inflated.

Consider and compare just two 3-year periods of bank regulatory grading, 1990 to 1992, and 2004 to 2006. In the first period, 1990 to 1992, when lenders primarily issued prime loans where we saw none of the predatory aspects that we have seen recently, the average failure rate was 10 percent bank failure of the CRA exam.

Now, fast-forward to the recent 3-year period, 2004–2006. This, of course, was the height of much of the unfair lending practices that created the problems we have today. In a period of time when we had the most outlandish, most predatory, usurious, unfair, and discriminatory kind of lending, we saw a 900 percent drop in the percentage of failure CRA ratings that banks got on their CRA exam. So CRA-grade inflation was improper moding was promoted by allowing banks to pick and choose what activities and affiliated institutions to include in their CRA exams. Imagine that? The bank gets to say, well, yes we want this affiliate that does this kind of lending counted at our exam, or they don't.

And so they use it to manipulate the score, and the regulators go along with that. Moreover, we have not had a public hearing on a bank merger since 2004, despite several major mergers involving branch closures and other serious ramifications for working class and minority neighborhoods. Numerous studies have found that CRA encourages responsible lending to low- and moderate-income communities in a way that is consistent with safety and soundness concerns. A study by the Joint Center for Housing studies at Harvard University estimates that without CRA, over 336,000 fewer home purchases would have been made to low- and moderate-income neighborhoods between 1993 and 2000.

The Federal Reserve Bank, in their review of the Home Mortgage Disclosure Act data, has found that home loans issued by banks are significantly less likely to be high-cost and exhibit risky features than those issued by the independent mortgage companies and other non-CRA-covered institutions. These studies offer an important endorsement for the value in the potential of CRA.

Greater CRA coverage for banks and other financial services firms would improve on these impressive statistics and enhance financial services access for working families in their communities across the Nation. Curiously, Federal regulators often say that their principal focus is to ensure the safety and soundness of the financial system, yet, the foreclosure crises demonstrates that the key way to ensure safety and soundness of this financial services

system is to ensure proper financial services protections for consumers is in the credit markets.

As long as short-term bank profitability is the sole or principal measure of safety and soundness, crises like the one we face today could occur again. The changes to the law I have suggested today in my opening remarks and detailed in my testimony are largely included in H.R. 1289, the CRA Modernization Act of 2007, proposed by Representative Eddie Bernice Johnson from Texas and 14 other co-sponsors. Passing that law is essential.

Yet strengthening CRA will have little effect without enforcement. Congress also must ensure that the laws it enacts are thoroughly and fully enforced. In addition to the foreclosure crisis, we face today broader and systemic challenges of financial access. Payday lending, abusive credit card issuers, and related alternative high-cost financial services have grown exponentially over the past decade. Their growth has been accompanied by the closing and departure of bank branches from the same communities. With a CRA examination passing rate of 99 percent, it is clear that the Federal regulatory agencies are not seriously considering the Service Test of the CRA exam, or the overall history of opening and closing bank branches in minority or underserved communities.

In conclusion, if this foreclosure crisis has taught us anything, it is that America must be effective in supporting efforts to sustain a Financially Inclusive Society. Consumer protection laws, CRA and the fair lending laws must be obeyed and they must be accompanied by adequate and effective regulatory enforcement mechanisms. The financial services needs of working class Americans must be respected and promoted if we are to have the kind of economic mobility that creates more stakeholders.

And I'm wrapping up, Mr. Chairman. Thank you.

Americans willing to work hard, pay their taxes, practice their faith, and who are seeking to build a more promising economic future for their families, should no longer be subjected to the kind of lending malfeasance that we have experienced in the past several years. The need for a strong and expanded CRA with meaningful enforcement has never been greater.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Taylor can be found on page 179 of the appendix.]

The CHAIRMAN. Next, we are going to have votes. We are back to real votes now. These are not procedural ones, so we will probably have a break for about a half hour, then I'm going to have to leave. But there will be other people testifying.

Before I leave, I did want to ask Mr. Taylor one question. The legislation you mention by Congresswoman Johnson expands CRA coverage but does not expand it to credit unions, so I just wondered what your position would be on that.

Mr. TAYLOR. Yes well, we were hoping that Representative McGovern has. It also, Mr. Chairman, does not call for—

The CHAIRMAN. Well, let's just talk about the issue I raised.

Mr. TAYLOR. Yes, I totally agree. And in Massachusetts, our experience has been that they perform as well or as better than banks. And those that aren't covered in Massachusetts because they are federally-chartered credit unions do not do as well.

The CHAIRMAN. Well, because I was told that they weren't there, and with regards to the bill, I just want to make sure that is where we were. Next, we'll hear from Marva Williams, who is the senior program officer at the Chicago Local Initiatives Support Corporation. Ms. Williams?

STATEMENT OF MARVA WILLIAMS, SENIOR PROGRAM OFFICER, CHICAGO LOCAL INITIATIVES SUPPORT CORPORATION

Ms. WILLIAMS. Thank you. I appreciate this opportunity to testify today.

My name is Marva Williams, and I am a senior program officer of the Chicago office of the Local Initiative Support Corporation, or LISC.

As many people have testified today, CRA is critical to bringing capital and financial services to lower income communities, and it has encouraged banks and thrifts to increase sound and profitable lending, to devolve flexible and financial products, to make community and development loans and investments available, and to encourage partnerships between financial institutions and community-based organizations.

Since 1980, LISC has worked in numerous partnerships involving banks and thrifts, nonprofit housing development organizations, and government agencies. LISC currently invests over $1 billion each year in these partnerships, leveraging $25 billion since 1980. Our work covers a range of activities that contribute to sustainable communities, and in fact the Chicago office was one of the first LISC offices to devolve a sustainable.

The CHAIRMAN. Ms. Williams, we are time-limited. We did want this to be about CRA and not LISC.

Ms. WILLIAMS. Okay, thank you.

As others have testified today, CRA has worked remarkably well. However, it has not kept pace with the financial industries' trends over the last 30 years. Banks no longer originate a majority of home mortgage loans. They currently originate less than half of home mortgages. As Representative Cleaver noted, banks are no longer oriented to a local area, and so the assessment area is no longer appropriate or very useful.

In 1977, the overriding concern was denial of credit in entire lower income neighborhoods. However, as John Taylor and others have mentioned, subprime lenders are now aggressively pursuing those communities. And I believe that the subprime mortgage crisis has shown us that prudent government regulation is important, not only for consumers and communities, but also for the safety and soundness of our financial system. And then last, banks and thrifts were peripheral to government housing and community development programs, and that is no longer true.

I offer the following observations and suggestions for CRA. CRA coverage should be expanded beyond banks and thrifts. The CRA coverage to assessment areas around branches is no longer appropriate. Although CRA examinations occur regularly, CRA is most influential when a bank or thrift applies to merge with or acquire another institution. CRA should be enforced on a regular basis during examinations. The regulators should also actively and regularly invite public comment and public hearings.

The community development activities of large banks and thrifts should be considered together. Community development activities are qualitively different from other kinds of activities such as home mortgages and small business loans. Community development activities are generally smaller in volume, and sometimes more complex, but they add value and should contribute to a concerted strategy.

Many rural communities have few if any banks with sufficient capacity to address complex community development needs. Banks and thrifts that serve local community needs should receive full recognition for that. Data requirements and performance criteria have not changed significantly over the last 30 years. Some thought should be given to updating an institution's qualitative and quantitative data reflecting recent learning in the asset development field.

And, last, I am concerned about geographic redlining based on the predominant race of the community. Fair lending laws applied to individual borrowers and CRA applies to lower income communities, but neither law explicitly addresses disparate service to minority communities.

In closing, I urge the Financial Services Committee to make CRA an effective tool for ending geographic discrimination and to increase the potential for asset development of lower income and minority communities and consumers.

Thank you.

[The prepared statement of Ms. Williams can be found on page 247 of the appendix.]

The CHAIRMAN. Thank you. We are going to break now for a vote. I apologize. We have probably a half hour or so that we will be gone. But the votes are 15 minutes, and we only have about 3 minutes left, and it is a substantive vote, and not a procedural one. We will resume. That is just the nature of the business that we are in.

[Recess]

The CHAIRMAN. As I was saying—actually, I am changing what I was saying. This really is a very important issue. I apologize for the disruptive day. I guarantee there were a lot of interested members; we had about 15 members at one point or another. That is indicative of real interest. We have talked among each other and there is real concern here.

And this is more important to me than the photo op, so I will not be going to the White House. He can sign the bill without me. Although, when he acts without me, he does not do as well as when he acts with me. So we are just down to a signing now, so there is no problem. And I want to get this complete.

I appreciate—this has been very useful to us. And I just want to again assure you that your time has not been wasted. We are paying serious attention here.

Professor White, why don't you go ahead.

STATEMENT OF LAWRENCE WHITE, PROFESSOR OF ECONOMICS, NEW YORK UNIVERSITY-STERN SCHOOL OF BUSINESS

Mr. WHITE. Thank you, Mr. Chairman. My name is Lawrence White, and I am a professor of economics at the NYU Stern School

of Business. I am here solely representing myself. I appreciate this opportunity to be here and thank you for the opportunity.

My views on the CRA differ from those of my fellow panelists. Despite the good intentions and worthwhile goals of CRA's advocates, the CRA is simply the wrong instrument for achieving those goals. The CRA is fundamentally an effort to "lean" on banks and savings institutions in a vague and subjective process to make loans that its advocates believe would otherwise not be made.

The CRA processes have gotten better over the years. But still, fundamentally, they are a vague and subjective process—because, "meet the credit needs" is inherently a vague concept.

There is a fundamental contradiction at the heart of CRA. If these loans are profitable, then banks and thrifts should already be making them, unless the banks are lazy or dumb or ill-intentioned. And maybe that is a decent characterization of what the banking world was like in the pre-1970's era. But I think it is hard to describe the competitive banking world of 2008 in those terms. Banks may not be the perfect profit maximizers of economics textbooks, but to think that they systematically overlook profitable opportunities, I think, is just not correct.

Or maybe there are spillover effects such that individual loans aren't profitable, but collectively loans would be profitable. In that case, we ought to be seeing banks forming consortia and joint ventures among themselves. After all, this is a small numbers situation, and they do form consortia and joint ventures all the time.

Or the loans are unprofitable. In which case, either those loans are going to have to be cross-subsidized by super-profitable areas—but with increased competition there is going to be less and less super-profitable opportunities. Or the loans will cause losses. Or the obligations will be shirked in some manner. And none of these are good bases for policy.

In sum, the localism orientation of the CRA is an anachronism. It is based on an inherent contradiction that runs counter to the broad sweep of public policy that has encouraged deregulation and greater reliance on competition. Ironically, at a time when residents of low- and moderate-income communities are having to rely on high-cost check cashing and payday lending services, which a number of the people testifying this morning have talked about, because of the absence of bank locations to which they can turn, the CRA obligations may well be discouraging banks from establishing locations in these communities and offering better priced services. This is especially if those locations are going to carry the burden not only of providing those services but also of forced lending to those communities. If bank branches are going to be characterized as institutions that drain deposits out of these communities, if banks are going to be told that just drive-through locations are not sufficient, if they are going to be given a hard time when they try to exit an area, then banks are not going to want to set up establishments in the first place. Barriers to exit are barriers to entry.

There is a better way. First, vigorous enforcement of the Equal Credit Opportunity Act and other relevant statutes to prevent discrimination on the basis of racial or ethnic characteristics or other categories of personal discrimination is essential. It is terrifically important.

Second, vigorous enforcement of the antitrust laws, to make sure that financial markets remain competitive is important. But competition should not be allowed to veer off into predatory behavior.

Third, if there are socially worthwhile loans and investments that somehow are not being made by existing lenders, then those loans should be made through the public fisc in an on-budget and transparent process. The Community Development Financial Institutions Fund, which is financed through the public fisc, which is administered by the Treasury, is a good example of this kind of funding process. And, as appropriate, its funding should be increased so as to support these kinds of socially worthwhile investments and loans.

Finally, if public policy persists with something that resembles the CRA, then the bank and thrift CRA obligations should be made explicit and tradable among banks. This would make an opaque process more transparent and would introduce the types of efficiencies and specialization that has made the cap-and-trade system for dealing with sulfur dioxide emissions among electric utilities such a successful program.

Thank you again for the opportunity to testify this morning. I will be happy to answer questions from the committee.

[The prepared statement of Professor White can be found on page 238 of the appendix.]

The CHAIRMAN. And our final witness on this panel is Professor Michael Barr of the University of Michigan Law School.

STATEMENT OF MICHAEL BARR, PROFESSOR, UNIVERSITY OF MICHIGAN LAW SCHOOL

Mr. BARR. Thank you, Chairman Frank, and distinguished members of the committee. It is an honor to be here today to discuss CRA.

CRA has helped to revitalize low- and moderate-income communities and has provided expanded opportunities for low- and moderate-income households. Going forward, CRA could be strengthened to ensure its continued role in encouraging sound lending, investment, and services. At the same time, CRA cannot be expected to resolve the range of financial problems facing low- and moderate-income communities today.

This committee has already taken strong leadership to clean up the mortgage business and I am confident that the committee will continue to lead in resolving our housing crisis.

At its core, CRA helps to overcome market failures in low-income communities. By fostering competition among banks and thrifts serving low-income areas, CRA generates larger volumes of lending from diverse sources, adds liquidity to the market, and decreases the risk of each bank's loan. Encouraged by the law, banks and thrifts have developed expertise and specialization in serving low-income communities. And they have created innovative products that meet the credit needs of working families in low-income areas with manageable risks.

Increased lending by responsible originators to low-income communities has occurred under CRA and such responsible lending has not led to the kind or extent of excessively risky activity undertaken outside of CRA's purview. Despite the fact that CRA has in-

creased bank and thrift lending in low- and moderate-income communities, such institutions are not the only ones operating in these areas.

In fact, subprime lending exploded in the late 1990's, reaching over $600 billion and 20 percent of all originations by 2005. More than half of subprime loans were made by independent mortgage companies, another 30 percent by affiliates of banks or thrifts, and the remaining 20 percent were made by banks and thrifts themselves.

Although reasonable people can disagree about how to interpret the available evidence, my own judgment is that the worst and most widespread abuses have occurred in the institutions with the least Federal oversight. The housing crisis we face today, driven by serious problems in subprime lending and spreading rapidly, suggests that our system of home mortgage regulation is seriously deficient. We need to fill what my friend the late Federal Reserve Board Governor Ned Gramlich aptly termed, "the giant hole in the supervisory safety net."

Banks and thrifts are subject to comprehensive Federal regulation and supervision, their affiliates far less so, and independent mortgage companies not at all. Market-based systems designed to ensure sound practices in this sector—broker reputational risk, lender oversight, investor oversight, rating agency oversight, and so on—simply have not worked. Conflicts of interest, lax regulation, and boom times covered up the abuses, at least for a while, at least for those not directly affected by the abusive practices. But no more. As has become all to evident, the subprime market has been plagued by serious problems.

In some ways, CRA can help. Competition from banks and thrifts can help to drive out abusive practices. However, in recent years, there was intense competition among mortgage market participants to provide products that investors wanted, not those that households needed. Further Federal regulation is thus necessary to combat abusive practices, prevent a race to the bottom in bad lending behavior, and restore integrity to our housing markets. We need to ensure that all participants in the mortgage process have the right incentives to engage in sound lending practices.

One step would be to include affiliates in the banks' performance context for CRA. For example, CRA regulations provide that evidence of illegal credit practices will affect an institution's CRA rating. Illegal credit practices of an affiliate should also be relevant to its affiliate bank's rating, and the bank agency should engage in risk-based examination of affiliates.

Along with maintaining and strengthening CRA, Congress ought to enact a range of complementary policies. We need to give new authorities to FHA, Fannie Mae, and Freddie Mac to arrange through responsible originators for the refinancing of loans at terms that reduce the likelihood of default, foreclosure, and liquidation. We should take this opportunity to implement commonsense reforms to the mortgage market to reduce the likelihood of crises in the future, as this committee has in its mortgage reform bill. And we eagerly await that legislation being enacted by the other chamber and being signed into law.

In moving forward, we should remind ourselves of Ned Gramlich's question: "Why are the most risky loan products sold to the least sophisticated borrowers?" Well, lenders hid the ball. Many borrowers took out loans that they did not understand and could not afford, with predictable results. That is why we need a new opt-out home mortgage plan, a plan under which borrowers would be offered a standard set of mortgages with sound underwriting and straightforward terms. Borrowers could opt out of the plan, but lenders would face incentives not to push borrowers into loans that they could not understand or afford.

CRA in the past has helped to expand access to responsible credit to low- and moderate-income households. And in my view, it can continue to do so in the future. Innovation has been a hallmark of our financial system and with the appropriate mix of private sector initiative, government policy, and regulatory supervision, we can expect our financial system once more to be vibrant, strong, and inclusive.

[The prepared statement of Professor Barr can be found on page 77 of the appendix.]

The CHAIRMAN. Thank you.

Mr. White, let me ask, as I understand the argument is that the notion that you have to push banks to make these loans is based on, as you said, the notion that they are either lazy or ill-intentioned or inefficient. And essentially, we can count on them to make loans that make sense.

Mr. WHITE. That would be—

The CHAIRMAN. Then why do we need the racial discrimination—I find this glaring contradiction. You talk strongly about the need for racial enforcement. I must tell you the people whom I have heard previously make the argument, namely that you don't have to tell profit-making institutions to make a profit, they know enough to do that, generally don't want us telling them—I mean, is there something—they are not ill-intentioned, except that they are racist? Why, if the banks can do this on their own, is it so important that we deal with the race question?

Mr. WHITE. Basically, because racial, ethnic, and other types of discrimination are simply unacceptable.

The CHAIRMAN. But how does it—no. No, it is not—you don't reach unacceptability. If we are dealing with rational, well-intentioned, efficient, non-lazy institutions that know how to get money to be made, why do we have to make an exception with regard to race? I mean, do we have a set of perfectly sensible, well-functioning, profit-maximizing institutions, but they are blind about race? That just doesn't compute.

In other words, you are making an exception for race, it seems to me, because nobody likes to say that we shouldn't fight racism. But I don't think it fits with your argument.

Mr. WHITE. Well, you know, unfortunately, we have a history of discrimination of various kinds. And that is just unacceptable.

The CHAIRMAN. I understand that. But we also have a history—you said, well, this might have made sense in the 1970's. I mean, has history cleaned up its act in some areas, but not others? You say, you know, there was a period with banks—just again, if the banks are the thoughtful, well-intentioned, profit—rational, effi-

cient profit maximizers you make, then it wouldn't seem to me that we would need this.

The other question I would have is this. Again, if these are banks—and not just banks, but other financial institutions, who made all those subprime loans? I mean, where did they come from? Were they made by efficient, well-intentioned profit maximizers?

Mr. WHITE. In a world of securitization, there is clearly a problem of moral hazard, of a short-term perspective, reputation doesn't come into the picture. People make the loan, pass it on to somebody else, and say, ah—

The CHAIRMAN. That doesn't sound like efficient profit maximizers who are well-intentioned to me. I am saying, you accept the fact that we have had these failures elsewhere. I don't understand why you assume we don't need to do anything in the other area.

Mr. WHITE. I see competitive processes. I see the kinds of extra things that I mentioned in my statement, as providing an alternative to this really vague—

The CHAIRMAN. But banks don't compete for Black people? Why don't competitive processes help the Black and Hispanic people? I mean, why don't the competitive processes work there?

Mr. WHITE. I think that you have informational problems, for sure. But the way to deal with those is not leaning on banks and thrifts—

The CHAIRMAN. I think the problem is too much information. They know that they are black. Maybe if they didn't, it wouldn't be so bad.

All right, let me tell the others where I have some agreement. When we are talking about imposing these requirements, as I believe we should, let me deal with the argument about the quid pro quo which we heard earlier, in the earlier panel. I don't think there is an institution on whom we are considering imposing some requirements that cannot be shown to get some benefit from the Federal Government. So I don't think this notion that we are picking people who are honestly just walking down the street, entirely minding their own business, and giving them this burden.

But if we do decide that there should be requirements on people who don't have a geographical footprint, how do we define the obligation? I understand there is enforcement and other issues. But it does seem to me if we get to it, that is going to be the critical, conceptual question. How do we define the obligation for people who don't have a geographic footprint? Does anyone want to start?

Ms. Seidman.

Ms. SEIDMAN. I think that it is worth distinguishing on the geography issue between the community development issues and the consumer servicing issues.

The CHAIRMAN. Agreed.

Ms. SEIDMAN. If we just talk about the consumer service issues, Montrice, this morning, mentioned that OTS has been facing up to this issue for—

The CHAIRMAN. For those of us who don't spend quite as much time in these circles as you, Montrice was who, now? Please identify—

Ms. SEIDMAN. Montrice Yakimov from OTS, earlier today.

The CHAIRMAN. Thank you.

Ms. SEIDMAN. OTS has been working those issues for about 10 years now. Some of my co-panelists may not like fully the way that we did it then and I believe they still do it now, but if you start with a question, does an entity do any business in a broad, geographic area, then ask do they do an equivalent amount or an appropriate amount for low- and moderate-income consumers, you get somewhere.

You also get somewhere if you just ask the national question. You just ask the question of, if I am doing home mortgage lending, how much am I doing in what income strata? How much—if we bring race into this, how much am I doing in what race strata? And then that is when it becomes critically, critically, critically important to make certain that the consumer protection and fair lending concepts are embedded in the analysis.

The CHAIRMAN. I appreciate it. Because, you know, when I asked the others, one perfectly rational approach is to say, okay, it will be functional as opposed to geographical. Where there is no geographic footprint, then the obligations are functional and that is perfectly reasonable. But that is what—and you are right, Ms. Yakimov did mention the work that had been done going back to when you were there and offered to share that with us and we will look for that.

Professor Barr.

Mr. BARR. I agree with the chairman that a functional approach makes a lot of sense. And in particular, looking at the kinds of products and services that are being offered.

We were talking in the earlier panel about the problems of the unbanked. One of the problems of the unbanked is that the products and services that banks and thrifts tend to offer, such as a traditional checking account, don't make any sense for them. And so you would want to look at whether the bank is offering a low-cost, low-risk bank account that would be useful to low-income people. In the credit area, is the bank offering a credit product that makes sense for low-income people? And you can make that assessment in a qualitative way based on the kinds of products and services being offered.

The CHAIRMAN. But what if we are talking about—Mr. Taylor.

Mr. TAYLOR. Yes, I just wanted to get back to the original question of measuring nondepository institutions and—

The CHAIRMAN. Right, that is a very important one.

Mr. TAYLOR. There is data out there that can show you the pattern and practice of where their lending is occurring. And you are able to draw some conclusions about whether they are just sort of marketing and being very successful in making loans or disproportionately denying loans in what we would call protected areas, low- and moderate-income and minority neighborhoods, or whether they are just marketing all their loans and being very successful in middle and upper income suburbs.

You know, I think what you do is you look at the data and then, you know, the regulator would say, well, gee, you know, you have an affirmative obligation, assuming CRA was extended, to make sure that creditworthy borrowers in other low-income communities which are not showing up in your data set and your market seems to be—you are heavily marketing in the northeast or nationally or

whatever. You seem to be not being successful, I think you can do that through the available data.

The CHAIRMAN. Anyone else? Yes, Ms. Williams.

Ms. WILLIAMS. There have been some thoughts about how to improve the service tests that I think could apply to this area. And that is that it is possible to "geocode," to determine the geographical location of people who have checking and savings accounts at an institution and to look at the market share ratio of those consumers compared to higher income consumers. And that would be one way of determining whether they are making an equal effort to low- and moderate-income communities and consumers and upper income consumers and communities.

The CHAIRMAN. And I am going to turn to Mr. Baca now, because he is also here. I may return to this afterwards.

The gentleman from California.

Mr. BACA. Thank you very much, Mr. Chairman. And thank you for hosting this important meeting and asking so many important questions that you have just asked.

Mr. Taylor, a question that I have: You mentioned that you think some sort of CRA-like program should be imposed on credit unions. Yet wasn't CRA imposed on banks because there was clear demonstration and evidence of bank redlining on low-income minority communities that they didn't find profitable?

Mr. TAYLOR. Yes. And in fact, that is exactly what you will find with most credit unions, that when we have done studies and others have done studies on this, while they have improved in recent years, in most States, credit unions, particularly those that are geography based, lag banks. They are behind banks and thrifts in making loans to low-income and to minority borrowers. And in many States, to women borrowers.

When we tell people this, they are always kind of shocked. Really, credit unions? Weren't they created for the purpose of being an alternative to the banking system because it wasn't serving people of small means? Wasn't that the language in their act?

It was. But unfortunately, the industry has evolved to the point where we really do need—and especially because not only do they have deposit insurance, but they actually have tax exemption. They should never lag, let alone even be competitive with banks, they should be far and ahead of banks and thrifts in serving traditionally underserved populations because of the extra benefit, the added benefits that they get from the U.S. taxpayer.

Mr. BACA. And they are doing that in a lot of the areas.

Just to follow up on that, why do you do so when Home Mortgage Disclosure Act data shows that the following to be true. A low- to moderate-income LMI application is more likely to get his or her loan approved at a credit union than at a CRA lender? And an LMI borrower is much less likely to be charged with higher rates, fees, at credit unions than at CHR lenders. And credit unions make a larger portion of their mortgage loans to LM borrowers than do CRA lenders, especially now, as we look at the foreclosures and the impact it has had on a lot of minorities, especially on Hispanics and African Americans?

Mr. TAYLOR. Yes. Well, if you don't make the loans, you are not foreclosing on anybody. And I would dispute the data that you just put forward, that is number one.

Number two, most of the borrowing that comes to the populations that you expressed a concern about, minorities and low- and moderate-income people, are not coming from either the credit unions or from the banks. Unfortunately, the problem loans that we are talking about are coming from non-CRA regulated institutions.

You would think that the credit unions would have been far and away, in serving that population, perhaps reducing the amount of exposure that traditionally underserved people have to these predatory aspects of the market that are not covered by CRA, but they are not.

Mr. BACA. Okay. Mr. Taylor, could you please state for the record how much money NCLR gets from banking interests in the way of conference attendance and other sponsorship or services?

Mr. TAYLOR. NCLR, the National Council of La Raza, I couldn't tell you. But I assume you really mean to ask us how much NCRC gets.

Mr. BACA. Right.

Mr. TAYLOR. Right. We get about—well, we certainly get sponsored by financial institutions of all sorts for our annual conference, but we are primarily supported by grants and dues. We own a property, which generates income. So we have a very eclectic funding source. But we would be happy to have credit unions support us, if they were so moved.

Mr. BACA. Thank you.

Mr. TAYLOR. I do want to say that the disparities in white and black approval rates are higher at credit unions than they are at banks, the disparities in white/black approval rates are higher, according to the HMDA data, than they are—at credit unions than they are at banks. And we would be glad to give you that information.

The CHAIRMAN. All right, let me—I just want to get back, because the other area, my colleague from North Carolina got into it. People who mend, it is one thing. The other question is, it gets into a harder area conceptually. Some of you heard Mr. Watt asking, well, what other institutions?

There are firms not traditionally in the banking business who were major funders of the securitization of subprime loans. Are these entities that we should consider and what would the criteria be? You know, some of the financing of the subprime market obviously got far beyond the traditional. I agree with Mr. Taylor that, in fact, the regulated institutions did a much better job here than the others.

Are we talking about securities firms or some aspects of securities firms? Are there entities that securitize mortgage loans? What would be the criteria, Ms. Seidman?

Ms. SEIDMAN. There are a couple of things. First of all, to some extent, it was the securities side of the banks that were participating. In that respect, the investment test can be brought to bear.

The CHAIRMAN. That is easy. What about the securities people who weren't in parts of banks?

Ms. SEIDMAN. On the consumer side, suitability seems to work reasonably well in the securities industry. The question is, can we make it work on the investment banking side?

The current way that we think about regulation of the securities industry is disclosure and protection of the investor. First of all, we now know that there wasn't disclosure and there wasn't—

The CHAIRMAN. If I wanted answers to the easy questions, I would ask somebody else. I mean, I understand all that. But the question is, let's get to the hard question. Do we want to go beyond the current method? Do we want to impose some CRA-like requirements on those securities firms not parts of banks that have, in fact, the ones who entered into this through their role in the mortgage business?

Ms. SEIDMAN. And I would respond in two ways. The first is that, as to their activities with respect to consumers, I think that there is the possibility of a positive, affirmative obligation.

The CHAIRMAN. Okay, because remember, and here is the deal, look, this is the conversation. The issue here is that they are clearly involved with consumers, but not at the retail level.

Ms. SEIDMAN. I understand.

The CHAIRMAN. The question is, do you take an involvement with consumers at the wholesale level and translate that into one of these obligations? That is the kind of question we have to deal with.

Ms. SEIDMAN. And I think the answer is that, if we can get to the goal of responsible products and services, we may be able to do it in the securities industry in a way that is not classically CRA—

The CHAIRMAN. I see, by better regulation of the products?

Ms. SEIDMAN. We ought to think about it in terms of functionality.

The CHAIRMAN. Anyone else on that subject?

Mr. BARR. I agree that there may be a narrower way of thinking about the question if we focus, for example, on a requirement of due diligence on the part of securitizers to assure that the products and services that they are packaging at least comply with underlying law. There is usually a recitation of that—

The CHAIRMAN. A version of that is in the bill that we passed.

Mr. BARR. Correct.

Mr. TAYLOR. It just needs to be a little stronger than it is, in that there be an easier—that they are accountable in a way—

The CHAIRMAN. Well with enforcement, there are two separate questions—the requirements and then the enforcement itself.

Mr. TAYLOR. Yes.

The CHAIRMAN. The enforcement, I realize, I think we need further work. But the principle, and I feel frankly rather proud that we breached that wall by being the first ones to impose this kind of requirement and now we will have conversations about how better to enforce it. Although I must say, in this case, I think for the near term, people are sufficiently scared. Giving them the requirement is going to have an impact. I think there is going to be a reluctance to get caught.

We do need to build up enforcement. But again, we are all agreeing then that the obligation, in effect, is not a classic CRA obliga-

tion in that you have to provide this response to that consumer, but it is part of the regulatory process in general.

Any further comments? Yes, Ms. Seidman?

Ms. SEIDMAN. I would like to say something in response to Professor White's point that you and he were talking about.

The CHAIRMAN. Go ahead. And Professor, you will be able to respond.

Ms. SEIDMAN. I think what we need to recognize is that in all businesses, choices are made about which opportunities to pursue and which opportunities to spend capital on and which opportunities to spend capital on in order to research to decide whether to pursue.

What CRA does is say, look at our communities, look at the opportunities in our communities, just as you would look at the opportunities in China. I think it is an incredibly important rebalancing that doesn't require one to assume that banks are stupid in order to say that it is valuable.

The CHAIRMAN. Professor White, do you want to respond?

Mr. WHITE. This sounds like 1975 to me; it doesn't sound like 2008.

The CHAIRMAN. Well, I wish it was 1975. We wouldn't have a subprime crisis.

Any further discussion? If not, I thank the witnesses.

Again, I just want to tell people that the Congressional Black Caucus had a previously scheduled, very serious, long meeting. That is why a number of my colleagues who were here earlier are not here now. But I again want to assure you, it is not a sign of lack of interest. The material is going to be read. Staff members have been monitoring the conversations and we will be dealing very seriously with this issue.

We will call the next panel now.

Again with my neighbor and banker—Mr. Larry Fish—who is the chairman of the Citizens Financial Group. Mr. Fish.

STATEMENT OF LAWRENCE K. FISH, CHAIRMAN, CITIZENS FINANCIAL GROUP

Mr. FISH. Thank you, Mr. Chairman, and members of the committee. I am Lawrence K. Fish, a banker and chairman of Citizens Financial Group, Citizens Bank. I appreciate the opportunity to testify here today to discuss my personal views, based on over 35 years actually doing banking business, and my experience with the Community Reinvestment Act.

In my opinion, this Act has brought tremendous benefits to our entire Nation. Specifically, I believe the Community Reinvestment Act: one, corrected a previous wrong; two, has been good for our communities; three, and maybe most importantly, has been good business; and, four, has been used as a guiding principle as policymakers consider how to ensure that the rapidly changing financial services industry appropriately contributes to the economic development of all our communities and our Nation in the future.

First, the CRA helped right a previous wrong by addressing a practice common in the banking industry in the 1960's and 1970's known as redlining. CRA ended that practice.

Second, CRA has been good for our communities. In the span of just one generation, the law has dramatically improved America's previously underserved cities and neighborhoods. Since 1977, more than $1.5 trillion has been lent to communities for development. And as regulated bank mortgage lenders ventured into underserved neighborhoods, small business lenders followed.

In 2005, nearly $11.6 billion worth of small loans were made to small business owners in low-income areas, up from $8 billion in 1996. Together, home and business ownership build immense social capital. They begin a cycle of wealth creation, neighborhood stability, and even educational achievement. Seen in this way, CRA-generated ownership has helped provide an economic corollary, in fact, to the Civil Rights Act.

Third, and this may be a bit surprising coming to you from a banker like me, but I believe CRA is good business. Citizens Financial Group has built a highly successful business around these emerging markets. In the past 15 years, we have grown from the 6th largest bank in the Nation's smallest geographical State, to the 8th largest bank in the United States, with over $160 billion in assets. Based in Providence, Rhode Island, we now have branches in 13 States.

This growth took place not in spite of our commitment to CRA, but in part because of it. We now speak more than 70 languages in our branches. Many of these branches are in markets that we might not have entered without CRA.

Apparently other financial institutions have had similar results. According to the Federal Reserve, and I am surprised this wasn't brought up this morning, 98 percent of large residential lenders reported that their CRA loans are profitable. Within that group, 24 percent found them as profitable as or more profitable than conventional loans. Unexpectedly, banks came to see CRA communities as emerging markets.

Finally, the question you are interested in, Mr. Chairman, where do we go from here? The Department of the Treasury recently renewed a far-reaching effort seeking public input to improve the overall financial regulatory structure to deal with fast changes in the industry. We understand that you, with your public comments, that this is also a priority of yours, one with which I wholeheartedly agree.

This is likewise an opportunity for policymakers to consider modernizing community reinvestment requirements using CRA as a guiding principle. The financial services industry has changed significantly over the past 30 years and it is an appropriate moment to consider how the opportunities and benefits created by CRA might be extended.

Let me give just two quick examples. Let's consider giving more dynamic CRA credit for successful programs in financial literacy. Financial literacy is not just about having knowledge of financial products and services. It's about how to access them.

Second, we should consider expanding CRA participants to include credit unions. Credit unions operate in their communities and are regulated in exactly the same manner as similar banks. Given their number and their total assets, it's logical that CRA benefits and opportunities be extended to them as well.

I make these recommendations because I believe CRA has convinced me that when businesses invest in underserved communities, they are much more likely to return to health.

Thank you for the opportunity of inviting me to be here today and I look forward to your questions.

[The prepared statement of Mr. Fish can be found on page 118 of the appendix.]

The CHAIRMAN. Thank you, Mr. Fish.

Next is Rahn Barnes, who is the vice president and CRA office manager of the community development department at Provident Bank, and he is testifying on behalf of the American Bankers Association.

Mr. Barnes.

STATEMENT OF RAHN V. BARNES, VICE PRESIDENT/CRA OFFICER/MANAGER OF THE COMMUNITY DEVELOPMENT DEPARTMENT, PROVIDENT BANK, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. BARNES. Thank you, Mr. Chairman. Mr. Chairman and members of the committee, my name is Rahn Barnes, and I am CRA officer and manager of community development for Provident Bank, a $6.5 billion bank headquartered in Baltimore, Maryland. I am pleased to be here today and present the views of the American Bankers Association.

The ABA believes that bank compliance with the spirit and letter of the Community Reinvestment Act is healthy. Forging partnerships and developing a deeper understanding of the perspectives of all parties has led to an open and effective system that now more accurately reflects banks' involvement in serving our communities.

This evolution has not been without its difficulties, but it has led to improvements. This afternoon, I would like to talk briefly about the maturation of CRA compliance and suggest ways it can become more effective.

CRA implementation has matured and clearly demonstrates that banks serve their communities well. The bank regulators' initial attempt to meet the mandate of the Act put the emphasis on process rather than performance. CRA examinations became paper trails for talking the talk rather than recognition that banks were walking the walk.

The dissatisfaction on the part of bankers, community activists, and regulators led to important changes in the regulatory requirements and examination process. These include balancing the burden between smaller and larger institutions, enlarging the range of lending that received CRA credit in rural communities, and requiring consideration of any evidence of discriminatory lending or violations of consumer credit protection laws.

Moreover, the CRA examination process is now an open one, incorporating public opinion as well as the regulators' review of banks' compliance. It would be an exaggeration to say that banks are content with the burdens that remain, but the new CRA regulations are certainly a marked improvement over the old regulations and now better reflect banks' contributions to their communities.

The bottom line is that banks that do not serve the credit needs of their entire community do not prosper. Drill down in a CRA public evaluation and you will read about how we compete for market share across all income levels and all neighborhoods. It is therefore not surprising that the banking industry excels at satisfying community credit needs.

Looking forward, bankers believe that the CRA process must continue to evolve to meet changing markets and participants. There are several areas where improvements can be made. First, the CRA regulations and examination are still too complex and should be simplified. For example, the banking agencies added an entirely new CRA examination, the intermediate small bank CRA examination. To add a third category which has a wholly new approach to assessing community development activities was an unnecessary complication of an already complicated regulation.

Second, regulators also need to adjust the process to encourage responsiveness to changing markets. For example, the definitions for determining community development activities that qualify for CRA credit are still too complex and narrow in scope. Moreover, CRA regulations should recognize the financial literacy training provided by banks that benefits the entire community. Currently, CRA restricts consideration unless the majority of the participants are low- and moderate-income residents.

Third, to fulfill the spirit of CRA, banks need broader authority to make public welfare investments. Without broader authority, banks are prevented from participating in some important community development projects. We appreciate your leadership, Mr. Chairman, and that of Ranking Member Bachus, to change this through your bill, H.R. 1066.

In conclusion, the ABA believes that there has been significant evolution of the implementation of the Community Reinvestment Act. We believe the changes to simplify the process add flexibility and broaden the authority to make public welfare investments that will continue to improve CRA for the future.

Mr. Chairman, I would be happy to answer any questions you or the committee may have.

[The prepared statement of Mr. Barnes can be found on page 66 of the appendix.]

The CHAIRMAN. Thank you.

Speaking of neighbors, Ron Homer, who is the chief executive officer of the Access Capital Strategies.

STATEMENT OF RON HOMER, CHIEF EXECUTIVE OFFICER, ACCESS CAPITAL STRATEGIES, LLC

Mr. HOMER. Good afternoon. Chairman Frank and members of the committee, I am particularly honored and pleased to have the opportunity to testify here before you today. By way of background, I have had 37 years of experience in banking and the financial services industry. I founded Access Capital Strategies in 1997. We operate a community investment fund that is a qualified CRA investment. We serve about 120 banks throughout the country. However, in addition, we have attracted investments from about 20 nonbank institutions that comprise about 25 percent of the fund.

Prior to that, I was a CEO of a community bank and had the opportunity in 1995 to testify before this body on behalf of the ABA on the revisions for the current CRA regulations that were—that the previous testifier mentioned changed from talking-the-talk to walking-the-walk regulations.

So I am here to say that my experiences both as a banker, a businessman, an activist—I also serve as the vice chair of the Initiative of a Competitive Inner City, which was founded with Professor Michael Porter in 1994 to do research on market-based opportunities in inner city neighborhoods.

So many of my experiences that I will relate to you and opinions, while they're anecdotal, they are also backed by the study of the Joint Center for Housing Studies at Harvard, which was prepared as a result of the 25th anniversary of CRA, so I would refer you back to that for some of the data.

Clearly, CRA has encouraged banks to better serve low- and moderate-income communities. In fact, the data shows that as a result of these regulations, CRA-regulated banks make a much higher percentage of conventional prime mortgage loans in the areas where their branches are located than all the other competition, despite the fact that they had a diminishing amount of the overall mortgage market in that area. So they are highly motivated to seek the most efficient products. In fact, their advantage in conventional prime loans among African Americans are a full 20 percent higher; among Latinos 16 percent higher. So in the areas which they have designated as their assessment area, they do a better job of providing low-cost mortgage loans and possibly, had the Act been expanded like the Joint Studies Housing Study recommended in terms of functionality across lines, some of the subprime lending activity might have been mitigated, through the borrowers themselves, who would have had a wider range of choices available to them.

So that brings me to my first point. I would recommend that while the Act has been successful in motivating banks to find, as Larry Fish mentioned, new profit opportunities, there are ways in which the Act could function better and provide a national service. First, I encourage the consideration of expanding the traditional mortgage lending focus around assessment areas to the broad footprint of banks wherever they do business. And as I think you mentioned, to use functionality as the test as opposed to geography.

In particular, I think the banks should be evaluated not just on the deposit taking parts of their institutions, but also on affiliated mortgage companies and other entities that might be engaged either in the securitization or the selling or the purchase of mortgage-related securities. And I think that would be a fact-based, easy way to monitor what they are doing.

One of the criteria I suggest using, because it has been shown that between 35 to 50 percent of the mortgage lending that has taken place, particularly in some minority and Hispanic neighborhoods could have qualified for prime mortgages under the criteria. So one of the ways of measuring their relative performance is just a report card showing what percentage of the loans they make in these areas are conventional loans versus what percentage are subprime.

In terms of the enforcement mechanism, I think that certainly this committee's legislative oversight of the regulatory bodies would definitely be helpful. I think over the last 5 to 6 years, there has been not maybe enough attention about looking into how the regulations have been enforced.

Secondly, because of the overall deregulation of the industry, looking at the remedies for noncompliance might look at branch expansion or expansion in business lines or other hurdles other than the actual acquisition and merger of institutions.

The role of public comment. I think that public comment has been effective, particularly in getting commitments from major banks, fairly broad-scale major banks. But I think that over time, probably some mechanism that would get all the banks to have consistent effort and particularly around what some people think is the grade inflation. So I think maybe creating some type of safe harbor mechanisms where thresholds are met on performance would be helpful. It would take some of the tension around the actual acquisition merger scenario and spread it out so there is a more evenness of commitment over time.

The changes in the structure of the Financial Services Committee definitely warrant looking at other nonbank entities or nondepository entities. I definitely think that those entities affiliated with banks should be included in CRA because, indirectly, they get the subsidy and the quid pro quo of the deposit insurance one way or the other, even if it's in the bank holding company. How you do it and how you expand it to those who do not have deposit-taking entities, I'm not sure. But my experience, because we do a lot of business in Utah, is that just about ever investment bank that you have looked at in the subprime issue as a major player has an industrial loan corporation in Utah, so they probably could be pulled in, in any event.

But last but not least, I think the law has principally been effective when activists, regulatory bodies, legislature, and the banking institutions that are regulated themselves, all are fairly clear as to what the goals and the objectives are of the Act. So I would encourage the work of your committee to help bring those parties together so that we have a clear and consistent message.

As the name of our firm indicates, we have a goal of efficient access to capital for communities throughout the country. We understand that to build a healthy community, access to capital is critical. So we therefore stand ready to work with you and we commend you for taking on this issue and we stand prepared to work with you in the implementation of the current Act as well as any changes that might take place. Thank you.

[The prepared statement of Mr. Homer can be found on page 121 of the appendix.]

The CHAIRMAN. Next, Cynthia Blankenship, who is the vice chairman and CEO of the Bank of the West, and she is here on behalf of the Independent Community Bankers.

Ms. Blankenship.

STATEMENT OF CYNTHIA BLANKENSHIP, VICE CHAIRMAN AND CHIEF OPERATING OFFICER, BANK OF THE WEST, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS ASSOCIATION

Ms. BLANKENSHIP. Thank you. Mr. Chairman and members of the committee, thank you for the introduction. I, in fact, do represent the Independent Community Bankers of America. I am pleased to have the opportunity to present the views of the ICBA on the implementation of CRA.

ICBA represents 5,000 community banks. Bank of the West has assets of $250 million, serving small businesses in the Dallas/Fort Worth Metroplex and the agricultural community of Vernon, Texas. We have eight locations, three of which are located in low- to moderate-income areas.

Community bankers are strongly committed to the goals of the Community Reinvestment Act. We appreciate the valuable improvements that the Federal financial regulatory agencies have made in the CRA examination procedures. ICBA strongly believes that the nation's credit unions should also comply with CRA under these improved procedures.

Community banks are locally owned and operated institutions. Community reinvestment and community development are what we are all about. We do it on a daily basis. We play a key role in local civic activities. We are focused only on serving our communities with loans and other services that promote development.

The simple fact is the health of the community bank and the economic vitality of the community depend on one another. If our communities don't survive and thrive, neither do we.

Public policy can build on this by providing incentives and by removing unnecessary regulatory costs. For example, we urge the Senate to pass H.R. 1352, a bill to reduce SBA fees and permit a low documentation loan program for seasoned lenders. This will make the program more effective in our communities.

Congress could also enhance our ability to serve our customers by enacting regulatory relief provisions included in Representative Velazquez's Communities First Act.

The Federal Home Loan Banks, Fannie Mae, and Freddie Mac already help community banks provide commonsense mortgages to their customers that enable them to both become and remain homeowners. CRA regulations and examinations are working well for community banks.

Ten years ago, the Federal banking agencies adopted a tiered examination system for CRA and successfully reduced the unnecessary and unproductive paperwork burden imposed by CRA rules. Before the Clinton Administration initiated these changes, a Grant Thornton study found that community banks spent $1 billion each year on CRA paperwork, much of which focused on documenting the bank's study of community needs. This contradicted the prediction by the primary author of the 1977 act, Chairman William Proxmire, that, "the regulations would be very minimal and would not require additional reporting."

The streamlined examination procedures for smaller banks that the regulators adopted in 1995 and improved beginning in 2004, helped CRA compliance costs toward Chairman Proxmire's original

intent. Community banks are still required to invest in their communities, which they would do regardless of the Act. However, performance, not production of paper is the examiner's focus. The key factors are the bank's loan to deposit ratio, the percentage of local lending, the distribution of loans to different income levels and business sizes, and geographic distribution of loans.

In 2007, the regulators increased the small bank level from $250 million to $1 billion, but added an investment test for intermediate small banks between $250 million and $1 billion. Unfortunately, an important competitor for community banks, the tax exempt credit union industry, remains completely exempt from CRA.

When CRA was enacted, credit unions mostly served members of a single group or a limited product line. That world has changed. Credit unions now offer business loans and serve so many different groups and communities that virtually anyone with a pulse can become a credit union member.

Over 120 credit unions have more than $1 billion in assets. Studies show the rationale for the tax and CRA exemptions, that they serve limited memberships and people of modest means, no longer applies. In 2000, the National Credit Union Administration acted on these facts and adopted a rule requiring community credit unions to have a community action plan. Unfortunately, when NCUA's board changed, it repealed the CAP rule, taking a giant step backward.

We strongly recommend Congress build on the agency's work in 2000 and require credit unions to comply with CRA requirements in the same manner with the same asset size distinctions as banks and thrifts.

Thank you very much for the opportunity to testify.

[The prepared statement of Ms. Blankenship can be found on page 88 of the appendix.]

The CHAIRMAN. Thank you. And our last witness, and we appreciate her patience as well as her good work, Judy Kennedy, who is the president and CEO of the National Association of Affordable Housing Lenders, and therefore represents one of the important constituency groups that is one of the vehicles through which CRA operates.

Ms. Kennedy.

STATEMENT OF JUDY KENNEDY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL ASSOCIATION OF AFFORDABLE HOUSING LENDERS

Ms. KENNEDY. Thank you, Chairman Frank, in recognizing that the members who are here are the choir to whom I am preaching.

The CHAIRMAN. I would say, Ms. Kennedy, you do not have to apologize for preaching to the choir to the Reverend Cleaver, who has on occasion done that himself.

Ms. KENNEDY. So, having heard a lot of great testimony, let me today just say who we are, suggest what's working right, quickly what's not working, and make a couple of suggestions about how to improve it.

NAAHL's members are major banks that won an outstanding rating and will do what it takes to get it, and their blue-chip nonprofit lender partners, like LISC, like Access, who help banks in

achieving the numbers that get outstanding ratings. We are committed to bringing more private capital to low- and moderate-income communities. We are proud of the fact that we have learned how to lend and invest properly.

But I thought Ellen Seidman hit the nail on the head when she said that CRA has helped banks to look at the hurdle rate differently. "Profitably" doesn't mean double digit profits, but it does mean that you incorporate the social and the public good will achievements into the hurdle rate, and you do get a positive return.

We have already learned how to help borrowers with little or no cash to bring to the closing table to become homeowners and to stay homeowners.

Just a couple of statistics that are amazing. On the affordable rental housing side, private capital is leveraging the low income housing tax credit, depending on the locality, 10 to 25 times, which obviously allows us to produce a lot more units. In just each of the last 3 years alone, institutions reported over $50 billion each year of community development loans, largely for affordable rental housing, accessible to people under 80 and 50 percent of area median income, and for other community and economic development.

During the same period, lenders reported making—and this is also staggering—$800 billion in each of those 3 years of mortgages, single-family mortgages and small business loans, to low- and moderate-income borrowers or in low- and moderate-income census tracts.

So the numbers are pretty compelling. But I worked for Senator Proxmire and Representative McKinney, and I have to think that they are not smiling on Larry White this afternoon.

The CHAIRMAN. I don't think that is appropriate. Talk about substance. There is no reason to get into that.

Ms. KENNEDY. He is a friend. He is a friend.

We have a regulated system with tremendous supervision and examination that crosses every "T" and dots every "I" that has produced these numbers. It is all good news.

But think of community and economic development as a three-legged stool and CRA is one strong leg of that stool. But we have two other legs, one missing and one weak.

The weak part is the regulation and examination part. Believe it or not, we have a community development regulation that discourages banks from doing multifamily affordable housing. It treats small business lending and single-family mortgage lending as layers of a cake, but only if you get at least a satisfactory on those layers do you get any credit for doing the really hard stuff, the multi-layered, multi-subsidized, multifamily housing.

And so we have highly recommended for the last 10 years that we treat community development lending for what it is, one of the most important types of what a bank can lend and invest in.

Unfortunately, some examiners' focus on assessment areas has discouraged what has been a tremendous success story of CRA: the pooling of banks' money in loan and equity funds like Massachusetts Housing Investment Corporation and Massachusetts Housing Partnership. These funds have allowed banks to diversify their risk, hire the right skillset, and make a difference throughout their States. Asking a bank in North Carolina to invest in a loan fund

that may produce housing in Durham, when they are not located within 100 miles of Durham, always seemed to be the norm but, all of a sudden, it is being discounted or even disallowed.

So the regulation and examination, at least of institutions over $1 billion, still needs a lot of improvement.

And then finally, given the numbers I just shared with you, given $50 billion a year in community development loans almost all under $3 million, and $800 billion in single-family, CRA-eligible mortgage loans, it would be great if Fannie Mae and Freddie Mac would bring the benefits of liquidity, particularly at this critical time, to the CRA market.

[The prepared statement of Ms. Kennedy can be found on page 152 of the appendix.]

The CHAIRMAN. Thank you all.

Let me ask in general some of the questions we have had before. Many of you represent the banking industry. The question of expanding this to entities not now covered, are there examples of lines of business, entities not now covered by CRA where it would be logical to extend it? Yes, Ms. Blankenship?

Ms. BLANKENSHIP. Well, Chairman Frank, from a small community bank that was privately held and started in 1986, one of our biggest challenges to remain part of very many communities that we serve, many of those low- to moderate-income, is the competition. And—

The CHAIRMAN. Well, you have mentioned credit unions. I am wondering, are there any additional entities? You have been very clear about wanting to cover—

Ms. BLANKENSHIP. I think the mortgage industry has also been a competitor of ours. We do make some direct mortgages, but we saw a lot of that competition with the pricing and the aggressive nature of that.

The CHAIRMAN. Well, I appreciate that. As you know, this committee's bill that passed the House extends many of the actual regulations. In fact, what we tried to do was to conceptualize to a great extent the regulations that the banks regulators impose on depository institutions and apply them to all mortgage originators and we think that has worked well.

We talked about, for instance, the securitizers who have played a very important role—is there a way to deal with them? Should we be dealing with them?

Ms. KENNEDY. Well, we are in this mess because two unregulated, unexamined companies nurtured an alternative network of mortgage lenders that were not examined, regulated, or supervised. So, for example, had the CRA applied to Fannie Mae and Freddie Mac and if it had been enforced, we probably wouldn't be in this pickle.

The CHAIRMAN. Fannie and Freddie? How—

Ms. KENNEDY. They would have had the same kind of examination, regulation on both the fair lending and the HMDA side as well as the Community Reinvestment side, that—

The CHAIRMAN. Except they were buying—well, on the HMDA side? What's the—

Ms. KENNEDY. Well, for example, not only did they buy the loans, Chairman Frank, but in 2004, I am told—

The CHAIRMAN. You are told? I need you to be sure. I'm told—

Ms. KENNEDY. Okay. It's in a HUD report. It's in a HUD report from July. But I think your staff have heard this too from Bill Apgar and John Weicher. Fannie and Freddie persuaded HUD to let them use AAA-rated securities backed by subprime loans with many of the characteristics we are now dealing with, as counting towards "affordable housing" goals. That is how they achieved their goals for 2004, and it is probably how they will achieve them for 2005 and 2006. That is when the runup occurred.

Had there been a CRA examination, by something like a bank regulator, of Fannie and Freddie, the GSEs could never have used AAA-rated securities as their home mortgage lending in low-income census tracts or to low-income borrowers. So, in other words, instead of the GSEs engaging in the low end of the market, they nurtured the high-cost end of the market.

The CHAIRMAN. But it was the low end of the market.

Ms. KENNEDY. No, it wasn't the low-cost, low-balance end. I mean, basically, on a day when prime mortgage rates were at 6 percent, GSEs were financing subprime MBS with mortgages probably yielding between 8 and 10 percent.

The CHAIRMAN. Any other entities that people think ought to be covered?

Mr. HOMER. Well, as I mentioned, I think the mortgage industry, because that is where we are focusing on, and the spillover to subprime and the fact that it looks like there is inefficiency in delivering products to certain communities where they are not getting the best deal, looking at bank holding companies and all of their various affiliate organizations and their engagement in the mortgage market to understand what percentages in CDOs and subprime, what percentages conventional, etc., would be a first step at least to know who is doing what and then to rank them and then maybe give them bonus points for being more efficient and putting more—

The CHAIRMAN. I don't see your point.

Mr. HOMER. —effort in that area. And it could be through safe harbor on expansion—

The CHAIRMAN. I appreciate that. It just occurred to me that what we have done in the subprime area is to extend some regulation of the prohibitory sort, but you might want to then take a step further and then give some incentives to do some things. And that might be helpful because we're being told, oh, if you put these limits on subprime lending, then not just bad loans but good loans will disappear; people will be afraid of the whole area. And one way to potentially dilute that would be to give, along with the prohibitions, some incentives so that people—you change the risk calculation there. So it is not simply, oh, if you make those loans, you might get hurt. The answer is, yes, if you make them inappropriately, you might be hurt, but if you make them appropriately, you will get some credit.

And so CRA credit in that area would be a logical concomitant of what we have done. I appreciate that.

Mr. HOMER. Right.

Ms. KENNEDY. Chairman Bair, obviously, is moving in that direction. But my members tell me that in Louisiana and New York re-

cently, banks that move into areas that lack insured institutions with branching in underserved areas are now getting government deposits as an incentive.

The CHAIRMAN. As an incentive, yes.

No, I think that is very important that you don't just prohibit. Because people can overreact to the prohibition, and one way you deal with that is to give some incentives and some awards.

Anything else?

If not, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman.

I missed the opportunity to question the last panel and missed most of the testimony of this panel and I am sorry for that. But I understand who would supervise and administer a CRA requirement for credit unions. That would be easy, because we have a regulator. Who would supervise and administrator a CRA regimen for mortgage lenders, for example, or would it be necessary to—I mean, I can understand we can set up some criteria. But unless there is some enforceability to it either by a regulator or by a private right of action, for example, I don't know how it would be administered. Does anybody have any ideas about that?

Mr. HOMER. There are a good portion of mortgage originators, and after the subprime, more and more will be part of bank holding companies. So bringing in unaffiliated mortgage companies owned by bank holding companies would bring in a good percentage.

The remaining mortgage lenders are generally licensed by States or more and more States are bringing them in under licensure so that would probably be the vehicle. Or if you want to be extreme, you could require Federal licensing of mortgage lenders.

Mr. WATT. I think our bill actually at least sets some standard. I don't know about licensing itself. But the bill, the anti-predatory lending bill—

Mr. HOMER. Much like the securities industry, where there is a minimum threshold of amounts of capital, etc., and bring them under.

Mr. WATT. I have heard a couple people suggest—and I am not sure if it was on this panel because I didn't hear the testimony on this panel—but somebody suggested that the suitability standards for non-CRA participants is somehow a substitute. I understand—I am a strong supporter of suitability standards and I think that is important. And it—it helps to clarify the standards for those that you do serve. But I am not sure how it imposes any obligation such as CRA to serve.

So can somebody explain how that would—well, at least that is what I thought somebody on the prior panel suggested, that in some measure suitability standards served the same purpose as CRA.

You all obviously didn't say that, so you can't explain it. All right. All right, in that case, I won't ask you to explain it if you didn't say it. I missed my opportunity to ask the last panel that question, and it is gone forever, except my staff heard it and they will propound it in writing maybe to the last panel.

I appreciate you all being here. I am sorry I don't have more questions because I wasn't here to hear most of the testimony, and

I have already been with Ms. Kennedy earlier today, and spoke to their group, so we already had an exchange about some of these issues.

So I will yield back the balance of my time and recognize the gentleman, Representative Cleaver.

Mr. CLEAVER. Thank you, Mr. Chairman.

I want to revisit this whole issue that I raised earlier. If you read the language—I am sorry. As you know, in the language of CRA is the term, local community. And as I mentioned earlier, things have changed dramatically since 1977 when this legislation was enacted. And so we don't have banks that serve communities as much as we do now. I guess, Ms. Blankenship, you might have more in your organization.

And so I raised the question earlier about redefinition of "local community." But I want to add to that a couple of other issues.

First of all, I used to do an NPR radio talk show, and I went after the payday lenders. And I had a show with a live audience. I ended up in the audience with a whole row of poor people who came to support the payday lenders. And they came to support the payday lenders because they said without the payday lenders, they had no place to cash their checks. They go to work, they come home. The only place, payday lenders.

So, you know, there is an absence in the poorest neighborhoods, I think, you might agree, of banks that are participating in CRA.

And then, Ms. Blankenship, you were mentioning credit unions, that perhaps we ought to extend CRA to credit unions. Well, can you legitimately and fairly include credit unions without including payday lenders, check cashers, and remittance agents? I mean, where do we stop? Because in my world, the payday lenders are far more dangerous in terms of putting something back in the community than credit unions. It is a conundrum. Fix it. Please.

Ms. BLANKENSHIP. Well, to answer your question, Congressman, I think that there should be more regulation on those entities that don't fall under CRA, as we do, a local bank that really provides services in low- to moderate-income areas. I think a good place to start is the credit unions. But we are certainly not opposed to you extending that regulation to the other entities, which you addressed.

Mr. CLEAVER. You realize, that would probably close them down. I mean, if you required CRA for Joe Willy's Friday Check Cashing Company, I mean, he is out of business. And that is okay if you are in banking. But if you are in politics and Joe Willy's can't cash Ms. Thompson's check, and that is the only place to cash it, then we have a problem.

Ms. BLANKENSHIP. But I would argue respectfully that the community banks fill more of a role in that than maybe some of the large national bank chains, as far as accommodating the check cashing and some of the needs of those low- to moderate-income areas. Because I know that we do in several of our markets. And we have the flexibility to do that.

Mr. CLEAVER. Mr. Homer?

Mr. HOMER. Your question, well, one, going back to the local community issue, I think if you changed "local community" to "underserved communities" and then gave institutions the flexibility to

choose the underserved community that they desired, that would be one way to get at it, to give them a menu. Because you are absolutely right. When I ran a bank, I was not going to not accept a deposit because it didn't come from my community. I accepted them—I was a community bank in Boston but I had customers in California and all over. So changing that one word from local community to underserved communities, I think, would have a tremendous impact in attracting capital and services into areas that need it.

Mr. FISH. I would like to comment on that, Representative.

Mr. CLEAVER. Yes, Mr. Fish?

Mr. FISH. I think—I don't know what community you represent.

Mr. CLEAVER. I represent Kansas City, Missouri, and the surrounding area.

Mr. FISH. So I have great sympathy for the comments that you made. But I think it is dangerous to apply the presumption that local communities are underserved by all banks based on the experience in Kansas City.

Let me explain what we do. And I can—I don't know if you were here for my comments, but we look at these markets as emerging markets and we believe that there is good business to be done in these markets. So some of these things, we try and look like a local bank, in a branch that is in an underserved community. And what do we do?

Well, we give every branch in those communities somewhere between $2,500 and $3,500 a year so they can participate in a community sense, so that if somebody walks in and needs $25 for the Boy Scouts, or $50 for the Lions Club, our branch manager doesn't need to say, I'll take it up with the head office.

We try and look like the neighborhood inside those branches. So we speak their language. We try and make the office friendly as opposed to intimidating.

Despite all of that, in our neighborhoods, our biggest competitors are not the other banks; our biggest competitors are the check cashers, Western Union and the payday lenders. And I think the long-term answer to that, it is so expensive for these neighborhoods to do their financial services business. If they came into a bank and opened a checking account with overdraft protection and a savings account, their life would be so much simpler.

We can't cash checks; it's difficult to cash checks for people who don't have accounts with the bank. I could go into that.

Mr. CLEAVER. No, I understand all that.

Mr. FISH. Okay, so you understand all that.

So my point is, the answer to this is financial literacy. The answer to this is not only education for the consumer in these underserved neighborhoods about their personal finances, but financial literacy in terms of education about the fact that they can go into a bank.

Mr. CLEAVER. I want to interrupt you, and then I am finished, Mr. Chairman.

Mr. FISH. I was being long-winded, but I feel very passionate about it.

Mr. CLEAVER. No, and I can tell you are passionate about it.

The frustration of being on this committee—I mean, this is a committee I wanted to be on. I was blessed to be on the exact committee I wanted to be on. However, whenever we start talking about regulations, what inevitably is injected into the conversation is financial literacy. I mean, I don't care what the subject is. You know, as a substitute for whatever we might be proposing, the panelists, at least one, somebody says, well, the solution is financial literacy.

I don't disagree. We may be talking about 10 or 15 years to raise the level of financial literacy to a point where people are not going to Sam's Friday payday check cashing place.

The problems we have are today. I mean, they are right—they are on us today, tonight. I mean, people are going to the payday places today. And so it is an issue for me. I mean, it goes back—do you regulate everybody? Or do you just tell everybody their problem is financial literacy? Just become literate?

Mr. FISH. Regulate payday lenders.

Mr. CLEAVER. And impose CRA requirements? On them?

Mr. FISH. I suspect you will diminish service to the community.

Ms. KENNEDY. After Representative Watt left us this morning, we had a 2½ hour agonizing debate with the best advocates, the best bankers, some government officials, and Ms. Seidman who has been on both sides. And, you know, we ended with financial literacy, still very important.

Because how it feels to the bankers and the nonprofits that are responsible lenders is that they proved that CRA lending was good business. Not the highest profitability, but it was good business and it could be done responsibly, with consumer-friendly terms. And the bad guys moved in without any scruples, without any oversight, any regulation, or any examination.

So I think we are reaching a point where banks would say regulate the payday lenders. But we would also say, you know, this multifaceted problem, what Representative Watt called an onion, involving many, many layers, one piece of which is a credit scoring system that may not reflect our multinational demographics anymore. Members are working on an alternative credit scoring system through NeighborWorks America and Citigroup.

We have so many facets of this problem. But surely having a highly tightly regulated banking regime that is very "bean-counting," while having totally unregulated, unexamined entities that have no oversight, is a huge part of the problem.

Mr. CLEAVER. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Murphy.

Mr. MURPHY. Thank you, Mr. Chairman. I don't have any original questions of my own. I think Mr. Cleaver's line of questioning is an important one and an interesting one and we sort of are bracketed by two different ways of approaching that and so I want to fill in the middle here and ask that question to the panel.

Because I think whether we are talking about CRA or other obligations, I think it is an important one that major urban communities like Kansas City face, but smaller urban communities like Waterbury, Connecticut, and Danbury, Connecticut, that I represent face. So I might just pose that question to the rest of the panel, maybe focusing on CRA as it relates to nonbank entities

such as payday lenders, as a way of talking about whether we should be looking at a new Federal regulatory structure for the—for payday lenders and like entities.

Mr. HOMER. I will go back to the old saying, you have to go where the money is. And so I think a change in the definition of how entities that are regulated now and maybe broadening it to their whole slew of ammunition, bullets, so these banks are all affiliated with other financial services entities, changing the definition to serving underserved communities as opposed to local, and thereby engaging all of the tremendous talent and innovation that is in these markets, they created CDO quads and sold them to people so they can do just about anything, would be a part of the beginnings of today's solution.

Because I think—I will give you an example. One of the values of CRA, we create mortgage-backed securities that are guaranteed by Fannie and Freddie that only comprise loans to people below 80 percent of median. Now, intuitively, people say well that is either kind of risky or it is not going to—the fact is that those mortgages consistently outperform the mortgage backed index in the Lehman A, for the simple reason that people don't—they just don't prepay as fast and as much as other clients.

So over time, we have shown to public pension funds and other investors, that actually taking the time to invest in those areas will actually give you a better return over time. So some parts of the regulation can help introduce profit-making organizations so people who are looking for good investments, to opportunities they otherwise would have ignored just for the lack of information or experience.

And so incenting people who have capital and the capacity and the talent to come up with these products in an efficient way through regulation and introducing them to them may be one way of getting them engaging and building incentives to—we provide a lot of incentives for renewable energy, for all kinds of things that we think have a long-term social good.

So also figuring out how you can build in regulatory incentives or even particular subsidies or tax credits around how well they do this may be another way to—to reinforce it. Because we have to address the problems of these communities if we are going to be strong as a nation.

Mr. BARNES. I would like an opportunity to address the question as you raised it, Congressman Murphy, and also Congressman Cleaver.

I think the "local community" is still relevant. There is always the opportunity for change. But as a small, large bank under the CRA regulations, we still aggressively look at our local community. We can feel what our colleague down the table has suggested, the pressure from our friends in the credit union leagues, credit unions. But basically we do try to address what is happening in our local marketplace.

I am in Baltimore. The FDIC has identified our City as one of their alliance for economic inclusion target cities, pilot markets. And in essence, we are trying to identify a small dollar loan that would be an alternative to payday lenders.

This is a tight credit market to be considering that type of product. But clearly, through some collaborative efforts of other ABA members and banks in our market, we are looking to try to provide a product that might be an alternative to the payday loans.

Ms. BLANKENSHIP. Well, just to follow up on your question, I think you really have to look at the spirit of who is currently regulated and why they are complying with CRA. For instance, we don't comply with it only because we have to; we comply with it just as a matter of staying in business. We chose those markets, and whether there were a CRA or not, we would comply with it and fulfill the spirit of the law.

I think where your focus needs to be are on the non—the currently nonregulated entities, the nonregulated mortgage companies, the nonregulated payday lenders.

The CHAIRMAN. Thank you all. Let me just add one last question.

I forgot to do it before, so I would ask you to think about this and get back to us. One obvious area that we just didn't get to enough is the various forms of insurance companies, major financial entities that evolved in many ways over the years. Does it make sense to put some sort of community reinvestment type obligation on the insurance companies of various sorts and, if so, how would we do it? Yes, Ms. Kennedy?

Ms. KENNEDY. Our group believes strongly that the nexus to the Federal benefits is an important one for CRA as we know it. But we also believe strongly that insurance companies that have any kind of benefits should have to insure properties that our members make loans on.

The CHAIRMAN. So you would cover them under CRA?

Ms. KENNEDY. We would require them to have—well, we would propose that they have an affirmative obligation to insure in underserved areas.

The CHAIRMAN. Which is a type of CRA obviously relevant to them. You don't give insurance companies an obligation to do things other than insurance.

Ms. KENNEDY. Right.

The CHAIRMAN. Any others? Ms. Blankenship?

Ms. BLANKENSHIP. Again, just, you know, the playing field should be level with respect to CRA. Banks have learned to comply with it.

The CHAIRMAN. I will throw this out right here. You mentioned the duck didn't come down, as it would have for the older people, on Groucho Marx, on You Bet Your Life, if you said the magic word—level playing field.

I have been looking. I frequently am told about the problems of the playing field not being level and it is often invoked by people who point out that they are at the bottom of an unlevel playing field.

I am still looking for the entity in America that is at the top of the unlevel playing field. I have not found one. It appears to be an extraordinary geometrical or geographical foundation. It is always—people are always at the bottom and no one is at the top. So if you ever find anybody who has benefitted from the unlevel playing field in his or her mind, let me know.

Mr. Homer.

Mr. HOMER. I would say to the extent that the insurance companies are competing for investments and then deploy those investments through communities that—looking at the insurance industry and imposing some type of requirement. Again, as you can tell from my testimony, my bent is always with a carrot rather than a stick, so providing some built-in incentives for the insurance industry to be engaged in these communities through regulation or subsidy would be the preference.

The CHAIRMAN. Thank you. Mr. Barnes.

Mr. BARNES. As a CRA officer, the water is just fine, come on in. Love to have investment bankers and insurance industry. As was alluded to earlier by Ms. Kennedy, one of the challenges is when you are trying to lend in certain markets, you can't get insurance. So effectively you almost have an issue that you can't do mortgages. So I think that is an obvious example—

The CHAIRMAN. That is a very important point.

Mr. BARNES. —of where they need to be involved affirmatively. And I appreciate the comment from Mr. Homer about the carrot as opposed to the punitive version, if it could be fashioned in a manner that would be an incentive to be involved, it would be a positive.

The CHAIRMAN. I have to say this with regard to insurance, as you mentioned, Mr. Kanjorski is really focusing our efforts on insurance. There was a lot of discussion about whether or not there should be an optional Federal charter. And without indicating one way or the other, I will tell you this, if there is one, it is going to come with significant social responsibilities. I think that is one of the things that people should contemplate. And again, that would go along with what Ms. Kennedy said, because that would be—there would be a nexus there, in terms of a Federal benefit.

Mr. Fish, we appreciate it. Do you want to finish up?

Mr. FISH. No, I have nothing to add.

The CHAIRMAN. All right, I thank the panel. And please feel free to elaborate on any of this.

We will be in touch with all of you because this is an ongoing, important issue for this panel. The hearing is now adjourned.

[Whereupon, at 3:03 p.m., the hearing was adjourned.]

A P P E N D I X

February 13, 2008

Statement of Congressman Kenny Marchant-- FSC hearing – "The Community Reinvestment Act: Thirty Years of Accomplishments, but Challenges Remain"

Thank you Chairman Frank for allowing me to introduce one of my constituents, Cynthia Blankenship, who is here today to testify on behalf of the Independent Community Bankers of America.

Cynthia Blankenship is the chairman-elect of ICBA, which is a group I have worked with very closely in the past. I am very excited to work with her in the future in her new capacity as chairman-elect and I think all the members of this committee will be pleased as well.

By way of background, Mrs. Blankenship is currently serving as Vice Chairman/Chief Operating Office of the Bank of the West in Irving, TX. She is the chairman of the ICBA Congressional Affairs Committee and vice chairman of the Strategic Planning Committee. So as you can tell she didn't run for chairmanship of ICBA out of boredom.

She has had a long and accomplished career in banking, plying her trade at several prominent banking institutions in Texas, such as the Independent National Bank of Irving, First National Bank of Grapevine, and

Farmers and Merchants State Bank of Krum, Texas, before going out on her own in 1986 and opening up the Bank of the West with her husband, Gary. She knows this business from top to bottom, and if there is anyone that is qualified to head up an organization like ICBA, it's Cynthia Blankenship.

Thank you again Chairman Frank for allowing me the time for an introduction.

Statement of

Rahn V. Barnes

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Financial Services

United States House of Representatives

February 13, 2008

Statement of Rahn V. Barnes
on behalf of the
American Bankers Association
before the
Committee on Financial Services
United States House of Representatives

February 13, 2008

Mr. Chairman and members of the Committee, my name is Rahn Barnes. I am Vice President and CRA Officer and Manager of Community Development for Provident Bank, headquartered in Baltimore, Maryland. Provident is a $6.5 billion, full-service commercial bank, with 142 branches in Maryland, Virginia, the District of Columbia and southern Pennsylvania. I am pleased to be here today to present the views of the American Bankers Association on the Community Reinvestment Act, enacted 30 years ago by Congress. The American Bankers Association (ABA) brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $12.7 trillion in assets and employ over 2 million men and women.

The ABA believes that bank compliance with the spirit and letter of the Community Reinvestment Act is healthy, reflecting the fact that bankers, regulators and community groups have all learned from one another over the past 30 years. Forging partnerships and the development a deeper understanding of the perspectives of all parties has led to an open and effective system that now more accurately reflects banks' involvement in serving their entire communities. This evolution of the process has not been without its difficulties, but it has led to improvements. In marking the milestone of the Community Reinvestment Act's 30th anniversary, we think it valuable to look back on its

maturation, consider its current state and look forward to its prospects. To that end, my testimony will make the following three points:

- The banking agencies' implementation of the Community Reinvestment Act has matured so that CRA examinations more clearly demonstrate that bankers are serving their entire communities well.
- The CRA examination process is an open process incorporating public opinion and comment as well as the regulators' review of banks' compliance.
- Going forward, we believe that the CRA regulatory process must improve by favoring simplicity, encouraging greater flexibility, and recognizing the value added by specialized expertise developed by bankers over the last three decades of complying with CRA.

I. CRA Implementation Clearly Demonstrates that Banks Serve Their Communities Well

The Community Reinvestment Act is a relatively simple mandate to the banking regulators to encourage, and to assess the record of, depository institutions in helping to meet the credit needs of their entire community. Since enactment in 1977, there have been few amendments to the law – requiring a public evaluation; requiring multi-state examinations to include state-by-state CRA analysis; allowing regulators to give credit for investments in minority- and women-owned banks; and requiring Satisfactory or better CRA ratings in order for a bank holding company to become a financial holding company. These amendments have not fundamentally changed the initial charge of the statute: that regulators should encourage and evaluate the efforts of their regulated institutions to help meet the credit needs of their communities.

However, revisions to the CRA regulatory process have been much more extensive. Bank regulators' initial attempt to meet the mandate of the Act put the emphasis on process rather than performance. Banks were assessed on 12 factors that were more about getting through compliance wickets than about actually delivering credit into local neighborhoods to the citizens and businesses that needed the capital. The CRA examination process became a paper trail for talking the talk, rather than recognition that banks were walking the walk.

In fact, there was almost unanimous dissatisfaction with the CRA regulatory process by the early 1990s. This dissatisfaction on the part of bankers, community activists and regulators led to important changes in the regulatory requirements under CRA and to the examination process itself. Among the changes included in new regulations issued in 1995 were the recognition that CRA evaluations should be streamlined for small banks, that performance by larger banks could be achieved by providing loans, investments and services, that all banks operated in a context taking into consideration their capabilities and their markets, and that what constituted community development should be pegged to activities with favorable impact on identified community needs. While application of these concepts has been accompanied by growing pains for agencies, community groups and banks and it would be an exaggeration to say banks are content with the burdens that remain, the reality is that the new CRA regulations are a marked improvement in important ways over the old CRA regulations.

The post-1995 CRA examination process reflects banks' contributions to their communities far better than the old examination procedures, fostering recognition of the level of community-based lending banks have always engaged in. By differentiating between large banks and small banks, the regulations have balanced documentation and reporting requirements with measurement of performance of more than 88 percent of the banking assets of the nation under the more detailed large bank examination procedures. At the same time, more than 90 percent of banks by number that

represent less than 12 percent of industry assets are spared some reporting burdens that are unnecessary to evaluating their commitment and service to their communities.

No more succinct evidence that the CRA today better reflects banks' success in serving the credit needs of their local communities can be cited than to observe that 98 percent of banks and savings associations receive composite CRA ratings of Satisfactory or better. Some may scoff at this achievement, but the fundamental truth is that banks are tested in the marketplace every day to demonstrate their responsiveness to the needs of their local communities—and those that do not serve the credit needs of their entire community do not prosper. It is, therefore, not surprising that the banking industry excels at satisfying community credit needs.

Banks are in the business of promoting financial intermediation—of bringing together those with capital and those who need capital. We do not build communities on our own. Our role is to help individuals and businesses build our communities—and we compete vigorously among ourselves for the privilege. Drill down in a CRA public evaluation and you will read about how we compete for market share across all income levels and all neighborhoods. You will also see how we help individuals reach their dreams, provide enterprising business men and women a boost toward success, and partner with community organizations to serve populations of modest means or neighborhoods with special needs.

To illustrate what I am talking about, Provident recently expanded its relationship with the Baltimore affiliate of NeighborWorks Neighborhood Housing Services (NHS). My bank had long recognized and supported the NHS Baltimore affiliate's exemplary track record in homeownership counseling. We were also aware of the targeted low-to-moderate income (LMI) lending and servicing experience of the Baltimore affiliate. Acknowledging that experience and recognizing the need, a new loan purchase and servicing agreement was recently "inked" inaugurating a new partnership between

Provident and Baltimore NHS. Based on its frontline grass roots experience, NHS developed a targeted niche product, which Provident approved as a lending tool. This tool is designed to assist homeowners who may have been victims of predatory real estate practices and who may be in danger of foreclosure.

