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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	Memorandum for the President & the Vice President (4 pages)	04/07/1999	P5
002. memo	Memorandum to the President (3 pages)	02/22/1999	P5
003. memo	Memorandum to the President (3 pages)	02/22/1999	P5

COLLECTION:

Clinton Presidential Records
Policy Development
Lisa Green
OA/Box Number: 20587

FOLDER TITLE:

[Community Reinvestment Act Legislative Strategy] [1] [loose]

2012-0043-S
ms435

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
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MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Rick Carnell
Sarah Rosen

cc: Michael Barr

From: Chris Lewis CL

Date: December 28, 1998

Subject: CRA Protest Data

Enclosed are materials provided to Senate Banking Committee minority staff on protested 1998 national bank deposit facility applications.

If you should have any questions, I will return to the office on Tuesday January 5, 1999. I can be reached at 874-8607.

TO: Gene Sperling
FROM: Lisa Green
DATE: April 21, 1999
RE: CRA Meeting w/ External Groups for April 22, 1999

Location: OEOB, Room 180

Purpose: The purpose of tomorrow's meeting is to communicate the Administration's strategy and action plan for safeguarding the Community Reinvestment Act. The meeting is an opportunity to exchange information with many of the groups that vocally oppose the CRA provisions proposed by Gramm and to hear their plans for fighting the legislative battle against CRA.

Others Presenters: You will be joined in the meeting by Larry Stein and Bruce Reed (or Paul Weinstein) and introduced by Marybeth Kayhill. There may also be attendees from Treasury and other agencies, but they are not expected to present.

Format: Informal roundtable. 5-10 minute overview by each presenter. Dialogue with the groups about their strategies to combat current legislative efforts to weaken CRA.

Audience: Representatives from approximately 20 civil rights organizations and interest groups are expected to attend. All of the invited groups are urging continuing support for the preservation of CRA.

Theme: Many of the groups oppose the following three legislative provisions that would severely weaken CRA:

<u>Opposition to CRA Provisions in the Senate Version of the Financial Services Modernization Act of 1999</u>

1) Banks not in compliance with CRA will be allowed to expand their affiliations and engage in new powers. The new law will eliminate the requirement for a bank to maintain a satisfactory CRA rating as a condition for expansions (i.e. mergers and new branches).

2) The bill provides 'safe harbor' for institutions that have at least a satisfactory CRA rating (during any prior 36 month period). This provision effectively eliminates opportunity for public comment on community reinvestment activities.

3) A small bank exemption (for banks with less than $100 milllion in assets) limits credit access to rural communities. Approximately 76% of rural banks will fall in the small bank category.

<u>Attachments</u>

List of Invitees
Talking Points
Memorandum from Sarah (dated 4/15) with an update on recent activities on Financial Modernization
Early Draft of CRA memorandum to President (written by Sarah and Paul with your comments in the margins)
Joint Letter from civil rights organizations expressing concern over Senate CRA provisions
One Page Fact Sheet on Community Reinvestment Act – How Does CRA Work?
One Pager on Financial Commitments to Underserved Communities through CRA
Legislative Summary (from most recent DRAFT of CRA memorandum to the President)
General Background Information

TALKING POINTS FOR CRA MEETING
12:00 PM April 22, 1999 – OEOB, Room 180

- **This Administration strongly supports CRA.** We've worked very hard to both streamline and strengthen the Community Reinvestment Act. CRA has been on the books for more than 20 years but 95% of all the financial commitments made under the law have been made since 1993, under this Administration. That's more than $1 trillion in long-term commitments to invest in people.

- **The President is committed to preserving existing CRA as we know it and not as proposed by the Senate.** A veto threat was issued by the President in March in opposition to the Senate bill developed by Chairman Gramm. The bill reported out by the Senate would 1) undermine the relevance of CRA because it increases leeway for affiliations between banks and non-bank institutions but does not require them to have satisfactory CRA ratings to undertake non-bank activities 2) reduce access to credit in rural communities by exempting small banks from CRA and 3) severely dampen opportunity for public comment on the reinvestment activities of financial institutions by creating a safe harbor for instititutions that have at least a satisfactory CRA rating.

- **Our strategies to safeguard CRA in the House include helping to move forward the financial services bill put forth by the House Banking Committee, developed by Chairman Leach and Ranking Democrat LaFalce.** This bill contains no weakening of CRA and requires banks to have and maintain an adequate CRA record in order to engage in new financial activities.

- **In the Senate, Secretary Rubin held a press conference with Daschle and Sarbanes to support their alternatives to Gramm's proposals.** The Daschel and Sarbanes legislative recommendations would not weaken CRA.

- **We are also seeking opportunities for the President and Secretary Rubin to highlight the vital importance of CRA.** There are many examples of CRA's success in building homes, creating jobs, and restoring hope in economically distressed communities throughout the United States. We are looking for your input on successful investments where we can focus attention.

- **The Administration will continue to strongly oppose any legislation that would weaken CRA.** This issue is of great personal interest and importance to the President and the First Lady. The President will not hesitate to issue additional veto threats against any bills that would weaken CRA.

  In his letter responding to Gramm's version of the Financial Modernization Act, President Clinton stated " **In its current form, the bill would undermine the effectiveness of the Community Reinvestment Act .... The CRA is working, and we must preserve its vitality as we write the financial constitution for the 21st Century. ... I agree with you that reform of the laws governing our nation's financial services industry would promote the public interest. However, I will veto the bill if it is presented to me in its current form.**

TALKING POINTS FOR CRA MEETING
12:00 PM April 22, 1999 – OEOB, Room 180

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Neighborhood Reinvestment Corporation

NeighborWorks®
FOUNDER

CC: Dauna
Tim
Sarah Rosen
12-23-98

DR 98/467

1325 G Street, NW, Suite 800
Washington, DC 20005

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http://www.nw.org

file: CRA

December 14, 1998

The Honorable Ellen Seidman
Director
Office of Thrift Supervision
1700 G Street NW, Fifth Floor
Washington DC 20552

Dear Ellen:

In response to your questions regarding the growth in NeighborWorks® organizations investments and changes in the Community Reinvestment Act regulations I have prepared the attached chart. I'm working on some alternative (graphic) ways to present the formation for the non-table-oriented reader.

Clearly the growth in the NeighborWorks® network, the strong economy and the low interest rates have aided in the dramatic growth during the past several years. Certainly the encouragement of CRA has played a role as well.

Investment by insurance companies in Neighborhood Housing Services of America, Inc. (NHSA) has been over a 20-year period. Clearly in the early days it was small -- measured $1 million at a time. More recently that investment has been in increments of $10 million and up. Part of that is due to the flawless performance of the NHSA notes. Additionally, a considerable part of that is due to the personal involvement of CEOs and many staff of the companies at the local levels. The end of June 1998 numbers stand at $157.1 million.

Hopefully this information is helpful to you.

Sincerely,

George

George Knight

Enclosure

xc: Sonja White w/enclosure

RECEIVED
1998 DEC 17 P 2:51
DIRECTOR

Neighborhood Housing Services of America Inc.

Insurance Participant in NHSA Secondary Market Loan Products

INVESTOR	Total Notes
State Farm	$56.2 M
Allstate	$35.5 M
Prudential	$17.5 M
USAA*	$17.0 M
Nationwide*	$10.4 M
Equitable	$10.0 M
Metropolitan	$5.0 M
Aetna	$4.0 M
Mutual Benefit Life	$1.0 M
Wausau	$0.5 M

* Estimate -- the actual split for this investment may change as purchases are made.

Neighborhood Reinvestment
Research Department
December 4, 1998

j:\research\misc\misc\Insurance.xls

NeighborWorks® Organizations

Direct Investment from 1991 - 1998

	1991	1992	1993	1994	1995	1996	1997	1998
All NWOs Reporting	157	160	168	165	168	173	169	175
Total Investment	$111,438,294	$200,180,337	$212,568,581	$268,382,531	$357,557,709	$420,091,819	$550,288,627	$819,287,487
NWO Investment	$21,371,556	$28,720,993	$29,290,510	$33,229,659	$30,444,655	$32,707,293	$64,811,411	$79,127,241
Other Investment	$90,066,738	$171,459,344	$183,278,071	$235,152,872	$327,113,054	$387,384,526	$485,477,216	$740,160,246
Conventional	$35,041,741	$54,686,290	$72,459,876	$119,033,528	$190,668,298	$232,217,998	$298,458,561	$446,572,303
CRA History	Old CRA Rules				Revised	Mandatory Small Banks	Mandatory Large Banks	

Definitions:

"RLF Investment" pertains to NeighborWorks® organization's revolving loan funds.

"Other Investments" includes investments from conventional/private, public and all other sources (foundations, non-profits,etc.)

"Conventional" investments, which are included in "Other investment" pertains exclusively to investments of banks and other lending institutions.

Source: Neighborhood Reinvestment Quarterly Reports from 1991 to 1998.

All yearly data refers to the fiscal year of October 1 to September 30.

The Research Department started collecting quarterly data in January, 1991 (2nd quarter). Therefore, the 1991 figures above include three actual quarters and one estimated quarter.

Office of the Comptroller of the Currency

Volume and Average Processing Times For Non-Protested and Protested Applications Decided 1/1/98-12/14/98

Type of Application	Covered by CRA	Volume of Applications Decided	Average Processing Time	Number of Applications with CRA Comments to OCC	Average Processing Time for Protested Applications
Charter	YES	60[1]	103 days	0	-
Conversion	YES	23	47 days	0	-
Real Merger	YES	93	48 days	0	-
Reorganization	YES	268	49 days	4	85 days
Branch	YES	1464	33 days	1	70 days
Relocation	YES	203	31 days	0	-
Total Applications Covered by CRA		2111			
New Federal Branch or Agency	NO	1	25 days	0	-
Operating Subsidiary	NO	134	80 days	1	76 days
Change in Bank Control	NO	12	75 days	1	50 days
Fiduciary Powers	NO	33	25 days	0	-
Capital	NO	77	23 days	0	-
Total Applications		2368			

Source: Bank Organization and Structure

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[1] This number includes seven uninsured trust charters which are not subject to CRA.

Office of the Comptroller of the Currency

Listing of Protested Applications
Decided 1/1/98-12/14/98

Type of Filing Name of Bank	**Date Received**	**Date Decided**	**Number of Days to Process**	**Asset Size of Applicant (in $ billion) as of 6/30/98**
Corporate Reorganization				
1) Star Bank/Great Financial FSB	11/17/97	1/28/98	73	14.562
2) First Union/CoreStates	2/12/98	4/15/98	63	213.300
3) First Merit/Premier B&T[2]	1/22/98	4/30/98	99	6.147
4) NationsBank/Barnett	6/8/98	9/18/98	103	232.397
Branch				
5) BankBoston	4/3/98	6/16/98	70	68.216
Operating Subsidiary				
6) First Union/Money Store	4/15/98	6/29/98	76	213.300
Change in Bank Control				
7) Dillard NB	6/3/98	7/22/98	50	0.007

Source: Bank Organization and Structure

[2] Four protests were withdrawn after an investment initiative was signed by FirstMerit.

Office of the Comptroller of the Currency

Summary of Reasons for Removal from Expedited Review
(1/1/98 - 12/14/98)

Reason for Removing	**Number Removed**
CRA Protests	4
Other CRA Issues	9
Supervisory including Y2K	20
Legal Issues	10
Competitive Issues	6
Fair Lending Issues	2
National Historic Preservation Issues	2
TOTAL APPLICATIONS REMOVED FROM EXPEDITED REVIEW	**53**

Source: Bank Organization and Structure

was done by the committee in bringing this matter to the Senate floor.

I, again, thank Chairman D'AMATO for his skillful work in developing the legislation to this point and bringing it to the floor of the Senate.

Mr. President, I yield the floor.

Mr. GRAMM addressed the Chair.

The PRESIDING OFFICER. The Senator from Texas.

Mr. GRAMM. Mr. President, let me add my voice to those who have congratulated Senator D'AMATO and Senator SARBANES for this bill. I believe we have put together a good bill. I think it is a dramatic improvement over the House bill. It does, for the first time, in an effective manner begin to look at capital requirements and safety and soundness, and, in doing so, it will dramatically improve the quality and regulation of credit unions all over the country. I think those who are part of the credit union movement want people to know that their deposits are safe, sound, insured, regulated and protected in the savers' interest.

Second, the bill, for the first time, begins to put appropriate limits on the amount of business loans that credit unions can make. There are those who believe, and I happen to be one of them, that credit unions were chartered to provide consumer credit to their members as part of a cooperative effort. A dramatic movement of credit unions into commercial lending would circumvent the whole intent of the credit union movement, and in my opinion, it would be a negative factor on the progress of the credit union movement. In this bill, we for the first time set limits on the amount of credit union assets that can go into commercial loans. That is a very positive step.

We deal with the common bond issue, and we settle once and for all the principle that every American ought to have the right to join a credit union—not any credit union—but join a credit union within an appropriate field of membership. It my view, and I believe that we achieve this with this bill, that it should be possible for every American citizen to find an appropriate field of membership by which he or she can associate with others, and have the opportunity to join a credit union and to affiliate with that credit union if they choose to do it.

Those are the positive things about this bill. I am a strong supporter of the bill. I intend to vote for this bill, but there is one provision in the bill to which I am very strongly opposed.

