

**Evans, Sandra E**

**From:** Michael Butchko [MButchko@nw.org]  
**Sent:** Wednesday, October 17, 2001 12:19 PM  
**To:** 'regs.comments@ots.treas.gov'  
**Subject:** Comments on joint advance notice of proposed rulemaking regarding Community Reinvestment Act Regulations

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**DATE:** October 17, 2001  
**SUBJECT:** Docket No. 2001-49, RIN 1550-AB48, 12 CFR Part 563e,  
Community Reinvestment Act Regulations

Dear Sir/Madam:

In accordance with the request for comments regarding the Advance Notice of Proposed Rulemaking (ANPR), published in the Federal Register on July 19, 2001 (66 FR 37602-37608), the Neighborhood Reinvestment Corporation submits the following comments for consideration.

Background Information Regarding the Neighborhood Reinvestment Corporation:

The Neighborhood Reinvestment Corporation is a public nonprofit corporation established by Act of Congress in 1978 (P.L. 95-557). The Corporation evolved from an interagency task force established in the early 1970's by the federal financial regulatory agencies and the U.S. Department of Housing and Urban Development (HUD) to respond to concerns about "red-lining" and increase bank and thrift industry lending in declining neighborhoods.

Neighborhood Reinvestment's continuing mission is to strengthen distressed urban, suburban and rural communities through a national network of local community-based partnership organizations composed of community residents, private sector and local government entities - known collectively as the NeighborWorks® network.

In pursuing its mission, Neighborhood Reinvestment:

- \* provides technical assistance and funding (that gets leveraged many times over by private sector funding) to its affiliated NeighborWorks® network members, and also provides training, information services and other resources to NeighborWorks® organizations and the community development industry as a whole;
- \* coalesces public and private support for local, regional and national community reinvestment efforts;
- \* contributes to policy decisions concerning affordable housing and other means of transforming neighborhoods and improving the lives of lower-income families; and

\* monitors changes in the field, assesses the need for new approaches, and initiates research or programs to address those needs.

The NeighborWorks® network founded by Neighborhood Reinvestment has evolved to an impressive network of more than 230 locally-directed nonprofit organizations working to expand affordable housing opportunities and support community revitalization efforts in more than 2,000 communities across the United States -- in 48 states, the District of Columbia and the Commonwealth of Puerto Rico. NeighborWorks® organizations operate in our nation's largest cities and in some of its smallest rural communities. The following comments are informed by our experience in working with these local NeighborWorks® organizations and their local, regional and national lending partners.

#### Comments Regarding the Proposed Rule:

There have been many positive developments in the field of community reinvestment since regulatory changes to the Community Reinvestment Act were implemented in 1995. Many regulated financial institutions have stepped up with innovations in lending, investment and services, backed by billions of dollars in commitments. Some of these institutions were not previously involved in activities that promoted community reinvestment, and now are pleased to be participating in programs that are both mission-driven and economically sound. Informal discussions with our lending partners reflect a general feeling that there is no compelling need to make changes to the Community Reinvestment Act regulations at this time.

Our affiliated NeighborWorks® organizations tend to agree that the Community Reinvestment Act has been very effective in encouraging banks and thrifts to provide vital capital to under-served communities. Together with our affiliated NeighborWorks® organizations, Neighborhood Reinvestment sees a substantial positive change from the early 1990's in terms of the flow of capital to previously under-served communities and populations. Mortgages, home equity and home rehabilitation loans appear to be much more available in the low-income communities served by NeighborWorks® organizations, as are credit card, automobile and personal loans. A number of factors -- including the 'encouragement' provided by the Community Reinvestment Act -- have contributed to this increased availability of capital, including: an expanding economy, a highly competitive banking environment, lower interest rates, expanded capacity in the non-profit community/economic development field, and technological innovations that make small scale lending more economically feasible.

As the economy enters a period of slower growth, however, we are cognizant

of the economic pressures that may work to reverse the CRA-encouraged advances of the last few years. We look to the Community Reinvestment Act, particularly during this period of economic retrenchment, to reinforce the commitments of regulated institutions toward serving the capital needs of low and moderate-income communities and populations. And, toward that end, offer the following thoughts and observations.