The partnership's ultimate goal is neighborhood and community stabilization in our attempt to help stem the growing tide of foreclosures in Baltimore. Provident is also close to closure on similar arrangements with other NeighborWorks affiliates in the shared footprints of Greater Washington and Central Virginia.

II. The CRA Examination Process is Open, Incorporating Public Comment and Review of Banks' Compliance

The fact that you can read about my bank's performance and the performance of every bank in this country is no small feat. The availability of the bank's CRA Public Evaluation combined with the regulation's open solicitation to the community to comment on the institution's CRA performance has led to a CRA process that is largely transparent, with significant opportunity for community residents and groups to comment. The value of public CRA evaluations in documenting an institution's lending to its community is that it brings to bear the power of public scrutiny as the engine of encouragement. It enables the members of the community themselves to understand and compare the institutions that serve them—and to respond with their voice and their patronage.

Elements of this open process include tens of thousands of pages published each year detailing bank performance, all of which is readily available on the Internet. Another element is that the CRA regulations require maintaining a CRA public file containing the institution's latest CRA Public Evaluation, a map of the community served by the institution, and any comments from the community

since the last CRA examination, among other things. This file is available for review by the public and by examiners at any time, and regulations require posting of a lobby notice in every branch of the bank notifying the public of this resource.

We also note that while the Community Reinvestment Act is not an anti-discrimination statute in the way that the Fair Housing Act or the Equal Credit Opportunity Act prohibit discrimination in lending, the regulators have added to the CRA examination process a requirement to take into account any evidence of illegal discrimination in lending or other illegal consumer credit practices. The bank regulators have done so under the argument that illegal or discriminatory credit practices cannot be said to help meet the credit needs of a community but rather the reverse. Because banks and savings institutions, unlike other lenders, are ***regularly examined*** for their compliance with the fair lending laws and the consumer protection laws, such as the Truth-in-Lending Act and federal law prohibiting unfair or deceptive acts and practices, agencies have a record of the bank's compliance with these laws when the regulator conducts a CRA examination. Mandatory inclusion in the CRA Public Evaluation of a negative finding by examiners, resulting in a downgrade in CRA rating, brings greater visibility to the fair lending record of banks and savings associations than is seen in other, less scrutinized sectors of the mortgage market.

Thus, we conclude that the CRA examination process is one that has improved considerably over time, in particular by balancing the burden between smaller and larger institutions, enlarging the range of lending that receives CRA credit in rural communities, and requiring consideration of any evidence of discriminatory lending or violations of consumer credit protection laws. Given the transparency of the evaluation process and the many avenues for the interested public to comment on, provide input to, or criticize that public record, no other enforcement mechanism for CRA is needed.

III. The CRA Examination Process can be Improved

Looking forward, bankers believe that the CRA regulatory process must continue to evolve to meet changing markets and participants. We believe that there are three major areas where improvements can be made:

- Simplify the regulatory process to reduce unnecessary burden.
- Add flexibility to the regulations to encourage responsiveness of the institution to its particular community's needs.
- Provide broader authority to make public welfare investments.

Simplify the Regulatory Process: In many ways, the CRA regulations and examination are still too complex. To begin, bankers are required to know not only the ins and outs of the CRA regulations but also the much more complex specifics of the supplementary guidance issued by the regulators in the CRA Questions and Answers. We believe it notable that the CRA Q&A is considerably longer and more detailed than the CRA regulations, and is much harder to use. The regulators have proposed a complete revision of the last Q&A from 2001, but despite few controversies in the Q&A, it is still pending release from the regulators.

Another example of the drift into complexity came with the recent revisions to the CRA regulations re-balancing the definition of a "small bank" so as to relieve such institutions from unnecessary burden. Since the 1995 reform effort, the depository institution industry has continued to evolve and consolidate. Based on FDIC data, institutions over $1 billion in assets accounted for 88.3 percent of industry assets as of September 30, 2007. Proportionately and in absolute dollars, more banking assets are covered by the $1 billion large institution test today than were covered in 1995 when

the small bank/large bank distinction was first established and set at $250 million. While this change was an excellent example of the evolution of the CRA regulations, we note that in making this change the banking agencies added an entirely new CRA examination—the Intermediate Small Bank CRA Examination. To go from the simplicity of two examinations—one for small banks and one for large banks—to three examinations, with the new one containing a wholly new approach to assessing community development activities, was simply an unnecessary complication of already complicated regulations.

Add Flexibility: Regulators need to adjust the regulations and examination process to encourage responsiveness of institutions to changing markets rather than preserving a standardization to make measurement easier for the examiner. As a specific example, the definitions used to determine whether a loan, investment or service are community development that qualifies for CRA credit are still too complex and narrow in scope. Bankers, members of Congress and communities know that our citizens need a much higher level of financial literacy to function well in our complex economy. Many banks, in fact, participate in providing financial literacy training—training which benefits the entire community by educating the general public on how to save, budget, evaluate financial service offers and to qualify to buy a home. However, under the CRA regulations, much of this is not recognized as having a CRA value because the training does not fit the rather narrow restrictions requiring that any program document that a majority of the participants are low- or moderate-income residents. Frankly, proving such an impact can be daunting for the bankers in the community. More importantly, this restriction fails to recognize how our financial markets have evolved and the broad need for financial literacy in all economic and educational strata of our society.

Another area in which regulators need to be more responsive is in the process of revising the CRA Q&As, which are critical to meeting examination expectations. The last full revision of the Q&As was in 2001, and the latest revision has been pending for some time.

Broader authority to make public welfare investments: To fulfill the spirit of CRA, banks need broader authority to make public welfare investments. As we have noted, CRA is fundamentally a public evaluation process. It provides no new bank powers or authority. Rather it assesses how well banks use their existing powers to serve their communities. Without proper authority to make public welfare investments, banks are prevented from participating in some important community development projects.

The Financial Services Regulatory Relief Act of 2006 amended the OCC authority for national banks to make public welfare investments by raising the percentage allowed from 10 percent to 15 percent of capital and surplus. ABA supported this change. However, the amendment also changed the test for a valid public welfare investment from one primarily "to promote the public welfare, including the welfare of LMI communities and families" to "investments … each of which promotes the public welfare by benefiting primarily LMI communities or families…." This change in purpose appears to restrict the community development public welfare investments that national banks and state member banks may make, drastically reducing the economic development activities of community development lending. As a result, there appear to be community development investments that would qualify for CRA credit (in disaster areas or distressed or underserved communities or provide economic development) but can not be shown to be "primarily benefiting LMI communities or families." Since there is ***no*** investment authority under the CRA itself, most CRA community development investments are done under the public welfare authority, which is now limited. In addition, public welfare projects,

that are vital to the revitalization of our aging community infrastructure and benefit all citizens regardless of their income level, are also in jeopardy of losing bank investment. We therefore take this opportunity to recognize Chairman Frank and Ranking Member Bachus for their leadership in rectifying this situation, and we offer our support to H.R. 1066, which has passed the House and now awaits action in the Senate.

Finally, the regulators need to recognize better the value added by specialized expertise developed by bankers in meeting the community development needs of their communities. For example, the regulators need to adopt regulations supporting the investment in, and support of, minority institutions by majority institutions, something that Congress authorized 15 years ago but still is not implemented by the regulators. The regulators have proposed a Q&A that would do this, but the American Bankers Association and the National Bankers Association requested such a change almost 10 years ago, and despite the continuing crisis for minority banks to attract more capital in order to become more viable institutions, the regulators have not responded with implementing regulations.

Conclusion

The American Bankers Association believes that the current state of bank compliance with the spirit and letter of the Community Reinvestment Act is healthy and that bankers, regulators and nonprofit community groups have all learned from each other over the years in forging partnerships to promote their communities. We believe that there has been significant evolution of the implementation of the CRA over the years, and that evolution will need to continue. We recommend changes to simplify the process, add flexibility, and broaden the authority to make public welfare investments, all of which will improve CRA for the future.

Prepared Testimony of Michael S. Barr
Professor of Law, University of Michigan Law School
Before the
Committee on Financial Services
U.S. House of Representatives
Hearing On
"The Community Reinvestment Act:
Thirty Years of Accomplishments, But Challenges Remain"
February 13, 2008

Chairman Frank, Ranking Member Bachus, and distinguished Members of the Committee, it is an honor to be here today to discuss the Community Reinvestment Act (CRA).

The Community Reinvestment Act has helped to revitalize low- and moderate-income communities and provided expanded opportunities for low- and moderate-income households. Going forward, CRA could be strengthened in several ways to ensure its continued role in encouraging sound lending, investment and services in low- and moderate-income communities. At the same time, CRA cannot be expected to resolve the range of financial problems facing low- and moderate-income communities today. This Committee has already taken strong leadership to clean up the mortgage business and drive out abuses, and I am confident that the Committee will continue to lead in resolving the subprime mortgage crisis we face today.

The Community Reinvestment Act

The Community Reinvestment Act of 1977 (CRA) encourages federally insured banks and thrifts to meet the credit needs of the communities that they serve, including low- and moderate-income areas, consistent with safe and sound banking practices. Federal banking agencies examine banks periodically on their CRA performance and rate the institutions. Regulators consider a bank's CRA record in determining whether to approve that institution's application for mergers with, or acquisitions of, other depository institutions. Banks and thrifts must have a satisfactory CRA record if they, or their holding companies, are to engage in newly authorized financial activities, such as certain insurance and securities functions.

Changes to CRA regulations issued in 1995 focused evaluations on objective performance measures rather than previously used process-oriented factors.[1] These regulations require large banks and thrifts to disclose information about their small-business, small-farm, and community-development lending. The regulations provide for tailored examinations of large banks, small banks, and wholesale or limited-purpose institutions that more closely align with the business strategies of each institution type. Large banks are evaluated on a three-part test of their lending, investments, and services, while small banks undergo a streamlined review of lending.

For large banks, the lending test accounts for 50 percent of the bank's CRA rating and evaluates its performance in home mortgage, small-business, small-farm, and community-development lending. Examiners consider the number and amount of loans to low- and moderate-income borrowers and areas, and "innovative or flexible lending practices." Under the investment test, which accounts for 25 percent of the bank's CRA grade, the agency evaluates

the amount of the bank's investments, innovation, and responsiveness to community needs. Under the service test, which makes up the remaining 25 percent of the bank's evaluation, the agency analyzes "the availability and effectiveness of a bank's systems for delivering retail banking services and the extent and innovativeness of its community development services." The agency assesses an institution's record under these three tests in light of the "performance context" in which the institution is operating, including economic and market factors; the bank's capacities, constraints, and business plans; and "the performance of similarly situated lenders."

Since enactment, CRA has been, and remains today, the subject of extensive debate. Many scholars vigorously question the theoretical and empirical claims that motivated CRA, and many also advocate eliminating the law.[2] These critics argue that CRA is trying to address a nonexistent problem, and that even if intervention is warranted, CRA is an inappropriate avenue. Many critics also suggested that CRA was having little, if any, positive effect, and at a high cost. However, in earlier work, I have systematically rebutted these prior criticisms of CRA and laid a solid theoretical and empirical foundation for the Act.[3] Those findings are summarized here.

CRA Reasonably Addresses Market Failures in Low-Income Communities

At its core, CRA helps to overcome market failures in low-income communities. By fostering competition among banks in serving low-income areas, CRA generates larger volumes of lending from diverse sources, and adds liquidity to the market, decreasing the risk of each bank's loan. Encouraged by the law, banks and thrifts have developed expertise in serving low-income communities, and they have created innovative products that meet the credit needs of working families and low-income areas with manageable risks.

These market innovations have taken several forms. Banks and thrifts have engaged in special marketing programs to targeted communities; experimented with more flexible underwriting and servicing techniques to serve a broader range of households, and funded credit counseling for borrowers. Many larger institutions have developed specialized units that focus on the needs of low- and moderate-income communities. Others have formed partnerships with community-based organizations and community development financial institutions (CDFIs). CDFIs provide local expertise and financial education, and assume portions of risk that banks do not want to bear. Spurred in part by the CRA investment test, banks have invested in CDFIs in record numbers, strengthening their ability to serve low-income markets.

CRA also facilitates coordination among banks to reduce information costs. Because the law requires all insured depositories to lend in their communities, it reduces "free rider" problems. It has spurred the development of multi-bank community development corporations and loan consortia to serve low- and moderate-income communities more effectively. Moreover, banks get CRA consideration for both originating and purchasing loans, creating a trading system. Institutions can also get credit under the CRA investment test for purchasing loan securities. The development of this secondary market has increased liquidity and transparency.

A positive lending cycle thus began in many communities once ignored by mainstream lenders. Under CRA, lenders know that other banks will be making loans to a community, reducing all institutions' liquidity risk, speeding the gathering and dissemination of information,

and producing positive information externalities. Increased lending by responsible originators to low-income communities has occurred under CRA and such responsible lending has not led to the kind or extent of excessively risky activity under taken outside of CRA's purview.

Studies have found that CRA improved access to home mortgage credit for low-income borrowers during the 1990s, as CRA regulatory intensity increased.[4] Between 1993 and 1999, depository institutions covered by the CRA and their affiliates made over $800 billion in home mortgage, small business, and community development loans to low- and moderate-income borrowers and communities.[5] The number of CRA-eligible mortgage loans increased by 39 percent between 1993 and 1998, while other loans increased by only 17 percent. Even excluding affiliates, banks increased their lending to low- and moderate-income borrowers and areas by 10 percent over this period, compared with no growth at all for these lenders in their other markets. As a result, the share of all mortgage lending by CRA-covered institutions and their affiliates to these borrowers and areas increased from 25 to 28 percent.

A series of factors beyond CRA also contributed to these gains. Strong economic growth and low inflation during the 1990s led to rapid income growth, low unemployment rates, and low real interest rates. Innovation helped drive down the costs of lending. Consolidation in the financial services sector enhanced competition among national players with economies of scale and scope. And other laws—such as fair lending and secondary mortgage market regulations—operated in intensified ways during this period.

Controlling for the effects of these factors, however, CRA lenders increased their CRA-eligible home purchase lending faster than those not regulated by CRA from 1993 to 1999.[6] The Joint Center for Housing Studies at Harvard University concluded: "CRA-regulated lenders originate a higher proportion of loans to lower-income people and communities than they would if CRA did not exist."[7] By one estimate, the Joint Center found that CRA's effect on increasing home mortgage lending to low-income borrowers was equivalent to a 1.3 percentage point decrease in unemployment. Another study found that CRA boosts the number of small businesses that can access credit by four to six percent, increasing payrolls and reducing bankruptcies—without crowding out other financing available to small businesses or adversely affecting bank profitability or loan performance.[8] In sum, recent evidence shows that CRA provides important benefits to low-income communities.

Critics of CRA assert that it leads to unprofitable lending. But the weight of evidence suggests otherwise. In a Federal Reserve Board survey of CRA-covered institutions, most responded that CRA lending was profitable or marginally profitable, and not overly risky.[9] Pushing further into low-income markets under CRA has not weakened banks' profitability and soundness. In the small "special programs" that serve as banks' CRA laboratories, employing new and innovative strategies, most institutions reported low delinquency and charge-off rates. In fact, most institutions surveyed reported a net charge-off rate of zero for these programs.

Reforms put into place in 1995 reduced compliance costs for all banks and streamlined CRA regulations even further for the smallest institutions. Evidence suggests the reforms worked. In 2002, the Independent Community Bankers of America surveyed its membership about the cost of CRA regulation.[10] Although the study is designed to highlight the high compliance costs of

CRA, the data reported in the study suggest otherwise. The mean employee cost for CRA compliance was $84,445 per year for small banks (average assets of $216 million) and about $30,000 more per year for larger "community" banks (average assets of $666 million). Average CRA employee costs as a percentage of assets were thus negligible—0.017 percent for larger "community" banks, and 0.039 percent for small banks. These costs seem manageable.

CRA Should Have Done More to Combat Abuses in the Subprime Market

Despite the fact that CRA appears to have increased bank and thrift lending in low- and moderate-income communities, such institutions are not the only ones operating in these areas. In fact, with new and lower-cost sources of funding available from the secondary market through securitization, and with advances in financial technology, subprime lending exploded in the late 1990s, reaching over $600 billion and 20% of all originations by 2005. More than half of subprime loans were made by independent mortgage companies not subject to comprehensive federal supervision; another 30 percent of such originations were made by affiliates of banks or thrifts, which are not subject to routine examination or supervision, and the remaining 20 percent were made by banks and thrifts. Although reasonable people can disagree about how to interpret the evidence, my own judgment is that the worst and most widespread abuses occurred in the institutions with the least federal oversight.

The housing crisis we face today, driven by serious problems in the subprime lending, suggests that our system of home mortgage regulation, including CRA, is seriously deficient. We need to fill what my friend, the late Federal Reserve Board Governor Ned Gramlich aptly termed, "the giant hole in the supervisory safety net."[11] Banks and thrifts are subject to comprehensive federal regulation and supervision; their affiliates far less so; and independent mortgage companies, not at all. Moreover, many market-based systems designed to ensure sound practices in this sector—broker reputational risk, lender oversight of brokers, investor oversight of lenders, rating agency oversight of securitizations, and so on—simply did not work. Conflicts of interest, lax regulation, and "boom times" covered up the extent of the abuses—at least for a while, at least for those not directly affected by abusive practices. But no more.

As has become all too evident, the subprime market has been plagued by serious problems. Some subprime borrowers who could have qualified for loans from prime lenders end up in the subprime market, paying higher rates: Preliminary research suggests up to 35% of subprime borrowers could qualify for prime mortgage loans.[12] Some minority borrowers may have been improperly "steered" to higher cost lenders by brokers or real estate professionals. Even after accounting for neighborhood and borrower characteristics that influence lending decisions, there is "a strong geographic concentration of subprime lending in those neighborhoods where there is a large population of African American homeowners" and "African-American borrowers, regardless of the neighborhood where they are located, have relatively high likelihood of obtaining a subprime compared to a prime loan."[13]

Moreover, studies have documented abusive practices in the subprime sector.[14] These practices have included "flipping," repeatedly refinancing a loan in a short period of time. Flipping subjects a borrower to high fees, including prepayment penalties, which diminish the borrower's home equity without providing significant benefit. Loans have been "packed" with additional products (such as credit life insurance) without the borrower understanding that the products were optional or unsuitable.[15] Loans have included fees unrelated to risk or servicing, and which are structured to disguise the loans' true costs.[16] Some brokers have made home

mortgage loans without regard to the borrower's ability to repay.[17] These so-called "asset based" loans often were made by brokers who earned high fees and were less concerned about their reputations among lenders.[18] In other cases borrowers have testified that "unscrupulous mortgage brokers, lenders, home improvement contractors, appraisers, and combinations thereof" engaged in "outright fraud" as well as "deceptive or high-pressure sales tactics," and often "prey[ed] on . . . the elderly, minorities, and individuals with lower incomes and less education."[19]

While credit risk is a key determinant of whether a borrower receives a prime or subprime loan, "credit risk alone may not fully explain why borrowers end up in the subprime market."[20] For example, borrowers who are older, Hispanic, or search less for interest rates are more likely to end up in the subprime market.[21] Having a subprime loan is an important determinant of refinancing with a subprime loan even after controlling for relevant factors related to risk and creditworthiness: Some 60% of subprime borrowers who refinanced did so with subprime loans rather than prime ones,[22] indicating that many subprime borrowers get stuck in that market.

The higher price that borrowers pay is a function not only of using a subprime lender, but also of negotiating with mortgage brokers, who dominate the subprime market. Brokers are compensated for getting borrowers to pay higher rates than those for which the borrower would qualify. Such "yield spread premiums" are used widely.[23] In loans with yield spread premiums, there is wide dispersion in prices paid to mortgage brokers. Within the group of borrowers paying yield spread premiums, African Americans paid $474 more for their loans, and Hispanics $590 more, than white borrowers; thus, even if minority and white borrowers could qualify for the same rate, in practice minority borrowers are likely to pay much more.[24]

CRA has not yet done enough to integrate the prime and subprime markets, as evidenced by these problems.[25] In some ways, CRA is well positioned to help overcome the bifurcation between the prime and subprime markets by enhancing competition from banks and thrifts. Overcoming that bifurcation would improve market efficiency, reduce racial discrimination, and speed the process of correcting other market failures. Competition from banks and thrifts can help to drive out abusive practices and improve price transparency in these markets. However, given the large role played by independent mortgage companies and brokers, bank and thrift competition under CRA is not enough, on its own, to drive out bad practices. In recent years, there was intense competition among mortgage market participants to provide harmful products. Further federal regulation is thus also necessary to combat abusive practices, prevent a race to the bottom in bad lending behavior, and restore integrity to our housing markets. We need to ensure that all participants in the mortgage process have the right incentives to engage in sound lending practices and are subject to the right kind of regulatory oversight.

CRA Performance Context Should Include Affiliates of Banks and Thrifts

One suggestion going forward is that it is both possible under existing law and desirable as a matter of policy to take account of affiliate activity while respecting the fact that CRA applies only to insured depositories. For example, CRA regulations already provide that evidence of illegal credit practices will affect an institution's CRA rating.[26] The laws governing such credit practices are equally applicable to banks and thrifts and non-depository creditors. Illegal credit practices of an affiliate that has been included at the option of the depository institution for purposes of a CRA examination are relevant to its rating, but so too should be the illegal credit practices of affiliates not so included. Given the cost of regularly examining all affiliates for

such practices, enforcement of other credit laws should occur through risk-based examinations of affiliates.[27] In addition to direct enforcement of such credit laws, the results of such compliance examinations should be taken into account in the performance context under CRA.

Banks should include activities of affiliates and bank regulators should determine whether such activities are serving the credit needs of their community. For example, some borrowers may be ending up in a bank's subprime unit, or subprime affiliate, or obtaining an inappropriate loan, when in fact they could qualify for a mortgage on better terms. The regulators now give CRA consideration for "promoting" borrowers from the subprime to the prime market,[28] and banks and thrifts should thus have in place procedures to ensure that borrowers with good credit histories get access to their prime mortgage units and products, and that all borrowers get access to the best loan for which they qualify, from whatever part of the company offers the product.

In principle, the OCC considers a bank's subsidiaries' assets in determining the performance context in which a bank operates.[29] Similarly, the assets and activities of all of the affiliates of a bank should also be considered in assessing the performance context within which a bank meets its obligations under CRA. After all, a bank's affiliates are hardly irrelevant to the bank's business decisions, including how to meet the credit needs of their communities. The Gramm-Leach-Bliley Act made a financial holding company's commencement of newly authorized activities, or its merger with newly authorized entities, contingent on satisfactory CRA performance by all of the affiliate banks or thrifts. A bank's affiliates have a strong interest in ensuring adequate CRA performance by all the insured depositories of the holding company.

Holding companies provide scale economies to their subsidiaries in complying with bank regulations.[30] Banks that are part of holding companies face lower regulatory burdens from the same regulation than their non-affiliated counterparts of similar size. Thus, affiliation should generally be weighed, not ignored, in determining tradeoffs between regulatory burdens and benefits. Banks that are part of holding companies have available to them the range of expertise of the holding company, which is useful for developing programs to meet community needs under CRA. The holding company and its subsidiaries can offer a range of services to the bank in helping the bank meet its CRA performance goals, such as innovative loan products, securitization, or expertise in investment and other matters. These affiliates do affect a bank's CRA performance, and the bank should therefore be assessed, taking the expertise and resources of the parent institution into account. The agencies should thus include the assets and activities of affiliates in assessing performance context for CRA examinations of banks and thrifts.

CRA Should Encorage Innovation and Quality in Lending and Community Investment

The success of CRA in encouraging home mortgage lending is in part a consequence of the ability of regulators to count home mortgage loans. However, as such lending became more commonplace, bank and thrift examiners generally failed to take sufficient account of whether financial institutions moved beyond the production of more home mortgages, to assess whether financial institutions were truly meeting the needs of low- and moderate-income communities. Such an assessment might include a qualitative judgment about whether the home mortgage loans offerred were innovative in meeting the needs of low-income households—and not just innovative in meeting the needs of investors. Such an assessment might also have taken greater account of the extent to which major institutions developed specialized units to serve low-income communities. And such an assessment might have given more weight to innovative and complicated community development lending and investment. These more nuanced and

qualitative assessments are important to understanding how well a financial institution is serving its whole community. As a result of examiners' generally more narrow focus on loan production, these aspects of financial institutions' innovation have been undervalued in recent years, and many major financial institutions have cut back on such innovation. A renewed focus on truly innovative work would help restore CRA's role in fostering a culture and structure of community development in major firms.

CRA Services Test Should Focus on Innovative Products and Services

CRA could also help to focus banks and thrifts on opportunities to provide bank accounts to low-income persons.[31] The CRA service test, which evaluates bank and thrift performance in meeting transaction, savings, and other community needs, has received inadequate attention from bank regulators in CRA examinations. Michael Stegman has documented that banks rarely receive "needs to improve" ratings on the service test, and the service test is often used to increase the overall score of borderline banks.[32] Examiners should focus on the extent to which banks and thrifts are actually attracting low-income customers with innovative retail products and services. Given the importance of technology in serving low-income clients in a cost-effective manner, service examinations should move away from an overwhelming focus on bank branches towards a more quantitative and qualitative assessment of the extent to which technology-based products are expanding access for low-income persons.[33]

The 1995 regulations provide sufficient flexibility for analysis of an institution's performance, but agency examination procedures provide insufficient guidance as to how to measure an institution's activities in ways that actually matter to low-income consumers. The service test, in practice, has received perfunctory attention from examiners, with public evaluations containing little or no analysis of whether low-income consumers actually use bank or thrift products or services. Examinations under the service test could be vastly improved by taking three steps.

First, examiners should evaluate the extent to which institutions offer low-cost accounts and other products designed to meet the account needs of low-income individuals. Low-cost electronic accounts with direct deposit, no overdraft, and an automatic savings plan may hold special promise in this regard. Regardless of the form of the account, examiners should attempt to make a qualitative judgment about the range of product offerings of the institutions, based on research into low-income consumer needs, and taking into account the costs to institutions of providing accounts and the requirements of sound banking practice.

Second, banks and thrifts should be evaluated based on the number of low- and moderate-income account holders at their institution, whether in a traditional, or more innovative, account. Quantitative measures of usage should provide a portrait of an institution's performance under the service test, and data collection on the numbers of accounts provided should not in and of itself be burdensome. Information on account usage is critical to meeting the financial services needs of low-income communities.

Third, the agencies should give negative consideration to activities that undermine the provision of quality services to the poor. For example, participation by banks or thrifts in arrangements with affiliates or other parties that do not provide adequate consumer protection, or

raise compliance, operational, or other risks, should receive negative consideration as part of the performance context under the service test.[34] As they have with payday lending, agencies should ensure that banks and thrifts are not merely "renting" their charters to these firms, but are engaged in appropriate monitoring and supervision of practices. This may require targeted, risk-based compliance examinations of these parties or affiliates.

Range of Responses Needed to Restore Integrity and Stability to Financial Markets

Along with maintaining and strengthening CRA, Congress ought to enact a range of complementary policies to address the housing crisis.

With colleagues at the Center for American Progress, I have proposed the Saving America's Family Equity (SAFE) loan plan, under which the Federal Housing Administration, Fannie Mae and Freddie Mac would arrange through responsible originators for the refinancing of loans at terms that reduce the likelihood of default, foreclosure and liquidation. The SAFE loan plan would help the market rapidly and transparently to re-price existing mortgage pools, build capital, and restore financial stability. Investors would take a hit. Speculators would be excluded. But the SAFE loan plan would provide a restructuring process to help responsible borrowers stay in their homes. The SAFE loan plan would contain an automatic shut-off valve that would end the program once market-pricing and liquidity are restored.

In addition to the SAFE plan, judicially supervised modifications of home mortgages should be permissible under certain narrow circumstances when the other available option, foreclosure, is not in any one's interest. Moreover, with significant foreclosures comes concentrated, local economic harm, including depressed property values, abandoned buildings, and crime. Congress should help hard-hit states and localities with additional, timely funding for Community Development Block Grants and HOME funds, as well as targeted state and local aid to counsel borrowers, prevent foreclosures and deal with abandoned and foreclosed properties.

Furthermore, we should take this opportunity to implement common sense reforms to the mortgage market, to reduce the likelihood of such a crisis in the future. Chairman Frank, Ranking Member Bachus, and this Committee have successfully championed important legislation to clean up the mortgage process and regulate mortgage brokerage to drive out abuses.[35] Such legislation should be enacted by the other chamber and signed into law. In addition, the Federal Reserve Board's recent proposals to bar unfair and deceptive mortgage practices should be implemented immediately while the Board works to strengthen them further. Moreover, to increase transparency, all borrowers need to be able to get firm price quotes on loans and settlement services in order to comparison shop. We also need to increase public disclosure of broker and lender conduct and regulatory monitoring of credit standards.

In addition, Harvard economist Sendhil Mullainathan, Princeton psychologist Eldar Shafir, and I have argued for a new, opt-out mortgage plan.[36] While the causes of the mortgage crisis are myriad, a central problem was that brokers and lenders offered loans that looked much less expensive than they really were, because of low initial monthly payments and hidden costly features. As Ned Gramlich asked, "Why are the most risky loan products sold to the least

sophisticated borrowers?"[37] The question answers itself. And so, many borrowers took out loans that they did not understand and could not afford, with predictable results.

In retirement policy, behavioral research has led Congress to promote "opt out" plans under which employers sign workers up for retirement benefits unless the worker chooses not to participate. This policy has significantly improved people's retirement savings. Under an opt-out home mortgage plan, borrowers would be offered a standard set of mortgages, with sound underwriting and straightforward terms. And that's the mortgage they'd get, unless they opted out. An opt-out system would mean borrowers would be more likely to get straightforward loans they could understand, without blocking beneficial financial innovation.

Conclusion

Now in its thirtieth year, the Community Reinvestment Act has helped to expand access to responsible credit to low- and moderate-income households. That is a laudable achievement. Going forward, CRA regulations should focus on encouraging innovative ways to provide credit to low- and moderate-income households, invest in the development of communities, and offer retail services that meet the needs of those who have been left out of the financial services mainstream. At the same time, Congress should undertake other initiatives to end abusive practices, and to restore integrity and stability to our financial markets. Among these, Congress should consider using the insights of behavioral economics to develop "opt out" policies that make it less likely that households will predictably make costly mistakes. Congress should also take up targeted incentives to encourage the financial sector to better serve low- and moderate-income households. Innovation is a hallmark of America's financial system, and with the appropriate mix of governmental policies and regulatory supervision, we can expect our financial system once again to be vibrant, strong—and inclusive.

Endnotes

[1] See 12 CFR 25 (applying to nationally-chartered banks), 12 CFR 228 (applying to state-chartered banks), and 12 CFR 563e (applying to thrifts).

[2] See, e.g., Jeffery W. Gunther, "Should CRA Stand for 'Community Redundancy Act?'" *Regulations* 23 (3) (2000): 56-60; Jeffrey M. Lacker, "Neighborhoods and Banking." *Economic Quarterly* 81 (2) (1995): 13–38; Jonathan R. Macey and Geoffrey P. Miller, "The Community Reinvestment Act: An Economic Analysis." *Virginia Law Review* 79 (1993): 291-348; Lawrence J. White, "The Community Reinvestment Act: Good Intentions Headed in the Wrong Direction." *Fordham Urban Law Journal* 20 (1993): 281-291.

[3] Michael S. Barr, "Credit Where it Counts: The Community Reinvestment Act and its Critics." *New York University Law Review* 80 (2) (2005): 513-652.

[4] See Michael S. Barr and others, "The Community Reinvestment Act," in C. Guene and E. Mayo, eds., *Banking and Social Cohesion: Alternative Responses to a Global Market* (Charlbury, Oxfordshire: Jon Carpenter, 2001); Robert B. Avery and others, "Trends in Home Purchase Lending: Consolidation and the Community Reinvestment Act." *Federal Reserve Bulletin* 85 (1999); Robert B. Avery and others, "Credit Risk, Credit Scoring, and the Performance of Home Mortgages." *Federal Reserve Bulletin* 82 (1996); Douglas D. Evanoff and Lewis M. Siegal, "CRA and Fair Lending Regulations: Resulting Trends in Mortgage Lending." *Economic Perspectives* 20 (1996); Michael LaCour-Little, "Does the Community Reinvestment Act Make Mortgage Credit More Widely Available? Some New Evidence Based on the Performance of CRA Mortgage Credits." Conference paper presented at the Midyear Meeting of the American Real Estate and Urban Economics Association meeting, Washington, May 4, 1998.

[5] Robert E. Litan and others, "The Community Reinvestment Act After Financial Modernization: A Baseline Report" (U.S. Treasury Department, 2000); Robert E. Litan and others, "The Community Reinvestment Act After Financial Modernization: A Final Report" (U.S. Treasury Department, 2001). For further analysis of these reports, see Eric Belsky, Michael Schill, and Anthony Yezer, "The Effect of the Community Reinvestment Act on Bank and Thrift Home Purchase Mortgage Lending" (Harvard University Joint Center for Housing Studies, 2001).

[6] Litan and others, "The Community Reinvestment Act After Financial Modernization: A Final Report"; Belsky, Schill, and Yezer, "The Effect of the Community Reinvestment Act on Bank and Thrift Home Purchase Mortgage Lending."

[7] Harvard University Joint Center for Housing Studies, "The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System" (2002).

[8] Jonathan Zinman, "Do Credit Market Interventions Work? Evidence from the Community Reinvestment Act" (Federal Reserve Bank of New York, 2002).

[9] Board of Governors of the Federal Reserve System, *The Performance and Profitability of CRA-Related Lending*, report submitted to the Congress pursuant to Section 713 of the Gramm-Leach-Bliley Act of 1999, July 17, 2000.

[10] Grant Thornton LLP, Independent Community Bankers of America, "The High Cost of Community Bank CRA Compliance: Comparison of 'Large' and 'Small' Community Banks" (2002).

[11] Edward M. Gramlich, "Booms and Busts: The Case of Subprime Mortgates," Presented in Jackson Hole, Wyoming, Aug. 31, 2007.

12 FREDDIE MAC, AUTOMATED UNDERWRITING: MAKING MORTGAGE LENDING SIMPLER AND FAIRER FOR AMERICA'S FAMILIES Chap. 5 (Sept. 1996), http://www.freddiemac.com/corporate/reports/moseley/mosehome.htm.

13 Paul S. Calem et al., *The Neighborhood Distribution of Subprime Mortgage Lending*, 29 J. REAL EST. FIN. & ECON. 393, 407 (2004).

14 For a full discussion of such practices, see generally CURBING PREDATORY HOME MORTGAGE LENDING, HUD-TREASURY REPORT (2000). *See also* Michael S. Barr, *Access to Financial Services in the 21st Century: Five Opportunities for the Bush Administration and the 107th Congress*, 16 NOTRE DAME J.L. ETHICS & PUB. POL'Y 447, 455–62 (2002) (describing problems in and opportunities for reform of subprime mortgage market).

15 *See* HUD-TREASURY REPORT, *supra*, at 2.

16 *Id.*

17 *Id.*

18 *Id.* at 76–77.

19 *Id.* at 2.

20 Marsha J. Courchane et al., *Subprime Borrowers: Mortgage Transitions and Outcomes*, 29 J. REAL EST. FIN. & ECON. 365, 373 (2004).

21 *Id.* at 371–72.

22 *Id.* at 375, tbl.1.

23 *See* H. Jackson & J. Berry, *Kickbacks or Compensation: The Case of Yield Spread Premiums* (2003) at 127.

24 *Id.* at 125 (describing differences in "total mortgage broker compensation," which includes both yield spread

premiums and their functional equivalents, broker "discount fees"); *see also* JACK GUTTENTAG, ANOTHER VIEW OF PREDATORY LENDING 8 (Wharton Fin. Inst. Ctr., Working Paper No. 01-23-B, 2000) ("According to the brokers, [a] major determinant of profit per loan is the sophistication of the borrower relative to the sales skills of the loan officer."), *available at* http://fic.wharton.upenn.edu/fic/papers/01/0123.pdf.

[25] *See, e.g.*, Bd. of Governors of the Fed. Res. Sys., *In re* Citigroup Inc. & Citifinancial Credit Co., Order to Cease and Desist and Order of Assessment of a Civil Money Penalty Issued Upon Consent, May 27, 2004 (alleging subprime affiliate engaging in asset-based lending in violation of HOEPA, requiring co-signators to sell more credit insurance in violation of Regulation B, misleading examiners, and assessing civil money penalties of $70 million and securing agreement to pay restitution to borrowers), *at* http://www.federalreserve.gov/boarddocs/press/enforcement/2004/20040527/attachment.pdf (last visited Mar. 30, 2005). *But see* OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION: CITIBANK, N.A. 7, 11–12 (June 9, 2003) (rating Citibank outstanding after evaluating performance of bank and its mortgage affiliates, including Citifinancial, and noting that fair lending concerns at another affiliate "did not significantly impact our CRA assessment of Citibank" because affiliate did not constitute significant percentage of institution's low- and moderate-income mortgage lending), *at* http://www.occ.treas.gov/ftp/craeval/may04/1461.pdf (last visited Mar. 30, 2005).

[26] 12 C.F.R. § 25.28(c) (2004).

[27] That is, the regulators could determine whether evidence suggests that an affiliate poses a risk of engaging in abusive practices, and then devote examination resources to investigating the extent of any such practices.

[28] Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestments; Notice, 66 Fed. Reg. 36,620, 36,628 (July 12, 2001).

[29] *See* OCC Bulletin 97-26, July 3, 1997 (noting that examiners should consider subsidiaries in bank's performance context); Letter from Julie L. Williams, Acting Comptroller, OCC, to Congressman Bruce L. Vento, May 8, 1998 (noting that "OCC examiners . . . include operating subsidiary assets when assessing a national bank's capacity for community reinvestment").

[30] *See* ELLIEHAUSEN, at 26 (noting economies of scale for compliance with ongoing regulations).

[31] Elsewhere, I have proposed a new tax credit to encourage banks and thrifts to offer low-cost, electronically based bank accounts with no overdraft or hidden fees. See Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121 (2004). I have also proposed a system under which the IRS would directly deposit tax refunds into bank accounts for low-income households who do not or cannot designate such an account. See Michael S. Barr, *An Inclusive, Progressive National Saving and Financial Services Policy*, 1 HARVARD LAW & POLICY REV. 161 (2007). Together with CRA, such policies could help to transform the financial services marketplace for low-income households.

[32] *See* MICHAEL STEGMAN & ROBERT FARIS, CREATING A SCORECARD FOR THE CRA SERVICE TEST (Brookings Inst., Policy Brief No. 96, 2002) (revealing that only fifteen CRA examinations out of nearly 2,000 conducted over five years resulted in a rating of "needs to improve" on the service test, and no bank earned a "substantial noncompliance" rating on service activities).

[33] *See* Michael S. Barr, *Access to Financial Services in the 21st Century: Five Opportunities for the Bush Administration and the 107th Congress*, 16 NOTRE DAME J.L. ETHICS & PUB. POL'Y 447, 452 (2002); *see also* Michael S. Barr, *Comment Letter of October 26, 2001*, Community Reinvestment Act Joint Advance Notice of Proposed Rulemaking (OCC Docket No. 01-16, Board Docket No. R-1112, FDIC Re: 12 CFR 345, OTS Docket No. 2001-49), *available at* http://www.ots.treas.gov/docs/95338.pdf.

[34] For example, OTS gave Crusader Bank a "needs to improve" rating in 2000 in part because of its payday lending operations; Crusader abandoned its payday lending relationship in 2001.

[35] H.R. 3915, The Mortgage Reform and Anti-Predatory Lending Act of 2007.

[36] For details of the opt-out mortgage proposal, see Michael S. Barr, Sendhil Mullainathan and Eldar Shafir, *Behaviorally Informed Home Mortgage Regulation*, Joint Center on Housing Studies, 2007.

[37] Gramlich, op. cit.

Testimony of

Cynthia Blankenship
Vice Chairman/COO, Bank of the West

On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Financial Services

Hearing on
"Implementation of The Community Reinvestment Act"

February 13, 2008
Washington, D.C.

Mr. Chairman and Ranking Member Bachus, I am Cynthia Blankenship, Vice-chairman and Chief Operating Officer of Bank of the West in Irving Texas. I am also Chairman-elect of the Independent Community Bankers of America.[1] I am pleased to have this opportunity to present the views of the nation's community bankers on the implementation of the Community Reinvestment Act.

ICBA represents 5,000 community banks throughout the country. Bank of the West is part of a two-bank holding company with assets of $250 million. We have eight locations in the Dallas/Fort Worth metroplex. We serve the small business community with a focus on SBA lending and real estate. The other institution in the holding company is the Bank of Vernon with assets of $30 million located in Vernon, Texas which is an agricultural community.

My testimony today will describe community banks' commitment to their communities and policies that enhance our ability to carry out that commitment. It then reviews the history of the implementation of the Community Reinvestment Act, with a particular emphasis on exam procedures that are tiered to recognize the differences between banks of different sizes. Finally, we strongly urge Congress to extend CRA to the credit union industry. This would recognize the vast differences between the credit union industry of today and that industry as it existed in 1977, when CRA became law.

Community Banks Invest in Their Communities

The Community Reinvestment Act requires that federal bank regulators evaluate how each FDIC-insured institution affirmatively meets "the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution," and take that record into account when evaluating an application for a deposit facility by the institution.

Community banks are locally owned and operated institutions that are integral parts of their communities and engage in community reinvestment and community development on a daily basis. Community banks generally serve only their local communities with deposit, lending and other banking services.

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[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $908 billion in assets, $726 billion in deposits, and more than $619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

Local community bankers frequently play a key role in many civic activities, such as serving on the development corporation board, hospital board, chamber of commerce or school board. In part, this is good business practice for community bankers. But a primary goal is to ensure their local communities are vibrant and thriving. The health of the bank is closely interwoven with the ongoing economic vitality of the local community and its residents

Access to credit and equity capital is an essential ingredient for creating and retaining jobs, developing affordable housing, revitalizing neighborhoods, and enhancing the economies of cities and rural communities. ICBA strongly supports community reinvestment and community development as a means of addressing these needs.

Over the last 20 years, banks have been consolidating into large multi-state operations. One of the collateral effects is that local community groups no longer have access to a local decision-maker in these banks who is integrally involved with the community. In contrast, the local community banker understands community needs and can make quick decisions regarding funding for housing, job-creating small businesses and other local economic needs. Such is not the case when a funding request must go through a branch of a multi-state bank and is then forwarded to an office many miles away where the request can become mired in a bureaucracy.

ICBA Supports Incentives for Community Investments

ICBA believes public policy can build on community banks' commitment to their communities by providing incentives and by removing unnecessary regulatory costs that detract from smaller banks' ability to serve their communities.

Fortunately, some of these incentives are already in place, and ICBA encourages policymakers to take steps to expand on these programs. For example, my bank places special emphasis on small businesses. One of our primary goals is to provide them with long term capital by originating and servicing small business loans through the loan guarantee programs of the Small Business Administration.

One important step would be for the Senate to enhance SBA programs by adopting H.R. 1332 which passed the House last year. The legislation would reduce SBA fees and permit a low-documentation loan program for seasoned lenders. The provisions are also included in Rep. Nydia Velazquez's Communities First Act (H.R. 1869). Streamlining and simplifying SBA loans and taking steps to encourage additional lenders to participate are key to promoting economic development in our communities.

Community banks also have provided homebuyers with common-sense mortgages that enabled them to both become and remain homeowners. The Federal Home Loan Banks and the housing GSEs, Fannie Mae and Freddie Mac, have been valuable partners for community banks in these efforts.

Last November, ICBA working with our partners, sponsored National Community Mortgage Week. Under that program, ICBA bankers held open-houses in nearly 1,000 locations. Community bankers reviewed mortgage documents and discussed financing options with consumers. As well-capitalized, stable, common sense lenders, community bankers were available to help clear up homeowners' confusion homeowners and help them refinance their existing mortgage.

Congress could also enhance community banks' ability to serve our customers by enacting regulatory relief provisions included in Rep. Velazquez's Communities First Act (H.R. 1869). The Act includes reductions in the paperwork burden that falls disproportionately on community banks. These tasks take time and staff resources that could be better used serving our customers.

ICBA is pleased that the House-passed GSE regulatory reform bill (H.R. 1427) includes important enhancements to the FHLBanks' Community Financial Institution program. That program, enacted as part of the Gramm-Leach-Bliley Act, permits the FHLBanks to assist CFIs' lending to agriculture and small businesses, providing another incentive for community reinvestment. The House bill permits more community banks to qualify for the program by increasing the eligibility threshold to $1 billion in assets. It also directs the new regulator to more closely oversee the FHLBanks' implementation of this program.

Finally, the House has passed the Depository Institution Community Development Investments Enhancement Act (H.R. 1066). That bill revises the statutory language for permissible public welfare investments by banks which was enacted in the Financial Services Regulatory Relief Act of 2006. The revisions permit banks to make investments in:

- designated disaster areas that were not low- or moderate-income (LMI) prior to the disaster;
- underserved or distressed rural communities that do not meet the LMI definition; and
- mixed-income affordable housing in areas targeted for revitalization in conjunction with government-sponsored housing initiatives.

The bill also permits banks to use New Markets tax credits in high poverty census tracts where area median incomes do not meet the LMI definition. ICBA and other groups have urged the Senate to pass this legislation. This legislation will help banks to continue making investments that benefit the public welfare and contribute to the overall health and vitality of their local communities.

Successful Reduction in CRA Paperwork

Over the past 15 years, the Federal banking agencies have successfully reduced the unnecessary and unproductive paperwork burden imposed on community banks under the Community Reinvestment Act regulations and examination procedures. As a result, community bankers can re-focus their efforts to actually investing in their communities, rather than documenting their efforts. Instead of allocating resources to the process, community bankers can make loans and investments that benefit their communities.

Before the agencies began this effort, ICBA released a study[2] conducted by Grant Thornton which reported that CRA compliance was the single most expensive regulatory burden placed on community banks. In that 1992 study, Grant Thornton studied the amount of time a representative sample of community banks actually spent preparing the paperwork that was the hallmark of CRA compliance at the time. Based on this data, Grant Thornton estimated that community banks spent 14.4 million hours on CRA compliance, double the number of hours they spent on the next most burdensome regulation, Truth in Lending. The annual dollar cost was an estimated $1 billion. One Wisconsin banker described the situation this way:

> In a community of less than 350 buildings, one bank and a 2.5 block business district, the absurdities of CRA become readily apparent. We are required to spend hundreds of non-productive hours building documentation to prove what is readily apparent from a zip code list of either deposits or loans: We get our deposits locally and we lend locally.[3]

Not only were the CRA examination procedures ill-suited to community bank operations, they actually put community banks at a disadvantage when compared with larger institutions. Large banks' branch networks generally avoid direct CRA examination. And, such banks can afford to hire staff dedicated to CRA compliance. In contrast, smaller banks often simply have existing employees take on these responsibilities.

This outcome contradicted the prediction by the primary author of the 1977 Act, Chairman William Proxmire (D-Wisc.), that CRA would not impose additional paperwork on banks. "We would all be happier to have minimal regulations; but on the basis of experience in those two States, the regulations would be very minimal, and would not require additional reporting."[4]

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[2] *Regulatory Burden; The Cost to Community Banks.* A study prepared for the Independent Bankers Association of America by Grant Thornton.

[3] *Materials on the Regulatory Burden,* submitted by for the Independent Bankers Association of America to the Subcommittee on Financial Institutions, Supervision, Regulation and Insurance of the Committee on Banking, Finance and Urban Affairs, June 23, 1992.

[4] Congressional Record S 8960 – June 6, 1977

ICBA is pleased to report that the streamlined examination procedures for smaller banks that the regulators adopted in 1995, and improved in 2007, helped move CRA compliance costs toward Chairman Proxmire's original intent. The current tiered CRA examination system is less burdensome, more flexible, and recognizes the unique challenges of rural areas by expanding the definition of "community development" activities in underserved non-metropolitan middle-income markets.

These changes to the CRA examination procedures have not changed the statutory requirements imposed under the Act. Community banks are still required to invest in their communities – which they would do regardless of the Act. However, the paperwork requirements are substantially reduced. Performance, not production of paper, is the examiners' focus.

The agencies began the process of reforming CRA in 1993 when President Clinton directed them to review their CRA examination procedures with an eye to shifting their emphasis to performance rather than paperwork. At that time, CRA performance evaluations had degenerated into form over function, and many bankers and community groups were ready for a change. In a Herculean effort, the agencies, community groups and bankers – including the ICBA – played an active role to overhaul the CRA regulations and examination procedures.

ICBA urged the agencies to recognize the differences between community banks and their larger competitors and adopt a tiered system with streamlined examination procedures focused on lending performance for smaller banks.

In August 1993 ICBA proposed that community banks which meet certain criteria be granted a satisfactory rating. These criteria included:

- Makes the majority of its loans locally and has a good loan mix, including commercial, agricultural, real estate, and consumer.
- Has no legitimate, bona-fide, complaints from community members.
- Has a reasonable loan-to-deposit ratio based on peer group analysis and local economic conditions.
- Has no evidence of discriminatory practices.
- Has properly delineated its community.
- Has orally reported to examiners its ascertainment of community needs and community outreach.

In 1995, the federal banking agencies completely revised the CRA examination process. Instead of focusing on the process of compliance, the new rules focused on actual performance. The new rules established a test for smaller institutions – ones with less than $250 million in assets – designed to determine whether they were *actually complying.*

These criteria closely tracked our association's recommendations:

- A reasonable loan-to-deposit ratio.
- Percentage of the bank's lending activity in the bank's service area.
- Distribution of loans to borrowers of different income levels and business and farms of different sizes.
- Geographic distribution of loans within the bank's service area.
- Record of action taken, if warranted, in response to written complaints about the bank's CRA performance.

Bankers quickly concluded that the regulations had succeeded in their basic goal: emphasize performance over paperwork. Under these regulations, examiners look at a bank's *actual performance* – the loans and investments it makes in its community – and not documentation of the bank's *study* of community needs. The revisions streamlined and reduced the paperwork burdens associated with CRA and freed bankers to put their resources – both time and funding – where it counts: on actually performance that benefits their communities.

When the Federal banking agencies adopted these new rules in 1995, they committed to a comprehensive review after five years to make certain that the goal of reducing burden and focusing on performance instead of process were being met. The agencies began their review in 2000 and published an advance notice of proposed rulemaking in July 2001 asking for public comment.

By that time it was clear that the definition of "small bank" required an update. Over time, as banks merged and the idea of one bank stretching from coast-to-coast became a reality – the differences between large banks and small banks became more pronounced. A 2002 Grant Thornton study[5] found that examination costs placed an unfair burden on "large" community banks. According to a survey of community banks, the mean employee cost attributable to CRA (full and part-time employees) was 36.5 percent higher ($115,270 annually) at large community banks than at small community banks ($84,443 annually). In each of two case studies—one contrasting costs for a bank that grew from "small" to "large" bank status, and one contrasting costs for a "small" and "large" bank owned by the same holding company—CRA compliance costs were four or more times greater for large community banks than for small ones.

After reviewing the public comments, the federal banking agencies wrestled with how to adjust the successful tiered review process to update it and found themselves at an impasse. The Office of Thrift Supervision broke the logjam by publishing a final rule raising the size limit for small savings associations eligible for the streamlined exam from $250 million to $1 billion.

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[5] *The High Cost of Community Bank CRA Compliance: Comparison of 'Large' and 'Small' Community Banks.* Grant Thornton, September 16, 2002

In August 2004, the other agencies published a similar proposal, but added a community development test for mid-tier institutions between $250 million and $1 billion in assets. The community development test for mid-tier "intermediate small banks" was intended to meet the demands of community groups that banks demonstrate their commitment to community development while also alleviating some of the burdens and costs associated with the large bank exam assessment. In August of 2005, the FDIC, Federal Reserve, and Comptroller of the Currency adopted a joint final rule along these lines. The OTS revised its rule on March 22, 2007, conforming its rule to the other agencies' by including the community development test for thrifts with assets between $250 million and $1 billion in assets.

Credit Unions Should Not Be Exempt from CRA

While the banking agencies have made effective improvements to CRA examination procedures that apply to banks and thrifts, an important competitor for community banks – the credit union industry – remains completely exempt from CRA.

When Congress enacted CRA in 1977 the vast majority of credit unions served members of a single group with a limited product line. The credit union world has changed substantially since then, with Congress and the National Credit Union Administration expanding credit unions' product line and geographic reach:

- Credit unions have substantial leeway to offer business loans and aggressively skirt the statutory 12.25 percent cap;
- Many credit unions have converted to community charters, making their geographic footprint equivalent to their community bank competitors; and
- A large number of credit unions now serve so many disparate groups that virtually anyone with a pulse can become a credit union customer.
- There is an increasing number of large, full service, credit unions over $1 billion in assets.

As a result of these and other changes, the credit union industry has become a full and direct competitor with community banks. The Congressional Research Service has reported that through credit union service organizations, "credit unions may provide their members with panoply of sophisticated financial services and products that rivals the offerings of banks and thrifts." The CRS report notes that "over the past 30 years, most of the distinctions between credit unions and other depository institutions have been eliminated or reduced because of deregulation; consequently, the justification for the tax exemption for credit unions has been increasingly questioned."[6]

[6] Congressional Research Service. "Should Credit Unions be Taxed?" August 2005.

Today's credit unions have virtually no limit to their customer base; the "common bond" requirement has become meaningless. For example, NCUA gave the Los Angeles Financial Credit Union approval to serve: "Anyone who lives, worships, works in, or attends school in Los Angeles County." This encompasses a county of more than 10 million people and a geographic area larger than the states of Delaware and Rhode Island combined. Other examples abound.

We note that the state of Massachusetts already requires credit unions to comply with the state CRA statute. While Massachusetts has led the way in this area of competitive inequity between community banks and credit unions, we must also point out that credit unions in every state remain exempt from taxation.

In 2005, the Tax Foundation undertook an analysis of the credit unions' Federal Tax exemption.[7] The study calculated that the exemption is worth $2 billion annually. For the average credit union, this meant a return on assets ½ percentage points – 50 basis points – higher than the average bank. Only 6 basis points of the subsidy may be used to lower interest rates. Another 11 "are absorbed by higher labor costs."[8] There is little or no effect on deposit rates or other costs.

A host of other studies round out the picture. A 2005 study by the National Community Reinvestment Coalition determined that banks actually do a better job of fulfilling the credit unions' mission than the credit unions. This study highlighted how banks "consistently exceed credit unions' performance in lending to women, minorities, and low and moderate-income borrowers and communities."[9] A 2003 Government Accountability Office study found that credit unions serve a more affluent clientele than banks. This GAO study concluded that "credit unions overall served a lower percentage of households of modest means than banks."[10]

Another study by the Woodstock Institute concluded that credit unions serve a higher percentage of middle- and upper-income customers than lower-income households.[11] Similarly, a study by the Virginia Commonwealth University concluded that credit unions tend to serve a higher proportion of wealthier households in their customer base.[12]

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[7] "Competitive Advantage: A Study of the Federal Tax Exemption for Credit Unions," by Professor John A. Tatom, Ph.D. Tax Foundation, 2005.
[8] Page 22.
[9] "Credit Unions: True to Their Mission?" National Community Reinvestment Coalition, May 2005. www.ncrc.org.
[10] General Accounting Office. "Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management." October 2003.
[11] Woodstock Institute. "Rhetoric and Reality: An Analysis of Mainstream Credit Unions' Record of Serving Low-Income People. February 2002.
[12] School of Business, Virginia Commonwealth University. A Study on the Comparative Growth of Banks and Credit Unions in Virginia: 1985-1995." August 1997.

Today there are more than 120 credit unions with $1 billion or more in assets , providing sophisticated banking products and services to wealthy and middle-income members.

In one instance, the NCUA acted on these facts. Effective November 27, 2000, NCUA adopted a rule that required all credit unions with a community charter to adopt a Community Action Plan. The rule would have required

> that a community credit union address in either its marketing or business plan or other appropriate separate documentation, such as the strategic plan, project differentiation, etc, how it plans on serving the entire community, including how the credit union will market to the community and what products and services will be offered by the credit union to assist underserved members in the community.[13]

Unfortunately, the membership of the NCUA's board changed soon after the agency adopted the CAP requirements and the rule was repealed. In 2002, JoAnn Johnson – then a board member, now chairman – attempted to justify this action by claiming that credit unions were already serving persons of "modest means." This is easier said than proven. During the 2005 Ways and Means Committee hearing on credit unions' tax exemption NCUA Chairman Johnson and credit union representatives had a difficult time demonstrating that they were meeting their statutory mandate of serving persons of modest means.

ICBA believes that the NCUA had the right idea when it adopted the CAP proposal in October of 2000 and took a giant step backward when it repealed the rule the following year. We strongly recommend that Congress build on the agency's work in 2000 and require credit unions to comply with CRA requirements in the same manner, and with the same asset size distinctions, as banks and thrifts.

Conclusion

ICBA greatly appreciates the opportunity to participate in this important hearing. Community bankers are strongly committed to the goals of the Community Reinvestment Act; community investment and development are at the core of each community bank's mission. We appreciate the valuable improvements that the federal financial regulatory agencies have made in CRA examination procedures. They are an excellent example of constructive change that has reduced the burden of regulation while enhancing its effectiveness. ICBA strongly believes that <u>all</u> federally insured depository institutions should comply with CRA under these improved procedures, including the nation's credit unions.

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[13] NATIONAL CREDIT UNION ADMINISTRATION, 12 CFR Part 701, final rule, effective November 27, 2000, section 5, COMMUNITY CHARTERS, COMMUNITY ACTION PLAN (CAP) (since rescinded).

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Statement of

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Director, Division of Consumer and Community Affairs

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

February 13, 2008

Chairman Frank, Ranking Member Bachus, and members of the Committee, I want to thank you for this opportunity to discuss the Community Reinvestment Act (CRA). Enacted in 1977, the CRA states that federally insured banks and thrifts have an obligation to help meet the credit needs of the communities in which they are chartered, including low- and moderate-income neighborhoods, consistent with safe and sound operations. The act also directs the federal bank and thrift regulatory agencies, including the Federal Reserve, to implement the CRA through regulations, and to examine banks and thrifts to determine whether they meet their CRA obligations.

I serve as Director of the Federal Reserve Board's Division of Consumer and Community Affairs. The division administers the Board's responsibilities for rulewriting and examinations for federal laws involving consumer protection in financial services, including the CRA. We oversee and provide policy direction for consumer compliance and CRA examinations of state member banks conducted by Federal Reserve examiners. Through our national Community Affairs Program, we share knowledge about successful approaches to community development with bankers and other CRA stakeholders. We also analyze and report to the Board on CRA issues that arise in connection with certain applications by financial entities to expand their businesses.

In my remarks today, I will provide some historical context about the CRA, discuss the Federal Reserve's CRA examination program, describe how CRA is considered when evaluating applications, and outline some key challenges we face in ensuring that the CRA remains effective and relevant.

Historical Context of the CRA

Concerns about the deteriorating condition of America's cities, particularly lower-income neighborhoods, led to the enactment of the Community Reinvestment Act in 1977. Many advocates for the passage of this new law believed that this deterioration was fueled by, among other things, limited credit availability. Some blamed the lack of credit availability on mainstream depository institutions, and charged that they were willing to accept insured deposits from households and small businesses in lower-income neighborhoods but unwilling to lend or invest in those same neighborhoods despite the presence of creditworthy consumers.

A number of factors, including an undeveloped secondary mortgage market, the lack of a comprehensive national credit reporting system, more costly credit evaluation methods, and unlawful redlining were all put forward to explain why credit to lower-income neighborhoods was limited at the time of the CRA's passage. At the time, state and federal rules prohibited interstate branching and acquisitions, and even intrastate branching in some cases. These factors reduced competition and the ability of lenders to diversify geographic risk and, taken together, contributed to the concern that banking institutions were not adequately serving the credit needs of some residents of their communities.

In passing the CRA, Congress reaffirmed the long-standing principle that insured depository institutions must serve "the convenience and needs" of the communities in which they are chartered to do business, which included meeting their credit needs. The Bank Holding Company Act of 1956 already required the Federal Reserve Board, when reaching decisions on proposed acquisitions by banks or bank holding companies, to evaluate how well the institutions involved were meeting community needs, consistent with the requirements of safety and soundness. Some argued that this CRA obligation was a *quid pro quo* for privileges such as the

protection afforded by federal deposit insurance and access to the Federal Reserve's discount window.

The CRA is actually one of several laws intended to reduce credit-related discrimination, expand access to credit, and shed light on lending activity. The CRA itself focuses on the provision of credit to low- and moderate-income communities. On the other hand, the Equal Credit Opportunity Act (1974) and the Fair Housing Act (1968) explicitly prohibit discrimination on the bases of race, sex, or other personal characteristics. The Home Mortgage Disclosure Act (1975), which requires the disclosure of mortgage lending and application data, was enacted to increase transparency and to support public and private investment activity.

The debate surrounding the passage of the CRA was contentious, with critics charging that the law would distort credit markets, create unnecessary regulatory burden, lead to unsound lending, and cause the governmental agencies charged with implementing the law to allocate credit. Partly in response to these concerns, the act adopted by Congress included little prescriptive detail. Instead, the CRA simply requires the Federal Reserve and the other federal financial supervisory agencies:

- to encourage federally insured depository institutions to help meet the credit needs of their entire communities, including low- and moderate-income areas, consistent with safe and sound operations;
- to assess their records of performance under the CRA during examinations; and
- to take those CRA records into account when evaluating proposals for expansion.

The law gives the agencies considerable discretion and flexibility to fashion programs and procedures to carry out the purposes of the law, to issue implementing regulations that include measures of performance, and to modify those regulations in response to changing

markets. This flexibility has contributed to CRA's relevance and adaptability through times of rapid economic and financial change, and widely differing economic circumstances among neighborhoods.

CRA Regulations and Examinations

CRA examinations have been at the core of our efforts to encourage state member banks to help meet the credit needs of their communities since the first set of CRA regulations was adopted in 1978. We have adjusted the CRA examination process over the years on our own initiative and in response to statutory changes, some of which have been significant.

The 1978 CRA regulations focused CRA examinations on factors related to the process used by institutions to determine the credit needs of their community and to their responses to those needs. The evaluation of an institution's performance was based on the application of twelve assessment factors, including the ascertainment of community credit needs, marketing and the types of credit offered, the geographic distribution of loans, the record of opening and closing branches and providing services, participation in local community development projects, and the financial and legal capability of the institution. To avoid allocating credit, and to allow for creativity by institutions in meeting the varying credit needs of their localities, these regulations did not require specific products to be offered or attempt to prescribe any particular required level of lending. Further, all covered institutions were subject to the same set of rules and assessment factors, without differentiating based on size or location.

Until the passage of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) in 1989, CRA examinations culminated in a confidential examination report and rating that was provided only to the bank or thrift. FIRREA amended the CRA to require the agencies to publicly issue CRA ratings and written performance evaluations describing

institutions' CRA performance using facts and data to support the agencies' conclusions. This requirement makes CRA examinations unique among other supervisory activities, which are confidential matters. In the absense of any statutory authority for the agencies to address poor CRA performance through enforcement actions, public disclosure of CRA ratings and evaluations may well serve to motivate an institution to improve a weak CRA record, or encourage an institution to maintain an otherwise favorable record.

Also in FIRREA, Congress amended the CRA to require the current four-tiered CRA examination rating system with descriptive performance levels of Outstanding, Satisfactory, Needs to Improve, or Substantial Noncompliance in place of the five-tiered system in use by the agencies at the time. In response to these statutory changes, the agencies amended the CRA regulations and examination procedures accordingly to prescribe the method for assigning an institution's rating, and preparing and issuing public evaluations. Each rating encompasses a wide range of potential performance outcomes. For state member banks evaluated by the Federal Reserve over the past six years, 15.8 percent received an Outstanding rating, 83.7 percent earned a Satisfactory rating, and .5 percent were assigned either Needs to Improve or Substantial Noncompliance CRA ratings.

The CRA regulations were substantially revised again in 1995, in response to a directive to the agencies from President Clinton to review and revise the CRA regulations to make them more performance-based, and to make examinations more consistent, clarify performance standards, and reduce cost and compliance burden. This directive addressed criticisms that the regulations, and the agencies' implementation of them through the examination process, were too process-oriented, burdensome, and not sufficiently focused on actual results. The agencies also changed the CRA examination process to incorporate these revisions.

Examination Approaches

Since 1995, the agencies' CRA regulations have tailored the examination approach to the institution's size or its business operations. Currently, for depository institutions with assets greater than $1.061 billion[1] CRA performance is evaluated based on a lending test, an investment test, and a service test. Under the lending test, an institution's lending performance is evaluated on both quantitative and qualitative factors, and the outcome is generally weighted to count for 50 percent of the institution's overall CRA rating. An institution with a Needs to Improve or Substantial Noncompliance rating on the lending test cannot be assigned an overall passing grade for CRA.

Under the investment and service tests, investments benefiting low- and moderate-income individuals and neighborhoods, or distressed or underserved rural areas are assessed, and services to the entire community, including low- and moderate-income individuals and neighborhoods, are reviewed. An institution's performance in making investments and providing services each accounts for 25 percent of the institution's overall rating. Examiners also weigh the innovativeness of the institution's community development lending, investment, and service programs and activities.

Institutions with assets between $265 million and $1.061 billion are designated as "intermediate small institutions" and are evaluated on their record of lending in low- and moderate-income areas and to lower-income people in the institutions' assessment areas. A community development test is also included in the review of these institutions. This test encourages institutions to engage in a range of community development lending, investment, and services but provides them flexibility to target their resources where they will produce the most

[1] As part of regulatory changes made in 2005, the agencies adjust the asset size thresholds for small and large institutions annually on the basis of changes in the Consumer Price Index. The asset sizes in this statement reflect the thresholds in effect for 2008. See 12 CFR 228.12(u).

community benefit. The designation of "intermediate small institutions" was the product of a regulatory change that followed from a 2002 interagency review of the effectiveness of the 1995 regulatory changes.

Currently, institutions with assets less than $265 million are evaluated primarily on their lending performance in their communities, including low- and moderate-income areas and populations. Given their more limited capacity and resources, small institutions are not expected to engage in more complex community development activities.

The regulations also provide a different evaluation method for institutions designated as "wholesale" or "limited purpose." This examination method focuses on evaluating an institution's community development lending, services, and investments. In addition, any institution can opt to develop a CRA "strategic plan" and be evaluated under that plan, if it is approved.

During the CRA examination, examiners assess an institution's performance within the context of all relevant factors, such as its business strategy, capacity and constraints, the overall economic conditions and credit needs in its assessment area[2], and the availability of community development activities appropriate to the institution. This performance context recognizes that while insured depository institutions have an affirmative obligation to meet the credit needs of the communities in which they are chartered, they must engage only in activities that are safe and sound.

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[2] Under the CRA regulations, a bank must delineate an assessment area or areas that correspond to commonly recognized metropolitan areas or political subdivisions that surround its main office, branches and deposit-taking ATMs in which the bank bas originated or purchased a substantial portion of its loans. See 12 CFR 228.41. The assumption underlying this approach is that branches, and certain ATMs, serve as the deposit-taking arm of the institution and, therefore, define its community for reinvestment purposes. The assumption also encompasses one of Congress' findings in passing the CRA--that regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business. See 12 USC 2901.

Public Involvement

To ensure a broad and balanced CRA assessment, examiners routinely conduct interviews with local business people, government officials, housing and consumer advocates, realtors, trade association representatives, and many others. The purpose of these interviews is to obtain information about, among other things, general credit needs of the community, the availability or the lack of availability of credit, and how different institutions respond to those credit needs. The comments of these individuals are factored into the examiners' CRA rating.

The community also has other opportunities to participate in the CRA evaluation process. The public can offer comments on an institution's CRA performance and those comments are publicly available. Examiners review the institution's public comment file and take comments into account when evaluating an institution's overall CRA performance. To assist the public, and to encourage public comments, the agencies inform the public every calendar quarter of upcoming CRA examinations.

Illegal Lending Discrimination

Under the CRA regulations, the Federal Reserve's evaluation of a bank's CRA performance takes into account evidence of illegal lending discrimination or other illegal credit practices.[3] Federal Reserve examiners conduct a fair lending review concurrently with, or close in time to each CRA evaluation, and the findings from that review are factored into the CRA evaluation.

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[3] In addition to findings involving discrimination in violation of the Equal Credit Opportunity Act and the Fair Housing Act, other violations that affect the evaluation of a bank's CRA performance include: violations of Section 32 of the Home Ownership and Equity Protection Act (HOEPA), which addresses "high cost" mortgages; violations involving kickbacks and unearned fees under Section 8 of the Real Estate Settlement Procedures Act (RESPA); violations of the Truth in Lending Act's (TILA) provisions regarding a consumer's right of rescission; and unfair or deceptive practices in violation of Section 5 of the Federal Trade Commission Act.

The public CRA performance evaluation summarizes a bank's record of complying with the fair lending laws, and states whether violations were found and, if so, whether they negatively affected the bank's overall CRA rating. Pursuant to the CRA regulations, various factors relating to the violations will be considered when determining the bank's assigned CRA rating, including the nature and extent of discriminatory practices, the policies and procedures in place to prevent such practices, and corrective action taken by the bank. A finding of discrimination could result, for example, in a downgrade of the rating otherwise earned to either Needs to Improve or Substantial Noncompliance, or from Outstanding to Satisfactory. However, if the discrimination was isolated, or occurred despite the existence of generally effective internal controls to prevent such practices, the existence of the violation may be reported in the public CRA performance evaluation without actually lowering the bank's CRA rating. This reflects the fact that each CRA rating category encompasses a range of conduct and performance. An inadvertent or isolated violation may not be sufficient to move the bank's overall performance assessment out of that range and into a lower rating category.

Implementation

One of the implementation issues faced by the agencies in the examination process has been addressing questions from examiners and the industry alike about the specific dollar level of lending or investments that an institution needs to qualify for a particular CRA rating. The agencies have not provided that level of specificity for several reasons. First, introducing specific quantitative expectations into the CRA evaluation would constitute credit allocation, which is not a part of the statute. Second, any prior attempts by the agencies to introduce ratios, percentages, or market share comparisons into the CRA evaluation process have been met with strong opposition from the industry and consumer advocates alike about whether to stipulate

such a benchmark and, if so, the appropriate figure,[4] and widely divergent views from covered institutions of different sizes operating in different markets. Third, specifying numerical targets could serve as a strong disincentive by an institution to do more, even when the institution has the capacity. Fourth, numerical targets could be contrary to the safe and sound operation of the institution. Instead, the agencies have historically evaluated each institution's record in the context of its individual circumstances, and the circumstances of the community it serves.

The frequency of CRA examinations is determined by, and in some cases limited by, an institution's size and prior CRA rating. The Federal Reserve conducts CRA examinations of state member banks with assets greater than $250 million and favorable ratings on a two-year cycle; a one-year cycle applies if the rating is less than satisfactory. By statute, the examination cycle is significantly longer for banks with assets less than $250 million and ratings of Satisfactory or Outstanding. Under the CRA, the agencies are prohibited from examining these entities for CRA purposes any more frequently than every four or five years if the bank is rated Satisfactory or Outstanding, respectively, for CRA. Congress added this limitation to the statute as part of the Gramm-Leach-Bliley Act in 1999 as a way to reduce regulatory burden. We may, however, examine these banks on shorter cycles if the rating is below satisfactory, and under other very narrow and limited exceptions.

The Federal Reserve has had a dedicated consumer compliance and CRA examination program in place since the late 1970s. The program is staffed with specialized examiners at each Federal Reserve Bank who are responsible for conducting consumer compliance and CRA

[4] For example, the agencies' 1993 proposal to revise the CRA regulation introduced a performance test that called for a "reasonable" loan-to-deposit ratio for small institutions with assets below $250 million, and provided a rebuttable presumption that 60 percent would be considered reasonable. The public comments received on that part of the proposal argued for either higher or lower values, or none at all. This led the agencies to ultimately conclude that setting a precise number would not only be daunting but, more importantly, counter-productive. The final regulations contain a loan-to-deposit test for small institutions, but do not specify a numerical proxy for "reasonable."

examinations. These examiners receive special training in CRA at schools administered by the Board, and in regional or Reserve Bank classes, which sets them apart from examiners solely concerned with safety and soundness matters.

CRA and the Application Process

Under the Bank Merger Act and the Bank Holding Company Act, the Federal Reserve is required to take into account a number of factors when it reviews banking organizations' applications for expansion. These include the competitive effects of the proposal in the relevant markets; the financial and managerial resources and future prospects of the bank holding company and its banking subsidiaries; and the convenience and needs of the communities affected. The public is notified when applications are filed and interested parties may comment on any of the statutory factors. Sometimes members of the public, advocacy organizations, and other interested parties comment in order to "protest" applications when they have concerns that an approval might diminish services to communities. In fact, the Federal Reserve sometimes receives numerous comment letters on applications by large banking organizations. Substantive comments are always considered in the evaluation of the proposal. The Board expects an applicant to have a solid program for meeting its CRA responsibilities in place and working well when it files an application.

In evaluating a banking application that is the subject of a protest, Federal Reserve staff consider the entire supervisory record of the institutions involved in the proposed transaction. Applications are evaluated on a case-by-case basis, but in every instance the following information is taken into account, as applicable:

- CRA and compliance examination reports;
- The bank's record of lending to small businesses and small farms;

- The bank's record of making home mortgage loans based on Home Mortgage Disclosure Act (HMDA) data reported by the financial institution;
- Recent actions the bank has taken to improve CRA and/or compliance performance weaknesses;
- Enforcement actions, and/or any identified fair lending referrals or investigations;
- Comments submitted by interested parties and the financial institution's response to those comments; and
- Any additional information requested by the Federal Reserve from the applicant to complete the record or to address concerns raised by the public.

When information cannot be effectively obtained from written comments, other sources, or supervisory processes, the Federal Reserve holds public meetings to gather input from the community. Transcripts of all public meetings held since 1998 are available on the Federal Reserve Board's website.

Since 1988, there have been more than 13,500 applications for the formation, acquisition, or merger of bank holding companies or state-member banks reviewed by the Federal Reserve Board. Over this time, twenty-five applications have been denied, with eight of those failing to obtain Board approval involving unsatisfactory consumer protection or community reinvestment issues. The low incidence of denied applications is attributable to the fact that institutions seeking to expand their operations are typically in sound financial and managerial condition and have good supervisory and CRA records. Management of applicant institutions has generally recognized the benefit that strong community investment programs offer. Further, institutions with poor records that have nonetheless submitted an application have generally withdrawn their application after discussions with Board staff.

The supervisory and public scrutiny that the CRA brings has prompted many banks to create specialized CRA business units within their organizations. The cases in which the Board has denied an application on CRA grounds have sent an unmistakable message that it is crucial to have a satisfactory record of CRA performance *before* applying to expand. Institutions likely understand that the Board will not allow promises of better future performance to compensate for inadequate current performance.

Current CRA Challenges

The thirty years since the CRA's enactment have been marked by dramatic changes in the financial services markets. The banking industry and, more broadly, the financial services industry have undergone a great deal of structural change, some with important implications for the potential effectiveness of the CRA. Since 1979, consolidations and mergers have decreased the number of banks and thrifts subject to the CRA by nearly 10,470, or 51 percent, with a loss of more than 3,120 institutions since 1995. At the same time, the surviving larger organizations generally experienced an expanded CRA footprint since they became responsible for CRA activities in the geographies previously covered by the institutions that were acquired. Even with all the consolidation, the banking industry remains diverse and robust. Although larger institutions hold a dominant share of the assets of the banking industry, many thousands of small and locally based institutions continue to serve the credit and deposit needs of their communities. Moreover, the banking industry continues to have room for new participants--approximately 1,870 banking institutions have entered the market since 1995.

As banks have significantly expanded their role in the broader financial services industry, overall competition in the marketplace has increased, and the lines between banks and nonbanks have blurred. Unlike in 1977, banks and holding companies now engage in interstate banking

and nontraditional lines of business and thus provide consumers more choices from which to obtain financial services. Nonbanks offer many traditional banking services, including a full range of credit services, while banks have become sources for securities and insurance products. Further, mortgage banking has evolved into an industry in which a very large number of lenders operate independently from banking organizations and rely on worldwide capital markets for their funding.

Simultaneously, advances in technology have redefined nearly every aspect of the industry--from loan underwriting to product delivery--with computers changing these and many other processes in ways unimaginable two decades ago. For example, the Board's August 2007 *Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit* discusses the revolutionary role played by one such technology, credit scoring. Credit scoring has provided a mechanism for realizing loan-processing and production efficiencies, and engaging in systematic risk-based pricing. Similarly, the Internet has enabled the collection of deposits and the disbursement of loans from and to virtually any location without bricks-and-mortar premises and allowed many consumers to save time and effort in credit shopping.

CRA-related activities of covered institutions have benefitted their communities, especially lower-income neighborboods. For example, overall mortgage loans to borrowers in lower-income neighborhoods by CRA covered institutions in their CRA assessment areas has increased from 13.4 percent of their assessment area mortgage loans in 1994 to 16.2 percent in 2006. This change suggests a greater focus on CRA-related lending by covered institutions. Research by Federal Reserve staff has found that such gains in lending appear to have had a tangible beneficial effect on local communities. The research found that the gains in homeownership rates from 1990 to 2000 were higher for neighborhoods deemed to be lower

income under the CRA rules than similar neighborhoods that were not.[5] Further, Federal Reserve research suggests that CRA covered institutions have been able to extend such loans profitably and that the performance of such loans is about the same as that of other mortgage loans.[6]

But, we still face difficult and complex challenges relating to the CRA's continued relevance. I'd like to talk about a couple of them today.