In this bill, for the first time ever, we begin to have the Federal Government direct credit unions as to how they will use their members' money. In this bill, for the first time ever, we begin the process of telling credit unions that the government is going to allocate some of a credit union's resources to promote a "public purpose," even though it may not be the purpose of credit union members. I believe that not only is this very bad and dangerous public policy, but I think the logic of it is totally inapplicable to credit unions and the credit union movement.

The name—it is a wonderful sounding name for a program that has nothing to do with any one word in the name—is Community Reinvestment Act. In this bill, for the first time ever, we apply in three different ways this Federal mandate and credit allocation to credit unions.

Let me explain why, despite all the arguments you can make on the merits or demerits of the Community Reinvestment Act, why it does not belong on this bill.

Credit unions are voluntary, private associations. They are nonprofit organizations. They are tax-exempt organizations. They represent a collective effort of members to pool their savings with a common objective. They pool their savings and they lend to each other, the members of the credit union. In doing so, they perform a cooperative credit function. In many cases, they provide credit that would not be available, certainly at rates that would not be available, in many cases, to the consumer.

They are not in the business of promoting any broad, general purposes, such as the general welfare of the country or the community. They are small, private associations that are organized for the purpose of promoting the welfare of their members. The whole purpose is to pool nickels, dimes and dollars to build a cash base that can be lent to members for things such as buying a new car or new truck, buying a new tractor.

The objective of the credit union is to promote the interest of credit union members. It is not a for-profit organization, and there is no logic to applying to it a provision of law where the Government adds an additional mandate that the credit unions should direct the money of those members to support some end other than the well-being of the people who put up the money in the first place.

Let me explain how this works, and I want to read your some language—in my mind, shocking language—that has been included in this bill in the House, and language that I believe should be removed.

In the bill, the House has set up this requirement for a Federal mandate and capital allocation that goes by the name of community reinvestment. I will talk in a moment as to why this provision has nothing to do with community or reinvestment.

This bill mandates that credit unions conform to this Federal capital allocation. Here is how it is defined, and here is basaically how it works:

In three different places, we have a reference to it in the bill. The first way that the bill would measure whether a credit union is complying with this Federal mandate allocating their members' hard-earned money is on page 58 in new section 215. In subsection (b), it is set out that credit unions have to comply with this community reinvestment, and that in doing so, they will be regularly evaluated by the Federal Government, and their record will be looked at to see if the credit union is "providing"—I want you to remember, that is "ing"—". . . providing affordable credit union services to all individuals of modest means . . . within the field of membership of the credit union. . . ."

In other words, in this section, the Federal Government will evaluate whether or not this credit union, in making loans, in allocating the money of the people who have joined the credit union, is providing affordable services—and I don't know how you define "affordable." I think I know how you define "providing:" you test whether they are actually doing it, although I could imagine some very interesting and intrusive methods of testing that the regulators might conjure up. But the test of "providing" can be a very rigorous test, since the standard is not whether the credit union is offering its services, it is not whether they are trying to do it. They are required to do it. They are to be "providing"—you are evaluating whether they are ". . . providing affordable credit union services to all individuals of modest means . . . within the field of membership of the credit union."

You need to understand, field of membership and membership are two different things. A credit union considers itself successful if it is able to get about 20 percent of the people who could join that credit union to join it. So, that in any field of membership normally about 80 percent of the people in the field of membership who were invited to join the credit union, who were invited to put up their money, sai[d] "No, I don't want to join your credi[t] union; I don't want to put my mone[y] into your credit union." But the firs[t] provision of this bill requires that th[e] credit union, to comply with this la[w] on Federally mandated capital alloca[tion], must be ". . . providing affor[d]able"—and where are these terms d[e]fined? Nowhere—"credit union servic[es] to all individuals of modest means . . within the field of membership."

Now, I do not believe we ought to [be] forcing credit union members, who p[ut] up their own money, to provide ser[v]ices to people that had an opportuni[ty] to join the credit union but decided n[ot] to join it. I think that violates t[he] whole spirit of the credit union mov[e]ment because a credit union is a coo[p]erative, and if you want credit uni[on] services, you join the credit union. Y[ou] participate in putting up the capi[tal] and you apply for loans or servi[ces] from the credit union.

The second evaluation has to do w[ith] community credit unions. And th[ese] are credit unions that serve an ent[ire] community. This second provision [re]quires that credit unions are "me[et]ing"—not trying to meet—and ple[ase] note, the law does not say that [you] "offer" services, that you offer "aff[ord]able" services, whatever that means

AMENDMENT NO.____ Calendar No.588

Purpose: To provide for the modernization of financial services legislation.

IN THE SENATE OF THE UNITED STATES—105th Cong., 2d. Sess.

H.R.10

Referred to the Committee on ______________________________
and ordered to be printed

Ordered to lie on the table and to be printed

AMENDMENT intended to be proposed by

____

Viz:

At the end of the bill add the following:

"SEC. . **MEANINGFUL EXAMINATIONS FOR COMPLIANCE WITH THE COMMUNITY REINVESTMENT ACT OF 1977.**

"Notwithstanding any other provision of law, any institution achieving a rating of 'satisfactory record of meeting community credit needs', or better, at the most recent examination of such institution pursuant to the Community Reinvestment Act of 1977 shall be deemed for all purposes to be in adequate compliance with the provisions of the Community Reinvestment Act of 1977 until the completion of a subsequent regularly scheduled examination pursuant to the Community Reinvestment

Act of 1977.

"SEC. . FAIR NOTICE OF CRA EXAMINATION.

"The Community Reinvestment Act of 1977 is amended by inserting the following new section:

" "SEC. 806A. FAIR NOTICE OF EXAMINATION.

" "Each appropriate Federal financial supervisory agency shall promulgate regulations ensuring the fair public notice of the schedule of examinations of regulated financial institutions pursuant to the Community Reinvestment Act of 1977.".".

On page 299, line 25, before the period insert the following: "and for which the Board has not determined within 60 days after such bank holding company has filed with the Board the declaration described in subsection (b)(1)(C) that such bank holding company is not in satisfactory compliance with the provisions of the Community Reinvestment Act of 1977".

On page 300, strike lines 14 through 19; on line 20 strike "(D)" and insert in lieu thereof "(C)"; and on line 24 strike "through (C)" and insert in lieu thereof "and (B)".

Beginning on page 301, line 10, strike all through page 302, line 20.

On page 315, line 24, strike "(C), or" and insert in lieu thereof "or (C)"; and on page 316, line 1, strike "(D)".

On page 316, strike lines 12 through 17.

On page 317, line 16, strike "(D)" and insert in lieu thereof "(C)".

Beginning on page 378, line 24, strike all through page 379, line 2, and insert in lieu thereof "and well managed;".

On page 379, strike lines 5 through 8 and insert in lieu thereof "managed; and"; strike lines 11 through 16; and on line 17 strike "(4)" and insert in lieu thereof "(3)".

On page 381, strike lines 5 through 25 and insert in lieu thereof "Act.".".

On page 408, strike lines 10 through 17 and insert in lieu thereof "contained therein.".".

On page 414, strike lines 13 through 20.

At the end of the bill add the following new section:

"SEC. . ANTI-EXTORTION AND ANTI-BRIBERY PROVISIONS.

"(a) PROHIBITION OF EXTORTION AND BRIBERY.—Notwithstanding any other provision of law, no regulated financial institution, as defined in section 803 of the Community Reinvestment Act of 1977, or any officer, director, or representative thereof, and no company, business, institution, or other entity affiliated with or controlled by any such regulated financial institution, or any officer director, or representative thereof,

"(1) may make any grant of money, financial contribution, donation, or payment (other than a loan) to any person not employed by such regulated financial institution or by any entity affiliated with or controlled by such regulated financial institution, or

"(2) may establish any quota or set aside with respect to employment, sales, purchases, or other business activities (other than loans)

in connection with or in response to any review, evaluation, or examination of the compliance of such regulated financial institution with the provisions of the Community Reinvestment Act of 1977 with the intent or purpose to motivate, encourage, or otherwise influence any person to provide or to refrain from providing information to any federal banking agency regarding the compliance of such regulated financial institution with the provisions of the Community Reinvestment Act of 1977, or to affect the content of any information that may be so provided.

"(b) PENALTIES.—Any person who conducts any activity prohibited in subsection (a) shall be fined not more than $1 million or imprisoned for not to exceed 1 year, or both, for each violation, and any person who knowingly receives or solicits any grant of money, financial contribution, donation, or payment (other than a loan) prohibited in subsection (a)(1) shall be fined not more than $1 million or imprisoned for not to exceed 1 year, or both, for each violation, and shall be required to remit to the Treasury the amounts of any activities prohibited in subsection (a).".

Withdrawal/Redaction Marker
Clinton Library

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001. memo	Memorandum for the President & the Vice President (4 pages)	04/07/1999	P5

COLLECTION:

Clinton Presidential Records
Policy Development
Lisa Green
OA/Box Number: 20587

FOLDER TITLE:

[Community Reinvestment Act Legislative Strategy] [1] [loose]

2012-0043-S
ms435

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inclusion of these funds in an emergency supplemental appropriation. Moreover, the Committee intends to exercise its oversight responsibilities to examine carefully the use of previous appropriations to the Palestinian Authority and examine the wisdom of any further transfer of taxpayer funds to the Palestinian Authority.

Financial Regulatory Relief and Economic Efficiency Act of 1999

The Committee will continue this year the process of regulatory reform and relief for our financial institutions and their customers. On February 11, 1999, the Committee ordered reported the Financial Regulatory Relief and Economic Efficiency Act of 1999. One of the provisions of this legislation would allow the Federal Reserve to pay interest on the private-sector bank reserves that it holds. This has been estimated by the Congressional Budget Office to result in a decrease in federal revenues (due to lower payments into the budget from the Federal Reserve) of $214 million in FY2000, and a five-year reduction in revenues of $661 million. On the other hand, these sterile reserves held by the Federal Reserve act as a tax upon banks, and one which banks are increasingly finding ways of avoiding by shifting funds elsewhere, decreasing the ability of the Federal Reserve to conduct monetary policy. For that reason, this provision has the support of the Federal Reserve Board and was reported out of the Committee without objection. We request that this change in law be accommodated in the budget resolution.

Securities Regulatory Reform

An ongoing concern of the Banking Committee is the large degree to which the fees collected by the Securities and Exchange Commission surpass the funding needed to operate the agency. In an attempt to reduce this disparity, provisions designed to phase in lower transactions fees were included in the National Securities Markets Improvement Act of 1996. Nonetheless, despite these efforts, the aggregate fee revenue has continued to outstrip the funding needs of the agency. For example, the actual fee revenue collected by the agency in fiscal year 1998 was $1.78 billion, while the SEC's appropriated spending level was just $341 million. Furthermore, fee revenue is expected to continue to exceed future SEC spending levels. Given the estimated fee collections of $1.62 billion, the revenues will exceed the agency's funding by almost 450% even if the agency is awarded its full FY 2000 budget request of $360.8 million. These fees clearly are taxes, not just user fees. The Committee will once again seek to enact legislation that will reduce the level of these fees to a position more in line with the agency's expenditures. Therefore, the Budget Committee should not assume such a continuing imbalance between SEC fee revenues and funding requirements.

Another priority of the Committee is the consideration of legislation designed to provide regulatory relief to the securities industry and its customers. In 1996, the Congress enacted the aforementioned National Securities Markets Improvement Act (NSMIA), which made changes to nearly every federal securities statute. The Committee plans to build upon the groundwork laid in NSMIA and embark upon a new effort to update our securities statutes in an effort maximize the economic efficiency with which our country's securities markets operate. Even though the budgetary impact of each of these changes is likely to be small, their cumulative beneficial effect on the overall economy could be substantial over time.

While the Committee on Agriculture, Nutrition and Forestry has original jurisdiction over the Commodity Futures Trading Commission (CFTC), the Banking Committee believes that the proposals to institute new CFTC fees have the potential to distort the allocation of capital between the commodities and securities markets and urges the Budget Committee to reject such proposals.

Public Utility Holding Company Act of 1999

On February 11, 1999, the Committee ordered reported the bill S. 313, the "Public Utility Holding Company Act of 1999." This bill represents the first step toward passing comprehensive electricity deregulation in the Senate, and it is expected to be joined on the Senate Floor with other elements of reform.

While the direct budgetary impact from enactment of S. 313 and related provisions is expected to be small, the General Accounting Office projects that the federal government, as the largest electric consumer in the country, could save hundreds of millions of dollars per year in the future as competition lowers retail electricity prices (GAO/RCED-97-244 September 30, 1997).

Housing and Community Development

The Committee notes favorably the passage of two major housing reform bills in the 105th Congress. The Multifamily Assisted Housing Reform and Affordability Act (MAHRAA) and the Quality Housing and Work Responsibility Act (QHWRA) were passed by the Banking Committee and adopted in the Fiscal Year 1998 and Fiscal Year 1999 VA-HUD-Independent Agencies Appropriations Acts, respectively.

Oversight of the Department of Housing and Urban Development (Department) is a priority for the Committee. The Committee continues diligent oversight of HUD's regulatory processes as the Department begins implementation of the Section 8 multifamily program reforms established by MAHRAA and the public housing reforms established by QHWRA, and will ensure that Congressional intent is honored.

MAHRAA reforms, known as "mark-to-market", should be fully implemented by Fiscal Year 2000. If these reforms are implemented in accordance with Congressional intent and in timely fashion, significant short- and long-term savings in mandatory and discretionary budget authority will result.