**The Lending Test: The balance between qualitative and quantitative criteria**

In addition to the prospects of a slower economy, the improved access to capital noted above has introduced several new issues, primarily associated with the nature and source of the capital provided. Based on numerous anecdotal reports, a substantial portion of the expanded access appears to be driven by subprime loans, which generally carry higher interest rates to reflect the cost of higher perceived credit risk and lesser economies of scale. While subprime lending has increased access to capital in a broad sense, questions arise as to whether the risk measurements used are objective, and whether the higher interest rates are applied equitably among geographic and socio-economic constituencies.

Questions also arise as to whether subprime lending is introduced to the exclusion of conventional loans at conventional rates. Some of this subprime lending activity has been categorized as predatory. Predatory lenders take advantage of consumers who are not conversant with the terms and conditions of the loans, resulting in excessive charges, borrower dislocation, and loss. In effect, as a result of expanded subprime and predatory activity, access to credit in the community has transferred from a quantitative issue to more of a qualitative one. Hence, regulators may wish to concentrate more on the quality of the lending conducted in the assessment areas and derive appropriate standards for the purpose of evaluation.

To the extent that the criteria and the emphasis are changed to address this transition, the regulators may wish to review the nature of the data collected in order to determine if current data is adequate for a qualitative analysis of lender activity.

**The Investment Test: Appropriate balance among lending, investment and service tests**

Along with the changing emphasis in the lending test from quantity to quality, another area that warrants review is the weighting of investments as they relate to large retail institutions. We think that under certain specific circumstances, the weighting should be significantly increased relative to the lending and service tests.

Many of Neighborhood Reinvestment's affiliated community-based organizations report reduced access to the senior managers within regulated financial institutions, who make decisions about grants, program related investments, loan participations and other forms of collaboration. As a result of mergers and consolidations within the financial services industry,

decisions

that were traditionally made closer to (and were more responsive to the needs of) the communities served, are now often made elsewhere, or at higher levels in the new organization. It has also resulted in a loss of flexibility -- and a loss in the development of innovative programs that can better serve the specific needs of residents in, and community development organizations that serve, low- and moderate-income neighborhoods.

More important, the loss of access to local decision-makers creates a greater need for financing and technical assistance among people with non-conforming credit and low incomes. Under such circumstances, substantive grants or investments in nonprofit organizations that can provide the financing and technical assistance more effectively than a bank or thrift should be encouraged. Regulators may wish to expand the range and value of incentives that encourage institutions to make these kinds of investments. The regulators may also wish to consider a range of incentives that encourage these institutions to assist geographically committed non-profits in taking over needs the institutions themselves cannot effectively provide.

Such incentives could be developed within the context of the regulatory relationship and could include: further reduction of stipulated reporting requirements, higher weighting of the collaborations for the purposes of the evaluation, or other such incentives - as long as they do not affect the regulatory commitment to safety and soundness. Actions to be encouraged could include the provision of grants, loans, technical assistance, services and/or other forms of support that enable non-profit organizations to provide a wide range of products and services to low income constituents, together with the decision-making function at the local level.

We would expect such an initiative to be matched by efforts in the community development sector to develop mechanisms and vehicles that facilitate bank participation. These may include, for example: transitioning various financial functions to a consortium entity designed for the purpose, and expanded service partnerships with community development entities involving such products and services as bookkeeping, check-cashing, ATMs and credit cards

The Service Test: Appropriate balance among lending, investment and service tests

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An enormous proliferation of check cashiers, payday lenders, pawn shops, rent-to-own stores and other non-regulated fringe lenders has invaded many low- and moderate-income communities, particularly as regulated financial institutions have left. Many of these fringe lenders charge exorbitant rates and do not provide a real service to the residents that remain in these communities. Because conventional financial service alternatives no longer exist in their neighborhoods, many residents turn to such fringe lenders to meet their 'banking' needs. The CRA service test evaluates,

among other things, the availability and effectiveness of a bank's systems for delivering retail-banking services in low- and moderate-income geographies and to low- and moderate-income individuals.

Serious consideration should be given to revising the CRA service test to make sure that low- and moderate-income geographies and individuals are able to easily access retail-banking services by regulated financial institutions in their communities. Financial institutions may be able to maintain a physical presence in those neighborhoods through the use of creative techniques such as mobile offices and by partnering with existing institutions, utilizing local nonprofit organizations, religious institutions, schools and community centers.