One issue involves the coverage of the law itself. Because of changes in the industry, and the fact that many financial transactions are now being offered by nonbank service providers and other types of financial entities, some have suggested extending the coverage of the CRA beyond insured banks and thrifts. On the one hand, insured banks and thrifts institutions remain the primary conduit for many financial services, including the full range of deposit account services, and continue to provide capital to communities. For example, the Federal Reserve's *2004 Survey of Consumer Finances* reveals that 77 percent of all households with at least one financial relationship identified a commercial bank or a thrift institution as their primary source for financial services, with 93 percent of those respondents acquiring services from a local bank or thrift--that is, one that is located within thirty miles of where they live. Further, the Federal Reserve's *2003 Survey of Small Business Finances* indicate that 88 percent of all small businesses identified a commercial bank or thrift as their primary source for financial services, again with 96 percent of those respondents acquiring these services from a local bank or thrift.

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[5] Robert B. Avery, Paul S. Calem and Glenn B. Canner, "The Effects of the Community Reinvestment Act on Local Communities," paper presented at the Federal Reserve System Conference titled "Sustainable Community Development: What Works, What Doesn't and Why," March 2003.

[6] The Performance and Profitability of CRA-Related Lending Report by the Board of Governors of the Federal Reserve System, submitted to the Congress pursuant to section 713 of the Gramm-Leach-Bliley Act of 1999, July 17, 2000.

On the other hand, institutions not covered by the CRA have become more active over time in the financial services market. Federal Reserve-sponsored surveys of small businesses and consumers document the increased use of nondepository institutions for financial services by small businesses and households. Small businesses surveyed between 1993 and 2003 reported a 14 percent increase in the use of nondepository institutions, and the percentage of households surveyed between 1992 and 2004 that used a nondepository institution nearly doubled to more than 60 percent.

However, expanding CRA's coverage to nondepository financial institutions would raise several issues. CRA is based on a fundamental *quid pro quo;* the insured banks and thrifts covered by the CRA receive special benefits, such as deposit insurance, and as a consequence are expected to help meet the credit needs of their local communities, including the low- and moderate-income areas. Determining which, if any, additional types of entities to cover and why, and what the scope of their responsibilities should be given that there is no area from which they take deposits, would need to be carefully studied and considered. A determination would also need to be made about an appropriate rating and public evaluation scheme for any newly covered entities, and how the law would be administered and by whom. The nexus between deposit-taking in geographic areas and lending in those areas, and the *quid pro quo* discussed above, have given the statute a strong conceptual underpinning. It would seem desirable that any expanded coverage have foundations of similar strength.

The agencies have grappled with the issue of the CRA and nondepositories when presented with the question of how to consider loans, investments and services offered by affiliates within a bank's corporate structure that are not covered by the CRA. At present, loans, investments, and services provided by a holding company affiliate are considered at the

discretion of an affiliated bank as part of its CRA evaluation, even though the affiliate itself has no CRA obligation. The agencies' regulations prevent a bank from "cherry-picking" only the most favorable affiliate loans or investments.[7] However, the CRA does not provide the agencies with the authority to impose a CRA obligation on entities that are not insured depository institutions. On the other hand, refusing to consider activities done by an affiliate or subsidiary, simply because of the choice of corporate structure, raises its own problems.

Another issue concerns whether the traditional notion of community needs to be revisited to ensure we have an appropriate CRA evaluation model for addressing how business is conducted today. The local geographical and deposit-taking rubric of the CRA statute was reflective of, and consistent with, the way financial markets operated in the 1970s. Local institutions with a brick-and-mortar presence did business in relatively confined geographic areas and generally made loans to local residents and businesses. Branching, both intrastate or interstate, was generally restricted, limited, or prohibited altogether. Thus, an institution's assessment area for CRA purposes was relatively easy to identify, and consistent with the community it served.

Today, many institutions do business regionally and nationally, and use multiple avenues--brokers, mail, Internet transactions, and loan production offices for instance--to make loans in, and sometimes to solicit deposits from many communities without maintaining traditional, full-service deposit-taking branches that trigger CRA responsibilities there. The implication is that these institutions may have a significant presence in some communities through means other than branches or ATMs but are not required to meet the needs of low- and

[7] Under the CRA regulations, if a bank elects to have the agencies consider loans within a particular lending category made by one or more of the bank's affiliates in a particular assessment area, the bank shall elect to have the Board consider all the loans within that lending category in that particular assessment area made by all of the bank's affiliates. See 12 CFR 228.22(c) and Federal Financial Institutions Examination Council Interagency Questions and Answers Regarding Community Reinvestment; §___.22(c)(2)(ii) – 1, 66 Federal Register 36634.

moderate-income areas in those communities. Expanding the concept of "community" beyond geographies containing deposit-taking offices and ATMs, however, would require reexamining the CRA's original purpose.

The agencies have made some adjustments on a case-by-case basis, consistent with their authority, to enable institutions that do a substantial portion of their lending outside their assessment areas through nontraditional channels to have that lending considered for CRA purposes. For example, an institution's loans to low- and moderate-income persons and small business and small farm loans outside of its assessment area(s) will be considered, but only if it has adequately addressed the needs of borrowers within its assessment area(s). Moreover, such loans will not compensate for poor lending performance inside the assessment area(s).[8] At the present time, the assessment area construct appears adequate to delineate the relevant communities of most institutions. Limitations of the CRA's current local geographic framework may become more acute as the market continues to evolve more toward the use of nontraditional product delivery methods and the contours of what are considered local communities become blurred.

Conclusion

The CRA is one of several laws enacted to ensure that consumers and communities have access to financial services and products regardless of location or demographics. Congress sought to achieve that goal not by imposing rigid, prescriptive rules but by charging regulators to use flexible standards that could change, as needed, over time. The agencies look to market developments, learn from data and research as they emerge, and solicit input from financial institutions, consumers, and advocates when assessing how their CRA regulations and

[8] See 12 CFR 228.22(c)(2) and Federal Financial Institutions Examination Council Interagency Questions and Answers Regarding Community Reinvestment; § ___.22(b)(2) and (3) – 4.

examination process should evolve. At the same time, while the agencies have a responsibility to update their CRA regulations and examination procedures as needed, the agencies must respect the boundaries on their authority established by Congress in the language, structure, and purposes of the statute.

I appreciate this opportunity to appear before the Committee and welcome any questions you may have.

TESTIMONY OF

LAWRENCE K. FISH
CHAIRMAN, CITIZENS FINANCIAL GROUP

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ON

THE COMMUNITY REINVESTMENT ACT:
THIRTY YEARS OF ACCOMPLISHMENTS, BUT CHALLENGES REMAIN

FEBRUARY 13, 2008

Mr. Chairman, Ranking Member Bachus, and Members of the Committee. I am Lawrence K. Fish, Chairman of Citizens Financial Group.

I appreciate the opportunity to testify here today to discuss my personal views, based on over 35 years in the banking business, of the Community Reinvestment Act. In my opinion, this Act has brought tremendous benefits to our entire nation.

Specifically, I believe the Community Reinvestment Act:

1. corrected a previous wrong;

2. has been good for our communities;

3. has been good for business, and

4. can be used as a guiding principle as policymakers consider how to ensure that the rapidly changing financial services industry appropriately contributes to the economic development of all our communities and our nation in the future.

First, the CRA helped right a previous wrong by addressing a practice common in the banking industry in the 1960s and 1970s known as redlining -- denying credit to people based on their neighborhood, race, marital status, last name and other indicators that served as false proxies for "too risky." Redlining was racist, sexist, deeply unfair and, as our industry would later learn, bad business.

The CRA ended this practice. By obligating banks to pursue lending opportunities within their local service areas, it prevented them from taking a community's deposits while ignoring its needs. In the 1990s, meeting strict new compliance tests for a bank's lending, investment and service activities became a prerequisite for approval of mergers and acquisitions. As the merger market intensified, so too did banks' attention to the CRA.

Second, the CRA has been good for our communities. In the span of just one generation, the law has dramatically improved America's previously-underserved cities and neighborhoods. Since 1977, more than $1.5 trillion has been lent for community development. And as regulated-bank mortgage lenders ventured into underserved neighborhoods, small-business lenders followed. In 2005, nearly $11.6 billion worth of small loans were made to business owners in low-income areas, up from $8.2 billion in 1996. Together, home and business ownership build immense social capital. They begin a cycle of wealth creation, neighborhood stability -- even educational achievement. Seen this way, CRA-generated ownership has helped provide an economic corollary to the Civil Rights Act.

Third, and this may come as a bit of a surprise to some of you coming from a banker like me, I believe the CRA has been good for business.

Citizens Financial Group has built a highly successful business around these emerging markets. In the last 15 years, we've grown from the sixth-largest bank in the nation's geographically smallest state to the eighth-largest bank in the United States with over $160 billion in assets. Based in Providence, R.I., we have branches in 13 states. This growth took place not in spite of our commitment to the CRA, but because of it. We now speak more than 70 languages at our branches. Many of these branches are in markets that we might not have entered without the CRA.

Apparently other financial institutions have had similar results. According to the Federal Reserve, 98 percent of large residential lenders reported that their CRA loans were profitable. Within that group, 24 percent found them as profitable as or more profitable than conventional loans. Unexpectedly, banks came to see CRA communities as emerging markets.

Finally, the question is "Where do we go from here?"

Thirty years ago -- and last year was the 30th anniversary of the CRA -- no one could have expected the vast structural changes that have taken place in the financial services industry. And likewise we can not precisely predict or anticipate the changes ahead.

The Department of the Treasury recently renewed a far-reaching effort, seeking public input, to improve the overall financial regulatory structure to deal with the vast changes in the industry. We understand Mr. Chairman, from your public comments, that this is also a priority of yours, one with which I wholeheartedly agree.

This is likewise an opportune time for policymakers to consider modernizing community reinvestment requirements using the CRA as a guiding principle. The financial services

industry has changed significantly over the past 30 years, and it is an appropriate moment to consider how the opportunities and benefits created by CRA might be extended.

Let me give two examples. First, let's consider giving more dynamic CRA credit for successful programs in financial literacy. Financial literacy is not just about having knowledge concerning financial products and services, it's about how to access them. Second, we should consider expanding CRA participants to include credit unions. Credit unions operate in their communities, and are regulated, in a manner quite similar to banks. Given their number and total assets, it is logical that CRA benefits and opportunities be extended to them as well.

I make these recommendations because the CRA has convinced me that when businesses invest in underserved communities, they are much more likely to return to health. As we commemorate its 30th anniversary, we should not only celebrate the Community Reinvestment Act, but also consider widening the circle of opportunity it creates.

Thank you again for the inviting me to testify, and I would be pleased to answer any questions.

Statement

of

Ronald A. Homer
Chief Executive Officer
Access Capital Strategies LLC

"The Community Reinvestment Act: Thirty Years of Accomplishments, but Challenges Remain"

House Committee on Financial Services
U.S. House of Representatives

February 13, 2008

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Chairman Frank, Ranking Member Bacchus and Members of the Committee

Good morning. I am particularly honored and pleased to have the opportunity to testify before you today.

Background

Since 1997, I have been the CEO of Access Capital Strategies LLC (Access Capital), a registered investment adviser. Access Capital's mission is to create a double bottom line return by investing in debt securities that support community development activities serving low and moderate income individuals and communities across the U.S.

These activities include investments in homeownership, affordable housing, education, community health centers and small businesses. Access Capital currently manages more than $700 million in this strategy from 120 banks and 10 other investors that include insurers, foundations, public pension funds and state reserve funds. These investments have been made in 46 states, the District of Columbia and Guam.

Access Capital does not invest in sub-prime mortgages, specialized investment vehicles (SIVs), collateralized debt obligations (CDOs), private label mortgage backed securities, home equity loans or loans for second homes or vacation properties.

I am also the Vice Chair of the Initiative for a Competitive Inner City (ICIC), a national not-for-profit organization founded in 1994 by Harvard Business School Professor Michael Porter, to focus research on market-based opportunities in inner cities that create jobs and income for its residents.

Prior to co-founding Access Capital, I was the CEO of a community bank located in Boston for more than thirteen years. During that time I served on The Federal Reserve Board Consumer Advisory Council and was the founding chair of the American Bankers Association's Center for Community Development. As a result of my experience, I was an active participant and gave a number of testimonies before this body, in the

dialogue between the regulators and the banking industry regarding the revisions made to the Community Reinvestment Act regulations in 1995.

These revisions, with some modifications, form the basis for the CRA performance based evaluations carried out by bank regulators today. Therefore, I am especially appreciative that you have invited me back some thirteen years later to share with the Committee my observations and opinions on this matter.

CRA's role in increasing access to credit, investments and services in underserved communities

My experiences as a banker, businessman, investor and advocate are consistent with the research findings of Harvard's Joint Center for Housing Studies "The 25th Anniversary of the Community Reinvestment Act: Past Accomplishments and Future Regulatory Challenges". Indeed had many of its recommendations been heeded, the magnitude of the problems created by the unchecked expansion of the sub-prime market in low and moderate income communities may have been averted or mitigated.

Since the adoption of performance based evaluations, CRA has provided significant incentives for CRA-regulated institutions to expand the provision of credit to lower income and/or minority communities where those institutions maintain deposit-taking operations. As a result of these regulations, CRA-regulated lenders have consistently made more conventional, conforming prime home purchase loans to CRA-eligible borrowers than out of area lenders or noncovered organizations.

HMDA data shows that the CRA-eligible share of conventional prime lending to blacks is 20 percentage points higher for CRA-regulated lenders operating in their assessment areas than for independent mortgage companies. For Hispanics, the equivalent gap is 16 percentage points.

These statistics are particularly important given the estimates that between 30 to 50 percent of these populations have opted for sub-prime loans even though they could have received a conforming conventional prime loan. It is reasonable to conclude that without CRA the fallout from foreclosures in some neighborhoods would be even more dramatic.

Are current examination criteria sufficient?
While I have been out of the banking industry for more than 10 years, the nature of our current business requires us to work with a vast range of banks in preparation for their regulatory exams. For the most part, the examination criteria are adequate however one suggested reform would be to build upon the CRA's traditional mortgage lending focus by expanding assessment areas to cover a larger share of lending by banking organizations. Federal regulators should be encouraged to consider expanding assessment area definitions to include loans made by CRA-regulated entities outside of the areas where they maintain deposit-taking branches.

The current exam criteria place all of the emphasis on lending and investment activity in a bank's assessment area. Given the changes in the banking and mortgage industries, the use of technology in deposit gathering and mortgage lending, more examination should be given to CRA activity across its lending footprint. In particular, banks should also be evaluated on the lending activities of their affiliated mortgage companies.

Some of the sub-prime lending abuses may have been mitigated if banks had been evaluated over the past five years on the ratio of their conforming conventional prime lending to sub-prime lending in low and moderate income communities through their entire lending footprint as opposed to limiting this evaluation to activity in their respective assessment areas.

Adequacy of the enforcement mechanism
Over the last five years, I have noticed a waning of interest on the part of banks in seeking CRA lending and investment opportunities. I believe that this may reflect the longer exam cycles, less consolidation in the industry and lower intensity of enforcement by the regulators including grade inflation in ratings. Additional regulatory oversight by the legislative branch along with a change in the attitude of the executive branch may improve both enforcement and the flow of capital. The fallout from sub-prime foreclosures may also cause more attention for the need for responsible credit products and alternatives. Perhaps a more aggressive use of CRA ratings in the approval of branch expansion and business line expansion may be considered.

The role of public comment
Public comment has played an important role in developing large-scale CRA commitments from very large banks. However, more emphasis should be

given to a bank's ongoing performance as well as some reward for sustaining an outstanding CRA rating over multiple exam cycles. This may encourage mid-sized banks to be less scrutinized by advocacy groups allowing them to conduct a more sustained CRA effort.

Changes in the structure of the financial services industry

The fact that loans made by CRA-regulated institutions in their designated assessment areas as a percentage of all loans have declined has several implications. First, a large and growing share of the mortgage lending industry such as independent mortgage companies, finance companies, and credit unions falls entirely outside the CRA's regulatory reach. Even among CRA-regulated banking organizations, the fastest growth has been in out-of-area lending, or lending that takes place outside the markets where these organizations maintain deposit-gathering branches, and therefore is not subject to the CRA examination process.

In addition, many of these banking organizations facilitated the dramatic growth of the sub-prime market through their investment banking operations and through the purchase and sale of exotic mortgage related securities.

Given the sub-prime debacle and its impact on the overall economy, federal regulators should be encouraged to expand its CRA examination to all of the mortgage related lending activities of banks. In addition, Congress should consider expanding the CRA to include the residential mortgage lending operations of a more diverse set of organizations playing an important role in lending to lower income people and communities.

Adequacy of the federal banking agencies' examination of discriminatory, predatory and illegal lending

Since I am no longer directly involved in this process, it is difficult for me to give a fact-based opinion. However, it appears to me that most of the known abuses have been from non-regulated entities and the best preventative measure would be an expansion of the number of entities that are subject to regulatory examination.

Factors that influence the effectiveness of CRA

The law has been effective when and where applied. In my opinion, the biggest factor in the effective implementation has been in having a well-vetted and shared clarity of scope, purpose and goals of the ACT coupled

with an effective and constant communication among the stakeholders regarding the progress made in achieving the goals.

Conclusion

Chairman Frank and distinguished members, I thank you for the opportunity to participate in today's hearing. From my company's name you can tell that we believe that the efficient assess to capital is essential to the healthy development of a community. To that end, I commend your leadership on these important matters and we stand ready to assist in its implementation.

For Release Upon Delivery
10:00 a.m., February 13, 2008

TESTIMONY OF

ANN F. JAEDICKE

DEPUTY COMPTROLLER FOR COMPLIANCE POLICY

OFFICE OF THE COMPTROLLER OF THE CURRENCY

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

OF THE

U.S. HOUSE OF REPRESENTATIVES

FEBRUARY 13, 2008

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

INTRODUCTION

Chairman Frank, Ranking Member Bachus, and members of the Committee, I am Ann Jaedicke, Deputy Comptroller for Compliance Policy, at the Office of the Comptroller of the Currency (OCC). I am pleased to appear before you today to discuss the Community Reinvestment Act (CRA) and the effectiveness of this law over the past three decades.

CRA began with a seemingly simple concept -- banks that take deposits from the local community where they are chartered have an obligation to help meet the credit needs of that community. Despite that modest goal, the original bill as introduced by Senator Proxmire was opposed by many on the grounds that it would effectively allocate credit to particular areas, substitute the judgment of the government for that of lenders in how best to meet the demand for credit, and undermine the safety and soundness of depository institutions subject to CRA. The proponents of the legislation prevailed, however, and CRA became law.

We are now in the thirty-first year since the CRA was enacted. Although the law has had its measure of criticism, more often than not the CRA has been praised as a constructive and creative response to the disinvestment faced by many, primarily urban, neighborhoods at the time the law was conceived. In our view, CRA has proven in the intervening years to have been a powerful force in effecting positive change by helping to

improve conditions in underserved and economically depressed urban and rural communities throughout the country.

This hearing offers an excellent opportunity to reflect on the CRA -- and to discuss the challenges we face going forward. To further this discussion, we offer the following perspectives:

- First, the CRA has proven to be a remarkably effective and resilient piece of legislation and has provided the federal banking agencies with the flexibility they need to respond to changing circumstances and community needs.

- Second, the CRA has acted as an incentive for insured depository institutions to provide billions of dollars in home loans, small business and farm loans, and community development investments and services in communities across the country.

- Third, CRA lending and investments have proven to be safe, sound, and generally profitable.

- And, fourth, there are opportunities to improve CRA going forward to respond to changes in financial markets. Among other things, revisions to the interagency CRA regulations could help address disinvestment faced by some middle-income communities, as well as low- and moderate-income communities, as a result of

increasing levels of mortgage foreclosures. In addition, as described in more detail below, we need to remove impediments that exist in other federal laws that currently prevent national banks from making such investments -- with or without changes to the CRA rules. Congress also may want to reevaluate the scope of the CRA itself to address a growing imbalance in the types of financial transactions that are covered, and those that are not covered, by CRA.

My testimony will describe the OCC's process for evaluating the CRA performance of national banks and address how CRA evaluations are affected by evidence of unlawful lending discrimination and other questions raised in the Chairman's letter of invitation. Next, my statement discusses the effectiveness of CRA, by looking at the amount of lending that has been attributed to the law, and by providing a few examples of specific projects across the country where CRA has made an impact. Finally, I will address the future of the CRA by describing three CRA-related suggestions recently made by Comptroller Dugan.

BACKGROUND

Congress passed the CRA in 1977 to encourage banks and thrifts to increase their lending and services to low- and moderate-income persons and areas in their communities, *consistent with safe and sound banking practices.*[1] The CRA applies only to banks and savings associations the deposits of which are insured by the Federal

[1] *See* 12 U.S.C. § 2901(a)(3), (b).

Deposit Insurance Corporation.[2] Affiliates of insured depository institutions that are not themselves insured depository institutions are not directly subject to the CRA, nor are credit unions or independent mortgage companies, for example.

The CRA requires each federal financial supervisory agency to assess the record of each covered depository institution in helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The law also directs the agencies to take that record into account when deciding whether to approve an application by the institution for a deposit facility.[3] An application for a deposit facility includes an application to establish a branch, relocate a main office or branch, merge with or acquire another insured depository institution, or receive a banking charter.[4]

ASSESSING THE CRA PERFORMANCE OF NATIONAL BANKS

CRA Regulations and Examinations

Neither the CRA nor its implementing regulations provide specific thresholds or ratios applicable to the examination or application processes. Rather, the rules contemplate an evaluation of each lender's record, taking into consideration the individual institution's business model and the environment in which it operates. An

[2] *Id.* §§ 2902(2), 2903(a)(1), 1813(c)(2).
[3] *Id.* § 2903(a)(1), (2).
[4] 12 C.F.R. § 25.29(a). *See also*, 12 C.F.R. § 228.29(a) (FRB); 12 C.F.R. § 345.29(a) (FDIC); and 12 C.F.R. § 563e.29(a) (OTS).

institution's capacity to help meet community credit needs is influenced by many factors, including its financial condition and size, resource constraints, legal impediments, and local economic conditions that could affect the demand and supply of credit. Examiners must consider these factors when evaluating an institution's performance under CRA.[5]

The CRA regulations prescribe different evaluation methods tailored to respond to differences in institutions' structures and operations. For example, the regulation provides a streamlined assessment method for small institutions with assets of less than $265 million.[6] The small bank performance evaluation emphasizes lending performance by focusing on the bank's loan-to-deposit ratio, the percentage of loans made within the bank's assessment area, and the distribution of loans among borrowers and geographies of different incomes, and businesses of different sizes.[7] Intermediate small banks, those with assets of at least $265 million but less than $1.061 billion, are evaluated under the same lending performance criteria as small banks as well as under a separate community development test that considers the responsiveness of a bank's community development loans, investments, and services to the community development needs of their local communities.[8]

Large banks -- those with assets of at least $1.061 billion -- are evaluated under three tests: the lending test, the investment test, and the service test.[9] The lending test performance criteria focus on the number and amount of loans originated in the bank's

[5] 12 C.F.R. § 25.21(b).
[6] *Id.* at §§ 25.12(u)(1), 25.26(a).
[7] *Id.* at § 25.26(b).
[8] *Id.* at § 25.26(a)(2), (b)-(c).
[9] *Id.* at § 25.21(a).

assessment area, the distribution of the bank's lending to individuals and geographies of different income levels and to businesses of different sizes, and the number and amount of the bank's community development loans.[10] The investment test is used to evaluate the number and amount of the bank's investments with a primary purpose of community development,[11] while the service test considers the retail and community development services that the bank has provided.[12]

Banks that are designated as wholesale or limited-purpose institutions are evaluated only on their community development loans, investments, and services.[13] Finally, the regulations allow any institution, regardless of size or business strategy, the choice to be evaluated under an approved CRA strategic plan.[14] This provides banks the flexibility to be evaluated in conformance with their own customized CRA performance objectives.

Examiners request and review information relevant to a bank's CRA performance prior to beginning their CRA evaluation of the bank. Examiners review HMDA data, if the bank is a HMDA reporter, to gauge the number and amount of home mortgage loans and the loan distribution among borrowers and geographies of different incomes.[15] If the bank is a large bank subject to CRA data reporting requirements, examiners review CRA data regarding small business, small farm, and community development loans. Prior to

[10] *Id.* at § 25.22(b).
[11] *Id.* at § 25.23.
[12] *Id.* at § 25.24.
[13] *Id.* at § 25.25.
[14] *Id.* at § 25.27.
[15] *See* Large Institution CRA Examination Procedures, at pp. 1, 4 (Feb.2006), available at http://www.occ.treas.gov/ftp/bulletin/2006-17a.pdf; Small Institution CRA Examination Procedures, at p. 4 (Feb. 2006), available at http://www.occ.treas.gov/ftp/bulletin/2006-17b.pdf.

the examination, examiners often request additional relevant information from the bank.[16] For example, examiners may request information about (1) other relevant loan data that the bank would like examiners to consider; (2) investments that the bank has made that it would like considered; (3) branch location information, along with information about branches that were opened or closed during the examination cycle; (4) the types of banking products (loan and deposit) offered by the bank; (5) the bank's delineated assessment areas; and (6) the bank's performance context. Finally, in connection with a CRA examination, examiners review public comment letters filed with the bank concerning the bank's CRA performance, as well as "community contact" information described below, to help them evaluate the bank's responsiveness to community credit needs.[17]

Upon the conclusion of CRA examinations, the OCC provides banks with written performance evaluations (PEs), which, unlike banks' Reports of Examinations, are public documents.[18] In a PE, conclusions are made about each performance criterion for the type of bank evaluated (e.g., large, intermediate small, small, limited purpose, etc.). These conclusions are supported by facts and data, which may be found either in the narrative discussion of the PE or in tabular form. A bank's rating(s) are derived from the conclusions about each performance criterion. An intrastate bank will have only one rating – an overall bank CRA rating. An interstate bank will have a CRA rating for each state in which it has at least one branch or main office, a CRA rating for each multistate

[16] *See* Comptroller's Handbook, Community Reinvestment Act Examination Procedures, at 117-119 (May 1999) (Comptroller's Handbook), available at http://www.occ.treas.gov/handbook/craep.pdf.
[17] Comptrollers Handbook, *supra* n.16, at 35.
[18] *See* 12 U.S.C. § 2906(b); 12 C.F.R. § 25.42(a)(2).

metropolitan area if it has at least one branch or main office in more than one state of the multistate metropolitan area, and an overall bank CRA rating. By statute, the ratings that a bank may receive are "Outstanding," "Satisfactory," "Needs to Improve," and "Substantial Noncompliance."[19]

The CRA statute, as amended by the Gramm-Leach-Bliley Act, limits the frequency of CRA examinations in institutions with aggregate assets of not more than $250 million that were rated Outstanding or Satisfactory in the most recent CRA examination. Such a national bank may not be subject to a CRA examination more often than (1) once every 60 months, if it received an Outstanding rating on its most recent examination; or (2) once every 48 months, if it received a Satisfactory rating on its most recent examination. The statute provides the OCC with discretion to examine such banks more or less frequently, however, upon reasonable cause, as determined by the OCC.

For banks with total assets of $250 million or less that received a rating of less than Satisfactory in the most recent CRA examination, the statute provides the OCC with discretion to conduct routine CRA examinations as frequently as the OCC deems necessary.[20] The OCC ordinarily will begin a CRA examination for these institutions within 36 months of the close date of the prior examination.[21] For banks with assets of more than $250 million, CRA examinations are ordinarily scheduled to begin within 36 months after the close date of the last CRA examination. In response to a question posed in the Chairman's letter of invitation asking for examples of any criticisms we may have

[19] 12 U.S.C. § 2906(b)(2).
[20] 12 U.S.C. § 2908(a)(3).
[21] The OCC uses the term "close date" to refer to the supervisory office approval date.

received regarding the adequacy of our CRA examination process, we occasionally hear complaints when particular examinations have not met these target timeframes.

OCC examiners throughout the country conduct CRA examinations of national banks. Our examiners are assisted by a team of OCC Community Affairs Officers with respect to aspects of these evaluations. Among other things, OCC examiners and Community Affairs Officers conduct discussions with various representatives of the community in connection with each CRA examination. These "community contacts" typically are people who know about local community credit needs and who may have information about how well the bank undergoing the examination has been helping to respond to those community needs. Community contact discussions help OCC's examiners understand community perceptions about the bank's performance, and also help to identify additional credit and community development opportunities for the bank.

In order to share the best practices we have seen in the community reinvestment arena and through the examination process, OCC Community Affairs Officers also consult with national banks to assist them in crafting their community development plans and CRA strategies. They conducted over 350 such consultations with national banks on a variety of CRA matters in 2007, and have conducted a total of over 1,000 such consultations during the past five years. Most recently, they have been consulting with banks about to reach the intermediate small bank and large bank thresholds, to ensure that they understand their new CRA performance requirements. This type of support often

facilitates the institution's participation in new types of community development projects and investments.

A financial institution's CRA rating and CRA record play an important role in its public profile and reputation, as this information is made available to the public. Federal banking regulators are required to make CRA ratings public.[22] In addition, agency regulations require financial institutions to keep a public file that includes information about their CRA activities, a copy of all public comments on their CRA record, and a copy of the public section of their most recent CRA performance evaluation.[23]

In the letter of invitation, you asked for specific information about the CRA ratings of national banks, including the percentage of banks that received a rating below "Satisfactory" during the last six years, and about whether there is any correlation between size of the institution and its rating. Since 2000, an average of eighty-five percent of national banks that were evaluated for CRA performance received a "Satisfactory" rating, fourteen percent received an "Outstanding" rating, and around one percent received a "Needs to Improve" rating. The CRA ratings assigned by the other federal banking agencies are generally consistent with the OCC's figures, in that the greatest percentage of institutions receive a "Satisfactory" CRA rating and few, if any, receive a rating lower than "Satisfactory."

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[22] *See* 12 U.S.C. § 2906(b); 12 C.F.R. § 25.28; 12 C.F.R. § 228.28 (FRB); 12 C.F.R. § 345.28 (FDIC); and 12 C.F.R. § 563e.28 (OTS).
[23] *See, e.g.,* 12 C.F.R. § 25.43 (OCC); 12 C.F.R. §228.43 (FRB); 12 C.F.R § 345.43 (FDIC); 12 C.F.R. § 563e.43 (OTS).

Banks large and small recognize that their CRA ratings have the potential to affect their business reputation. However, it is not surprising to find that banks with the greatest assets generally tend to have high CRA ratings. The largest institutions have both more public visibility and more resources to devote to CRA activities, and achieving and maintaining an "Outstanding" CRA rating is a corporate objective set by senior management at many of these banks. In addition, banks seeking to open or relocate a branch, or merge, consolidate with, or acquire another institution, know that they have a better chance for expeditious approval if they have high CRA ratings.

In this regard, your letter asked about the impact of CRA ratings on corporate applications. Banks with less than "Satisfactory" overall CRA ratings as a rule do not file corporate applications subject to CRA review and consequently the OCC has denied one application on the basis of a "Needs to Improve" CRA rating during the past ten years. Aside from ratings, CRA performance affects the OCC's evaluation of an application for a deposit facility in other ways as well. In particular, a CRA record that displays weakness in certain areas can have an impact on the terms and conditions under which approval may be granted and, thereby, contributes to "enforcement" of the CRA.

Banks are required to publish notice of their application -- and to solicit public comment on the application. Public comments are a valuable, critical component of the application process. They can provide information on potential weaknesses in CRA performance that should be evaluated. Therefore, in addition to taking the bank's CRA record into account, the OCC also carefully considers any public comments that have

been received before making a decision on an application, and will require applicants to respond satisfactorily to any issues raised.

The OCC generally relies on written information submitted during the application process, including public comments, to reach a decision on an application. The public may request that we hold a public hearing or other meeting to discuss CRA and other matters related to the application. For example, on occasion, we arrange meetings between the applicant and persons who have submitted adverse comments on the application to discuss their concerns. However, we generally find that the information we need to evaluate an application is best obtained during the public comment period through a process of an information exchange in which the applicants are required to respond in writing to written comments about CRA-related concerns.

As noted above, banks typically do not file an application if the applicant has less than a "Satisfactory" overall CRA rating. Thus, "enforcement" of the CRA is not accomplished solely through denials of applications by banks with poor CRA ratings. Indeed, in a number of instances when concerns are raised in connection with an application, either by the public or through our evaluation of the record, about a bank's CRA performance or compliance with fair lending and consumer protection laws, the OCC has obtained specific commitments from the institution to address those concerns. In addition, in some instances, the OCC has imposed conditions on our approval of an application to address CRA and related issues. Finally, some proposals may not proceed

as initially planned, and applications may not be filed, based on preliminary discussions with the OCC about potential CRA-related concerns about the proposal.

CRA and Fair Lending Enforcement

Since 1978, one of the factors taken into consideration during a CRA performance evaluation has been evidence of prohibited discriminatory or other illegal credit practices.[24] When the OCC and the other banking agencies revised their CRA regulations in 1995, evidence of discriminatory or other illegal credit practices was expressly included in the regulation as a factor that *could* adversely affect a bank's CRA evaluation.[25]

In 2005, the agencies further revised their joint CRA regulations to clarify that a bank's evaluation *would be* adversely affected by discriminatory or other illegal credit practices by the bank regardless of whether the practices involve loans in the bank's assessment areas or in any other location.[26] The revised rule further provided that a bank's CRA evaluation *would be* adversely affected by evidence of discrimination or other illegal credit practices by any affiliate in connection with loans inside the bank's assessment areas, if any loans of that affiliate have been considered at the bank's election in the bank's CRA evaluation.[27] The adverse effect on the bank's CRA rating of illegal credit practices by an affiliate is limited to affiliate loans within the bank's assessment

[24] 12 C.F.R. § 25.7(f) (1979).
[25] 60 Fed. Reg. 22,156, 22,183 (May 4, 1995) (*codified at* 12 C.F.R. § 25.28(c) (1996)).
[26] 70 Fed. Reg. 44,256, 44,267 (Aug. 2, 2005) (*codified at* 12 C.F.R. § 25.28(c)(1)(i) (2006)).
[27] *Id.*

areas because, under the regulation, a bank may elect to include as part of its own CRA evaluation only those affiliate loans that are within the bank's assessment areas.[28]

Therefore, at each CRA examination, examiners refer to a bank's fair lending evaluation to determine the effect on the bank's CRA evaluation of evidence of lending discrimination, if any, and the examiner's findings are discussed in the PE. If no evidence of discrimination is found, this also will be noted in the PE. In determining the impact of a substantive fair lending violation or abusive lending practice on a bank's CRA rating, the interagency CRA regulations require the agencies to consider a number of factors. These factors include the nature, extent, and strength of the evidence of a violation; the policies and procedures the bank has in place to prevent the practices at issue; any corrective action the bank has taken or has committed to take; and any other relevant information.[29] Decisions about the impact of evidence of illegal discrimination on a bank's CRA rating are made on a case-by-case basis and supported in the bank's report of examination and CRA PE.

THE IMPACT OF CRA

Although it is difficult to quantify with precision the total dollar amount of loans, investments and services that can be attributed to CRA, some data indicate that the CRA has led to very substantial levels of funding for community reinvestment activities. These data are useful to note today, because they lend credence to the widely held view

[28] *Id.* at p. 44,263.
[29] 12 C.F.R. § 25.28(c)(2).

that the law has been effective in achieving the goals set by Congress over thirty years ago.

For example, data collected by the federal banking agencies indicates substantial levels of lending related to CRA performance by banks. Recent reports by the Federal Financial Institutions Examination Council (FFIEC) on CRA lending by institutions required to report loan information under the CRA regulations show that over $56 billion in community development loans, $306 billion in small business loans, and $12.5 billion in small farm loans, were originated or purchased by CRA-covered depository institutions in 2006 alone.[30]

Looking at one component of the CRA contributions of national banks supervised by the OCC -- public welfare *investments* -- we estimate that, over the past fifteen years, national banks have made over $25 billion of such CRA-eligible investments.

While these are very impressive statistics, they do not capture the "on the ground" impact on distressed communities of individual loans and investments made by banks, often in conjunction with community partners, as a result of CRA. One example is the revitalization of the distressed neighborhoods not far from this hearing room. Across the river in Anacostia, neighborhoods got a boost starting in 1995 when a bank-owned community development corporation (CDC) bought and renovated neglected apartments and built a new community center. The bank CDC went on to partner with two community-based organizations, creating affordable condominiums in the same

[30] *See* http://www.ffiec.gov/hmcrpr/cra072607.htm.

development, and building new affordable town homes on the site of a nearby abandoned and crime-filled apartment complex. The developments made their mark on this neighborhood, which Comptroller Dugan saw first hand during a visit there. Private investment has followed and the area has regained its standing as a desirable place to live.

To take another example, the Comptroller also visited the East Liberty neighborhood in Pittsburgh, which is undergoing significant revitalization as a result of the CRA. In East Liberty, one CRA project begun in 2002 has acted as a catalyst for other investments and transformed a warehouse into a successful grocery store that attracted new shoppers to the area. Other nearby projects have followed, including a $34 million commercial development promoted and financed by a bank-affiliated CDC using New Markets Tax Credits and other funding sources. Development in this area has created more than 400 jobs, and at least $200 million in additional projects are planned or underway.

It is important to remember that the fundamentals of *safe and sound* banking practices have kept these CRA loans and investments profitable over the years. Low Income Housing Tax Credit investments, for example, have performed well with default rates among the lowest of any class of commercial real estate. Other incentives, such as New Markets Tax Credits, CDFI funds, and other investment vehicles, also have performed well over the past three decades to bring bank capital to underserved areas in a safe, sound, and sustainable way. Generally speaking, returns on CRA-eligible loans and investments in housing and community projects across the country have been favorable.

As a result, CRA activities over the years have come to be viewed more in terms of "good business," that add social capital and hard assets to the community as well as profitability to an institution's bottom line, rather than as a "tax" on the operations of the institution.

IMPROVING CRA FOR THE FUTURE

As Comptroller Dugan said yesterday, the CRA clearly has accomplished a great deal providing incentives to bring needed credit and capital investments to underserved communities. But, recent events also make it clear we should not bask in the glow of past accomplishments, however significant they have been. Thirty years after the CRA was enacted, we continue to face daunting problems of disinvestment and community economic distress, including in communities affected by the turmoil in the mortgage markets. I would like to describe three proposals suggested by Comptroller Dugan related to CRA and community revitalization that address these issues.

Need for Legislation to Restore National Bank Public Welfare Investment Authority

It is important to recognize that as much as the CRA has helped strengthen communities since its inception, there is more that can be done to help revitalize and stabilize our nation's communities. One step is to remove needless impediments in federal law -- not in the CRA itself -- that prevent national banks making investments that

would help some of these communities. The federal law that authorizes national banks to make "public welfare" investments was amended a little over a year ago by the Financial Services Regulatory Relief Act of 2006. While these amendments increased the aggregate *amount* of investments permissible for national banks, they simultaneously decreased the *types* of investments that may be made.

For more than fifteen years before the law was changed, national banks were authorized to make "investments designed to primarily promote the public welfare, *including* the welfare of low- and moderate-income communities or families." However, the 2006 amendments cut back on this authority and restricted it to investments that promote the public welfare by "benefiting *primarily* low- and moderate-income communities or families." Now, national banks and their CDC subsidiaries may make public welfare investments only if those investments primarily benefit low- and moderate-income areas and people. In other words, national banks (including a CDC subsidiary) are now effectively *prohibited* from making direct equity investments to help foreclosure-plagued urban and suburban middle-income areas. And indirect investments, such as investments in foreclosure relief funds, also become more difficult because the fund must be able to assure the investing bank that its benefits flow primarily to low- and moderate-income areas and people. Where a fund provides benefits to communities made up of a mix of low-, moderate-, and middle-income census tracts, this may not be easy to do as a practical matter.

One immediate result of the 2006 amendment was to prevent national banks from continuing to make certain public welfare investments that previously had been authorized -- and that are specifically encouraged by the CRA regulations. For example, banks may receive favorable CRA consideration for making investments that benefit designated disaster areas and underserved and distressed middle-income *rural* communities. But, the authority of national banks to directly make these CRA-eligible investments in middle-income communities was eliminated by the 2006 amendments described above.

In addition, the 2006 amendment prohibits national banks from making investments that would provide mixed-income affordable housing -- *in areas targeted by state and local governments for revitalization and pursuant to the local government's development plan* -- if, for example, less than 50 percent of the multifamily housing units are to be occupied by low- or moderate-income people or if the government-designated revitalization area is not a low- or moderate-income census tract.

Comptroller Dugan has been very appreciative of the leadership of Chairman Frank and Representative Bachus in recognizing the anomalous results of the 2006 amendments and achieving unanimous, bipartisan passage by the House of Representatives of H.R. 1066, which would restore the broader preexisting public welfare investment standard. A comparable bill recently has been introduced in the Senate, but it has not yet been acted on.

The need for Congress to enact this legislation has taken on greater urgency recently. A broad range of communities across our nation, including neighborhoods classified as "middle income" in the 2000 Census, are suffering the adverse consequences of rising mortgage delinquencies and foreclosures. Foreclosed properties are not just empty houses. The absence of homeowners and empty, deteriorating properties can depress entire communities.

The Comptroller pointed out in his remarks just yesterday that there is a pressing need for new community development investments that will help revitalize and stabilize *all* local communities devastated by high levels of foreclosures. Many communities are not neatly delineated by the low-, moderate-, and middle-income designations used for census purposes. Federal policies should not prevent these revitalizing investments simply because a community contains tracts designated by the Census nearly 10 years ago as "middle-income." Conditions have changed since then, and some of these communities have suffered significant declines in income levels and in local economic and housing conditions.

The OCC strongly urges that the public welfare investment authority of national banks be restored by enacting legislation like H.R. 1066. In doing so, Congress would be adding an important tool to our collective efforts to address the risks and consequences of rising foreclosures. For example, restoring the public welfare investment authority for national banks would permit them to make capital investments in funds that are targeted to mortgage foreclosure relief in all American communities, including middle-income

areas. Paired with a CRA incentive described below, investments of this type by national banks and other depository institutions would also provide an important additional source of economic stimulus to communities in distress.

Need for Changes to CRA Rules to Address Foreclosure Concerns

There is another step we could take to address foreclosure relief in the context of the CRA regulations themselves. Just yesterday, the Comptroller proposed an important CRA regulatory initiative to address the community disinvestment issues affecting the broad range of communities that are being hard hit by the rising tide of mortgage defaults and foreclosures. Currently, the CRA rules recognize community development investments that are targeted to low- and moderate-income areas and distressed or underserved rural areas in need of "revitalization and stabilization."

The Comptroller urged the development of a CRA incentive for additional mortgage relief efforts in middle-income communities significantly affected by the subprime mortgage turmoil as well. Specifically, he called for a targeted amendment to the interagency CRA regulations. This amendment would provide a CRA incentive for community development investments that revitalize and stabilize middle-income urban and suburban communities that are "distressed" based on unprecedented levels of foreclosures and related economic factors. With this change, the banking agencies could give favorable CRA consideration for -- and thereby encourage -- loans, services, and investments in more communities suffering from the consequences of foreclosures.

We believe that we should be able to propose this change in the very near term by revising the definition of "community development" in the CRA rules. As noted above, there is precedent for such an approach: when the agencies recognized the need to expand the CRA rules in 2005, we revised the "community development" definition to provide CRA credit for underserved and distressed *middle-income rural areas* and for designated disaster areas. The change that the Comptroller called for yesterday is consistent with the flexibility we have shown in implementing the CRA to adapt our rules to respond to changing circumstances and changing community credit needs.

Changing the CRA regulations in this manner will provide incentives for all types of community development activities by insured depository institutions. However, it is important to emphasize that unless Congress restores the public welfare investment *authority* of national banks as described above, distressed middle-income communities facing the effects of rising foreclosures and related problems will continue to be deprived of investments by some of the largest banks in the country -- even if the CRA rules are revised.

Need to Reassess Original Scope of CRA

Finally, it is obvious that in the thirty years since the CRA was enacted, there have been profound changes in the structure of the financial services industry and the types of companies that offer loans and other financial services. While insured depository institutions previously may have provided most financial transactions of the type that are evaluated under CRA, now many *non-bank* companies provide such

financial products and services.[31] In light of these developments, a legitimate question may be raised: What are the public policy reasons for continuing to restrict the application of CRA to insured depository institutions?

Indeed, when we look at the subprime foreclosure situation, the current coverage of CRA is perversely ironic. Insured depositories were by no means the main providers of the 2-28 adjustable-rate subprime mortgages that have led to so many problems in communities around the countries. Indeed, national banks and their subsidiaries originated only about 10 percent of all subprime mortgages in 2006. Yet only insured depositories are subject to CRA, and only these institutions are motivated by CRA to engage in activities that will help address the problem through community reinvestment and lending activities. In contrast, over half of subprime mortgages of the last several years – and the ones with the most questionable underwriting standards – were originated through mortgage brokers for securitization by nonbanks, including major investment banks. Yet these nonbanks, having played such a large role in the subprime mortgages that have caused such problems in communities nationwide, are not covered by CRA and therefore have no CRA incentive to address these problems.

Covering some or all of these non-banks under the CRA has the potential to bring billions of additional community reinvestment dollars to local communities, and it would build on and enhance the substantial contributions already being made by banks for CRA

[31] *See* Apgar and Duda, *The Twenty-Fifth Anniversary of the Community Reinvesment Act: Past Accomplishments and Future Regulatory Challenges*, FRBNY Economic Policy Review, at 12, 19 (2003). (The authors note the links between lending and bank branch-based deposit gathering on which CRA was based has weakened dramatically in recent years and recommend that Congress consider expanding the CRA to cover non-depository institutions that provide mortgage credit.)

purposes. It also would add a degree of transparency to the lending operations of these non-bank lenders, through the CRA public evaluations and public comment process. In addition, extending CRA to non-bank providers would address disparities in the civic responsibilities imposed on companies that are competing to offer comparable financial products and services.

As the Comptroller said yesterday, the time may be ripe to evaluate whether a legislative determination, made over thirty years ago, about the scope and coverage of CRA continues to be appropriate given the significant changes to the delivery of credit in our financial markets in the intervening years.

CONCLUSION

Thank you, Mr. Chairman, for the opportunity to appear before you today. I would be pleased to answer any questions you might have.

Statement

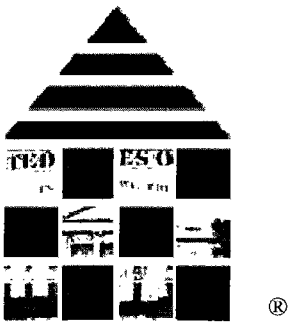
of

Judith A. Kennedy
President and CEO

National Association of Affordable Housing Lenders
on
The Community Reinvestment Act

House Committee on Financial Services
U.S. House of Representatives

February 13, 2008



CELEBRATING 30 YEARS OF SUCCESSFUL COMMUNITY INVESTMENT

NAAHL represents America's leaders in moving private capital to those in need, 200 organizations committed to increasing lending and investing private capital in low- and moderate-income (LMI) communities. This "who's who" of private sector lenders and investors includes 50 major banks, 50 blue-chip non-profit lenders, and others in the vanguard of affordable housing, including insurance companies, community development corporations, mortgage companies, financial intermediaries, pension funds, and foundations.

SUCCESSFUL COMMUNITY INVESTMENT

Thank you for the opportunity to testify about the importance of the Community Reinvestment Act (CRA) in meeting America's affordable housing and community development needs. We believe that CRA has been, and will continue to be, critical to the preservation and expansion of housing affordable to low and moderate individuals (LMI) because it encourages private capital lending and investing in affordable housing and community development projects nationwide.

The private-public partnership fostered by CRA has evolved and matured over the past 30 years. For-profit and non-profit lenders and investors, developers, community leaders, and government at all levels, have all learned to collaborate as partners in devising new solutions and creative strategies for financing affordable housing that people are proud to call home in thousands of communities across the United States.

We have also learned how to lend and invest private capital safely in underserved areas and to help borrowers with little cash to bring to the closing table.

We have learned over the years how to do it right: how to build affordable rental housing and homeownership properties that contain a mix of incomes, built with the discipline of the private market and using government resources responsibly. These homes are of high quality and lasting value, and remain affordable over the long run.

"TAKING THE ROUGH EDGES OFF OF CAPITALISM"

Since enacted in 1977, CRA has provided a regulatory incentive for funneling literally hundreds of billions of dollars into low and moderate income communities. Former Federal Reserve Board (Fed) Chairman Paul Volcker recently characterized the law as "taking the rough edges off of capitalism," by clarifying the responsibility of all Federally-insured depository institutions "to help meet the credit needs of their communities," including those of the less affluent.

This infusion of private capital leverages public subsidy for affordable rental homes as much as 10 to 25 times, so affordable homes can be built with a limited amount of government support. In an era of shrinking federal subsidy, an active and growing primary market for affordable housing lending is key to achieving homes affordable to persons whose income is classified as "low" (those under 50 percent of area median income) and "moderate" (those under 80 percent of AMI).

Every academic study of CRA has confirmed that the law has been enormously successful in incentivizing insured depository institutions' involvement in underserved areas.

- In each of the past 3 years alone, insured institutions report over $50 billion per year in community development loans on housing affordable to low (under 50% of area median income) and moderate (under 80%) income (LMI) households.

- During the same period, lenders reporting under the Home Mortgage Disclosure Act (HMDA) reported making about $800 billion in mortgages to LMI borrowers and in LMI areas.

This increased lending and equity investing have spurred economic growth and demand, thereby increasing banks' opportunities to make even more loans and sell more services. Banks also use their "public welfare investment" authority to finance Low Income Housing Tax Credits (LIHTCs), New Market Tax Credits (NMTCs), and other housing and economic development funds. Banks currently hold at least one-third of housing tax credits, which help to finance 98 percent of affordable rental housing and 40 percent of all multifamily starts in the U.S.

CRA investments also support critically needed community development, urban revitalization, rural development, and job creation. They do so in a manner that is not only beneficial to the communities served, but also ensures their profitability, and safety and soundness. In addition, banks supervised by the Fed, and the Federal Deposit Insured Corporation (FDIC), as well as the OCC, are examined not only on CRA-qualifying investments, but also on the loans and services provided to LMI persons and areas. Affordable housing lending has become increasingly sophisticated as experienced practitioners develop new products and share best practices. For just a few examples,

- Over 15 years, the Massachusetts Housing Investment Corporation (MHIC) has provided over $1 billion in financing for over 11,000 units of affordable housing

- In New York, the Community Preservation Corporation (CPC) has financed the preservation and development of more than 145,000 units of housing representing public and private investments of over $6.5 billion

- In only 9 years, the Alabama Multifamily Loan Consortium has originated more than $70 million in mortgages financing over 2,000 affordable apartments across the state, 10 percent of which must be accessible to tenants with disabilities, including "Rosa Parks Homes", the first elderly and disabled LIHTC affordable rental apartments in Montgomery.

- The California Community Reinvestment Corporation in 17 years has provided more than $800 million in affordable housing loans and made 26,000 apartments available to residents who earn 60 percent or less of area median income (AMI), including preserving "Curtis Johnson Homes" in Los Angeles.

- In our own metro area, just think of Columbia Heights redevelopment; Anacostia's resurgence; or even the expansion of our beloved St. Coletta facility. St. Coletta is one of only a handful of charter schools in the U.S. serving students with autism and multiple disabilities. With Bank of America's letter of credit backing publicly issued tax-exempt bonds and a taxable loan, St. Coletta not only refinanced its existing facility but also finance new construction of another building designed by renowned architect Michael Graves.

Given two decades of innovation and solid experience, our vanguard can offer specific suggestions for ways to ensure the sustainability of community investment, and also to encourage even more in the new millennium.

NAAHL POLICY RECOMMENDATIONS

FIRST, DO NO HARM
We now have a mature, sophisticated understanding of bringing private capital to underserved areas. Sometimes differing regulations among agencies, the reality of 4 different bank regulations and hundreds of examiners have undermined confidence in what qualifies for favorable CRA consideration. The lack of predictability about what examiners count as CRA credit is a deterrent to lending and investing in emerging markets. More training for bank examiners about the nature of community development lending and investment would help banks and thrifts better achieve the policy goals set forth in federal legislation. Community development lending and investment is quite specialized more like an art than a science. Banks should be given the benefit of the doubt, not the third degree. Uneven or lagging regulations and enforcement could dilute the impact CRA can make.

FULL CREDIT FOR POOLED INVESTMENTS
We recommend strongly that a bank should continue to receive full CRA credit for the entire dollar amount of its investment in national, as well as statewide and regional funds that make community development loans or investments, generally as defined under the CRA rules, regardless of the location of the fund's projects, provided that at some point at least some of the fund's projects are located in the bank's assessment area(s) or broader statewide or regional area that includes the bank's assessment area(s). This principle of banks pooling their resources, diversify their risks, and hiring an expert skill set to lend and invest on the banks' behalf is an important principle, and major CRA success story, that predates even the law.

COMMUNTY DEVELOPMENTTEST OPTION
We also recommend that insured institutions have the option of a Community Development Test, providing flexibility in the provision of community development lending, community development investments, as long as the institution undertakes meaningful activities in both.

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. In order to receive community development credit for CRA purposes, a project need not have community development as its "primary purpose", so long as a significant consequence of the project or activity benefits LMI individuals or communities.

RESTORE THE PRIOR STANDARD FOR PUBLIC WELFARE INVESTMENTS
Since Hurricane Andrew in 1992, insured institutions could have no more than 10 percent of their capital in public welfare investments. In late 2006, Congress increased that cap to 15 percent in regulatory relief legislation (S.2856/H.R. 6072), but in so doing, it decreased opportunities for direct bank investments.

With strong bipartisan support, the House of Representatives addressed this problem by approving H.R. 1066 early last year, to restore the previous standard for banks' direct public welfare investments and provide parity for thrift charters. The bill specifically recognizes the significance of past and future direct investments in rebuilding disaster areas, designated redevelopment areas, rural, distressed communities, and mixed income housing. Senators Mike Crapo (R-Idaho) and Tim Johnson (D-SD) introduced a near-identical version of the House passed bill, S. 2487, on December 18, 2007.

Upon enactment, banks and thrifts will once again be able to make direct investments in:
1) Designated disaster areas (Lower Manhattan, Gulf Coast)
2) Designated redevelopment areas
3) Mixed income housing (as cities like Chicago, New York and Boston desire) where neither the neighborhood, nor the majority of tenants, is under 80 percent of area median income
4) A small business investment fund that is not qualified under a separate Small Business Investment Company (SBIC) authority
5) 3,500 distressed, middle-income, rural areas

SECOND, HARMONIZE BANK REGULATIONS AND GSE GOALS
GSEs Are AWOL
Despite a charter change directing the GSEs to *lead the industry* in ensuring that access to mortgage credit is available to low and moderate income families, and take less of a return to do so, Fannie Mae and Freddie Mac have not yet brought the benefits of a government-sponsored secondary market to the prime segment of the LMI market.

Two top HUD officials from the Clinton and Bush administrations, both highly respected researchers, have said that the GSE affordable housing goals are based on the volume of affordable loans in the prime market. Yet year after year Fannie Mae and Freddie Mac's best "seller/servicer" customers complain to the GSEs that they refuse to help primary lenders meet the credit needs of their communities. Fannie Mae and Freddie Mac's resistance to consumer-friendly, CRA-eligible, conventional, sound prime loans has

dramatically reduced the liquidity of CRA eligible, consumer friendly loans. Worse, HUD has actually allowed the GSEs to convert triple A rated securities backed by higher cost, subprime loans, as meeting their "affordable housing" goals. Instead of the GSEs engaging in the lower cost, lower balance mortgage market, the market adapted to the GSEs, their appetite for higher-yielding loans and their alternative network of unregulated mortgage originators.

As a result, billions of dollars in CRA-eligible loans remain on the books of the originating lenders, unless and until the lenders can replenish their supply of funds to do more; consequently, primary lenders, both banks and non-profits, to peddle sound loans like Fuller Brush men of old. Investors include pension funds, insurance companies, and other organizations but involve mostly expensive, time-consuming private placements.

We ask Congress to approve H.R. 3915, the House-passed mortgage reform bill sponsored by Reps. Frank and Bachus, incorporating the affirmation to purchase and responsibility to purchase CRA loans as in Senator Reed's bill, S. 2391. Congress now has what may be a "once in a generation" opportunity to ensure that the GSEs begin to purchase responsible loans from primary lenders, both insured institutions and their non-profit partners, to replenish lenders' supply of loan funds so the cycle can begin again.

ADDITIONAL POLICY INCENTIVES

At the federal level, the Federal Deposit Insurance Corporation under the leadership of Chairman Sheila Bair has developed a small-dollar loan pilot program that offers CRA credit to insured institutions which provide small loans in a safe and sound manner. The FDIC's small-dollar loan program, which announced its first bank participants last week, is designed as an alternative to payday lending. New York and Louisiana lawmakers have passed legislation that directs state government deposits to insured depository institutions that open branches in underserved communities.

Meaningful updating of CRA incentives by the bank regulators has already provided a boost to some lenders' efforts. Updating decade-old CRA regulations to acknowledge the importance of community development lending would make a real difference. For example:

- Banks with outstanding CRA ratings would enjoy safe harbors at the time of acquisition or merger

- Outstanding institutions could benefit from reduced premiums for deposit insurance

Thank you and we look forward to working with you to increase the flow of private capital to help meet the credit needs of all communities.

TESTIMONY OF

HOWARD F. PITKIN
COMMISSIONER, CONNECTICUT DEPARTMENT OF BANKING

On

"THE COMMUNITY REINVESTMENT ACT: THIRTY YEARS OF ACCOMPLISHMENTS, BUT CHALLENGES REMAIN"

Before the

COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

February 13, 2008, 10:00 a.m.
Room 2128, Rayburn House Office Building

Good morning, Chairman Frank, ranking member Bachus, and distinguished members of the committee. I am pleased to be here today on behalf of the Connecticut Department of Banking to discuss the Community Reinvestment Act (CRA), which marks its 18th anniversary in our state this year. My testimony will discuss the administration of our CRA program and the application of CRA to both banks and credit unions in Connecticut. I will also highlight some CRA initiatives of other states.

I also appear today as a member of the Conference of State Bank Supervisors (CSBS). CSBS is the professional association of state officials responsible for chartering, supervising and regulating the nation's over 6,000 state-chartered commercial and savings banks, and almost 400 state-licensed foreign banking offices nationwide. For more than a century, CSBS has given state bank supervisors a national forum to coordinate, communicate, advocate and educate on behalf of state bank regulation.

Connecticut is also a member of the National Association of State Credit Union Supervisors (NASCUS). NASCUS is a professional association of State credit union regulators representing 48 state regulators throughout the nation, including Puerto Rico.

The Department of Banking is a state government agency responsible for the regulation of financial institutions and related entities. The Connecticut Department of Banking (the Department) is responsible for the regulation and examination of financial institutions, including 41 state chartered domestic banks with total assets of $28.9 billion and 38 state chartered credit unions with total assets of $2.6 billion. As Banking Commissioner I am charged with administering the banking and credit union laws of the state as well as the laws regarding securities, tender offers and business opportunities. I also administer the Truth-in-Lending Act and other consumer credit laws. The Department responds to consumer inquiries, investigates complaints and provides consumer financial and investor education through its outreach program.

The Department's mission is to protect users of financial services from unlawful or improper practices by requiring that regulated entities and individuals adhere to the law; assuring the safety and soundness of state chartered banks and credit unions; educating and communicating with the public and other stakeholders; and promoting cost-efficient and effective regulation.

The Community Reinvestment Act, not only in Connecticut but nationwide, has provided access to lending and investment programs just by highlighting a need for community investment and initiatives. CRA encourages financial institutions to seek out lending and investment programs that promote community development lending and investing. Various state and federal affordable housing programs are good examples of such lending and investment opportunities for banks.

As the Connecticut Banking Commissioner, I am pleased to discuss the CRA program and initiatives undertaken within my state.

CRA Program in Connecticut

Connecticut enacted a state CRA law [Chapter 664a Part II, Section 36a-30 through 36a-36] on July 1, 1990, that established general requirements for Connecticut banks to reinvest in their communities. The law authorized the Banking Commissioner to assess a bank's record of helping to meet the credit needs of its local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of the bank. The state statute references federal CRA provisions including areas of collecting and reporting loan data, CRA disclosure statements, maintaining a public file and examination assessment factors. Beyond the federal CRA public notice requirements, each Connecticut bank must also publish a State of Connecticut Community Reinvestment Notice announcing public access to the bank's performance evaluations and clearly stating where to send written comments to the Banking Commissioner.

Effective July 1, 2001, Connecticut enacted a state CRA law [Chapter 664a Part II, Section 36a-37 through 36a-37e] that set similar requirements for Connecticut State Chartered Community Credit Unions. A Community Credit Union means a Connecticut credit union that has $10 million or more in total assets, the membership of which is limited to persons within a well-defined community, neighborhood or rural district.

Connecticut state chartered banks have had a long standing record of compliance with the State and Federal Community Reinvestment Act (CRA), as demonstrated by the number of "Outstanding" and "Satisfactory" ratings assigned the banks during on-site performance evaluations. Since

1999, no Connecticut state chartered bank has received a CRA rating below "Satisfactory."

In February 2005, then-Banking Commissioner John P. Burke decided to reduce the banks' burden of on-site CRA examinations by establishing an off-site program at the state level. Under this off-site program, we have created a CRA profile on each of our banks. We require each bank to update their CRA profile on an annual basis, reporting such items as changes to the assessment area, products and services offered, or other community development or investment initiatives. We encourage our banks to include any other relevant data that describes expanded community activities within the defined assessment area.

We also receive a copy of the bank's federal CRA examination. We review this information and incorporate it into the bank's CRA profile, along with additional statistical analysis utilizing Home Mortgage Disclosure Act (HMDA) data and CRA software that indicates where the bank is lending. This software tool provides analysis of lending statistics by bank, tract, town, county, Metropolitan Statistical Area (MSA), state and assessment area. The software allows examiners to map assessment areas for reasonability, demographics, and location of low- and moderate-income census tracts. Examiners also use valuable peer information to compare bank performance with the marketplace.

We have found this process very effective in keeping CRA at the forefront and helping the Department with timely processing of various applications that call for consideration of the bank's CRA compliance. Pursuant to Section 36a-32(3)(c), the Banking Commissioner shall consider, but not be limited to, the bank's record of performance when considering an application for the establishment of a branch, relocation of a main office or branch office, or a merger or consolidation with or acquisition of assets or stock or assumption of liabilities of another bank. A bank's record of performance in helping meet the credit needs of a community may be the basis for denying or conditioning such application.

Implementing an off-site CRA monitoring system to assess the performance of state-chartered institutions has afforded the opportunity to reduce regulatory burden, while keeping us abreast of the lending performance and trends of our community banks between on-site examinations. We have found the off-site program provides more opportunity to interact with the

bank's CRA officer through the annual submission of data, updates and assessments during the application process, and periodic contact. Implementation of the off-site program does not restrict the Banking Commissioner's authority to conduct an on-site examination, if deemed necessary.

Department of Banking staff must include an assessment of the institution's CRA compliance in the evaluation of branch, merger or acquisition applications we process. In assessing the bank's CRA efforts, examiners review the institution's CRA policy, the institution's CRA statement & goals, and the internal CRA program assessment, the CRA plan (if required to be submitted), the CRA notice and the adequacy of the assessment. Connecticut law requires that any bank with a CRA rating other than "Outstanding" must submit a CRA plan (Plan) and publish a notice of the Plan's availability for public comment for a period of 30 days. Very rarely, if ever, have we received a comment on a filed CRA Plan.

As I mentioned, Connecticut established a CRA requirement for Connecticut state chartered community credit unions in July 2001. While federal credit unions are not subject to CRA, two states, including Connecticut and Massachusetts, have implemented CRA programs for credit unions. Under Connecticut's program, the credit union is examined on-site for CRA compliance. The Department makes a written evaluation of the credit union's CRA performance, with three major areas: (1) a statement of the Commissioner's assessment; (2) a discussion of the facts of the assessment; and (3) an assigned rating and description of the rating. Connecticut uses the same rating scale of "Outstanding," "Satisfactory," "Needs to Improve," and "Substantial Noncompliance" for both banks and credit unions.

Community credit unions subject to CRA requirements in Connecticut are assessed on such factors as: the credit union's record of helping to meet the credit needs of its community through qualified investments; the availability and effectiveness of its systems in delivering retail credit union services and the extent and innovativeness of community development services; the loan to share ratio given the credit unions size and financial condition; the percentage of total loans; the record of lending and lending-related activities to borrowers of different income levels and businesses and farms of different sizes; the geographic distribution of loans; any action taken in response to written complaints related to community reinvestment performance; any efforts to work with delinquent residential mortgage customers who are

unemployed or underemployed to facilitate a resolution of the delinquency; and any written comments received by the Banking Commissioner.

Accountability to the community is an important aspect of CRA's mission; thus, Connecticut posts CRA ratings for both the banks and credit unions on our website. Pursuant to Connecticut statutes [Sections 36a-33 and 36a-37e], the Banking Commissioner must prepare and submit a report to the State Treasurer of the list of banks and credit unions that have received a rating of needs to improve or of substantial noncompliance in connection with CRA. No bank or credit union included on such list may receive public deposits.

CRA Initiatives in Other States

The Community Reinvestment Act has been an example of federalism at work, with six states[1] plus the District of Columbia enacting their own Community Reinvestment Acts at the state level. Some states have gone beyond in the provisions of Federal law, expanding the application of their CRA statutes, what qualifies for CRA credit, or how CRA is enforced. Other states have simply mirrored the Federal statute, giving them the opportunity to enforce the Federal statute through their own laws. Examples of states that have passed CRA laws are:

Massachusetts

Massachusetts enacted a state Community Reinvestment Act statute (Massachusetts General Laws chapter 167, section 14, with implementing regulations at 209 CMR 46.00 *et seq.*) in 1982

The law has always been applied to both state-chartered banks and all state-chartered credit unions, regardless of their common bond. The regulations are adapted to address the common bond of certain credit unions.

Massachusetts law differs from federal law in that Massachusetts has a five-tiered rating system. State law includes a rating of "High Satisfactory" that

[1] In addition to Connecticut the following states have their own CRA laws: Massachusetts (G.L.c. 167, s.14), New York (NYBL 28-b), Rhode Island (R.I. Gen. Laws Section 19-9-4), Washington (Chapter 30.60.RCW) West Virginia (Section 31A-8B-1, et Seq.))

is not part of federal law; a Massachusetts state-chartered institution may be rated "Outstanding," "High Satisfactory," "Satisfactory," "Needs to Improve" or "Substantial Noncompliance".

The Division may consider a state-chartered bank's or state-chartered credit union's CRA rating as the basis of a denial of various applications requiring the Division's approval. Alternatively, a CRA rating of "Satisfactory" or better is one of the criteria for additional powers for state-chartered banks and state-chartered credit unions under approvals under the bank parity and credit union parity regulations at 209 CMR 47.00 *et seq.* and 209 CMR 50.00 *et seq.*, respectively. In addition, the Division has an alternative CRA examination procedure for state-chartered banks and state-chartered credit unions with a CRA rating of "Outstanding" or "High Satisfactory."

The Massachusetts CRA statute was also the model for recently enacted legislation, Chapter 206 of the Acts of 2007, which requires "CRA-type" analyses during examination of residential mortgage lenders that have made 50 or more residential mortgage loans in the previous calendar year.

New York

New York's Section 28-b is the statutory authority for Part 76, which is almost identical to the Federal CRA regulation. While Part 76 closely mirrors the Federal regulation's focus on performance, it incorporates the 12 assessment factors listed in Section 28-b. These factors include process factors such as ascertainment of community credit needs, marketing and board of directors' involvement in formulating CRA related policies and monitoring performance. The Federal CRA regulation now focuses on performance and no longer mentions the 12 factors.

A banking institution subject to CRA evaluation by the New York State Banking Department is defined as a "New York State-chartered commercial bank, trust company, savings bank, savings and loan association or FDIC insured branch of a foreign bank."

New York regulations include a fifth type of community development activity, not included in the Federal regulation: activities that seek to prevent defaults and/or foreclosures in loans classified as "supporting affordable housing or economic development."

These CRA statues and regulations are part of New York's broader recognition that a safe and sound bank is one that treats communities and individual customers fairly, and that responsible lending practices do not discriminate by race, creed or neighborhood.

Washington State

In 1985, the Washington State Legislature enacted two identical statutes, entitled "Community Credit Needs." One affects Washington State-chartered commercial banks (Ch. 30.60 RCW) and the other affects Washington State-chartered mutual savings banks and stock savings banks (Ch. 32.40 RCW). The statutes are the equivalent of "state CRA" statutes, but they essentially permit the Division of Banks to defer to the FDIC on CRA examinations. However, they obligate the Washington State Department of Financial Institutions (rather than just applicable federal banking regulators, e.g., the Fed, FDIC, OCC or OTS) to consider the CRA ratings of applicants with regard to (1) mergers by a bank or bank holding company of a Washington State-chartered bank or savings bank, (2) acquisition of 5% or more of the stock of a Washington State-chartered bank or savings bank, and (3) branching. The Washington State Department of Financial Institutions has relied upon the FDIC's CRA examination process and ratings in fulfilling Chapter 30.60 RCW and Chapter 32.40 RCW. The Washington State Department of Financial Institutions has considered the CRA ratings of affected institutions in making its decision to approve, disapprove or condition the approval of a merger, stock acquisition or branching application, several times since the enactment of these statutes.

Conclusion

The Community Reinvestment Act has unquestionably made an impact on banks and the communities they serve. CRA requirements are embedded in the chartering of financial institutions; considered in the approval, denial or conditioning of applications for such activities as branching, consolidation or acquisitions; and considered with other expansion initiatives. For example, a bank's CRA profile is an essential element of assessing the value of any new product or service being offered to the bank's customers.

If Congress or the federal regulators are considering changes to CRA statutes, regulations or guidelines, these changes should include a consideration of fewer restrictions on the type of or dollar thresholds for

investments. We should continue to encourage and foster community-focused lending and investing, a building block in the foundation of community banking.

Thank you for your time this morning, and for inviting me to be here with you today to celebrate 30 years of accomplishments under the Community Reinvestment Act. I would be pleased to answer any questions that you have.

NEW AMERICA
FOUNDATION

Testimony of Ellen Seidman
Director, Financial Services and Education Project
Before the
Committee on Financial Services, United States House of Representatives
February 13, 2008

Chairman Frank, Ranking Member Bachus and Members of the Committee, thank you very much for the opportunity to testify today about the effectiveness and future of the Community Reinvestment Act, one of the most creative and innovative banking laws on the books today. My name is Ellen Seidman, and I direct the Financial Services and Education Project at the New America Foundation. The New America Foundation is a non-profit, post-partisan public policy institute in Washington DC. As part of our project, we have been focused on the development of what we are calling a new responsibility and accountability agenda for consumer financial services in the 21st century. CRA plays a large role in that agenda.

But my experience with CRA goes beyond studying it. In addition to my position at New America, I am Executive Vice President for National Policy and Partnership Development at ShoreBank Corporation. ShoreBank is the nation's oldest and largest Community Development Financial Institution (CDFI).[1] In the 1970s, ShoreBank's founder and Chairman, Ron Grzywinski, was the only commercial banker to testify in favor of CRA. The commitment is just as strong today as it was then, as evidenced by ShoreBank's ongoing mortgage Rescue Loan Program to assist borrowers in trouble in our Chicago neighborhoods. CRA has been critically important in bringing patient capital to ShoreBank as well as to other Community Development Financial Institutions whose mission—and record—is to provide well-designed, responsible credit and other financial products and services to lower income communities, businesses and consumers.[2]

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[1] Since its founding in 1973, ShoreBank has made cumulative mission investments of more than $3 billion, including financing of more than 50,000 affordable housing units. The bank consistently receives an Outstanding CRA rating.

[2] In addition to my work with ShoreBank, I sit on the boards of two large and effective CDFIs, Coastal Enterprises, Inc., and the Low Income Investment Fund. Over its 29-year history, CEI has directly financed $286 million for business, housing and development in rural northern New England, leveraging an additional $1 billion from banks and other partners During the past 23 years, LIIF has directly financed almost $700 million of low-income housing, charter schools and child care facilities, resulting in 54,000 units of affordable housing, 47,000 child care spaces and 38,000 charter school seats. Like all CDFIs, both CEI and LIIF have multiple sources of revenue and support. However, direct funding from, participation in lending with and service on boards and committees by representatives of banks and thrifts (who are motivated at least in part by CRA), is extremely important to the survival and effectiveness of both institutions.

I have also had experience on the other side of the fence. From October 1997 to December 2001, I was the Director of the Office of Thrift Supervision. As OTS Director, one of my strong priorities was to make certain that the institutions we regulated understood the importance of meeting both the letter and the spirit of the Community Reinvestment Act. I also was eager to make certain they appreciated the benefits their business as community bankers could reap by paying attention, responsibly, to the needs of all customers and communities in their service areas.

Thirty Years of CRA

In 1977, concerned about the denial of credit to lower income communities—both minority and white—Congress enacted the Community Reinvestment Act (CRA). CRA states that "regulated financial institutions have [a] continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered." The statute goes on to require that federal bank regulators both "assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of such an institution" and "take such record into account in its evaluation of an application for a deposit facility by such institution."[3] Institutions are given one of four ratings, from Outstanding to Substantial Noncompliance, and examination reports (called Public Evaluations) are made public.

In the 30 years since its enactment, CRA has generated major changes in the manner in which banks and thrifts view and serve low- and moderate-income communities and consumers. Billions, perhaps trillions, of dollars of credit and investment has come into these communities spurred, incented, or directed by the Act and collateral laws such as the Home Mortgage Disclosure Act (HMDA),[4] various anti-discrimination statutes, and obligations placed on Fannie Mae and Freddie Mac.[5] And while there was a time when those subject to CRA complained bitterly about it, in general that time has passed.

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[3] 12 USC 2901.

[4] 12 USC 2801. HMDA was enacted in 1975, and requires virtually all institutions making residential mortgage loans to maintain records concerning applications, denials, income, race, gender, location, use and, since 2004 for certain loans, price of individual loan transactions, and to report this information to the federal banking regulatory agencies or the Department of Housing and Urban Development. The Federal Financial Institutions Examination Council makes the information for individual institutions as well as for geographies available to the public in paper and electronic form, and individual institutions are required to have their information available to the public at their offices.

[5] See Joint Center for Housing Studies, "The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System," March 2002 (at www.jchs.harvard.edu/research/crarepport.html) ("CRA has expanded access to mortgage credit; CRA-regulated lenders originate more home purchase loans to lower-income people and communities than they would if CRA did not exist"); Remarks of Eugene A. Ludwig, Comptroller of the Currency, July 15, 1997 (at www.occ.treas.gov/ftp/release/97-65.txt) ("Since CRA became law in 1977, we have witnessed more than $215 billion of loan commitments for low and moderate income lending. . . . Since 1993 . . . home mortgage loans to low and moderate income census tracts have risen by 22 percent, more than twice as fast as the rate of growth in all home mortgage loans. In the past four years, banks have invested four times as much in community development projects as they did in the whole previous thirty years."); Remarks of Senator Levin, quoting Chairman Alan Greenspan, 145 Cong. Rec. S4775-76 (1999) ("CRA has 'very significantly increased the amount of credit in communities' and the changes have been 'quite profound.' In 1997 alone, almost 2,000 banks and thrifts reported $64 billion in CRA loans, including 525,000 small business loans worth $34 billion; 213,000 small farm loans worth $11 billion; and 25,000 community development loans totaling $19 billion.").

That same period has also seen major changes in the United States financial system. On the institutional side, both non-bank financial institutions and the capital markets have far greater impact on the financial and economic lives of low- and moderate-income consumers and communities than they did in 1977. From the consumer's perspective, the need for transactional services, savings and investment opportunities that are easy to access and use, and for credit that is high quality and fairly priced have outstripped the simple need for access to credit. From the community perspective, both branch closures and the consolidation of the banking industry have left many communities with more limited access to bank services and decision makers and to the talents and leadership of local bankers in meeting community economic development needs. At the same time, however, community based organizations, including community development corporations, Community Development Financial Institutions, loan funds, counseling agencies, advocates and others, have grown to serve these communities directly and leverage the efforts of banks and thrifts operating under CRA.

During the early 1990s, there were unsuccessful attempts to repeal CRA. However, the Clinton Administration's strong support for the statute; the Riegle-Neal Act of 1994,[6] which allowed interstate banking and branching and precipitated a series of major bank mergers; increased advocacy by community-based organizations; and revisions to the regulations in 1995,[7] ushered in a period of intense activity under CRA. That period largely came to an end by 2001, as a new Administration revised priorities, merger activity slowed down substantially, and the far larger banks that emerged largely focused on their home towns and on national goals, rather than the more local focus that smaller or sub-regional institutions had provided.[8] In 2005 and 2007, bank regulators issued new regulations that vastly reduced the number of banks evaluated for all three of lending, services and investments in low- and moderate-income communities and established a new "intermediate small bank test" that focused on lending and community development activities for institutions with $250 million to $1 billion in assets.[9]

It is time to engage in some fresh thinking about both the credit discrimination issues that resulted in CRA's enactment and how to meet the broader financial services needs of low- and moderate-income consumers. We need to consider both how the banking and thrift industries can be encouraged to better serve lower income consumers and communities and how that obligation can be extended to other providers of essential financial services. The task is made especially difficult by the fact that the industry includes firms regulated at the federal level in a manner different than banks and thrifts (such as securities firms); firms regulated primarily by states in a relatively uniform fashion (such as insurance companies); firms regulated in highly variable fashion primarily by states (such as independent mortgage bankers and money transfer agents); and firms and individuals often subject only to laws of general applicability (such as mortgage brokers).