Public housing reforms contained in QHWRA should also be fully implemented by Fiscal

Year 2000. Such reforms will result eventually in increased operating efficiencies and income for public housing authorities. The Committee anticipates that over time this will result in a reduced need for HUD budget authority and outlays.

The Committee continues its ongoing interest in reviewing HUD's mission and in consolidating or eliminating housing and community development programs in order to improve efficiencies, enhance accountability, save taxpayer money and provide greater responsibility and flexibility to State and local governments.

The Administration's Fiscal Year 2000 budget proposes a $2.5 billion increase in budget authority and a myriad of new programs and responsibilities for the Department of Housing and Urban Development. The budget is apparently based on the premise that HUD has put its house in order and is capable of expanding its reach. HUD, however, remains classified by the General Accounting Office as a "high-risk" agency, and Congress must review carefully HUD's budget proposals in the context of the Department's well-established and longstanding weaknesses. In FY 1999, $8.8 billion was appropriated for HUD programs whose authorizations expired in FY 1994. The Committee believes these programs deserve careful review before launching several new initiatives.

Despite the laudable goals of many of the proposed initiatives, the Committee finds no rationale for the creation or expansion of programs to serve public policy purposes which are or could otherwise be served within HUD's existing programmatic framework or through the efforts of another agency. The Committee has particular concerns with Administration proposals that are inconsistent with HUD's mission and capacity. In addition, increased funding for these and other discretionary programs are financed in the President's budget through tax increases. In an era of record-high federal revenues, the Committee urges that HUD programs be funded within existing spending allocations. The Committee sees no justification for increasing HUD's overall funding and is opposed to any tax increases.

Further, the Committee strongly opposes proposals to convert discretionary programs into mandatory programs. The Committee is also concerned about the President's proposal to provide only partial funding of section 8 contract renewals in FY 2000, while requesting remaining funds as an advance appropriation for FY 2001. Such a program, if enacted, would only add further uncertainty and volatility to this troubled program.

In order for the Department to fulfill its historic mission within the resources available, the Committee recommends that HUD concentrate its efforts on the effective development of multifamily and public housing reform regulations and the successful implementation of its management reform plan.

National Flood Insurance Program

The Committee has shown consistent support for the National Flood Insurance Program (NFIP), as administered by the Federal Emergency Management Agency (FEMA). The Committee notes favorably the three-year reauthorization of the NFIP in the Quality Housing and Work Responsibility Act which was adopted in the Fiscal Year 1999 VA-HUD-Independent Agencies Appropriations Act.

The Committee supports FEMA's efforts to update and modernize its flood-mapping technologies and flood-zone hazard maps in order to improve its much needed services. However, the Committee recognizes no justification for the Administration's budget proposal to partially fund flood map modernization efforts through a $15 mortgage transaction fee required for every home purchase or home refinance. The Committee notes the broad-ranging implications of the imposition of such a homeownership tax on over 5 million Americans per year.

The Committee would oppose any attempts to raise flood insurance premiums beyond rates consistent with the maintenance of the NFIP's solvency. Any unjustified increases could deter full participation in the program and damage the fiscal stability of the NFIP.

Community Development Financial Institutions Fund

The Committee opposes any increase in funding for the Community Development Financial Institutions Fund (CDFI). The Committee has not received adequate assurances that CDFI's current operations are fully consistent with Congressional intent and void of any form of misuse of public monies.

Examination Fees for State-Chartered Banks

The Committee in the past has on a bipartisan basis consistently opposed a new Federal examination fee for state-chartered banks. This proposal was submitted by the Administration in each of the five past proposed budgets and the proposal was rejected by this Committee each time. The Administration has renewed its proposal to raise over $900 million by FY 2004 through the imposition of this fee on state-chartered banks. None of the income from these proposed fees would be used to enhance the safety and soundness of state chartered institutions under the President's budget. Every dime of these fees would be spent on totally unrelated programs.

Committee members continue to oppose this tax and to express several concerns with the proposal. First, a new federal examination fee would undermine the "dual banking" system. Second, it would create an inequity for state-chartered banks that already pay exam fees assessed by their state regulators. Third, the banking industry as a whole, including state-chartered banks, cover all the expenses of the Federal Deposit Insurance Corporation (FDIC) through insurance premium assessments and through forgone interest on mandated sterile reserves held by the Federal Reserve System.

Mass Transit

In 1998, Congress passed the Transportation Equity Act for the 21st Century (TEA-21), that provided substantial increases in authorized funding for mass transit and created a separate category for transit spending within overall limits on discretionary spending. The creation of the mass transit category (and a similar category for highway spending) guarantees for the first time that federal gasoline tax revenues will be spent for their intended purpose, mass transit and highway infrastructure. The Committee strongly supports this principle and urges full funding of the mass transit category.

Unfortunately, the President's FY 2000 Budget proposes to deviate from the carefully balanced mechanism created in TEA-21. The precise spending levels for mass transit and highways, and the procedure for adjusting those levels, were the product of sensitive negotiations, and agreement on these issues was only possible after consensus was reached on exactly how that spending would be allocated, both among programs and among the States within those programs.

The President's proposal would create an entirely new mechanism to distribute $1.5 billion in gasoline tax revenues above the levels predicted last year. The Committee opposes reopening TEA-21 less than one year after its enactment, which is the practical effect of the President's proposal, and urges the Budget Committee to follow the funding procedures laid out in TEA-21. Should the budget resolution assume any deviation from current law, the Committee would be compelled to revisit the entire mass transit authorization in order to reconstruct the carefully balanced compromise achieved last year.

Social Security

Currently, Social Security operates as a traditional government benefit program, with payments to beneficiaries financed by current taxes. However, the President's FY2000 Budget proposes one significant departure in the financing of Social Security benefits — the investment by the federal government of Social Security tax receipts in equities.

While not included in the budget's detailed numerical presentations, the President's "Framework" for Social Security would direct about 20% of the portion of the surplus he reserves for Social Security into stock investments. Over time, the federal government would become the largest single investor in the stock market, giving it extraordinary power to distort the flow of capital in the market to further political goals and creating the potential for government interference in the operation of private businesses. Government investment of Social Security funds in equity markets would have the same disastrous economic effects of the state capitalism model which has been practiced and rejected by dozens of countries around the globe. The result would include diminished returns, reduced economic growth, and greater risk to retirees.

If the power of compound interest from investment in private securities is to be unleashed as part of Social Security reform, such investment should be owned by individual Social Security beneficiaries and carried out by professional money managers, subject to regulation only to ensure safety and soundness. The Committee believes that government-run investment as proposed in the President's budget is inconsistent with our mandate to safeguard capital markets and should be rejected.

Yours respectfully,

PHIL GRAMM
Chairman

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

March 5, 1999

The Honorable Pete V. Domenici, Chairman
The Honorable Frank R. Lautenberg, Ranking Member
Committee on the Budget
Washington, D.C. 20510

Dear Chairman Domenici and Senator Lautenberg:

This letter transmits the views and estimates of the Committee on Banking, Housing, and Urban Affairs regarding the funding of programs in our jurisdiction, as required by Section 301 of the Congressional Budget Act of 1974.

Financial Services Modernization

One of the most significant tasks before the Committee this year will be consideration of legislation to modernize our financial services regulatory regime. Legislation to accomplish this goal was ordered reported by the Committee on March 4, 1999. Whether or not they made much sense in the past, current laws defining the boundaries between banking, securities, and insurance activities and the financial institutions that provide these services are now an expensive impediment to meeting the needs of customers and the competitive requirements of our financial industries. While enactment of this legislation is not expected to result in significant budgetary impact in the short run, it should in the long run prove to be an enhancement to economic growth, improving the efficiency and competitiveness of our nation's providers of financial services. The legislation ordered reported by the Committee also makes changes in the Savings Association Insurance Fund (SAIF), namely the elimination of the SAIF Special Reserve and the Deposit Insurance Fund Special Reserve. The need for these reserves no longer exists, and action to return their resources to the general SAIF resources could avoid budget scoring problems in future years. We ask that the Budget Resolution take these changes into account.

Community Reinvestment Act (CRA)

The Community Reinvestment Act was made a part of the federal statutes in 1977 with the limited purpose of requiring banks and savings and loan associations to make loans in the same communities where they take deposits. CRA has since been corrupted into a system of legalized extortion, often with the assistance of regulators. Moreover, it has increasingly replaced market-directed financial activity with politically directed and motivated channeling of private sector financial resources. From a small beginning, CRA-directed funding has taken on a sizeable share of the economy, totaling nearly $700 billion in commitments in 1998. This cronyizing of the American economy is more typical of a third world economy and will undoubtedly be damaging to our national economic growth. It might be advisable for the Congressional Budget Office and others to analyze the impact of CRA on the economy and on federal budgetary receipts.

Taxation of Credit Unions

This Committee is opposed to proposals that would change the tax treatment of credit unions. While direct legislative jurisdiction over taxation of credit unions is not within this Committee's jurisdiction, the vitality and structure of the nation's credit unions is. The contributions that credit unions make to Americans as alternative financial cooperatives are substantial. Credit unions readily fulfill this need for affordable financial services and do so as non-profit institutions. While credit unions continue to fulfill this role as non-profit institutions, taxation of credit unions would be inconsistent with the longstanding principle of tax treatment of such institutions.

International Finance and Trade

The President requested a 10 percent increase in Export-Import Bank funding for Fiscal Year 2000, to $881 million. While the President's lack of a coherent trade policy, particularly his lack of support for fast track trade authority, resulted in a decline of U.S. export receipts during 1998, this failure should not be offset by an increase in Federal export subsidy programs. This increase should not be accommodated in the budget resolution.

The President requested $1.4 billion for multilateral development banks in FY 2000. Although Congress appropriated $1.5 billion in FY 1999, $539 million was subject to an adjustment of the discretionary spending limits under Section 314 of the Congressional Budget Act. This adjustment will not apply to funding of multilateral development banks in FY 2000. Therefore, the President's request is effectively a 49 percent or $457 million increase over the 1999 adjusted level. The Committee believes that this increase should not be accommodated in the budget resolution. Economic development in targeted countries is better addressed through the lowering of trade barriers. The Committee plans extensive oversight hearings this year on all international financial institutions, including the multilateral development banks.

The Banking Committee will consider the re-authorization of the Export Administration Act this year. It is not anticipated, however, that this will require any significant increase in funding to administer our nation's export control program.

Pursuant to the Wye River Memorandum, the Administration requests an emergency supplemental appropriations for the Palestinian Authority in the amounts of $200 million in FY 1999, $100 million in FY 2000 and $100 million in FY 2001. The Committee sees no grounds for inclusion of these funds in an emergency supplemental appropriation. Moreover, the Committee intends to exercise its oversight responsibilities to examine carefully the use of previous appropriations to the Palestinian Authority and examine the wisdom of any further transfer of taxpayer funds to the Palestinian Authority.

Financial Regulatory Relief and Economic Efficiency Act of 1999

The Committee will continue this year the process of regulatory reform and relief for our financial institutions and their customers. On February 11, 1999, the Committee ordered reported the Financial Regulatory Relief and Economic Efficiency Act of 1999. One of the provisions of this legislation would allow the Federal Reserve to pay interest on the private-sector bank reserves that it holds. This has been estimated by the Congressional Budget Office to result in a decrease in federal revenues (due to lower payments into the budget from the Federal Reserve) of $214 million in FY2000, and a five-year reduction in revenues of $661 million. On the other hand, these sterile reserves held by the Federal Reserve act as a tax upon banks, and one which banks are increasingly finding ways of avoiding by shifting funds elsewhere, decreasing the ability of the Federal Reserve to conduct monetary policy. For that reason, this provision has the support of the Federal Reserve Board and was reported out of the Committee without objection. We request that this change in law be accommodated in the budget resolution.

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An ongoing concern of the Banking Committee is the large degree to which the fees collected by the Securities and Exchange Commission surpass the funding needed to operate the agency. In an attempt to reduce this disparity, provisions designed to phase in lower transactions fees were included in the National Securities Markets Improvement Act of 1996. Nonetheless, despite these efforts, the aggregate fee revenue has continued to outstrip the funding needs of the agency. For example, the actual fee revenue collected by the agency in fiscal year 1998 was $1.78 billion, while the SEC's appropriated spending level was just $341 million. Furthermore, fee revenue is expected to continue to exceed future SEC spending levels. Given the estimated fee collections of $1.62 billion, the revenues will exceed the agency's funding by almost 450% even if the agency is awarded its full FY 2000 budget request of $360.8 million. These fees clearly are taxes, not just user fees. The Committee will once again seek to enact legislation that will reduce the level of these fees to a position more in line with the agency's expenditures. Therefore, the Budget Committee should not assume such a continuing imbalance between SEC fee revenues and funding requirements.

Another priority of the Committee is the consideration of legislation designed to provide regulatory relief to the securities industry and its customers. In 1996, the Congress enacted the aforementioned National Securities Markets Improvement Act (NSMIA), which made changes to nearly every federal securities statute. The Committee plans to build upon the groundwork laid in NSMIA and embark upon a new effort to update our securities statutes in an effort maximize the economic efficiency with which our country's securities markets operate. Even though the budgetary impact of each of these changes is likely to be small, their cumulative beneficial effect on the overall economy could be substantial over time.

While the Committee on Agriculture, Nutrition and Forestry has original jurisdiction over the Commodity Futures Trading Commission (CFTC), the Banking Committee believes that the proposals to institute new CFTC fees have the potential to distort the allocation of capital between the commodities and securities markets and urges the Budget Committee to reject such proposals.