To the extent that lenders can develop effective lower cost alternatives to payday loans and other forms of local credit, there should be an appropriate bonus in the lending test.

**Affiliate Activities:** are the tests effective in evaluating the performance of the institution in helping to meet the credit needs of its entire community, and consistent with the CRA statute?

Much of the subprime and predatory lending noted above is conducted by entities that are not regulated by the FFIEC agencies. Hence, the CRA statute and regulations have not been able to adequately address their work.

However, some of the subprime lending is provided by entities that are affiliated with regulated institutions. Some of the predatory lending has also reportedly been provided by such affiliated entities. Currently, these affiliates may or may not fall within the purview of the Community Reinvestment Act, depending on the election of the holding company that owns them. The absence of CRA governance in these instances is a concern. Where a regulated institution directly or indirectly conducts subprime or predatory lending to the exclusion of conventional lending, it is expressing a financial strategy for the community it is targeting, and defining an important part of its relationship with that community.

Logically, such lending should be incorporated into the evaluation of the regulated institution's commitment to reinvesting in the communities it serves. Many trade and community groups would likely support such a requirement. Many regulated institutions are critical of predatory lending, but they are likely to view such a requirement as a regulatory encroachment with significant negative implications for insurance, brokerage and other products and services that are not presently governed by the CRA statute.

Without some form of middle ground, it is possible that disputes over subprime or predatory lending performed by the affiliates of regulated entities will continue to be conducted in public without the benefit of measured discussion and calm resolution. Is it possible to review the subprime and predatory lending activity of affiliates as it affects the assessment areas -- without simultaneously expanding the scope of the

CRA to other non-regulated activities? Given the negative publicity surrounding the activities of some lenders over the past several years, we think it a question worthy of analysis.

We would stress, however, that discouraging regulated institutions from directly or indirectly engaging in subprime lending could prove counter-productive. Regulated institutions are more likely to provide the service in a responsible manner, and discouraging them from participating in subprime lending would only serve to expand the market share of unregulated institutions, some of whom are filling the gap in a totally unscrupulous manner.

If middle ground on the subject of assessing non-regulated lending affiliates can be found and established in a practical manner, it would alter the definition of the assessment area, as well as the nature of the activities that are included in the evaluation.

Small Institutions: are the performance standards effective in evaluating such institutions' CRA performance?

We note that many small banks and thrifts report difficulty in complying with CRA regulations. We have been advised that the loan to deposit ratio test is a key concern of some small banks and thrifts. Complaints apparently arise because the loan to deposit ratio, which is essentially a measure of safety and soundness, is being used to create a potentially imprudent level of risk exposure.

With the NeighborWorks® network's increased focus on rural needs and the consequent greater focus on working with small banks, we are concerned that our partnerships with them be governed by measures that facilitate rather than impede reinvestment. We would suggest that the loan to deposit ratio test be dropped - particularly in regard to small banks and thrifts. Emphasis, instead, should be on the remaining tests - the percentage of loans made in the assessment area, and the demographic distribution of such loans.

In addition, we think that the small banks and thrifts would benefit from the improved weighting of the investment and service tests noted above.

Assessment areas: do the rules establish a reasonable and sufficient standard for designating the communities within which the institution's activities will be evaluated?

Technological developments in the financial services industry present a reason to review the manner in which assessment areas are defined. The advent of interstate banking, combined with Internet and telephone banking, national solicitation of deposits and a host of other national and regional efficiencies have altered the traditional meaning of "community" as well as "market". For many regulated institutions, headquarters location, local community commitments and geographical segmentation generally -- are no

longer determining strategic factors. Consequently, the force of the CRA may be diminished or marginalized.

There is a serious question as to whether this issue is outside the purview of the ANPR and related regulations. However, given the pace and magnitude of changes in the financial services industry we think it appropriate to take this opportunity to set forth a possible perspective on this issue:

In the Community Reinvestment Act, Congress found 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 . . . including the need for credit services as well as deposit services and . . . have continuing and affirmative obligation[s] to meet the credit needs of the local communities in which they are chartered." [12 U.S.C. § 2901(a)]. The law requires the appropriate Federal financial supervisory agency to "assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods . . ." [12 U.S.C. § 2903(a)(1)] -- see also 12 U.S.C. § 2906 (a)(1). In providing such evaluation, the information is to be presented separately "for each metropolitan area in which a regulated depository institution maintains one or more domestic branch offices," [12 U.S.C. § 2906(b)(1)(B)], and "for each State in which the institution maintains 1 or more domestic branches." Taking the language further: 12 U.S.C. § 2906(d)(1)(B) states: "Domestic branch" under the Act is defined as "any branch office or other facility of a regulated financial institution that accept deposits, located in any state." [12 U.S.C. § 2906(e)(1)] (emphasis added). Hence, it is possible that the definition of a domestic branch could include not only a physical office, but also a facility -- such as the Internet -- that provides a customer with the ability to make a deposit to the regulated financial institution from the customer's home or other location.