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[6] Pub. L. No. 103--328; 108 Stat. 2338 (1994)

[7] The 1995 regulations established the three part lending, service and investment test for institutions with more than $250 million in assets, and a lending-only test for smaller institutions, unless they were part of a larger holding company. 60 FR 22156 (May 4, 1995)

[8] See Joint Center, op. cit. page 135 (". . . this report documents that the impact of CRA on mortgage lending has waned in recent years, as dramatic changes in the banking and broader financial services industries have weakened the link between mortgage lending and smaller branch-based deposit gathering organizations on which CRA was based.")

[9] 70 FR 44256 (August 2, 2005); 72 FR 13249 (March 22, 2007)

What have we learned from CRA?

What have we learned from thirty years of experience under CRA? First, we have learned that what is measured gets done. The two strongest areas of activity under CRA have been residential lending and investments such as affordable multifamily housing, community facilities and support for community development corporations and Community Development Financial Institutions. These are two areas where measurement is relatively straight-forward (HMDA makes measurement of residential lending particularly easy), and regulators and outside forces have kept up a steady stream of questions about "how much are you doing, where and for whom?".

Second, especially in the past 10 years as computers have improved and the internet has become a widespread means of communication, we have learned that the regulatory system can be significantly leveraged—with enhanced intensity and frequency of attention—by information made directly available to the public. The homeownership successes under the CRA have resulted from the combination of CRA and its companion statute, HMDA. Especially since 1990, when HMDA data was vastly increased and made more generally available, the public, advocacy groups, and the media have been able to use the data to generate change in the activities and policies of financial institutions. Moreover, the institutions themselves have been able to use the data to compare their performance to that of their peers, and to know outside of an examination where improvements are needed.

Third, CRA has generated a fair amount of innovation, in an industry that is—or certainly was—not especially known for innovation, especially with respect to entry into new markets. In the investment area, this has included the "CRA MBS," the "EQ2," and effective use of the low-income housing and new markets tax credits. In lending, expanded underwriting for both prime and non-prime loans was encouraged by the opportunity for CRA credit. Recently, CRA service credit has probably had an impact in encouraging banks to explore better ways to serve "underbanked" consumers. CRA changed the hurdle rate for new products, services and markets, encouraging banks and thrifts to look for investments and products for which a part of the return was in CRA credit, rather than dollars. Once these initiatives were started, many have proven to be sustainable in purely financial terms.

Fourth, CRA's implicit requirement that banks enter new markets where gaining trust, getting business and making a profit were not familiar has required partnership and collaboration with a wide variety of more community-oriented institutions. Partners include social service agencies, religious entities, credit counseling agencies and governmental units. But perhaps more importantly, CRA has also led to partnerships with community development corporations and with community-based financial institutions, including Community Development Financial Institutions and non-profit loan funds, often generating significant opportunities to leverage scarce philanthropic and government funds and develop innovative products and strategies.

While these features of CRA have been, on the whole, positive, other experiences with the statute suggest areas for caution and improvement.

First, CRA applies only to banks and thrifts. The myriad of other types of organizations, ranging from credit unions through mortgage bankers, securities firms and insurance companies to check

cashers, payday lenders, pawn shops and mortgage brokers, who provide some or all of the same types of financial services to some or all of the people and places CRA was designed to assist, remain uncovered. While some of these entities have, either in general (e.g., credit unions) or in specific locations (e.g., insurance companies in Massachusetts), other types of obligations to provide service broadly, and still others (e.g., securities brokers) have customer service standards, the requirements are not uniform in intent, coverage or method of enforcement. For lower income consumers and those in lower income communities this difference has been exacerbated, as alternative providers have expanded their presence while regulated entities have either continued to stay away or reduced service.

Second, CRA has become a complex regulatory regime, especially with respect to the service and investment tests. The question of "what counts" is the subject of endless, and frequently frustratingly unpredictable, discussion, debate and guesswork. Regulatory enhancements are an extremely long process (the most recent started in 2001 and ended in 2007), and development of the questions and answers that provide a practical gloss on the regulations can take almost as long. Moreover, the complexity focuses largely on inputs (e.g., how many branches, how many loans) rather than outcomes (e.g., how many lower-income people served) or—admittedly more difficult—impacts (e.g., how have their lives been improved). The "bean counting" feature of the lending test, especially for residential loans, has resulted not only in excessive focus on home loans, but also on a press for quantity with limited (and only recent) attention paid to quality.

Third, although CRA's lack of an explicit enforcement mechanism beyond the publication of ratings and examination results and consideration when an institution is applying to merge with or acquire another institution or open a branch has proven effective during periods of high merger activity and for institutions set on expansion, a broader system of incentives and sanctions is needed. Improvements in the rating system (e.g., a more-than-four-point scale), a public evaluation database more friendly to analysis, and external incentives and sanctions such as linked deposits, restrictions on and opportunities to do business with a jurisdiction, and potentially even increases or reduction in deposit insurance could serve to keep CRA on the front burner during periods of little merger activity or with respect to institutions unlikely to be either acquirers or acquired would be desirable.[10]

Fourth, the spatial origin of CRA has had several negative effects. First, as institutions have spread geographically and become more reliant on the capital markets for funding, and especially as they have engaged in business strategies that place limited reliance on physical presence, the essential underpinning of CRA—that at least a substantial portion of money gathered in a place where the bank is "located" should be reinvested there—has become both less relevant and more difficult to square with business reality. Second, notwithstanding that redlining had its origin in racial discrimination, the statute is "color-blind," which has limited its impact in the many of the communities and populations it was meant to benefit. Third, we have learned that it is important to focus on both people and places; higher-income consumers in low-income or minority places have been disadvantaged, as have lower-income and, especially, minorities, no matter where they live. Fourth, in areas such as Salt Lake City, Utah; Wilmington, Delaware; and New York City,

[10] Recent substantial losses related to participation in unaffordable and unsustainable mortgage lending—whether directly or through investment activity—should serve as irrefutable evidence of the link between safety and soundness, and thus insurance risk, and dealing with consumers fairly and equitably.

where banks have congregated for business reasons, the competition for CRA investments has created an artificial market that drives up prices and siphons investment from other communities. A related concern has been the limited amount of money available for investment in rural areas, in part because of technical issues surrounding the geography of rural census tracts, but also because many rural areas are outside the assessment areas of major financial institutions.

Finally, the "optional" features of CRA have proven the most difficult to implement effectively. These include the strategic plan option and the option whether to include loans and other activities by affiliates in a bank's CRA analysis. The strategic plan option has been rarely used, in spite of its theoretical utility for institutions with non-traditional business strategies, especially internet banks and others with a limited geographic base. The ability to count affiliate loans, which are often subject to far less regulatory supervision and scrutiny than loans made in the bank, toward meeting CRA goals also raises concerns, especially with respect to lending outside of a bank's major assessment areas.

This experience suggests six conclusions:

- For lasting impact over a broad range of issues in an industry that changes quickly, a basic statutory scheme that is broadly directive but not overly prescriptive is preferred.
- Some sort of uniformity of requirement across the multitude of industries that provide substantially similar financial services to consumers is highly desirable, even in the face of different regulatory and enforcement schemes.
- The evolving technologies of both analysis and media present enormous opportunities to involve the public, the advocacy community and the media in enforcing a statutory scheme, as long as the public is provided relatively frequent, accurate, reliable and useable information about the facts that demonstrate adherence to the scheme; similarly, technology has vastly reduced the cost to institutions of providing such information.
- The public, the advocacy community and the media cannot operate in a vacuum; regulatory interaction with specific companies is a necessary base on which to lever the public and media effects.
- Things that can be counted in a fairly straight-forward manner generate the most impact, but it is important to count the right things in the right places; ensuring that consumer protection and non-discrimination laws and regulations are part of an analysis of how well an institution is doing is essential.

More broadly, given the strong evidence that serving lower-income consumers and communities does not present itself as a profit-maximizing strategy for financial institutions and the capital markets, both advocacy from and partnerships and collaboration with community-focused institutions for whom these consumers are major stakeholders is essential; the existence, strength and effectiveness of such institutions needs external support from government, philanthropy and the private sector.

People or Place? Both

The language of the CRA statute is focused on communities, and the impetus for its enactment was redlining of entire neighborhoods. Investment in the housing, businesses, facilities and infrastructure of communities is essential to community vitality and a critically important part of CRA's importance and impact. Nevertheless, the manner in which financial institutions dealt with the people in low- and moderate-income communities—limiting their access to credit,

closing branches and moving out—was also at the heart of CRA's origins. Apart from announcements of lending targets and analysis of residential mortgage lending (a function more of HMDA than CRA), however, the people element of CRA has received comparatively less focus. With home mortgage foreclosures hitting record levels with projections to continue increasing at least through 2008, consumer revolving debt breaking records and delinquencies rising quickly, and an estimated 40 million Americans without or not making optimal use of bank accounts, this is a good time to consider how the people aspects of CRA can be improved. And although improving the service test is an element of this, broader reforms are needed. This is the focus of the remainder of my testimony.

A new paradigm for responsibility in consumer financial services

I believe it is time for a new paradigm for consumer financial services, one just as bold as CRA was 30 years ago:

> Any financial institution that provides an essential consumer product must make that product available in a fair and transparent manner to low- and moderate-income consumers in all communities in all broad geographies in which the entity does more than an incidental amount of business in the product.[11]

Fairness and transparency are principles of general applicability in the financial services sector. But there are special reasons to focus on how these principles apply to low- and moderate-income consumers. These include a smaller margin for error and lack of capital on which to base a recovery when something goes wrong; generally lower education levels; less access to quality and timely financial advice; and, especially in the last 15 years, a younger population often with limited experience with the American financial system.

In this context, *fair* means that an entity providing essential consumer financial services to the general public, directly or through agents, abides by the following principles:

- Essential financial services meet the needs and desires of low- and moderate-income consumers, with sufficient market research undertaken to accurately assess those needs.
- Essential financial services are offered at equitable prices and terms, based on cost and an accurate assessment of risk.
- Analysis of potential profitability over time, need for capital and other criteria for investment, is done on a basis that is no less favorable for service to low- and moderate-income consumers than for similar opportunities relating to wealthier consumers.

Transparency has two essential dimensions, one relating to consumers and one to the public:

- Potential and actual customers are provided with quality service and accurate information, delivered in a timely and understandable fashion, about the terms of products, including realistic information about risks

[11] The paradigm would not explicitly cover financial institutions that do not provide products to consumers directly or through agents, such as investment banks and Fannie Mae and Freddie Mac. However, the responsibilities institutions have in directly serving consumers should carry through to their investment activities. See Letter from Edward B. Kramer, Deputy Superintendent of Banks, State of New York Banking Department, "Due Diligence Recommendations Concerning the Eligibility of Loan Purchases and Investments for Consideration Under the Community Reinvestment Act," July 26, 2001, available at http://www.banking.state.ny.us/lt010726.htm.

- Information about the manner in which firms provide essential consumer financial services is available to the public or, in the case of information that is truly proprietary, a government intermediary. That information is available in a manner, and with sufficient quality, quantity and timeliness, to make it possible for persons outside the firm to accurately assess the extent to which a firm meets its obligations, both during the current period and over time.

This paradigm thus focuses on the effective development, marketing and distribution of well-designed and understandable essential consumer products and services, and a requirement of equity across communities and consumers of all types. It concentrates the attention of business, the public and government on what is important to consumers and uses the market forces generated by consumers with the knowledge and resources to demand high quality financial services to extend the reach of those products and services to the rest of the market.

What types of products and services should be subject to a new responsibility paradigm?
It is important not to pull back on current coverage of CRA. At the same time, it is also clear that not all products, services or financial institutions should be covered. To take an extreme example, it is neither necessary nor an appropriate use of scarce enforcement resources to ensure that hedge fund investment opportunities be available to low- and moderate-income consumers. However coverage should not be excessively limited, or too tied to current economic conditions and financial structures and opportunities.

A useful way to think about product and service coverage is to focus on those financial products and services that are essential to full and active participation in the American middle class. These include products and services to meet transactional, credit, saving and investment, and insurance needs. Products and services should be considered "essential" only if they are broadly used by the public. Although the items included will probably change over time, by defining as much as possible in terms of functionality rather than specific products, we can reduce the need for additions or subtractions.

With respect to transactions, the on-going virtually revolutionary changes occurring with pre-paid cards and the likelihood of major breakthroughs in the use of mobile phones to effect financial services strongly urge a functional approach. Essential functionalities are: (i) converting sources of revenue (especially paychecks and benefits of all sorts) into useable means of payment; and (ii) a means of making timely and secure payments and transfers to savings or investment.

For credit, essentiality may be defined in terms of what credit needs are likely to be. This, of course, is the area of initial concern under CRA, and it continues to be critical to provide the leverage for major wealth-building investments such as a home or higher education and to smooth income fluctuations. Thus, essential credit products are: (i) small dollar short-term credit, whether secured or unsecured; (ii) auto credit; (iii) mortgage credit, and (iv) credit for post-secondary education.

Saving and investment are categories that were not part of the initial CRA focus, in part because one of the problems CRA was attempting to respond to was that people in lower income

communities were saving by making deposits in local financial institutions, but those savings were not being reinvested in the communities. Our current debt-led economic troubles and negative national personal saving rate demonstrate the need for increased saving. As to investments, in 1977 individual access to investment opportunities was not only limited, but the need for such opportunities was reduced by the prevalence of defined-benefit retirement plans, in which the employer took responsibility for investment decisions and outcomes. This has changed in the intervening period. The new paradigm should cover: (i) non-purpose-limited short-term savings opportunities; (ii) longer-term low-risk savings and investment opportunities (e.g., insured accounts, CDs, and Treasury obligations including savings bonds); and (iii) tax-advantaged investment opportunities such as retirement accounts and section 529 education plans.

Finally, insurance is an essential product in a number of areas and highly desirable in others. In most states, owners of automobiles must be insured, and mortgage creditors demand homeowners insurance. Beyond the requirements, both of these types of insurance are important in protecting the assets that are most important to the financial well-being of most families. It is therefore important to include automobile and homeowners insurance in the new responsibility and accountability regime. Medical insurance, including long-term care coverage, is also highly desirable; recent research has demonstrated that a significant portion of bankruptcies are caused by uninsured medical expenses. However, this is an issue that goes far beyond the financial services sector and requires a much broader solution.

How do these principles relate to current CRA enforcement and interpretation?
To bring CRA more fully in line with both the modern financial services system and the principles and scope proposed, some changes would be desirable. The most important are the following:

- CRA should cover service to low- and moderate-income consumers everywhere a bank or thrift does a significant amount of business in any of the essential products—for that product. If a firm operates nationally, it should be evaluated on how well it serves low- and moderate income consumers nation-wide with the type of product it is offering nationally.
- Effective public disclosure regimes should be added that cover additional essential products, including in particular the types of and use by low- and moderate-income consumers of essential transaction and savings products.
- Any for-profit subsidiary or holding company affiliate that provides any of the essential products should be evaluated in the same manner and at the same time as the largest bank or thrift in the holding company group.
- Consumer protection and fair lending responsibilities must be more firmly embedded in CRA evaluations, extending the 2005 regulatory revisions that explicitly included consideration of such laws and regulations in evaluating lending activities[12] to include transactional, saving and investment offerings and investments where consumer products are implicated.

[12] See 12 CFR 345.28(c) (FDIC); 12 CFR 228.28(c) (Federal Reserve); 12 CFR 25.28(c) (OCC); 12 CFR 563e.28(c) (OTS).

- Incentives should be established that are external to CRA, potentially including reductions in insurance premiums for Outstanding performance. To stimulate better performance and limit grade inflation, the number of Outstanding ratings should be limited, perhaps to a solely increasing percentage above current levels.

Extending the paradigm

Simply extending CRA to other types of financial institutions, placing examination and enforcement responsibility on their regulators to the extent they have them, or surrogates such as the US Department of Housing and Urban Development, is a potential way to extend the paradigm. For credit unions, regulated under a regime similar to banks and thrifts and also the beneficiaries of federal deposit insurance, such extension would appear to be appropriate, perhaps modifying the credit unions' statutory service obligation to take into account enhanced responsibilities under a new regime. However, for other types of financial services entities, operating under different types of—or no—regulatory regime, alternative solutions are probably required. These solutions should take maximum advantage of regulatory systems and responsibilities already in place, aiming to achieve equity in result, rather than complete consistency in regulatory methodology.

A first step should be to ensure that any requirement for public reporting and dissemination of information about credit extended beyond residential lending include all creditors who extend similar types of credit. As HMDA has demonstrated, with uniform reporting requirements, an option to use government-supplied software, and a single entity (in the case of HMDA the Federal Reserve) responsible for cleaning the data, making it publicly available and doing initial analysis, the obligation to report can be extended to institutions that are not subject to general federal regulatory jurisdiction. Although HUD is the initial recipient of mortgage data under HMDA, information about other types of credit could be provided initially to state regulators in the case of entities so regulated or directly to the Federal Reserve.

Similarly, public reporting on non-credit services should be tailored to the type of service and include all those providing such services as a significant part of their business. For example, while information about income levels of checking and savings account holders of a limited typology of accounts may be the primary focus in understanding whether banks, thrifts and credit unions are meeting a service obligation, for insurance companies the information collected might relate to the characteristics of holders of defined types of policies. Because this information would be industry-specific, it should be gathered and disseminated by industry specific regulators where such exist, under standards developed in coordination with bank regulators. As with credit information, other types of financial services providers could provide information directly to the Federal Reserve.

Public dissemination of information is serves to inform the public and expand the likelihood that high quality service for all consumers will be a competitive advantage. However, to ensure that providers are meeting their obligations, public dissemination of data must be accompanied by a regulatory regime that evaluates compliance and has consequences both directly for the institution and by making the public aware of how an institution is behaving. In the context of an already difficult undertaking, this is the most difficult part. We cannot expect wholesale

adoption of the bank regulatory model by other regulatory regimes, and it is unlikely that would even be desirable.

Instead, the principles reflected in the responsibility paradigm should be adopted into various regulatory regimes in a manner that is consistent with the scope and intent of the particular regime, and that is consistent with and builds on existing and improved consumer-oriented obligations and protections. For state-regulated entities, national legislation establishing principles, a regulatory floor, and a back-up regulatory regime should states not move toward adoption of the regulatory minimum would appear to be the appropriate mechanism.

Consistent integration of the principles of the paradigm into disparate regulatory regimes will require consultation and collaboration at both the state and federal levels. Moreover, with respect to financial services companies not currently subject to any federal regulation and limited state regulation, consideration of a combination of enhanced state regulatory authority (and funding), increased responsibility and funding for the Federal Trade Commission and/or creation of statutory responsibilities at the state and federal levels, with private rights of action to enforce them are all appropriate.

Even considered in the context of existing regulatory regimes, the adoption in full of the new responsibility paradigm is a major undertaking. It is, however, possible to stage adoption, and several schemes suggest themselves. One possibility is to start with the products most likely to create major problems for consumers, and with the entities that sell those products. The current situation in the credit markets suggests that credit products should be first on the agenda, followed perhaps by investment products. A second scheme would be to stage implementation based on the lack of availability or accountability for essential products. In this scheme, an initial focus could be on transaction products, where federally regulated depositories are not effectively serving millions of Americans and alternative providers are subject to little scrutiny and public accountability. A third alternative would be to start where existing statutory and regulatory schemes are most developed and where implementation of the principles of the agenda would require relatively modest changes. This suggests that, beyond banks and thrifts, the agenda's principles should be applied first to credit unions, then to insurance companies and their agents and to securities brokers.

Each alternative has benefits and drawbacks, the first two largely related to development of new regulatory regimes and the last to exacerbating the competitive inequality that exists in the current uneven regulatory system. But they do suggest ways to improve, in measured increments, the essential financial products and services consumers need and the manner in which those services are delivered.

Conclusion

Thirty years ago, large swaths of American cities were dying for lack of credit. By enacting CRA, the federal government challenged the banking industry to help those communities and their residents to a better life. Together with related statutes such as HMDA and anti-discrimination and consumer protection laws, CRA has had a substantial and positive impact in bringing credit and other financial services to low- and moderate-income consumers and communities.

However, the thirty years since the statute's adoption have seen massive changes in the number, complexity and types of financial products consumers use, how they are marketed and accessed, and who provides them. Simultaneously, the increase in homeownership, workforce restructuring, and the decline in employer-provided retirement and health benefits, require consumers to take much greater responsibility for their financial health and stability. Many Americans are not doing well in meeting this new responsibility. The personal savings rate is negative, foreclosures and bankruptcies are at record levels, and debt burdens are overwhelming many more families. The new responsibility paradigm presented here challenges the entire financial services industry—as CRA did thirty years ago—to help American consumers do better.

Testimony

Written Testimony of

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Submitted to the

United States House of Representatives
Committee on Financial Services

"The Community Reinvestment Act:
Thirty Years of Accomplishments, but
Challenges Remain

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Introduction

Chairman Frank and Ranking Minority Member Bachus, it is a pleasure and honor to be here today testifying about the Community Reinvestment Act (CRA). I am the President and CEO of the National Community Reinvestment Coalition (NCRC). NCRC is an association of more than 600 community-based organizations that promote access to basic banking services including credit and savings, to create and sustain affordable housing, job development and vibrant communities for America's working families. Our members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned business associations, local and social service providers from across the nation.

As we celebrate thirty years of the Community Reinvestment Act (CRA), we should reflect on the powerful and proven effects that this law has had on increasing access to capital and credit in low- and moderate-income communities. Looking back, we see a law that has stimulated the flow of billions of dollars each year to lower-income and minority communities to expand homeownership and promote healthy neighborhoods.

A regulatory infrastructure for the housing finance market that has remained largely unchanged since the 1970s is chiefly to blame for the current foreclosure crisis. In this matter, we are fortunate to have thirty years of experience with the Community Reinvestment Act which allows us to plot a path forward. The changing and complicated nature of the financial system, and its centrality to the economic wellbeing for all Americans, demands that we modernize CRA and extend its reach.

Numerous studies have found that CRA encourages responsible lending to low- and moderate-income communities in a way that is consistent with safety and soundness concerns. Importantly, most of the unfair and deceptive practices in the subprime market were the work of non-CRA covered mortgage lending institutions.

The current crisis demonstrates that a key component to a robust and sound economy is the inclusion and full participation of all households in an efficiently functioning and responsibly regulated financial system. The National Community Reinvestment Coalition, under the rubric of the "Financially Inclusive Society," is examining ways in which the many thoughtful financial innovations that have been developed over the past decade, can be better prioritized and organized into a comprehensive legislative proposal, that might one day lead to true equality of access to financial services for all Americans.

The testimony I bring to the Committee today, on behalf of NCRC, addresses the following points:

1. **How CRA increases access to credit, investments and services in low- and moderate-income communities**

2. **How to improve the examination process and criteria**

3. **How to improve the adequacy of the enforcement mechanism for CRA compliance**

4. **The role of public comment and the degree public participation should play in the CRA evaluation and application approval process**

5. **Whether changes in the financial services industry have reduced the effectiveness of CRA and how expanding CRA to additional financial service providers may improve the effectiveness of the law**

6. **Whether federal banking agencies' examinations of institutions are adequate in finding evidence of discriminatory, predatory or illegal lending**

7. **Other Factors that Impair Effectiveness of CRA: Less Frequent Exams for Small Banks**

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1. How CRA Increases Access to Credit, Investments and Services in Low- and Moderate-Income Communities.

CRA imposes an affirmative and continuing obligation upon banks to serve the credit needs of communities, including and especially low- and moderate-income (LMI) communities. Because-banks have the privilege of safeguarding and investing community wealth, they have been given a lawful duty to meet community lending and credit needs. Banks most effectively respond to the credit needs of communities when they receive public feedback and consider community priorities. CRA exams and the merger application process offer opportunities for citizens to submit written and oral comments to banks and regulatory officials concerning the performance of banks in meeting credit needs. Regulatory officials consider these comments when assigning ratings on CRA exams and when deciding whether to approve or deny merger applications. Additionally, the publicly available data on home lending, small business lending, community development lending and branching become key tools for citizens to evaluate a bank's dedication to serving public credit needs.

CRA makes banks publicly accountable for responding to community needs. The quality of collected data, CRA exams and the merger application process determine the extent to which this accountability is preserved and the degree to which community credit needs are met. CRA also encourages banks to reach out to form programmatic relationships with community groups, including NCRC member organizations.

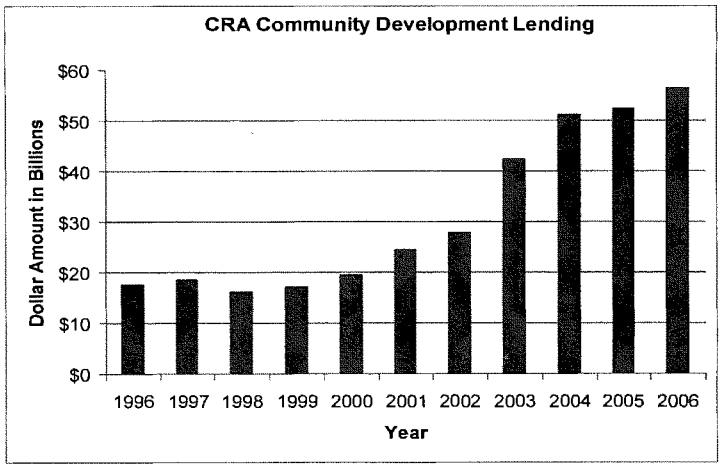
As shown in the survey of NCRC members in the testimony appendix, NCRC's members have experienced success in obtaining community development financing. For example, the Housing Development Fund (HDF), in Connecticut, manages almost $50 million in funding from banks. This organization has obtained capitalized funding pools from banks that, in return, receive CRA credit for their participation. HDF has used this funding to provide financial assistance to affordable housing developers and to first-time home buyers. To date, HDF has financed almost 600 affordable housing units and helped an additional 600 families purchase homes.

The San Diego Fair Banking Coalition received bank support for its Women Entrepreneurs program (WE). WE is a 54-hour entrepreneurial training program for women starting or operating a small business. WE also provides participants with individualized and confidential business consulting as needed.

According to NCRC studies, banks and thrifts (depository institutions) have made 341,619 community development loans totaling more than $344 billion since 1996. From 1996 to 2006, the annual dollar amount of community development loans increased 219 percent - from $17.7 billion to $56.5 billion, respectively. (See graph below.) During this same period, depository institutions also made 12,433,172 small business loans in low- and moderate-income neighborhoods totaling more than $513 billion.

The CRA merger application process has motivated banks to make $4.6 trillion in CRA agreements and commitments to LMI and minority communities. As described in NCRC's *CRA Commitments* publication, CRA agreements are detailed pledges for offering affordable home loans, small business loans, community development investments, and branches in working class and minority communities.[1]

[1] NCRC's *CRA Commitments*, via http://www.ncrc.org/policy/cra/CRA%20Commitments%2007.pdf.



Overall, banks make considerably more home loans in geographical areas covered by CRA agreements than those that are not.[2] This was documented in a study conducted by Federal Reserve economists using NCRC's CRA database. The incentives provided by CRA encourage banks to seek out opportunities in previously underserved markets. According to the Treasury Department, CRA-covered lenders increased home mortgage loans to LMI borrowers by 39 percent from 1993 to 1998. This increase is more than twice that experienced by middle- and upper-income borrowers during the same period (17 percent).[3] Likewise, study by *The Joint Center for Housing Studies* at Harvard University estimates that without CRA, 336,000 fewer home purchase loans would have been made to LMI borrowers and communities between 1993-2000.[4] The study also reveals that banks issue a higher number of loans to LMI borrowers in geographical areas covered by CRA exams than in areas not covered by the exams (Banks are generally not subject to CRA exams in geographical areas in which they engage in lending through brokers, as opposed to branches).

CRA's effectiveness can also be measured by comparing the lending patterns of CRA-covered banks with those of lending institutions not covered by CRA exams. Data suggests that banks make a greater percentage of their loans to minorities and LMI borrowers than non-CRA covered mortgage companies and credit unions. In 2005, CRA-covered depository institutions made 5.8 percent of their home purchase loans to low-income borrowers, while non-CRA lenders issued only 4.8 percent of these loans to the

[2] Raphael Bostic and Breck Robinson, *Do CRA Agreements Influence Lending Patterns?* July 2002, available via bostic@usc.edu.
[3] Robert Litan, Nicolas Retsinas, Eric Belsky and Susan White Haag, *The Community Reinvestment Act After Financial Modernization: A Baseline Report*, produced for the United States Department of the Treasury, April 2000
[4] The Joint Center for Housing Studies at Harvard University, *The 25th Anniversary of the Community Reinvestment Act: Access to Capitol in an Evolving Financial Services System*, March 2002.

same group. Depository institutions and non-CRA covered lenders made 25.1 percent and 23.8 percent of their home purchase loans, respectively, to low and moderate-income borrowers. Also, in 2006 (the most recent home loan data available), depository institutions extended 23.5 percent of home purchase loans to LMI groups, whereas non-CRA covered lenders extended 21.5 percent.

NCRC's study *Credit Unions: True to Their Mission*, showed that over a three-year time period, banks consistently outperformed credit unions in offering home loans to minorities, women, and low- and moderate-income borrowers in a majority of states.[5] The study found that in Massachusetts (the only state with CRA for credit unions) state-chartered credit unions that abided to CRA guidelines served LMI, minorities and female borrowers at a rate significantly greater than non-CRA federally-chartered credit unions.

CRA has remained true to its statutory purpose of requiring banks to serve credit needs consistent with safety and soundness. In fact, CRA can be an important antidote to the predatory and unsafe lending that has contributed to the foreclosure crisis. In their review of HMDA data, the Federal Reserve has found that home loans issued by banks are significantly less likely to be high-cost and exhibit risky features such as piggyback lending. The Federal Reserve Board showed that 34.3 percent of the home purchase loans issued by non-CRA covered lenders were high cost loans in 2005.[6] By contrast, only 5.1 percent of the home purchase loans issued by depository institutions and closely scrutinized on CRA exams were high cost. These findings were corroborated by Traiger & Hinckley LLP which observed 33.5 percent of high-cost loans issued by non-CRA covered lenders in 2006, as opposed to only 11.5 percent of high-cost home purchase loans issued by CRA covered institutions.[7]

Research has not fully explained why CRA covered institutions issue fewer high-cost loans, but it confirms that they do. One factor may be that CRA-covered institutions are subjected to a higher level of regulatory scrutiny than non-CRA covered institutions, including fair lending and safety and soundness evaluations. Compliance with the law and keeping a good reputation and relationships in the community may be sufficient motivating factors for banks to lend responsibly.

Another factor may be that CRA encourages institutions to holistically meet community needs - from lending for homeownership to rental housing, basic banking, and small business lending. Under this rubric, banks are encouraged and are awarded points on CRA exams for preparing borrowers carefully for home loans through building savings and by providing quality homeownership counseling. Non-CRA covered institutions, by contrast, are not similarly encouraged to carefully respond to such needs nor to prepare community residents for homeownership.

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[5] *Credit Unions: True to their Mission?* available via http://www.ncrc.org/policy/states/cu_report2.php.
[6] Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, *Higher Priced Home Lending and the 2005 HMDA Data,* Federal Reserve Bulletin, September 8, 2006.
[7] Traiger and Hinckley, LLP, *The Community Reinvestment Act: A Welcome Anomaly to the Foreclosure Crisis,* January 7, 2008.

2. How to Improve the Examination Process and Criteria

Our testimony has so far described how CRA has leveraged significant increases in lending and investing. The remainder of the testimony will focus on the importance of strengthening CRA to adapt to changing conditions.

Research supports that CRA has been effective in providing financial institutions with incentives to serve their communities and increase loans, investments, and services. At the same time, necessary improvements will enable CRA to realize its full potential in directing resources towards the economic revitalization of LMI and minority communities.

Much of CRA's leverage is attributable to the fact that CRA evaluation outcomes are public. The CRA report card that measures banks' reinvestment performance has encouraged the industry to become conscientious of and responsive to community needs. The design of large-bank CRA evaluation recognizes a variety of community needs that are met through bank lending, investing, and provision of basic services. Had the large bank exam only focused on lending, banks would neglect vital investments and basic services. In contrast, had lending been downplayed on exams, less progress would have been recorded over CRA's 30 years in lending to LMI communities. In addition, the weighting system (50% lending, 25% investment, and 25% services) on the large bank exam has struck the right balance in the importance accorded to lending, investing, and services.

While the overall framework on large bank CRA exams has been successful, the following exam procedures are in need of reform.

A. ***Assessment Areas*** - The geographical coverage of CRA exams;
B. ***Affiliates*** - Whether CRA exams consider the behavior of mortgage company affiliates;
C. ***Minority Borrowers and Communities*** - Consideration of minority borrowers and communities on CRA exams;
D. ***Evaluation of Branching*** - Evaluations for considering branching on CRA exams;
E. ***Data*** - Data limitations that reduce the effectiveness of CRA exams.

Each of these issues are now discussed in turn:

A. ***Assessment Areas*** - The geographical coverage of CRA exams

The geographical locations covered by CRA exams generally consists of metropolitan areas or counties that contain bank branches. When Congress enacted CRA in 1977, banks received deposits and made loans through branches, and the majority of bank lending occurred through these branches. Today, banks utilize diverse channels for lending. While some banks still issue loans predominantly through branches, many others make the majority of their loans through brokers, correspondents, and other non-branch means.

Though the CRA regulation stipulates that assessment areas include geographical regions containing bank branches, the regulation also states that assessment areas shall include geographical regions surrounding branches in which the bank has originated or purchased a substantial portion of its loans.[8] Despite the clarity of this regulatory clause, the federal agencies usually adopt a narrow definition of assessment areas for banks or thrifts that issue most of their loans through non-branch channels. For these banks, it is not unusual to encounter CRA exams that cover only the geographical area of the bank's headquarters and thus a minority of the bank's lending.

Data reveals that discriminatory and unsafe practices are more likely to occur when CRA exams cover loans defined by narrow assessment areas procedures. In 2007, NCRC identified several lending institutions engaged in questionable practices, including: refusal to make loans under a minimum loan amount (usually $75,000 or $100,000), refusal to make loans to row homes, and failure to offer loans within entire cities (such as Baltimore and Philadelphia). In other cases, lending institutions charged higher interest rates on loans that could not be justified by legitimate business necessity. NCRC investigations revealed four banks engaged in these practices. Tellingly, only 11% to 13% of the loans investigated were in the banks' assessment areas.

Occasionally, federal agencies will review a sample of loans outside assessment areas to determine if lending performance remains consistent with lending inside assessment areas. But the agencies sampled loans outside the assessment areas for only one of the four banks that NCRC investigated. In general, the reviews of lending outside of assessment areas have not been satisfactory. The sample of loans reviewed usually consist of a minority of a bank's total loans. Also, it is not uncommon for an examiner to issue vague conclusions, for example, that lending is consistent inside and outside of assessment areas.

To address the problem of assessment areas, NCRC recommends a solution consistent with HR 1289 - the CRA Modernization Act of 2007. Under this bill, if a bank has captured one half a percent or more of the local lending market, a CRA exam would designate the geographical area served by the bank as an assessment area. A procedure such as this would ensure that a majority of a bank's loans were scrutinized by CRA exams. We believe that policymakers would want the majority of a bank's loans and purchases to be included on CRA exams so that the exam can effectively ensure that the loans are serving low- and moderate-income populations in a safe and sound and non-discriminatory manner.

B. ***Affiliates*** - Whether CRA exams consider the behavior of mortgage company affiliates

Under CRA currently, banks have the option of including their non-depository affiliates, such as mortgage companies, on CRA exams. This procedure often leads to the "cherry picking" of affiliates to be included in CRA exam process. Banks are tempted to include

[8] See Section 345.41 of the FDIC's CRA regulation available via http://www.fdic.gov/regulations/community/community/index.html

affiliates on CRA exams if the affiliates perform admirably but will opt against inclusion if the affiliates are engaged in risky lending or discriminatory policies. This is counter to the essential purpose of CRA, which is to ensure that the institution as a whole is meeting credit needs in a responsible manner. It is not sufficient if only one part of the institution is complying.

Four non-depository affiliates of banks were identified by NCRC's fair lending investigations to be engaging in redlining or other discriminatory practices. These four affiliates were not included on their bank's CRA examinations. Current CRA examination procedures enable banks' affiliates to engage in such practices undetected. The CRA Modernization Act would end this serious gap in CRA enforcement by mandating the inclusion of affiliates on CRA exams.

Combined Effects of Inadequate Procedures for Assessment Areas and Affiliates

Inadequate procedures for assessment areas and affiliates often result in CRA exam coverage of only a minority of loans made by major lenders in metropolitan areas. NCRC analyses' usually show that fewer than five of the top 20 lenders (in terms of the most loans issued) in a metropolitan area typically have a CRA exam that actually measures performance in that metropolitan area. In some cases, banks can be half or more of the top 20 lenders, but their CRA exams' assessment areas do not include the particular metropolitan area. Also, non-depository affiliates can be excluded from their CRA exams.

The Joint Center for Housing Studies at Harvard University conducted a national study with results that mirrored NCRC's analyses. The study found that just under 30 percent of the home purchase loans issued in 2000 were made by CRA institutions in CRA assessment areas.[9]

Fundamentally, the inadequate procedures for assessment areas and affiliates lead to the failure of federal agencies to implement CRA's statutory purpose. The CRA intends a bank to meet the credit needs of all communities in which it operates. Therefore, it is not sufficient for CRA exams to cover a minority of a bank's and its affiliate's loans.

C. ***Minority Borrowers and Communities*** - Consideration of minority borrowers and communities on CRA exams

On a CRA exam, lending to low- and moderate-income borrowers and communities is examined in detail. A major part of the lending test consists of scrutinizing the percentage of a bank's loans made to low- and moderate-income borrowers compared to the demographics of the bank's community and to the percentage of loans made to LMI borrowers issued by the bank's competitors. Tables throughout the CRA exam engage in this analysis for home purchase lending, refinance lending, home improvement lending and small business lending.

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[9] Joint Center for Housing Studies, Harvard University, *The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System*, March 2002.

CRA exams have a fair lending component that assesses whether a bank discriminated by rejecting qualified minority applicants or steering minorities with good credit to subprime loans. While the fair lending test is necessary, it does not test whether banks are affirmatively making loans to minorities. In other words, a bank can employ non-discriminatory policies but still make relatively few loans to minorities because it does not market to minority communities. It may pass its fair lending review because it treated the few minorities who applied fairly, but it can still make very low percentages of its loans to minorities. If, on the other hand, lending to minorities was an explicit criteria on CRA exams, then consistently low percentages of loans to minorities in all loan types and geographical areas would contribute to a lower rating for the bank.

Given the evidence of lending disparities by race, NCRC has called for CRA exams to explicitly examine lending and services to minority borrowers and communities. In our *Broken Credit System* report, we show that minority neighborhoods received larger percentages of subprime loans than predominantly white neighborhoods, even after controlling for creditworthiness and other housing stock characteristics.[10] Federal Reserve economists came to similar conclusions about high levels of subprime loans in minority neighborhoods after controlling for creditworthiness.[11] In our more recent report, *Income is No Shield against Racal Differences in Lending*, NCRC found that racial disparities in high-cost lending are large even when comparing middle- and upper-income minorities against middle- and upper-income whites. Finally, in another NCRC study, *Are Banks on the Map*, we find larger disparities in branching by race of neighborhood than by income of neighborhood in 25 large metropolitan areas.[12] NCRC hypothesizes that a lack of analysis in CRA exams by race of neighborhood has contributed to the greater disparities in branches by race than income. Overall, we believe that a consideration of lending and branching by race of borrower and neighborhood would lessen the racial disparities in access to bank services and loans.

Before the CRA regulatory reforms in the mid-1990's, CRA exams under Assessment Factor D would often use HMDA data to assess performance of lending to minorities. An example of this approach is employed in the evaluation of Signet Bank conducted by the Federal Reserve Bank of Richmond in 1996. This use of HMDA data should be reinstated and expanded given the reality that lending differences by race and ethnicity remain persistent and significant. If the regulatory agencies do not reinstate lending and service to minorities as criteria on CRA exams, then Congress should amend CRA to add lending and service to minorities as provided in the CRA Modernization Act of 2007.

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[10] *Broken Credit System* available via http://www.ncrc.org/policy/cra/documents/ncrcdiscrimstudy.pdf

[11] Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. Available via pcalem@frb.gov. also Paul S. Calem, Jonathan E. Hershaff, and Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, in Fannie Mae Foundation's Housing Policy Debate, Volume 15, Issue 3, 2004 pp. 603-622

[12] See NCRC's *Income is No Shield against Racial Differences in Lending* via http://www.ncrc.org/pressandpubs/documents/NCRC%20metro%20study%20race%20and%20income%20disparity%20July%2007.pdf, and *Are Banks on the Map* via http://www.ncrc.org/pressandpubs/documents/NCRCAreBanksontheMap.pdf

D. Evaluation of Branching - Evaluations for considering branching on CRA exams;

The service test evaluates a bank's distribution of branches in low- and moderate-income communities, assesses the range of bank services and deposit products for these communities, and scrutinizes the level of community development services such as financial counseling offered by a bank.

Access to branches and deposit accounts are essential to assist low- and moderate-income consumers to engage in banking relationships, establish savings for loan down payments and collateral requirements, and prepare themselves for acquiring home and small business loans. Research conducted by the Federal Reserve Board demonstrated that banks offer a higher percentage of prime loans when they issue loans through branches than when they make loans through brokers.[13] NCRC's research for the Appalachian Regional Commission likewise revealed that small business lending is higher in rural counties with a greater number of bank branches.[14] The provision of affordable products through branches is critical for the efforts of low- and moderate-income families to build wealth through increases in home and small business ownership. However, LMI and minority communities have a proliferation of payday lending outlets and other fringe lenders whose high fees hinder the ability to save and build wealth.

Because branching and access to basic banking services are vital to wealth building, the CRA service exam needs to be rigorous and comprehensive, holding banks to a high standard of branching and service provision in LMI neighborhoods. Research suggests the contrary. A study conducted by the Center for Community Capitalism concluded that CRA service test scores are likely to be inflated when low scores on the lending test and investment test confront banks with the possibility of CRA exam failure. The Center's econometric analysis is supported by qualitative analysis showing that banks with low lending and investment tests often receive "High Satisfactory" or better scores on the service test while offering few services and branches in low- and moderate-income communities.[15]

NCRC member The Woodstock Institute found lackluster service tests that did not hold banks accountable for branching and offering community development services. For example, of the 14 banks in Woodstock's sample with the highest scores on the service test, eight had branch distributions in low- and moderate-income communities that were well below the averages for all lenders, as a group, in the banks' assessment areas. The exams also were inconsistent in providing data and detail on the level of bank services;

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[13] Avery, Brevoort, Canner, Federal Reserve Bulletin, op. cit.

[14] *Access to Capital and Credit for Small Businesses in Appalachia via* http://www.ncrc.org/pressandpubs/press_releases/documents/2007/NCRC%20Study%20for%20ARC.pdf

[15] Michael A. Stegman, Kelly Thompson Cochran, and Robert Faris, Center for Community Capitalism, University of North Carolina, *Creating a Scorecard for the CRA Service Test: Strengthening Basic Banking Services under the Community Reinvestment Act*, 2001.

some exams provided numbers of accounts and financial counseling seminars offered while others merely mentioned that the banks provided services.[16]

Mid-Size Banks: Less Scrutiny of Branches in Low- and Moderate-Income Census Tracts

Another concern with the assessment of bank services is the community development test, applied to mid-size banks with assets of between $250 million to $1 billion (adjusted annually for inflation). As part of regulatory changes to CRA, federal banking agencies replaced the service and investment test with a new community development test of mid-size banks. This new test scrutinizes branching activity as part of its examination of the level of community development services provided by a mid-size bank. Since this new test no longer had a specific criterion examining branching activity, community organizations expressed concern that exams may decrease the attention to branching activity overall and in low- and moderate-income census tracts.

To address these concerns, NCRC and the Economic Justice Project of the Justice Action Center based at the New York Law School conducted analysis of the new mid-size bank exams. Our sample of 92 banks included data collected on the adequacy of the new community development exam for assessing branching patterns.[17]

The scrutiny of branching in low- and moderate-income census tracts appears to have decreased significantly under the new exam format. Of the 92 sampled exams, 29 exams or approximately 32 percent of the total number of exams lacked basic information on the number of branches in LMI census tracts, as shown in the table below. When the income levels of census tracts with branches are not collected, it is not possible to analyze the extent of the bank's branching in low- and moderate-income census tracts. In contrast, the previous exams of the 92 banks in our sample omitted information on the number of branches in LMI tracts on just three exams.

Information on Branches in LMI Tracts

Sample of CRA Exams	Total	# Without Info. on LMI Branches	
		Count	Percent
Current Exams	92	29	31.5%
Previous Exams	92	3	3.3%
On Current Exams			
Discussions of LMI Branches	92	43	46.7%
No Discussions of LMI Branches	92	49	53.3%

[16] Woodstock Institute, *Measuring the Provision of Banking Services for the Underbanked: Recommendations for a More Effective Community Reinvestment Act Service Test*, March 2007.
[17] The full study will be published in the spring of 2008 in the *New York Law School Law Review*.

Further examination of the sample suggests that the new exams are not giving sufficient attention to branching activity. In our review of the exams, we found that 80 mid-size exams discussed the overall number of branches while 12 exams did not mention branches at all. In addition, in the majority of cases, exams did not discuss the number or distribution of branches in low- and moderate-income tracts. In 49 cases, the exam did not discuss the number or percentage of branches in LMI census tracts and in only 43 exams was the distribution of branches across income category of census tract discussed. Commentary was often lacking on whether the distribution of branches met community needs in LMI tracts or was proportional to the number of LMI tracts or people in the tracts.[18]

When federal banking agencies adopted the new CRA exams for mid-size banks, the agencies re-assured the general public that scrutinizing branching would be an important part of the new exams. The previous exams had an explicit criterion of evaluating the distribution of branches across income level of census tracts. According to the federal agencies, the new exams would evaluate community development services. Examiners would assume that community development services such as low-cost checking accounts were provided to a community if bank branches were in low- and moderate-income census tracts.[19] But how could the examiners make a determination that community development services were available if they failed to document how many branches were in low- and moderate-income tracts in a significant number of bank exams in our sample?

NCRC recommends that the diminished attention to services for mid-size banks and the lackluster nature of the large bank service test should be addressed. The regulatory agencies should construct clear and objective measures for comparing the distribution of branches to the distribution of LMI neighborhoods and people in those neighborhoods. The agencies should collect data on the number and percent of deposit accounts in LMI neighborhoods so that CRA exams contain substantive analyses on the distribution of deposit accounts instead of assertions that banks provide services to LMI people. Similarly, the rigor of analyses of community development services should be enhanced with data on the number of financial counseling sessions and other community development services. Enhanced service tests are critical for bolstering the number of branches and the amount of affordable bank services in LMI and minority communities.

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[18] An example of the cursory review of branching patterns is apparent in the 2006 CRA exam of First South Bank located in Washington, North Carolina and overseen by the Federal Deposit Insurance Corporation (FDIC).

[19] The interagency Question and Answer document as revised as of March 10, 2006 has the following question and answer: *§ll.26(c)(3)–1: What will examiners consider when evaluating the provision of community development services by an intermediate small bank? A1:* Examiners will consider not only the types of services provided to benefit low- and moderate-income individuals, such as low-cost bank checking accounts and low-cost remittance services, but also the provision and availability of services to low- and moderate-income individuals, including through branches and other facilities located in low- and moderate-income areas. Generally, the presence of branches located in low- and moderate-income geographies will help to demonstrate the availability of banking services to low- and moderate-income individuals.

E. ***Data*** - Data limitations that reduce the effectiveness of CRA exams

If data is of limited quality, CRA exams cannot effectively measure bank's performance. Federal agencies have used the Home Mortgage Disclosure Act (HMDA) data in detail on exams, but further enhancements in the use of this data are needed. In contrast, the agencies' use and development of the CRA small business data has been lacking.

The agencies provide detailed tables on home loan lending. The narrative and tables on the CRA exams separately analyze home purchase, refinance, and home improvement lending. This is necessary since the separate types of home lending respond to different credit needs. In other areas of analysis, however, the use of HMDA data should be enhanced on CRA exams.

Data on purchases should be analyzed separately from loan originations in order to bolster the integrity of CRA exams. If loan originations were analyzed separately from loan purchases, it would be more difficult for banks to manipulate CRA exams through the selling and buying of loans. In addition, community advocates assert that originating a loan is a more difficult task than purchasing a loan and should be weighted more heavily on CRA exams. At the least, these activities should be analyzed separately (back in 2004 the agencies proposed separate data tables on originations and purchases only to abandon this proposal).[20]

The quality of HMDA data on loan purchases should be enhanced. Currently, Regulation C requires data on loan purchases to include the census tract location of property but not the race, gender, or income of the borrower. Banks should be required to collect the same information on borrower and neighborhood characteristics on loan purchases as they do on loan originations. Some banks collect complete information on loan purchases while others do not. The rigor of CRA exams would be enhanced if data on loan purchases was made uniform.

CRA exams should use the new pricing information in HMDA data to separately evaluate prime and high-cost lending. Just as home purchase and refinance lending responds to different credit needs so to does prime and high-cost lending. Also, it is important to ensure that banks making both prime and high-cost lending offer a balanced product mix to LMI borrowers and communities. This objective can be achieved only if prime and high-cost lending are analyzed separately.

While the major issue associated with HMDA data has been its application on CRA exams, the predominant issue regarding small business data is that of quality. The federal agencies significantly lessened the quality of this data by exempting mid-size banks from requirements to collect and report it. As NCRC demonstrated in its report for the Appalachian Regional Commission, mid-size banks are an important source of credit for small businesses, particularly in rural areas and medium sized cities and towns. The agencies' decision to delete the reporting requirement for mid-size banks negatively affects

[20] See the February 6, 2004 Federal Register for the proposal via http://www.fdic.gov/regulations/laws/federal/04CRA.html

CRA's ability to ensure that banks continually respond to credit needs, including those of small businesses.

Limited information available on the demographics of small business borrowers hinders an accurate assessment of banks' responsiveness to credit needs. Periodic national surveys sponsored by the Federal Reserve Board consistently point towards the likelihood of discrimination in small business lending.[21] A powerful way to stop such discrimination and disparities in lending is to publicly provide data on the number of loans for minorities and women. Yet, the CRA small business data lacks information on the gender and race of the small business owner. It also lacks detail on the revenue size of the small business and has other limitations such as not separately reporting originations from renewals of loans.

NCRC surveyed its community organization members to gauge their experience in using CRA to finance various housing and small business-related activities. The survey respondents indicated that they have not been as successful as housing projects have in securing bank financing for small business development. This finding may be related to small business data issues in that CRA exams and stakeholders in the process have generally focused more on affordable housing than small business development. This is another reason to enhance small business loan data and augment the attention devoted to small business financing in CRA exams.

Rep. James McGovern introduced the Access and Openness in Small Business Lending Act of 2003 (H.R. 1748) that would require reporting the race and gender of the small business owner and mandate additional demographic detail in the CRA small business data. NCRC recommends that Congress pass this bill, even if the Federal Reserve Board lifts the current prohibition of banks voluntarily reporting the race and gender of borrowers of small business loans. In addition, Congress should either pass a bill or urge the regulatory agencies to reverse their decision exempting mid-size banks from CRA small business data reporting requirements.

3. How to Improve the Adequacy of the Enforcement Mechanism for CRA Compliance

Ratings on CRA exams and actions on merger applications are the enforcement mechanisms under CRA. A federal agency can deny, delay, or approve with specific conditions a bank's request to merge with another institution. Denials of merger applications are extremely rare. Delays or conditional approvals are the current enforcement tools employed in the merger application process. The lackluster record of enforcement suggests improvements are necessary.

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[21] See NCRC's *Access to Capital and Credit for Small Businesses in Appalachia* for a discussion of the literature and the Federal Reserve sponsored surveys via http://www.ncrc.org/pressandpubs/press_releases/documents/2007/NCRC%20Study%20for%20ARC.pdf

CRA Grade Inflation

As the table below shows, the current failure rate for banks has hovered between 1 to 2 percent in recent years (ratings of needs-to-improve or substantial noncompliance indicate a bank has failed its CRA exam). When ratings first became public in 1990, more than 10 percent of banks failed their CRA exams. During the first five years of the public availability of CRA ratings, more than 5 percent of banks failed their CRA exams each year.

Year	Outstanding		Satisfactory		Needs to Improve		Substantial Noncompliance		Total
	Count	Percent	Count	Percent	Count	Percent	Count	Percent	
1990	340	10.9%	2,474	79.5%	280	9.0%	19	0.6%	3,113
1991	407	8.3%	4,016	81.6%	453	9.2%	46	0.9%	4,922
1992	653	12.7%	4,067	78.9%	395	7.7%	40	0.8%	5,155
1993	941	14.7%	5,060	79.3%	355	5.6%	26	0.4%	6,382
1994	1,000	18.1%	4,249	76.7%	275	5.0%	15	0.3%	5,539
1995	1,363	24.3%	4,106	73.1%	138	2.5%	7	0.1%	5,614
1996	1,214	26.5%	3,275	71.5%	81	1.8%	11	0.2%	4,581
1997	829	22.4%	2,807	75.7%	59	1.6%	11	0.3%	3,706
1998	681	18.6%	2,915	79.6%	59	1.6%	7	0.2%	3,662
1999	679	18.6%	2,915	79.7%	55	1.5%	7	0.2%	3,656
2000	220	17.5%	1,001	79.6%	30	2.4%	7	0.6%	1,258
2001	132	10.6%	1,088	87.1%	23	1.8%	6	0.5%	1,249
2002	201	9.8%	1,820	89.0%	18	0.9%	5	0.2%	2,044
2003	283	10.1%	2,492	89.2%	17	0.6%	3	0.1%	2,795
2004	329	13.1%	2,170	86.1%	17	0.7%	3	0.1%	2,519
2005	244	15.9%	1,278	83.2%	10	0.7%	4	0.3%	1,536
2006	171	13.1%	1,109	84.9%	20	1.5%	6	0.5%	1,306
2007	154	10.5%	1,292	87.8%	20	1.4%	4	0.3%	1,470
Total	**9,841**	16.3%	**48,134**	79.5%	**2,305**	3.8%	**227**	0.4%	**60,507**

Undoubtedly, banks improved their CRA performance over the years as they bolstered their efforts to make loans, investments and services in low- and moderate-income communities. At the same time, however, it is implausible that less than 2 percent of banks have failed to abide by their CRA responsibilities. As discussed above, the Center for Community Capitalism demonstrates inflation in the CRA services test. In addition, Rick Marsico in his book *Democratizing Capital* reveals how quantitative criteria are applied in an inconsistent manner on CRA exams, suggesting that a number of CRA exams have ratings that cannot be justified.[22]

The CRA Modernization Act contains a number of provisions that would be helpful for preventing grade inflation. The first is introducing more ratings. Currently, the CRA component tests (such as the Lending Test) have Outstanding, High Satisfactory, Low Satisfactory, Needs-to-Improve, and Substantial Noncompliance as possible grades. In contrast, the final rating on a CRA exam can be one of four grades: Outstanding,

[22] Richard D. Marsico, *Democratizing Capital: The History, Law, and Reform of the Community Reinvestment Act*, Carolina Academic Press, 2005.

Satisfactory, Needs-to-Improve, and Substantial Noncompliance. The final rating should also include High and Low Satisfactory as possible grades. In this manner, the general public and the federal agencies are more able to assess actual differences and gradations in performance. If the agencies remain wary of failing banks, they can apply grades such as Low Satisfactory when the banks truly deserve them. Moreover, the distinctions at the higher end of performance become more meaningful when the possible passing ratings include Outstanding, High Satisfactory, and Satisfactory.

If a low CRA rating in an assessment area triggered requirements for a bank to improve its performance, a bank would be more likely to adequately serve all geographical areas, including smaller cities and rural areas in addition to large cities. Currently, low CRA ratings even on a state level rarely have concrete ramifications for banks. The CRA Modernization Act of 2007 would require federal agency enforcement to correct low ratings and would require public input in this process. If a bank receives a rating of Low Satisfactory or worse in any assessment area, the Modernization Act would require it to submit a CRA improvement plan to its regulatory agency, describing how it intends to bolster its CRA performance in that assessment area.[23] The general public would have an opportunity to comment on the CRA improvement plan. The regulatory agency must either approve the CRA improvement plan or send it back to the bank for modifications. After the agency approves the CRA improvement plan, the bank must submit quarterly reports so that the regulatory agency and general public can monitor performance under the terms of the plan.

4. The Role of Public Comment and the Degree Public Participation Should Play in the CRA Evaluation and Application Approval Process.

The merger application process presents significant opportunities for federal agencies to enforce CRA. Yet, the enforcement of community reinvestment obligations through the merger application process has been lacking over the last several years.

In testimony before this committee earlier this year, an official representing the Federal Reserve Board (FRB) testified that the FRB has held only 13 public meetings since 1990 on mergers. This is less than one meeting per year in an era in which consolidations have profoundly changed the banking industry. In addition, the FRB representative stated that since 1988, the FRB received 13,500 applications for the formation of banks or the merger of institutions involving bank holding companies or state-chartered banks that were members of the Federal Reserve System. Yet, only twenty five of these applications were denied with 8 of these denials involving consumer protection or community needs issues.[24]

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[23] The concept of an improvement plan builds upon a procedure mandated by the current CRA regulation. At section 345.43 of the FDIC's version of the regulation, a bank with a less than Satisfactory rating shall allow the public to inspect a description of its efforts to "improve its performance in helping to meet the credit needs of its entire community." This description is to be updated quarterly.

[24] See http://www.federalreserve.gov/newsevents/testimony/braunstein20070521a.htm for Ms. Braunstein's testimony.

Realistically, the possibilities of merger denials in the future are small. But the agencies can influence the outcome of merger applications in other ways. Conditional approvals have been issued in the past requiring banks to institute non-discriminatory and anti-predatory lending safeguards. In addition, public hearings and meetings held by the regulatory agencies often facilitate mutually acceptable solutions to deficiencies in bank performance. Sometimes a bank will make a CRA agreement with a community group as described above. In other instances, the bank will pledge to implement a new lending program or best practice that responds to a community concern expressed at the hearing. Regulatory agencies may also require or encourage a specific reform after careful consideration of community input. As the Federal Reserve official indicated in testimony, however, public hearings are rare. Conditional merger approvals have also become almost non-existent in recent years.

The last major merger applications that were subject to public hearings were the Bank of America and Fleet merger and J.P. Morgan Chase and Bank One merger in 2004. In 2006, Wachovia acquired the largest lender of exotic mortgages, World Savings, yet there was no public hearing on this merger that posed significant fair lending and safety and soundness issues. Likewise, Regions had proposed to take over Amsouth bank in 2006. Although this merger involved two of the larger banks in the South, the Federal Reserve declined to hold a public hearing when the merger clearly had ramifications for the recovery of the Gulf States after Hurricane Katrina. More recently, the Federal Reserve declined to hold a hearing on the merger of Bank of New York and Mellon although the Bank of New York had received low ratings on two of the three tests on their two most recent CRA exams.[25]

The Office of Thrift Supervision (OTS) used to require the holding of a meeting between merging thrifts and community groups when such a meeting was requested by a community group that had submitted written comments pertaining to the merger. This procedure should be implemented by all the agencies. Meetings, as distinguished from public hearings, usually involve relatively small number of stakeholders, including regulatory officials, a few community leaders, and representatives of the merging institutions. These meetings are easy to convene and provide valuable dialogue.

When regulatory agencies receive several requests from community groups or citizens for a public forum, they should hold public hearings in addition to any meetings that might take place. Public hearings are more involved than meetings in that several community groups, citizens, elected officials, and others testify. Meetings allow for in-depth dialogue and debate among a handful of important stakeholders but public hearings become necessary when hundreds of citizens and community organizations wish to testify. Regulatory officials must afford them the opportunity to testify so that the officials can understand the gravity of the situation and the importance of the banks to the affected communities.

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[25] Bank of New York received a low satisfactory on its lending and service test from the Federal Reserve Bank of New York on both its 2005 and 2003 CRA exams. In other words, the bank was close to failing on two CRA exams in succession. Yet, no public hearing on the merger occurred.

Finally, the CRA Modernization Act of 2007 has a provision stopping a merger proceeding if a bank has a failed rating in any assessment area. If a bank receives a rating of Needs to Improve or Substantial Noncompliance in any assessment area, its regulatory agency cannot accept or approve any merger application submitted by the bank until the bank improves the rating on a subsequent CRA exam. This provision assures that a bank must have passing grades and reasonable CRA performance in all assessment areas, including smaller cities and rural areas, in addition to larger cities. In addition, the CRA Modernization Act stipulates that if a bank receives Low Satisfactory in an assessment area, its regulatory agency must consider progress made in meeting the goals described in the improvement plan as an integral factor when reviewing a merger application.

5. Whether Changes in the Financial Services Industry have Reduced the Effectiveness of CRA and How Expanding CRA to Additional Financial Service Providers May Improve the Effectiveness of the Law.

In the 30 years since CRA's enactment, the financial industry has changed in profound ways. Lending is no longer confined to bank branches. Accordingly, CRA assessment areas must be expanded to include geographical areas beyond bank branches. In addition, non-depository affiliates of banks must be included on CRA exams. Moreover, banks now face more formidable competitors than they did in 1977. These competitors must be covered by CRA. As long as these competitors remain uncovered, it remains likely that their lending will be less safe and sound than the banks' and/or that they will offer a smaller portion of loans than banks to low- and moderate-income communities. Above, we describe how credit unions and independent mortgage companies do not offer as large a percentage of home loans to low- and moderate-income borrowers as banks. NCRC's fair lending investigation discussed above revealed that 26 of the 35 institutions engaged in redlining and other discriminatory practices were independent mortgage companies not covered by CRA.

Congress should follow the example of the Chairman's state of Massachusetts. Massachusetts has covered credit unions with CRA for a number of years. The Bay State has also recently enacted a community reinvestment requirement for mortgage companies. The CRA Modernization Act of 2007 would likewise require the application of CRA to independent mortgage companies.

The CRA Modernization Act would also require the application of CRA to insurance companies and would impose HMDA-like data disclosure requirements on insurance companies. A number of states already collect data on insurance provision and provide this data to the general public.[26] After the denials of insurance for victims of Hurricane Katrina, it would seem that the time has come to shed a public spotlight on the practices of

[26] Gregory D. Squires, Sally O'Connor, and Josh Silver, *The Unavailability of Information on Insurance Unavailability: Insurance Redlining and the Absence of Geocoded Disclosure Data*, Housing Policy Debate, Vol. 12, Issue 2, Fannie Mae Foundation 2001.

insurance companies and the distribution of their policies by characteristics of consumers and communities.

Finally, the CRA Modernization Act would require the application of CRA to securities firms. CRA exams would measure the extent to which securities firms are serving low- and moderate-income and minority consumers. Wealth building would be augmented considerably if more people of modest means and more minorities had access to mutual funds and other similar products. In addition if a law channeled more security firm investments into minority and working class neighborhoods, the economic development prospects of these communities would be significantly enhanced.

6. Whether Federal Banking Agencies' Examinations of Institutions are Adequate in Finding Evidence of Discriminatory, Predatory or Illegal Lending

Evidence of discriminatory and illegal lending can result in downgrades of CRA ratings for banks if discrimination and illegal lending were widespread and the lender did not take action to end the practices. There is no evidence to believe that the fair lending reviews conducted concurrently with CRA exams are rigorously testing for abusive, discriminatory and illegal lending.

In most cases, even for the largest banks in the country, the fair lending section of the CRA exam reports in one to three sentences that the regulatory agency tested for evidence of illegal and discriminatory lending and that no such lending was found.[27] There is no discussion of what precisely had been done to reach this conclusion. Meanwhile, excessive high-cost lending pervades financially vulnerable communities, compounding their financial challenges, and making access to the financial services mainstream more difficult.

In one instance, NCRC examined a thrift that specialized in subprime lending. The CRA exam report for that thrift noted that it issued a high percentage of loans to low- and moderate-income borrowers. The CRA fair lending review, however, did not describe if the examiner made any efforts to determine if the subprime lending was conducted in a non-discriminatory manner or was consistent with safety and soundness. In another case, an exam mentioned that a bank specialized in adjustable rate lending, but the fair lending review did not mention whether the examiner assessed if the loans were offered in a non-discriminatory manner and whether they were safe and sound.

Providing more detailed descriptions of fair lending reviews should be straightforward. The agencies used to provide detailed descriptions in the fair lending section of CRA exams in the mid-1990's under the previous "assessment factor" format of CRA exams.

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[27] For example, a federal agency had this to say on the CRA exam's fair lending review of one large bank with several affiliates, a number of whom make high cost loans: "We found no evidence of illegal discrimination or other illegal credit practices." That was the only sentence in the fair lending review section.

For example, under Assessment Factor F, which assessed evidence of discriminatory or illegal practices, the Federal Reserve Bank of Richmond conducted matched file reviews of more than 300 loan applications in a CRA exam dated January 1996 of Signet Bank. The exam also described regression analysis, which sought to determine if race was a factor in loan rejections. The analysis considered variables not available in the HMDA data such as credit histories, the stability of employment, and applicant debt obligations. This type of substantive fair lending review provides the general public with confidence that the regulatory agency performed a detailed anti-discrimination analysis. It was after the CRA regulations were reformed during the mid-1990s in an effort to improve the rigor of the exams that these descriptions of fair lending reviews disappeared from the CRA exams.

When a violation of anti-discrimination laws is discovered through fair lending reviews, it is common for the federal agencies to make a bank promise to eliminate the practice instead of lowering a CRA rating. The CRA regulation specifies that examiners are to weigh the evidence and extent of a discriminatory and illegal practice when deciding whether to lower a CRA rating.

Some discretion in requiring corrective actions or lowering ratings is appropriate, but guidelines should specify when discrimination will lower ratings. Isolated instances of discrimination can be corrected through promised reforms. On the other hand, widespread discrimination should result in failed ratings. Discriminatory underwriting, including prohibiting loans to row homes redlines entire communities. It is ineffective and insufficient to rely on the banks' promise to reform. A failed CRA rating provides a significant deterrent against discriminatory behavior because a failed CRA rating prevents a bank holding company from acquiring a non-depository financial institution as long as the rating remains in place.[28] The punishment can be removed at the time of the next CRA exam, provided that the bank can undergo a thorough fair lending review and demonstrate that it has eradicated all discriminatory practices.

7. Other Factors that Impair Effectiveness of CRA: Less Frequent Exams for Small Banks

The Gramm-Leach-Bliley Act reduced the frequency of small bank CRA exams. Under GLBA, small banks with assets of under $250 million are examined only once every four years if they have a Satisfactory CRA rating and once every five years if they have an Outstanding rating.

When small banks are examined that infrequently, they have little incentive to affirmatively and continually adhere to their reinvestment obligations. They will have reduced incentives to make sufficient numbers of loans to low- and moderate-income borrowers during the entire four or five year time period between exams, and may only focus their efforts during the last year or two before exams. It is commonsense that

[28] The Gramm-Leach-Bliley Act instituted the "have and maintain" passing rating requirement.

infrequent examinations lead to infrequent commitments to reinvestment, while more frequent examinations lead to more consistent commitments to reinvestment.

In the survey in the appendix, NCRC's community organization members have reported that less frequent exams have reduced the amount of lending and reinvestment activity by small banks to low- and moderate-income borrowers.

This reduction in exam frequency responded to industry complaints about the "burden" of CRA exams. The lack of a careful cost-benefit analysis is readily apparent in the GLBA stretch-out of the small bank CRA exam schedule. The small bank exam is a quick and straightforward exam that focuses on lending and dispenses with the investment and service test of the large bank exam. For any small bank that is true to the mission of a community banker, the small bank CRA exam is a relatively easy exam, usually of ten pages or less.

Despite the brevity of the exam, its importance cannot be under-estimated. In too many poor rural communities, the CRA exam process is the only mechanism that holds small banks accountable for serving low- and moderate-income borrowers and communities. Smaller banks do not merge nearly as often as their larger counterparts, rendering the merger application process a seldom-used avenue for holding smaller banks accountable. Community groups are also not as prevalent in smaller rural communities as in large cities. Thus, the major mechanism for holding small banks accountable is the CRA exam.

In their analysis on small bank burdens, the federal banking agencies have found that CRA regulations "impose a modest information collection burden on small institutions – an average of 10 burden hours per institution per year."[29] In addition, the relatively few trade articles on small bank CRA exams also reveal few complaints about burden. In fact, an American Banker article shortly after the CRA regulation reform in 1995 is entitled "Small Banks Give Thumbs-Up to Streamlined CRA Exams." In this article, small bankers are quoted as saying that the exams were not burdensome and that CRA examiners took less than one day of their time.[30]

Conclusion

In light of the present day lending crisis and its disparate impact on minority and low and moderate income communities, CRA must be modernized and enhanced to apply to non-bank financial institutions, as well as secondary market institutions. CRA has been effective in bringing trillions of dollars of loans, investments, and services to low- and moderate-income communities. Too many LMI and minority communities still remain left out of the financial mainstream under the current construct, however. In order for America to truly become a financially inclusive society, the federal agencies' application of CRA to

[29] Federal Register, May 28, 1999 (Volume 64, Number 103), pages 29083 through 29086
[30] Small Banks Give Thumbs-Up To Streamlined CRA Exams, Jaret Seiberg of the American Banker, Thursday, February 1, 1996.

banks needs strengthening, and CRA must also be applied to non-bank financial institutions.

CRA has great potential to act as an antidote to the foreclosure crisis by requiring all financial institutions to safely and soundly serve minority and low- and moderate-income communities.

As described in detail above, the following steps must be taken:

1) Extend CRA to cover non-depository institutions. CRA must be extended to include:

A.) Credit Unions
B.) Securities Companies
C.) Mortgage Companies
D.) Insurance Firms
E.) Investment Banks

2) Agency Oversight:

- Federal agencies must work with banks and community organizations to further develop best practices and models for replication in the areas of small business development and foreclosure prevention. NCRC's survey of its member organizations revealed less success using CRA to encourage financing for small business development and foreclosure prevention than other activities.

- CRA's scrutiny of illegal and predatory lending practices must become more transparent and rigorous. Evidence of widespread discriminatory practices must result in downgrades in CRA ratings.

- The agencies must hold more public hearings on merger applications and issue more conditional merger approvals.

- Low scores for any assessment area must trigger regulatory enforcement, including the submission of improvement plans and heightened attention during the merger application process

- The stretch-out of the small bank CRA exam cycle should be eliminated. Small banks should be examined as frequently as large banks.

3) Reform CRA Assessment Areas and Affiliate Procedures:

- Assessment area procedures must be reformed so that a great majority of a bank's loans are on CRA exams.

- All non-depository affiliates of banks must be included on CRA exams.

) **Refinement of CRA Examination criteria:**

- CRA exams must explicitly consider lending, investments, and services to minority borrowers and communities
- Federal agencies must enhance the rigor of the service test and increase data collection of bank deposit accounts, at least by income level of neighborhood.
- The community development test of mid-size banks must do a better job assessing the provision of bank branches and services in low- and moderate-income neighborhoods.
- CRA exams must separately consider purchases and loan originations.
- CRA exams must also separately consider prime and high-cost lending.
- The quality of CRA small business data needs to be enhanced through the disclosure of the race and gender of the small business owner.
- CRA grade inflation needs to be counteracted by increasing the number of possible ratings.

Appendix

NCRC's CRA Survey conducted in the fall of 2007 follows

NCRC CRA Survey

Survey Objective

Thirty years since the implementation of the Community Reinvestment Act (hereafter CRA), banks have been motivated to provide over four trillion in loans, investments, and services for working class and minority communities.

This National Community Reinvestment Coalition (NCRC) survey assesses how the CRA has assisted non-profit community based NCRC member organizations in carrying out their mission of revitalizing predominantly minority and low- and moderate-income neighborhoods. The survey was conducted in the summer and fall of 2007.

Survey Results

Characteristics of Survey Respondents

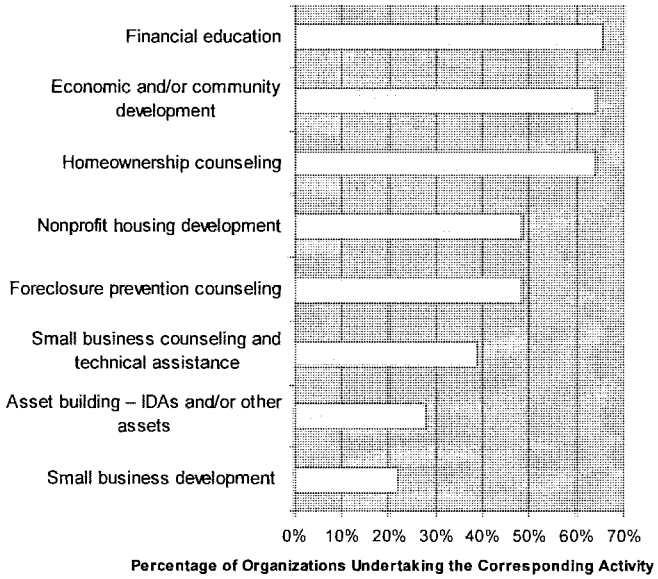
In an effort to advocate for a strong Community Reinvestment Act, the NCRC survey generated responses from 66 of its member organizations from 25 different states.

The survey asked NCRC members for the extent to which they provided the following services:

- Homeownership counseling
- Foreclosure prevention counseling
- Small business counseling and technical assistance
- Nonprofit housing development
- Economic and/or community development
- Small business development (e.g., providing infrastructure such as incubators)
- Asset building
- Financial education

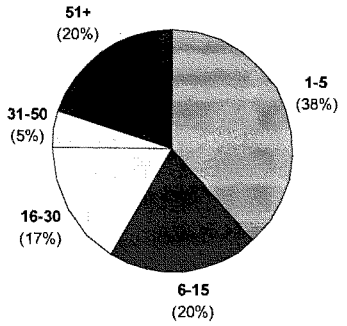
Of the above, activities most commonly provided by the surveyed organizations were homeownership counseling, financial education, and economic/community development (over 60% of the organizations provided the three corresponding services). Furthermore, almost half of all organizations provided housing development and foreclosure prevention services, whereas small business development was among the activities least commonly provided. (see Figure 1)

Figure 1. Activities of Participating Organizations



The majority of studied organizations were small with a total of 1-5 full-time employees (38.5% of all observed organizations) and 6-15 employees (20%). A significant amount of the studied organizations (20%) were large (i.e. 51 employees and above). (Please refer to Figure 2 for more detailed information on the size of the studied organizations)

Figure 2. Number of Full-time Employees in Participating Organizations

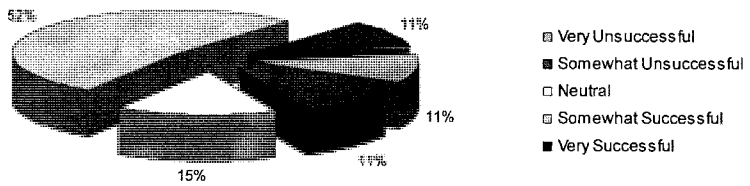


Success at Using CRA

We asked NCRC member organizations how successful they have been at obtaining financial support from banks (i.e., loans, grants, and investments) for projects and programs that benefit low- and moderate-income people.

While more than half of the surveyed member organizations reported success in obtaining funds from banks for their projects (52% reported being somewhat successful and 11% reported being very successful), 11% of the surveyed organizations reported being very unsuccessful and as many reported being somewhat unsuccessful at doing so. (Figure 3)

Figure 3. Success in Obtaining Financial Support from Banks for Projects Benefiting Low- and Moderate-income Communities



Moreover, the member organizations included in this study have been most successful in obtaining funds from banks for two of their activities, namely, homeownership counseling and financial education. Around 61% of all organizations responding to this question were very or somewhat successful in obtaining financial support for their homeownership counseling activities, and 63% were able to obtain funding for their financial education programs. A moderate success at obtaining funds for economic and community development, as well as asset building projects, was also reported. Foreclosure prevention counseling and small business development, on the other hand, were among the activities that were financed by banks less frequently (i.e. barely 30% and only 23% of the respondent organizations were very or somewhat successful in obtaining funding for foreclosure prevention and small business development projects respectively). (see Figure 3.1 at the back).

We also asked member organizations to assess how CRA has helped them to secure financing of their projects, and to provide us with some specific examples of CRA success stories.

Out of 33 organizations that responded to the above question, 21 confirmed that the CRA has been indeed helpful in their efforts to obtain aid for projects from financial institutions. Common

success stories include financing anti-predatory lending training sessions; projects that build, rehabilitate, or preserve units of affordable housing; mortgage default counseling and first time home buyer education; financial literacy training; obtaining small business loans; as well as micro-enterprise loan programs for women.

The following featured stories provide some insight into the CRA's potential to motivate financial institutions to support community development projects.

The Housing Development Fund (HDF), CT, has enjoyed huge success in capitalizing funding pools from banks that receive CRA credit for their participation. To date, HDF manages almost $50 million in funding from banks. HDF has deployed that funding in an array of financial assistance to developers of affordable housing and to individuals purchasing their first time homes. To date, HDF has financed almost 600 units, and helped an additional 600 households purchase affordable homes of their own.

Nueces County Community Action Agency, TX, benefits from a Community Development Corporation made up of several banks which have made available a zero percent loan for the CDC to use in developing 20.24 acres of land for 99 housing units for low-to-moderate income families. The zero interest loans by the Bank CDC made it possible to keep the costs of developing the lots at affordable prices to the homebuilder.