Public Utility Holding Company Act of 1999

On February 11, 1999, the Committee ordered reported the bill S. 313, the "Public Utility Holding Company Act of 1999." This bill represents the first step toward passing comprehensive electricity deregulation in the Senate, and it is expected to be joined on the Senate Floor with other elements of reform.

While the direct budgetary impact from enactment of S. 313 and related provisions is expected to be small, the General Accounting Office projects that the federal government, as the largest electric consumer in the country, could save hundreds of millions of dollars per year in the future as competition lowers retail electricity prices (GAO/RCED-97-244 September 30, 1997).

Housing and Community Development

The Committee notes favorably the passage of two major housing reform bills in the 105th Congress. The Multifamily Assisted Housing Reform and Affordability Act (MAHRAA) and the Quality Housing and Work Responsibility Act (QHWRA) were passed by the Banking Committee and adopted in the Fiscal Year 1998 and Fiscal Year 1999 VA-HUD-Independent Agencies Appropriations Acts, respectively.

Oversight of the Department of Housing and Urban Development (Department) is a priority for the Committee. The Committee continues diligent oversight of HUD's regulatory processes as the Department begins implementation of the Section 8 multifamily program reforms established by MAHRAA and the public housing reforms established by QHWRA, and will ensure that Congressional intent is honored.

MAHRAA reforms, known as "mark-to-market", should be fully implemented by Fiscal Year 2000. If these reforms are implemented in accordance with Congressional intent and in timely fashion, significant short- and long-term savings in mandatory and discretionary budget authority will result.

Public housing reforms contained in QHWRA should also be fully implemented by Fiscal

Year 2000. Such reforms will result eventually in increased operating efficiencies and income for public housing authorities. The Committee anticipates that over time this will result in a reduced need for HUD budget authority and outlays.

The Committee continues its ongoing interest in reviewing HUD's mission and in consolidating or eliminating housing and community development programs in order to improve efficiencies, enhance accountability, save taxpayer money and provide greater responsibility and flexibility to State and local governments.

The Administration's Fiscal Year 2000 budget proposes a $2.5 billion increase in budget authority and a myriad of new programs and responsibilities for the Department of Housing and Urban Development. The budget is apparently based on the premise that HUD has put its house in order and is capable of expanding its reach. HUD, however, remains classified by the General Accounting Office as a "high-risk" agency, and Congress must review carefully HUD's budget proposals in the context of the Department's well-established and longstanding weaknesses. In FY 1999, $8.8 billion was appropriated for HUD programs whose authorizations expired in FY 1994. The Committee believes these programs deserve careful review before launching several new initiatives.

Despite the laudable goals of many of the proposed initiatives, the Committee finds no rationale for the creation or expansion of programs to serve public policy purposes which are or could otherwise be served within HUD's existing programmatic framework or through the efforts of another agency. The Committee has particular concerns with Administration proposals that are inconsistent with HUD's mission and capacity. In addition, increased funding for these and other discretionary programs are financed in the President's budget through tax increases. In an era of record-high federal revenues, the Committee urges that HUD programs be funded within existing spending allocations. The Committee sees no justification for increasing HUD's overall funding and is opposed to any tax increases.

Further, the Committee strongly opposes proposals to convert discretionary programs into mandatory programs. The Committee is also concerned about the President's proposal to provide only partial funding of section 8 contract renewals in FY 2000, while requesting remaining funds as an advance appropriation for FY 2001. Such a program, if enacted, would only add further uncertainty and volatility to this troubled program.

In order for the Department to fulfill its historic mission within the resources available, the Committee recommends that HUD concentrate its efforts on the effective development of multifamily and public housing reform regulations and the successful implementation of its management reform plan.

National Flood Insurance Program

The Committee has shown consistent support for the National Flood Insurance Program (NFIP), as administered by the Federal Emergency Management Agency (FEMA). The Committee notes favorably the three-year reauthorization of the NFIP in the Quality Housing and Work Responsibility Act which was adopted in the Fiscal Year 1999 VA-HUD-Independent Agencies Appropriations Act.

The Committee supports FEMA's efforts to update and modernize its flood-mapping technologies and flood-zone hazard maps in order to improve its much needed services. However, the Committee recognizes no justification for the Administration's budget proposal to partially fund flood map modernization efforts through a $15 mortgage transaction fee required for every home purchase or home refinance. The Committee notes the broad-ranging implications of the imposition of such a homeownership tax on over 5 million Americans per year.

The Committee would oppose any attempts to raise flood insurance premiums beyond rates consistent with the maintenance of the NFIP's solvency. Any unjustified increases could deter full participation in the program and damage the fiscal stability of the NFIP.

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The Committee opposes any increase in funding for the Community Development Financial Institutions Fund (CDFI). The Committee has not received adequate assurances that CDFI's current operations are fully consistent with Congressional intent and void of any form of misuse of public monies.

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The Committee in the past has on a bipartisan basis consistently opposed a new Federal examination fee for state-chartered banks. This proposal was submitted by the Administration in each of the five past proposed budgets and the proposal was rejected by this Committee each time. The Administration has renewed its proposal to raise over $900 million by FY 2004 through the imposition of this fee on state-chartered banks. None of the income from these proposed fees would be used to enhance the safety and soundness of state chartered institutions under the President's budget. Every dime of these fees would be spent on totally unrelated programs.

Committee members continue to oppose this tax and to express several concerns with the proposal. First, a new federal examination fee would undermine the "dual banking" system. Second, it would create an inequity for state-chartered banks that already pay exam fees assessed by their state regulators. Third, the banking industry as a whole, including state-chartered banks, cover all the expenses of the Federal Deposit Insurance Corporation (FDIC) through insurance premium assessments and through forgone interest on mandated sterile reserves held by the Federal Reserve System.

Mass Transit

In 1998, Congress passed the Transportation Equity Act for the 21st Century (TEA-21), that provided substantial increases in authorized funding for mass transit and created a separate category for transit spending within overall limits on discretionary spending. The creation of the mass transit category (and a similar category for highway spending) guarantees for the first time that federal gasoline tax revenues will be spent for their intended purpose, mass transit and highway infrastructure. The Committee strongly supports this principle and urges full funding of the mass transit category.

Unfortunately, the President's FY 2000 Budget proposes to deviate from the carefully balanced mechanism created in TEA-21. The precise spending levels for mass transit and highways, and the procedure for adjusting those levels, were the product of sensitive negotiations, and agreement on these issues was only possible after consensus was reached on exactly how that spending would be allocated, both among programs and among the States within those programs.

The President's proposal would create an entirely new mechanism to distribute $1.5 billion in gasoline tax revenues above the levels predicted last year. The Committee opposes reopening TEA-21 less than one year after its enactment, which is the practical effect of the President's proposal, and urges the Budget Committee to follow the funding procedures laid out in TEA-21. Should the budget resolution assume any deviation from current law, the Committee would be compelled to revisit the entire mass transit authorization in order to reconstruct the carefully balanced compromise achieved last year.

Social Security

Currently, Social Security operates as a traditional government benefit program, with payments to beneficiaries financed by current taxes. However, the President's FY2000 Budget proposes one significant departure in the financing of Social Security benefits — the investment by the federal government of Social Security tax receipts in equities.

While not included in the budget's detailed numerical presentations, the President's "Framework" for Social Security would direct about 20% of the portion of the surplus he reserves for Social Security into stock investments. Over time, the federal government would become the largest single investor in the stock market, giving it extraordinary power to distort the flow of capital in the market to further political goals and creating the potential for government interference in the operation of private businesses. Government investment of Social Security funds in equity markets would have the same disastrous economic effects of the state capitalism model which has been practiced and rejected by dozens of countries around the globe. The result would include diminished returns, reduced economic growth, and greater risk to retirees.

If the power of compound interest from investment in private securities is to be unleashed as part of Social Security reform, such investment should be owned by individual Social Security beneficiaries and carried out by professional money managers, subject to regulation only to ensure safety and soundness. The Committee believes that government-run investment as proposed in the President's budget is inconsistent with our mandate to safeguard capital markets and should be rejected.

Yours respectfully,

PHIL GRAMM
Chairman

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
002. memo	Memorandum to the President (3 pages)	02/22/1999	P5

COLLECTION:

Clinton Presidential Records
Policy Development
Lisa Green
OA/Box Number: 20587

FOLDER TITLE:

[Community Reinvestment Act Legislative Strategy] [1] [loose]

2012-0043-S
ms435

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

- **P1** National Security Classified Information [(a)(1) of the PRA]
- **P2** Relating to the appointment to Federal office [(a)(2) of the PRA]
- **P3** Release would violate a Federal statute [(a)(3) of the PRA]
- **P4** Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
- **P5** Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
- **P6** Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

- **C.** Closed in accordance with restrictions contained in donor's deed of gift.
- **PRM.** Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
- **RR.** Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

- **b(1)** National security classified information [(b)(1) of the FOIA]
- **b(2)** Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
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- **b(7)** Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
- **b(8)** Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
- **b(9)** Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

SR|PW

This is a very good + helpful memo. We should clearly find a way to send this to POTUS -- even if don't include the last section. 2s Gramm's message re race-based quotas? If so, must think through response. Second, what if chances that Gramm has really bad examples for hearing. Must consider implications.

GG 2/27

Sarah Rosen
02/22/99 08:10:07 AM

Record Type: Record

To: See the distribution list at the bottom of this message

cc:

Subject: DRAFT POTUS CRA Memo

As I have discussed with many of you, the President has been talking "off the cuff" recently about protecting CRA. Paul and I thought it was important that he have a bit more detail about the debate on CRA, so that he understands the context in which his statements will be read. He cares passionately about the subject and has the appetite for more information here.

Attached is the draft for your comment. As I discussed with Gary, Paul feels strongly that we raise for the President the possibility (without any recommendation) of taking a more aggressive, pro-expansion position as a tactical move. I know that others feel that would be a mistake, alienating moderate Democrats, and question if it need be mentioned here. We've included a brief discussion at the end for your comment.

crapotus.me

Also, Treasury is working on the draft the reply letter to Senator Gramm. It would be easier for us to share both this memo and that draft with Gene and Bruce at the same time. Thanks.

Message Sent To:

Gary.gensler @ treas.sprint.com @ inet
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greg.baer @ treas.sprint.com @ inet
karen.kornbluh @ treas.sprint.com @ inet
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WEINSTEIN_P @ A1@CD@VAXGTWY @ VAXGTWY
Roger S. Ballentine/WHO/EOP

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b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

Community Reinvestment Act: Challenges Remain to Successfully Implement CRA (Chapter Report, 11/28/95, GAO/GGD-96-23).

Pursuant to a congressional request, GAO reviewed the major problems in implementing the Community Reinvestment Act (CRA), focusing on the: (1) extent to which regulatory reforms address these problems; (2) challenges regulators face in ensuring the success of CRA reforms; and (3) initiatives taken to enhance lending opportunities in low-income areas.

GAO found that: (1) bankers, community groups, and regulatory officials generally agree that there is too much reliance on bank documentation efforts and processes and CRA examinations are inconsistent and fail to reflect the accuracy of a lending institution's performance; (2) the revised CRA regulations clarify the data used to assess results against performance-based standards, but the affected parties disagree about whether the data collection requirements provide for meaningful performance assessment or are unduly burdensome; (3) differences in examiner training and experience, vague interpretations of CRA standards, and inadequate information and time for implementing CRA performance ratings will challenge regulators as they implement the revised regulations; (4) bankers, regulators, and community groups are taking part in a variety of individual and cooperative initiatives to improve community lending and reduce related burdens; (5) barriers to community lending and investment include the higher costs and risks associated with community lending and the underwriting requirements of major participants in secondary mortgage markets; and (6) Congress has considered proposals to amend CRA that will reduce the compliance burden and exempt small institutions from CRA requirements.

--------------------------- Indexing Terms -----------------------------

REPORTNUM:	GGD-96-23
TITLE:	Community Reinvestment Act: Challenges Remain to Successfully Implement CRA
DATE:	11/28/95
SUBJECT:	Proposed legislation
	Regulatory agencies
	Bank examination
	Banking law
	Banking regulation
	Community development programs
	Reporting requirements
	Lending institutions
	Economically depressed areas
IDENTIFIER:	Community Reinvestment Improvement Act of 1995
	Microenterprise Opportunity Expansion Act
	RTC Community Investment Program
	RTC Affordable Housing Program
	Community Banking and Economic Empowerment Act of 1993

Cover
== COVER

Report to Congressional Requesters

November 1995

COMMUNITY REINVESTMENT ACT -
CHALLENGES REMAIN TO SUCCESSFULLY
IMPLEMENT CRA

GAO/GGD-96-23

Community Reinvestment

(233410)

Abbreviations
== ABBREV

ATM - Automated Teller Machine
BEA - Bank Enterprise Act
BHC - Bank Holding Company
CA - Community Affairs
CAO - Community Affairs Office
CDB Act - Community Development Banking and Financial Institutions Act
CDC - Community Development Corporation
CDD - Community Development Division
CDFI - Community Development Financial Institution
CRA - Community Reinvestment Act
ECOA - Equal Credit Opportunity Act
Fannie Mae - Federal National Mortgage Association
FHA - Fair Housing Act
FHFB - Federal Housing Finance Board
FHLB - Federal Home Loan Bank
FDIC - Federal Deposit Insurance Corporation
FDICIA - Federal Deposit Insurance Corporation Improvement Act
FIRREA - Financial Institutions Reform, Recovery, and Enforcement Act
FRB - Federal Reserve Board
Freddie Mac - Federal Home Loan Mortgage Corporation
HMDA - Home Mortgage Disclosure Act
MSA - Metropolitan Statistical Area
OCC - Office of the Comptroller of the Currency
OTS - Office of Thrift Supervision
SBA - Small Business Administration

Letter
== LETTER

B-259931

November 28, 1995

The Honorable Jim Leach
Chairman
The Honorable Henry B. Gonzalez
Ranking Minority Member
Committee on Banking and
Financial Services
House of Representatives

The Honorable Marge Roukema
Chairwoman
The Honorable Bruce F. Vento
Ranking Minority Member
Subcommittee on Financial
Institutions and Consumer Credit
Committee on Banking and
Financial Services
House of Representatives

The Honorable Joseph P. Kennedy II
House of Representatives

This report responds to requests concerning the effectiveness of the Community Reinvestment Act. It discusses the major problems with the implementation of the act identified by the affected parties, the extent to which the recent regulatory reform efforts have addressed those problems, and the challenges that regulators need to address as they implement the new CRA regulations. It also discusses initiatives that banks have taken independently or in partnership with others to enhance community lending.