Such an interpretation can have significant implications. A number of regulated financial institutions, for example, have Web sites that allow customers to open and maintain deposit accounts online. Some of these institutions have a physical or Internet presence in all fifty states, and accept and receive deposits from each state. For them, the appropriate assessment area may be the entire United States. Other institutions have an Internet presence in some, but not all, of the states. For these institutions, it may be appropriate to look more directly at where their deposits and other activities occur, and use that as a basis for delineating their assessment area. For example, it may be appropriate for a bank to define its assessment area as all of the MSAs and RSAs in which at least five percent of its deposits originate. Either way, in theory, all communities they serve could be viewed as "local", and such institutions would, at a minimum, be required to meet the credit needs of the entire community, especially the credit needs of low- and moderate-income neighborhoods.

This view may not be pertinent to current interpretation and practice, but

it points up the potential for increasing inequity and/or confusion in the application of the law. Given today's technological developments and industry trends, the brick and mortar presence of a regulated institution is diminishing as a platform for providing products and services. The determination of what constitutes an appropriate assessment area needs to be revisited in light of the purposes of the statute and technological developments, and regulators should arrive at a conclusion as to how these developments will be evaluated going forward.

As part of the review of this question it may also be appropriate to revisit the definitions and weightings of the service test.

#### Strategic Plans

We have no comment on the normal handling and weighting of the Strategic Plan.

However, the review of a strategic plan for community development activity going into a merger is of considerable interest. Alteration in commitment of resources and/or service delivery following major mergers is a fact of life. In the community development field, such retrenchments include many positive steps, as well as negative ones. On the negative side, reductions in grants, certain kinds of loans, branch presence and access to key personnel have occasionally come without warning. While, a strategic plan is still just a plan, a number of our affiliated NeighborWorks® organizations have commented on the need for greater specificity prior to merger approval on the surviving entity's community development plans.

Finally, Neighborhood Reinvestment and its affiliated NeighborWorks® organizations have noted that most regulated financial institutions are rated "satisfactory" for CRA purposes, with few being rated "outstanding." Some 'satisfactory institutions' appear to have insufficient incentives to work towards an "outstanding" rating. The CRA regulations will work best when there is a strong impulse on the part of financial institutions generally to strive to be leaders in responsiveness and creativity to the needs of low-income populations and geographies. Under the circumstances, regulators might wish to develop a range of incentives, which provide financial benefits in the form of paperwork reduction, reduced reporting requirements and/or relief in another category of procedure not pertaining to safety and soundness. Coincidentally, regulators might wish to add one or two categories of performance to the "satisfactory" range; e.g., a "B" and a "D" grade in addition to the "C", instead of a one-size fits all "C" grade. Such a step would likely prompt greater attention to the development of community-based initiatives.

## Data Collection

We recognize that the collection and analysis of data may be one of the primary cost burdens of CRA compliance, and that a request for greater precision and specificity may add to this burden. Nevertheless there may be issues that would require collection of additional data. In addition to the issue of quality versus quantity - as it relates to subprime and predatory lending (noted above), we believe the CRA would benefit from better information on small business lending, rural lending, pricing, and fees. Linkages to HMDA needs would also be beneficial.

## Conclusion

In summation, Neighborhood Reinvestment believes that the Community Reinvestment Act has provided lending institutions with the framework to direct capital to underserved communities. However, with current technology and the current state of the economy, the CRA is facing a series of issues that our comments to the ANPR attempt to address.

Thank you for your consideration of these comments and for your efforts of behalf of underserved communities and households across America. Please feel free to contact me with any questions or concerns you may have regarding these comments, at (202) 220-2415 or by email at elazar@nw.org.

Sincerely,

Ellen Lazar  
Executive Director