ACCORD Corporation, NY, has a pool of funds totaling $6.85 million from 8 banks, an additional $1 million line of credit from Bank of America, and over a million dollars of direct investments in another lending pool. All of these investments are directly related to banks addressing their CRA requirements. As a result of the bank pool resources alone, over the past 12 years, ACCORD Corporation has made $24.5 million in loans for projects that have created, rehabilitated or preserved 722 units of affordable housing.

The Community Action Services, UT, receives funding every year from several financial institutions through their CRA grants program. This funding comes from about 4 banks each year and the grants range between $1,000 and $18,000. This funding is critical to the organization's program and helps to match its request to HUD for the Housing Counseling grant. The CRA funds are for the provision of the following vital services: mortgage default counseling, first time home buyer education and counseling, predatory lending counseling in lending, reverse equity mortgage counseling for seniors, case management for the Utah IDA Program, and in-depth financial literacy training (in partnership with Utah State University Extension).The Home Buyer and Mortgage Counseling program specifically targets low and moderate income families, seniors and minority groups (especially Hispanic residents). Without the CRA funding, the organization would have to cut this program in half.

The Fair Banking Coalition succeeded in pressuring Citibank, San Diego National Bank, and Washington Mutual into creating a special no fee, no overdraft, banking account with free money orders to address the needs of families represented in an organization of former welfare mothers called SPIN (Supportive Parents Information Network). In addition, the organization designed and launched a new cooperative market for micro business owners who are SPIN members. Discussions with Wells Fargo and US Bank, to establish this basic bank account, are currently in progress.

For the past two years, the San Diego Fair Banking Coalition has also received support from Citibank for its Women Entrepreneurs program (WE). WE is a 54-hour entrepreneurial training for women starting or operating a small business. Along with the training, participants are provided individualized and confidential business consulting. Citibank's support has been key to maintaining this program.

Over the last 15 years the number of bank braches in Hartford has decreased by 50%. As bank consolidation has increased, the larger banks left in the market have had less interest in inner city small businesses. Community Development Financial Institutions (CDFIs) are tying to fill the service gaps left by the closed banks. CDC Small Business Finance is a state funded CDFI that has created formal partnership agreements with five area banks through which funds are partnered on a subordinate basis with a bank's senior debt to provide loans banks could not provide on their own. The banks want to partner with this CDFI because of their CRA requirements. In ten years, the organization has provided more than $16 million in loans to nearly 70 small businesses.

While most organizations included in this study reported a positive impact of the CRA to their ability to sustain projects benefiting underserved communities, a handful of other organizations experienced no direct benefit from the CRA to their activities. Namely, 5 out of 33 organizations responding to the question about specific CRA success stories failed to observe a direct link between the CRA and their success in obtaining funding for development projects. The reason most often cited for not being able to develop a funding relationship with a bank was that the organization operates in areas populated with predominantly small banks that undergo CRA exams rather rarely.

In sum, while the CRA has been an essential step foreword in motivating financial institutions to meet the needs of low- and moderate-income communities, much remains to be done in responding to the credit needs of underserved communities. In particular, this survey suggests that NCRC members have had the least success in financing small business development. Furthermore, foreclosure prevention counseling has received relatively few resources as of the fall of 2007, when this survey was completed, but we expect this to change quickly given the national foreclosure crisis. Moreover, to further stimulate banks' support for community development, it appears that CRA exams and coverage need to be expanded.

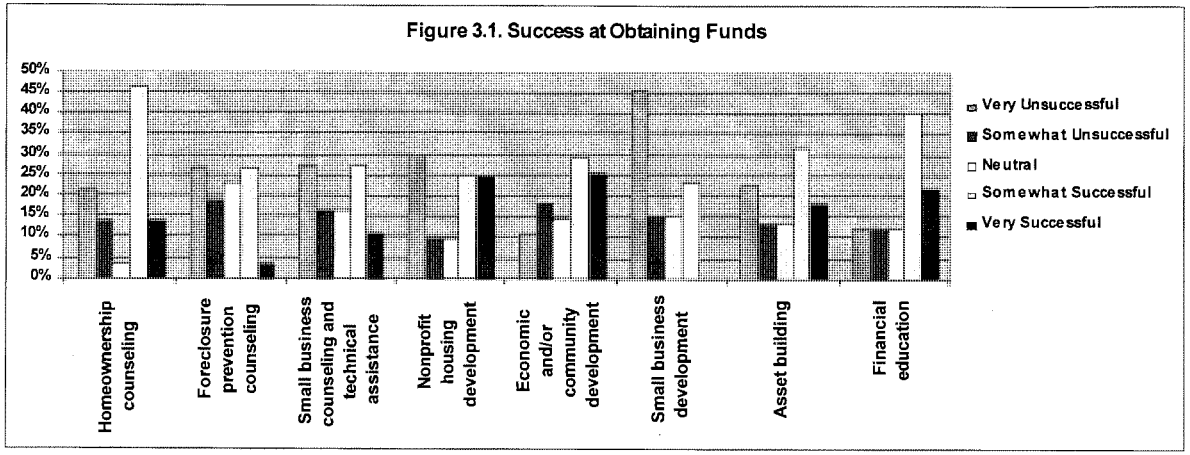


Figure 3.1. Success at Obtaining Funds
50%
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
Homeownership counseling
Foreclosure prevention counseling
Small business counseling and technical assistance
Nonprofit housing development
Economic and/or community development
Small business development
Asset building
Financial education
Very Unsuccessful
Somewhat Unsuccessful
Neutral
Somewhat Successful
Very Successful

Table 1. Activities Undertaken by NCRC Member Organizations.

Please identify the activities undertaken by your organization. Check all that apply.		
answer options	**Response Percent**	**Response Count**
Homeownership counseling	64.06%	41
Foreclosure prevention counseling	48.44%	31
Small business counseling and technical assistance	39.06%	25
Nonprofit housing development	48.44%	31
Economic and/or community development	64.06%	41
Small business development (e.g., incubators, or constructing/rehabbing properties for small businesses)	21.88%	14
Asset building – IDAs and/or other assets	28.12%	18
Financial education	65.62%	42
answered question		64
skipped question		4

Table 2. Size of Surveyed Organizations.

How many full-time employees does your organization have?		
answer options	**Response Percent**	**Response Count**
1-5	38.46%	25
6-15	20.00%	13
16-30	16.92%	11
31-50	4.62%	3
51+	20.00%	13
answered question		65
skipped question		3

Table 3. Success at Obtaining Financial Support for Developmental Programs and Activities.

Please rate how successful you have been at obtaining financial support from banks (i.e., loans, grants, and investments) for projects and programs that benefit low- and moderate-income people in the following areas. Use "N/A" when the category is Not Applicable.													
answer options	Very Unsuccessful	Very Unsuccessful (%)	Somewhat Unsuccessful	Somewhat Unsuccessful (%)	Neutral	Neutral (%)	Somewhat Successful	Somewhat Successful (%)	Very Successful	Very Successful (%)	N/A	Rating Average	Response Count
Homeownership counseling	6	21.43%	4	14.29%	1	3.57%	13	46.43%	4	14.29%	11	3.18	39
Foreclosure prevention counseling	7	26.92%	5	19.23%	6	23.08%	7	26.92%	1	3.85%	12	2.62	38
Small business counseling and technical assistance	5	27.78%	3	16.67%	3	16.67%	5	27.78%	2	11.11%	18	2.78	36
Nonprofit housing development	6	30.00%	2	10.00%	2	10.00%	5	25.00%	5	25.00%	13	3.05	33
Economic and/or community development	3	11.11%	5	18.52%	4	14.81%	8	29.63%	7	25.93%	7	3.41	34
Small business development (e.g, incubators, constructing/rehabbing properties for small businesses)	6	46.15%	2	15.38%	2	15.38%	3	23.08%	0	0.00%	21	2.15	34
Asset building – IDAs and/or other assets	5	22.73%	3	13.64%	3	13.64%	7	31.82%	4	18.18%	14	3.09	36
Financial education	4	12.50%	4	12.50%	4	12.50%	13	40.63%	7	21.88%	7	3.47	39
Your activities/projects as a whole	4	10.53%	4	10.53%	6	15.79%	20	52.63%	4	10.53%	1	3.42	39
												answered question	42
												skipped question	26

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About NCRC

The National Community Reinvestment Coalition is an association of more than 600 community-based organizations that promote access to basic banking services including credit and savings, to create and sustain affordable housing, job development and vibrant communities for America's working families. Our members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority and women-owned business associations, local and social service providers from across the nation.

EMBARGOED UNTIL DELIVERY

STATEMENT OF

SANDRA L. THOMPSON
DIRECTOR
DIVISION OF SUPERVISION AND CONSUMER PROTECTION
FEDERAL DEPOSIT INSURANCE CORPORATION

on

THE COMMUNITY REINVESTMENT ACT: THIRTY YEARS OF ACCOMPLISHMENTS, BUT CHALLENGES REMAIN

before the

FINANCIAL SERVICES COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

February 13, 2008
2128 Rayburn House Office Building

Chairman Frank, Ranking Member Bachus and members of the Committee, thank you for the opportunity to testify today on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding the Community Reinvestment Act (CRA)[1] on the occasion of the thirtieth anniversary of the Act. CRA was landmark legislation and its effect has been significant in enhancing credit opportunities nationwide.

In my testimony, I will provide some brief background on the statute and regulation, discuss how the FDIC evaluates and monitors CRA performance, explain the effect of CRA on the financial institution application process and describe CRA's positive impact. I also will focus on how the FDIC is using CRA to address current challenges, such as mortgage foreclosures, the need for affordable small-dollar loans, the exceptionally high cost of credit and the need for basic banking services in many underserved communities.

Background

Before CRA was enacted in 1977, there were severe shortages of credit available to low- and moderate-income neighborhoods, as well as concerns about redlining[2] and discrimination. CRA was intended to expand access to credit and reduce discriminatory credit practices. The statute built on earlier legislation such as the Home Mortgage

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[1] Codified at 12 U.S.C. § 2901 et seq.

[2] "Redlining" is a form of illegal disparate treatment in which a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located. Interagency Fair Lending Examination Procedures, incorporated in the FDIC Compliance Examination Handbook, http://www.fdic.gov/regulations/compliance/handbook/html/chapt04.html.

Disclosure Act of 1975 (HMDA), the Equal Credit Opportunity Act in 1974 and the Fair Housing Act in 1968. Consistent with safe and sound operations, CRA assigns federally insured financial institutions a "continuing and affirmative" obligation to help meet the credit needs of their entire communities, including low- and moderate-income neighborhoods.[3]

Evolution of CRA Regulations

In the thirty years since CRA's passage, there have been significant changes in the financial services sector in terms of both industry characteristics and available products. The agencies have revised the CRA regulations over time to keep pace with financial sector developments.

The original implementing regulations for CRA, issued by the agencies in October 1978, established criteria for evaluating bank and thrift CRA performance.[4] Public evaluations provided narrative descriptions of financial institutions' efforts, but with few hard numbers to support the examiners' conclusions. The emphasis in the original regulations was on process, and the same performance criteria were used to evaluate all banks and thrifts regardless of size or business focus.

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[3] *See* 12 U.S.C. § 2901(a).

[4] These criteria included: the ascertainment of community credit needs, marketing and type of credit extended; the geographic distribution and record of opening and closing branches; discriminatory and other illegal credit practices; and community development needs and efforts. The examination procedures considered thirteen subcategories under these broad concepts. *See* 43 Fed. Reg. 47144, 47152 (Oct. 12, 1978).

Over time, these regulations were criticized by both industry and community groups for an over-reliance on process to the detriment of actual performance. In response, the agencies amended the CRA regulations in May 1995 to require that an institution's CRA activities be evaluated against the institution's performance context, taking into account both economic and demographic information about the institution's assessment area and the available lending, investment, and service opportunities. In response to growing specialization within the banking industry, the revised regulations provided separate tests for large retail, small retail, and wholesale/limited purpose institutions,[5] and incorporated an option for banks and thrifts to include the activities of their affiliated companies in their CRA exams.

When the agencies issued the revised regulations in May 1995, they committed to review the regulations again within 10 years. With the considerable changes in the financial services sector over that time, a number of potential revisions were considered. After an advanced notice of proposed rulemaking and several subsequent notices of proposed rulemaking, the agencies issued final rules in 2005.[6] These rules included a number of revisions, including clearer consideration of discriminatory or other illegal credit practices, which I will address in more detail later in my testimony when I discuss how illegal lending is incorporated in the CRA review.

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[5] The 1995 revisions to the regulations implementing CRA defined "large banks" as those having assets of $250 million or more or affiliated with a holding company controlling banking assets of $1 billion or more. Per revisions in 2005, "large banks" currently are banks having assets equal or greater than $1.061 billion (due to an inflationary adjustment), with banks below that threshold classified as "small banks" or "intermediate small banks." *See* 12 C.F.R. § 345.12(u). Limited purpose banks offer only narrow product lines such as credit cards. *See* 12 C.F.R. § 345.12(n). Wholesale banks are not in the business of offering home mortgage, small business or farm, or consumer loans to retail customers, but do not meet the criteria for being a limited purpose bank. *See* 12 C.F.R. § 345.12(x). A bank must apply for and receive approval of either a wholesale or limited purpose designation. 12 C.F.R. § 345.25(b).

[6] 70 Fed.Reg. 44256, 44269 (Aug. 2, 2005).

Over the years since promulgation of the original CRA implementing regulations, the agencies have periodically issued a series of interagency CRA questions and answers (CRA Q&As) designed to give further guidance to examiners and bankers.[7] Most recently, in July 2007, the agencies issued for public comment proposed revisions of the existing CRA Q&As and addressed a number of emerging issues.[8] For example, the proposed revisions highlight that establishing loan programs to provide relief for low- and moderate-income homeowners facing foreclosures will warrant favorable consideration as being responsive to the needs of the institution's assessment area. Other proposed changes encourage institutions to support national foreclosure relief programs and counseling. The agencies expect to issue the final revised CRA Q&As in the upcoming weeks.

FDIC's CRA Review and Evaluation Process

Consistent with statutory requirements, FDIC examiners evaluate the CRA performance of the approximately 5,200 institutions under the Corporation's supervision.[9] As I noted above, for most institutions, this performance is evaluated under tests that draw distinctions among institutions based on their size and business

[7] *See, e.g.,* 12 C.F.R. Part 345; 66 Fed.Reg. 36620 et seq. (July 12, 2001).
[8] 72 Fed. Reg. 37922 (July 11, 2007).
[9] As with consumer compliance examinations, an institution's size and examination history determine the frequency with which its CRA performance is evaluated. The CRA frequency schedule incorporates limits imposed by the Gramm-Leach-Bliley Act of 1999 on CRA evaluations of small institutions, i.e., currently those with $250 million in assets or less, that have previously received strong CRA ratings. *See* 12 U.S.C. §2908. There are 30 special purpose banks supervised by the FDIC that are not subject to CRA requirements. These institutions do not perform commercial or retail banking services by granting credit to the public in the ordinary course of business. 12 C.F.R. § 345.11(c)(3). An institution must apply for and receive approval for such a designation.

strategies.[10] When conducting CRA evaluations, examiners consider factors such as the business opportunities available, as well as the size and financial condition of institutions.[11]

Lending institutions with assets greater than $1.061 billion (adjusted annually for inflation) are subjected to a three-part lending, services and investment test that evaluates both their retail and community development activities.[12] The lending test evaluates a bank's record of helping to meet the credit needs of its assessment areas by considering a bank's home mortgage, small business, small farm, and community development lending. The investment test evaluates a bank's record of helping to meet the credit needs of its assessment area(s) through qualified investments that benefit its assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s). The services test analyzes both the availability and effectiveness of a bank's systems for delivering retail banking services and the extent and innovativeness of its community development services.[13]

Small banks are evaluated under a test that focuses on their lending performance. The test encompasses the following five criteria: a "reasonable" loan-to-deposit ratio; the percentage of loans in the bank's assessment area; the bank's distribution of loans to individuals of different income levels and to businesses and farms of different sizes; the

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[10] All institutions may develop their own strategic plans to fulfill CRA responsibilities, subject to public comment and agency approval. *See* 12 C.F.R. §§ 345.21(a)(4) and 345.27.
[11] *See* FDIC Compliance Handbook, Chapter XI (Community Reinvestment Act), http://www.fdic.gov/regulations/compliance/handbook/htrnl/chapt11.html.
[12] *See* 12 C.F.R. § 345.21(a)(1).
[13] *See* 12 C.F.R. § 345.21(a) and §§ 345.22-345.24.

geographic distribution of loans; and the bank's record of responding to written complaints about its lending performance in its assessment area.[14] Most FDIC-supervised institutions qualify as small banks under CRA.

In recent years, the FDIC and the other banking regulators established a streamlined examination for "intermediate small banks" (ISBs).[15] ISBs are evaluated under the five-part small bank lending test, and a flexible community development test.[16] The community development test scrutinizes the amount and responsiveness of an ISB's community development lending, investing, and services.[17] This approach was intended to permit ISBs to make use of a flexible combination of community development activities tailored to both the needs of the community and the capacity of the bank.[18] ISBs are required to achieve satisfactory ratings on both the lending and the community development test to receive an overall CRA rating of "Satisfactory."[19]

Wholesale and limited purpose banks are subject to a community development test that considers community development loans, community development services, and qualified investments. All banks have the option of developing a strategic plan for meeting their CRA responsibilities, subject to public comment and approval by the FDIC.

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[14] *See* 12 C.F.R. § 345.26(b).
[15] ISBs were initially defined as institutions with assets of $250 million to $1 billion. With the annual adjustments for inflation, ISBs currently have assets that range between $265 million and $1.061 billion. *Id.* at § 345.12(u)(1).
[16] *See* 12 C.F.R. § 345.26(a)(2).
[17] *See* 12 C.F.R. § 345.26(c).
[18] *See* 70 FR 44256, 44259-60 (Aug. 2, 2005).
[19] *See* 12 CFR § 345, Appendix A at (d)(3)(i).

CRA Performance Context and Data Used by Examiners

An institution's performance under all of the relevant CRA tests is judged in the context of information about the institution and its community, competitors, and peers. Examiners consider: (1) the economic and demographic characteristics of the assessment area(s); (2) lending, investment, and service opportunities in the assessment area(s); (3) the institution's product offerings and business strategy; (4) the institution's capacity and constraints; (5) the prior performance of the institution and, in appropriate circumstances, the performance of similarly situated institutions; and (6) other relevant information.[20] Advances in technology and the availability of various economic, demographic and business data through private and public sources greatly assist examiners as they evaluate an institution's performance context.

In addition, large banks must report information about their small business, small farm, and community development loans.[21] If a bank reports data under HMDA,[22] examiners can consider the institution's historical mortgage loan performance as well as its performance against other market participants, including the performance of other federally supervised institutions and independent mortgage companies. In the absence of HMDA or other reported data, examiners sample an institution's home mortgage, small

[20] *See* 12 C.F.R. § 345.21(b).
[21] *See* 12 C.F.R. § 345.42.
[22] HMDA reporting requirements apply to depository institutions that have a home or branch office in a metropolitan statistical area (MSA), originate at least one home purchase loan or refinancing loan secured by a first lien on a one-to-four family dwelling, and, for the reporting of 2008 HMDA data, had total assets of more than $37 million at the end of 2007. *See 12* C.F.R. § 203.2(e)(1). Many non-depository mortgage lenders also are required to report HMDA data. Only about 54 percent of the banks supervised by the FDIC are required to report HMDA data. The remaining banks are not required to submit HMDA data either because their assets are below the threshold for HMDA filing or they are not located in a metropolitan area.

business, small farm, and community development loans, as applicable. Consumer loans are also sampled if the institution requests that they be reviewed or if they represent a substantial majority of the institution's business.

CRA Performance Evaluation

Upon the conclusion of each examination, the examiner prepares a written evaluation of the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods.[23] The FDIC and other financial institution regulatory agencies facilitate public review of CRA evaluations by posting them on their Internet websites, and institutions must make them available to the public.[24]

Each CRA evaluation must contain the institution's rating and a statement describing the basis for the rating.[25] While the content of the public evaluation varies depending on the nature of the institution examined and the assessment method used, the public portion of the evaluation generally contains the following information:

- The institution's CRA rating;
- A description of the financial institution;
- A description of the financial institution's assessment area; and
- Conclusions regarding the financial institution's CRA performance, including the facts, data, and analyses that were used to form such conclusions.[26]

[23] *See* 12 U.S.C. §2906(a)(1).
[24] *See* 12 U.S.C. §2906(a)(2).
[25] *See* 12 U.S.C. §2906(b)(1)(iii).
[26] *See* FDIC Compliance Handbook, Chapter XI (Community Reinvestment Act Performance Evaluation Templates), http://www.fdic.gov/regulations/compliance/handbook/html/chapt11.html.

Nature and Effect of CRA Ratings

The agencies assign each institution one of four performance ratings: "Outstanding," "Satisfactory," "Needs to Improve," and "Substantial Noncompliance."[27] Determining the CRA rating for an institution involves an assessment of a number of qualitative and quantitative factors against the backdrop of the institution's performance context. To foster consistency in this process, the agencies rely on a matrix which sets forth a description of the elements of the various tests and what performance level is required for each of the ratings.[28]

In 2007, the FDIC conducted 1,017 CRA examinations. Of these, 55 received an "Outstanding" rating, 944 received a "Satisfactory" rating, 14 received a "Needs to Improve" rating, and four received a "Substantial Noncompliance" rating.[29] Because of the strong incentives offered by CRA, few institutions receive a "Needs to Improve" or "Substantial Noncompliance" rating. In the past six years, the FDIC has assigned these ratings a total of 89 times, to 63 institutions. One of these institutions received a "Substantial Noncompliance" rating for each year, while another five institutions were rated "Needs to Improve" or "Substantial Noncompliance" 3 or 4 times in a row. Of these 63 institutions, seven had assets of over $1 billion, and 21 had assets between $250 million and a billion. Fifteen had assets between $50 million and $250 million, and 21

[27] *See* 12 U.S.C. § 2906(b)(2).
[28] *See* 12 C.F.R. § 345, at Appendix A (FDIC publication of ratings matrix used by all of the financial institution regulatory agencies.)
[29] These figures are for performance evaluations conducted in 2007 for which a rating has been assigned. Performance evaluations are made public three months after receipt by the financial institution, to allow the opportunity for a supervisory appeal. Therefore the exact number of each type of rating could change.

had assets of less than $50 million. Although some of these banks are located in metropolitan areas, one-third are located in rural areas.

The Effect of Fair Lending Violations on CRA Ratings

Consistent with interagency regulatory guidance, discriminatory or other illegal credit practices, including violations of the fair lending laws, are considered when evaluating CRA performance and may result in a lower CRA rating. The FDIC regulation covering discriminatory or other illegal lending practices, as amended in 2005, states that:

> The FDIC's evaluation of a bank's CRA performance is adversely affected by evidence of discriminatory or other illegal credit practices in any geography by the bank or in any assessment area by any affiliate whose loans have been considered as part of the bank's lending performance.[30]

Evidence of discriminatory or other illegal credit practices considered as part of the CRA evaluation includes, but is not limited to:

- discrimination against applicants on a prohibited basis in violation, for example, of the Equal Credit Opportunity Act or the Fair Housing Act;
- violations of the Home Ownership and Equity Protection Act;
- violations of section 5 of the Federal Trade Commission Act;
- violations of section 8 of the Real Estate Settlement Procedures Act; and

[30] 12 C.F.R. § 345.28(c)(1).

- violations of the Truth in Lending Act provisions regarding a consumer's right of rescission.[31]

The 2005 amendments strengthened the CRA regulations in several respects. First, they expressly incorporated into the regulation the examples of discriminatory or other illegal credit practices cited above. Second, the amendments clarified that discriminatory or other illegal credit practices carried out by the institution under review in any geography could be adversely considered by the regulators. This part of the amendment made clear that the agencies could consider lending discrimination that had occurred outside an institution's CRA assessment area.[32] Finally, the amendments added express coverage of discriminatory or other illegal credit practices by an affiliate within the institution's assessment area if the relevant lending was considered as part of the institution's CRA performance evaluation.

The effect of an illegal credit practice by an institution is determined in the overall context of the institution's CRA performance. The FDIC's regulation, substantively identical to the other regulators', states that in determining the effect of evidence of such practices on the bank's assigned rating:

> the FDIC considers the *nature, extent, and strength* of the evidence of the practices; the policies and procedures that the bank . . . has in place to prevent the practices; any corrective action that the bank . . . has taken or has committed to take, including voluntary corrective action

[31] *Id.*

[32] Under the CRA regulations, a bank chooses one or more assessment areas within its geographic regions which the FDIC uses to evaluate the bank's record of helping to meet the credit needs of its community. *See* 12 C.F.R. § 345.41.

> resulting from self-assessment; and any other relevant information.[33]

In order to determine the impact of an illegal credit practice on an institution's CRA rating, examiners follow a deliberative process. First, they use interagency examination procedures[34] to assign a preliminary CRA rating based in the performance tests described earlier. Examiners then review the results of the institution's most recent compliance examination, which includes the fair lending review, to determine whether evidence of discriminatory or other illegal credit practices has been found. If that is the case, examiners consider the nature, extent, and strength of the evidence, as required by the regulation. Through this analysis, they determine the extent to which illegal credit practices will affect the institution's CRA rating.

For FDIC-supervised institutions evaluated between January 1, 2002 and September 30, 2007, fair lending violations resulted in 14 CRA rating downgrades: three downgrades to "Satisfactory", and eleven to "Needs to Improve." We are considering similar action with respect to several other CRA ratings currently under review. Depending upon the nature and extent of evidence of any discriminatory or other illegal credit practice discovered by our examiners, the FDIC may accelerate the CRA examination cycle to consider the impact of the practice on the bank's CRA rating.

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[33] 12 C.F.R. § 345.28(c)(2) (emphasis added)

[34] These procedures have been incorporated into the FDIC Compliance Handbook at Chapter XI (Community Reinvestment Act), http://www.fdic.gov/regulations/compliance/handbook/html/chapt11.html

CRA Enforcement -- the Applications Process

In contrast to fair lending violations, which can be addressed through mandatory corrective action and financial penalties, CRA is enforced through the applications process and the public disclosure of ratings. The CRA rating is required to be a factor in the supervisory agency's review and approval of the institution's application to expand its business by opening a branch, relocating a home office, merging with or acquiring another institution,[35] as well as in the review of an application for deposit insurance for a proposed new institution. Poor CRA ratings or negative public comments can slow down or halt the processing of an application important to an institution's growth and business activities.

In evaluating all these applications, the FDIC must take into account the applicant institution's CRA performance or, in the case of a new institution, its proposed CRA plan, as well as the views expressed by any interested parties about an institution's CRA performance. To facilitate public comment, the FDIC maintains a publicly available database of all applications subject to the CRA, and commenters have between fifteen and thirty days to submit comments, depending on the type of application.[36]

The FDIC can deny or conditionally approve applications based on CRA concerns identified either through public comment or the supervisory review process.[37] Many

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[35] *See* 12 C.F.R. § 345.29.
[36] Applications Subject to the Community Reinvestment Act and Public Comment, http://www2.fdic.gov/cra/. *See* 12 C.F.R. §§ 303.23, 303.44, 303.65 and 303.86.
[37] *See* 12 C.F.R. § 345.29(d).

situations are resolved through a commitment by the applicant to undertake or refrain from certain activities. In some circumstances, no resolution is possible. Before FDIC staff recommends denial, however, the applicant is informed of the likely negative outcome and offered the opportunity to withdraw the application and thereby avoid a likely denial by the FDIC Board of Directors.[38]

In light of this process, many applicants withdraw their applications, and as a result, denied applications are extremely rare. In the last ten years, the FDIC has not denied any applications as a result of CRA ratings or comments. As an example, of the over 2,400 deposit insurance applications received in the last ten years, 20 percent were withdrawn, and in 14 of these applications the FDIC noted CRA performance deficiencies. In the same time period, the FDIC received close to 20,000 branch and merger applications.

Maintaining the Quality of the Examination Process

The FDIC follows a number of procedures designed to promote accuracy and consistency in the CRA evaluation process. Before examiners are permitted to lead a CRA performance evaluation, they must complete a commissioning process which includes specialized CRA training. Extensive written guidance is available to examiners as they prepare performance evaluations. Once evaluations are written, the evaluations are subject to supervisory review before they are finalized and published. In addition, we

[38] Only the FDIC Board of Directors may deny an application.

periodically conduct field and regional office reviews that sample and assess the quality of performance evaluations that have already been issued.

The FDIC continually assesses its efforts to achieve consistency and accuracy in CRA evaluations and to adjust and expand procedures as warranted. This is an ongoing process and we have received valuable insights in this regard from consumers and industry, as well as from periodic reports by the Government Accountability Office (GAO) and from the FDIC's Office of Inspector General (OIG).

As I noted earlier, criticism about the undue focus on process prompted the 1995 regulation changes to increase regulators' attention to performance. That same year, the GAO reviewed the examination processes at all the agencies and made a number of recommendations for improvement, including developing more comprehensive training for examiners, focusing increased attention on data accuracy, and revising the presentation of information in performance evaluations to improve clarity.[39] The agencies implemented enhancements responding to the recommendations as they implemented the revised regulations. In response to recommendations by the FDIC OIG in 2000 and 2007,[40] the FDIC provided additional specific guidance to examiners relating to presentation of data and support for conclusions. The FDIC also provided further

[39] GGD-96_23 (Nov. 1995), GAO Report *Community Reinvestment Act: Challenges Remain to Successfully Implement CRA*. http://www.gao.gov/archive/1996/gg96023.pdf.
[40] Audit of the Division of Compliance and Consumer Affairs' Community Reinvestment Act Examination Process, OIG Audit Report 00-026 (July 7, 2000), http://www.fdicig.gov/reports00/00-026.pdf; FDIC's Implementation of the 2005 Amendments to the Community Reinvestment Act Regulations, OIG Audit Report 07-008 (March 30, 2007), http://www.fdicig.gov/reports07/07-008.pdf.

direction to supervisors who review performance evaluations, in order to improve the consistency of performance evaluations.

The Positive Impact of CRA

Studies have pointed to increases in lending to low- and moderate-income customers and minorities in the decades since the CRA's passage. For example, a study by the Joint Center for Housing Studies at Harvard University reported that HMDA data for 1993 through 2000 show that home purchase lending to low- and moderate-income people living in low- and moderate-income neighborhoods grew by 94 percent -- more than in any of the other income categories.[41]

In a GLBA-mandated study of the performance and profitability of CRA-related lending activities published in 2000 by the Federal Reserve Board, most of the institutions responding reported that CRA-related mortgage lending tended to be either profitable or marginally profitable.[42] The study also indicated that often origination and servicing costs for CRA-related mortgage lending were not dissimilar to those for other loans.[43] In addition, almost all respondents reported that their CRA-related small

[41] *The Community Reinvestment Act: Access to Capital in an Evolving Financial Services System*, The Joint Center for Housing Studies, Harvard University, March 2002.
[42] The Performance and Profitability of CRA-Related Lending Report by the Board of Governors of the Federal Reserve System, Submitted to the Congress pursuant to section 713 of the Gramm-Leach-Bliley Act of 1999, July 17, 2000, at v.
[43] *Id.* at vii.

business lending was either profitable or marginally profitable, and four percent reported that it was more profitable than non-CRA small business lending.[44]

CRA encourages banks to participate in innovations and to adopt new lending opportunities, consistent with safe and sound lending practices. According to the GLBA study, "Nearly two-thirds of respondents report that their CRA-related home purchase and refinance lending has led to such opportunities."[45]

Over its history, CRA has made a significant contribution to the revitalization of many low- and moderate-income communities in both urban and rural areas, and has changed the way banks approach lending in their communities. However, more remains to be done.

The Role of CRA in Addressing Current Challenges

CRA, as passed in 1977, provides flexibility because it contains broad goals without detailed requirements about how to achieve them. With its focus on the needs of the community as opposed to specific products or services, it allows bankers to alter their offerings in response to changing credit demands. It also allows federal bank and thrift regulatory agencies to address emerging issues and respond quickly to local and national crises. For example, to help stabilize and revitalize the Gulf Coast communities in the

[44] *Id.* at xxi.
[45] *Id.* at xii.

aftermath of Hurricanes Katrina and Rita, the agencies provided CRA credit for all institutions for recovery-related loans and investment.

Today, the FDIC is promoting the use of CRA to encourage solutions to several key consumer financial concerns, specifically, encouraging alternatives for homeowners facing mortgage foreclosures, meeting the need for affordable small-dollar loans, addressing the exceptionally high cost of credit and the need for basic banking services in many underserved communities.

Foreclosure Prevention

Between now and the end of 2008, subprime hybrid ARMs representing hundreds of billions of dollars in outstanding mortgage debt will undergo payment resets. Almost 1.3 million hybrid loans are scheduled to undergo their first reset during 2008,[46] and an additional 422,000 subprime hybrid loans are scheduled to reset in 2009. The combination of declining home prices and scarce refinancing options will stress these mortgage holders and could result in hundreds of thousands of additional mortgage foreclosures over the next two years.[47]

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[46] FDIC estimates based on the Loan Performance Securities Database. They reflect data collected through August 2007 on first-lien mortgages secured by owner-occupied properties where the mortgage has been securitized in private MBS issues. These figures have been adjusted to include an estimate of subprime securitized loans that are not included in the Loan Performance database.

[47] Statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation, on "Accelerating Loan Modifications, Improving Foreclosure Prevention and Enhancing Enforcement" before the Financial Services Committee, U.S. House of Representatives, December 6, 2007.

In April 2007, the federal financial regulatory agencies issued guidance encouraging financial institutions to consider prudent workout arrangements to keep borrowers in their homes,[48] and made clear that there may be favorable CRA consideration for programs to transition low- and moderate-income borrowers from higher cost to lower cost loans, provided the loans are made in a safe and sound manner.

Consistent with the April 2007 statement, the agencies have proposed revisions to several CRA Q&As to encourage institutions to work with homeowners who are facing foreclosures. The agencies have stated that they would view favorably for CRA purposes establishing loan programs that provide relief to low- and moderate-income homeowners facing foreclosure.[49]

For banks or thrifts that are not direct lenders, or without the resources to offer refinancing programs, making investments in or loans to a lending consortium or a foreclosure prevention program, perhaps including financial counseling, may be a way to provide assistance to troubled borrowers and earn positive CRA credit. In several states, local lenders have already formed consortiums to provide rescue funds. Through one-on-one counseling, banks also can assist borrowers in understanding the terms of their existing loans and identifying potential problems, such as future resets. In addition, banks can provide borrowers with referrals to bona fide rescue programs they can trust,

[48] Statement on Working with Residential Borrowers, FIL-35-2007 (April 17, 2007), www.fdic.gov/news/news/financial/2007/fil07035.html.
[49] 72 Fed. Reg. 37922, 37939 (July 11, 2007).

such as Neighborworks' HOPE program and the HOPE NOW Alliance, all of which are activities viewed positively for CRA purposes.[50]

Affordable Small-Dollar Loan Products

The current CRA regulations place emphasis on home mortgage, small business, and small farm loans. While these loans serve important needs, in recent years there has been tremendous demand for small-dollar loans, and a corresponding growth in high cost credit products, such as payday loans. These loans often trap borrowers in an unending cycle of debt as a result of annual percentage rates (APRs) of 300 percent or higher.[51]

The FDIC has encouraged banks to seek innovative ways to provide consumers with access to reasonably priced small-dollar loans and has used CRA incentives to further this effort. In 2007, the FDIC released its Affordable Small Loan Guidelines,[52] which explore several aspects of product development, including affordability, streamlined underwriting and built-in savings components. FDIC examiners give favorable consideration to small-dollar loan programs consistent with these guidelines when evaluating CRA performance.

Also, the FDIC has approved a two-year pilot project to review affordable and responsible small-dollar loan programs in financial institutions. At the end of January,

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[50] *See* FIL-35-2007, April 17, 2007, Working with Residential Borrowers.
[51] *See* Preamble to Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 32 C.F.R. Part 232, 72 Fed.Reg. 50580 et seq. (August 31, 2007).
[52] FIL-50-2007, June 19, 2007 http://www.fdic.gov/news/news/financial/2007/fil07050.html.

Chairman Bair launched this program with 30 volunteer banks of different sizes from across the country participating. The project is designed to assist bankers by identifying information on replicable business models for affordable small-dollar loans. Best practices resulting from the pilot will be identified and become a resource for other institutions.

Basic Banking Services

The FDIC also has started to explore using positive CRA consideration as an incentive for banks to offer products that build wealth and provide for financial security, such as individual retirement and health care accounts. In recent years, the FDIC has pursued a number of new initiatives to promote broader access to banking services by traditionally underserved populations and to ensure adequate consumer protection in the provision of these services.

The FDIC has formed an advisory committee -- the Advisory Committee on Economic Inclusion -- to explore in detail the kinds of incentives regulators currently provide to banks, and whether we can do more to encourage savings products. In addition, the FDIC has launched a new national initiative to form a network of local coalitions around the country charged with helping underserved communities gain access to federally insured institutions. This network -- the Alliance for Economic Inclusion -- is focusing on unbanked and underserved populations in nine markets across the country,

and is exploring ways to use CRA to improve access to banking services for these communities.

The FDIC has long recognized the importance of minority depository institutions in promoting the economic viability of minority and underserved communities. The FDIC relied on the CRA statute, absent any implementing regulations or guidance, to give positive CRA consideration for bank activities that support minority banks serving low- and moderate-income areas regardless of whether the minority bank is located in the supporting bank's assessment area. [53]

High Cost of Credit

Recently, changes to the HMDA regulation[54] mandated the collection of certain pricing information on "higher priced" home mortgage loans beginning in 2004.[55] The HMDA pricing data has allowed researchers to see where, to whom, and by whom, these higher-priced loans -- an indicator of subprime and to some extent Alt-A lending -- are being made.

Patterns evident in these new HMDA data underscore questions about the scope of CRA and the way we evaluate the credit services provided by banks, particularly mortgage loans. While credit has become more available, a smaller percentage is subject

[53] Pursuant to a 1992 amendment to CRA, *see* 12 U.S.C 2907. See also recently proposed Q&A on investments in minority- or women-owned financial institutions and low-income credit unions in. 72 Fed. Reg. 37922. 37924 (July 11, 2007).
[54] *See* 12 C.F.R. Part 203.
[55] *See* 12 C.F.R. § 203.4(a)(12).

to CRA evaluation. In recent years, independent mortgage companies, particularly those focused on subprime lending, have made an increasing share of home loans. CRA does not apply to their activities. Insured depository institutions increasingly lend outside of the areas where they operate branches, and sometimes do this through affiliated entities, which are only included in the evaluation at the institution's option. In the most recent HMDA pricing data available, 19 percent of the conventional first lien mortgage loans originated by depository institutions were higher-priced, compared to 23 percent by bank subsidiaries, 38 percent by other bank affiliates, and more than 40 percent by independent mortgage companies.[56] Moreover, loans extended within banks' CRA assessment areas were less likely to be higher priced than loans originated outside of banks' assessment areas.[57]

These patterns raise questions about what should constitute a bank's assessment area and whether only lending within the assessment area should be considered. They also raise questions about whether continuing to cover only banks and thrifts under CRA is achieving the goals established by CRA thirty years ago -- that is, to work towards meeting the credit needs of entire communities. These patterns highlight the importance of focusing attention on not just whether loans are being made but also at what price and by whom, particularly with regard to minority borrowers, as highlighted consistently by the HMDA data, and as similarly evidenced by the cost of many short-term, small-dollar loan products.

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[56] Avery, Brevoort, Canner, The 2006 HMDA Data, Federal Reserve Bulletin, December 2007, at A89.
[57] *Id.* at A75.

Conclusion

Because Congress wrote the CRA in a way that allowed for adaptation to changing conditions over the years, the statute has been highly flexible and CRA, through the implementing regulations, has evolved significantly over the thirty years since enactment. As credit has become available more broadly to low- and moderate-income borrowers and neighborhoods, significant progress has been achieved toward meeting the original goals of the legislation.

Yet, there continue to be areas where CRA could have an important impact on the business activities of banks and thrifts. Through periodic revisions of the regulations, and regularly updated guidance, the agencies address evolving financial needs in communities. Today those needs include basic banking services, savings programs, affordable small-dollar loans, and foreclosure prevention programs. CRA's flexibility ensures that it will continue to enhance the ability of all consumers to access and benefit from our banking system.

Thank you for the opportunity to testify today. I look forward to answering any questions.

STATEMENT OF LAWRENCE J. WHITE
before the
FINANCIAL SERVICES COMMITTEE
of the
U.S. HOUSE OF REPRESENTATIVES
FEBRUARY 13, 2008
on
"THE COMMUNITY REINVESTMENT ACT: THIRTY YEARS OF ACCOMPLISHMENTS, BUT CHALLENGES REMAIN"

My name is Lawrence J. White. I am a Professor of Economics at the NYU Stern School of Business. I represent solely myself at this hearing. I have attached a brief biographical summary at the end of this statement.

I am pleased and honored to have been invited to testify at this hearing on the Community Reinvestment Act of 1977 (CRA). I will not try to summarize the CRA or the extensive literature on it in this brief statement. I have written about the CRA in the past (White 1993, 2000, 2002). Recent comprehensive reviews of the CRA can be found in Apgar and Duda (2003), Barr (2005), and Bernanke (2007), and a recent symposium on the CRA can be found in the Western New England Law Review, Vol. 29, No. 1 (2006).

My views about the CRA surely differ from those of many of the other individuals who will testify at today's hearing. I believe that, despite the good intentions and worthwhile goals of the CRA's advocates, the CRA is an inappropriate instrument for achieving those goals.

Fundamentally, the CRA is a regulatory effort to "lean on" banks and savings institutions,[1] in vague and subjective ways, to make loans and investments that (the CRA's proponents believe) those depository institutions would otherwise not make. It is a continued effort to preserve old structures in the face of a modernizing financial economy. At base, the CRA is an anachronistic

[1] For the remainder of this statement I will use the word "banks" to include both commercial banks and savings institutions, unless otherwise indicated.

and protectionist effort to force artificially a local focus for finance in an increasingly competitive, increasingly electronic, and ever-widening realm of financial services. Further, ironically, the burdens of the CRA may well discourage banks from setting up new locations in low-income neighborhoods and thus providing local residents with better-priced alternatives to high-cost check-cashing and payday lending establishments.

There is a better way. First, to the extent that lending problems can be traced to discrimination against racial or ethnic groups or involving other categories of personal discrimination, the right tool is more vigorous enforcement of anti-discrimination laws -- notably, the Equal Credit Opportunity Act of 1974.

Second, vigorous enforcement of the antitrust laws, especially with respect to mergers, is necessary to keep financial markets competitive, so that banks and other lenders are constantly under competitive pressure to provide attractive services offerings to their customers. Of course, vigorous competition should not veer off into predatory practices, in which aggressive sales personnel take advantage of unsophisticated customers who are insufficiently aware of better alternatives.

Third, to the extent that there are socially worthwhile lending opportunities that somehow are not being satisfied by existing lending institutions, these projects should be funded through the public fisc, in an on-budget and transparent process. The Community Development Financial Institutions Fund, authorized by the Riegle Community Development and Regulatory Improvement Act of 1994 and managed by the U.S. Treasury, is a good example of this kind of public funding mechanism. To the extent that its current funding levels are inadequate, they should be increased.

Finally, if public policy persists with something that resembles the CRA, the annual local lending obligations of banks should be explicitly quantified. These obligations could then be traded among banks, so that a system could arise that is similar to the "cap and trade" system that has proved so successful for dealing with sulfur dioxide emissions in a low-cost and efficient manner

(Klausner 1995; Richardson 2002).

The remainder of this statement will expand on these ideas.

The Drawbacks of the CRA

Consider the basic concept of the CRA: Banks are somehow neglecting loan opportunities in the communities in which they have establishments -- primarily, in low- and moderate-income (LMI) communities -- and must be forced to lend in those communities. Another version of this argument is that a bank that gathers deposits from customers that are located geographically close to that bank's physical location is "draining" deposits out of the community when it lends those funds elsewhere.

At its base, this concept rests on the notion either that (a) banks are lazy (or ill-intentioned) and are inefficiently passing up profitable opportunities to lend to creditworthy customers in LMI communities, and so they must be forced to do so; or (b) they are monopolies with market power and excess profits that can be used to cross-subsidize the unprofitable loans in the LMI community that they can be forced to make. Either version has the flavor of the pre-1970s world of banks and banking, where competition was not especially vigorous and state and national regulations often impeded entry and prevented banks from branching outside their home communities, which thereby often created pockets of local market power.

Further the notions that banks have special obligations toward "their" communities and that the communities need and deserve this protection again smack of that pre-1970s world of localized finance.

Let us instead consider lending in the context of the first decade of the twenty-first century. In that context, there are at least five bases for questioning the wisdom of the CRA. First, if loans are profitable, profit-seeking banks should already be making them. In this case, CRA is redundant at best (but is still costly, because of the costs of compliance and of regulatory monitoring). Of

course, banks make mistakes and may not be the perfect maximizers of introductory economics textbooks. But the CRA is based on the notion that banks systematically overlook profitable opportunities in LMI communities. And that seems unlikely in today's environment.

Alternatively, there may be spillover effects that cause single loans to be unprofitable but that would cause a group of loans to be profitable. In that case, we should expect to see banks forming joint ventures or other types of coalitions to "internalize" the externality and make these profitable loans.

On the other hand, if the loans are not profitable, then (a) they require a cross-subsidy from the excess profits from other (super-profitable) activities of the bank; but in the increasingly competitive environment of financial services there will be little or no excess profits; or (b) they will involve losses for the bank; or (c) they will be shirked and avoided, with accompanying cynicism. Neither of these last two prospects should be the basis for good public policy.

Second, why should a bank have a special obligation to lend to a specific local geographic area? What is special about local geographic areas or about the specific placement of physical bank locations? Should the bank also have an obligation to hire only employees who live in that same geographic area? Must it buy its desks from local merchants?

The localism orientation of the CRA is an anachronism that runs counter to the broad sweep of public policy in the financial services area, which has been to erase protectionist measures (such as restrictions on intra-state and interstate branching, and the forced compartmentalization of financial services) and to place more trust in competition.

Further, the "draining deposits" notion ignores the substantial value to a LMI community of a bank that offers primarily deposit services and a few related services (such as check-cashing and cash transfer, and perhaps some personal loans). To the extent that community leaders are concerned that the community's citizens are using higher-cost alternatives, such as check-cashing offices and payday lenders, they should welcome banks, even if the banks provide a limited menu

of services. Ironically, the lending obligations of CRA (and the extra burden of exiting an area if the operations there turn out to be unprofitable) may well discourage the establishment of branches in LMI areas in the first place. Barriers to exit are barriers to entry.

Third, why place this special obligation on banks? After all, there are many other categories of lenders for most of the types of loans that banks make. Are banks special? If so, in what ways are they special, and are those ways relevant for CRA purposes?

Banks are special in at least two important ways: (a) They (along with credit unions) provide federally insured deposits, which is an important benefit for financially unsophisticated customers who seek a safe place for their transactions accounts and for simple savings; deposit insurance also provides stability for the overall banking system by forestalling the kinds of depositor runs on banks that plagued American banking before 1933 (and that Britain revisited in September 2007 with their Northern Rock debacle); and (b) Commercial banks especially are important sources of credit for small and medium-size enterprises (SMEs).

Both special features are good arguments for vigorous antitrust enforcement, to ensure that bank mergers do not create anticompetitive environments in local markets for deposits and for SME lending. Neither provides an argument for imposing CRA requirements to make loans that they would not be inclined otherwise to make.

Fourth, in a dynamic setting, banks' choices of locations will surely be influenced by the regulatory burdens that accompany those choices. As was discussed above, to the extent that they see decisions to locate in LMI areas as carrying extra regulatory burdens (and as involving greater difficulties of exit in the event that the location proves to be unprofitable), they are less likely to locate in those areas in the first place.

Fifth, the vagueness of the CRA's language -- that banks should meet "the credit needs of its entire community, including low- and moderate-income neighborhoods..." -- has led to vagueness and subjectivity of enforcement. Initially, enforcement focused on a bank's efforts toward serving

its community and the documentation of those efforts; after 1995, enforcement focused more on documenting lending outcomes; in essence, pre-1995 regulation focused on inputs, while post-1995 regulation focuses more on outputs. Although the latter is surely an improvement over the former, nevertheless the inherent vagueness of "needs" inevitably leads to the vagueness and subjectivity of enforcement. This can't be the basis of good public policy.

In sum, the CRA is fundamentally at odds with the modern sweep of public policy with respect to financial regulation and with the reasons and arguments that underlie the direction that policy has taken. It emphasizes protectionism and localism and distrusts competition in an era when the sweep of policy is to reduce and eliminate local barriers and to rely more on competition than on forced lending. And, by discouraging entry in LMI areas, the CRA may well be contrary to the long-run interests of the communities that it is intended to help.

Better Public Policies

These criticisms of the CRA should not be interpreted as a statement that no governmental actions are warranted. As I stated at the beginning of this statement, there is a better way to achieve the goals of the CRA's advocates.

First, discrimination by lenders of any kind with respect to racial or ethnic or other prohibited categories should be vigorously prosecuted under the Equal Credit Opportunity Act and any other available statute, such as the Fair Housing Act of 1968.

Second, the antitrust laws should be vigorously enforced, so as to keep financial markets competitive.

Third, to the extent that there is a good social case for local lending and investment that local lenders somehow do not satisfy, those loans and investments should be funded through the public fisc, in an on-budget and transparent process. The Community Development Financial Institutions Fund is a good example of this kind of funding, and it should be expanded to replace

whatever socially worthwhile projects would be eliminated if CRA were repealed.

Finally, if the CRA remains in force, its vague and subjective regulatory enforcement should be replaced by a set of specific annual lending obligations that would encompass both originations and portfolio holdings. These obligations would then be tradable among banks. Those banks that were less efficient at originating and holding these types of loans could pay other banks that were more efficient at the activities to take over these obligations. This system, in addition to making more transparent the obligations that are often opaque, could achieve the kinds of efficiencies that have attracted attention to the "cap and trade" system for controlling sulfur dioxide emissions by electric utilities.

Conclusion

The CRA is not a good public policy tool for achieving the goals of it advocates. There are better ways. I urge this Committee to consider those alternatives.

I would be happy to answer any questions from the Committee.

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Biographical Summary

Lawrence J. White is Arthur E. Imperatore Professor of Economics at New York University's Stern School of Business and Deputy Chair of the Economics Department at Stern. During 1986-1989 he was on leave to serve as Board Member, Federal Home Loan Bank Board, and during 1982-1983 he was on leave to serve as Director of the Economic Policy Office, Antitrust Division, U.S. Department of Justice. He is currently the General Editor of The Review of Industrial Organization and Secretary-Treasurer of the Western Economic Association International.

Prof. White received the B.A. from Harvard University (1964), the M.Sc. from the London School of Economics (1965), and the Ph.D. from Harvard University (1969). He is the author of The Automobile Industry Since 1945 (1971); Industrial Concentration and Economic Power in Pakistan (1974); Reforming Regulation: Processes and Problems (1981); The Regulation of Air Pollutant Emissions from Motor Vehicles (1982); The Public Library in the 1980s: The Problems of Choice (1983); International Trade in Ocean Shipping Services: The U.S. and the World (1988); The S&L Debacle: Public Policy Lessons for Bank and Thrift Regulation (1991); and articles in leading economics and law journals.

He is editor or coeditor of eleven volumes: Deregulation of the Banking and Securities Industries (1979); Mergers and Acquisitions: Current Problems in Perspective (1982); Technology and the Regulation of Financial Markets: Securities, Futures, and Banking (1986); Private Antitrust Litigation: New Evidence, New Learning (1988); The Antitrust Revolution (1989); Bank Management and Regulation (1992); Structural Change in Banking (1993); The Antitrust Revolution: The Role of Economics, 2nd edn. (1994); The Antitrust Revolution: Economics, Competition, and Policy, 3rd edn. (1999); The Antitrust Revolution: Economics, Competition, and Policy, 4th edn. (2004); and The Antitrust Revolution: Economics, Competition, and Policy, 5th edn. (2009, forthcoming). He was the North American Editor of The Journal of Industrial Economics, 1984-1987 and 1990-1995.

Prof. White served on the Senior Staff of the President's Council of Economic Advisers during 1978-1979, and he was Chairman of the Stern School's Department of Economics, 1990-1995.

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Testimony of

Marva E. Williams

Senior Program Officer, Chicago

Local Initiatives Support Corporation

Community Reinvestment Act

House Committee on Financial Services

U.S. House of Representatives

February 13, 2008

Statement of Marva E. Williams
Local Initiatives Support Corporation (LISC)

Thank you for the opportunity to testify today on the Community Reinvestment Act (CRA). I am Marva E. Williams, Senior Program Officer in LISC's Chicago office.

CRA has been critical to bringing the capital and financial services that low-income communities – indeed, communities of all incomes – need to contribute to and benefit from the American economy and society. Encouraged by CRA, banks and thrifts have:

- Increased safe, sound, and profitable lending for homeownership and small businesses and farms to low- and moderate-income consumers and communities.
- Developed flexible financial products and services, and marketing strategies.
- Made community development loans and investments to build and preserve affordable housing, economic development projects, and community service facilities that are helping to stabilize families and low-income communities.

Since 1980 LISC has worked in numerous partnerships involving banks and thrifts, nonprofit housing and community development organizations, and government at all levels to revitalize urban and rural communities. LISC currently invests over $1 billion each year in these partnerships. Over time we have invested $8.6 billion, generating $25.3 billion of development activity, including 230,000 affordable homes and 32 million feet of retail and community facilities. Most of this money has come from the private sector, including banks, mostly in the form of loans and investments. Our work covers a wide range of activities that contribute to sustainable communities, including housing, economic development, building family wealth and incomes, education, and healthy lifestyles and environments. Our first name is local, and we operate through 30 local offices and a national rural development program, so we experience low-income communities and see how CRA works up close. Please visit my city, Chicago, or anywhere else LISC works to see how communities once considered hopeless are now reviving, and how CRA is making a positive difference.

In our experience, CRA has been remarkably valuable, but despite important regulatory improvements in 1995, it has not kept pace with many changes in banking, finance, and community development over the last 30 years. For example:

- In 1977, banks and thrifts originated 80% of home mortgages. Insured deposits provided a primary source of funds for home mortgage lending. Today, the

secondary market is the primary source of capital for mortgages, and these capital flows are global. By 2006, banks and thrifts originated only 43% of home mortgages, so CRA covers a much smaller share of mortgage lending activities. Many of the largest banks and thrifts operate mortgage bank affiliates, which CRA covers only at the bank/thrift's option and only in areas surrounding branches.

- In 1977, there was no interstate banking and in many states branching was limited or prohibited. Banks were local institutions, deeply involved with civic life. CRA was written to ensure that local deposits were reinvested locally, so it focused on the area surrounding a bank's branches. Today, banks may operate nationwide and conduct much of their consumer business through non-branch channels, including the internet and mortgage brokers. In many cities and even entire states, the major banks are based elsewhere.

- In 1977, the overriding concern of low-income and minority communities was redlining – the denial of credit to entire low-income neighborhoods. Many credit-worthy borrowers had trouble getting loans, especially in low-income and minority communities. Today, thanks to CRA, access to responsible lending is far more available in low-income neighborhoods. The Federal Reserve Board has found CRA lending to be safe, sound, and profitable. But subprime lenders – most of which are not subject to CRA – have aggressively and disproportionately marketed loans to these same kinds of borrowers and neighborhoods. A study by Traiger & Hinckley LLP "concludes that CRA Banks were substantially less likely than other lenders to make the kinds of risky home purchase loans that helped fuel the foreclosure crisis." [1]The subprime mortgage crisis has shown that prudent government regulation is important not only for consumers and communities, but also for the safety and soundness of the financial system and the broader economy.

- In 1977, banks and thrifts were peripheral to federal housing and community development programs and policies. Today, largely because of CRA, banks and thrifts now provide loans and investments that are integral to a sophisticated and mostly decentralized system that taps federal programs like HOME, CDBG, the CDFI Fund and McKinney-Vento homeless housing, as well as tax incentives like the Low Income Housing Tax Credit, New Markets Tax Credit, Historic Rehabilitation Tax Credit, and tax-exempt bonds. Banks also finance the preservation of housing developed through older federal programs, such as Section 8 and public housing. Bank/thrift involvement also links CRA with other federal policies, including: the affordable housing goals set for Fannie Mae and Freddie Mac, which encourage secondary market purchases of mortgages that CRA encourages banks and thrifts to originate; public welfare investment authority, which permits banks to make community development investments, including those based on tax credits; and even the Basel international banking accords, which set risk-based capital standards that determine whether a bank's

[1] Traiger & Hinckley LLP, "The Community Reinvestment Act: A Welcome Anomaly in the Foreclosure Crisis" www.traigerlaw.com, p. 1.

community development investments and loans will generate an adequate return on its capital.

We would offer the following observations and suggestions for modernizing CRA.

- Confining CRA to banks and thrifts no longer makes sense because they now originate a minority of home mortgage loans. CRA should be extended to all home mortgage lenders of significant size, as the Home Mortgage Disclosure Act does. Similarly, CRA should apply to credit unions, which also take federally insured deposits. In assessing performance, it will be important for regulators to consider carefully the local market context – for example, whether the market is well served or underserved, and whether homeownership is relatively widespread and affordable or not. Expectations for home mortgage lending to low-income families should be different in New York City and Toledo.

- Confining CRA coverage to areas around bank/thrift branches no longer makes sense, since branches no longer determine where banks/thrifts do business, branching is irrelevant to non-bank/thrift lenders, and deposits are no longer the primary source of lending and investments. Instead, lending under CRA should be based on where the lender is doing most of its business or where the lender has a substantial market share. Coverage of consumer services, such as checking accounts, could be based on where an institution's depositors are located.

- Although CRA examinations occur regularly, CRA is actually enforced only when a bank/thrift applies for a new power, most commonly to merge with or acquire another institution. As such, CRA enforcement does not apply as long as an institution is not involved in a merger or acquisition. We believe it makes more sense to enforce CRA when as regular examinations are completed. The regulators should also actively and regularly invite public comment on an institution's CRA performance.

- The community development activities of a large bank/thrift should be considered together. Community development activities are qualitatively different from more numerous and standardized home mortgages, small business and farm lending, and consumer lending. Community development activities are generally smaller in volume and sometimes more complex, but they add value and should contribute to a concerted strategy. Currently, community development activities are considered within three separate parts of the CRA exam. As a result, a bank's overall community development activities are hard to assess coherently and become an after-thought instead of integral to CRA performance.

- Many rural areas, smaller cities, and even some entire states have few if any banks with sufficient capacity to address complex community development needs. Banks/thrifts that already adequately serve local community development needs should receive full recognition for community development activities nationwide. Capable banks have expressed an interest in bringing their expertise

and capital to underserved areas if they were to receive full recognition under CRA for doing so.

- CRA alone cannot address every issue. CRA should be better coordinated with other related policies, including anti-discrimination laws, consumer protection laws like Home Owners Equity Protection Act, the affordable housing goals set for the Government Sponsored Enterprises, and public welfare investment authority. For example, fair lending laws apply to individual borrowers and CRA applies to communities, but neither law explicitly addresses disparate service to minority communities. Better coordination – and changes in laws as appropriate – will help ensure that consumers and communities are adequately served.

This concludes my testimony. I would be happy to answer your questions.

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Statement of

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Managing Director for Compliance and Consumer Protection
Office of Thrift Supervision

concerning

The Community Reinvestment Act: Thirty Years of Accomplishments, But Challenges Remain

before the

Committee on Financial Services
United States House of Representatives

February 13, 2008

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Testimony on The Community Reinvestment Act: Thirty Years of Accomplishments, But Challenges Remain

before the
Committee on Financial Services
United States House of Representatives
February 13, 2008

Montrice Godard Yakimov
Managing Director Compliance and Consumer Protection
Office of Thrift Supervision

I. Introduction

Good morning, Chairman Frank, Ranking Member Bachus, and Members of the Committee. Thank you for the opportunity to offer testimony on behalf of the Office of Thrift Supervision (OTS) to commemorate the 30th anniversary of the Community Reinvestment Act (CRA). The CRA continues to be a critical legislative milestone for financial institutions and the communities they serve throughout this country. I am very pleased to help celebrate the many and varied contributions that CRA has made in the past three decades to assist regulated institutions in meeting the credit needs of their communities, and particularly low-and moderate-income neighborhoods.

In my testimony today I will discuss (i) the role CRA has played in expanding access to financial services in underserved communities, (ii) the examination process and enforcement mechanisms in place to identify and address CRA issues, (iii) the CRA ratings distribution for savings associations, (iv) the impact of CRA ratings on corporate applications; (v) the ways CRA may be modified or expanded to increase its effectiveness and impact in the changing landscape of today's financial services industry, and (vi) other pivotal issues you have asked OTS to address during today's hearing.

II. The Role of the CRA in Serving Underserved Communities

The CRA was enacted on October 12, 1977 to combat mortgage redlining and discriminatory lending patterns and to encourage banks and thrifts to make concerted efforts to meet the credit needs of all segments of their communities, including low-and moderate-income areas. The legislation addressed vital needs at a crucial time in our history. The CRA helped to democratize credit availability by creating "a continuing and

affirmative obligation" for financial institutions to meet the credit needs of their communities. The CRA statute and implementing regulations also encouraged depository institutions and community-based organizations to work cooperatively and collaboratively to promote the accessibility of credit and related banking services to underserved communities.

The CRA and its implementing regulations[1] have encouraged: (1) the expansion of branches in low-and moderate-income neighborhoods; (2) the development of innovative and responsive retail products and services for low-and moderate-income households; (3) the use of flexible credit underwriting criteria; and (4) the formation of partnerships with local nonprofit entities to provide loans, investments and services that foster community and economic development.

The CRA has also provided the impetus for many financial institutions, often in partnership with community-based organizations, to revitalize low-and moderate-income neighborhoods through loans and investments. One notable illustration of how the thrift industry is meeting the needs of lower-income households is its leadership profile in the origination of multi-family housing loans, a frequent instrument used to finance affordable housing. As of September 30, 2007, OTS-regulated savings associations had approximately 4.14 percent of their assets in multi-family loans, in contrast to commercial banks, which had approximately 1.03 percent of their assets in multi-family loans.

The CRA has also contributed significantly to the rise in other types of community lending and investments, particularly small business and community development lending by savings associations. Beginning in 1996 through 2006,[2] OTS-supervised institutions generated substantial increases in the number and dollar volume of small business and community development loans. In 1996, OTS-supervised savings associations originated 36,342 small business loans totaling $3.5 billion. By 2006, savings associations originated approximately five million small business loans, totaling nearly $29 billion. This is particularly noteworthy given that small business lending is an important driver in the economic empowerment of low and moderate-income neighborhoods.[3]

In addition to small business lending, the dollar volume of community development loans savings associations have originated increased from approximately $2 billion in 1996 to nearly $10.5 billion in 2006. Such increases are attributable, in part, to CRA's focus on community development which has led to substantial

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[1] For the OTS, the CRA regulations are found at 12 CFR part 563e.

[2] Institutions collected and reported loan data in these categories, as applicable, as a result of revisions to the CRA regulations in 1995.

[3] According to a report issued by the Small Business Administration in August of 2007, small businesses employ about half of all private sector employees, pay more than 45 percent of total U.S. private payroll and have generated 60 to 80 percent of net new jobs annually over the last decade. US Small Business Administration, Office of Advocacy, Frequently Asked Questions, August 2007.

accomplishments in the creation of affordable housing for low- and moderate-income individuals, expansion of community services targeted to low–and moderate-income individuals, activities that promote economic development, and activities that revitalize and stabilize low- and moderate-income geographies.

Along with small business and community development lending, OTS-regulated institutions continue to make sizable CRA-eligible investments. For example, a review of qualified investment data reported by OTS-regulated large institutions for 2006 and 2007 shows that current-year investments total approximately $899 million. Prior-period data totaling approximately $148 million represent investments made in previous years that are still carried on the institutions' books and given weighted consideration by examiners. The aggregate dollar volume of investments for these institutions is approximately $1.047 billion.

With respect to services, the OTS has also reviewed the branch distributions for savings associations from 2003 through 2006 to determine the number and percentage of branches located in low- and moderate-income geographies and the dollar volume of deposits made through those branch offices. During this four-year period, the average dollar volume of branch deposits located in low-and moderate-income areas amounted to approximately $212.4 million. That figure represents approximately 28 percent of the total volume of deposits in branches located in every census tract income level. The average number of branches located in low- and moderate-income geographies during the four-year time period is 1,969, which represents approximately 20.4 percent of savings associations' branches located in all census tracts. The percentage of branches in lower-income tracts is generally proportional to the level of deposits for those tracts.

During CRA examinations, OTS examiners consider whether an institution is offering products that are suitable for lower-income customers. In addition, we encourage institutions to review the services offered through their branch network to assess whether their branch locations are adequately serving low and moderate-income populations.

OTS Director John Reich has emphasized that a strong branch presence in low- and moderate-income communities is an effective delivery system to provide lower-cost financial products and services that stabilize neighborhoods. An important reason why OTS made our CRA regulations consistent with those of the other banking agencies is the ability to use the service test performance criteria to evaluate to what extent thrift institutions are providing retail and community development services in their market areas, consistent with safety and soundness principles and consumer protection laws. OTS will continue to emphasize the importance of maintaining and expanding branch networks in low- and moderate-income communities as an important financial services delivery system and an alternative to higher-cost financial services products offered by non-depository institutions.

III. OTS Examination and Oversight of CRA Compliance

On May 4, 1995, the federal banking agencies jointly published revised CRA regulations that dramatically refocused the way we evaluate CRA compliance. The revised regulations emphasized performance-based requirements and replaced the prior assessment factors that were criticized as rewarding process over measurable results. The revised regulations recognized that each institution's capacity to help meet community credit needs is affected by many factors. These factors include the institution's asset size and financial condition, product offerings and business strategy, legal impediments (such as investment and lending limits), local economic and market conditions, and the performance of regulated and unregulated competitors and similarly situated institutions, which could influence the supply of, and demand for, credit. The regulations required examiners to consider these factors, which comprise the institution's "performance context," when evaluating a financial institution's performance under CRA.

As a result of the revisions, the CRA regulations, policy guidance, and examination procedures embody clear, flexible, and sensible performance criteria that:

- Accommodate differences in institutions and the communities in which they operate;
- Minimize burden;
- Promote consistency and objectivity; and
- Allow examiners to exercise their judgment (within regulatory parameters), rather than unduly adhere to rigid, prescriptive procedures.

Currently, the CRA regulations and corresponding examination procedures provide different evaluation methods that address various institutional structures and operations. For small institutions with total assets under $250 million,[4] examinations entail using a streamlined assessment method that emphasizes lending performance. For intermediate small institutions – those institutions with total assets between $250 million and $1 billion – the assessment method evaluates both lending performance and the provision of community development activities (community development loans, qualified investments, and community development services). Large retail institutions – with total assets of $1 billion or more – are subject to CRA evaluations involving three performance tests that assess lending, investment, and service performance. Finally, for wholesale and limited purpose institutions, the assessment method focuses on community development lending, investments, and service activities.

In addition, the CRA regulations permit any institution, irrespective of asset size or business profile, the option to be evaluated under a strategic plan with specific performance goals pre-approved by the institution's regulator.

Both the regulations and the examination procedures establish and promote evaluation methods based on objective data that institutions can also use to measure their

[4] The asset threshold for small and intermediate small savings associations is adjusted annually based on changes to the Consumer Price Index.

performance. Examiners use various data, against the backdrop of an institution's performance context, to assess a savings association's CRA performance. These data include the number and dollar volume of home mortgage and small business loans within the institution's delineated assessment area(s); the number and dollar volume of loans made to low-and moderate-income people, small businesses and small farms; and the extent of loan penetration in low-and moderate-income geographies. As noted previously, some institutions are also evaluated on their performance in providing community development lending, qualified investments, and community development services.

OTS CRA Realignment

In March 2007, OTS published a final CRA rule that brought our regulations back into alignment with the regulations of the other banking agencies in several key areas. Previously, in August 2005, the FDIC, FRB, and OCC issued a joint final rule that created a new community development test for intermediate small banks; adopted language that clarified how evidence of discrimination or practices that violate an applicable law, rule or regulation would adversely affect an institution's CRA rating; and established a provision to adjust asset thresholds for institutions annually for inflation based on the Consumer Price Index.[5] These changes support the core principles and policy objectives of CRA regarding lending to low- and moderate-income communities, making community development investments, and participating in services that stabilize and revitalize low- and moderate-income neighborhoods.

Other important changes include revising the definition of "community development." The OTS adopted this revision in April 2006, which was the first step in the CRA realignment process. The definition was expanded to include activities that revitalize or stabilize:

(A) Low- or moderate-income geographies
(B) Designated disaster areas; or
(C) Distressed or underserved, nonmetropolitan middle-income geographies designated by OTS based on:

  (i) Rates of poverty, unemployment, and population loss; or
  (ii) Population size, density, and dispersion. (Activities are deemed to revitalize and stabilize designated geographies based on population size,

[5] At the time of the 1995 revisions, the banking agencies had committed to review the regulations to ensure their effectiveness in assessing the CRA performance of different institutions and eliminate unnecessary regulatory burden. The category of "intermediate small bank/intermediate small savings association" was established in 2005 to evaluate institutions having total assets between $250 million and $1 billion using a more streamlined approach than the lending, investment and service tests under which large, retail institutions are evaluated. Although intermediate small institutions are evaluated under both a lending and community development test, they are no longer required to collect and report data on small business or small farm loans or the location of certain mortgage loans, thereby reducing the costly and time-intensive data collection and reporting burden for those institutions.

density, and dispersion if they help to meet essential community needs, including the needs of low- and moderate-income individuals.)

Making the OTS's CRA regulations and examination procedures uniform with those of the other banking regulators facilitates more consistent and effective evaluations of the CRA performance of banks and thrifts operating within the same market areas. In realigning our rule with that of the other banking agencies, OTS incorporated changes that reinforce longstanding CRA objectives when assessing the ongoing performance of savings associations in meeting the needs of their local communities.

The OTS CRA Examination Process

The OTS uses the Interagency CRA Examination Procedures to conduct routine CRA examinations on a regularly scheduled basis. Generally, OTS conducts a CRA examination of a savings association with total assets of $250 million or more, and with a prior rating of "Satisfactory" or better, every 24 to 36 months. For savings associations having total assets under $250 million and a CRA rating of "Satisfactory" or better, OTS examines every 48 to 60 months in accordance with the parameters set forth in Section 712 of the Gramm-Leach-Bliley Act. Savings associations of any asset size with CRA ratings less than "Satisfactory" may be examined as frequently as every 6 to 18 months.

As is the case with the other banking agencies, OTS has been criticized for "inflating" CRA ratings assigned to our savings associations. Our experience has shown that as the CRA regulations have become more performance-driven, and as institutions have become more conversant with their CRA obligations, banks and thrifts have enhanced and adapted their compliance management infrastructure to make more loans, investments, and services to comply with the Community Reinvestment Act. Furthermore, they have expanded their ability to make more complex and responsive products and services available and accessible to customers throughout their assessment area(s), which also contributes to higher CRA ratings.

CRA ratings

At the completion of every CRA examination, OTS publishes an evaluation of the institution's CRA performance under the applicable assessment method[6]. The evaluation contains the rating of the institution's performance in helping to meet the credit needs of its community and also provides a conclusion that describes and supports the basis for the rating. Like the other banking agencies, the OTS assigns a savings association one of four ratings: "Outstanding," "Satisfactory," "Needs to Improve," or "Substantial Noncompliance."

[6] Institutions are evaluated as a large savings association, small savings association, intermediate small savings association, a wholesale or limited purpose institution, or an institution that has an approved CRA strategic plan.

Of the 762 institutions[7] that were evaluated from January 1, 2002 to December 31, 2007, 221 were rated "Outstanding," and 532 were rated "Satisfactory." Nine institutions, approximately 1%, were rated below "Satisfactory," including eight savings associations that received a CRA rating of "Needs to Improve" over the six-year period, and one institution that was assigned a rating of "Substantial Noncompliance" during that time frame. The institution rated "Substantial Noncompliance" had assets of $33 million. Most of the institutions rated less than satisfactory appear to be located in nonmetropolitan areas and had assets under $300 million.

OTS has observed a correlation between the size and location of an institution and the probability of receiving a less-than-satisfactory CRA rating. Larger institutions with substantial compliance and risk management infrastructures generally receive a higher percentage of "Outstanding" CRA ratings, compared to smaller savings associations. It is important to note, however, that smaller community banks and thrifts can offset the lack of an elaborate compliance or CRA infrastructure by deploying resources that enable them to take a leadership posture in the provision of loans and investments. An example of this approach is a small institution that seeks out and makes CRA-qualified investments that may enable the small bank or thrift to receive an "Outstanding" rating.

Enforcement mechanisms for CRA compliance

The OTS's CRA regulations require that we evaluate a thrift institution's record of helping to meet the credit needs of its entire market area(s), including low – and moderate - income geographies, consistent with safe and sound banking operations. The institution's record of serving its local community credit needs is considered when we evaluate an application to open new branches or relocate an existing branch, undertake a merger or consolidation, and engage in other corporate activities.

As is the case with the other banking agencies, OTS publishes a notice of scheduled CRA examinations on a quarterly basis. The public is invited to submit comments about an institution's CRA performance as early as possible in the examination process; these comments are considered when evaluating the institution's record and assigning the CRA rating.

It is important to note, however, that the CRA and OTS's CRA regulations require the agency to consider the CRA performance record or proposed CRA plans in acting on various applications. OTS must consider the CRA performance of an institution in applications to relocate or establish branch or home offices, mergers or consolidations under the Bank Merger Act, control or acquisition applications under Section 10(e) of HOLA, and for charter conversions to the federal thrift charter from non-OTS regulated institutions. For new charter applications proposing to charter a federal thrift where no existing CRA performance exists, OTS will consider how the proposed charter intends to meet its CRA objectives. Our records show that OTS has not denied an application for CRA-related reasons during the past ten years.

[7] This figure includes OTS-supervised savings associations with a state or federal charter.

The most recent reports of examination by OTS or by the applicant's other federal regulator are reviewed for CRA performance as part of the application review process. These applications are also subject to publication requirements, inviting the public to submit written comments. Such comments may involve CRA considerations or the performance of an existing institution's performance in meeting the credit needs of its community, or may involve any other applicable regulatory criteria involved in rendering a decision, including (among other things) the financial capacity of the applicant, management resources, impact on competition, or other legal and regulatory considerations. Any comments received by OTS are considered during the application review process. The institution's record of performance may be the basis for denying or conditioning approval of an application by an institution or holding company, and the adequacy of the CRA plan may provide a basis for denying or conditioning approval an application for a new institution.

OTS also holds meetings with commenters when we determine that the meeting will benefit the decision-making process. This process provides an appropriate opportunity for input by community groups and other interested parties about an institution's CRA performance. Moreover, this process may culminate in the institution and the commenter(s) entering into a CRA Agreement, or an informal commitment by the institution to undertake additional CRA obligations to address the concerns raised by the commenters.

The potential negative impact on applications is one strong enforcement mechanism the Congress established in connection with CRA. Additional enforcement may be carried out by the banking agencies through the examination and supervisory process. In our experience, enforcement actions warranted for CRA are generally reflective of other challenges with an institution's compliance program that are also addressed through the supervisory process. An institution that has demonstrated less-than-satisfactory CRA performance may require an enforcement action to address problems identified. In recent years OTS has taken several enforcement actions against savings associations for failing to satisfactorily comply with their obligations under the Community Reinvestment Act including cease and desist orders and the assessment of civil money penalties.

Process for evaluating institutions

Since the inception of the CRA regulations, OTS has considered, as an indicator of CRA performance, evidence of discriminatory or other illegal credit practices. When such evidence is present, it is an adverse factor in the final rating. Indeed, the evaluation of every financial institution covered by CRA has considered, as an indicator of performance, evidence of discriminatory or other illegal credit practices. Section 563e.28(c) of the OTS CRA regulations indicates that a finding of discrimination or other illegal credit practices will adversely affect a savings association's CRA performance, along with other factors such as the nature and extent of the evidence, the policies and procedures that the savings association has in place to prevent discrimination or other illegal credit practices, and corrective action that the savings association has undertaken

or has committed to take, particularly voluntary corrective action resulting from self-assessment and other relevant information.

Evidence of discriminatory or other illegal credit practices considered as part of the CRA evaluation includes, but is not limited to:

- Discrimination against applicants on a prohibited basis in violation, for example, of the Equal Credit Opportunity Act or the Fair Housing Act;
- Violations of the Home Ownership and Equity Protection Act;
- Violations of section 5 of the Federal Trade Commission Act;
- Violations of section 8 of the Real Estate Settlement Procedures Act; and
- Violations of the Truth in Lending Act provisions regarding a consumer's right of rescission.

Since 1990, there have been 37 instances in which the OTS downgraded the CRA rating of an institution in response to evidence of discriminatory or other illegal credit practices.

Both CRA and fair lending compliance are critical elements of the compliance examination function at OTS. A thrift institution's CRA assessment must reflect not only its record of meeting the credit needs of the communities it serves but also its compliance with fair lending laws.

As part of our efforts to enhance our examination capabilities, we have added staff resources, including a Fair Lending Specialist based in Washington, to augment fair lending subject matter experts in our regional offices. We have worked to develop important fair lending econometric models and tools. We have provided additional training to our examiners, and, during the past 18 months, we have undertaken a systemic review of our compliance policies and examination procedures to identify areas to strengthen our overall effectiveness in examining savings associations' compliance with federal consumer protection laws.