We are sending copies of this report to the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the Acting Director of the Office of Thrift Supervision. We are also sending copies to members of the House and Senate banking committees, other interested committees and subcommittees, and other interested parties.

This report was prepared under the direction of Mark J. Gillen, Assistant Director. If you have any questions, please call me on (202) 512-8678.

James L. Bothwell, Director
Financial Institutions
and Markets Issues

EXECUTIVE SUMMARY
== Chapter 0

PURPOSE
-- Chapter 0:1

Concerns that banks and thrifts (institutions) were not responsive to credit needs in low- and moderate-income areas prompted Congress to enact the Community Reinvestment Act of 1977 (CRA). CRA requires the federal bank and thrift regulatory agencies (regulators) to encourage institutions to help meet credit needs in all areas of the communities they serve, consistent with safe and sound operations. CRA also requires the regulators to assess institutions' CRA performance during examinations and to consider that performance in their evaluations of institutions' applications for expanding or relocating of their operations. Growing concern about the effectiveness of CRA's implementation and its regulatory burden on institutions recently led to the regulators' major reform effort, which resulted in revised CRA regulations that were issued in May 1995.

The former Chairmen, House Committee on Banking, Finance and Urban Affairs and its Subcommittee on Consumer Credit and Insurance, asked GAO to address four questions: (1) What were the major problems in implementing CRA, as identified by the affected parties--bankers, regulators, and community groups? (2) To what extent do the regulatory reforms address these problems? (3) What challenges do the regulators face in ensuring the success of the reforms and what, if any, actions would help the regulators in facing these challenges? and (4) What initiatives have been taken or proposed to help bankers overcome community lending barriers and enhance lending opportunities, particularly in low- and moderate-income areas?

BACKGROUND

-- Chapter 0:2

The debate preceding enactment of CRA was similar to the current debate. Community groups urged its passage to curb what they believed to be a lack of adequate lending in low- and moderate-income areas. Bankers generally opposed CRA as an unnecessary measure that could adversely affect business decisions by mandating credit allocation and cause safety and soundness problems by forcing institutions to make excessively risky loans. More recently, changing market conditions along with increased public disclosure have raised bankers' concerns about the issues of competition and regulatory burden. More specifically, bankers have become concerned about the competitive advantages for nonbank financial institutions, such as mortgage companies, that compete with banks but are not subject to CRA requirements. Bankers also objected that the cost and paperwork burdens imposed by CRA are not offset by positive incentives, such as protection against protests of expansion plans, to encourage CRA compliance. However, community groups have raised concerns about limited CRA enforcement and insufficient disclosure of information on institutions' community lending performance.

As concerns about CRA increased from all affected parties, both the administration and Congress looked for ways to make CRA more effective and less burdensome. The stated goals of the regulators' reform initiative, announced by the President in July 1993, were to (1) base CRA examinations more on results than paperwork, (2) clarify performance standards, (3) make examinations more consistent, (4) improve enforcement to provide more effective sanctions, and (5) reduce the cost and burden of compliance. Subsequently, the regulators issued two notices of proposed rule-making and, after receiving extensive public comments, promulgated the revised CRA regulations in May 1995. Several legislative proposals have also sought to reduce the burden associated with CRA compliance.

RESULTS IN BRIEF

-- Chapter 0:3

Through interviews with bankers, community groups, and regulatory officials, GAO identified four major problems with the regulators' compliance examinations and enforcement of CRA that all the affected parties agreed were problems: (1) too little reliance on lending results and too much reliance on documentation of efforts and processes, leading to an excessive paperwork burden; (2) inconsistent CRA examinations by regulators resulting in uncertainty about how CRA performance is to be rated; (3) examinations based on insufficient information that may not reflect a complete and accurate measure of institutions' performance; and (4) dissatisfaction with regulatory enforcement of the act, which largely relies on protests of expansion plans to ensure institutions are responsive to community credit needs. However, the reasons they gave for why they believed the problems adversely affected their interests--which form the basis for their concerns--and the often contradictory solutions they offered to address the problems, showed that the affected parties differed considerably on how best to revise CRA.

The revised CRA regulations address some, but not all, of the major problems. In response to the first problem, the regulations adopt a results-based examination process. The regulators' success in lessening problems related to inconsistent examinations largely depends on how effectively examiners exercise their discretion when implementing the reforms. To alleviate concerns about insufficient information, the regulations clarify the data to be used to assess results against performance-based standards. However, the affected parties disagree about whether the data collection requirements provide for meaningful performance assessment or are unduly burdensome. The regulations do not address the different enforcement concerns of bankers and community groups.

From its review, GAO believes that some of the difficulties that have hindered past CRA implementation efforts will likely continue to challenge the regulators as they implement the revised regulations. These difficulties include (1) differences in examiner training and experience levels as well as differences in how examiners interpret vague CRA standards; (2) insufficient information to assess institutions' CRA performance and inadequate disclosure in public evaluation reports of the information and rationale used to determine institutions' CRA performance ratings; and (3) insufficient time for examiners to complete all of their responsibilities during CRA examinations. In addition, some regulators were unable to complete CRA examinations for all their banks within their proposed time frames. Furthermore, the regulators estimate that the revised regulations will increase examiner responsibilities, including performing analyses previously required of institutions.

GAO also found from its review that, independent of the regulatory and legislative reform efforts, many bankers, regulators, community groups, and others have taken part in a variety of individual and cooperative initiatives to improve institutions' community lending and reduce related burdens. Through these initiatives, according to participants, institutions have been able to overcome real or perceived barriers to lending in low- and moderate-income areas (community lending). Barriers to community lending and investment may include a variety of economic factors, such as higher costs and risks of community lending compared with other lending and underwriting requirements of major participants in the secondary mortgage markets.

Regulators, to varying degrees, have also played a key role in facilitating cooperation and disseminating information to their institutions about such initiatives through outreach efforts of their community affairs programs. As they further develop these programs and better coordinate their efforts, the regulators' role in this respect should be enhanced.

Congress has considered proposals to amend CRA to reduce the compliance burden and to exempt small institutions from its requirements. In addition, Congress, in recently enacted legislation, has encouraged community development lending. Further, other legislation has been proposed to encourage community lending through financial subsidies or other positive incentives.

PRINCIPAL FINDINGS
-- Chapter 0:4

AFFECTED PARTIES AGREE ON MAJOR PROBLEMS BUT CONCERNS AND SOLUTIONS DIFFER
-- Chapter 0:4.1

All of the affected parties that GAO spoke with--bankers, community groups, and regulators--generally agreed on the problems with the implementation of CRA. However, the reasons they gave for why they believed the problems adversely affected their interests--which form the basis for their concerns--and the often contradictory solutions they offered to address the problems showed that the affected parties differed considerably on how best to revise CRA. Bankers generally analyzed problems in terms of regulatory burden and wanted regulatory or legislative changes that would reduce the burden of paperwork and data reporting. They also generally supported proposals to increase certainty about performance ratings through regulatory guarantees such as safe harbors that would protect highly rated institutions from CRA-based protests of applications for expansion or relocation. In addition, they believed that CRA performance standards should be flexible enough to consider factors such as an institution's business strategy, financial condition, and its community's credit needs.

Community groups, however, raised concerns about their ability to hold institutions, as well as regulators, accountable for performance and sought changes to increase that accountability. For example, they wanted to improve the disclosure of information in public evaluation reports so that they could assess institutions' community lending performance more easily. Community groups also identified as a problem the fact that enforcement of the act was limited to regulatory denials of applications for expansion or relocations of their operations. Their concern was that no sanctions were available to penalize poor performers that did not have plans to expand or move. To strengthen regulators' enforcement of the act, they advocated use of additional enforcement actions, such as cease-and-desist orders and civil money penalties. They strongly opposed safe harbors.

REVISED REGULATIONS ADDRESS SOME, BUT NOT ALL, MAJOR PROBLEMS
-- Chapter 0:4.2

Overall, the revised regulations address some of the major problems of the affected parties but do not wholly satisfy the often contradictory positions of bankers and community groups. The regulations address the problem of overreliance on documentation of an institution's compliance efforts and processes by shifting the focus of assessment standards from compliance efforts to actual results in three performance areas--lending, investment, and services.

The potential effect of the regulations on some of the other problems is not as clear. Effective implementation of the regulations is key to addressing examination-related inconsistency because examiners are to continue exercising considerable discretion in assessing an institution's performance. In developing the regulations, the regulators tried to balance the need for objective standards with the need for flexibility in assessing different types of institutions operating under differing financial conditions and serving widely different types of communities. The revised regulations have increased examiner responsibilities, created the need for related comprehensive examiner training, and could affect the amount of resources needed to effectively complete examinations.

The revised regulations may not entirely resolve the problem of insufficient data for performing CRA examinations. Although the regulations clarify the data collection requirements to assess institutions' CRA performance, they do not directly address the problems of inaccurate data provided by institutions or the inadequate disclosure of information in the public evaluation reports. Public evaluation reports are the public's primary source of information about institutions' CRA performance and the regulators' consistency in CRA examinations.

Also, the revised regulations do not resolve the widespread dissatisfaction with regulatory enforcement of the act. The initial reform proposals sought to strengthen enforcement by calling for regulators to use existing formal enforcement actions set forth in the banking laws, such as cease-and-desist orders and civil money penalties. However, the Department of Justice issued an opinion in late 1994 that such actions are not within the scope of CRA. The reforms would also have addressed bankers' concerns by specifying how CRA ratings would be considered in applications, i.e., a "satisfactory" or better rating would generally result in the approval of an application. However, many commentors to the proposed rules objected to the perceived restriction on public protests of banks' applications. Consequently, both proposed measures were dropped from consideration by the regulators.

CHALLENGES TO SUCCESSFULLY IMPLEMENTING REGULATIONS

-- Chapter 0:4.3

From its review, GAO found several challenges that the regulators face to successfully implement the revised regulations. Inconsistency resulted in part from examiners (1) exercising considerable discretion in interpreting vague CRA standards and (2) rating institutions' performance differently by focusing on different parts of the examination guidance. Frequent changes in the focus of examinations within the past several years also contributed to inconsistency. Insufficient examiner experience and training was cited by bankers and community groups as further contributing to inconsistency because it led to inadequate expertise on the part of examiners knowing how to properly evaluate institutions' community lending performance.

Some examiners told GAO that they had difficulty assessing compliance when data provided by institutions were inaccurate or incomplete. In addition, some of the regulators reported data quality problems with home mortgage lending data submitted by institutions and used by the regulators to assess performance. Further, the regulators' responses to institutions with poor data quality have been inconsistent.

Information accessibility has been a concern of community groups that monitor institutions' CRA performance and the regulators' CRA examinations. Some of these groups were concerned that publicly available evaluation reports do not provide enough information about institutions' actual lending performance. In addition, inadequate information about the regulators' rationale for how they rate institutions has contributed to concerns by bankers and the public about examination consistency.

Finally, some examiners told GAO that they lacked the time during examinations to perform all of the data gathering and analysis tasks that they are expected to do during CRA examinations, such as making contacts in the community to assess community needs. Some regulatory officials estimate that implementation of the revised regulations will require examiners to do more during examinations. Recognizing this possibility, the regulators are developing new techniques to reduce examination time. If these efforts are not successful, examiners may face situations where they either cannot perform necessary analyses or must shift responsibility for conducting such analyses back to the institutions. Such actions could reduce examination quality as well as increase institutions' regulatory burden.

INITIATIVES HAVE OVERCOME SOME BARRIERS TO COMMUNITY LENDING
-- Chapter 0:4.4

Successful community lending initiatives have demonstrated that having good communication and cooperation among regulators, bankers, community groups, and others is key to overcoming lending barriers. In such initiatives, institutions have made community lending an integral part of their business strategies; involved community groups in their plans and programs; and developed targeted underwriting standards, programs, and products to meet community needs. From its review, GAO learned of community lending initiatives that participants believe may overcome perceived or actual barriers to lending in low- and moderate-income areas. Barriers described by bankers included higher transaction costs and credit risks as well as restrictions related to secondary mortgage market underwriting standards. Some bankers have found ways that may lower the relatively high transaction costs and credit risks to individual institutions of community reinvestment loans by sharing those costs and risks through participations in multi-institution programs. In addition, some major participants in the secondary markets have recently undertaken initiatives intended to make them more responsive to community development concerns. Furthermore, Congress has enacted legislation to facilitate community lending through other means, such as the recently enacted Riegle Community Development and Regulatory Improvement Act of 1994, which authorized funds for community partnerships to help finance revitalization projects, and the Bank Enterprise Act, which authorized direct subsidies for certain community lending activities.

GAO also found that banking regulators, to varying degrees, play a key role in helping institutions enhance their community lending programs. Using the available resources of their community affairs programs, some regulators have helped facilitate community development by disseminating information about various community lending techniques and investment opportunities. The resources and longevity of the regulators' community affairs programs differ. For example, the Federal Reserve Board's (FRB) program has a full-time staff of 70 and was established in the early 1980s, while the Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency (OCC) each has fewer than 10 full-time staff in its recently established program. Further development of these programs and better coordination of efforts could enhance the regulators' role in encouraging community development lending.

CONGRESS HAS CONSIDERED PROPOSALS TO REDUCE BURDEN AND ENCOURAGE COMMUNITY

LENDING
-- Chapter 0:4.5

Congress has considered proposals that would reduce the burden of complying with CRA and encourage banks to lend to all areas of their community. Many bankers have supported proposals that would amend CRA to exempt small banks from CRA examinations. Bankers and others have also suggested that CRA be replaced or supplemented with financial subsidies or other positive incentives. Some of their suggested alternatives have included modifying or supplementing CRA with incentives such as tax credits, deposit insurance credits, streamlined or less frequent examinations, and revisions of safety and soundness requirements for CRA lending. Community groups have generally opposed proposals that would reduce CRA obligations for financial institutions, but some groups have supported proposals that would increase incentives for community lending.

The varied positions taken by the affected parties further demonstrate that the debate about how best to achieve the goals of community reinvestment is both complicated and contentious. The approach embodied in the current CRA statute uses the levers of compliance examinations and application aprovals to increase community reinvestment lending. The new regulations are an attempt to generate better results with less regulatory burden. However, given the positions of the different parties, it is not clear that the results will fully satisfy all of those parties.

MATTER FOR CONGRESSIONAL
CONSIDERATION
-- Chapter 0:5

If the concerns raised by the affected parties should persist even after the regulators have had sufficient time to implement the revised regulations, Congress may want to consider revisiting and revising the CRA statute to clarify its intent and scope, possibly examining alternative strategies for reaching its goals. Such strategies might include incentives to strengthen positive CRA performance by bankers and additional enforcement authority for regulators to discourage negative performance.

RECOMMENDATIONS
-- Chapter 0:6

GAO is also making recommendations to the heads of the federal bank and thrift regulatory agencies related to the major challenges identified by GAO that have hindered past CRA implementation efforts. The recommendations on page 66 are intended to ensure the effective implementation of the revised regulations and consistency of CRA examinations.

AGENCY COMMENTS
-- Chapter 0:7

GAO received written comments on a draft of this report from the Federal Deposit Insurance Corporation (FDIC), FRB, OCC, and OTS. A discussion of the regulators' comments and GAO's evaluation appears at the end of chapters 3 and 4. Overall, officials from the four banking agencies generally agreed with the report's discussion of major concerns and problems that the regulators and other affected parties have faced as they sought to build into the revised regulations an appropriate balance between flexibility and consistency for CRA compliance examinations. In general, the regulators acknowledged that GAO's recommendations were considered and have been, or will be, useful to them as they seek to address CRA compliance through the revised regulations. The regulators pointed out actions they plan to take as they implement the revised regulations, including interagency training and development of uniform performance evaluations. These actions focus on ensuring consistent interpretations of the revised regulations.

With regard to the "Matter for Congressional Consideration," FDIC and OCC were concerned that congressional action before sufficient time has passed for full implementation of the revised regulations may be premature and that further revisions to CRA without feedback on the effectiveness of the revised regulations could undermine their implementation. OTS noted that the agencies have already agreed to conduct a full review of the revised regulations 5 years after they are fully implemented. GAO agrees that the regulators have made extensive efforts in revising the regulations to address the diverse concerns raised about the effectiveness of CRA. Consequently, GAO modified the matter for congressional consideration to suggest that Congress may want to consider the results from implementation of the revised CRA regulation in its deliberation as to whether the objectives of community reinvestment are being well served through the CRA statute and regulations.

INTRODUCTION

== Chapter 1

Congressional concerns that banks and thrifts (institutions) were not adequately responsive to credit needs of the communities they served, including low- and moderate-income areas, prompted the passage of the Community Reinvestment Act (CRA) in 1977. The act requires each federal bank and thrift regulator--the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) for banks, and the Office of Thrift Supervision (OTS) for thrifts--(regulators) to encourage institutions under its jurisdiction to help meet the credit needs in all areas of the community the institution is chartered to serve, consistent with safe and sound operations. The act also requires the regulators to periodically assess institutions' community lending performance during examinations and to consider that performance in their evaluations of institutions' applications for expansion or relocation of their operations. Growing concern about the effectiveness of CRA's implementation and its regulatory burden on institutions led to the regulators' major reform effort, which resulted in two major proposed CRA revisions, issued in December 1993 and October 1994, and a final revised CRA regulation in May 1995.

This report responds to a request from the former Chairmen, House Committee on Banking, Finance and Urban Affairs and the Subcommittee on Consumer Credit and Insurance asking us to evaluate whether the regulators' reform efforts would improve compliance with the CRA, encourage institutions' lending to their entire communities, and reduce unnecessary burden. The former Chairmen also asked us to evaluate the regulators' implementation of the fair lending laws--the Fair Housing Act (FHA), the Equal Credit Opportunity Act (ECOA), and the Home Mortgage Disclosure Act (HMDA). The result of our work on fair lending will be discussed in a separate report.

BACKGROUND

-- Chapter 1:1

The debate preceding enactment of CRA was similar to the current debate. Community groups urged its passage to curb what they believed to be a lack of adequate lending in low- and moderate-income areas. Bank and thrift officials (bankers) generally opposed CRA as an unnecessary measure that could, among other things, unduly affect business decisions by mandating credit allocation and cause safety and soundness problems by forcing institutions to make excessively risky loans.

AMENDMENTS TO CRA
-- Chapter 1:1.1

Since the passage of CRA, the regulatory, economic, and legislative environments have changed. It is therefore useful to review the history of, and substantive amendments to, CRA to understand its origins and where emphasis has shifted. Table 1.1 briefly illustrates the major amendments to CRA since its passage.

Table 1.1

Amendments to CRA

Year	Amendments
1977	Passed as title VIII of the Housing and Community Development Act of 1977.
1989	Amended by the Financial Institution Reform, Recovery, and Enforcement Act of 1989 (FIRREA) to require that the CRA examination rating and a written evaluation of each assessment factor be made publicly available. FIRREA also established a four-part qualitative rating scale.
1991	Amended by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) to require public discussion of data underlying the regulator's assessment of an institution's CRA performance in the public portion of the CRA evaluation.
1992	Amended by the Housing and Community Development Act of 1992 to provide that the regulators consider activities and investments involving minority-and women-owned financial institutions and low-income credit unions in assessing the CRA performance records of institutions cooperating with such institutions to meet local community credit needs.
1994	Amended by the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 to require that institutions with interstate branching structures receive a separate rating and written evaluation for each state in which they operate and a separate written evaluation of their performance within a multistate metropolitan area where they have branches in two or more states within the area.

Source: GAO's review of the laws.

CRA was passed as title VIII of the Housing and Community Development Act of 1977 (12 U.S.C. 2901 et seq.). CRA requires each federal banking regulator to use its authority, when examining institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered, consistent with the institution's safe and sound operation.\1 In connection with these examinations, the regulators are required to assess an institution's record of lending in its community and take it into account when evaluating any type of application by an institution for a deposit facility.\2

CRA was amended by FIRREA to require that the regulator's examination rating and a written evaluation of each assessment factor be made publicly available. FIRREA also established a four-part qualitative rating scale so that the publicly available CRA ratings would not be confused with the five-part numerical ratings given to institutions by the regulators on the basis of the safety and soundness of their operations. These safety and soundness ratings are confidential. In 1991, FDICIA further amended CRA to require public discussion of data underlying the regulators' assessment of an institution's CRA performance in the public CRA evaluation. The Housing and Community Development Act of 1992 amended CRA to require that the regulators consider activities and investment involving minority- and women-owned financial institutions and low-income credit unions in assessing the CRA performance of institutions cooperating in these efforts. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 amended CRA to require that institutions with interstate branching structures receive a separate rating and written evaluation for each state in which they have branches and a separate written evaluation of their performance within a multistate metropolitan area where they have branches in two or more states within the area.

The principle contained in CRA, that institutions must serve the "convenience and needs" of the communities in which they are chartered to do business consistent with safe and sound operations, is one that federal law governing deposit insurance, bank charters, and bank mergers had embodied before CRA was enacted. The Banking Act of 1935 declared that banks should serve the convenience and needs of their communities. The Bank Holding Company Act, initially passed in 1956, requires FRB, in acting on acquisitions by banks and bank holding companies, to evaluate how well a bank meets the convenience and needs of its communities within the limits of safety and soundness. Under CRA, the concept of "convenience and needs" was refined to explicitly include extensions of credit.

\1 Although the regulations were developed on an interagency basis and are virtually identical, each of the regulators has its own set of CRA regulations. For FRB they can be found at 12 CFR part 228; for OCC at 12 CFR part 25; for FDIC at 12 CFR part 345, and for OTS at 12 CFR part 563e.

\2 An "application for deposit facility" is defined as an application to the appropriate supervising regulator for (1) a charter for a national bank or federal savings and loan (S&L); (2) deposit insurance in connection with a newly chartered state bank, savings bank, S&L, or similar institution; (3) the opening of a domestic branch or other facility with the ability to accept insured bank or S&L deposits; (4) the relocation of a home office or branch; (5) the merger or consolidation with, or acquisition of the assets, or assumption of the liabilities of an insured depository institution; or (6) the acquisition of shares or assets of an insured depository institution requiring approval under the Bank Holding Company Act or the National Housing Act.

THE FAIR LENDING LAWS ARE RELATED TO CRA

-- Chapter 1:1.2

CRA and the fair lending laws, while separate, have related objectives. The primary purpose of CRA was to prohibit redlining--arbitrarily failing to provide credit to low- and moderate-income neighborhoods. FHA and ECOA prohibit lending discrimination based on certain characteristics of potential and actual borrowers. The FHA, passed by Congress in 1968 as title VIII of the Civil Rights Act of 1968, among other things prohibits discrimination in residential real estate-related transactions on the basis of an applicant's race, color, religion, gender, handicap, familial status, or national origin. Such prohibited activities include denying or fixing the terms and conditions of a loan based on discriminatory criteria. The ECOA, passed in 1974, prohibits discrimination with respect to any aspect of a credit transaction based on race, color, religion, national origin, gender, marital status, age, receipt of public assistance, or the exercise, in good faith, of rights granted by the Consumer Credit Protection Act.

HMDA was enacted by Congress in 1975 to provide regulators and the public with information so that both could determine whether depository institutions were serving the credit needs of their communities but was expanded over time to detect evidence of possible discrimination based on the individual characteristics of applicants. HMDA established a reporting obligation for depository institutions. Initially, HMDA required depository institutions with total assets of more than $10 million to compile data on the number and total dollar amount of mortgage loans originated or for which the institution received completed applications or purchased during each fiscal year by geographic area and make that data available for public inspection. In 1989, HMDA was amended to require collection and reporting of data on race, gender, and income characteristics of mortgage applicants to provide data to assist in identifying discriminatory lending practices and enforcing fair lending statutes. Amendments to HMDA in 1988 and 1991 expanded the reporting requirements to most mortgage banking subsidiaries of bank and thrift holding companies and independent mortgage companies not affiliated with depository institutions. In 1992, HMDA was amended to require affected financial institutions to make available to the public, upon request, their loan application registers, which maintain data for loans covered by HMDA.

Both HMDA and CRA were originally enacted to remedy a perceived lack of lending by institutions to the communities in which they were chartered to do business by the regulators. HMDA was amended in 1989 to include the collection of data on race, sex, and income of applicants for credit to provide indications of possible lending discrimination. In addition, 2 of the 12 assessment factors, factors D and F, in the current CRA regulation address the issue of discrimination to be considered in determining an institution's CRA rating. Where available, HMDA data are to be used by examiners when assessing compliance with CRA, FHA, and ECOA.

EXAMINATION AND ENFORCEMENT OF CRA

-- Chapter 1:2

The federal banking regulators have primary responsibility for the examination of CRA performance and enforcement of the act. In addition to their responsibilities for examining institutions for financial condition and safe and sound operations, the regulators have been, since the late 1960s, responsible for examining and enforcing laws and regulations primarily related to matters other than safety and soundness. These include various consumer protection or civil rights laws and regulations intended to ensure that the provision of banking services is consistent with legal and ethical standards of fairness, corporate citizenship, and the public interest. These laws include CRA, and the regulators monitor compliance with them through compliance examinations.

THE REGULATORS HAVE APPROACHED COMPLIANCE PROGRAMS DIFFERENTLY

-- Chapter 1:2.1

Since the late 1960s, the number of laws and regulations covered by compliance examinations has increased to over 20. Believing that bank operations had become too complex to be adequately covered by a single group of examiners, the FRB established a special compliance examiner program in 1977, which is responsible for performing compliance examinations separately from safety and soundness examinations. The FRB made the compliance examiner program permanent in 1979. A distinct group of compliance examiners, initially established by this program, has remained in place since 1979 and has grown relative to the number of Federal Reserve member banks.