Potential expansion of CRA

CRA has played a significant role in increasing lending to low-and moderate-income borrowers and communities. However, more can be done. OTS has supported legislative initiatives to bring additional housing, services and jobs to low-and moderate-income families and communities throughout the nation.

One such proposal, which Chairman Frank has spoken in support of, advocates making CRA applicable to credit unions. We believe all depository institutions should participate in CRA to increase the provision of financial services to low-and moderate-income families and communities.

OTS understands there may be practical obstacles to applying the current CRA model to non-depository institutions. For example, it would be difficult to define assessment areas for institutions such as financial holding companies and mortgage

banking companies. Nevertheless, OTS is committed to actions that increase access to credit and wealth for low-and moderate-income families and, if Congress would like to pursue a dialogue about the benefits of modernizing CRA to include all financial institutions, we would be happy to participate.

Factors that impair the effectiveness of CRA

OTS has advocated and supported legislation to remove unnecessary barriers that limit growth and stability of low-and moderate-income communities.

First, Director Reich has made recommendations, for inclusion in additional federal economic stimulus, which would increase the ability of OTS-supervised institutions to engage in small business and commercial lending. Small business and commercial lending are keys to economic growth and recovery, particularly in low- and moderate-income areas. Both would help build vibrant communities by permitting institutions to expand existing lending programs to address local, regional, and national constrictions on credit availability. The proposal would remove the cap entirely on small business lending and increase the cap on other commercial lending from 10 percent to 20 percent. The Home Owner's Loan Act (HOLA) now caps the aggregate amount of loans for commercial purposes at 20 percent of savings institutions assets. Any commercial loans in excess of 10 percent must be small business loans. Earlier versions of this proposal were included in legislation passed by the House in both the 108th and 109th Congress. We would like to see quick action on this proposal.

Our next recommendation is to update the authority for savings institutions' community development investments. Changes are needed to HOLA to clarify the types of investment opportunities that meet the technical requirement of the law. Originally, savings institutions could readily determine the areas in their region that qualified under HOLA for providing investments for underserved and distressed communities. However, due to changes that evolved in HUD's Title I program (which is the current reference in the HOLA), savings institutions now find their authority to invest in these HUD qualified investments unclear. Another issue that OTS believes should be addressed is the current aggregate limit of two percent of assets in community development investments.

The community development investment authority of savings associations can be clarified by revising and updating HOLA to permit savings institutions to invest in entities engaged in making public welfare investments. H.R. 1066, which passed last year, would accomplish this by: (1) amending HOLA to eliminate the HUD Title I reference and, instead, reference investments that support the public welfare and (2) revising the cap from 2 percent of assets to 15 percent of capital and surplus. We believe these changes to HOLA would greatly enhance the ability of savings associations to assist low-and moderate-income communities and families.

H.R. 1066 would also restore these previously qualifying categories of investments. Unfortunately, the Senate has not yet acted on this legislation. We hope the Senate will act soon to pass this important legislation to enable banks to make public

welfare investments that bring housing, services and jobs back to needy communities by clarifying the existing community development investment authority of federal savings associations. Finally, H.R. 1066 is also important to ensure that banks and thrifts may engage in cooperative partnerships to enhance available capital for public welfare investments that support struggling communities.

The House of Representatives has been very active on these issues in the past. We are hopeful that the Senate will act on this legislation that we believe would go a long way to increase savings institutions' ability to serve these needs.

IV. Improve the Effectiveness of CRA

Reaching the Unbanked and Underbanked

The banking regulators continue to explore how CRA can provide incentives to encourage banks and thrifts to develop more affordable deposit products and services that will expand financial literacy to unbanked and underbanked customers. An estimate by the Federal Reserve indicates that approximately 10 percent of American families are unbanked and approximately 45 million people lack access to credit. Studies have shown that 46 percent of African-Americans and 34 percent of Hispanic Americans do not have an account at an insured bank or thrift institution. These figures indicate that, despite the great strides realized by financial institutions under CRA, many families remain outside of the financial services mainstream.

There are many partners, both public and private, working to reach the unbanked and underbanked in many communities throughout the country. The OTS is participating in the FDIC's Alliance for Economic Inclusion (AEI), which is a national initiative to form a network of local coalitions to help underserved populations in nine markets throughout the country. The purpose of AEI is to expand financial access and increase market competition by delivering measurable results. In each of these markets, AEI is forming coalitions of local financial institutions, community organizations, and local and state agencies to identify viable strategies to work around the barriers that impede underserved target populations from participating in the financial mainstream. Products and services include basic checking and savings accounts, low-cost remittance products, small-dollar loan programs, and responsible mortgage lending products. The demand for responsible mortgage products for nonprime borrowers has assumed much greater significance in view of the current subprime mortgage market turmoil.

The OTS is also working with the thrift industry in a number of initiatives to facilitate the expansion of quality financial products and services to unbanked and underbanked people. Our efforts include encouraging the creation of savings association CRA programs that develop products suitable for entry-level consumers and, as was noted earlier, we are committed to continuing these efforts.

Furthermore, the banking agencies are proposing Interagency Question and Answer (Q&A) policy guidance that provides examples of community development

services, which would include low-cost financial products and services that benefit low - and moderate - income persons.

Supporting Minority-Owned Financial Institutions

Consistent with the OTS CRA realignment, OTS has joined the other banking regulators in proposing guidance to permit non-minority – and non-women-owned financial institutions to receive favorable CRA consideration for investing in minority-- and women-owned institutions and low-income credit unions, which would assist these institutions in meeting their local community credit needs. The minority- or women-owned institution or low-income credit union need not be located in, and the activities need not benefit, the assessment area(s) of the non-minority– or non-women-owned institution, and need not even be located in the same state or region as the minority– or women-owned institution or low-income credit union. This is an important addition to the interagency CRA guidance and reflects the statutory intent of CRA to promote investments in, and support for, minority–owned financial institutions.

The guidance will include examples of activities undertaken by a majority-owned financial institution in cooperation with a minority– or women–owned financial institution or low-income credit union that would receive positive CRA consideration. The examples include making deposits or capital investments, purchasing loan participations, or providing technical expertise to assist a minority– or women–owned institution or low-income credit union improve its lending policies and practices.

Minority banks and thrift institutions play a significant role in providing home mortgage loans, loans to small businesses and other valuable financial products and services in many low-and moderate income communities. Particularly in today's volatile mortgage market, it is imperative that the regulators continue to support minority institutions through the supervisory process, as a key channel in the provision of access to mainstream financial products and services in underserved communities.[8]

Foreclosure Mitigation

In July 2007, the OTS, along with the other federal banking agencies, issued for comment several proposed Questions and Answers (Qs&As) to clarify the types of foreclosure prevention activities eligible for CRA favorable consideration. A proposed Q&A will provide examples of community development services, which will highlight that credit counseling that assists low– and moderate-income borrowers in avoiding foreclosure on their homes, will receive CRA favorable consideration. Another proposed Q&A will note that establishing loan programs that provide relief to low– and moderate-income homeowners facing foreclosure is another type of lending activity that would warrant favorable consideration under CRA.

[8] The OTS program to support minority institutions is outlined in the OTS Policy Statement on Minority Institutions at www.ots.treas.gov.

In addition to the proposed Qs&As, the existing interagency Q&A policy guidance published in July 2001 provides positive CRA consideration for lenders that offer loan programs that include financial education components on how to avoid abusive or unsuitable lending activities. Existing guidance also states that favorable CRA consideration will be given to lenders that offer programs to transition borrowers from loans with higher rates and fees to lower-cost loans, consistent with safe and sound lending practices. The expanded guidance is part of the growing list of tools that regulators, lawmakers, and the financial services industry have advanced to counter the mounting number of foreclosures nationwide.

V. What Lies Ahead

The availability of responsible lending programs for all borrowers, both prime and subprime, is critical to sustain affordable homeownership and to ensure that the American dream of home ownership remains attainable. The OTS believes this point is particularly important in the context of the 30th anniversary commemoration of the Community Reinvestment Act. We believe policy solutions to current challenges facing the mortgage market, families and communities should not unintentionally reverse hard fought gains to democratize and expand credit access to low and moderate income borrowers.

The current challenges in the mortgage market have prompted both new and reinvigorated alliances between banks and thrifts and the nonprofit sector to avoid foreclosures and preserve neighborhoods. Many community organizations are also stepping up their efforts to offer foreclosure mitigation assistance, including counseling programs, and implement strategies to preserve and maintain foreclosed properties in their neighborhoods to prevent a further erosion of property values and related problems

Irresponsible underwriting and in some cases abusive lending practices, primarily by nonregulated mortgage industry participants, has created substantial financial hardship for many homeowners. These abusive lending practices have also disrupted the broader credit markets and the securities industry. As members of the Committee are aware, the OTS recently issued an Advanced Notice of Proposed Rulemaking relating to unfair or deceptive acts or practices, which sought public comment on approaches the OTS should consider in determining whether, and to what extent, additional regulation is needed to ensure customers of OTS-regulated entities are treated fairly. Our efforts in this important area continue and we intend to move forward with a proposed rulemaking to establish a clear set of rules and standards for thrift institutions in this area.

VI. Conclusion

OTS-supervised savings associations have an exemplary record in the provision of credit, investments, and services in their markets, particularly in low-and moderate-income areas. The CRA has provided the impetus for many financial institutions, often in partnership with community-based organizations, to revitalize low-and moderate-income neighborhoods through loans and investments.

The need to provide both short-term and longer-range relief to expand access to credit and ensure market stability may well shape future CRA changes. The OTS is committed to maintaining a robust CRA examination and fair lending oversight process, and to ensuring the strongest environment we can provide to safeguard consumer protections. We look forward to working with members of this Committee to determine additional efficient and effective regulatory responses, including CRA, to recent market conditions.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

LAWRENCE B. LINDSEY
MEMBER OF THE BOARD

April 12, 1995

The Honorable Barney Frank
United States House of Representatives
2210 Rayburn House Office Building
Washington, DC 20515-2104

Dear Congressman Frank:

This letter responds to an issue you raised during the hearings held by the Subcommittee on Financial Institutions on March 8 regarding reform of the Community Reinvestment Act. You asked whether we knew of any circumstances in which loans to low- and moderate-income borrowers had caused safety and soundness problems for a bank or thrift, due to default, delinquency and the like.

I believe my quick answer at the time was "no." Certainly, the anecdotal information I have heard would indicate that loans to low- and moderate-income people perform with respect to repayment as well as, and in some cases better than, loan to others. Furthermore, I have heard of no cases in which a bank's portfolio contained such a large number of such loans that even if a significant number of the borrowers defaulted, it would put the bank in a seriously adverse safety and soundness position.

After you raised the question, I took some time to seek out some harder data and studies that might illuminate the matter. I was not able to find a lot in this vein, but I'll briefly share what I was able to locate. One reason for the few studies on the matter, I suspect, is that the data necessary to conduct them are, rightly I believe, generally closely and confidentially held in the loan files of the customers. Consequently, producing the necessary data, without compromising confidential information, can be time-consuming and expensive.

Nonetheless, the Woodstock Institute in Chicago conducted a study of the performance of residential loans in low and moderate-income areas as compared to loans made in other neighborhoods. The October 1993 study based its conclusions on a sample of 2231 loans collected by the National Association of Affordable Housing Lenders from seven willing lenders. A few of the more interesting findings of this study regarding single family loans in low- and moderate-income areas were (1) over half of all loans that were ever delinquent were delinquent only once;

(2) the delinquency rate for loans that had been delinquent for 90 days or more was one tenth of a percent; and (3) the delinquency rates for a national sample of loans, containing data on loans in areas of all income levels, was 7.5 to 8.5 times greater. The same study reviewed the performance of multifamily loans in low- and moderate-income areas and, though the characteristics of the data sets did not allow the researchers to make perfect comparisons, the study did conclude that the loans made in low- and moderate-income areas experienced delinquency rates one to three times greater than national samples. Foreclosure rates, however, seem more aligned to national samples. As a result, the combined delinquency and foreclosure rates for multifamily housing loans in low- and moderate-income areas were slightly superior to those gleaned from national samples reflecting loans in all income areas.

GE Capital Mortgage Insurance Company also did a study of its own loans that were originated between 1987 and 1991. It concluded that borrowers with annual incomes of less than $40,000 were eight percent less likely than those with higher incomes to become delinquent on their loan payments and that the lowest income group (less than $20,000 annual income) had the best delinquency performance.

In addition, Richard G. Fritz, Vice President and Senior Economist at the Federal Home Loan Bank of Atlanta, presented a paper in January of 1994 which highlighted results from his study on the performance of the Atlanta Mortgage Consortium. The consortium was created in 1988 shortly after the Atlanta Journal/Constitution newspapers published a series called "The Color of Money" that was critical of the racial distribution of mortgage loans made by Atlanta lenders. The paper, "Consortium Residential Lending and Community Reinvestment: An Analysis of the Atlanta Mortgage Consortium", shows that for loans made during what Mr. Fritz calls Phase I of the program's existence (roughly its first year), the consortium experienced heavy long term delinquencies (11.9%). However, adjustments were made to the consortium's lending criteria during the next two years or so (Phase II) and the delinquency rate was significantly reduced to 6.7%. The consortium continued to effectively serve the low-income population of Atlanta after making the underwriting adjustments for Phase II.

In order to contribute an additional measure of comparison regarding the consortium's lending performance, I would like to provide some national data for the time periods that roughly correspond to the two phases of the study. During the Phase I period, the national delinquency rate was 4.78% for all mortgage loans and 6.65% for all FHA loans (possibly a more

apt comparison given FHA's relative emphasis on a similar market). National rates during Phase II were approximately 5% for all mortgage loans and 7.32% for FHA loans. Further, I am informed by other sources that during the first quarter of 1995, the AMC experienced a 9.99% delinquency rate while all FHA loans in the state of Georgia experienced a 10.01% delinquency rate.

I think that this experience shows that, although it is possible to go too far in reducing credit criteria, it is also possible, with a sensible set of adjustments to those criteria, to serve low-and moderate-income areas effectively. It also demonstrates that the consortium approach to lending in these areas can serve to spread the risk and make this type of lending possible without undue risk to any individual institution. I think it is important, however, to put this discussion in a fuller context, and to indicate that the answers to the question you raised are probably more complex than this response has so far indicated, particularly with respect to FHA-insured loans. In this regard, I would point out that a recent study, co-authored by Glenn Canner, an economist here at the Board, showed that FHA-insured loans in low-and moderate-income areas experienced nearly twice the default rates (as distinguished from a delinquency rate) of those made in upper income areas during the sample period.

Finally, I would simply cite some statistics offered by the National Association of Community Development Loan Funds, reflecting loans made by its 41 member funds. Through 1993, these funds had made $193.1 million in 3,960 loans for housing and businesses. The Association reports that its members had financed 43,369 housing units, 88% affordable to low-income tenants. Loan losses through 1993 were $1.69 million, or .87% of the total.

I believe this information responds to the question you raised. As you can see, the potential answers are complex and may turn on the programs and experiences chosen for review and the comparisons made. Furthermore, I would add that though these studies and data appear reliable, I have not personally reviewed their underpinnings and can only offer them for your consideration. Additionally, aside from the issue of repayment performance, there is the issue of profitability. We have no studies on the relative profitability of loans in low- and moderate-income areas compared to other areas. We do know, however, that in many cases these loans are subsidized (the AMC loans are an example) or involve credit counseling or other risk mitigating aspects that have an impact on their performance as a matter of relative profitability. Nonetheless, I have not heard of situations involving loans of this type putting any banks at

risk. And the success stories for these kind of lending are numerous. If you would like any other details on these studies and data, please contact me.

Sincerely,

Lawrence B. Lindsey

Response to request for information posed by Chairman Frank
from Sandra Thompson, Director
Division of Supervision and Consumer Protection,
Federal Deposit Insurance Corporation

Q: Please provide suggestions as to what CRA should look like if Congress were to modify the traditional concept of assessment areas used under CRA with regard to entities with no local geographic "footprint."

A: The question raised by Chairman Frank has been the subject of considerable discussion by the FDIC and other bank regulators in recent years as new types of financial institutions have become more prevalent.

As you know, CRA already covers institutions that lack a geographic footprint. These entities generally fall into two categories: non-branch retail institutions that serve a national or regional base, and monoline institutions.[1] Neither relies on a branch structure or physical presence to receive deposits or to market and make loans, and thus do not fit the geographical assessment area analysis and standard evaluation methods of CRA. The non-branch retail institutions are full-service banks that accept retail deposits and can offer a wide range of deposit and loan products and services, but rely on alternative marketing and delivery channels, such as the Internet. Monoline institutions offer a single or limited product line and include credit card banks and mortgage lenders. They do not have a branch structure and do not routinely accept deposits.

For non-branch retail institutions and monoline institutions, as with any other institutions, the applicable test under CRA is based upon the institution's size and business strategy, specifically the large or small bank evaluation methods in the case of a retail bank or the community development test for a wholesale or limited purpose bank. The agencies utilize a flexible regulatory approach based upon the institution's performance context.[2] A number of these institutions, particularly monoline banks that do not qualify as wholesale or limited purpose banks, have pursued the strategic plan option since the criteria considered under the alternative tests would not appropriately evaluate their performance.

While the agencies use the current tests to evaluate institutions without a real geographic footprint, the tests are still tied to a geographic assessment area and have stretched regulatory

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[1] Such institutions include industrial loan companies that offer specialized credit.

[2] The agencies recognize that an institution may not fit every aspect of a particular test. In assigning ratings, the agencies have stated, in the Interagency Q&A that discusses Appendix A to the CRA regulations (describing the ratings tests), that exceptionally strong performance in some aspects of a particular rating profile may compensate for weak performance in others. As an example, the agencies cite the case of a retail institution that uses a non-branch delivery system to obtain deposits and to deliver loans, and that may have almost all of its loans outside its assessment area. Such an institution would likely have weak performance under the lending test criteria applicable to lending activity, geographic distribution, and borrower characteristics within the assessment area. According to the Q&A, the institution may compensate for such weak performance by exceptionally strong performance in community development lending in its assessment area or in a broader statewide or regional area that includes its assessment area.

flexibility to its limit. Removing the geographic limits could result in a more realistic approach to evaluating these institutions and perhaps some much needed community development lending and investment in areas of the country that have substantial needs but where few institutions are located.

Assessment Areas for Entities without a Local Geographic Footprint

For institutions without a local geographic footprint, Congress could consider permitting such institutions to rely on their customer base as their assessment area, consistent with how financial institutions serving the military are treated under CRA.[3] Under existing regulations, a financial institution whose business predominantly consists of serving the needs of military personnel and their dependents, who are not located within a defined geographic area, may delineate its entire deposit customer base as its "community" or assessment area.[4]

One difficulty with adopting this approach for the institutions without a geographic footprint relates to the issue of comparables needed to do a performance evaluation under CRA. Comparables are used in the CRA evaluation as a means of evaluating a bank's CRA performance by comparing it against the performance of competitors and peers in terms of defined categories, such as lending to low- and moderate-income individuals and areas. The lack of concentration in any specific geography raises the challenge of what demographic and economic data to consider in establishing income classifications, the market for mortgage and small business lending, and other comparables, since these are linked to geographic location and vary significantly, even within a single state. An alternative means for setting up comparables for CRA analysis purposes might be to look to the institution's customer income distributions and compare them to national or regional statistics.

Other Approaches to Evaluating CRA Performance for Institutions without a Local Geographic Footprint

Other methods of evaluation that might be structured so as to avoid being tied to the concept of an assessment area might include: 1) a community development test, based on the existing test applicable to wholesale and limited purpose banks; 2) a lending test, based on the current large bank lending test, that would focus on loan data collected for Home Mortgage Disclosure Act (HMDA) purposes or obtained through internal recordkeeping, for the geographic areas in which the institution's loans are located; or 3) a strategic plan option, which is an alternative already available to all institutions regardless of business strategy or asset size. Each method presents challenges.

1. *Community Development Test*

The existing community development test applied to wholesale and limited purpose banks evaluates the institution's record of helping to meet the credit needs of its assessment area(s) through community development lending, qualified investments, or community development services. Under current CRA regulations, the institution is still required to draw an assessment

[3] 12 U.S.C. § 2902(4)
[4] 12 C.F.R. § 345.41(f).

area(s) around its main office, branches, and deposit-taking ATMs.[5] An institution subject to the community development test may receive CRA consideration of any qualifying activity outside its assessment area assuming, wherever located, it has a "satisfactory" performance rating within its assessment area.[6] If the CRA were amended to allow alternative approaches that were not tied to geography, the test could be revised so that institutions could meet their CRA requirements by responding to community development needs throughout the country.

2. *Lending Test*

Some lenders, particularly mortgage lenders, could be subject to a modified lending test similar to the lending test required for large banks, which looks at the geographic and borrower income distribution of the institution's loans. The difficulty with this test would arguably be the need to determine what areas are to be examined, since there may be tremendous variation in median income and housing costs throughout a city or state, let alone nationwide, and any evaluation of income and loan amounts requires a comparison against specific economic and demographic data or alternative determinants. As previously noted, if an institution truly has a national or even regional footprint, an alternative approach would be to compare customer income distribution to national or regional statistics.

3. *Strategic Plan*

Under the existing CRA regulations, all institutions have the option of submitting a strategic plan, developed with public input and subject to approval by the regulators.[7] A number of institutions, such as industrial loan companies, that do not offer retail banking services or that meet the regulation's definition of limited purpose have pursued this alternative.

The current strategic plan option provides that the institution specify measurable goals for helping to meet the credit needs of each assessment area covered by the plan, particularly the needs of low- and moderate-income geographies and individuals, through lending, investment and services, as appropriate.[8] The institution must establish an assessment area or areas tied to their physical location; a bank with multiple assessment areas may prepare a single plan for all of its assessment areas or one or more plans for one or more of its assessment areas.[9] If CRA were amended to provide for a different definition of assessment area for non-branch banks, this may help them to set more meaningful strategic plan goals.

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[5] 12 C.F.R. § 345.41(b).
[6] 12 C.F.R. § 345.25(e).
[7] 12 C.F.R. § 345.27(a).
[8] 12 C.F.R. § 345.27(f)(1)(i).
[9] 12 C.F.R. §345.27(c)(2).

Response to question posed by Congressman Ellison
from Sandra Thompson, Director
Division of Supervision and Consumer Protection,
Federal Deposit Insurance Corporation

Q: Please provide information regarding the Pilot Project for Affordable Small Dollar Loans.

A: The FDIC's Small Dollar Loan Pilot is a two-year pilot project to identify affordable alternatives to payday loans and other high cost loans that are harmful to consumers and communities. Working with banks across the country, the FDIC's goal is to promote programs that are affordable, responsible, and profitable. At the conclusion of the study, we will share industry best practices and asset building strategies, like automatic savings components, with other financial institutions to help them establish banking relationships with the unbanked and underbanked.

Thirty banks have been selected initially to participate in the pilot. The banks selected are headquartered in 17 states (including two in Minnesota) with over 550 branches located in 27 states. They have total assets ranging from $20 million to $10 billion. They are in diverse geographic locations and in both urban and rural communities.

In order to evaluate the success of the pilot, participating institutions will be asked to provide quarterly data about the loans in the program, the overall value and profitability of the program, and the benefit to consumers. First quarter 2008 data will be collected beginning May 15, 2008.

While participation is strictly voluntary, potential benefits to banks participating in the pilot are: positive CRA consideration; the potential for profitably expanding into new markets; and community goodwill from providing credit products that are less expensive than existing offerings. We are working closely with participating banks to help them identify ways to streamline underwriting, cut costs, and develop sustainable and scaleable programs.

The application for banks to participate in the program will remain on the FDIC website and it is anticipated that additional banks will be added to the pilot during the two-year study period. Additional information regarding the program may be found at www.FDIC.gov/SmallDollarLoans.

Response to question posed by Congresswoman Waters
from Sandra Thompson
Director, Division of Supervision and Consumer Protection
Federal Deposit Insurance Corporation

Q: Please provide a copy of the proposed interagency Questions and Answers Related to Community Reinvestment (Q&As), issued in July 2007, that address the problems of subprime borrowers facing unaffordable resets of their mortgage interest rates.

A: The Q&As provide guidance to financial institutions, community groups, the public, and examiners regarding CRA and the implementing regulations. The relevant text of the proposed CRA Q&As follows, along with some additional background information.

When the bank regulators issued the July 2007 proposed revisions to the CRA Q&As, we incorporated the April 2007 Statement on Working with Mortgage Borrowers (the Statement) into the proposed updates. The FDIC and the other financial institution regulators had published the Statement to inform financial institutions that they could receive favorable CRA consideration for programs that assist low- and moderate-income borrowers avoid foreclosure. A copy of the Statement is attached.

The agencies hope to publish the final Q&As in the second quarter of 2008.

Proposed Interagency Questions and Answers Related to Community Reinvestment

By way of background, the Q&As[1] have been published for more than ten years and are periodically updated. In the most recent update, the agencies are proposing nine new questions and answers, as well as substantive and technical revisions to the existing Q&As. Because we issued the proposed updates for comment, we provided an explanation of each proposal in a Preamble to the actual Q&As. The complete Federal Register notice of the proposal is attached to this response.

There are three specific proposed revised Q&As that relate to foreclosure issues. Set out below is the Preamble description of each one, followed by the actual Q&A:

- **Investments in a National or Regional Fund.**

  Preamble: The agencies are proposing additional guidance . . . to clarify that an institution that makes a loan or investment in a national or regional community development fund should be able to demonstrate that the investment meets the geographic requirements of the CRA regulation. If a fund does not become involved in a community development activity that meets both the purpose and geographic requirements of the regulation for the institution,

[1] The Q&As are grouped by the provision of the CRA regulations that they discuss, are presented in the same order as the regulatory provisions, and employ an abbreviated method of citing to the regulations. Each question is numbered using a system that consists of the regulatory citation and a number, connected by a dash. For example, the first question addressing 12 CFR 11.26 would be identified as § 11.26—1.

the institution's investment generally would not be considered under the investment or community development tests. The agencies also are proposing to highlight in the Q&A an example of a fund providing foreclosure relief to low- and moderate-income homeowners.

Question §ll.23(a)—2: In order to receive CRA consideration, should an institution be able to demonstrate that an investment in a national or regional fund with a primary purpose of community development meets the geographic requirements of the CRA regulation by benefiting one or more of the institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s)?

Answer: Yes. A financial institution should be able to demonstrate that the investment meets the geographic requirements of the CRA regulation, although the agencies will employ appropriate flexibility in this regard. There are several ways to demonstrate that the institution's investment meets the geographic requirements. For example, if an institution invests in a new nationwide fund providing foreclosure relief to low- and moderate-income homeowners, written documentation provided by fund managers in connection with the institution's investment indicating that the fund will use its best efforts to invest in a qualifying activity that meets the geographic requirements may be used for these purposes. Similarly, a fund may explicitly earmark all projects or investments to its investors and their specific assessment areas. Note, however, that a financial institution has not demonstrated that the investment meets the geographic requirements of the CRA regulation if the fund "double counts" investments, by earmarking the same dollars or the same portions of projects or investments in a particular geography to more than one investor. In addition, if a fund does not earmark projects or investments to individual institution investors, an allocation method may be used that recognizes that each investor institution has an undivided interest in all projects in a fund; thus, each investor institution may claim its pro-rata share of each project that meets the geographic requirements of that institution. If, however, a fund does not become involved in a community development activity that meets both the purpose and geographic requirements of the regulation for the institution, the institution's investment generally would not be considered under the investment or community development tests. See Q&As §ll.12(h)—6 and §ll.12(h)—7 for additional information about the geographic requirements for qualified investments (recognition of investments benefiting an area outside an institution's assessment area(s)).

- **Examples of Community Development Services**

Preamble: [This question] provides examples of community development services. The agencies also propose to revise the example of community development services describing various types of consumer counseling services to highlight credit counseling that can assist borrowers in avoiding foreclosure on their homes.

Question §ll.12(i)—3: What are examples of community development services?

Answer: Examples of community development services include, but are not limited to, the following: Providing credit counseling, homebuyer and home-maintenance counseling, financial planning or other financial services education to promote community development

and affordable housing, including credit counseling to assist borrowers in avoiding foreclosure on their homes.

- **Responsive Lending Activities.**

  Preamble: [This question] discusses types of lending activities that help meet the credit needs of an institution's assessment areas and that may warrant favorable consideration as activities that are responsive to the needs of the institution's assessment areas. The agencies propose to revise the answer to highlight that establishing loan programs that provide relief to low- and moderate-income homeowners who are facing foreclosure is another type of lending activity that would warrant favorable consideration as being responsive to the needs of an institution's assessment areas. The agencies encourage institutions to develop and participate in such programs, consistent with safe and sound lending practices.

  Question §ll.22(a)—1: Are there any types of lending activities that help meet the credit needs of an institution's assessment area(s) and that may warrant favorable consideration as activities that are responsive to the needs of the institution's assessment area(s)?

  Answer: Credit needs vary from community to community. However, there are some lending activities that are likely to be responsive in helping to meet the credit needs of many communities. These activities include: . . . establishing loan programs that provide relief to low- and moderate-income homeowners who are facing foreclosure on their homes.

Attachments (3)

FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
FIL-35-2007
April 17, 2007

WORKING WITH RESIDENTIAL BORROWERS
FDIC Encourages Institutions to Consider Workout Arrangements for Borrowers Unable to Make Mortgage Payments

Summary: The Federal Deposit Insurance Corporation (FDIC) encourages financial institutions to work constructively with residential borrowers who are financially unable to make their contractual payments on their home loans. Prudent workout arrangements are generally in the long-term best interest of both the financial institution and the borrower.

Distribution:
FDIC-Supervised Banks (Commercial and Savings)

Suggested Routing:
Chief Executive Officer
Chief Loan Officer
Chief Compliance Officer

Related Topics:
. *Interagency Guidance on Nontraditional Mortgage Product Risks*
http://www.fdic.gov/news/news/financial/2006/fil06089.html
. *Interagency Questions and Answers on the Community Reinvestment Act* http://www.ffiec.gov/cra/pdf/qa261.pdf
. *Homeownership Counseling Act*
http://www.fdic.gov/news/news/financial/2002/fil0243.html
. HUD counseling services at (800) 569-4287 or at
http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm
. *NeighborWorks America* at (888) 995-HOPE (4673) or
http://www.nw.org/network/neighborworksprogs/foreclosuresolutions/default.asp
. *HOPE for Homeowners* http://www.995hope.org

Attachment:
Statement on Working with Mortgage Borrowers

Contacts:
Examination Specialist Beverlea (Suzy) Gardner at (202) 898-3640 or BGardner@FDIC.gov, or Mira Marshall, Acting Chief, CRA/Fair Lending Section, at (202) 898-3912 or MMarshall@fdic.gov

Note:
FDIC financial institution letters (FILs) may be accessed from the FDIC's Web site at
www.fdic.gov/news/news/financial/2007/index.html.

To receive FILs electronically, visit
http://www.fdic.gov/about/subscriptions/fil.html.

Paper copies of FDIC financial institution letters may be obtained via the FDIC's Public Information Center (1-877-275-3342 or 703-562-2200).

Highlights:

- Many residential borrowers may face significant payment increases when their adjustable-rate mortgage loans reset in the coming months. These borrowers may not have sufficient financial capacity to service a higher debt load, especially if they were qualified based on a low introductory payment.
- The FDIC encourages financial institutions to consider prudent workout arrangements that increase the potential for residential borrowers to keep their homes. For example, institutions might consider modifying loan terms, including converting loans with variable rates into fixed rate products to provide financially stressed borrowers with predictable payment requirements.
- Financial institutions do not face regulatory penalties if they pursue reasonable workout arrangements with borrowers who have encountered financial problems. Financial institutions should follow prudent underwriting practices in determining whether to consider a workout arrangement.
- Institutions may receive favorable Community Reinvestment Act consideration for programs that transition low- and moderate-income borrowers from higher cost loans to lower cost loans, provided that all loans are made in a safe and sound manner.
- Institutions are reminded of the Homeownership Counseling Act and the Servicemembers Civil Relief Act requirements.
- Working closely with lenders, reputable organizations can help borrowers avoid foreclosure. These organizations include the Center for Foreclosure Solutions sponsored by NeighborWorks and HOPE for Homeowners.

Press Releases

Statement on Working with Mortgage Borrowers

The federal financial institutions regulatory agencies[1] encourage financial institutions to work constructively with residential borrowers who are financially unable to make their contractual payment obligations on their home loans. Prudent workout arrangements that are consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower.

Many residential borrowers may face significant payment increases when their adjustable rate mortgage (ARM) loans reset in the coming months. These borrowers may not have sufficient financial capacity to service a higher debt load, especially if they were qualified based on a low introductory payment. The agencies have long encouraged borrowers who are unable to meet their contractual obligations to contact their lender or servicer to discuss possible payment alternatives at the earliest indication of such problems.

The agencies encourage financial institutions to consider prudent workout arrangements that increase the potential for financially stressed residential borrowers to keep their homes. However, there may be instances when workout arrangements are not economically feasible or appropriate.

Financial institutions should follow prudent underwriting practices in determining whether to consider a workout arrangement. Such arrangements can vary widely based on the borrower's financial capacity. For example, an institution might consider modifying loan terms, including converting loans with variable rates into fixed-rate products to provide financially stressed borrowers with predictable payment requirements.

The agencies will continue to examine and supervise financial institutions according to existing standards. The agencies will not penalize financial institutions that pursue reasonable workout arrangements with borrowers who have encountered financial problems. Further, existing supervisory guidance and applicable accounting standards do not require institutions to immediately foreclose on the collateral underlying a loan when the borrower exhibits repayment difficulties. Institutions should identify and report credit risk, maintain an adequate allowance for loan losses, and recognize credit losses in a timely manner.

Financial institutions may receive favorable Community Reinvestment Act (CRA) consideration for programs that transition low and moderate income borrowers from higher cost loans to lower cost loans, provided the loans are made in a safe and sound manner.[2] Financial institutions, working alone or in conjunction with reputable organizations such as the Center for Foreclosure Solutions sponsored by NeighborWorks, can assist borrowers in avoiding foreclosure through credit counseling.[3] Such programs also help financially stressed borrowers avoid predatory foreclosure rescue scams.

Under the Homeownership Counseling Act, financial institutions should inform certain borrowers who are delinquent on their mortgage loans (home loans secured by a single family dwelling that is the borrower's principal residence) about the availability of homeownership counseling. The Department of Housing and Urban Development (HUD) maintains a list of approved counselors.[4]

If a service member defaults on a mortgage, the Servicemembers Civil Relief Act (SCRA) prohibits the sale, foreclosure, or seizure of service member property secured by the mortgage during the period of

military service, or within 90 days thereafter. Institutions are required to notify service members of their rights under the SCRA.[5] While the SCRA requirements apply only to obligations that were originated prior to the service member's military service, the agencies encourage institutions to work with service members and their families who are unable to meet any of their contractual mortgage obligations.

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[1] The federal financial institutions regulatory agencies consist of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision (collectively, the agencies).

[2] Consideration as a CRA flexible lending practice may be granted in instances where such action helps to meet the credit needs of low- and moderate-income individuals or geographies within the institution's assessment area, and is consistent with safe and sound lending practices. Also see Q&A § __.22(a)– 1 (2001 Interagency Questions and Answers Regarding Community Reinvestment). Federal credit unions are not subject to CRA requirements.

[3] Consideration as a CRA community development service may be granted in instances where such activities help to meet the credit needs of low- and moderate-income individuals or geographies within the institution's assessment area. Also see Q&A § __.12(j)– 3 (2001 Interagency Questions and Answers Regarding Community Reinvestment). Federal credit unions are not subject to CRA requirements.

[4] Information on HUD's counseling services is available at http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm or (800) 569-4287.

[5] HUD's service member notice is available at http://www.hud.gov/offices/adm/hudclips/forms/files/92070.pdf - 27k (PDF Help).

Last Updated 4/17/2007 communications@fdic.gov

Federal Register

Wednesday,
July 11, 2007

Part III

Department of the Treasury

Office of the Comptroller of the Currency

Office of Thrift Supervision

Federal Reserve System

Federal Deposit Insurance Corporation

Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Notice

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

[Docket ID OCC–2007–0012]

FEDERAL RESERVE SYSTEM

[Docket No. OP–1290]

FEDERAL DEPOSIT INSURANCE CORPORATION

RIN 3064–AC97

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

[Docket ID OTS–2007–0030]

Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Notice

AGENCIES: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Office of Thrift Supervision, Treasury (OTS).

ACTION: Notice and request for comment.

SUMMARY: The staffs of the OCC, the Board, the FDIC, and OTS (collectively, the "agencies") have combined three previously adopted publications of informal staff guidance answering questions regarding community reinvestment (Interagency Questions and Answers). The Interagency Questions and Answers address frequently asked questions about community reinvestment to assist agency personnel, financial institutions, and the public. The agencies are proposing nine new questions and answers, as well as substantive and technical revisions to the existing Interagency Questions and Answers. Among the proposed new questions and answers is one that addresses activities engaged in by a majority-owned financial institution with a minority-or women-owned financial institution or a low-income credit union. In addition, three revisions are intended to encourage institutions to work with homeowners who are unable to make mortgage payments by highlighting that they can receive CRA consideration for foreclosure prevention programs for low- and moderate-income homeowners, consistent with the interagency Statement on Working with Mortgage Borrowers issued April 17, 2007. Public comment is invited on the proposed new and revised questions and answers, as well as any other community reinvestment issues.

DATES: Comments on the proposed questions and answers are requested by September 10, 2007.

ADDRESSES: Comments should be directed to:

OCC: You may submit comments by any of the following methods:

- *E-mail: regs.comments@occ.treas.gov.*
- *Fax:* (202) 874–4448.
- *Mail:* Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 1–5, Washington, DC 20219.
- *Hand Delivery/Courier:* 250 E Street, SW., Attn: Public Information Room, Mail Stop 1–5, Washington, DC 20219.

Instructions: You must include "OCC" as the agency name and "Docket ID OCC–2007–0012" in your comment. In general, OCC will enter all comments received into the docket without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments, including attachments and other supporting materials, received are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials by any of the following methods:

- *Viewing Comments Personally:* You may personally inspect and photocopy comments at the OCC's Public Information Room, 250 E Street, SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874–5043. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.
- *Docket:* You may also view or request available background documents and project summaries using the methods described above.

Board: You may submit comments, identified by Docket No. OP–1290, by any of the following methods:

- *Agency Web Site: http://www.federalreserve.gov.* Follow the instructions for submitting comments at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.*
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.
- *E-mail: regs.comments@federalreserve.gov.* Include docket number in the subject line of the message.
- *Fax:* 202/452–3819 or 202/452–3102.
- *Mail:* Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments are available from the Board's Web site at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm* as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP–500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FDIC: You may submit comments, identified by RIN number 3064–AC97 by any of the following methods:

- *Agency Web site: http://www.fdic.gov/regulations/laws/federal/propose.html.* Follow instructions for submitting comments on the Agency Web Site.
- *E-mail: Comments@FDIC.gov.* Include the RIN number in the subject line of the message.
- *Mail:* Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.
- *Hand Delivery/Courier:* Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Instructions: All submissions received must include the agency name and RIN number. All comments received will be posted without change to *http://www.fdic.gov/regulations/laws/federal/propose.html* including any personal information provided.

OTS: You may submit comments, identified by ID OTS–2007–0030, by any of the following methods:

- *E-mail: regs.comments@ots.treas.gov.* Please include ID OTS–2007–0030 in the subject line of the message and include your name and telephone number in the message.
- *Fax:* (202) 906–6518.
- *Mail:* Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: ID OTS–2007–0030.
- *Hand Delivery/Courier:* Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9 a.m. to 4 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, Attention: ID OTS–2007–0030.

Instructions: All submissions received must include the agency name and

docket number for this notice. All comments received will be entered into the docket without change, including any personal information provided. Comments, including attachments and other supporting materials received are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

• *Viewing Comments On-Site:* You may inspect comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment for access, call (202) 906–5922, send an e-mail to *public.info@ots.treas.gov*, or send a facsimile transmission to (202) 906–6518. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10 a.m. and 4 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

FOR FURTHER INFORMATION CONTACT:

OCC: Margaret Hesse, Special Counsel, Community and Consumer Law Division, (202) 874–5750; or Karen Tucker, National Bank Examiner, Compliance Policy Division, (202) 874–4428, Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

Board: Anjanette M. Kichline, Senior Supervisory Consumer Financial Services Analyst, (202) 785–6054; or Brent Lattin, Attorney, (202) 452–3667, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

FDIC: Mira Marshall, Acting Chief, CRA & Fair Lending Section, (202) 898–3912; Faye Murphy, Fair Lending Specialist, Division of Supervision and Consumer Protection, (202) 898–6613; or Susan van den Toorn, Counsel, Legal Division, (202) 898–8707, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

OTS: Celeste Anderson, Senior Project Manager, Compliance and Consumer Protection, (202) 906–7990; or Richard Bennett, Counsel, Regulations and Legislation Division, (202) 906–7409, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

Background

The OCC, the Board, the FDIC, and OTS implement the Community Reinvestment Act (CRA) (12 U.S.C. 2901 *et seq.*) through their CRA regulations. *See* 12 CFR parts 25, 228, 345, and 563e. The OCC, Board, and FDIC revised their CRA regulations in a joint final rule published on August 2, 2005 (70 FR 44256) (2005 joint final rule). OTS did not join the agencies in adopting the August 2005 joint final rule; OTS published separate final rules on August 18, 2004 (69 FR 51155), March 2, 2005 (70 FR 10023), April 12, 2006 (71 FR 18614), and March 22, 2007 (72 FR 13429). Upon the effective date of OTS's March 2007 final rule, July 1, 2007, OTS's CRA regulation will be substantially the same as the CRA regulations of the OCC, Board, and FDIC.

The agencies' regulations are interpreted primarily through "Interagency Questions and Answers Regarding Community Reinvestment," which provide guidance for use by agency personnel, financial institutions, and the public, and which are supplemented periodically. Interagency Questions and Answers were first published under the auspices of the Federal Financial Institution Examination Council in 1996 (61 FR 54647), and were revised on July 12, 2001 (2001 Questions and Answers) (66 FR 36620).

Subsequent to the adoption of the 2005 joint final rule, the OCC, Board, and FDIC, after notice and public comment, published new guidance in the form of questions and answers on March 10, 2006 (71 FR 12424) (2006 Questions and Answers). Because of the desire to provide guidance about the 2005 joint final rule in a timely manner, the 2006 Questions and Answers addressed primarily matters related to the 2005 joint final rule, without updating the 2001 Questions and Answers. On September 5, 2006, after notice and public comment, OTS published new guidance in the form of questions and answers pertaining to the revised definition of "community development" and certain other provisions of the CRA rule common to all four agencies (OTS's September 2006 Questions and Answers). 71 FR 52375. The 2001 Questions and Answers remained effective along with the new 2006 Questions and Answers and OTS's September 2006 Questions and Answers.

These Proposed Interagency Questions and Answers and Request for Comment

The document published today combines the previously adopted 2001 Questions and Answers with the 2006 Questions and Answers and OTS's September 2006 Questions and Answers. In addition, the agencies are proposing for comment nine new questions and answers that will be added to the Interagency Questions and Answers. These nine new questions and answers are described below. OTS is also proposing four new and one revised questions and answers that are virtually identical to new and revised questions and answers the OCC, Board, and FDIC adopted in the 2006 Questions and Answers. The proposed questions and answers that are new for OTS are Q&As § ____.12(u)(2)—1, § ____.26(c)—1, § ____.26(c)(3)—1, and § ____.26(c)(4)—1; the proposed revised question and answer for OTS is Q&A § ____.26—1. These Q&As primarily relate to intermediate small savings associations.

The agencies are also proposing to revise many of the previously adopted questions and answers. Most of the revisions are not substantive, rather they clarify or update the existing questions and answers, move existing questions and answers within the guidance (Q&As § ____.21(a)—1 and § ____.28(b)—1), or merely conform the numbering of the question to the correct regulatory provision. The agencies also propose to delete an appendix that listed contact information for Bureau of Census offices because institutions may now obtain information from the FFIEC's Web site. The agencies are explicitly requesting comment on specific questions and answers in which the revisions may be deemed to be of significance. These proposed revised questions and answers are also discussed below.

The proposed new and revised questions and answers have been added to the combined Interagency Questions and Answers, which is being published in its entirety to enable commenters to review the proposed revisions in the context of the rest of the guidance. The text of the combined Interagency Questions and Answers is found at the end of this publication. Language that is proposed to be deleted as compared to the 2001 and 2006 Questions and Answers adopted by the OCC, Board, and FDIC is bracketed; language that is proposed to be added to these agencies' guidance is enclosed within arrows. Where these agencies' current questions and answers differ substantially from those of OTS, the differences are footnoted. After the agencies have considered any comments received in response to this proposal, the agencies will publish the final guidance in the **Federal Register**.

The Interagency Questions and Answers are grouped by the provision of the CRA regulations that they discuss, are presented in the same order as the regulatory provisions, and employ an abbreviated method of citing to the regulations. For example, the small bank

performance standards for national banks appear at 12 CFR 25.26; for Federal Reserve System member banks supervised by the Board, they appear at 12 CFR 228.26; for state nonmember banks, they appear at 12 CFR 345.26; and for thrifts, the small savings association performance standards appear at 12 CFR 563e.26. Accordingly, the citation would be to 12 CFR ____.26. Each question is numbered using a system that consists of the regulatory citation (as described above) and a number, connected by a dash. For example, the first question addressing 12 CFR ____.26 would be identified as § ____.26—1.

Although a particular question and answer may be found under one regulatory provision, e.g., 12 CFR ____.22 relating to the lending test, its content may also be applicable to, for example, small institutions, which are evaluated pursuant to small institution performance standards found at 12 CFR ____.26. Thus, readers with a particular interest in small institution issues, for example, should also consult the guidance that describes the lending, investment, and service tests. To assist readers in finding relevant guidance, the Interagency Questions and Answers will be indexed by topic when they are adopted as final guidance.

Proposed New Questions and Answers

The agencies specifically request comment on the nine proposed new questions and answers described below.

I. *Investments in minority- or women-owned financial institutions and low-income credit unions.*

The CRA statute provides that, when evaluating the CRA performance of a non-minority-owned and non-women-owned (majority-owned) financial institution, the agencies may consider as a factor capital investment, loan participation, and other ventures undertaken by the institution in cooperation with minority- and women-owned financial institutions and low-income credit unions provided that these activities help meet the credit needs of local communities in which such institutions are chartered. 12 U.S.C. 2903(b). The agencies' CRA regulations do not specifically address activities that a majority-owned financial institution may engage in with a minority- or women-owned financial institution or a low-income credit union.

The Interagency Questions and Answers currently describe investments in minority- and women-owned financial institutions and low-income credit unions as an example of a qualified investment in Q&A § ____.12(t)—4.

The agencies have been asked whether a majority institution's activity in conjunction with a minority- or women-owned financial institution or low-income credit union must benefit the majority-owned institution's assessment area(s) or the broader statewide or regional area that includes the majority-owned institution's assessment area(s). The CRA statute specifies that the activities must help meet the credit needs of local communities in which the minority- or women-owned institutions or low-income credit unions are chartered.

The agencies generally evaluate institutions' activities in the institution's assessment area(s) or a broader statewide or regional area that includes the assessment area(s). For example, a community development loan is defined, in part, as one benefiting the institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s). 12 CFR ____.12(h)(2)(ii). Similarly, the investment test evaluates an institution's record of helping to meet the credit needs of its assessment area(s) through qualified investments that benefit its assessment area(s) or a broader statewide or regional area that includes its assessment area(s). 12 CFR ____.23(a). In addition, the service test evaluates an institution's record of helping to meet the credit needs of its assessment area(s) through its provision of retail banking and community development services. 12 CFR ____.24(a). Finally, the community development test applicable to wholesale and limited purpose institutions states that community development activities that benefit the institution's assessment area(s) or the broader statewide or regional area that includes its assessment area(s) are considered in a CRA evaluation, and community development activities that benefit areas outside the institution's assessment area(s) will be considered if the institution has adequately addressed the needs of its assessment area(s). 12 CFR ____.25(e).

The agencies propose a new question and answer, §____.12(g)—4, that would give full effect to section 2903(b)'s broader geographic language. The proposed question and answer would state that activities engaged in by a majority-owned financial institution with a minority- or women-owned financial institution or a low-income credit union that benefit the local communities where the minority- or women-owned financial institution or low-income credit union is located will be favorably considered in the CRA performance evaluation of the majority-owned institution. The minority- or women-owned institution or low-income credit union need not be located in, and the activities need not benefit, the assessment area(s) of the majority-owned institution or the broader statewide or regional area that includes its assessment area(s).

II. *Intermediate small institutions' affordable home mortgage loans and small business and small farm loans.*

Q&A §____.12(h)—2 states that mortgage loans made by a retail institution that is not required to report such loans under the Home Mortgage Disclosure Act (HMDA) will be evaluated as home mortgage loans, and that small business and small farm loans made by an institution that is not required to report small business and small farm loan data under the CRA regulations will, nonetheless, be evaluated as small business and small farm loans. Institutions do not have the option of having such loans considered as community development loans.

The agencies are proposing a new question and answer, §____.12(h)—3, which would clarify this guidance only as it affects intermediate small institutions. Intermediate small institutions are not required to collect and report small business and small farm loan data pursuant to the CRA regulations. Further, some intermediate small institutions may not be required to report home mortgage loans under the HMDA. Unlike large or small retail institutions, intermediate small institutions' lending is evaluated using two performance tests, which are rated separately—the retail lending test and the community development test. If the current guidance (Q&A §____.12(h)—2) were applied to an intermediate small institution, its overall CRA performance under the two tests may be adversely affected because home mortgage loans and small loans to businesses and farms that have a community development purpose could never be considered under the community development test. The proposed question and answer would permit institutions evaluated under the intermediate small institution performance standards to choose to have such loans evaluated as community development loans, provided the loans otherwise meet the regulatory definition of "community development," *or* as retail home mortgages, small business loans, or small farm loans, as applicable. An institution that elects to have certain home mortgage, small business, or small farm loans considered as community

development loans should notify its examiners of that decision prior to the start of its CRA examination.

Please note that the agencies are also proposing to revise Q&A §____.12(h)—2 to except intermediate small institutions from applicability of that guidance.

III. *Examples of "other loan data."*

The agencies' CRA regulations, at 12 CFR ____.22(a)(2), state that originations and purchases of loans, as well as *any other loan data* the institution may choose to provide, including data on loans outstanding, commitments, and letters of credit will be considered in an institution's evaluation. Q&A §____.22(a)(2)—3 provides that information about home mortgage loan modification, extension, and consolidation agreements (MECAs) may be provided by an institution to examiners as "other loan data." Other questions and answers found throughout the guidance describe various lending-related activities as "other loan data." *See, e.g.*, Q&As §____.12(l)—2 and §____.42(c)(2)—3.

The agencies are proposing a new question and answer, which will follow the question and answer discussing MECAs, listing in one place the other various activities mentioned throughout the interagency guidance that may be provided to examiners for consideration as "other loan data." In addition, the proposed question and answer, Q&A §____.22(a)(2)—4, includes a discussion about when information on loans for properties with a certain amount or percentage of units set aside for affordable housing may be provided to examiners as "other loan data." If these loans are in an amount greater than $1 million, they would not be collected or reported as small business loans. If the loans do not have a primary purpose of community development, they would not be collected or reported as community development loans. Therefore, to ensure that institutions may have these loans considered during their CRA evaluations, the question and answer provides that institutions may, at their option, provide information about them to examiners as "other loan data."

IV. *Purchased loan participations.*

The agencies' staffs have received a number of questions about whether institutions that purchase loan participations should collect and report them, as applicable, as purchases of loans, and whether they will receive lending consideration for such purchases. The proposed question and answer, Q&A §____.22(a)(2)—6, provides that loan participations are treated as the purchase of a loan, even though the institution has purchased only a part of a loan. Institutions receive the same consideration for their loan participations as they would receive for a purchased whole loan of the same type and amount. Although this proposed question and answer interprets the large institution lending test, 12 CFR ____.22(a)(2), the same guidance would also apply to the other examination types—small institution test, community development test applicable to wholesale and limited purpose institutions, and the strategic plan. (For guidance about reporting loan participations, see proposed new Q&A §____.42(b)(2)—4 and Q&A §____.42(a)(2)—1, as proposed to be revised.)

V. *Small business loans secured by a one-to-four family residence.*

In 2005, the agencies published technical revisions to their CRA regulations that reflected changes in the standards for defining metropolitan statistical areas made by the U.S. Office of Management and Budget (OMB) in December 2000; census tracts designated by the U.S. Census Bureau (Census); and changes to the Board's Regulation C (12 CFR part 203), which implements the HMDA. 70 FR 15570 (Mar. 28, 2005). In the supplementary information published with the agencies' technical revisions, the agencies discussed the effect that the Board's revisions to Regulation C regarding the treatment of refinancings of home mortgage loans would have on CRA evaluations. 70 FR at 15573. As explained in the supplementary information, revised Regulation C defined the term, "refinancing," so that a loan is reportable as a refinancing if it satisfies and replaces an existing obligation, and both the new and the existing obligation are secured by a lien on a dwelling. 12 CFR 203.2(k). The agencies revised the definition of "home mortgage loan" in their CRA regulations to include refinancings, as well as home purchase loans and home improvement loans, as defined in the Board's regulations at 12 CFR 203.2. *See* 12 CFR ____.12(l).

For banks subject to the Call Report instructions: Because of the change in the Regulation C definition, loans to refinance small business or small farm loans are reportable as home mortgage loans for HMDA purposes (and would ordinarily be considered as home mortgage loans for CRA purposes) if they are secured by a dwelling and the replaced loan also was secured by a dwelling. If a dwelling continues to serve as collateral solely through an abundance of caution and where the terms of the loan, as a consequence, have not been made more favorable than they would have been in the absence of the lien, then the refinancing is also reportable for Call Report and CRA purposes as a loan to a small business or a loan to a small farm. If a refinancing of a small business or small farm loan is reported both as a home mortgage loan under HMDA and as a loan to a small business or a loan to a small farm on the Call Report and on the CRA disclosure, there is the potential for "double counting" of these loans in CRA examinations. *See* 70 FR at 15573.

For savings associations subject to the Thrift Financial Reporting instructions: Because of the change in the Regulation C definition, a savings association's loans to refinance small business or small farm loans are reportable as home mortgage loans if they are secured by a dwelling and the replaced loan also was secured by a dwelling. This is true even if the loans are reported as non-mortgage commercial loans on the Thrift Financial Report (TFR). This results in the potential for "double counting" of the loans in CRA examinations. *See* 70 FR at 15573.

To clarify some of these issues, the agencies are proposing a new question and answer, Q&A §____.22(a)(2)—7, to provide guidance about small business and small farm loans where a dwelling serves as collateral.

VI. *Investments in a national or regional fund.*

The agencies are proposing additional guidance, Q&A §____.23(a)—2, to clarify that an institution that makes a loan or investment in a national or regional community development fund should be able to demonstrate that the investment meets the geographic requirements of the CRA regulation. If a fund does not become involved in a community development activity that meets both the purpose and geographic requirements of the regulation for the institution, the institution's investment generally would not be considered under the investment or community development tests. The agencies are also proposing to highlight in the Q&A an example of a fund providing foreclosure relief to low- and moderate-income homeowners.

VII. *Examination as an intermediate small institution.*

The agencies allow a one-year "lag period" between when an institution is no longer a small institution (i.e., it had assets meeting or exceeding the small institution asset threshold amount delineated in 12 CFR ____.12(u)(1) as of December 31 of both of the prior two calendar years) and when it reports CRA data to be used in its evaluation under the lending, investment, and service tests. *See* 12 CFR ____.42(b). The lag

period allows the institution to collect loan data for one year before being evaluated under the lending, investment, and service tests.

The agencies' staffs have been asked whether an institution that was a small institution, but not an intermediate small institution, will also be allowed a one-year lag period before it is evaluated as an intermediate small institution once it becomes an intermediate small institution. The proposed question and answer, Q&A §____.26(a)(2)—1, clarifies that there is no lag period between becoming an intermediate small institution and being examined as an intermediate small institution because there is no data collection and reporting requirement for intermediate small institutions.

VIII. *Reporting of a participation in a community development loan.*

Under the CRA regulations, an institution is required to report the aggregate number and aggregate amount of community development loans originated or purchased. 12 CFR ____.42(b)(2). The agencies' staffs have been asked what loan purchase amount institutions that purchase participations in community development loans should report—the principal balance of the loan at origination or the amount of the participation purchased.

The agencies are proposing a new question and answer, Q&A §____.42(b)(2)—4, to clarify that institutions that purchase community development loan participations should report only the amount of their purchase. The proposed data collection and reporting of purchases of community development loan participations is different from the collection and reporting of purchases of small business and small farm loan participations. An institution reports the amount at the origination of the loan when it purchases a participation in a small business or small farm loan. *See* Q&A §____.42(a)(2)—1. As explained in that question and answer, reporting the amount of the loan at origination is consistent with the Call Report's or Thrift Financial Report's use of the "original amount of the loan" to determine whether a loan should be reported as a "loan to a small business" or a "loan to a small farm" and in which loan size category a loan should be reported. However, when assessing the volume of small business and small farm loan purchases for purposes of evaluating lending test performance under the CRA, examiners evaluate an institution's small business and small farm lending based on the amount of the participation that is purchased. *See id.*

The CRA regulations require that, when reporting small business and small farm loans originated or purchased, institutions report, among other things, the amount of the loans at origination. 12 CFR ____.42(a)(2). However, when reporting community development loan data, an institution reports only the aggregate number and aggregate amount of community development loans originated or purchased. 12 CFR ____.42(b)(2). Because the regulation does not specify whether the amount of purchased community development loans must be the amount of the loan at origination or the amount of the loan at purchase, the agencies propose that institutions should report the amount of the loan participations purchased. Reporting only the amount of the loan participation that was purchased will provide a more accurate picture of institutions' community development loan activities. The agencies specifically request comment on whether having a different collection and reporting treatment for community development loans is appropriate.

IX. *Refinanced or renewed community development loans.*

The agencies are proposing a question and answer, Q&A §____.42(b)(2)—5, to clarify that, generally, the same limitations that apply to the reporting of refinancings and renewals of small business and small farm loans apply to refinancings and renewals of community development loans. *See* Q&A §____.42(a)—5. Generally, an institution may report only one community development loan origination (including a renewal or refinancing of that loan that is treated as an origination) per loan per year. If the loan amount is increased upon renewal or refinancing, the institution may report only the increase if the origination of the loan was also reported during the same year.

Revised Questions and Answers

The agencies are proposing revisions to a number of previously adopted questions and answers. Many of the proposed revisions update the guidance to reflect the 2005 technical revisions that conformed the agencies' regulations to OMB, Census, and Board regulatory revisions, and to the changes made in the 2005 joint final rule and OTS's March 2007 final rule. In many instances, the proposed revisions merely clarify existing guidance by conforming the guidance to the revised regulations, improving readability, or adopting current terminology.

Although most of the proposed revisions are deemed to be insignificant clarifications, the agencies specifically request comment on the following revised questions and answers:

I. *Activities that promote economic development.*

Q&A §____.12(g)(3)—1 describes the types of activities that promote economic development by financing small businesses and small farms. The agencies are proposing to revise Q&A §____.12(g)(3)—1 to clarify the language in the current answer and to add loans to or investments in Rural Business Investment Companies (RBICs) and New Markets Tax Credit-eligible Community Development Entities (CDEs) as types of loans or investments that the agencies will presume to promote economic development.

After notice and comment, the agencies added an investment in a RBIC as an example of a qualified investment in Q&A §____.12(t)—4. 71 FR at 12433; 71 FR at 52379 (OTS). The purpose of the Rural Business Investment Program, which is a joint initiative between the U.S. Small Business Administration and the U.S. Department of Agriculture, is intended to promote economic development by financing small businesses located primarily in rural areas. Thus, the agencies propose to revise Q&A §____.12(g)(3)—1 to provide that there is a presumption that an investment in a RBIC will promote economic development.

Likewise, the agencies are proposing that loans to or investments in CDEs will be presumed to promote economic development. Loans to or investments in CDEs pursuant to the New Markets Tax Credit program generally have a primary purpose of community development, as that term is defined in the CRA regulations. To the extent that a CDE lends to or invests in small businesses or farms, a loan to or investment in the CDE promotes economic development by financing small businesses or farms. Also, because the primary mission of the CDE is to service "low-income communities," loans and investments made by the CDE generally would help to revitalize or stabilize low- or moderate-income geographies. Thus, the agencies propose to revise Q&A §____.12(g)(3)—1 to provide that there is also a presumption that an investment in a CDE will promote economic development.

II. *Examples of community development loans.*

Q&A §____.12(h)—1 provides examples of community development loans. For the same reasons as addressed above in connection with the proposed revision to Q&A §____.12(g)(3)—1, the agencies propose to revise the fourth bullet in the answer

to Q&A §____.12(h)—1 to add a loan to a New Markets Tax Credit-eligible CDE as an example of a community development loan.

The agencies also propose to add a new bullet to the same question and answer stating that another example of a community development loan is a loan in an amount greater than $1 million to a business, when the loan is made as part of the Small Business Administration's (SBA's) 504 Certified Development Company program. (Such loans in amounts of $1 million or less would be small business loans for CRA purposes.) The SBA's 504 loan program is a long-term financing tool for economic development within a community. (See 13 CFR 120.800 *et seq.* for additional information about SBA's 504 program.) The 504 program provides growing businesses with long-term, fixed-rate financing for major fixed assets, such as land and buildings. A Certified Development Company is a nonprofit corporation that works with the SBA and private-sector lenders to provide financing to local small businesses. Loans to businesses under the 504 program must meet job creation criteria or a community development goal, or have a public policy goal. Generally, to meet the job creation criteria, a business must create or retain one job for every $50,000 provided by the SBA, except for "Small Manufacturers," which have a $100,000 job creation or retention goal. Examples of the 504 program's public policy goals include business district revitalization, rural development, and expansion of minority business development. Based on the economic development and community revitalization purposes and goals of the 504 program, the agencies believe that loans to businesses made in connection with the program would have a primary purpose of community development, as defined in the CRA regulations.

III. *Examples of community development services.*

Q&A §____.12(i)—3 provides examples of community development services. The agencies propose to add a new example of a community development service to this question and answer. The agencies believe that increasing access to financial services by opening or maintaining branches or other facilities that help to revitalize or stabilize a low- or moderate-income area, designated disaster area, or a distressed or underserved nonmetropolitan middle-income area would have a primary purpose of community development under the fourth prong of the definition of "community development." Thus, the agencies propose to add a new bullet in the answer to state that opening or maintaining branches and other facilities that help to revitalize or stabilize low- or moderate-income geographies, designated disaster areas, or distressed or underserved nonmetropolitan middle-income geographies is an example of a community development service and would be considered as a community development service unless the opening or maintaining of the branches or other facilities has been considered in the evaluation of the institution's retail banking services under 12 CFR ____.24(d). See Q&As
§ ____.12(g)(4)(ii)—2,
§ ____.12(g)(4)(iii)—3, and
§ ____.12(g)(4)(iii)—4 for additional guidance about activities that revitalize or stabilize designated disaster areas and distressed or underserved nonmetropolitan middle-income geographies, respectively. (With regard to an institution that is evaluated under the service test, branch openings are already considered as part of the availability and effectiveness of the institution's systems for delivering retail banking services. *See* 12 CFR ____.24(d)(2). Similarly, whether an institution maintains branches is also considered under the service test when examiners evaluate the distribution of the institution's branches based on geography income and the institution's record of opening and closing branches. *See* 12 CFR____.24(d)(1) & (2).

The agencies also propose to revise the example of community development services describing various types of consumer counseling services to highlight credit counseling that can assist borrowers in avoiding foreclosure on their homes.

Finally, the agencies propose to add to the examples of financial services with the primary purpose of community development that increase access to financial services for low- or moderate-income individuals individual development accounts (IDAs) and free payroll check cashing. (A cross-reference to this revised Q&A would be added to Q&A § ____.24(d)—2, which provides guidance about how examiners evaluate an institution's activities in connection with IDAs.)

IV. *Federal Home Loan Bank unpaid dividends.*

Since the 1995 revision of the CRA regulations, the agencies have agreed that Federal Home Loan Bank (FHLB) stock does not have a sufficient connection to community development to be considered a qualified investment. *See* Joint Final Rule, 60 FR 22156, 22161 (May 4, 1995). The agencies' staffs have received questions from financial institutions about whether funds retained by the FHLBs to support the Affordable Housing Program (AHP), in lieu of being paid out in dividends to investing institutions, would receive consideration as qualified investments. The agencies propose to clarify that the required annual AHP contributions of the FHLBs are not qualified investments because they are not investments by the investing financial institution members, but rather a use of its own funds by the FHLB. The agencies propose to revise Q&A §____.12(t)—3 to state that FHLB unpaid dividends are not qualified investments.

V. *Examples of qualified investments.*

Q&A §____.12(t)—4 provides examples of qualified investments. For the same reasons as addressed above in connection with the proposed revision to Q&A §____.12(g)(3)—1, the agencies propose to revise the first bullet in the answer to Q&A §____.12(t)—4 to add an investment in a New Markets Tax Credit-eligible CDE as an example of a qualified investment.

The agencies also propose to add a new fourth bullet that clarifies that an investment in a community development venture capital company that promotes economic development by financing small businesses would also be an example of a qualified investment. Although private community development venture capital companies are not statutorily authorized and government insured or guaranteed like the examples in the current third bullet of the Q&A (e.g., small business investment companies), community development venture capital companies may provide financing for small businesses that supports permanent job creation, retention, and/or improvement for persons who are currently low- or moderate-income, or supports permanent job creation, retention, and/or improvement either in low- or moderate-income geographies or in areas targeted for redevelopment by Federal, state, local, or tribal governments.

VI. *Small institution adjustment.*

Q&A §____.12(u)(2)—1, which was adopted by the OCC, Board, and FDIC in the 2006 Questions and Answers, provides information about the annual adjustments to the asset-size thresholds for small institutions and intermediate small institutions. (OTS does not currently have a comparable Q&A but is proposing to add one through this notice.) The agencies are proposing that this Q&A also refer the reader to the FFIEC's Web site for historical and current asset-size threshold information.

VII. *Responsive lending activities.*

Q&A § ____.22(a)—1 discusses types of lending activities that help meet the credit needs of an institution's assessment areas and that may warrant favorable consideration as activities that are responsive to the needs of the institution's assessment areas. The agencies propose to revise the answer to highlight that establishing loan programs that provide relief to low- and moderate-income homeowners who are facing foreclosure is another type of lending activity that would warrant favorable consideration as being responsive to the needs of an institution's assessment areas. The agencies encourage institutions to develop and participate in such programs, consistent with safe and sound lending practices.

VIII. *Constraints on affiliate lending.*

Q&A § ____.22(c)(2)(i)—1 explains the constraint that no affiliate may claim a loan origination or loan purchase if another institution claims the same loan origination or loan purchase. The agencies propose to revise the answer by adding illustrative examples to help explain this provision. The answer states that a bona fide sale of a loan originated by one affiliate to another affiliate would be considered a loan origination by the first institution and a loan purchase by the other affiliate; however, the same institution may not claim both the origination and the purchase of the same loan. The question would also be revised to indicate that this guidance is relevant to all institutions, regardless of their examination type.

IX. *Retail banking services delivery systems.*

Q&A § ____.24(d)—1 explains how examiners evaluate the availability and effectiveness of an institution's systems for delivering retail banking services. The agencies propose to revise Q&A § ____.24(d)—1 to correspond more closely to the service test performance criteria. The regulation provides that examiners will evaluate the current distribution of an institution's branches and, in the context of its current distribution of the institution's branches, the institution's record of opening and closing branches, particularly branches located in low- or moderate-income geographies or primarily serving low- or moderate-income individuals. The text of the answer would be modified to conform more closely to the regulatory language.

X. *Assessment areas may not extend substantially beyond metropolitan statistical area (MSA) boundaries.*

Q&As § ____.41(e)(4)—1 and § ____.41(e)(4)—2 address the maximum size of an assessment area and whether one assessment area may consist of both an MSA and two counties that both abut the MSA. The agencies propose to revise these two questions and answers to reflect the changes in the Standards for Defining Metropolitan and Micropolitan Statistical Areas by the OMB. Although the OMB continues to designate MSAs, the OMB no longer designates Consolidated MSAs (CMSAs), which consisted of Primary MSAs. The OMB has also adopted a new area designation: Metropolitan division. As previously noted, in the 2005 technical revisions, the agencies aligned their CRA regulations with the OMB's new nomenclature. *See* 70 FR 15570.

The proposed revisions to Q&As § ____.41(e)(4)—1 and § ____.41(e)(4)—2 adopt the revised nomenclature and also memorialize guidance that the agencies provided in the supplementary information that was published with the 2005 technical revisions. The agencies had noted in the supplementary information that one commenter suggested that the agencies, in their 2005 technical revisions, replace "CMSA" with "CSA" (combined statistical area), another new area standard that OMB adopted in 2000. The agencies declined to do so, but advised in the supplementary information that it may be appropriate for some institutions to delineate an assessment area based on a CSA. However, because CSAs can vary greatly in area and population, the agencies indicated that whether an assessment area should consist of a CSA is a determination to be made by each institution, considering its size, business strategy, capacity, and constraints, and subject to review by the appropriate agency. The agencies further noted that, if an institution designates an assessment area comprised of a CSA that, for example, consists of an MSA and a micropolitan statistical area (a new area standard adopted by OMB that is less populated than an MSA and considered a nonmetropolitan area for CRA purposes), examiners will separately evaluate performance in the MSA and the micropolitan statistical area within the assessment area because each of these areas has a distinct median income. Proposed revised Q&As § ____.41(e)(4)—1 and § ____.41(e)(4)—2 incorporate this information.

XI. *Reporting data under the CRA regulations.*

Q&A § ____.42—1 addresses when an institution must collect and report data. It focuses on a growing institution: One that was a small institution but that, over time, has outgrown that classification. The agencies propose to revise this question and answer for two reasons. First, because the definition of "small institution" has been revised and the asset-size threshold for small institutions is adjusted annually, the text and example in the guidance require updating. The proposed revision refers to the definition of a "small institution" in the agencies' CRA regulations so that the asset-size threshold does not become out-of-date as a result of annual adjustments. It also directs readers to the FFIEC's Web site for examples, over time, based on the revised and adjusted asset-size thresholds for small institutions. Second, the mailing address to which an institution reports CRA data has been changed, and the proposed new guidance reflects the revised address.

XII. *Reporting home equity lines of credit for both home improvement and business purposes.*

Q&A § ____.42(a)—7 addresses the reporting of a home equity line of credit, part of which is for home improvement purposes and part of which is for small business purposes. Because of changes in the treatment of refinancings of loans secured by dwellings in the Board's Regulation C (12 CFR part 203), which implements the HMDA (described above), the agencies are proposing to revise this question and answer to make it consistent with the revised Regulation C requirements.

XIII. *Participations in small business or small farm loans.*

Q&A § ____.42(a)(2)—1 provides guidance regarding the reporting of the amount of a small business or small farm loan that an institution purchases. The agencies propose to revise this question and answer to clarify that the guidance also applies to purchases of small business or small farm loan participations. The CRA regulations explicitly require institutions to collect and maintain "the loan amount at origination" when collecting data about small business and small farm loans. 12 CFR____.42(a)(2). The agencies are proposing to revise the question and answer to clarify that this data collection requirement applies to participations, as well as to the purchase of whole loans.

OTS Request for Comments

OTS specifically solicits comment on whether it should adopt the four new and one revised questions and answers that are virtually identical to guidance the OCC, Board, and FDIC adopted in the 2006 Questions and Answers. Those new questions and answers for OTS are Q&As § ____.12(u)(2)—1, § ____.26(c)—1, § ____.26(c)(3)—1, and § ____.26(c)(4)—

1; the proposed revised question and answer for OTS is Q&A § ____.26—1.

General Comments

In addition to the specific requests for comments on the proposed new and revised questions and answers, public comment is invited on issues raised by the CRA and the Interagency Questions and Answers. If, after reading the Interagency Questions and Answers, financial institutions, examiners, community organizations, or other interested parties have unanswered questions or comments about the agencies' community reinvestment regulations, they should submit them to the agencies. Such questions may be addressed in future revisions to the Interagency Questions and Answers.

Solicitation of Comments Regarding the Use of "Plain Language"

Section 722 of the Gramm-Leach-Bliley Act of 1999, 12 U.S.C. 4809, requires the agencies to use "plain language" in all proposed and final rules published after January 1, 2000. Although this proposed guidance is not a proposed rule, comments are nevertheless invited on whether the proposed interagency questions and answers are stated clearly and effectively organized, and how the guidance might be revised to make it easier to read.

Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA)

The SBREFA requires an agency, for each rule for which it prepares a final regulatory flexibility analysis, to publish one or more compliance guides to help small entities understand how to comply with the rule.

Pursuant to section 605(b) of the Regulatory Flexibility Act, the OCC and the FDIC certified that the 2005 joint final rule would not have a significant economic impact on a substantial number of small entities. 70 FR at 44264. Pursuant to section 605(b) of the Regulatory Flexibility Act, OTS certified that its March 22, 2007, April 12, 2006, March 2, 2005, and August 18, 2004 final rules would not have a significant economic impact on a substantial number of small entities. 72 FR 13429, 13434 (March 22, 2007); 71 FR 18614, 18617 (April 12, 2006); 70 FR 10023, 10030 (March 2, 2005); 69 FR 51155, 51161 (August 18, 2004).

The Board prepared a final regulatory flexibility analysis in connection with the 2005 joint final rule and found that the final rule minimized the economic impact on small entities by making the twelve small member banks that were not eligible for the streamlined CRA process prior to adoption of the joint final rule, eligible for the streamlined CRA process. Further, the joint final rule was intended by all three agencies to reduce unnecessary burden while maintaining or improving the CRA regulations' effectiveness in evaluating performance.

In the agencies' continuing efforts to provide clear, understandable regulations and to comply with the letter and the spirit of the SBREFA, the agencies have compiled the Interagency Questions and Answers. The Interagency Questions and Answers serve the same purpose as the compliance guide described in the SBREFA by providing guidance on a variety of issues of particular concern to small institutions.

The text of the combined Interagency Questions and Answers Regarding Community Reinvestment follows.

Language that is proposed to be deleted as compared to the current OCC, Board, and FDIC questions and answers is bracketed; language that is proposed to be added to these agencies' questions and answers is enclosed within arrows. Where these agencies' current questions and answers differ substantially from those of OTS, the differences are footnoted.

Interagency Questions and Answers Regarding Community Reinvestment

§ ____.11 Authority, purposes, and scope.

§ ____.11(c) Scope.

§§ ____.11(c)(3) & 563e.11(c)(2) Certain special purpose institutions.

§§ ____.11(c)(3) & 563e.11(c)(2)—1: *Is the list of special purpose institutions exclusive?*

A1. No, there may be other examples of special purpose institutions. These institutions engage in specialized activities that do not involve granting credit to the public in the ordinary course of business. Special purpose institutions typically serve as correspondent banks, trust companies, or clearing agents or engage only in specialized services, such as cash management controlled disbursement services. A financial institution, however, does not become a special purpose institution merely by ceasing to make loans and, instead, making investments and providing other retail banking services.

§§ ____.11(c)(3) & 563e.11(c)(2)—2: *To be a special purpose institution, must an institution limit its activities in its charter?*

A2. No. A special purpose institution may, but is not required to, limit the scope of its activities in its charter, articles of association, or other corporate organizational documents. An institution that does not have legal limitations on its activities, but has voluntarily limited its activities, however, would no longer be exempt from Community Reinvestment Act (CRA) requirements if it subsequently engaged in activities that involve granting credit to the public in the ordinary course of business. An institution that believes it is exempt from CRA as a special purpose institution should seek confirmation of this status from its supervisory agency.

§ ____.12 Definitions.

§ ____.12(a) Affiliate.

§ ____.12(a)—1: *Does the definition of "affiliate" include subsidiaries of an institution?*

A1. Yes, "affiliate" includes any company that controls, is controlled by, or is under common control with another company. An institution's subsidiary is controlled by the institution and is, therefore, an affiliate.

§ [§] ____.12(f) [& 563e.12(e)] Branch.

§ [§] ____.12(f) [& 563e.12(e)]—1: *Do the definitions of "branch," "automated teller machine (ATM)," and "remote service facility (RSF)" include mobile branches, ATMs, and RSFs?*

A1. Yes. Staffed mobile offices that are authorized as branches are considered "branches►,◄" and mobile 'ATMs' and 'RSFs' are considered "ATMs" and "RSFs."

§ [§] ____.12(f)[& 563e.12(e)]—2: *Are loan production offices (LPOs) branches for purposes of the CRA?*

A2. LPOs and other offices are not "branches" unless they are authorized as branches of the institution through the regulatory approval process of the institution's supervisory agency.

§ [§] ____.12([h]►g◄)[& 563.12(g)] Community development.

§ [§] ____.12([h]►g◄)[& 563.12(g)]—1: *Are community development activities limited to those that promote economic development?*

A1. No. Although the definition of "community development" includes activities that promote economic development by financing small businesses or farms, the rule does not limit community development loans and services and qualified investments to those activities. Community development also includes community- or tribal-based child care, educational, health, or social services targeted to low- or moderate-income persons, affordable housing for low- or moderate-income individuals, and activities that

revitalize or stabilize low- or moderate-income areas►, designated disaster areas, or underserved or distressed nonmetropolitan middle-income geographies◄.