FDIC initiated a compliance examiner program in the late 1970s that established a compliance specialty but did not represent a separate career path and did not preclude examiners from also conducting safety and soundness examinations. FDIC did not establish an entirely separate compliance examiner force exclusively responsible for compliance examinations until 1990. FDIC's compliance examiner program was not fully staffed, however, until the end of 1993. The compliance examiners remained part of FDIC's Division of Supervision until an August 1994 reorganization that consolidated activities formerly divided between the Division of Supervision and the Office of Consumer Affairs into a single Division of Compliance and Consumer Affairs.

Similar to FDIC, OCC established a compliance examination specialty in the late 1970s. The specialty did not represent a separate career path for examiners and often resulted in examiners spending only a portion of their time doing compliance examinations. Junior examiners were usually responsible for doing compliance examinations. The perceived greater attractiveness of safety and soundness work combined with the safety and soundness crisis in the banking industry during the late 1980s and early 1990s rendered the compliance specialty a low priority.

OCC began to develop a separate compliance program with a separate compliance examiner career path in 1993. OCC currently has an operating staff of compliance examiners composed of approximately 170 people. An additional 110 people are to be part-time compliance examiners who will be expected to devote a minimum of 20 percent of their time to compliance examinations. OCC believes that devoting at least 20 percent of these examiners' time to compliance will ensure that they maintain a sufficient level of expertise. This group is to be responsible for compliance examinations of "program" banks, banks with $1 billion or more in assets. Banks with less than $1 billion in assets, approximately 70 percent of OCC's banks, are to continue to be examined by OCC's nonspecialized examiners.

Although OTS supervises thrifts, as opposed to commercial banks, it is responsible for assessing compliance with most of the same compliance laws and regulations as the banking regulators. In 1989, OTS established a separate compliance examiner program in which compliance examinations are to be conducted by specially trained, career professional staffs in the OTS regional offices. The original mandate for establishing such a program came from the Federal Home Loan Bank Board. The passage of FIRREA, which abolished the Federal Home Loan Bank Board and established OTS, slowed the process of establishing the compliance examiner program. The program was fully implemented in 1990 and as of December 1994, OTS had 105 compliance examiners on board.

Table 1.2 shows the number of institutions subject to examination and the number of compliance examiners for each regulator at year end for the period beginning in 1988.

Table 1.2

Number of Banks, Thrifts, and Compliance Examiners per Regulator From Year-end 1988 to Year-end 1994

Year	Banks	Examiners	Banks	Examiners	Banks	Examiners	Thrifts	Examiners
1988	1,063	116	8,207	22	4,435	N/A	2,970	N/A
1989	1,047	124	7,975	22	4,170	N/A	2,898	N/A
1990	1,014	137	7,838	22	3,973	N/A	2,541	N/A
1991	982	164	7,630	89	3,801	N/A	2,208	82
1992	957	201	7,431	151	3,598	N/A	1,954	92
1993	968	198	7,206	265	3,321	94	1,730	105
1994	979	246	7,031	300	3,078	170	1,543	105

Note: Where a regulator did not maintain a separate compliance examiner program or was unable to provide data, it is noted in the table by an "N/A." For example, OTS was unable to provide the number of compliance examiners before 1991.

Source: Data provided by FRB, FDIC, OCC, and OTS.

The regulators rely primarily on the examination process to ensure that institutions comply with CRA. The CRA examination is a major component of an institution's compliance examination and in some cases, for example, where an application is pending, it is done independently from the compliance examination. Although they have approached their compliance programs differently, the regulators jointly developed and issued the original regulations for CRA examinations in 1978.

CURRENTLY, CRA EXAMINATIONS ARE TO EVALUATE INSTITUTIONS ON TECHNICAL AND QUALITATIVE COMPLIANCE

-- Chapter 1:2.2

When examining an institution's compliance with CRA, an examiner is to evaluate its technical compliance with a set of specific rules, such as recordkeeping requirements, and to qualitatively evaluate the institution's efforts and performance in serving the credit needs of its entire community.\3 The examiner is to do this in a variety of ways, which include using a CRA "examination checklist," reviewing a questionnaire filled out by the institution and returned to the examiner prior to the examination, and reviewing a wide variety of institution records and data. Table 1.3 lists the CRA regulation's technical requirements.

Table 1.3

CRA Technical Regulatory Requirements

Requirements
CRA statement
The board of directors of each institution must adopt, and at least annually review, a CRA statement which the institution will make available to members of the public upon request. The statement should include a delineation on a map of each local community served by the institution and a list of specific types of credit that the institution is prepared to extend within each local community.
Additional information
The regulation also encourages each institution to include additional information in its CRA statement such as how its current efforts help meet community credit needs, a periodic report regarding its record of helping to meet community credit needs, and a description of its efforts to ascertain the credit needs of its community, including efforts to communicate with members of its community regarding credit services.
A copy of the CRA notice
An institution must provide in each office a CRA Notice, the exact wording of which is prescribed in the regulation.
Public file
Each institution must keep a file that is readily available for public inspection consisting of any CRA Statements in effect in the last 2 years, a copy of the public section of the institution's most recent CRA Performance Evaluation, and any written comments, received from the public within the last 2 years, relating to the CRA Statement, Performance Evaluation, or the institution's record of helping to meet community credit needs.
CRA performance evaluation
After a CRA examination, each institution will receive from its regulator a written, public CRA evaluation. This evaluation must be kept in the Public File. The institution must provide a copy of this evaluation to the public upon request, charging a minimal fee.

Source: FRB, FDIC, OCC, and OTS compliance examination manuals.

Assessing compliance with the technical requirements of CRA is relatively straightforward. An institution either maintains its CRA statement and file or it does not, and the examiner can determine whether the institution complied with the technical requirements by working through the CRA checklist. However, assessing qualitative compliance with CRA is more difficult and subjective.

\3 These rules are set forth at 12 CFR part 228 for FRB, 12 CFR part 345 for FDIC, 12 CFR part 25 for OCC, and 12 CFR part 563e for OTS.

These rules remain in effect until July 1, 1997, at which time the new regulations concerning performance tests, standards, and ratings become effective.

CRA COMPLIANCE IS CURRENTLY ASSESSED USING 12 ASSESSMENT FACTORS

-- Chapter 1:2.3

In addition to the technical requirements of the CRA regulations, the regulators are to evaluate each institution on the basis of its efforts to ascertain community credit needs and its determination and performance in helping to meet those needs. When examining an institution, the examiner is instructed to apply the CRA procedures on a case-by-case basis to accommodate institutions that vary in size, type, expertise, and locale. Regulatory guidance indicates that community credit needs will often differ with the specific characteristics of each local community, and institutions may serve these local credit needs in a variety of ways.

The qualitative aspect of an institution's performance is currently to be assessed according to 12 factors. These factors were developed as part of the original regulations implementing CRA and have not changed. To allow the examiner sufficient flexibility necessary to weigh the factors and categories consistent with their significance in the context of a particular institution, the regulators have not assigned a relative weighting to the factors. However, regulatory guidance notes that compliance with antidiscrimination laws and regulations, including ECOA and FHA, is a significant factor in reaching the overall CRA rating. Moreover, regulatory guidance issued in 1992 also stresses that examiners are to weigh CRA performance over process, i.e., how well an institution helps meet the credit needs of its community over documentation showing how the institution ensures CRA compliance.

Financial institutions are to demonstrate their CRA performance under various assessment factors in several ways. For example, an institution is required to assess the credit needs of its community. To show that an assessment was done an institution might document its discussions with members of the community, such as community groups or civic organizations, regarding credit needs of the community. To show that it lends to all parts of its community, an institution might plot its lending data onto a map to show the geographic locations where the institution has extended credit. A sophisticated form of coding loans according to their location is called geocoding.\4

The CRA assessment factors are grouped under five performance categories identified in guidance provided by the regulators and published in the Federal Register on May 1, 1990. Table 1.4 lists the assessment factors to be reviewed by compliance examiners during a CRA examination.

Table 1.4

CRA Assessment Factors

Performance categories and related assessment factors

Ascertainment of community credit needs

Assessment factor A

Activities to ascertain credit needs and efforts to communicate with the community, including the extent of the institution's efforts to communicate with members of its community regarding the credit services being provided by the institution.

Assessment factor C

The extent of participation by the institution's board of directors in formulating the institution's policies and reviewing its performance related to CRA.

Marketing and types of credit offered and extended

Assessment factor B

The extent of the institution's marketing and special credit-related programs to make members of the community aware of the credit services offered by the institution.

Assessment factor I

The institution's origination of residential mortgage loans, housing rehabilitation loans, home improvement loans, and small business or small farm loans within its community, or the purchase of such loans originated in its community.

Assessment factor J

The institution's participation in governmentally insured guaranteed or subsidized loan programs for housing, small businesses, or small farms.

Geographic distribution and record of opening and closing offices

Assessment factor E

The geographic distribution of the institution's credit extensions, credit applications, and credit denials.

Assessment factor G

The institution's record of opening and closing offices and providing services at offices.

Discrimination and other illegal credit practices

Assessment factor D

Any practices intended to discourage applications for types of credit set forth in the institution's CRA Statement(s).

Assessment factor F

Evidence of prohibited discriminatory or other illegal credit practices.

Community development

Assessment factor H

The institution's participation, including investments, in local community development and redevelopment projects or programs.

Assessment factor K

The institution's ability to meet various community credit needs based on its financial condition and size, legal impediments, local economic conditions, and other factors.

Assessment factor L

Any other factors that, in the regulatory authority's judgment, reasonably bear upon the extent to which an institution is helping to meet the credit needs of its entire community.

Source: FRB, FDIC, OCC, and OTS compliance examination manuals.

\4 The location of a loan may be designated in several different ways for the purposes of geocoding, including census tract, zip code, or other designation of local areas.

COMPLIANCE EXAMINATIONS GENERALLY RESULT IN TWO RATINGS
-- Chapter 1:2.4

A compliance examination generally results in two ratings: (1) a compliance rating for an institution's overall compliance effort with regard to various laws, other than CRA, covered by the compliance examination and (2) a CRA rating for the institution's compliance with CRA. Although the regulators may do a CRA examination separately from a compliance examination, officials from all four regulators said that they generally do them together. A compliance rating is based on a numerical scale ranging from 1 for top rated institutions to 5 for the lowest rated institutions. The CRA scale is a four-part descriptive scale including "outstanding," "satisfactory," "needs to improve," and "substantial noncompliance."\5

Although there have been fluctuations over time, approximately 90 percent of all institutions examined for CRA compliance have received a "satisfactory" rating or better since July 1990 when, as a result of amendments to CRA contained in FIRREA, ratings were made public, and the rating scale was changed. Table 1.5 shows aggregate CRA ratings and ratings for each regulator since July 1, 1990, when the regulators began publicly disclosing CRA ratings.

Table 1.5

CRA Ratings for All Banks an
Examined From July 1, 1990
December 31, 1994

Regulators	Rating	Number	Percentage	Number	Percentage	N
FRB	Outstanding	35	11	75	11	
	Satisfactory	239	78	544	80	
	Needs to improve	30	10	52	8	
	Substantial noncompliance	4	1	5	1	
	Total	388	100	676	100	
FDIC	Outstanding	78	6	240	9	

	Satisfactory	1,093	83	2,286	83
	Needs to improve	144	11	215	8
	Substantial noncompliance	6	0	27	1
	Total	1,321	100	2,768	100
OCC	Outstanding	13	13	95	11
	Satisfactory	73	71	674	76
	Needs to improve	15	15	112	13
	Substantial noncompliance	2	2	9	1
	Total	103	100	890	100
OTS	Outstanding	19	5	67	8
	Satisfactory	255	72	594	74
	Needs to improve	74	21	128	16
	Substantial noncompliance	8	2	18	2
	Total	356	100	807	100
All Regulators	Outstanding	145	7	477	9
	Satisfactory	1,660	80	4,098	80
	Needs to improve	263	13	507	10
	Substantial noncompliance	20	1	59	1
	Total	2,088	100	5,141	100

Note: Ratings for the year 1990 include only those given by the regulators from July 1, 1990, the effective date of public disclosure of CRA ratings, to the end of the year.

Source: FRB, FDIC, OCC, and OTS.

\5 The regulators also rate institutions on the safety and soundness of their operations on the basis of the results of a separate safety and soundness examination.

THE APPLICATIONS PROCESS IS THE PRIMARY CRA ENFORCEMENT MECHANISM

Chapter 1:2.5

Federal regulators are to take an institution's CRA record into account when considering certain types of applications from depository institutions, including most applications for mergers and acquisitions among depository institutions. This requirement is written directly into the CRA. Although CRA compliance is not to be the only issue the regulators consider when reviewing applications, it may play a major role.

Community groups and some members of Congress have described the applications approval process as not being an effective enforcement mechanism for CRA because the regulators do not always deny applications on the basis of an applicant's poor CRA performance. Table 1.6 shows the number of applications denied on the basis of poor CRA performance since 1989.