§ [§]____.12([h]►g◄)[& 563e.12(g)]—2: *Must a community development activity occur inside a low- or moderate-income area►, designated disaster area, or underserved or distressed nonmetropolitan middle-income area◄ in order for an institution to receive CRA consideration for the activity?*

A2. No. Community development includes activities [outside of low- and moderate-income areas]►, regardless of their location,◄ that provide affordable housing for, or community services targeted to, low- or moderate-income individuals and activities that promote economic development by financing small businesses and farms. Activities that stabilize or revitalize particular low- or moderate-income areas►, designated disaster areas, or underserved or distressed nonmetropolitan middle-income areas◄ (including by creating, retaining, or improving jobs for low- or moderate-income persons) also qualify as community development, even if the activities are not located in these [low- or moderate-income] areas. One example is financing a supermarket that serves as an anchor store in a small strip mall located at the edge of a middle-income area, if the mall stabilizes the adjacent low-income community by providing needed shopping services that are not otherwise available in the low-income community.

§ [§]____.12([h]►g◄)[& 563e.12(g)]—3: *Does the regulation provide flexibility in considering performance in high-cost areas?*

A3. Yes, the flexibility of the performance standards allows examiners to account in their evaluations for conditions in high-cost areas. Examiners consider lending and services to individuals and geographies of all income levels and businesses of all sizes and revenues. In addition, the flexibility in the requirement that community development loans, community development services, and qualified investments have as their "primary" purpose community development allows examiners to account for conditions in high-cost areas. For example, examiners could take into account the fact that activities address a credit shortage among middle-income people or areas caused by the disproportionately high cost of building, maintaining or acquiring a house when determining whether an institution's loan to or investment in an organization that funds affordable housing for middle-income people or areas, as well as low- and moderate-income people or areas, has as its primary purpose community development.

►§ ____.12(g)—4: *The CRA provides that, in assessing the CRA performance of non-minority- and non-women-owned (majority-owned) financial institutions, examiners may consider as a factor capital investments, loan participations, and other ventures undertaken by the institutions in cooperation with minority- or women-owned financial institutions and low-income credit unions, provided that these activities help meet the credit needs of local communities in which the minority- or women-owned institutions or low-income credit unions are chartered. Must such activities also benefit the majority-owned financial institution's assessment area?*

A4. No. Although the regulations generally provide that an institution's CRA activities will be evaluated for the extent to which they benefit the institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s), the agencies apply a broader geographic criterion when evaluating capital investments, loan participations, and other ventures undertaken by that institution in cooperation with minority- or women-owned institutions or low-income credit unions, as provided by the CRA. Thus, such activities will be favorably considered in the CRA performance evaluation of the institution (as loans, investments, or services, as appropriate), even if the minority- or women-owned institution or low-income credit union is not located in, or such activities do not benefit, the assessment area(s) of the majority-owned institution or the broader statewide or regional area that includes its assessment area(s). The activities must, however, help meet the credit needs of the local communities in which the minority- or women-owned institutions or low-income credit unions are chartered.◄

§ [§]____.12([h]►g◄)(1)[& 563e.12(g)] *Affordable housing (including multifamily rental housing) for low- or moderate-income individuals*

§ [§]____.12([h]►g◄)(1)[& 563e.12(g)(1)]—1: *When determining whether a project is "affordable housing for low- or moderate-income individuals," thereby meeting the definition of "community development," will it be sufficient to use a formula that relates the cost of ownership, rental►,◄ or borrowing to the income levels in the area as the only factor, regardless of whether the users, likely users, or beneficiaries of that affordable housing are low- or moderate-income individuals?*

A1. The concept of "affordable housing" for low- or moderate-income individuals does hinge on whether low- or moderate-income individuals benefit, or are likely to benefit, from the housing. It would be inappropriate to give consideration to a project that exclusively or predominately houses families that are not low- or moderate-income simply because the rents or housing prices are set according to a particular formula.

For projects that do not yet have occupants, and for which the income of the potential occupants cannot be determined in advance, or in other projects where the income of occupants cannot be verified, examiners will review factors such as demographic, economic►,◄ and market data to determine the likelihood that the housing will "primarily" accommodate low- or moderate-income individuals. For example, examiners may look at median rents of the assessment area and the project; the median home value of either the assessment area, low- or moderate-income geographies or the project; the low- or moderate-income population in the area of the project; or the past performance record of the organization(s) undertaking the project. Further, such a project could receive consideration if its express, bona fide intent, as stated, for example, in a prospectus, loan proposal►,◄ or community action plan, is community development.

§ [§]____.12([h]►g◄)(3)[& 563e.12(g)(3)] Activities that promote economic development by financing businesses or farms that meet certain size eligibility standards.

§ [§]____.12([h]►g◄)(3)[& 563.12(g)(3)]—1: *"Community development" includes activities that promote economic development by financing businesses or farms that meet certain size eligibility standards. Are all activities that finance businesses and farms that meet these size eligibility standards considered to be community development?*

A1. No. [To be considered as] ►The concept of◄ "community development" under [§§] ►12 CFR◄____.12([h]►g◄)(3)[and 563e.12(g)(3)] ►involves both a "size" test and a "purpose" test. An institution's◄[, a] loan, investment, or service[, whether made]►meets the "size" test if it finances, either◄ directly or through an intermediary, [must meet both a size test and a purpose test. An activity meets the size

requirement if it finances entities that] ►entities that◄ either meet the size eligibility standards of the Small Business Administration's Development Company (SBDC) or Small Business Investment Company (SBIC) programs, or have gross annual revenues of $1 million or less.

To meet the ►"◄purpose test,►"◄ the [activity]► institution's loan, investment, or service◄ must promote economic development. [An activity is]► These activities are◄ considered to promote economic development if [it supports]► they support◄ permanent job creation, retention, and/or improvement for persons who are currently low- or moderate-income, or supports permanent job creation, retention, and/or improvement either in low- or moderate-income geographies or in areas targeted for redevelopment by Federal, state, local►,◄ or tribal governments. The agencies will presume that any loan to or investment in a SBDC, SBIC, [or]► Rural Business Investment Company,◄ New Markets Venture Capital Company►, or New Markets Tax Credit-eligible Community Development Entity◄ promotes economic development. ►{But also refer to Q&As § ____.42(b)(2)— 2, § ____.12(h)—2, and § ____.12(h)—3 for more information about which loans may be considered community development loans.}◄

In addition to their quantitative assessment of the amount of a financial institution's community development activities, examiners must make qualitative assessments of an institution's leadership in community development matters and the complexity, responsiveness, and impact of the community development activities of the institution. In reaching a conclusion about the impact of an institution's community development activities, examiners may, for example, determine that a loan to a small business in a low- or moderate-income geography that provides needed jobs and services in that area may have a greater impact and be more responsive to the community credit needs than does a loan to a small business in the same geography that does not directly provide additional jobs or services to the community.

§ [§]____.12([h]►g◄)(4)[& 563e.12(g)(4)] Activities that revitalize or stabilize [low- or moderate-income]► certain◄ geographies.

§ ____.12(g)(4)—1: *Is the revised definition of community development,* effective September 1, 2005 ►(under the OCC, Board, and FDIC rules) and effective April 12, 2006 (under OTS's rule), ◄applicable to all [banks]► institutions◄ or only to intermediate small [banks]► institutions◄? [1]

A1. The revised definition of community development is applicable to all [banks]► institutions◄. ►Examiners will not use the revised definition to qualify activities that were funded or provided prior to September 1, 2005 (under the OCC, Board, and FDIC rules) or prior to April 12, 2006 (under OTS's rule).◄

§ ____.12(g)(4)—2: *Will activities that provide housing for middle-income and upper-income persons qualify for favorable consideration as community development activities when they help to revitalize or stabilize a distressed or underserved nonmetropolitan middle-income geography or designated disaster areas?*

A2. An activity that provides housing for middle- or upper-income individuals qualifies as an activity that revitalizes or stabilizes a distressed nonmetropolitan middle-income geography or a designated disaster area if the housing directly helps to revitalize or stabilize the community by attracting new, or retaining existing, businesses or residents and, in the case of a designated disaster area, is related to disaster recovery. The Agencies generally will consider all activities that revitalize or stabilize a distressed nonmetropolitan middle-income geography or designated disaster area, but will give greater weight to those activities that are most responsive to community needs, including needs of low- or moderate-income individuals or neighborhoods. Thus, for example, a loan solely to develop middle- or upper-income housing in a community in need of low- and moderate-income housing would be given very little weight if there is only a short-term benefit to low- and moderate-income individuals in the community through the creation of temporary construction jobs. ([A]► Except in connection with intermediate small institutions, a◄ housing-related loan is not evaluated as a "community development loan" if it has been reported or collected by the institution or its affiliate as a home mortgage loan, unless it is a multifamily dwelling loan. *See* ► 12 CFR ◄[§]____.12([i]►h◄)(2)(i) and Q&As § [§]____.12([i]►h◄) [& 563e.12(h)]—2► and § __.12(h)—3◄.) An activity will be presumed to revitalize or stabilize such a geography or area if the activity is consistent with a bona fide government revitalization or stabilization plan or disaster recovery plan. *See* Q&As § [§]____.12([h]►g◄)(4)(i)[& 563.12(g)(4)]—1 and § [§]____.12([i]►h◄) [& 563e.12(h)]—[4]►5◄.

In *underserved* nonmetropolitan middle-income geographies, activities that provide housing for middle- and upper-income individuals may qualify as activities that revitalize or stabilize such underserved areas if the activities also provide housing for low- or moderate-income individuals. For example, a loan to build a mixed-income housing development that provides housing for middle- and upper-income individuals in an underserved nonmetropolitan middle-income geography would receive positive consideration if it also provides housing for low- or moderate-income individuals.

§ [§]____.12([h]►g◄)(4)►(i)◄[& 563e.12(g)(4)] Activities that revitalize or stabilize low- or moderate-income geographies.

§ [§]____.12([h]►g◄)(4)►(i)◄[& 563e.12(g)(4)]—1: *What [are] activities [that]►are considered◄to "revitalize or stabilize" o low- or moderate-income geography►, and how are those activities considered◄?*

A1. Activities that revitalize or stabilize a low- or moderate-income geography are activities that help to attract ►new, or◄[and] retain ►existing,◄ businesses [and]►or◄ residents. Examiners will presume that an activity revitalizes or stabilizes a low- or moderate-income geography if the activity has been approved by the governing board of an Enterprise Community or Empowerment Zone (designated pursuant to 26 U.S.C. § 1391) and is consistent with the board's strategic plan. They will make the same presumption if the activity has received similar official designation as consistent with a federal, state, local►,◄ or tribal government plan for the revitalization or stabilization of the ►low- or moderate-income◄ geography. To determine whether other activities revitalize or stabilize a low- or moderate-income geography, examiners will evaluate the activity's actual impact on the geography, if information about this is available. If not, examiners will determine whether the activity is consistent with the community's formal or informal plans for the revitalization and stabilization of the low- or moderate-income geography. For more information on what activities revitalize

[1] The inserts and deletions are shown as compared to the current Q&A for the OCC, Board, and FDIC. The current Q&A for OTS reads: "Is the same definition of community development applicable to all savings associations? Yes, one definition of community development is applicable to all savings associations." 71 FR at 52377.

or stabilize a low- or moderate-income geography, see ►Q&As◄ § [§]____.12([h]►g◄)[& 563e.12(g)]—2 and § [§]____.12 ([i]►h◄)[& 563.12(h)]—4.

§____.12(g)(4)(ii) Activities that revitalize or stabilize designated disaster areas.

§____.12(g)(4)(ii)—1: *What is a "designated disaster area" and how long does it last?*

A1. A "designated disaster area" is a major disaster area designated by the federal government. Such disaster designations include, in particular, Major Disaster Declarations administered by the Federal Emergency Management Agency (FEMA) (*http://www.fema.gov*), but excludes counties designated to receive only FEMA Public Assistance Emergency Work Category A (Debris Removal) and/or Category B (Emergency Protective Measures).

Examiners will consider [bank]►institution◄ activities related to disaster recovery that revitalize or stabilize a designated disaster area for 36 months following the date of designation. Where there is a demonstrable community need to extend the period for recognizing revitalization or stabilization activities in a particular disaster area to assist in long-term recovery efforts, this time period may be extended.

§____.12(g)(4)(ii)—2: *What activities are considered to "revitalize or stabilize" a designated disaster area, and how are those activities considered?*

A2. The Agencies generally will consider an activity to revitalize or stabilize a designated disaster area if it helps to attract new, or retain existing, businesses or residents and is related to disaster recovery. An activity will be presumed to revitalize or stabilize the area if the activity is consistent with a bona fide government revitalization or stabilization plan or disaster recovery plan. The Agencies generally will consider all activities relating to disaster recovery that revitalize or stabilize a designated disaster area, but will give greater weight to those activities that are most responsive to community needs, including the needs of low- or moderate-income individuals or neighborhoods. Qualifying activities may include, for example, providing financing to help retain businesses in the area that employ local residents, including low- and moderate-income individuals; providing financing to attract a major new employer that will create long-term job opportunities, including for low- and moderate-income individuals; providing financing or other assistance for essential community-wide infrastructure, community services, and rebuilding needs; and activities that provide housing, financial assistance, and services to individuals in designated disaster areas and to individuals who have been displaced from those areas, including low- and moderate-income individuals (*see, e.g.*, Q&As §____.12([j]►i◄)[& 563e.12(i)]–3; §____.12([s]►t◄)[& 563e.12(r)]—4; §____.22(b)(2) & (3)–4; §____.22(b)(2) & (3)—5; and §____.24(d)(3)–1).

§____.12(g)(4)(iii) Activities that revitalize or stabilize distressed or underserved nonmetropolitan middle-income geographies.

§____.12(g)(4)(iii)—1: *What criteria are used to identify distressed or underserved nonmetropolitan, middle-income geographies?*

A1. Eligible nonmetropolitan middle-income geographies are those designated by the Agencies as being in distress or that could have difficulty meeting essential community needs (underserved). A particular geography could be designated as both distressed and underserved. As defined in ►12 CFR◄[§]____.12(k), a geography is a census tract delineated by the United States Bureau of the Census.

A nonmetropolitan middle-income geography will be designated as distressed if it is in a county that meets one or more of the following triggers: (1) An unemployment rate of at least 1.5 times the national average, (2) a poverty rate of 20 percent or more, or (3) a population loss of 10 percent or more between the previous and most recent decennial census or a net migration loss of five percent or more over the five-year period preceding the most recent census.

A nonmetropolitan middle-income geography will be designated as underserved if it meets criteria for population size, density, and dispersion that indicate the area's population is sufficiently small, thin, and distant from a population center that the tract is likely to have difficulty financing the fixed costs of meeting essential community needs. The Agencies will use as the basis for these designations the "urban influence codes," numbered "7," "10," "11," and "12," maintained by the Economic Research Service of the United States Department of Agriculture.

The Agencies [will] publish data source information along with the list of eligible nonmetropolitan census tracts on the Federal Financial Institutions Examination Council Web site (*http://www.ffiec.gov*).

§____.12(g)(4)(iii)—2: *How often will the Agencies update the list of designated distressed and underserved nonmetropolitan middle-income geographies?*

A2. The Agencies will review and update the list annually [as needed]. The list [will be] ►is◄ published on the Federal Financial Institutions Examination Council Web site (*http://www.ffiec.gov*).

To the extent that changes to the designated census tracts occur, the Agencies have determined to adopt a one-year "lag period." This lag period will be in effect for the twelve months immediately following the date when a census tract that was designated as distressed or underserved is removed from the designated list. Revitalization or stabilization activities undertaken during the lag period will receive consideration as community development activities if they would have been considered to have a primary purpose of community development if the census tract in which they were located were still designated as distressed or underserved.

§____.12(g)(4)(iii)—3: *What activities are considered to "revitalize or stabilize" a distressed nonmetropolitan middle-income geography, and how are those activities evaluated?*

A3: An activity revitalizes or stabilizes a distressed nonmetropolitan middle-income geography if it helps to attract new, or retain existing, businesses or residents. An activity will be presumed to revitalize or stabilize the area if the activity is consistent with a bona fide government revitalization or stabilization plan. The Agencies generally will consider all activities that revitalize or stabilize a distressed nonmetropolitan middle-income geography, but will give greater weight to those activities that are most responsive to community needs, including needs of low- or moderate-income individuals or neighborhoods. Qualifying activities may include, for example, providing financing to attract a major new employer that will create long-term job opportunities, including for low- and moderate-income individuals, and activities that provide financing or other assistance for essential infrastructure or facilities necessary to attract or retain businesses or residents. *See* Q&As §[§]____.12([h]►g◄)(4)[& 563e.12(g)(4)►(i)◄]—1 and §[§]____.12([i] ►h◄)[& 563e.12(h)]—[4] ►5◄.

§____.12(g)(4)(iii)—4: *What activities are considered to "revitalize or stabilize" an underserved nonmetropolitan middle-income*

geography, and how are those activities evaluated?

A4. The regulation provides that activities revitalize or stabilize an underserved nonmetropolitan middle-income geography if they help to meet essential community needs, including needs of low- or moderate-income individuals. Activities such as financing for the construction, expansion, improvement, maintenance, or operation of essential infrastructure or facilities for health services, education, public safety, public services, industrial parks, or affordable housing, will be evaluated under these criteria to determine if they qualify for revitalization or stabilization consideration. Examples of the types of projects that qualify as meeting essential community needs, including needs of low- or moderate-income individuals, would be a new or expanded hospital that serves the entire county, including low- and moderate-income residents; an industrial park for businesses whose employees include low- or moderate-income individuals; a new or rehabilitated sewer line that serves community residents, including low- or moderate-income residents; a mixed-income housing development that includes affordable housing for low- and moderate-income families; or a renovated elementary school that serves children from the community, including children from low- and moderate-income families.

Other activities in the area, such as financing a project to build a sewer line spur that connects services to a middle- or upper-income housing development while bypassing a low- or moderate-income development that also needs the sewer services, generally would not qualify for revitalization or stabilization consideration in geographies designated as underserved. However, if an underserved geography is also designated as distressed or a disaster area, additional activities may be considered to revitalize or stabilize the geography, as explained in Q&As § ____.12(g)(4)(ii)—2 and § ____.12(g)(4)(iii)—3.

§ [§] ____.12([i] ►h◄)[& 563e.12(h)] Community development loan.

§ [§] ____.12([i] ►h◄)[& 563e.12(h)]–1: *What are examples of community development loans?*

A1. Examples of community development loans include, but are not limited to, loans to:

- Borrowers for affordable housing rehabilitation and construction, including construction and permanent financing of multifamily rental property serving low- and moderate-income persons;
- Not-for-profit organizations serving primarily low- and moderate-income housing or other community development needs;
- Borrowers to construct or rehabilitate community facilities that are located in low- and moderate-income areas or that serve primarily low- and moderate-income individuals;
- Financial intermediaries including Community Development Financial Institutions (CDFIs), ►New Markets Tax Credit-eligible Community Development Entities,◄ Community Development Corporations (CDCs), minority- and women-owned financial institutions, community loan funds or pools, and low-income or community development credit unions that primarily lend or facilitate lending to promote community development[.] ►;◄
- Local, state, and tribal governments for community development activities; [and]
- Borrowers to finance environmental clean-up or redevelopment of an industrial site as part of an effort to revitalize the low- or moderate-income community in which the property is located[.]►; and
- Businesses, in an amount greater than $1 million, when made as part of the Small Business Administration's 504 Certified Development Company program.◄

The rehabilitation and construction of affordable housing or community facilities, referred to above, may include the abatement or remediation of, or other actions to correct, environmental hazards, such as lead-based paint, that are present in the housing, facilities, or site.

§ [§] ____.12([i]►h◄)[& 563e.12(h)]—2: *If a retail institution that is not required to report under the Home Mortgage Disclosure Act (HMDA) makes affordable home mortgage loans that would be HMDA-reportable home mortgage loans if it were a reporting institution, or if a small institution that is not required to collect and report loan data under ►the◄ CRA makes small business and small farm loans and consumer loans that would be collected and/or reported if the institution were a large institution, may the institution have these loans considered as community development loans?*

A2. No. Although small institutions are not required to report or collect information on small business and small farm loans and consumer loans, and some institutions are not required to report information about their home mortgage loans under HMDA, if these institutions are retail institutions, the agencies will consider in their CRA evaluations the institutions' originations and purchases of loans that would have been collected or reported as small business, small farm, consumer or home mortgage loans, had the institution been a collecting and reporting institution under the CRA or the HMDA. Therefore, these loans will not be considered as community development loans►, unless the small institution is an intermediate small institution (*see* § ____.12(h)—3)◄. Multifamily dwelling loans, however, may be considered as community development loans as well as home mortgage loans. *See also* ►Q&A◄ § ____.42(b)(2)—2.

►§ ____.12(h)—3: *May an intermediate small institution that is not subject to HMDA reporting have home mortgage loans considered as community development loans? Similarly, may an intermediate small institution have small business and small farm loans and consumer loans considered as community development loans?*

A3. Yes. These loans may be considered, at the institution's option, as community development loans provided they meet the regulatory definition of "community development." However, these loans may not be considered under both the lending test and the community development test for intermediate small institutions. Thus, if an institution elects that these loans be considered under the community development test, the loans may not also be considered under the lending test, and would be excluded from the lending test analysis.◄

§ [§] ____.12([i]►h◄)[& 563e.12(h)] —[3] ►4◄: *Do secured credit cards or other credit card programs targeted to low- or moderate-income individuals qualify as community development loans?*

A3. No. Credit cards issued to low- or moderate-income individuals for household, family, or other personal expenditures, whether as part of a program targeted to such individuals or otherwise, do not qualify as community development loans because they do not have as their primary purpose any of the activities included in the definition of "community development."

§ [§] ____.12([i] ►h◄)[& 563e.12(h)]—[4]►5◄: *The regulation indicates that community development includes "activities that revitalize or stabilize low- or moderate-income geographies." Do all loans in a low-to moderate-income geography have a stabilizing effect?*

A4. No. Some loans may provide only indirect or short-term benefits to low- or moderate-income individuals in a low- or moderate-income geography. These loans are not considered to have a community development purpose. For example, a loan for upper-income housing in a [distressed] ►low- or moderate-income◄ area is not considered to have a community development purpose simply because of the indirect benefit to low- or moderate-income persons from construction jobs or the increase in the local tax base that supports enhanced services to low- and moderate-income area residents. On the other hand, a loan for an anchor business in a [distressed] ►low- or moderate-income◄ area (or a nearby area)[, which] ►that◄ employs or serves residents of the area[,] and ►,◄ thus►,◄ stabilizes the area, may be considered to have a community development purpose. For example, in [an underserved, distressed] ►a low-income◄ area, a loan for a pharmacy that employs and [provides supplies to]►serves◄ residents of the area promotes community development.

§ [§]____.12([i]►h◄)[& 563e.12(h)]—[5]►6◄: *Must there be some immediate or direct benefit to the institution's assessment area(s) to satisfy the regulations' requirement that qualified investments and community development loans or services benefit an institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s)?*

A5. No. The regulations recognize that community development organizations and programs are efficient and effective ways for institutions to promote community development. These organizations and programs often operate on a statewide or even multistate basis. Therefore, an institution's activity is considered a community development loan or service or a qualified investment if it supports an organization or activity that covers an area that is larger than, but includes, the institution's assessment area(s). The institution's assessment area(s) need not receive an immediate or direct benefit from the institution's specific participation in the broader organization or activity, provided that the purpose, mandate, or function of the organization or activity includes serving geographies or individuals located within the institution's assessment area(s).

In addition, a retail institution that, considering its performance context, has adequately addressed the community development needs of its assessment area(s) will receive consideration for certain other community development activities. These community development activities must benefit geographies or individuals located somewhere within a broader statewide or regional area that includes the institution's assessment area(s). Examiners will consider these activities even if they will not benefit the institution's assessment area(s).

§ [§]____.12([i]►h◄)[& 563e.12(h)]—[6]►7◄: *What is meant by the term "regional area"?*

A6. A "regional area" may be [as small as a city or county or] as large as a multistate area. For example, the "mid-Atlantic states" may comprise a regional area.

Community development loans and services and qualified investments to statewide or regional organizations that have a bona fide purpose, mandate, or function that includes serving the geographies or individuals within the institution's assessment area(s) will be considered as addressing assessment area needs. When examiners evaluate community development loans and services and qualified investments that benefit a regional area that includes the institution's assessment area(s), they will consider the institution's performance context as well as the size of the regional area and the actual or potential benefit to the institution's assessment area(s). With larger regional areas, benefit to the institution's assessment area(s) may be diffused and, thus ►,◄ less responsive to assessment area needs.

In addition, as long as an institution has adequately addressed the community development needs of its assessment area(s), it will also receive consideration for community development activities that benefit geographies or individuals located somewhere within the broader statewide or regional area that includes the institution's assessment area(s), even if those activities do not benefit its assessment area(s).

§ [§]____.12([i]►h◄)[& 563e.12(h)]—[7]►8◄: *What is meant by the term "primary purpose" as that term is used to define what constitutes a community development loan, a qualified investment or a community development service?*

A7. A loan, investment or service has as its primary purpose community development when it is designed for the express purpose of revitalizing or stabilizing low- or moderate-income areas, ►designated disaster areas, or underserved or distressed nonmetropolitan middle-income areas, ◄ providing affordable housing for, or community services targeted to, low- or moderate-income persons, or promoting economic development by financing small businesses and farms that meet the requirements set forth in ►12 CFR ◄ [§ §]____.12([h]►g◄)[or 563e.12(g)]. To determine whether an activity is designed for an express community development purpose, the agencies apply one of two approaches. First, if a majority of the dollars or beneficiaries of the activity are identifiable to one or more of the enumerated community development purposes, then the activity will be considered to possess the requisite primary purpose. Alternatively, where the measurable portion of any benefit bestowed or dollars applied to the community development purpose is less than a majority of the entire activity's benefits or dollar value, then the activity may still be considered to possess the requisite primary purpose if (1) the express, bona fide intent of the activity, as stated, for example, in a prospectus, loan proposal, or community action plan, is primarily one or more of the enumerated community development purposes; (2) the activity is specifically structured (given any relevant market or legal constraints or performance context factors) to achieve the expressed community development purpose; and (3) the activity accomplishes, or is reasonably certain to accomplish, the community development purpose involved. The fact that an activity provides indirect or short-term benefits to low- or moderate-income persons does not make the activity community development, nor does the mere presence of such indirect or short-term benefits constitute a primary purpose of community development. Financial institutions that want examiners to consider certain activities under either approach should be prepared to demonstrate the activities' qualifications.

§ [§]____.12([j]►i◄)[& 563e.12(i)] Community development service.

§ [§]____.12([j]►i◄)[& 563e.12(i)]—1: *In addition to meeting the definition of "community development" in the regulation, community development services must also be related to the provision of financial services. What is meant by "provision of financial services"?*

A1. Providing financial services means providing services of the type generally provided by the financial services industry. Providing financial services often involves informing community members about how to get or use credit or otherwise providing credit services or information to the community. For example, service on the board of directors of an organization

that promotes credit availability or finances affordable housing is related to the provision of financial services. Providing technical assistance about financial services to community-based groups, local or tribal government agencies, or intermediaries that help to meet the credit needs of low- and moderate-income individuals or small businesses and farms is also providing financial services. By contrast, activities that do not take advantage of the employees' financial expertise, such as neighborhood cleanups, do not involve the provision of financial services.

§ [§]____.12([j]►i◄)[& 563e.12(i)]—2: *Are personal charitable activities provided by an institution's employees or directors outside the ordinary course of their employment considered community development services?*

A2. No. Services must be provided as a representative of the institution. For example, if a financial institution's director, on her own time and not as a representative of the institution, volunteers one evening a week at a local community development corporation's financial counseling program, the institution may not consider this activity a community development service.

§ [§]____.12([j]►i◄)[& 563e.12(i)]—3: *What are examples of community development services?*

A3. Examples of community development services include, but are not limited to, the following:

• Providing financial services to low- and moderate-income individuals through branches and other facilities located in low- and moderate-income areas, unless the provision of such services has been considered in the evaluation of [a bank's]►an institution's◄ retail banking services under ►12 CFR◄[§]____.24(d);

• ►Increasing access to financial services by opening or maintaining branches or other facilities that help to revitalize or stabilize a low- or moderate-income geography, a designated disaster area, or a distressed or underserved nonmetropolitan middle-income geography, unless the opening or maintaining of such branches or other facilities has been considered in the evaluation of the institution's retail banking services under 12 CFR ____.24(d);◄

• Providing technical assistance on financial matters to nonprofit, tribal or government organizations serving low- and moderate-income housing or economic revitalization and development needs;

• Providing technical assistance on financial matters to small businesses or community development organizations, including organizations and individuals who apply for loans or grants under the Federal Home Loan Banks' Affordable Housing Program;

• Lending employees to provide financial services for organizations facilitating affordable housing construction and rehabilitation or development of affordable housing;

• Providing credit counseling, home-buyer and home-maintenance counseling, financial planning or other financial services education to promote community development and affordable housing, including credit counseling to assist borrowers in avoiding foreclosure on their homes;

• Establishing school savings programs [and developing]►;◄

• ►Developing◄ or teaching financial [education] ►literacy◄ curricula for low- or moderate-income individuals;

• Providing electronic benefits transfer and point of sale terminal systems to improve access to financial services, such as by decreasing costs, for low- or moderate-income individuals;

• Providing international [remittances] ►remittance◄ services that increase access to financial services by low- and moderate-income persons (for example, by offering reasonably priced international [remittances] ►remittance◄ services in connection with a low-cost account); and

• Providing other financial services with the primary purpose of community development, such as low-cost bank accounts, including "Electronic Transfer Accounts" provided pursuant to the Debt Collection Improvement Act of 1996, ►individual development accounts (IDAs),◄ or free government ►or payroll◄ check cashing that increases access to financial services for low- or moderate-income individuals.

Examples of technical assistance activities that might be provided to community development organizations include:

• Serving on a loan review committee;

• Developing loan application and underwriting standards;

• Developing loan processing systems;

• Developing secondary market vehicles or programs;

• Assisting in marketing financial services, including development of advertising and promotions, publications, workshops and conferences;

• Furnishing financial services training for staff and management;

• Contributing accounting/bookkeeping services; and

• Assisting in fund raising, including soliciting or arranging investments.

§ [§]____.12([k]►j◄)[& 563e.12(j)] Consumer loan.

§ [§]____.12([k]►j◄)[& 563e.12(j)]—1: *Are home equity loans considered "consumer loans"?*

A1. Home equity loans made for purposes other than home purchase, home improvement or refinancing home purchase or home improvement loans are consumer loans if they are extended to one or more individuals for household, family, or other personal expenditures.

§ [§]____.12 ([k]►j◄)[& 563e.12(j)]—2: *May a home equity line of credit be considered a "consumer" loan even if part of the line is for home improvement purposes?*

A2. If the predominant purpose of the line is home improvement, the line may only be reported under HMDA and may not be considered a consumer loan. However, the full amount of the line may be considered a "consumer loan" if its predominant purpose is for household, family, or other personal expenditures, and to a lesser extent home improvement, and the full amount of the line has not been reported under HMDA. This is the case even though there may be "double counting" because part of the line may also have been reported under HMDA.

§ [§]____.12 ([k]►j◄)[& 563e.12(j)]—3: *How should an institution collect or report information on loans the proceeds of which will be used for multiple purposes?*

A3. If an institution makes a single loan or provides a line of credit to a customer to be used for both consumer and small business purposes, consistent with the Call Report and TFR instructions, the institution should determine the major (predominant) component of the loan or the credit line and collect or report the entire loan or credit line in accordance with the regulation's specifications for that loan type.

§ [§]____.12 ([m]►l◄)[& 563e.12(l)] Home mortgage loan.

§ [§]____.12 ([m]►l◄)[& 563e.12(l)]—1: *Does the term "home mortgage loan" include loans other than "home purchase loans"?*

A1. Yes. "Home mortgage loan" includes [a] "home improvement loan," [as well as a] "home purchase loan," ►and "refinancing,"◄ as defined in the HMDA regulation, Regulation C, 12 CFR part 203. This definition also includes multifamily (five-or-more families) dwelling loans[,] ►and◄ loans for the purchase of manufactured homes[, and refinancings of home improvement and home purchase

loans]. ►*See also* Q&A § ____.22(a)(2)—7.◄

§ [§]____.12 ([m]►l◄)[& 563e.12(l)]—2: *Some financial institutions broker home mortgage loans. They typically take the borrower's application and perform other settlement activities; however, they do not make the credit decision. The broker institutions may also initially fund these mortgage loans, then immediately assign them to another lender. Because the broker institution does not make the credit decision, under Regulation C (HMDA), they do not record the loans on their HMDA–LARs, even if they fund the loans. May an institution receive any consideration under CRA for its home mortgage loan brokerage activities?*

A2. Yes. A financial institution that funds home mortgage loans but immediately assigns the loans to the lender that made the credit decisions may present information about these loans to examiners for consideration under the lending test as "other loan data." Under Regulation C, the broker institution does not record the loans on its HMDA–LAR because it does not make the credit decisions, even if it funds the loans. An institution electing to have these home mortgage loans considered must maintain information about all of the home mortgage loans that it has funded in this way. Examiners will consider [this] ►these◄ other loan data using the same criteria by which home mortgage loans originated or purchased by an institution are evaluated.

Institutions that do not provide funding but merely take applications and provide settlement services for another lender that makes the credit decisions will receive consideration for this service as a retail banking service. Examiners will consider an institution's mortgage brokerage services when evaluating the range of services provided to low-, moderate-, middle- and upper-income geographies and the degree to which the services are tailored to meet the needs of those geographies. Alternatively, an institution's mortgage brokerage service may be considered a community development service if the primary purpose of the service is community development. An institution wishing to have its mortgage brokerage service considered as a community development service must provide sufficient information to substantiate that its primary purpose is community development and to establish the extent of the services provided.

§ [§]____.12 ([n]►m◄) [& 563e.12(m)] Income level.

§ [§]____.12 ([n]►m◄)[& 563e.12(m)]—1: *Where do institutions find income level data for geographies and individuals?*

A1. The income levels for *geographies*, i.e., census tracts[and block numbering areas], are derived from Census Bureau information and are updated ►approximately◄ every ten years. [Institutions may contact their regional Census Bureau office or the Census Bureau's Income Statistics Office at (301) 763–8576 to obtain income levels for geographies. *See* Appendix A of these Interagency Questions and Answers for a list of the regional Census Bureau offices.] The income levels for *individuals* are derived from information calculated by the Department of Housing and Urban Development (HUD) and updated annually. [Institutions may contact HUD at (800) 245–2691 to request a copy of "FY [year number, e.g., 1996] Median Family Incomes for States and their Metropolitan and Nonmetropolitan Portions."]

[Alternatively, institutions] ►Institutions◄ may obtain [a list of the 1990 Census Bureau-calculated] ►2000 geography income information◄ and the annually updated HUD median family incomes for metropolitan statistical areas (MSAs) and statewide nonmetropolitan areas by [calling] ►accessing◄ the Federal Financial Institution Examination Council's (FFIEC's) [HMDA Help] ►Web site at *http://www.ffiec.gov/cra* or by calling the FFIEC's CRA Assistance◄ Line at (202) [452–2016]►872–7584◄. [A free copy will be faxed to the caller through the "fax-back" system. Institutions may also call this number to have "faxed-back" an order form, from which they may order a list providing the median family income level, as a percentage of the appropriate MSA or nonmetropolitan median family income, of every census tract and block numbering area (BNA). This list costs $50. Institutions may also obtain the list of MSA and statewide nonmetropolitan area median family incomes or an order form through the FFIEC's home page on the Internet at <*http://www.ffiec.gov*.]

§ [§]____.12 ([o]► n◄)[& 563e.12(n)] Limited purpose institution

§ [§]____.12 ([o]►n◄)[& 563e.12(n)]—1: *What constitutes a "narrow product line" in the definition of "limited purpose institution"?*

A1. An institution offers a narrow product line by limiting its lending activities to a product line other than a traditional retail product line required to be evaluated under the lending test (i.e., home mortgage, small business, and small farm loans). Thus, an institution engaged only in making credit card or motor vehicle loans offers a narrow product line, while an institution limiting its lending activities to home mortgages is not offering a narrow product line.

§ [§]____.12 ([o]►n◄)[& 563e.12(n)]—2: *What factors will the agencies consider to determine whether an institution that, if limited purpose, makes loans outside a narrow product line, or, if wholesale, engages in retail lending, will lose its limited purpose or wholesale designation because of too much other lending?*

A2. Wholesale institutions may engage in some retail lending without losing their designation if this activity is incidental *and* done on an accommodation basis. Similarly, limited purpose institutions continue to meet the narrow product line requirement if they provide other types of loans on an infrequent basis. In reviewing other lending activities by these institutions, the agencies will consider the following factors:

- Is the [other] ►retail◄ lending provided as an incident to the institution's wholesale lending?
- Are the ►retail◄ loans provided as an accommodation to the institution's wholesale customers?
- Are the ►other types of◄ loans made only infrequently to the limited purpose institution's customers?
- Does only an insignificant portion of the institution's total assets and income result from the other lending?
- How significant a role does the institution play in providing that type(s) of loan(s) in the institution's assessment area(s)?
- Does the institution hold itself out as offering that type(s) of loan(s)?
- Does the lending test or the community development test present a more accurate picture of the institution's CRA performance?

§ [§]____.12([o]►n◄)[& 563e.12(n)]—3: *Do "niche institutions" qualify as limited purpose (or wholesale) institutions?*

A3. Generally, no. Institutions that are in the business of lending to the public, but specialize in certain types of retail loans (for example, home mortgage or small business loans) to certain types of borrowers (for example, to high-end income level customers or to corporations or partnerships of licensed professional practitioners) ("niche institutions") generally would not qualify as limited purpose (or wholesale) institutions.

§ [§]____.12([s]►t◄)[& 563e.12(r)] Qualified investment.

§ [§]____.12([s]►t◄)[& 563e.12(r)]1: *Does the CRA regulation provide*

authority for institutions to make investments?

A1. No. The CRA regulation does not provide authority for institutions to make investments that are not otherwise allowed by Federal law.

§[§]____.12([s]►t◄)[& 563e.12(r)]—2: *Are mortgage-backed securities or municipal bonds "qualified investments"?*

A2. As a general rule, mortgage-backed securities and municipal bonds are not qualified investments because they do not have as their primary purpose community development, as defined in the CRA regulations. Nonetheless, mortgage-backed securities or municipal bonds designed primarily to finance community development generally are qualified investments. Municipal bonds or other securities with a primary purpose of community development need not be housing-related. For example, a bond to fund a community facility or park or to provide sewage services as part of a plan to redevelop a low-income neighborhood is a qualified investment. ►Certain municipal bonds in underserved nonmetropolitan middle-income geographies may also be qualified investments. *See* Q&A § ____.12(g)(4)(iii)— 4.◄ Housing-related bonds or securities must primarily address affordable housing (including multifamily rental housing) needs ►of low- or moderate-income individuals◄ in order to qualify. *See also* ►Q&A◄ § ____.23(b)—2.

§[§]____.12([s]►t◄)[& 563e.12(r)]—3: *Are Federal Home Loan Bank stocks ►or unpaid dividends◄ and membership reserves with the Federal Reserve Banks "qualified investments"?*

A3. No. Federal Home Loan Bank (FHLB) stocks ►or unpaid dividends◄ and membership reserves with the Federal Reserve Banks do not have a sufficient connection to community development to be qualified investments. However, FHLB member institutions may receive CRA consideration ►as a community development service◄ for technical assistance they provide on behalf of applicants and recipients of funding from the FHLB's Affordable Housing Program. *See* ►Q&A◄ §[§]____.12([j]►i◄)[& 563e.12(i)]—3.

§[§]____.12([s]►t◄)[& 563e.12(r)]—4: *What are examples of qualified investments?*

A4. Examples of qualified investments include, but are not limited to, investments, grants, deposits or shares in or to:

- Financial intermediaries (including Community Development Financial Institutions (CDFIs), ► New Markets Tax Credit-eligible Community Development Entities,◄ Community Development Corporations (CDCs), minority- and women-owned financial institutions, community loan funds, and low-income or community development credit unions) that primarily lend or facilitate lending in low- and moderate-income areas or to low- and moderate-income individuals in order to promote community development, such as a CDFI that promotes economic development on an Indian reservation;
- Organizations engaged in affordable housing rehabilitation and construction, including multifamily rental housing;
- Organizations, including, for example, Small Business Investment Companies (SBICs), specialized SBICs, and Rural Business Investment Companies (RBICs) that promote economic development by financing small businesses;►
- Community development venture capital companies that promote economic development by financing small businesses;◄
- Facilities that promote community development ►by providing community services◄ for low- and moderate-income individuals, such as youth programs, homeless centers, soup kitchens, health care facilities, battered women's centers, and alcohol and drug recovery centers;
- Projects eligible for low-income housing tax credits;
- State and municipal obligations, such as revenue bonds, that specifically support affordable housing or other community development;
- Not-for-profit organizations serving low- and moderate-income housing or other community development needs, such as counseling for credit, home-ownership, home maintenance, and other financial [services education] ►literacy programs◄; and
- Organizations supporting activities essential to the capacity of low- and moderate-income individuals or geographies to utilize credit or to sustain economic development, such as, for example, day care operations and job training programs that enable [people] ►low- or moderate-income individuals◄ to work.

►*See also* Q&As § ____.12(g)(4)(ii)—2; § ____.12(g)(4)(iii)—3; § ____.12(g)(4)(iii)—4.◄

§[§]____.12([s]►t◄)[&563e.12(r)]—5: *Will an institution receive consideration for charitable contributions as "qualified investments"?*

A5. Yes, provided they have as their primary purpose community development as defined in the regulations. A charitable contribution, whether in cash or an in-kind contribution of property, is included in the term "grant." A qualified investment is not disqualified because an institution receives favorable treatment for it (for example, as a tax deduction or credit) under the Internal Revenue Code.

§[§]____.12([s]►t◄)[& 563e.12(r)]—6: *An institution makes or participates in a community development loan. The institution provided the loan at below-market interest rates or "bought down" the interest rate to the borrower. Is the lost income resulting from the lower interest rate or buy-down a qualified investment?*

A6. No. The agencies will, however, consider the ►responsiveness,◄ innovativeness►,◄ and complexity of the community development loan within the bounds of safe and sound banking practices.

§[§]____.12([s]►t◄)[& 563e.12(r)]—7: *Will the agencies consider as a qualified investment the wages or other compensation of an employee or director who provides assistance to a community development organization on behalf of the institution?*

A7. No. However, the agencies will consider donated labor of employees or directors of a financial institution [in the service test if the activity is] ►as◄ a community development service ►if the activity meets the regulatory definition of "community development service."◄

§ ____.12(t)—►8◄: When evaluating a qualified investment, what consideration will be given for prior-period investments?

A1. When evaluating [a bank's]►an institution's◄ qualified investment record, examiners will consider investments that were made prior to the current examination, but that are still outstanding. Qualitative factors will affect the weighting given to both current period and outstanding prior-period qualified investments. For example, a prior-period outstanding investment with a multi-year impact that addresses assessment area community development needs may receive more consideration than a current period investment of a comparable amount that is less responsive to area community development needs.

§[§]____.12([t]►u◄)[& 563e.12(s)] Small institution.

[§§ ____.12(t) & 563e.12(s)—1: *How are the "total bank and thrift assets" of a holding company determined?*

A1. "Total banking and thrift assets" of a holding company are determined by combining the total assets of all banks

and/or thrifts that are majority-owned by the holding company. An institution is majority-owned if the holding company directly or indirectly owns more than 50 percent of its outstanding voting stock.]

§ [§]____.12([t]►u◄)[& 563e.12(s)]—[2]►1◄: *How are Federal and State branch assets of a foreign bank calculated for purposes of the CRA?*

A[2]►1◄. A Federal or State branch of a foreign bank is considered a small institution if the Federal or State branch has ►assets◄ less than [$250 million in assets] ►the asset threshold delineated in 12 CFR ____.12(u)(1) for small institutions.◄ [and the total assets of the foreign bank's or its holding company's U.S. bank and thrift subsidiaries that are subject to the CRA are less than $1 billion. This calculation includes not only FDIC-insured bank and thrift subsidiaries, but also the assets of any FDIC-insured branch of the foreign bank and the assets of any uninsured Federal or State branch (other than a limited branch or a Federal agency) of the foreign bank that results from an acquisition described in section 5(a)(8) of the International Banking Act of 1978 (12 U.S.C. § 3103(a)(8)).]

►§ ____.12(u)(2) *Small Institution Adjustment*◄

§ ____.12(u)(2)—1: *How often will the asset size thresholds for small [banks] ►institutions◄ and intermediate small [banks] ►institutions◄ be changed, and how will these adjustments be communicated?*[2]

A1. The asset size thresholds for "small [banks] ►institutions◄" and "intermediate small [banks] ►institutions◄" will be adjusted annually based on changes to the Consumer Price Index. More specifically, the dollar thresholds will be adjusted annually based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted for each twelve-month period ending in November, with rounding to the nearest million. Any changes in the asset size thresholds will ba published in the **Federal Register**. ►Historical and current asset-size threshold information may be found on the FFIEC's Web site at *http://www.ffiec.gov/cra.*◄

§ [§]____.12([u]►v◄)[& 563e.12(t)] Small Business Loan

§ [§]____.12([u]►v◄)[& 563e.12(t)]—1: *Are loans to nonprofit organizations considered small business loans or are they considered community development loans?*

A1. To be considered a small business loan, a loan must meet the definition of "loan to small business" in the instructions in the "Consolidated Reports of Conditions and Income" (Call Report) and "Thrift Financial Report" (TFR). In general, a loan to a nonprofit organization, for business or farm purposes, where the loan is secured by nonfarm nonresidential property and the original amount of the loan is $1 million or less, if a business loan, or $500,000 or less, if a farm loan, would be reported in the Call Report and TFR as a small business or small farm loan. If a loan to a nonprofit organization is reportable as a small business or small farm loan, it cannot also be considered as a community development loan, except by a wholesale or limited purpose institution. Loans to nonprofit organizations that are not small business or small farm loans for Call Report and TFR purposes may be considered as community development loans if they meet the regulatory definition[.] ►of "community development."◄

§ [§]____.12([u]►v◄)[& 563e.12(t)]—2: *Are loans secured by commercial real estate considered small business loans?*

A2. Yes, depending on their principal amount. Small business loans include loans secured by "nonfarm nonresidential properties," as defined in the Call Report and TFR, in amounts [less than] ►of◄ $1 million ►or less◄.

§ [§]____.12([u]►v◄)[& 563e.12(t)]—3: *Are loans secured by nonfarm residential real estate to finance small businesses "small business loans"?*

A3. *Applicable to banks filing Call Reports:* Typically not. Loans secured by nonfarm residential real estate that are used to finance small businesses are not included as "small business" loans for Call Report purposes unless the security interest in the nonfarm residential real estate is taken only as an abundance of caution. (*See* Call Report Glossary definition of "Loan Secured by Real Estate.") The agencies recognize that many small businesses are financed by loans that would not have been made or would have been made on less favorable terms had they not been secured by residential real estate. If these loans promote community development, as defined in the regulation, they may be considered as community development loans. Otherwise, at an institution's option, the institution may collect and maintain data separately concerning these loans and request that the data be considered in its CRA evaluation as "Other Secured Lines/Loans for Purposes of Small Business." ►*See also* Q&A §____.22(a)(2)—7.◄

Applicable to institutions that file TFRs: Possibly, depending how the loan is classified for TFR purposes. Loans secured by nonfarm residential real estate to finance small businesses may be included as small business loans only if they are reported on the TFR as nonmortgage, commercial loans. (*See* TFR Q&A No. 62.) Otherwise, loans that meet the definition of mortgage loans, for TFR reporting purposes, may be classified as mortgage loans.

§ [§]____.12([u]►v◄)[& 563e.12(t)]—4: *Are credit cards issued to small businesses considered "small business loans"?*

A4. Credit cards issued to a small business or to individuals to be used, with the institution's knowledge, as business accounts are small business loans if they meet the definitional requirements in the Call Report or TFR instructions.

§ [§]____.12([w]►x◄)[& 563e.12(v)] Wholesale Institution

§ [§]____.12([w]►x◄)[& 563e.12(v)]—1: *What factors will the agencies consider in determining whether an institution is in the business of extending home mortgage, small business, small farm, or consumer loans to retail customers?*

A1. The agencies will consider whether:

- The institution holds itself out to the retail public as providing such loans; and
- The institution's revenues from extending such loans are significant when compared to its overall operations►, including off-balance sheet activities◄.

A wholesale institution may make some retail loans without losing its wholesale designation as described above in ►Q&A◄§ [§]____.12([o]►n◄)[& 563e.12(n)]—2.

§ ____.21 Performance tests, standards, and ratings, in general.

§ ____.21(a) Performance tests and standards.

►§ ____.21(a)—1: *How will examiners apply the performance criteria?*

A1. Examiners will apply the performance criteria reasonably and fairly, in accord with the regulations, the examination procedures, and this guidance. In doing so, examiners will disregard efforts by an institution to manipulate business operations or present information in an artificial light that does not accurately reflect an

[2] The inserts and deletions are shown as compared to the current Q&A for the OCC, Board, and FDIC. There currently is no comparable Q&A for OTS.

institution's overall record of lending performance.◄

§ ____.21(a)—[1]►2◄: *Are all community development activities weighted equally by examiners?*

A1. No. Examiners will consider the responsiveness to credit and community development needs, as well as the innovativeness and complexity, if applicable, of an institution's community development lending, qualified investments, and community development services. These criteria include consideration of the degree to which they serve as a catalyst for other community development activities. The criteria are designed to add a qualitative element to the evaluation of an institution's performance. (►"Innovativeness" and "complexity" are not factors in the community development test applicable to intermediate small institutions.)◄

§ ____.21(b) Performance context.

§ ____.21(b)—1: [Is]►*What is*◄ *the performance context[essentially the same as the former regulation's needs assessment]?*

A1. [No.] The performance context is a broad range of economic, demographic, and institution- and community-specific information that an examiner reviews to understand the context in which an institution's record of performance should be evaluated. The agencies will provide examiners with [much]►some◄ of this information[prior to the examination]. The performance context is not a formal[or written] assessment of community credit needs.

§ ____.21(b)(2) Information maintained by the institution or obtained from community contacts.

§ ____.21(b)(2)—1: *Will examiners consider performance context information provided by institutions?*

A1. Yes. An institution may provide examiners with any information it deems relevant, including information on the lending, investment, and service opportunities in its assessment area(s). This information may include data on the business opportunities addressed by lenders not subject to the CRA. Institutions are not required, however, to prepare a ► formal◄ needs assessment. If an institution provides information to examiners, the agencies will not expect information other than what the institution normally would develop to prepare a business plan or to identify potential markets and customers, including low- and moderate-income persons and geographies in its assessment area(s). The agencies will not evaluate an institution's efforts to ascertain community credit needs or rate an institution on the quality of any information it provides.

§ ____.21(b)(2)—2: *Will examiners conduct community contact interviews as part of the examination process?*

A2. Yes. Examiners will consider information obtained from interviews with local community, civic, and government leaders. These interviews provide examiners with knowledge regarding the local community, its economic base, and community development initiatives. To ensure that information from local leaders is considered—particularly in areas where the number of potential contacts may be limited—examiners may use information obtained through an interview with a single community contact for examinations of more than one institution in a given market. In addition, the agencies [will]►may◄ consider information obtained from interviews conducted by other agency staff and by the other agencies. In order to augment contacts previously used by the agencies and foster a wider array of contacts, the agencies [will]►may◄ share community contact information.

§ ____.21(b)(4) Institutional capacity and constraints.

§ ____.21(b)(4)—1: *Will examiners consider factors outside of an institution's control that prevent it from engaging in certain activities?*

A1. Yes. Examiners will take into account statutory and supervisory limitations on an institution's ability to engage in any lending, investment, and service activities. For example, a savings association that has made few or no qualified investments due to its limited investment authority may still receive a low satisfactory rating under the investment test if it has a strong lending record.

§ ____.21(b)(5) Institution's past performance and the performance of similarly situated lenders

§ ____.21(b)(5)—1: *Can an institution's assigned rating be adversely affected by poor past performance?*

A1. Yes. The agencies will consider an institution's past performance in its overall evaluation. For example, an institution that received a rating of "needs to improve" in the past may receive a rating of "substantial noncompliance" if its performance has not improved.

§ ____.21(b)(5)—2: *How will examiners consider the performance of similarly situated lenders?*

A2. The performance context section of the regulation permits the performance of similarly situated lenders to be considered, for example, as one of a number of considerations in evaluating the geographic distribution of an institution's loans to low-, moderate-, middle-, and upper-income geographies. This analysis, as well as other analyses, may be used, for example, where groups of contiguous geographies within an institution's assessment area(s) exhibit abnormally low penetration. In this regard, the performance of similarly situated lenders may be analyzed if such an analysis would provide accurate insight into the institution's lack of performance in those areas. The regulation does not require the use of a specific type of analysis under these circumstances. Moreover, no ratio developed from any type of analysis is linked to any lending test rating.

§ ____.22 Lending test.

§ ____.22(a) Scope of test.

§ ____.22(a)—1: *Are there any types of lending activities that help meet the credit needs of an institution's assessment area(s) and that may warrant favorable consideration as activities that are responsive to the needs of the institution's assessment area(s)?*

A1. Credit needs vary from community to community. However, there are some lending activities that are likely to be responsive in helping to meet the credit needs of many communities. These activities include:

- Providing loan programs that include a financial education component about how to avoid lending activities that may be abusive or otherwise unsuitable;
- Establishing loan programs that provide small, unsecured consumer loans in a safe and sound manner (i.e., based on the borrower's ability to repay) and with reasonable terms;
- Offering lending programs, which feature reporting to consumer reporting agencies, that transition borrowers from loans with higher interest rates and fees (based on credit risk) to lower-cost loans, consistent with safe and sound lending practices. Reporting to consumer reporting agencies allows borrowers accessing these programs the opportunity to improve their credit histories and thereby improve their access to competitive credit products[.] ►;
- Establishing loan programs that provide relief to low- and moderate-income homeowners who are facing foreclosure on their homes.◄

Examiners may consider favorably such lending activities, which have features augmenting the success and effectiveness of the ►small, intermediate small, or large◄ institution's lending programs.

§ ____.22(a)(1) Types of loans considered.

§ ____.22(a)(1)—1: *If a large retail institution is not required to collect and report home mortgage data under the HMDA, will the agencies still evaluate the institution's home mortgage lending performance?*

A1. Yes. The agencies will sample the institution's home mortgage loan files in order to assess its performance under the lending test criteria.

§ ____.22(a)(1)—2: *When will examiners consider consumer loans as part of an institution's CRA evaluation?*

A2. Consumer loans will be evaluated if the institution so elects ►and has collected and maintained the data◄; [and] an institution that elects not to have its consumer loans evaluated will not be viewed less favorably by examiners than one that does. However, if consumer loans constitute a substantial majority of the institution's business, the agencies will evaluate them even if the institution does not so elect. The agencies interpret "substantial majority" to be so significant a portion of the institution's lending activity by number [or] ►and◄ dollar volume of loans that the lending test evaluation would not meaningfully reflect its lending performance if consumer loans were excluded.

§ ____.22(a)(2) Loan originations and purchases/other loan data.

§ ____.22(a)(2)—1: *How are lending commitments (such as letters of credit) evaluated under the regulation?*

A1. The agencies consider lending commitments (such as letters of credit) only at the option of the institution ►, regardless of examination type◄. Commitments must be legally binding between an institution and a borrower in order to be considered. Information about lending commitments will be used by examiners to enhance their understanding of an institution's performance ►, but will be evaluated separately from the loans◄.

§ ____.22(a)(2)—2: *Will examiners review application data as part of the lending test?*

A2. Application activity is not a performance criterion of the lending test. However, examiners may consider this information in the performance context analysis because this information may give examiners insight on, for example, the demand for loans.

§ ____.22(a)(2)—3: *May a financial institution receive consideration under CRA for home mortgage loan modification, extension, and consolidation agreements (MECAs), in which it obtains home mortgage loans from other institutions without actually purchasing or refinancing the home mortgage loans, as those terms have been interpreted under CRA and HMDA, as implemented by 12 CFR [pt.] ►part◄ 203?*

A3. Yes. In some states, MECAs, which are not considered loan refinancings because the existing loan obligations are not satisfied and replaced, are common. Although these transactions are not considered to be purchases or refinancings, as those terms have been interpreted under CRA, they do achieve the same results. [An] ►A small, intermediate small, or large◄ institution may present information about its MECA activities with respect to home mortgages to examiners for consideration under the lending test as "other loan data."

►§ ____.22(a)(2)—4: *In addition to MECAs, what are other examples of "other loan data"?*

A4. Other loan data include, for example:

- Loans funded for sale to the secondary markets that an institution has not reported under HMDA;
- Unfunded loan commitments and letters of credit;
- Commercial and consumer leases;
- Loans secured by nonfarm residential real estate, not taken as an abundance of caution, that are used to finance small businesses or small farms and that are not reported as small business/small farm loans or reported under HMDA;
- Loans that do not have a primary purpose of community development, but where a certain amount or percentage of units is set aside for affordable housing; and
- An increase to a small business or small farm line of credit if the increase would cause the total line of credit to exceed $1 million, in the case of a small business line, or $500,000, in the case of a small farm line. ◄

§ ____.22(a)(2)—[4] ►5◄: *Do institutions receive consideration for originating or purchasing loans that are fully guaranteed?*

A4. Yes. [The test evaluates] ►For all examination types, examiners evaluate◄ an institution's record of helping to meet the credit needs of its assessment area(s) through the origination or purchase of specified types of loans. [The test does] ►Examiners do◄ not take into account whether or not such loans are guaranteed.

►§ ____.22(a)(2)—6: *Do institutions receive consideration for purchasing loan participations?*

A5. Yes. Examiners will consider the amount of loan participations purchased when evaluating an institution's record of helping to meet the credit needs of its assessment area(s) through the origination or purchase of specified types of loans, regardless of examination type. ◄

► § ____.22(a)(2)—7: *How are refinancings of small business loans, which are secured by a one-to-four family residence and that have been reported under HMDA as a refinancing, evaluated under CRA?*

A6. *For banks subject to the Call Report instructions:* A loan of $1 million or less with a business purpose that is secured by a one-to-four family residence is considered a small business loan for CRA purposes only if the security interest in the residential property was taken as an abundance of caution and where the terms have not been made more favorable than they would have been in the absence of the lien. (See Call Report Glossary definition of "Loan Secured by Real Estate.") If this same loan is refinanced and the new loan is also secured by a one-to-four family residence, but only through an abundance of caution, this loan is reported not only as a refinancing under HMDA, but also as a small business loan under CRA. (Note that small farm loans are similarly treated.)

It is not anticipated that "double-reported" loans will be so numerous as to affect the typical institution's CRA rating. In the event that an institution reports a significant number or amount of loans as both home mortgage and small business loans, examiners will consider that overlap in evaluating the institution's performance and generally will consider the "double-reported" loans as small business loans for CRA consideration.

The origination of a small business or small farm loan that is secured by a one-to-four family residence is not reportable under HMDA, unless the purpose of the loan is home purchase or home improvement. Nor is the loan reported as a small business or small farm loan if the security interest is not taken merely as an abundance of caution. Any such loan may be provided to examiners as "other loan data" ("Other Secured Lines/Loans for Purposes of Small Business") for consideration during a CRA evaluation. *See* Q&A § ____.12(v)—3. The

refinancings of such loans *would be* reported under HMDA.

For savings associations subject to the Thrift Financial Reporting instructions: A loan of $1 million or less with a business purpose secured by a one-to-four family residence is considered a small business loan for CRA purposes if it is reported as a small business loan for TFR purposes and was not reported on the TFR as a mortgage loan (TFR Instructions for Commercial Loans: Secured). If this same loan is refinanced and the new loan is also secured by a one-to-four family residence, and was not reported for TFR purposes as a mortgage loan, this loan is reported not only as a refinancing for HMDA, but is also reported as a small business loan under the TFR and CRA. The origination of a small business or small farm loan that is secured by a one-to-four family residence is not reportable under HMDA, unless the purpose of the loan is home purchase or home improvement. Nor is the loan reported as small business or small farm if it was reported as a mortgage on the TFR report.

OTS does not anticipate that "double-reported" loans will be so numerous as to affect the typical institution's CRA rating. In the event that an institution reports a significant number or amount of loans as both home mortgage and small business loans, examiners will consider that overlap in evaluating the institution's performance and generally will consider the "double-reported" loans as small business loans for CRA consideration.

The origination of a small business or small farm loan that is secured by a one-to-four family residence should be reported in accordance with Q&A §____.12(v)—3. The refinancings of such loans *would be* reported under HMDA.◄

§____.22(b) Performance criteria.

[§____.22(b)—1: *How will examiners apply the performance criteria in the lending test?*[3]

A1. Examiners will apply the performance criteria reasonably and fairly, in accord with the regulations, the examination procedures, and this Guidance. In doing so, examiners will disregard efforts by an institution to manipulate business operations or present information in an artificial light that does not accurately reflect an institution's overall record of lending performance.]

[3] Note that this Q&A would be slightly revised and moved to become Q&A §____.22(a)—1, not deleted.

§____.22(b)(1) Lending activity.

§____.22(b)(1)—1: *How will the agencies apply the lending activity criterion to discourage an institution from originating loans that are viewed favorably under CRA in the institution itself and referring other loans, which are not viewed as favorably, for origination by an affiliate?*

A1. Examiners will review closely institutions with (1) a small number and amount of home mortgage loans with an unusually good distribution among low- and moderate-income areas and low- and moderate-income borrowers and (2) a policy of referring most, but not all, of their home mortgage loans to affiliated institutions. If an institution is making loans mostly to low- and moderate-income individuals and areas and referring the rest of the loan applicants to an affiliate for the purpose of receiving a favorable CRA rating, examiners may conclude that the institution's lending activity is not satisfactory because it has inappropriately attempted to influence the rating. In evaluating an institution's lending, examiners will consider legitimate business reasons for the allocation of the lending activity.

§____.22(b)(2) & (3) Geographic distribution and borrower characteristics.

§____.22(b)(2) & (3)—1: *How do the geographic distribution of loans and the distribution of lending by borrower characteristics interact in the lending test ►applicable to either large or small institutions◄?*

A1. Examiners generally will consider both the distribution of an institution s loans among geographies of different income levels►,◄ and among borrowers of different income levels and businesses ►and farms◄ of different sizes. The importance of the borrower distribution criterion, particularly in relation to the geographic distribution criterion, will depend on the performance context. For example, distribution among borrowers with different income levels may be more important in areas without identifiable geographies of different income categories. On the other hand, geographic distribution may be more important in areas with the full range of geographies of different income categories.

§____.22(b)(2) & (3)—2: *Must an institution lend to all portions of its assessment area?*

A2. The term "assessment area" describes the geographic area within which the agencies assess how well an institution►, regardless of examination type,◄ has met the specific performance tests and standards in the rule. The agencies do not expect that simply because a census tract [or block numbering area] is within an institution's assessment area(s), the institution must lend to that census tract[or block numbering area]. Rather the agencies will be concerned with conspicuous gaps in loan distribution that are not explained by the performance context. Similarly, if an institution delineated the entire county in which it is located as its assessment area, but could have delineated its assessment area as only a portion of the county, it will not be penalized for lending only in that portion of the county, so long as that portion does not reflect illegal discrimination or arbitrarily exclude low- or moderate-income geographies. The capacity and constraints of an institution, its business decisions about how it can best help to meet the needs of its assessment area(s), including those of low- and moderate-income neighborhoods, and other aspects of the performance context, are all relevant to explain why the institution is serving or not serving portions of its assessment area(s).

§____.22(b)(2) & (3)—3: *Will examiners take into account loans made by affiliates when evaluating the proportion of an institution's lending in its assessment area(s)?*

A3. Examiners will not take into account loans made hy affiliates when determining the proportion of an institution's lending in its assessment area(s), even if the institution elects to have its affiliate lending considered in the remainder of the lending test evaluation. However, examiners may consider an institution's business strategy of conducting lending through an affiliate in order to determine whether a low proportion of lending in the assessment area(s) should adversely affect the institution's lending test rating.

§____.22(b)(2) & (3)—4: *When will examiners consider loans (other than community development loans) made outside an institution's assessment area(s)?*

A4. Consideration will be given for loans to low- and moderate-income persons and small business and farm loans outside of an institution's assessment area(s), provided the institution has adequately addressed the needs of borrowers within its assessment area(s). The agencies will apply this consideration not only to loans made by large retail institutions being evaluated under the lending test, but also to loans made by small►and intermediate small◄ institutions being

evaluated under [the small institution]►their respective◄ performance standards. Loans to low- and moderate-income persons and small businesses and farms outside of an institution s assessment area(s), however, will not compensate for poor lending performance within the institution s assessment area(s).

§ ____.22(b)(2) & (3)—5: *Under the lending test►applicable to small, intermediate small, or large institutions◄, how will examiners evaluate home mortgage loans to middle- or upper-income individuals in a low- or moderate-income geography?*

A5. Examiners will consider these home mortgage loans under the performance criteria of the lending test, i.e., by number and amount of home mortgage loans, whether they are inside or outside the financial institution's assessment area(s), their geographic distribution, and the income levels of the borrowers. Examiners will use information regarding the financial institution's performance context to determine how to evaluate the loans under these performance criteria. Depending on the performance context, examiners could view home mortgage loans to middle-income individuals in a low-income geography very differently. For example, if the loans are for homes or multifamily housing located in an area for which the local, state, tribal, or Federal government or a community-based development organization has developed a revitalization or stabilization plan (such as a Federal enterprise community or empowerment zone) that includes attracting mixed-income residents to establish a stabilized, economically diverse neighborhood, examiners may give more consideration to such loans, which may be viewed as serving the low- or moderate-income community's needs as well as serving those of the middle- or upper-income borrowers. If, on the other hand, no such plan exists and there is no other evidence of governmental support for a revitalization or stabilization project in the area and the loans to middle- or upper-income borrowers significantly disadvantage or primarily have the effect of displacing low- or moderate-income residents, examiners may view these loans simply as home mortgage loans to middle- or upper-income borrowers who happen to reside in a low- or moderate-income geography and weigh them accordingly in their evaluation of the institution.

§ ____.22(b)(4) Community development lending.

§ ____.22(b)(4)—1: *When evaluating an institution's record of community development lending► under the lending test applicable to large institutions◄, may an examiner distinguish among community development loans on the basis of the actual amount of the loan that advances the community development purpose?*

A1. Yes. When evaluating the institution s record of community development lending under ►12 CFR◄ [§]____.22(b)(4), it is appropriate to give greater weight to the amount of the loan that is targeted to the intended community development purpose. For example, consider two $10 million projects (with a total of 100 units each) that have as their express primary purpose affordable housing and are located in the same community. One of these projects sets aside 40 percent of its units for low-income residents and the other project allocates 65 percent of its units for low-income residents. An institution would report both loans as $10 million community development loans under the ►12 CFR◄ [§]____.42(b)(2) aggregate reporting obligation. However, transaction complexity, innovation and all other relevant considerations being equal, an examiner should also take into account that the 65 percent project provides more affordable housing for more people per dollar expended.

Under ►12 CFR◄ [§]____.22(b)(4), the extent of CRA consideration an institution receives for its community development loans should bear a direct relation to the benefits received by the community and the innovation or complexity of the loans required to accomplish the activity, not simply to the dollar amount expended on a particular transaction. By applying all lending test performance criteria, a community development loan of a lower dollar amount could meet the credit needs of the institution's community to a greater extent than a community development loan with a higher dollar amount, but with less innovation, complexity, or impact on the community.

§ ____.22(b)(5) Innovative or flexible lending practices.

§ .22(b)(5)—1: *What is the range of practices that examiners may consider in evaluating the innovativeness or flexibility of an institution s lending ►under the lending test applicable to large institutions◄?*

A1. In evaluating the innovativeness or flexibility of an institution's lending practices (and the complexity and innovativeness of its community development lending), examiners will not be limited to reviewing the overall variety and specific terms and conditions of the credit products themselves. In connection with the evaluation of an institution's lending, examiners also may give consideration to related innovations when they augment the success and effectiveness of the institution's lending under its community development loan programs or, more generally, its lending under its loan programs that address the credit needs of low- and moderate-income geographies or individuals. For example:

- In connection with a community development loan program, [a bank] ►an institution◄ may establish a technical assistance program under which the [bank] ►institution◄, directly or through third parties, provides affordable housing developers and other loan recipients with financial consulting services. Such a technical assistance program may, by itself, constitute a community development service eligible for consideration under the service test of the CRA regulations. In addition, the technical assistance may be favorably considered as an innovation that augments the success and effectiveness of the related community development loan program.
- In connection with a small business lending program in a low- or moderate-income area and consistent with safe and sound lending practices, [a bank] ►an institution◄ may implement a program under which, in addition to providing financing, the [bank] ►institution◄ also contracts with the small business borrowers. Such a contracting arrangement would not, standing alone, qualify for CRA consideration. However, it may be favorably considered as an innovation that augments the loan program's success and effectiveness, and improves the program's ability to serve community development purposes by helping to promote economic development through support of small business activities and revitalization or stabilization of low- or moderate-income geographies.

§ ____.22(c) Affiliate lending.

§ ____.22(c)(1) In general.

§ ____.22(c)(1)—1: *If an institution►, regardless of examination type,◄ elects to have loans by its affiliate(s) considered, may it elect to have only certain categories of loans considered?*

A1. Yes. An institution may elect to have only a particular category of its affiliate's lending considered. The basic categories of loans are home mortgage loans, small business loans, small farm loans, community development loans, and the five categories of consumer

loans (motor vehicle loans, credit card loans, home equity loans, other secured loans, and other unsecured loans).

§ ____.22(c)(2) Constraints on affiliate lending.

§ ____.22(c)(2)(i) No affiliate may claim a loan origination or loan purchase if another institutian claims the same loan origination or purchose.

§ ____.22(c)(2)(i)—1: *[How] ►Regardless of examination type, how◄ is this constraint on affiliate lending applied?*

A1. This constraint prohibits one affiliate from claiming a loan origination or purchase claimed by another affiliate. However, an institution can count as a purchase a loan originated by an affiliate that the institution subsequently purchases, or count as an origination a loan later sold to an affiliate, provided the same loans are not sold several times to inflate their value for CRA purposes. ►For example, assume that two institutions are affiliated. Bank A originates a loan and claims it as a loan origination. Bank B later purchases the loan. Bank B may count the loan as a purchased loan.

The same institution may not count both the origination and purchase. Thus, for example, if an institution claims loans made by an affiliated mortgage company as loan originations, the institution may not also count the loans as purchased loans if it later purchases the loans from its affiliate.◄

§ ____.22(c)(2)(ii) If an institution elects to have its supervisory agency consider loans within a particular lending category made by one or more of the institution s affiliates in a particular assessment area, the institution shall elect to have the agency consider all loans within that lending category in that particular assessment area made by all of the institution's affiliates.

§ ____.22(c)(2)(ii)—1: [How] *►Regardless af examinotion type, how◄ is this constraint on affiliate lending applied?*

A1. This constraint prohibits "cherry-picking" affiliate loans within any one category of loans. The constraint requires an institution that elects to have a particular category of affiliate lending in a particular assessment area considered to include all loans of that type made by all of its affiliates in that particular assessment area. For example, assume that an institution has [one or more]►several◄ affiliates, [such as]►including◄ a mortgage [bank]►company◄ that makes loans in the institution's assessment area. If the institution elects to include the mortgage [bank's]►company's◄ home mortgage loans, it must include all of [mortgage bank's] ►its affiliates'◄ home mortgage loans made in its assessment area. [The]►In addition, the◄ institution cannot elect to include only those low- and moderate-income home mortgage loans made by [the mortgage bank affiliate] ►its affiliates◄ and not home mortgage loans to middle- and upper-income individuals or areas.

§ ____.22(c)(2)(ii)–2: [How]►*Regardless of examinotion type, how◄ is this constraint applied if an institution's affiliates are also insured depository institutions subject to the CRA?*

A2. Strict application of this constraint against "cherry-picking" to loans of an affiliate that is also an insured depository institution covered by the CRA would produce the anomalous result that the other institution would, without its consent, not be able to count its own loans. Because the agencies did not intend to deprive an institution subject to the CRA of receiving consideration for its own lending, the agencies read this constraint slightly differently in cases involving a group of affiliated institutions, some of which are subject to the CRA and share the same assessment area(s). In those circumstances, an institution that elects to include all of its mortgage affiliate's home mortgage loans in its assessment area would not automatically be required to include all home mortgage loans in its assessment area of another affiliate institution subject to the CRA. However, all loans of a particular type made by any affiliate in the institution's assessment area(s) must either be counted by the lending institution or by another affiliate institution that is subject to the CRA. This reading reflects the fact that a holding company may, for business reasons, choose to transact different aspects of its business in different subsidiary institutions. However, the method by which loans are allocated among the institutions for CRA purposes must reflect actual business decisions about the allocation of banking activities among the institutions and should not be designed solely to enhance their CRA evaluations.

§ ____.22(d) Lending by a consortium or a third party.

§ ____.22(d)—1: *Will equity and equity-type investments in a third party receive consideration under the lending test?*

A1. If an institution has made an equity or equity-type investment in a third party, community development loans made by the third party may be considered under the lending test. On the other hand, asset-backed and debt securities that do not represent an equity-type interest in a third party will not be considered under the lending test unless the securities are booked by the purchasing institution as a loan. For example, if an institution purchases stock in a community development corporation ("CDC") that primarily lends in low- and moderate-income areas or to low- and moderate-income individuals in order to promote community development, the institution may claim a pro rata share of the CDC's loans as community development loans. The institution's pro rata share is based on its percentage of equity ownership in the CDC. ►Q&A◄ § ____.23(b)—1 provides information concerning consideration of an equity or equity-type investment under the investment test and both the lending and investment tests.► (Note that in connection with an intermediate small institution's CRA performance evaluation, community development loans, including pro rata shares of community development loans, are considered only in the community development test.)◄

§ ____.22(d)–2: [How] ►*Regardless of examination type, how◄ will examiners evaluate loans made by consortia or third parties [under the lending test]?*

A2. Loans originated or purchased by consortia in which an institution participates or by third parties in which an institution invests will[only] be considered►only◄ if they qualify as community development loans and will[only] be considered►only◄ under the community development criterion[of the lending test]. However, loans originated directly on the books of an institution or purchased by the institution are considered to have been made or purchased directly by the institution, even if the institution originated or purchased the loans as a result of its participation in a loan consortium. These loans would be considered under[all] the lending test►or community development◄ test criteria appropriate to them depending on the type of loan►and type of examination◄.

§ ____.22(d)—3: *In some circumstances, an institution may invest in a third party, such as a community development bank, that is also an insured depository institution and is thus subject to CRA requirements. If the investing institution requests its supervisory agency to consider its pro rata share of community development loans made by the third party, as allowed under 12 CFR .22(d), may*

the third party also receive consideration for these loans?

A3. Yes, ►regardless of examination type,◄as long as the financial institution and the third party are not affiliates. The regulations state, at 12 CFR____.22(c)(2)(i), that two affiliates may not both claim the same loan origination or loan purchase. However, if the financial institution and the third party are not affiliates, the third party may receive consideration for the community development loans it originates, and the financial institution that invested in the third party may also receive consideration for its pro rata share of the same community development loans under 12 CFR____.22(d).

§____.23 Investment test.

§____.23(a) Scope of test.

§____.23(a)—1: *May an institution►, regardless of examination type,◄ receive consideration under the CRA regulations if it invests indirectly through a fund, the purpose of which is community development, as that is defined in the CRA regulations?*

A1: Yes, the direct or indirect nature of the qualified investment does not affect whether an institution will receive consideration under the CRA regulations because the regulations do not distinguish between "direct" and "indirect" investments. Thus, an institution's investment in an equity fund that, in turn, invests in projects that, for example, provide affordable housing to low- and moderate-income individuals, would receive consideration as a qualified investment under the CRA regulations, provided the investment benefits one or more of the institution's assessment area(s) or a broader statewide or regional area(s) that includes one or more of the institution's assessment area(s). Similarly, an institution may receive consideration for a direct qualified investment in a nonprofit organization that, for example, supports affordable housing for low- and moderate-income individuals in the institution's assessment area(s) or a broader statewide or regional area(s) that includes the institution's assessment area(s).

►§____.23(a)—2: *In order to receive CRA consideration, should an institution be able to demonstrate that an investment in a national or regional fund with a primary purpose of community development meets the geographic requirements of the CRA regulation by benefiting one or more of the institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s)?*

A2. Yes. A financial institution should be able to demonstrate that the investment meets the geographic requirements of the CRA regulation, although the agencies will employ appropriate flexibility in this regard. There are several ways to demonstrate that the institution's investment meets the geographic requirements. For example, if an institution invests in a new nationwide fund providing foreclosure relief to low- and moderate-income homeowners, written documentation provided by fund managers in connection with the institution's investment indicating that the fund will use its best efforts to invest in a qualifying activity that meets the geographic requirements may be used for these purposes. Similarly, a fund may explicitly earmark all projects or investments to its investors and their specific assessment areas. (Note, however, that a financial institution has not demonstrated that the investment meets the geographic requirements of the CRA regulation if the fund "double-counts" investments, by earmarking the same dollars or the same portions of projects or investments in a particular geography to more than one investor.) In addition, if a fund does not earmark projects or investments to individual institution investors, an allocation method may be used that recognizes that each investor institution has an undivided interest in all projects in a fund; thus, each investor institution may claim its pro-rata share of each project that meets the geographic requirements of that institution. If, however, a fund does not become involved in a community development activity that meets both the purpose and geographic requirements of the regulation for the institution, the institution's investment generally would not be considered under the investment or community development tests. See Q&As §____.12(h)—6 and §____.12(h)—7 for additional information about the geographic requirements for qualified investments (recognition of investments benefiting an area outside an institution's assessment area(s)).◄

§____.23(b) Exclusion.

§____.23(b)—1: *Even though the regulations state that an activity that is considered under the lending or service tests cannot also be considered under the investment test, may parts of an activity be considered under one test and other parts be considered under another test?*

A1. Yes, in some instances the nature of an activity may make it eligible for consideration under more than one of the performance tests. For example, certain investments and related support provided by a large retail institution to a CDC may be evaluated under the lending, investment, and service tests. Under the service test, the institution may receive consideration for any community development services that it provides to the CDC, such as service by an executive of the institution on the CDC's board of directors. If the institution makes an investment in the CDC that the CDC uses to make community development loans, the institution may receive consideration under the lending test for its pro-rata share of community development loans made by the CDC. Alternatively, the institution's investment may be considered under the investment test, assuming it is a qualified investment. In addition, an institution may elect to have a part of its investment considered under the lending test and the remaining part considered under the investment test. If the investing institution opts to have a portion of its investment evaluated under the lending test by claiming [a]►its pro rata◄ share of the CDC's community development loans, the amount of investment considered under the investment test will be offset by that portion. Thus, the institution[only] would receive consideration under the investment test for►only◄ the amount of its investment multiplied by the percentage of the CDC's assets that meet the definition of a qualified investment.

§____.23(b)—2: *If home mortgage loans to low- and moderate-income borrowers have been considered under an institution's lending test, may the institution that originated or purchased them also receive consideration under the investment test if it subsequently purchases mortgage-backed securities that are primarily or exclusively backed by such loans?*

A2. No. Because the institution received lending test consideration for the loans that underlie the securities, the institution may not also receive consideration under the investment test for its purchase of the securities. Of course, an institution may receive investment test consideration for purchases of mortgage-backed securities that are backed by loans to low- and moderate-income individuals as long as the securities are not backed primarily or exclusively by loans that the same institution originated or purchased.

§____.23(e) Performance criteria

§____.23(e)–1: *When applying the ►four◄ performance criteria of [§] ►12 CFR◄____.23(e), may an*

examiner distinguish among qualified investments based on how much of the investment actually supports the underlying community development purpose?

A1. Yes. [Although § ____.23(e)(1) speaks in terms of the dollar amount of qualified investments, the criterion permits] ►By applying all the criteria, a qualified investment of a lower dollar amount may be weighed more heavily under the investment test than a qualified investment with a higher dollar amount that has fewer qualitative enhancements. The criteria permit◄ an examiner to ►qualitatively◄ weight certain investments differently or to make other appropriate distinctions when evaluating an institution's record of making qualified investments. For instance, an examiner should take into account that a targeted mortgage-backed security that qualifies as an affordable housing issue that has only 60 percent of its face value supported by loans to low-or moderate-income borrowers would not provide as much affordable housing for low- and moderate-income individuals as a targeted mortgage-backed security with 100 percent of its face value supported by affordable housing loans to low- and moderate-income borrowers. The examiner should describe any differential weighting (or other adjustment), and its basis in the [Public] ►Performance◄ Evaluation. ►See also Q&A § ____.12(t)–8 for a discussion about the qualitative consideration of prior period investments.◄ [However, no matter how a qualified investment is handled for purposes of § ____.23(e)(1), it will also be evaluated with respect to the qualitative performance criteria set forth in § ____.23(e)(2), (3), and (4). By applying all criteria, a qualified investment of a lower dollar amount may be weighed more heavily under the Investment Test than a qualified investment with a higher dollar amount, but with fewer qualitative enhancements.]

§ ____.23(e)—2: *How do examiners evaluate an institution's qualified investment in a fund, the primary purpose of which is community development, as [that is] defined in the CRA regulations?*

A2. When evaluating qualified investments that benefit an institution's assessment area(s) or a broader statewide or regional area that includes its assessment area(s) ►under the investment test◄, examiners will look at the following four performance criteria:

(1) The dollar amount of qualified investments;

(2) The innovativeness or complexity of qualified investments;

(3) The responsiveness of qualified investments to credit and community development needs; and

(4) The degree to which the qualified investments are not routinely provided by private investors.

With respect to the first criterion, examiners will determine the dollar amount of qualified investments by relying on the figures recorded by the institution according to generally accepted accounting principles (GAAP). Although institutions may exercise a range of investment strategies, including short-term investments, long-term investments, investments that are immediately funded, and investments with a binding, up-front commitment that are funded over a period of time, institutions making the same dollar amount of investments over the same number of years, all other performance criteria ►and performance context◄ being equal, would receive the same level of consideration. Examiners will include both new and outstanding investments in this determination. [The dollar amount] ►In addition, the review◄ of qualified investments[also] will [include] ►consider◄ the dollar amount of legally binding commitments recorded by the institution according to GAAP.

The extent to which qualified investments receive consideration, however, depends on how examiners evaluate the investments under the remaining three performance criteria—innovativeness and complexity, responsiveness, and degree to which the investment is not routinely provided by private investors. Examiners also will consider factors relevant to the institution's CRA performance context, such as the effect of outstanding long-term qualified investments, the pay-in schedule, and the amount of any cash call, on the capacity of the institution to make new investments.

§ ____.24 Service test.

§ ____.24(d) Performance criteria—retail banking services.

§ ____.24(d)—1: *How do examiners evaluate the availability and effectiveness of an institution's systems for delivering retail banking services?*

A1. Convenient access to full service branches within a community is an important factor in determining the availability of credit and non-credit services. Therefore, the service test performance standards place primary emphasis on full service branches while still considering alternative systems, such as automated teller machines ("ATMs"). The principal focus is on an institution's current distribution of branches[; therefore] ►and its record of opening and closing branches, particularly branches located in low-or moderate-income geographies or primarily serving low-or moderate-income individuals. However,◄ an institution is not required to expand its branch network or operate unprofitable branches. Under the service test, alternative systems for delivering retail banking services, such as ATMs, are considered only to the extent that they are effective alternatives in providing needed services to low- and moderate-income areas and individuals.

§ ____.24(d)—2: *How do examiners evaluate an institution's activities in connection with Individual Development Accounts (IDAs)?*

A2. Although there is no standard IDA program, IDAs typically are deposit accounts targeted to low- and moderate-income families that are designed to help them accumulate savings for education or job-training, down-payment and closing costs on a new home, or start-up capital for a small business. Once participants have successfully funded an IDA, their personal IDA savings are matched by a public or private entity. Financial institution participation in IDA programs comes in a variety of forms, including providing retail banking services to IDA account holders, providing matching dollars or operating funds to an IDA program, designing or implementing IDA programs, providing consumer financial education to IDA account holders or prospective account holders, or other means. The extent of financial institutions' involvement in IDAs and the products and services they offer in connection with the accounts will vary. Thus, subject to 12 CFR ____.23(b), examiners evaluate the actual services and products provided by an institution in connection with IDA programs as one or more of the following: community development services, retail banking services, qualified investments, home mortgage loans, small business loans, consumer loans, or community development loans. ►*See, e.g.*, Q&A § ____.12(i) 3.

Note that all types of institutions may participate in IDA programs. Their IDA activities are evaluated under the performance criteria of the type of examination applicable to the particular institution.◄

§ ____.24(d)(3) Availability and effectiveness of alternative systems for delivering retail banking services.

§ ____.24(d)(3)—1: *How will examiners evaluate alternative systems for delivering retail banking services?*

A1. The regulation recognizes the multitude of ways in which an institution can provide services, for example, ATMs, banking by telephone or computer, and bank-by-mail programs. Delivery systems other than branches will be considered under the regulation to the extent that they are effective alternatives to branches in providing needed services to low- and moderate-income areas and individuals. The list of systems in the regulation is not intended to be [inclusive] ►comprehensive◄.

§ ____.24(d)(3)—2: *Are debit cards considered under the service test as an alternative delivery system?*

A2. By themselves, no. However, if debit cards are a part of a larger combination of products, such as a comprehensive electronic banking service, that allows an institution to deliver needed services to low- and moderate-income areas and individuals in its community, the overall delivery system that includes the debit card feature would be considered an alternative delivery system.

§ ____.24(e) Performance criteria—community development services.

§ ____.24(e)—1: *Under what conditions may an institution receive consideration for community development services offered by affiliates or third parties?*

A1. At an institution's option, the agencies will consider services performed by an affiliate or by a third party on the institution's behalf under the service test if the services provided enable the institution to help meet the credit needs of its community. Indirect services that enhance an institution's ability to deliver credit products or deposit services within its community and that can be quantified may be considered under the service test, if those services have not been considered already under the lending or investment test (*see* ►Q&A◄ § ____.23(b)—1). For example, an institution that contracts with a community organization to provide home ownership counseling to low- and moderate-income home buyers as part of the institution's mortgage program may receive consideration for that indirect service under the service test. In contrast, donations to a community organization that offers financial services to low- or moderate-income individuals may be considered under the investment test, but would not also be eligible for consideration under the service test. Services performed by an affiliate will be treated the same as affiliate loans and investments made in the institution's assessment area and may be considered if the service is not claimed by any other institution. *See* ►12 CFR◄ [§§] ____.22(c) and ____.23(c).

§ ____.25 Community development test for wholesale or limited purpose institutions.

§ ____.25(a) Scope of test.

§ ____.25(a)—1: *How can certain credit card banks help to meet the credit needs of their communities without losing their exemption from the definition of "bank" in the Bank Holding Company Act (the BHCA), as amended by the Competitive Equality Banking Act of 1987 (CEBA)?*

A1. Although the BHCA restricts institutions known as CEBA credit card banks to credit card operations, a CEBA credit card bank can engage in community development activities without losing its exemption under the BHCA. A CEBA credit card bank could provide community development services and investments without engaging in operations other than credit card operations. For example, the bank could provide credit card counseling, or the financial expertise of its executives, free of charge, to community development organizations. In addition, a CEBA credit card bank could make qualified investments, as long as the investments meet the guidelines for passive and noncontrolling investments provided in the BHC Act and the Board's Regulation Y. Finally, although a CEBA credit card bank cannot make any loans other than credit card loans, under [§] ►12 CFR◄ ____.25(d)(2) (community development test-indirect activities), the bank could elect to have part of its qualified passive and noncontrolling investments in a third-party lending consortium considered as community development lending, provided that the consortium's loans otherwise meet the requirements for community development lending. When assessing a CEBA credit card bank's CRA performance under the community development test, examiners will take into account the bank's performance context. In particular, examiners will consider the legal constraints imposed by the BHCA on the bank's activities, as part of the bank's performance context in [§] ►12 CFR◄ ____.21(b)(4).

§ ____.25(d) Indirect activities.

§ ____.25(d)—1: *How are investments in third party community development organizations considered under the community development test?*

A1. Similar to the lending test for retail institutions, investments in third party community development organizations may be considered as qualified investments or as community development loans or both (provided there is no double counting), at the institution's option, as described above in the discussion regarding §§ ____.22(d) and ____.23(b).

§ ____.25(e) Benefit to assessment area(s).

§ ____.25(e)—1: *How do examiners evaluate a wholesale or limited purpose institution's qualified investment in a fund that invests in projects nationwide and which has a primary purpose of community development, as that is defined in the regulations?*

A1. If examiners find that a wholesale or limited purpose institution has adequately addressed the needs of its assessment area(s), they will give consideration to qualified investments, as well as community development loans and community development services, by that institution nationwide. In determining whether an institution has adequately addressed the needs of its assessment area(s), examiners will consider qualified investments that benefit a broader statewide or regional area that includes the institution's assessment area(s).

§ ____.25(f) Community development performance rating.

§ ____.25(f)—1: *Must a wholesale or limited purpose institution engage in all three categories of community development activities (lending, investment, and service) to perform well under the community development test?*

A1. No, a wholesale or limited purpose institution may perform well under the community development test by engaging in one or more of these activities.

§ ____.26 Small institution performance standards.

§ ____.26—1: *When evaluating a small or intermediate small [bank's] ►institution's◄ performance, will examiners consider, at the institution's request, retail and community development loans originated or purchased by affiliates, qualified investments made by affiliates, or community development services provided by affiliates?*[4]

A1: Yes. However, a small institution that elects to have examiners consider affiliate activities must maintain sufficient information that the examiners may evaluate these activities under the appropriate performance

[4] The inserts and deletions are shown as compared to the current Q&A for the OCC, Board, and FDIC. The comparable Q&A for OTS does not currently refer to the intermediate small institution test. *See* 71 FR at 52379.

criteria and ensure that the activities are not claimed by another institution. The constraints applicable to affiliate activities claimed by large institutions also apply to small and intermediate small institutions. *See* [Q&A] ►Q&As addressing◄ §____.22(c)(2) and related guidance provided to large institutions regarding affiliate activities. Examiners will not include affiliate lending in calculating the percentage of loans and, as appropriate, other lending-related activities located in [a bank's] ►an institution's◄ assessment area.

►*§____.26(a) Performance criteria.*

§____.26(a)(2) Intermediate small institutions.◄

►§____.26(a)(2)—1: *When is an institution examined as an intermediate small institution?*

A1. When a small institution has met the intermediate small institution asset threshold delineated in §____.12(u)(1) for two consecutive calendar year-ends, the institution may be examined under the intermediate small institution examination procedures. The regulation does not specify an additional lag period between becoming an intermediate small institution and being examined as an intermediate small institution, as it does for large institutions, because an intermediate small institution is not subject to CRA data collection and reporting requirements. Institutions should contact their primary regulator for information on examination schedules.◄

§____.26[(a) Performance criteria] ►*(b) Lending test.*◄

§____.26([a]►b◄)—1: *May examiners consider, under one or more of the performance criteria of the small institution performance standards, lending-related activities, such as community development loans and lending-related qualified investments, when evaluating a small institution?*

A1. Yes. Examiners can consider "lending-related activities," including community development loans and lending-related qualified investments, when evaluating the first four performance criteria of the small institution performance test. Although lending-related activities are specifically mentioned in the regulation in connection with only the first three criteria (i.e., loan-to-deposit ratio, percentage of loans in the institution's assessment area, and lending to borrowers of different incomes and businesses of different sizes), examiners can also consider these activities when they evaluate the fourth criteria—geographic distribution of the institution's loans.

►Although lending-related community development activities are evaluated under the community development test applicable to intermediate small institutions, these activities may also augment the loan-to-deposit ratio analysis (12 CFR ____.26(b)(1)) and the percentage of loans in the intermediate small institution's assessment area analysis (12 CFR ____.26(b)(2)), if appropriate.◄

§____.26([a]—►b◄)—2: *What is meant by "as appropriate" when referring to the fact that lending-related activities will be considered, "as appropriate," under the various small institution performance criteria?*

A2. "As appropriate" means that lending-related activities will be considered when it is necessary to determine whether an institution meets or exceeds the standards for a satisfactory rating. Examiners will also consider other lending-related activities at an institution's request ►, provided they have not also been considered under the community development test applicable to intermediate small institutions◄.

§____.26([a]►b◄)—3: *When evaluating a small institution's lending performance, will examiners consider, at the institution's request, community development loans originated or purchased by a consortium in which the institution participates or by a third party in which the institution has invested?*

A3. Yes. However, a small institution that elects to have examiners consider community development loans originated or purchased by a consortium or third party must maintain sufficient information on its share of the community development loans so that the examiners may evaluate these loans under the small institution performance criteria.

§____.26([a]►b◄)—4: *Under the small institution* ►*lending test*◄ *performance standards, will examiners consider both loan originations and purchases?*

A4. Yes, consistent with the other assessment methods in the regulation, examiners will consider both loans originated and purchased by the institution. Likewise, examiners may consider any other loan data the small institution chooses to provide, including data on loans outstanding, commitments, and letters of credit.

§____.26([a]►b◄)—5: *Under the small institution* ►*lending test*◄ *performance standards, how will qualified investments be considered for purposes of determining whether a small institution receives a satisfactory CRA rating?*

A5. The small institution lending test performance standards focus on lending and other lending-related activities. Therefore, examiners will consider only lending-related qualified investments for the [purposes] ►purpose◄ of determining whether [the] ►a◄ small institution ► that is not an intermediate small institution◄ receives a satisfactory CRA rating.

§____.26([a] ►b◄)(1) Loan-to-deposit ratio.

§____.26([a]►b◄)(1)—1: *How is the loan-to-deposit ratio calculated?*

A1. A small institution's loan-to-deposit ratio is calculated in the same manner that the Uniform Bank Performance Report/Uniform Thrift Performance Report (UBPR/UTPR) determines the ratio. It is calculated by dividing the institution's net loans and leases by its total deposits. The ratio is found in the Liquidity and Investment Portfolio section of the UBPR and UTPR. Examiners will use this ratio to calculate an average since the last examination by adding the quarterly loan-to-deposit ratios and dividing the total by the number of quarters.

§____.26([a]►b◄)(1)—2: *How is the "reasonableness" of a loan-to-deposit ratio evaluated?*

A2. No specific ratio is reasonable in every circumstance, and each small institution's ratio is evaluated in light of information from the performance context, including the institution's capacity to lend, demographic and economic factors present in the assessment area, and the lending opportunities available in the assessment area(s). If a small institution's loan-to-deposit ratio appears unreasonable after considering this information, lending performance may still be satisfactory under this criterion taking into consideration the number and the dollar volume of loans sold to the secondary market or the number and amount and innovativeness or complexity of community development loans and lending-related qualified investments.

§____.26([a]►b◄)(1)—3: *If an institution makes a large number of loans off-shore, will examiners segregate the domestic loan-to-deposit ratio from the foreign loan-to-deposit ratio?*

A3. No. Examiners will look at the institution's net loan-to-deposit ratio for the whole institution, without any adjustments.

§ ____.26([a]►b◄](2) Percentage of lending within assessment area(s).

§ ____.26([a]►b◄](2)—1: *Must a small institution have a majority of its lending in its assessment area(s) to receive a satisfactory performance rating?*

A1. No. The percentage of loans and, as appropriate, other lending-related activities located in the [bank's] ►institution's◄ assessment area(s) is but one of the performance criteria upon which small institutions are evaluated. If the percentage of loans and other lending related activities in an institution's assessment area(s) is less than a majority, then the institution does not meet the standards for satisfactory performance only under this criterion. The effect on the overall performance rating of the institution, however, is considered in light of the performance context, including information regarding economic conditions[,]►;◄ loan demand[,]►;◄ the institution's size, financial condition [and] ►,◄ business strategies, and branching network ►;◄ and other aspects of the institution's lending record.

§ ____.26([a] ►b◄](3) & (4) Distribution of lending within assessment area(s) by borrower income and geographic location.

§ ____.26([a] ►b◄](3) & (4)—1: *How will a small institution's performance be assessed under these lending distribution criteria?*

A1. Distribution of loans, like other small institution performance criteria, is considered in light of the performance context. For example, a small institution is not required to lend evenly throughout its assessment area(s) or in any particular geography. However, in order to meet the standards for satisfactory performance under this criterion, conspicuous gaps in a small institution's loan distribution must be adequately explained by performance context factors such as lending opportunities in the institution's assessment area(s), the institution's product offerings and business strategy, and institutional capacity and constraints. In addition, it may be impracticable to review the geographic distribution of the lending of an institution with ►very◄ few demographically distinct geographies within an assessment area. If sufficient information on the income levels of individual borrowers or the revenues or sizes of business borrowers is not available, examiners may use[proxies such as] loan size ►as a proxy◄ for estimating borrower characteristics, where appropriate.

►§ ____.26(c) Intermediate small institution community development test.◄

§ ____.26(c)—1: *How will the community development test be applied flexibly for intermediate small [banks] ►institutions◄?*[5]

A1: Generally, intermediate small [banks] ►institutions◄ engage in a combination of community development loans, qualified investments, and community development services. [A bank] ►An institution◄ may not simply ignore one or more of these categories of community development, nor do the regulations prescribe a required threshold for community development loans, qualified investments, and community development services. Instead, based on the [bank's] ►institution's◄ assessment of community development needs in its assessment area(s), it may engage in different categories of community development activities that are responsive to those needs and consistent with the [bank's] ►institution's◄ capacity.

An intermediate small [bank] ►institution◄ has the flexibility to allocate its resources among community development loans, qualified investments, and community development services in amounts that it reasonably determines are most responsive to community development needs and opportunities. Appropriate levels of each of these activities would depend on the capacity and business strategy of the [bank] ►institution◄, community needs, and number and types of opportunities for community development.

►§ ____.26(c)(3) Community development services.◄

§ ____.26(c)(3)—1: *What will examiners consider when evaluating the provision of community development services by an intermediate small [bank]►institution◄?*[6]

A1: Examiners will consider not only the types of services provided to benefit low- and moderate-income individuals, such as low-cost [bank] checking accounts and low-cost remittance services, but also the provision and availability of services to low- and moderate-income individuals, including through branches and other facilities located in low- and moderate-income areas. Generally, the presence of branches located in low- and moderate-income geographies will help to demonstrate the availability of banking services to low- and moderate-income individuals.

►§ ____.26(c)(4) Responsiveness to community development needs◄

§ ____.26(c)(4)–1: *When evaluating an intermediate small [bank's]►institution's◄community development record, what will examiners consider when reviewing the responsiveness of community development lending, qualified investments, and community development services to the community development needs of the area?*[7]

A1: When evaluating an intermediate small [bank's]►institution's◄ community development record, examiners will consider not only quantitative measures of performance, such as the number and amount of community development loans, qualified investments, and community development services, but also qualitative aspects of performance. In particular, examiners will evaluate the responsiveness of the [bank's]►institution's◄ community development activities in light of the [bank's]►institution's◄ capacity, business strategy, the needs of the community, and the number and types of opportunities for each type of community development activity (its performance context). Examiners also will consider the results of any assessment by the institution of community development needs, and how the [bank's]►institution's◄ activities respond to those needs.

An evaluation of the degree of responsiveness considers the following factors: the volume, mix, and qualitative aspects of community development loans, qualified investments, and community development services. Consideration of the qualitative aspects of performance recognizes that community development activities sometimes require special expertise or effort on the part of the institution or provide a benefit to the community that would not otherwise be made available. (However, "innovativeness" and "complexity," factors examiners consider when evaluating a large

[5] The inserts and deletions are shown as compared to the current Q&A for the OCC, Board, and FDIC. There currently is no comparable Q&A for OTS.

[6] The inserts and deletions are shown as compared to the current Q&A for the OCC, Board, and FDIC. There currently is no comparable Q&A for OTS.

[7] The inserts and deletions are shown as compared to the current Q&A for the OCC, Board, and FDIC. There currently is no comparable Q&A for OTS.

[bank]►institution◄ under the lending, investment, and service tests, are not criteria in the intermediate small [banks']►institutions'◄ community development test.) In some cases, a smaller loan may have more qualitative benefit to a community than a larger loan. Activities are considered particularly responsive to community development needs if they benefit low- and moderate-income individuals in low- or moderate-income geographies, designated disaster areas, or distressed or underserved nonmetropolitan middle-income geographies. Activities are also considered particularly responsive to community development needs if they benefit low- or moderate-income geographies.

§____.26([b]►d◄) Performance rating.

§____.26([b]►d◄)—1: *How can a small institution►that is not an intermediate small institution◄achieve an outstanding performance rating?*

A1. A small institution►that is not an intermediate small institution◄that meets each of the standards in the lending test for a "satisfactory" rating and exceeds some or all of those standards may warrant an "outstanding" performance rating. In assessing performance at the "outstanding" level, the agencies consider the extent to which the institution exceeds each of the performance standards and, at the institution's option, its performance in making qualified investments and providing services that enhance credit availability in its assessment area(s). In some cases, a small institution may qualify for an "outstanding" performance rating solely on the basis of its lending activities, but only if its performance materially exceeds the standards for a "satisfactory" rating, particularly with respect to the penetration of borrowers at all income levels and the dispersion of loans throughout the geographies in its assessment area(s) that display income variation. An institution with a high loan-to-deposit ratio and a high percentage of loans in its assessment area(s), but with only a reasonable penetration of borrowers at all income levels or a reasonable dispersion of loans throughout geographies of differing income levels in its assessment area(s), generally will not be rated "outstanding" based only on its lending performance. However, the institution's performance in making qualified investments and its performance in providing branches and other services and delivery systems that enhance credit availability in its assessment area(s) may augment the institution's satisfactory rating to the extent that it may be rated outstanding.

§____.26([b]►d◄)—2: *Will a small institution's qualified investments, community development loans, and community development services be considered if they do not directly benefit its assessment area(s)?*

A2. Yes. These activities are eligible for consideration if they benefit a broader statewide or regional area that includes a small institution s assessment area(s), as discussed more fully in►Q&As◄ §[§]____.12([i]►h◄)[& 563e.12(h)]—6►and §____.12(h)—7◄.

§____.27 Strategic plan.

§____.27(c) Plans in general.

§____.27(c)—1: *To what extent will the agencies provide guidance to an institution during the development of its strategic plan?*

A1. An institution will have an opportunity to consult with and provide information to the agencies on a proposed strategic plan. Through this process, an institution is provided guidance on procedures and on the information necessary to ensure a complete submission. For example, the agencies will provide guidance on whether the level of detail as set out in the proposed plan would be sufficient to permit agency evaluation of the plan. However, the agencies' guidance during plan development and, particularly, prior to the public comment period, will not include commenting on the merits of a proposed strategic plan or on the adequacy of measurable goals.

§____.27(c)–2: *How will a joint strategic plan be reviewed if the affiliates have different primary Federal supervisors?*

A2. The agencies will coordinate review of and action on the joint plan. Each agency will evaluate the measurable goals for those affiliates for which it is the primary regulator.

§____.27(f) Plan content.

§____.27(f)(1) Measurable goals.

§____.27(f)(1)—1: *How should ►annual◄[''] measurable goals[''] be specified in a strategic plan?*

A1. [Measurable]►Annual measurable◄goals (e.g., number of loans, dollar amount, geographic location of activity, and benefit to low- and moderate-income areas or individuals) must be stated with sufficient specificity to permit the public and the agencies to quantify what performance will be expected. However, institutions are provided flexibility in specifying goals. For example, an institution may provide ranges of lending amounts in different categories of loans. Measurable goals may also be linked to funding requirements of certain public programs or indexed to other external factors as long as these mechanisms provide a quantifiable standard.

§____.27(g) Plan approval.

§____.27(g)(2) Public participation.

§____.27(g)(2)—1: *How will the public receive notice of a proposed strategic plan?*

A1. An institution submitting a strategic plan for approval by the agencies is required to solicit public comment on the plan for a period of thirty (30) days after publishing notice of the plan at least once in a newspaper of general circulation. The notice should be sufficiently prominent to attract public attention and should make clear that public comment is desired. An institution may, in addition, provide notice to the public in any other manner it chooses.

§____.28 Assigned ratings.

§____.28—1: *Are innovative lending practices, innovative or complex qualified investments, and innovative community development services required for a "satisfactory" or "outstanding" CRA rating?*

A1. No. ►The performance criterion of innovativeness applies only under the lending, investment, and service tests applicable to large institutions and the community development test applicable to wholesale and limited purpose institutions.◄ Moreover, ►even under these tests,◄ the lack of innovative lending practices, innovative or complex qualified investments, or innovative community development services alone will not result in a "needs to improve" CRA rating. However, ►under these tests,◄ the use of innoovative lending practices, innovative or complex qualified investments, and innovative community development services may augment the consideration given to an institution's performance under the quantitative criteria of the regulations, resulting in a higher level of performance rating. ►See also Q&A §____.26(c)(4)—1 for a discussion about responsiveness to community development needs under the community development test applicable to intermediate small institutions.◄

[§____.28—2: *How is performance under the quantitative and qualitative*

performance criteria weighed when examiners assign a CRA rating?[8]

A2. The lending, investment, and service tests each contain a number of performance criteria designed to measure whether an institution is effectively helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, in a safe and sound manner. Some of these performance criteria are quantitative, such as number and amount, and others, such as the use of innovative or flexible lending practices, the innovativeness or complexity of qualified investments, and the innovativeness and responsiveness of community development services, are qualitative. The performance criteria that deal with these qualitative aspects of performance recognize that these loans, qualified investments, and community development services sometimes require special expertise and effort on the part of the institution and provide a benefit to the community that would not otherwise be possible. As such, the agencies consider the qualitative aspects of an institution's activities when measuring the benefits received by a community. An institution's performance under these qualitative criteria may augment the consideration given to an institution's performance under the quantitative criteria of the regulations, resulting in a higher level of performance and rating.]

§ ____.28(a) Ratings in general.

§ ____.28(a)—1: *How are institutions with domestic branches in more than one state assigned a rating?*

A1. The evaluation of an institution that maintains domestic branches in more than one state ("multistate institution") will include a written evaluation and rating of its CRA record of performance as a whole and in each state in which it has a domestic branch. The written evaluation will contain a separate presentation on a multistate institution's performance for each metropolitan statistical area and the nonmetropolitan area within each state, if it maintains one or more domestic branch offices in these areas. This separate presentation will contain conclusions, supported by facts and data, on performance under the performance tests and standards in the regulation. The evaluation of a multistate institution that maintains a domestic branch in two or more states in a multistate metropolitan area will include a written evaluation (containing the same information described above) and rating of its CRA record of performance in the multistate metropolitan area. In such cases, the statewide evaluation and rating will be adjusted to reflect performance in the portion of the state not within the multistate metropolitan statistical area.

§ ____.28(a)—2: *How are institutions that operate within only a single state assigned a rating?*

A2. An institution that operates within only a single state ("single-state institution") will be assigned a rating of its CRA record based on its performance within that state. In assigning this rating, the agencies will separately present a single-state institution's performance for each metropolitan area in which the institution maintains one or more domestic branch offices. This separate presentation will contain conclusions, supported by facts and data, on the single-state institution's performance under the performance tests and standards in the regulation.

§ ____.28(a)—3: *How do the agencies weight performance under the lending, investment, and service [test] ►tests◄ for large retail institutions?*

A3. A rating of "outstanding," "high satisfactory," "low satisfactory," "needs to improve," or "substantial noncompliance," based on a judgment supported by facts and data, will be assigned under each performance test. Points will then be assigned to each rating as described in the first matrix set forth below. A large retail institution's overall rating under the lending, investment and service tests will then be calculated in accordance with the second matrix set forth below, which incorporates the rating principles in the regulation.

POINTS ASSIGNED FOR PERFORMANCE UNDER LENDING, INVESTMENT AND SERVICE TESTS

	Lending	Service	Investment
Outstanding	12	6	6
High Satisfactory	9	4	4
Low Satisfactory	6	3	3
Needs to Improve	3	1	1
Substantial Noncompliance	0	0	0

COMPOSITE RATING POINT REQUIREMENTS

[Add points from three tests]

Rating	Total Points
Outstanding	20 or over.
Satisfactory	11 through 19.
Needs to Improve	5 through 10.
Substantial Noncompliance	0 through 4.

Note: There is one exception to the Composite Rating matrix. An institution may not receive a rating of "satisfactory" unless it receives at least "low satisfactory" on the lending test. Therefore, the total points are capped at three times the lending test score.

►§ ____.28(b) Lending, investment, and service test ratings◄

►§ ____.28(b)—1: *How is performance under the quantitative and qualitative performance criteria weighed when examiners assign a CRA rating?*

A2. The lending, investment, and service tests each contain a number of performance criteria designed to measure whether an institution is effectively helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, in a safe and sound manner. Some of these performance criteria are quantitative, such as number and amount, and others, such as the use of innovative or flexible lending practices, the innovativeness or complexity of qualified investments, and the innovativeness and responsiveness of community development services, are qualitative. The performance criteria that deal with these qualitative aspects of performance recognize that these loans, qualified investments, and community development services sometimes require special expertise and effort on the part of the institution and provide a benefit to the community that would not otherwise be possible. As such, the agencies consider the qualitative aspects of an institution's activities when

[8] Note that this Q&A would be moved to become Q&A § ___.28(b)—1, not deleted.

measuring the benefits received by a community. An institution's performance under these qualitative criteria may augment the consideration given to an institution's performance under the quantitative criteria of the regulations, resulting in a higher level of performance and rating.◄

§ ____.28(c) Effect of evidence of discriminatory or other illegal credit practices

§ ____.28(c)—1: *What is meant by "discriminatory or other illegal credit practices"?*

A1. An institution engages in discriminatory credit practices if it discourages or discriminates against credit applicants or borrowers on a prohibited basis, in violation, for example, of the Fair Housing Act or the Equal Credit Opportunity Act (as implemented by Regulation B). Examples of other illegal credit practices inconsistent with helping to meet community credit needs include violations of:

- The Truth in Lending Act regarding rescission of certain mortgage transactions and regarding disclosures and certain loan term restrictions in connection with credit transactions that are subject to the Home Ownership and Equity Protection Act;
- The Real Estate Settlement Procedures Act regarding the giving and accepting of referral fees, unearned fees or kickbacks in connection with certain mortgage transactions; and
- The Federal Trade Commission Act regarding unfair or deceptive acts or practices. Examiners will determine the effect of evidence of illegal credit practices as set forth in examination procedures and § ____.28(c) of the regulation.

Violations of other provisions of the consumer protection laws generally will not adversely affect an institution's CRA rating, but may warrant the inclusion of comments in an institution's performance evaluation. These comments may address the institution's policies, procedures, training programs, and internal assessment efforts.

§ ____.29 Effect of CRA performance on applications.

§ ____.29(a) CRA performance.

§ ____.29(a)—1: *What weight is given to an institution's CRA performance examination in reviewing an application?*

A1. In [cases]►reviewing applications◄ in which CRA performance is a relevant factor, information from a CRA[performance] examination of the institution is a particularly important consideration[in the application process because it represents]►. The examination is◄ a detailed evaluation of the institution's CRA performance by its Federal supervisory agency. In this light, an examination is an important, and often controlling, factor in the consideration of an institution's record. In some cases, however, the examination may not be recent►,◄ or a specific issue raised in the application process, such as progress in addressing weaknesses noted by examiners, progress in implementing commitments previously made to the reviewing agency, or a supported allegation from a commenter, is relevant to CRA performance under the regulation and was not addressed in the examination. In these circumstances, the applicant should present sufficient information to supplement its record of performance and to respond to the substantive issues raised in the application proceeding.

§ ____.29(a)—2: *What consideration is given to an institution's commitments for future action in reviewing an application by those agencies that consider such commitments?*

A2. Commitments for future action are not viewed as part of the CRA record of performance. In general, institutions cannot use commitments made in the applications process to overcome a seriously deficient record of CRA performance. However, commitments for improvements in an institution's performance may be appropriate to address specific weaknesses in an otherwise satisfactory record or to address CRA performance when a financially troubled institution is being acquired.

§ ____.29[b] Interested parties.

§ ____.29(b)—1: *What consideration is given to comments from interested parties in reviewing an application?*

A1. Materials relating to CRA performance received during the [applications]►application◄ process can provide valuable information. Written comments, which may express either support for or opposition to the application, are made a part of the record in accordance with the agencies' procedures, and are carefully considered in making the agencies' [decision]►decisions◄. Comments should be supported by facts about the applicant's performance and should be as specific as possible in explaining the basis for supporting or opposing the application. These comments must be submitted within the time limits provided under the agencies' procedures.

§ ____.29(b)—2: *Is an institution required to enter into agreements with private parties?*

A2. No. Although communications between an institution and members of its community may provide a valuable method for the institution to assess how best to address the credit needs of the community, the CRA does not require an institution to enter into agreements with private parties. [These agreements are not monitored or enforced by the agencies.]►The agencies do not monitor compliance with nor enforce these agreements.◄

§ ____.41 Assessment area delineation.

§ ____.41(a) In general.

§ ____.41(a)—1: *How do the agencies evaluate "assessment areas" under the [revised] CRA regulations[compared to how they evaluated "local communities" that institutions delineated under the original CRA regulations]?*

A1. The[revised] rule focuses on the distribution and level of an institution's lending, investments, and services rather than on how and why an institution delineated its["local community" or] assessment area(s) in a particular manner. Therefore, the agencies will not evaluate an institution's delineation of its assessment area(s) as a separate performance criterion[as they did under the original regulation]. Rather, the agencies will only review whether the assessment area delineated by the institution complies with the limitations set forth in the regulations at § ____.41(e).

§ ____.41(a)—2: *If an institution elects to have the agencies consider affiliate lending, will this decision affect the institution's assessment area(s)?*

A2. If an institution elects to have the lending activities of its affiliates considered in the evaluation of the institution's lending, the geographies in which the affiliate lends do not affect the institution's delineation of assessment area(s).

§ ____.41(a)—3: *Can a financial institution identify a specific► racial or◄ ethnic group rather than a geographic area as its assessment area?*

A3. No, assessment areas must be based on geography. ►The only exception to the requirement to delineate an assessment area based on geography is that an institution, the business of which predominantly consists of serving the needs of military personnel or their dependents who are not located within a defined geographic area, may delineate its entire deposit customer base as its assessment area.◄

§ ____.41(c) Geographic area(s) for institutions other than wholesale or limited purpose institutions.

§ ____.41(c)(1) Generally consist of one or more MSAs or metropolitan divisions or one or more contiguous political subdivisions.

§ ____.41(c)(1)—1: *Besides cities, towns, and counties, what other units of local government are political subdivisions for CRA purposes?*

A1. Townships and Indian reservations are political subdivisions for CRA purposes. Institutions should be aware that the boundaries of townships and Indian reservations may not be consistent with the boundaries of the census tracts [or block numbering areas] ("geographies") in the area. In these cases, institutions must ensure that their assessment area(s) consists only of whole geographies by adding any portions of the geographies that lie outside the political subdivision to the delineated assessment area(s).

§ ____.41(c)(1)—2: *Are wards, school districts, voting districts, and water districts political subdivisions for CRA purposes?*

A2. No. However, an institution that determines that it predominantly serves an area that is smaller than a city, town►,◄ or other political subdivision may delineate as its assessment area the larger political subdivision and then, in accordance with ►12 CFR◄ [§] ____.41(d), adjust the boundaries of the assessment area to include only the portion of the political subdivision that it reasonably can be expected to serve. The smaller area that the institution delineates must consist of entire geographies, may not reflect illegal discrimination, and may not arbitrarily exclude low- or moderate-income geographies.

§ ____.41(d) Adjustments to geographic area(s).

§ ____.41(d)—1: *When may an institution adjust the boundaries of an assessment area to include only a portion of a political subdivision?*

A1. Institutions must include whole geographies (i.e., census tracts[or block numbering areas]) in their assessment areas and generally should include entire political subdivisions. Because census tracts [and block numbering areas] are the common geographic areas used consistently nationwide for data collection, the agencies require that assessment areas be made up of whole geographies. If including an entire political subdivision would create an area that is larger than the area the institution can reasonably be expected to serve, an institution may, but is not required to, adjust the boundaries of its assessment area to include only portions of the political subdivision. For example, this adjustment is appropriate if the assessment area would otherwise be extremely large, of unusual configuration, or divided by significant geographic barriers (such as a river, mountain, or major highway system). When adjusting the boundaries of their assessment areas, institutions must not arbitrarily exclude low- or moderate-income geographies or set boundaries that reflect illegal discrimination.

§ ____.41(e) Limitations on delineation of an assessment area.

§ ____.41(e)(3) May not arbitrarily exclude low- or moderate-income geographies.

§ ____.41(e)(3)—1: *How will examiners determine whether an institution has arbitrarily excluded low- or moderate-income geographies?*

A1. Examiners will make this determination on a case-by-case basis after considering the facts relevant to the institution's assessment area delineation. Information that examiners will consider may include:

- Income levels in the institution's assessment area(s) and surrounding geographies;
- Locations of branches and deposit-taking ATMs;
- Loan distribution in the institution's assessment area(s) and surrounding geographies;
- The institution's size;
- The institution's financial condition; and
- The business strategy, corporate structure and product offerings of the institution.

§ ____.41(e)(4) May not extend substantially beyond [a CMSA]►an MSA◄ boundary or beyond a state boundary unless located in a multistate MSA.

§ ____.41(e)(4)—1: *What are the maximum limits on the size of an assessment area?*

A1. An institution [shall]►may◄ not delineate an assessment area extending substantially across the boundaries of [a consolidated metropolitan statistical area (CMSA) or the boundaries of an MSA, if the MSA is not located in a CMSA.]►an MSA unless the MSA is in a combined statistical area (CSA)). Although more than one MSA in a CSA may be delineated as a single assessment area, an institution's CRA performance in individual MSAs in those assessment areas will be evaluated using separate median family incomes and other relevant information at the MSA level rather than at the CSA level.◄

[Similarly, an]►An◄ assessment area► also◄ may not extend substantially across state boundaries unless the assessment area is located in a multistate MSA. An institution may not delineate a whole state as its assessment area unless the entire state is contained within [a CMSA]►an MSA◄. These limitations apply to wholesale and limited purpose institutions as well as other institutions.

An institution [shall]►must◄ delineate separate assessment areas for the areas inside and outside [a CMSA (or MSA if the MSA is not located in a CMSA)]►an MSA◄ if the area served by the institution's branches outside the [CMSA (or MSA)]►MSA◄ extends substantially beyond the [CMSA (or MSA)]►MSA◄ boundary. Similarly, the institution [shall]►must◄ delineate separate assessment areas for the areas inside and outside of a state if the institution's branches extend substantially beyond the boundary of one state (unless the assessment area is located in a multistate MSA). In addition, the institution should also delineate separate assessment areas if it has branches in areas within the same state that are widely separate and not at all contiguous. For example, an institution that has its main office in New York City and a branch in Buffalo, New York, and each office serves only the immediate areas around it, should delineate two separate assessment areas.

§ ____.41(e)(4)—2: *[Can]►May◄ an institution delineate one assessment area that consists of an MSA and two large counties that abut the MSA but are not adjacent to each other?*

A2. As a general rule, an institution's assessment area should not extend substantially beyond the boundary of an MSA [if the MSA is not located in a CMSA]. Therefore, the MSA would be a separate assessment area, and because the two abutting counties are not adjacent to each other and, in this example, extend substantially beyond the boundary of the MSA, the institution would delineate each county as a separate assessment area[(, so]►, assuming branches or deposit-taking ATMs are located in each county and the MSA. So◄, in this example, there would be three assessment areas[)]. [However, if the MSA and the two counties were in the same CMSA, then the institution could delineate only one assessment area including them all.]►However, if the MSA and the two counties were in the same CSA, then the institution could delineate only one assessment area including them all. But, the institution's CRA performance in the

MSAs and the non-MSA counties in that assessment area would be evaluated using separate median family incomes and other relevant information at the MSA and state, non-MSA level, rather than at the CSA level.◄

§ ____.42 Data collection, reporting, and disclosure.

§ ____.42—1: *When must an institution collect and report data under the CRA regulations?*

A1. All institutions except small institutions are subject to data collection and reporting requirements. ►("Small institution" is defined in the agencies' CRA regulations at § ____.12(u).) Examples describing the data collection requirements of institutions, in particular those that have just surpassed the asset-size threshold of a small institution, may be found on the FFIEC Web site at *http://www.ffiec.gov/cra.*◄[A small institution is an institution that, as of December 31 of *either* of the prior two calendar years, had total assets of less than $1 billion (as adjusted).

For example (assuming no adjustment to the $1 billion small bank asset level):

Date	Institution's asset size (in dollars)	Data collection required for following calendar year?
12/31/05	990 million	No.
12/31/06	1.1 billion	No.
12/31/07	980 million	No.
12/31/08	1.1 billion	No.
12/31/09	1.2 billion	Yes, beginning 1/01/10.]

All institutions that are subject to the data collection and reporting requirements must report the data for a calendar year by March 1 of the subsequent year. [In the example, above, the institution would report the data collected for calendar year 2010 by March 1, 2011.]

The Board of Governors of the Federal Reserve System [is handling the processing of] ► processes ◄ the reports for all of the primary regulators. [The reports should be submitted in a prescribed electronic format on a timely basis. The mailing address for submitting these reports is: *Attention:* CRA Processing, Board of Governors of the Federal Reserve System, 1709 New York Avenue, NW., 5th Floor, Washington, DC 20006].

► Data may be submitted on diskette, CD–ROM, or via Internet e-mail. CRA respondents are encouraged to send their data via the Internet. E-mail a properly encrypted CRA file (using the FFIEC software only Internet e-mail export feature) to the following e-mail address: *crasub@frb.gov.* Please mail diskette or CD–ROM submissions to: Board of Governors of the Federal Reserve System, Attention: CRA Processing, 20th & Constitution Avenue, NW., MS N502, Washington, DC 20551–0001. ◄

§ __.42—2: *Should an institution develop its own program for data collection, or will the regulators require a certain format?*

A2. An institution may use the free software that is provided by the FFIEC to reporting institutions for data collection and reporting or develop its own program. Those institutions that develop their own programs [must follow the precise format for the new CRA data collection and reporting rules. This format may be obtained by contacting the CRA Assistance Line at (202) 872–7584.] ► may create a data submission using the File Specifications and Edit Validation Rules that have been set forth to assist with electronic data submissions. For information about specific electronic formatting procedures, contact the CRA Assistance Line at (202) 872–7584 or click on "How to File" at *http://www.ffiec.gov/cra.* ◄

§ __.42—3: *How should an institution report data on lines of credit?*

A3. Institutions must collect and report data on lines of credit in the same way that they provide data on loan originations. Lines of credit are considered originated at the time the line is approved or increased; and an increase is considered a new origination. Generally, the full amount of the credit line is the amount that is considered originated. In the case of an increase to an existing line, the amount of the increase is the amount that is considered originated and that amount should be reported. However, consistent with the Call Report and TFR instructions, institutions would not report an increase to a small business or small farm line of credit if the increase would cause the total line of credit to exceed $1 million, in the case of a small business line, or $500,000, in the case of a small farm line. Of course, institutions may provide information about such line increases to examiners as other loan data.

§ __.42—4: *Should renewals of lines of credit be collected and/or reported?*

A4. Renewals of lines of credit for small business, small farm[or] ► , ◄ consumer ►, or community development ◄ purposes should be collected and reported, if applicable, in the same manner as renewals of small business or small farm loans. *See* ► Q&A ◄ § ____.42(a)—5. Institutions that are HMDA reporters continue to collect and report home equity lines of credit at their option in accordance with the requirements of 12 CFR part 203.

§ __.42—5: *When should merging institutions collect data?*

A5. Three scenarios of data collection responsibilities for the calendar year of a merger and subsequent data reporting responsibilities are described below.

- Two institutions are exempt from CRA collection and reporting requirements because of asset size. The institutions merge. No data collection is required for the year in which the merger takes place, regardless of the resulting asset size. Data collection would begin after two consecutive years in which the combined institution had year-end assets [of at least $250 million or was part of a holding company that had year-end banking and thrift assets of at least $1 billion] ► at least equal to the small institution asset-size threshold amount described in 12 CFR ____.12(u)(1).◄
- Institution A, an institution required to collect and report the data, and Institution B, an exempt institution, merge. Institution A is the surviving institution. For the year of the merger, data collection is required for Institution A's transactions. Data collection is optional for the transactions of the previously exempt institution. For the following year, all transactions of the surviving institution must be collected and reported.
- Two institutions that each are required to collect and report the data merge. Data collection is required for the entire year of the merger and for subsequent years so long as the surviving institution is not exempt. The

surviving institution may file either a consolidated submission or separate submissions for the year of the merger but must file a consolidated report for subsequent years.

§ __.42—6: *Can small institutions get a copy of the data collection software even though they are not required to collect or report data?*

A6. Yes. Any institution that is interested in receiving a copy of the software [may send a written request to: *Attn.:* CRA Processing, Board of Governors of the Federal Reserve System, 1709 New York Ave, NW., 5th Floor, Washington, DC 20006. They] ► may download it from the FFIEC Web site at *http://www.ffiec.gov/cra*. For assistance, institutions ◄ may [also] call the CRA Assistance Line at (202) 872–7584 or send [Internet] ► an ◄ e-mail to *CRAHELP@FRB.GOV*.

§ __.42—7: *If a small institution is designated a wholesale or limited purpose institution, must it collect data that it would not otherwise be required to collect because it is a small institution?*

A7. No. However, small institutions ► that are designated as wholesale or limited purpose institutions ◄ must be prepared to identify those loans, investments, and services to be evaluated under the community development test.

§ __.42(a) Loan information required to be collected and maintained.

§ __.42(a)—1: *Must institutions collect and report data on all commercial loans [under]* ► *of* ◄ *$1 million* ► *or less* ◄ *at origination?*

A1. No. Institutions that are not exempt from data collection and reporting are required to collect and report only those commercial loans that they capture in the Call Report, Schedule RC–C, Part II, and in the TFR, Schedule SB. Small business loans are defined as those whose original amounts are $1 million or less *and* that were reported as either "Loans secured by nonfarm or nonresidential real estate" or "Commercial and Industrial loans" in Part I of the Call Report or TFR.

§ __.42(a)— 2: *For loans defined as small business loans, what information should be collected and maintained?*

A2. Institutions that are not exempt from data collection and reporting are required to collect and maintain ► , ◄ in a standardized, machine ► — ◄ readable format, information on each small business loan originated or purchased for each calendar year:

- A unique number or alpha-numeric symbol that can be used to identify the relevant loan file;
- The loan amount at origination;
- The loan location; and
- An indicator whether the loan was to a business with gross annual revenues of $1 million or less.

The location of the loan must be maintained by census tract [or block numbering area]. In addition, supplemental information contained in the file specifications includes a date associated with the origination or purchase and whether a loan was originated or purchased by an affiliate. The same requirements apply to small farm loans.

§ ____.42(a)—3: *Will farm loans need to be segregated from business loans?*

A3. Yes.

§ ____.42(a)—4: *Should institutions collect and report data on all agricultural loans [under]* ►*of*◄ *$500,000*► *or less*◄ *at origination?*

A4. Institutions are to report those farm loans that they capture in the Call Report, Schedule RC–C, Part II and Schedule SB of the TFR. Small farm loans are defined as those whose original amounts are $500,000 or less *and* were reported as either "Loans to finance agricultural production and other loans to farmers" or "Loans secured by farmland" in Part I of the Call Report [and] ►or◄ TFR.

§ ____.42(a)–5: *Should institutions collect and report data about small business and small farm loans that are refinanced or renewed?*

A5. An institution should collect information about small business and small farm loans that it refinances or renews as loan originations. (A *refinancing* generally occurs when the existing loan obligation or note is satisfied and a new note is written, while a *renewal* refers to an extension of the term of a loan. However, for purposes of small business and small farm CRA data collection and reporting, it is [no longer] ►not◄ necessary to distinguish between the two.) When reporting small business and small farm data, however, an institution may only report one origination (including a renewal or refinancing treated as an origination) per loan per year, unless an increase in the loan amount is granted.► However, a demand loan that is merely reviewed annually is not reported as a renewal because the term of the loan has not been extended.◄

If an institution increases the amount of a small business or small farm loan when it extends the term of the loan, it should always report the amount of the increase as a small business or small farm loan origination. The institution should report only the amount of the increase if the original or remaining amount of the loan has already been reported one time that year. For example, a financial institution makes a term loan for $25,000; principal payments have resulted in a present outstanding balance of $15,000. In the next year, the customer requests an additional $5,000, which is approved, and a new note is written for $20,000. In this example, the institution should report both the $5,000 increase and the renewal or refinancing of the $15,000 as originations for that year. These two originations may be reported together as a single origination of $20,000.

§ ____.42(a)—6: *Does a loan to the "fishing industry" come under the definition of a small farm loan?*

A6. Yes. Instructions for Part I of the Call Report and Schedule SB of the TFR include loans "made for the purpose of financing fisheries and forestries, including loans to commercial fishermen" as a component of the definition for "Loans to finance agricultural production and other loans to farmers." Part II of Schedule RC–C of the Call Report and Schedule SB of the TFR, which serve as the basis of the definition for small business and small farm loans in the [revised] regulation, capture both "Loans to finance agricultural production and other loans to farmers" and "Loans secured by farmland."

§ ____.42(a)—7: *How should on institution report a home equity line of credit, part of which is for home improvement purposes[, but the predominant]*► *and*◄ *part of which is for small business purposes?*

A7. [The]► When an institution originates a home equity line of credit that is for both home improvement and small business purposes, the◄ institution has the option of reporting the portion of the home equity line that is for home improvement purposes► as a home improvement loan◄ under HMDA. [That]► Examiners would consider that◄ portion of the [loan]► line◄ [would be considered]when [examiners]► they◄ evaluate► the institution's◄ home mortgage lending. ► When an institution refinances a home equity line of credit into another home equity line of credit, HMDA reporting continues to be optional. If the institution opts to report the refinanced line, the entire amount of the line would be reported as a refinancing and examiners will consider the entire refinanced line when they evaluate the institution's home mortgage lending.◄

[If]► If an institution that has originated a home equity line of credit for both home improvement and small business purposes (or if an institution that has refinanced such a line into another line) chooses not to report a

home improvement loan (or a refinancing) under HMDA, and if◀ the line meets the regulatory definition of a "community development loan," the institution should collect and report information on the entire line as a community development loan. If the line does not qualify as a community development loan, the institution has the option of collecting and maintaining (but not reporting) the entire line of credit as "Other Secured Lines/Loans for Purposes of Small Business."

§ ____.42(a)—8: *When collecting small business and small farm data for CRA purposes, may an institution collect and report information about loans to small businesses and small farms located outside the United States?*

A8. At an institution's option, it may collect data about small business and small farm loans located outside the United States; however, it cannot report this data because the CRA data collection software will not accept data concerning loan locations outside the United States.

§ ____.42(a)—9: *Is an institution that has no small farm or small business loans required to report under CRA?*

A9. Each institution subject to data reporting requirements must, at a minimum, submit a transmittal sheet, definition of its assessment area(s), and a record of its community development loans. If the institution does not have community development loans to report, the record should be sent with "0" in the community development loan composite data fields. An institution that has not purchased or originated any small business or small farm loans during the reporting period would not submit the composite loan records for small business or small farm loans.

§ ____.42(a)—10: *How should an institution collect and report the location of a loan made to a small business or farm if the borrower provides an address that consists of a post office box number or a rural route and box number?*

A10. Prudent banking practices▶ and Bank Secrecy Act regulations◀ dictate that [an institution]▶institutions◀ know the location of [its]▶their◀ customers and loan collateral.▶ Further, Bank Secrecy Act regulations specifically state that a post office box is not an acceptable address.◀ Therefore, institutions typically will know the actual location of their borrowers or loan collateral beyond an address consisting only of a post office box.

Many borrowers have street addresses in addition to[post office box numbers or] rural route and box numbers. Institutions should ask their borrowers to provide the street address of the main business facility or farm or the location where the loan proceeds otherwise will be applied. Moreover, in many cases in which the borrower s address consists only of a rural route number[or post office box], the institution knows the location (i.e., the census tract[or block numbering area]) of the borrower or loan collateral. Once the institution has this information available, it should assign [a]▶the◀ census tract[or block numbering area] to that location (geocode) and report that information as required under the regulation.

[For loans originated or purchased in 1998 or later]▶However◀, if [the]▶an◀ institution cannot determine [the]▶a rural◀ borrower's street address, and does not know the census tract[or block numbering area], the institution should report the borrower's state, county, MSA▶ or metropolitan division◀, if applicable, and "NA," for "not available," in lieu of a census tract[or block numbering area] code.

§ ____.42(a)(2) Loan amount at origination.

§ ____.42(a)(2)—1: *When an institution purchases a small business or small farm loan,▶ in whole or in part,◀ which amount should the institution collect and report—the original amount of the loan or the amount at purchase?*

A1. When collecting and reporting information on purchased small business and small farm loans, including loan participations, an institution collects and reports the amount of the loan at origination, not at the time of purchase. This is consistent with the Call Report s and TFR's use of the "original amount of the loan" to determine whether a loan should be reported as a "loan to a small business" or a "loan to a small farm" and in which loan size category a loan should be reported. When assessing the volume of small business and small farm loan purchases for purposes of evaluating lending test performance under CRA, however, examiners will evaluate an institution s activity based on the amounts at purchase.

§ ____.42(a)(2)—2: *How should an institution collect data about multiple loan originations to the same business?*

A2. If an institution makes multiple originations to the same business, the loans should be collected and reported as separate originations rather than combined and reported as they are on the Call Report or TFR, which reflect loans outstanding, rather than originations. However, if institutions make multiple originations to the same business solely to inflate artificially the number or volume of loans evaluated for CRA lending performance, the agencies may combine these loans for purposes of evaluation under the CRA.

§ ____.42(a)(2)—3: *How should an institution collect data pertaining to credit cards issued to small businesses?*

A3. If an institution agrees to issue credit cards to a [business']▶business's◀ employees, all of the credit card lines opened on a particular date for that single business should be reported as one small business loan origination rather than reporting each individual credit card line, assuming the criteria in the "small business loan" definition in the regulation are met. The credit card program's "amount at origination" is the sum of all of the employee/business credit cards' credit limits opened on a particular date. If subsequently issued credit cards increase the small business credit line, the added amount is reported as a new origination.

§ ____.42(a)(3) The loan location.

§ ____.42(a)(3)—1: *Which location should an institution record if a small business loan's proceeds are used in a variety of locations?*

A1. The institution should record the loan location by either the location of the▶ small◀ business▶ borrower's◀ headquarters or the location where the greatest portion of the proceeds are applied, as indicated by the borrower.

§ ____.42(a)(4) Indicator of gross annual revenue.

§ ____.42(a)(4)—1: *When indicating whether a small business borrower had gross annual revenues of $1 million or less, upon what revenues should an institution rely?*

A1. Generally, an institution should rely on the revenues that it considered in making its credit decision. For example, in the case of affiliated businesses, such as a parent corporation and its subsidiary, if the institution considered the revenues of the entity's parent or a subsidiary corporation of the parent as well, then the institution would aggregate the revenues of both corporations to determine whether the revenues are $1 million or less. Alternatively, if the institution considered the revenues of only the entity to which the loan is actually extended, the institution should rely solely upon whether gross annual revenues are above or below $1 million for that entity. However, if the institution considered and relied on revenues or income of a cosigner or guarantor that is not an affiliate of the

borrower, such as a sole proprietor, the institution should not adjust the borrower s revenues for reporting purposes.

§ ____.42(a)(4)—2: *If an institution that is not exempt from data collection and reporting does not request or consider revenue information to make the credit decision regarding a small business or small farm loan, must the institution collect revenue information in connection with that loan?*

A2. No. In those instances, the institution should enter the code indicating "revenues not known" on the individual loan portion of the data collection software or on an internally developed system. Loans for which the institution did not collect revenue information may not be included in the loans to businesses and farms with gross annual revenues of $1 million or less when reporting this data.

§ ____.42(a)(4)—3: *What gross revenue should an institution use in determining the gross annual revenue of a start-up business?*

A3. The institution should use the actual gross annual revenue to date (including $0 if the new business has had no revenue to date). Although a start-up business will provide the institution with pro forma projected revenue figures, these figures may not accurately reflect actual gross revenue► and, therefore, should not be used◄.

§ ____.42(a)(4)—4: *When [collecting and reporting]► indicating◄ the gross annual revenue of small business or small farm borrowers, do institutions [collect and report]► rely on◄ the gross annual revenue or the adjusted gross annual revenue of [its]► their◄ borrowers?*

A4. Institutions [collect and report]► rely on◄ the gross annual revenue, rather than the adjusted gross annual revenue, of their small business or► small◄ farm borrowers► when indicating the revenue of small business or small farm borrowers◄. The purpose of this data collection is to enable examiners and the public to judge whether the institution is lending to small businesses and ►small◄ farms or whether it is only making small loans to larger businesses and farms.

The regulation does not require institutions to request or consider revenue information when making a loan; however, if institutions do gather this information from their borrowers, the agencies expect them to collect and [report] ►rely upon◄ the borrowers' gross annual revenue for purposes of CRA. The CRA regulations similarly do not require institutions to verify revenue amounts; thus, institutions may rely on the gross annual revenue amount provided by borrowers in the ordinary course of business. If an institution does not collect gross annual revenue information for its small business and small farm borrowers, the institution [would not indicate on the CRA data collection software that the gross annual revenues of the borrower are $1 million or less]► should enter the code "revenues not known"◄. [*See* ►Q&A◄ § ____.42(a)(4)—2.]

§ ____.42(b) Loan information required to be reported.

§ ____.42(b)(1) Small business and small farm loan data.

§ ____.42(b)(1)—1: *For small business and small farm loan information that is collected and maintained, what data should be reported?*

A1. Each institution that is not exempt from data collection and reporting is required to report in machine-readable form annually by March 1 the following information, aggregated for each census tract[or block numbering area] in which the institution originated or purchased at least one small business or small farm loan during the prior year:

- The number and amount of loans originated or purchased with original amounts of $100,000 or less;
- The number and amount of loans originated or purchased with original amounts of more than $100,000 but less than or equal to $250,000;
- The number and amount of loans originated or purchased with original amounts of more than $250,000 but not more than $1 million, as to small business loans, or $500,000, as to small farm loans; and
- To the extent that information is available, the number and amount of loans to businesses and farms with gross annual revenues of $1 million or less (using the revenues the institution considered in making its credit decision).

§ ____.42(b)(2) Community development loan data.

§ ____.42(b)(2)—1: *What information about community development loans must institutions report?*

A1. Institutions subject to data reporting requirements must report the aggregate number and amount of community development loans originated and purchased during the prior calendar year.

§ ____.42(b)(2)—2: *If a loan meets the definition of a home mortgage, small business, or small farm loan AND qualifies as a community development loan, where should it be reported? Can FHA, VA and SBA loans be reported as community development loans?*

A2. Except for multifamily affordable housing loans, which may be reported by retail institutions both under HMDA as home mortgage loans and as community development loans, in order to avoid double counting, retail institutions must report loans that meet the [definitions] ►definition◄ of [home mortgage,] ►"home mortgage loan,"◄ [small business,] ►"small business loan,"◄ or ►"◄small farm [loans] ►loan"◄ only in those respective categories even if they also meet the definition of ►"◄community development [loans.] ►loan."◄ As a practical matter, this is not a disadvantage for [retail] institutions ►evaluated under the lending, investment, and service tests◄ because any affordable housing mortgage, small business, small farm, or consumer loan that would otherwise meet the definition of [a] ►"◄community development loan►"◄ will be considered elsewhere in the lending test. Any of these types of loans that occur outside the institution's assessment area can receive consideration under the borrower characteristic criteria of the lending test. *See* ►Q&A◄ § ____.22(b)(2) & (3)—4.

Limited purpose and wholesale institutions ►that meet the size threshold for reporting purposes◄ also must report loans that meet the definitions of home mortgage, small business, or small farm loans in those respective categories[; however, they]►. However, these institutions◄ must also report any loans from those categories that meet the regulatory definition of "community development [loans] ►loan◄" as community development loans. There is no double counting because wholesale and limited purpose institutions are not subject to the lending test and, therefore, are not evaluated on their level and distribution of home mortgage, small business, small farm ►,◄ and consumer loans.

§ ____.42(b)(2)—3: *When the primary purpose of a loan is to finance an affordable housing project for low- or moderate-income individuals, but, for example, only 40 percent of the units in question will actually be occupied by individuals or families with low or moderate incomes, should the entire loan amount be reported as a community development loan?*

A3. Yes. As long as the primary purpose of the loan is a community development purpose, the full amount of the institution's loan should be included in its reporting of aggregate amounts of community development lending. However, as noted in ►Q&A◄ § ____.22(b)(4)—1, examiners may make qualitative distinctions among

community development loans on the basis of the extent to which the loan advances the community development purpose.

►§ ____.42(b)(2)—4: *When an institution purchases a participation in a community development loan, which amount should the institution report—the entire amount of the credit originated by the lead lender or the amount of the participation purchased?*

A4. The institution reports only the amount of the participation purchased as a community development loan. However, the institution uses the entire amount of the credit originated by the lead lender to determine whether the original credit meets the definition of a "loan to a small business," "loan to a small farm," or "community development loan." For example, if an institution purchases a $400,000 participation in a business credit that has a community development purpose, and the entire amount of the credit originated by the lead lender is over $1 million, the institution would report $400,000 as a community development loan.◄

►§ ____.42(b)(2)—5: *Should institutions collect and report data about community development loans that are refinanced or renewed?*

A5. Yes. Institutions should collect information about community development loans that they refinance or renew as loan originations. Community development loan refinancings and renewals are subject to the reporting limitations that apply to refinancings and renewals of small business and small farm loans. *See* Q&A § ____.42(a)—5.◄

§ ____.42(b)(3) Home mortgage loans.

§ ____.42(b)(3)—1: *Must institutions that are not required to collect home mortgage loan data by the HMDA collect home mortgage loan data for purposes of the CRA?*

A1. No. If an institution is not required to collect home mortgage loan data by the HMDA, the institution need not collect home mortgage loan data under the CRA. Examiners will sample these loans to evaluate the institution's home mortgage lending. If an institution wants to ensure that examiners consider all of its home mortgage loans, the institution may collect and maintain data on these loans.

§ ____.42(c) Optional data collection and maintenance.

§ ____.42(c)(1) Consumer loans.

§ ____.42(c)(1)—1: *What are the data requirements regarding consumer loans?*

A1. There are no data reporting requirements for consumer loans. Institutions may, however, opt to collect and maintain data on consumer loans. If an institution chooses to collect information on consumer loans, it may collect data for one or more of the following categories of consumer loans: motor vehicle, credit card, home equity, other secured, and other unsecured. If an institution collects data for loans in a certain category, it must collect data for all loans originated or purchased within that category. The institution must maintain these data separately for each category for which it chooses to collect data. The data collected and maintained should include for each loan:

- A unique number or alpha-numeric symbol that can be used to identify the relevant loan file;
- The loan amount at origination or purchase;
- The loan location; and
- The gross annual income of the borrower that the institution considered in making its credit decision.

Generally, guidance given with respect to data collection of small business and small farm loans, including, for example, guidance regarding collecting loan location data, and whether to collect data in connection with refinanced or renewed loans, will also apply to consumer loans.

§ ____.42(c)(1)(iv) Income of borrower.

§ ____.42(c)(1)(iv)—1: *If an institution does not consider income when making an underwriting decision in connection with a consumer loan, must it collect income information?*

A1. No. Further, if the institution routinely collects, but does not verify, a borrower's income when making a credit decision, it need not verify the income for purposes of data maintenance.

§ ____.42(c)(1)(iv)—2: *May an institution list "0" in the income field on consumer loans made to employees when collecting data for CRA purposes as the institution would be permitted to do under HMDA?*

A2. Yes.

§ ____.42(c)(1)(iv)—3: *When collecting the gross annual income of consumer borrowers, do institutions collect the gross annual income or the adjusted gross annual income of the borrowers?*

A3. Institutions collect the gross annual income, rather than the adjusted gross annual income, of consumer borrowers. The purpose of income data collection in connection with consumer loans is to enable examiners to determine the distribution, particularly in the institution's assessment area(s), of the institution's consumer loans, based on borrower characteristics, including the number and amount of consumer loans to low-, moderate-, middle-, and upper-income borrowers, as determined on the basis of gross annual income.

The regulation does not require institutions to request or consider income information when making a loan; however, if institutions do gather this information from their borrowers, the agencies expect them to collect the borrowers gross annual income for purposes of CRA. The CRA regulations similarly do not require institutions to verify income amounts; thus, institutions may rely on the gross annual income amount provided by borrowers in the ordinary course of business.

[§]§ ____.42(c)(1)(iv)–4: *Whose income does an institution collect when a consumer loan is made to more than one borrower?*

A4. An institution that chooses to collect and maintain information on consumer loans collects the gross annual income of all primary obligors for consumer loans, to the extent that the institution considered the income of the obligors when making the decision to extend credit. Primary obligors include co-applicants and co-borrowers, including co-signers. An institution does not, however, collect the income of guarantors on consumer loans, because guarantors are only secondarily liable for the debt.

§ ____.42(c)(2) Other loan data.

§ ____.42(c)(2)–1: *Schedule RC–C, Part II of the Call Report does not allow banks to report loans for commercial and industrial purposes that are secured by residential real estate, unless the security interest in the nonfarm residential real estate is taken only as an abundance of caution.* (See ►*Q&A*◄ *[§]§ ____.12([u] ►v◄) [& 563e.12(t)]–3.) Loans extended to small businesses with gross annual revenues of $1 million or less may, however, be secured by residential real estate. May a bank collect this information to supplement its small business lending data at the time of examination?*

A1. Yes. If these loans promote community development, as defined in the regulation, the bank should collect and report information about the loans as community development loans. Otherwise, *at the bank's option*, it may collect and maintain data concerning loans, purchases, and lines of credit extended to small businesses and secured by nonfarm residential real estate for consideration in the CRA

evaluation of its small business lending. A bank may collect this information as "Other Secured Lines/Loans for Purposes of Small Business" in the individual loan data. This information should be maintained at the bank but should *not* be submitted for central reporting purposes.

§____.42(c)(2)–2: *Must an institution collect data on loan commitments and letters of credit?*

A2. No. Institutions are not required to collect data on loan commitments and letters of credit. Institutions may, however, provide for examiner consideration information on letters of credit and commitments.

§____.42(c)(2)–3: *Are commercial and consumer leases considered loans for purposes of CRA data collection?*

A3. Commercial and consumer leases are not considered small business or small farm loans or consumer loans for purposes of the data collection requirements in 12 CFR [§]____.42(a) & (c)(1). However, if an institution wishes to collect and maintain data about leases, the institution may provide this data to examiners as "other loan data" under 12 CFR [§]____.42(c)(2) for consideration under the lending test.

§____.42(d) Data on affiliate lending.

§____.42(d)–1: *If an institution elects to have an affiliate's home mortgage lending considered in its CRA evaluation, what data must the institution make available to examiners?*

A1. If the affiliate is a HMDA reporter, the institution must identify those loans reported by its affiliate under 12 CFR part 203 (Regulation C, implementing HMDA). At its option, the institution may [either] provide examiners with ►either◄ the affiliate's entire HMDA Disclosure Statement or just those portions covering the loans in its assessment area(s) that it is electing to consider. If the affiliate is not required by HMDA to report home mortgage loans, the institution must provide sufficient data concerning the affiliate's home mortgage loans for the examiners to apply the performance tests.

§____.43 Content and availability of public file.

§____.43(a) Information available to the public.

§____.43(a)(1) Public comments related to [a bank's] ►an institution's◄ CRA performance.

§____.43(a)(1)–1: *What happens to comments received by the agencies?*

A1. Comments received by a Federal financial supervisory agency will be on file at the agency for use by examiners. Those comments are also available to the public unless they are exempt from disclosure under the Freedom of Information Act.

§____.43(a)(1)—2: *Is an institution required to respond to public comments?*

A2. No. All institutions should review comments and complaints carefully to determine whether any response or other action is warranted. A small institution subject to the small institution performance standards is specifically evaluated on its record of taking action, if warranted, in response to written complaints about its performance in helping to meet the credit needs in its assessment area(s) (►12 CFR◄ [§] ____.26([a]►b◄)(5)). For all institutions, responding to comments may help to foster a dialogue with members of the community or to present relevant information to an institution's Federal financial supervisory agency. If an institution responds in writing to a letter in the public file, the response must also be placed in that file, unless the response reflects adversely on any person or placing it in the public file violates a law.

►§____.43(a)(2) CRA performance evaluation.◄

§____.43(a)([1]►2◄)—[3]►1◄: *May an institution include a response to its CRA [Performance Evaluation] ►performance evaluation◄ in its public file?*

A[3]►1◄. Yes. However, the format and content of the evaluation, as transmitted by the supervisory agency, may not be altered or abridged in any manner. In addition, an institution that received a less than satisfactory rating during its most recent examination must include in its public file a description of its current efforts to improve its performance in helping to meet the credit needs of its entire community. ►*See* 12 CFR____.43(b)(5).◄ The institution must update the description on a quarterly basis.

§____.43(b) Additional information available to the public.

§____.43(b)(1) Institutions other than small institutions.

§____.43(b)(1)—1: *Must an institution that elects to have affiliate lending considered include data on this lending in its public file?*

A1. Yes. The lending data to be contained in an institution's public file covers the lending of the institution's affiliates, as well as of the institution itself, considered in the assessment of the institution's CRA performance. An institution that has elected to have mortgage loans of an affiliate considered must include either the affiliate's HMDA Disclosure Statements for the two prior years or the parts of the Disclosure Statements that relate to the institution's assessment area(s), at the institution's option.

§____.43(b)(1)—2: *May an institution retain [the compact disc provided by the Federal Financial Institution Examination Council that contains] its CRA [Disclosure Statement] disclosure statement ►in electronic format◄ in its public file, rather than printing a hard copy of the CRA [Disclosure Statement] ►disclosure statement◄ for retention in its public file?*

A2. Yes, if the institution can readily print out [from the compact disc (or a duplicate of the compact disc)] its CRA [Disclosure Statement for]►disclosure statement from an electronic medium (e.g., CD, DVD, or Internet website) when◄ a consumer [when the public file is requested] ►requests the public file◄. If the request is at a branch other than the main office or the one designated branch in each state that holds the complete public file, the [bank] ►institution◄ should provide the CRA [Disclosure Statement] ►disclosure statement◄ in a paper copy, or in another format acceptable to the requestor, within 5 calendar days, as required by ►12 CFR◄ [§]____.43(c)(2)(ii).

§____.43(c) Location of public information.

§____.43(c)—1: *What is an institution's "main office"?*

A1. An institution's main office is the main, home, or principal office as designated in its charter.

§____.43(c)— 2: *May on institution maintain a copy of its public file on an intranet or the Internet?*

A2. Yes, an institution may keep all or part of its public file on an intranet or the Internet, provided that the institution maintains all of the information, either in paper or electronic form, that is required in §____.43 of the regulations. An institution that opts to keep part or all of its public file on an intranet or the Internet must follow the rules in ►12 CFR◄[§]____.43(c)(1) and (2) as to what information is required to be kept at a main office and at a branch. The institution also must ensure that the information required to be maintained at a main office and branch, if kept electronically, can be readily downloaded and printed for any member of the public who requests a hard copy of the information.

§____.44 Public notice by institutions.

§____.44–1: *Are there any placement or size requirements for an institution's public notice?*

A1. The notice must be placed in the institution's public lobby, but the size and placement may vary. The notice should be placed in a location and be of a sufficient size that customers can easily see and read it.

§____.45—Publication of planned examination schedule.

§____.45–1: *Where will the agencies publish the planned examination schedule for the upcoming calendar quarter?*

A1. The agencies may use the **Federal Register**, a press release, the Internet, or other existing agency publications for disseminating the list of the institutions scheduled [to] for CRA examinations during the upcoming calendar quarter. Interested parties should contact the appropriate Federal financial supervisory agency for information on how the agency is publishing the planned examination schedule.

§____.45–2: *Is inclusion on the list of institutions that are scheduled to undergo CRA examinations in the next calendar quarter determinative of whether an institution will be examined in that quarter?*

A2. No. The agencies attempt to determine as accurately as possible which institutions will be examined during the upcoming calendar quarter. However, whether an institution's name appears on the published list does not conclusively determine whether the institution will be examined during that quarter. The agencies may need to defer a planned examination or conduct an unforeseen examination because of scheduling difficulties or other circumstances.

Appendix A to Part____—Ratings

APPENDIX A to Part____—1: *Must an institution's performance fit each aspect of a particular rating profile in order to receive that rating?*

A1. No. Exceptionally strong performance in some aspects of a particular rating profile may compensate for weak performance in others. For example, a retail institution ►other than an intermediate small institution◄ that uses non-branch delivery systems to obtain deposits and to deliver loans may have almost all of its loans outside the institution's assessment area. Assume that an examiner, after consideration of performance context and other applicable regulatory criteria, concludes that the institution has weak performance under the lending [test] criteria applicable to lending activity, geographic distribution, and borrower characteristics within the assessment area. The institution may compensate for such weak performance by exceptionally strong performance in community development lending in its assessment area or a broader statewide or regional area that includes its assessment area.

Appendix B to Part____—CRA Notice

APPENDIX B to Part____—1: *What agency information should be added to the CRA notice form?*

A1. The following information should be added to the form:

OCC-supervised institutions only: [The] ►For community banks, the◄ address of the deputy comptroller of the district in which the institution is located should be inserted in the appropriate blank. These addresses can be found at [12 CFR 4.5(a).] ►*http://www.occ.gov*. For banks supervised under the large bank program, insert "Large Bank Supervision, 250 E Street, SW., Washington, DC 20219–0001." For banks supervised under the mid-size/credit card bank program, insert "Mid-Size and Credit Card Bank Supervision, 250 E Street, SW., Washington, DC 20219–0001."◄

OCC-, FDIC-, and Board-supervised institutions: Officer in Charge of Supervision is the title of the responsible official at the appropriate Federal Reserve Bank.

[Appendix A—Regional Offices of the Bureau of the Census] is deleted in its entirety.

End of text of the Interagency Questions and Answers

Dated: June 26, 2007.

John C. Dugan,

Comptroller of the Currency.

Dated: June 26, 2007.

By order of the Board of Governors of the Federal Reserve System.

Jennifer J. Johnson,

Secretary of the Board.

Dated at Washington, DC, this 26th day of June, 2007.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

Dated: June 26, 2007.

By the Office of Thrift Supervision.

John M. Reich,

Director.

[FR Doc. 07–3223 Filed 7–10–07; 8:45 am]

BILLING CODE 4810–33–P; 5210–01–P; 6714–01–P; 6720–01–P

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