Table 1.6

Applications and CRA-Related Denials by
the Regulators From 1989 Through 1994

Year	Applications	Denials	Applications	Denials	Applications	Denials	Applications	Denials
1989	761	1	2,056	0	2,782	2	939	1
1990	696	0	2,099	0	3,049	2	893	0
1991	551	1	1,839	0	2,630	0	573	0
1992	619	1	1,891	0	2,610	4	837	0
1993	821	2	2,181	0	3,612	0	785	0
1994	826	0	2,883	3	4,368	0	1,010	0

Source: FRB, FDIC, OCC, and OTS.

Although they have been criticized for denying few applications on the basis of CRA performance, the regulators defend their records by stating that they consider the denial of an application to be a last resort. FRB and FDIC also approve applications with commitments. An example might include increased lending efforts in targeted neighborhoods. This provides the regulators with better enforcement leverage by explicitly tying an application's approval to tangible improvement of the applicant's CRA performance. However, regulatory guidance states that commitments can only remedy specific problems in an otherwise satisfactory CRA record and cannot be the basis for the approval of an application. OCC and OTS do not typically approve applications with commitments but instead prefer to conditionally approve applications, if deemed appropriate. The conditions for such approvals may be similar to commitments; however, the applicant institution must meet the conditions before consummation of the transaction for which it has applied. An example of a condition might be to require an applicant with a "needs to improve" CRA rating who is seeking to open a branch office to upgrade its rating to "satisfactory" before opening the branch. Table 1.7 shows the number of applications approved with commitments since 1989 by FRB and FDIC and shows the number of applications approved with conditions by OCC and OTS.

Table 1.7

Number of Applications Approved With
CRA-Related Commitments or Conditions
From 1989 Through 1994

Year	Approved with commitments	Approved with commitments	Approved with conditions	Approved with conditions
1989	5	0	15	2
1990	6	0	26	1
1991	7	0	18	1
1992	4	0	20	0
1993	9	0	18	0
1994	22	1	11	1

Source: FRB, FDIC, OCC, and OTS.

The regulators also pointed out that institutions considering expansion plans are aware of the role CRA plays in the approval process. An institution contemplating expansion would likely make sure that its CRA performance is at least satisfactory or reconsider submitting an application. Most institutions would prefer avoiding the adverse publicity and needless expense of filing an application only to be denied. If an institution perceives that its application for expansion is likely to be denied, it may choose to withdraw the application rather than have it formally denied.

PROTESTS HAVE PLAYED A MAJOR ROLE IN THE APPLICATIONS PROCESS
-- Chapter 1:2.6

In addition to potentially having an application denied, institutions wishing to expand must consider another element of the application process--the potential for a protest by community groups or other members of the public. Many bankers have complained that community groups have used protests of applications and the threat of adverse publicity, delay, possible public hearings--and their attendant costs--to force lending commitments from institutions attempting to expand. Because regulators must consider protests in their approval process, these groups have exercised a measure of leverage over institutions wishing to expand and have added an element to the process beyond the potential for an application denial. In some cases, agreements have been reached between bankers and community groups and then protests have been withdrawn and applications approved. In other cases, the regulators have approved the application after evaluating the protest and determining that it did not warrant a denial.

Table 1.8 shows the number of applications from 1989 to 1994 that had protests lodged against them and the number of protested applications that were denied.

Table 1.8

Number of Applications With CRA-Related Protests and Denials, From 1989 Through 1994

Year	Protested	Denied	Protested	Denied	Protested	Denied	Protested	Denied
1989	16	1	7	0	8	0	10	1
1990	27	0	7	0	6	0	7	0
1991	24	1	4	0	5	0	3	0
1992	28	0	0	0	9	1	7	0
1993	58	1	16	0	14	0	3	0
1994	55	0	13	0	28	0	5	0

Source: FRB, FDIC, OCC, and OTS.

To minimize disruptions to the applications process caused by protests, it is the regulators' policy to encourage and sometimes facilitate meetings between institutions wishing to expand and protestants to help them clarify their areas of dispute and perhaps come to an understanding. They encourage the parties at odds to come together before an application is submitted to the regulator for approval. However, the regulators do not broker agreements between the parties, nor do they monitor or enforce the implementation of such private agreements.

THE PUBLIC HAS PLAYED A KEY ROLE IN CRA ENFORCEMENT

-- Chapter 1:2.7

The public has played a key role in enforcing CRA in both the applications review process and the CRA examination process. This role was strengthened by amendments to CRA enacted by FIRREA in 1989 and FDICIA in 1991. Applications filed by institutions for expansion are a matter of public record, and the regulators invite public comment when they are considering them. Filing an application has the potential for inviting public comment and possibly protest. CRA examination guidance encourages examiners to contact community groups and other members of the public during examinations, and the regulators are expected to encourage interested parties to submit written comments on an institution's CRA performance, which are to be included in the institution's public CRA file. The CRA file is also to be reviewed by examiners during examinations.

When FIRREA made CRA ratings public and FDICIA required more detail in CRA evaluations, members of the public were provided with more information to use in deciding whether to protest an application or patronize an institution. For example, some local governments have established programs in which they have required the deposit of public funds to be made with only institutions having satisfactory or better CRA ratings. Public disclosure of CRA ratings has also made the regulators more accountable by allowing interested members of the public to see how the regulators were rating various institutions.

THE REGULATORS HAVE USED OTHER ENFORCEMENT MECHANISMS FOR CRA VIOLATIONS

-- Chapter 1:2.8

Each of the regulators has taken enforcement actions, such as supervisory agreements, memorandums of understanding, and cease and desist orders, to address CRA violations. Few such actions have been taken to date, and those taken have only been with the consent of the affected institutions. Those institutions were advised in the consent actions that in the event they did not comply, the regulators could take more stringent enforcement actions. The regulators have not taken any more stringent actions thus far. Moreover, in a December 1994 opinion, the Department of Justice determined that the regulators lack authority to use any enforcement mechanism for CRA other than measures taken in the context of an application.

The extent to which the regulators have used enforcement actions for CRA purposes is unclear because such actions generally include a variety of issues needing institution management attention in addition to CRA issues. FRB reported that 14 of the enforcement actions that it issued in 1993 included provisions related to technical CRA violations. OCC reported that 9 actions it issued included CRA provisions while OTS reported that it issued 8 such actions. FDIC does not currently track this information but said that it issues enforcement actions that include provisions for CRA violations.

PERSISTENT CONTROVERSY OVER CRA
LED TO REFORM EFFORT
-- Chapter 1:3

CRA has remained one of the most controversial banking laws. From its beginning, bankers have generally said they disliked the law, suggesting that it leads to credit allocation and imposes an unreasonable regulatory burden. Community groups, however, have maintained that the law is critical but has not been effectively enforced by the regulators and that institutions could do more to provide credit to underserved communities. Meanwhile, there has been a renewed call by some in Congress for more effective enforcement of CRA and less regulatory burden on institutions.

EARLY DEBATE PRECEDED
PASSAGE OF CRA AND HAS
CONTINUED SINCE
-- Chapter 1:3.1

In the mid-1970s, many Members of Congress said that too many institutions accepted deposits from households and small businesses in inner cities while directing a disproportionate amount of lending and investment elsewhere. They said that given this disinvestment, credit needs for urban areas in decline were not being met by the private sector. Moreover, they said the problem was worsening because public resources were becoming increasingly scarce.

In January 1977, the original Senate bill on community reinvestment was introduced. Opponents of that bill voiced serious concerns that the bill could result in credit allocation based on the volume of deposits coming from certain areas, without regard for credit demand or the merits of loan applications. They argued that the law would therefore disrupt the normal flow of capital from areas of excess supply to areas of strong demand and undermine the safety and soundness of depository institutions.

Proponents of the bill stated that it was meant to ensure only that bankers did not ignore good borrowing prospects in their communities and that they treated credit worthy borrowers even-handedly. Senator William Proxmire, the bill's sponsor, said that it would neither force high-risk lending nor substitute the views of regulators for those of bankers. He said that safety and soundness should remain the overriding factor when regulators evaluate applications for corporate expansion. Meeting the credit needs of the community was to be only one of the criteria for the regulators to evaluate when considering applications.

Since enactment of CRA, the debate has continued. Many bankers still regard CRA as an unwelcome statute that limits their flexibility in business decisions and mandates relatively low-profit lending that could cause safety and soundness problems. Bankers complain that CRA regulations are unclear and burdensome, reducing their competitiveness with other lenders who are not subject to CRA. CRA was among the major complaints by bankers in all major studies of regulatory burden, including our report.\6

We found that bankers' complaints included CRA-based documentation, reporting, and geocoding requirements as well as lack of recognition of banks' different characteristics, examination emphasis on form over substance, and a variety of other examination-related issues. In addition, bankers argued that other financial intermediaries, such as insurance and securities firms and credit unions, compete with banks for funds and loans but are not subject to CRA. Bankers said this results in a double standard that puts them at a competitive disadvantage.

Many community groups, however, have complained that too many institutions are receiving satisfactory CRA ratings without actually lending to their communities. They complained that CRA examinations are more concerned with an institution's CRA process, while ignoring whether it has engaged in actual lending to its community. In addition, they have complained that while over 90 percent of all institutions receive at least satisfactory CRA ratings, there continue to be large geographic areas that suffer from an inability to obtain credit from these institutions. These groups have called for an examination process that stresses actual lending performance over process. They have also called for better public disclosure of the information and the rationale used to assess institutions' lending performance.

Although arguments for and against CRA and various aspects of its implementation have often been presented as belonging to bankers or community groups, it is important to note that there have also been disagreements among members of these groups, further complicating efforts to satisfy all sides of the controversy. The interests of large and small institutions have at times diverged. For example, bankers from small institutions have often been more concerned with regulatory burden associated with documentation requirements of CRA while bankers from larger institutions, which can more easily absorb the expense of documentation requirements, have been more concerned with the role application protests have played in delaying their expansion plans. There have also been instances where some community groups have defended particular institutions that were accused of poor performance by the regulators or other community groups. Some community groups have said they prefer to work with institutions to reach agreements on community needs and how those needs should be met, while others said they rely more on protests to get institutions to make commitments to the community. There have also been differences among regulators about how to properly implement CRA, with some advocating stronger enforcement and others raising concerns about credit allocation.

\6 Regulatory Burden: Recent Studies, Industry Issues, and Agency Initiatives (GAO/GGD-94-24, Dec. 13, 1993).

CRA REFORM BECAME A TOP
ADMINISTRATION PRIORITY
-- Chapter 1:3.2

On July 15, 1993, the President announced his initiative to facilitate low- and moderate-income community economic development. In addition to other measures, the President called for a revision to the current CRA regulation that would move CRA examinations toward a performance-based system focusing on results rather than process and paperwork--especially results in low- and moderate-income areas of institutions' communities. He instructed the regulators to make examinations more consistent, improve enforcement to provide more effective sanctions, and reduce the cost and burden of compliance. The four regulators jointly released their proposed revision to the current CRA regulation for comment on December 21, 1993. The proposal would have replaced the current qualitative CRA examination system, including the 12 assessment factors, with a more quantitative system based on actual performance as measured through the use of three tests: the lending, service, and investment tests. A key element of the December 1993 proposal was the "market share test," which would, as part of the lending test, compare an institution's lending relative to other lenders in low- and moderate-income neighborhoods, with its lending in other parts of its service community. Collectively, the regulators received over 6,700 comment letters on the December 1993 proposal from representatives of the banking industry, community groups, Congress, and state and local governments. Reaction to the proposal was mixed and generally polarized based on the interests of the individual or organization commenting. On January 26, 1994, we submitted our analysis of the regulators' proposal in a letter\7 to the former Chairmen, House Committee on Banking, Finance and Urban Affairs and the Subcommittee on Consumer Credit and Insurance.

In response to comments received on their first proposal, the regulators released a second proposed CRA regulation that was published in the Federal Register on October 7, 1994. This proposal reflected comments received on the December 1993 proposal and the regulators' further internal considerations. While still striving for a system that measured performance and not efforts or processes, the new proposal made revisions to the first proposal that would increase the role of examiner discretion in CRA examinations. For example, the lending test would no longer be based on the market share test. Collectively, the regulators received over 7,200 comment letters on the October proposal.

In May 1995, FRB, OCC, OTS, and FDIC released the new revised CRA regulations. The final regulations retained, to a significant extent, the principles and structure of the December 1993 and October 1994 proposals but made changes to some details to respond to concerns raised in the comment letters and further regulator consideration.

The final revised regulation eliminates the previously discussed 12 assessment factors and substitutes a three-part, performance-based evaluation system for institutions that do not qualify as small institutions. The regulation defines small institutions as independent retail institutions with total assets of less than $250 million and holding company affiliates with total assets of less than $1 billion. The revised regulation includes a streamlined examination for small banks and the option for all institutions to have their CRA performance examined according to a regulator-approved strategic plan.

To take into account community characteristics and needs, the revised CRA regulation makes explicit the performance context against which the tests and standards set out in the proposed regulation are to be applied. This performance context includes consideration of six factors concerning the unique characteristics of the institution under examination and the market in which it operates.\8 To determine a performance context, the regulators are to request any information that the institution has developed on lending, investment, and service opportunities in its assessment area(s). The regulators have stated that they will not expect more information 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 regulators are to consider this information from the institution along with information from community, government, civic, and other sources to enable the examiner to gain a working knowledge of the institution's community. The revised CRA regulation gives particular attention to the institution's record of helping to meet credit needs of low- and moderate-income communities and individuals based on community characteristics and needs.

In general, the regulators are to rate an institution's performance under each of the tests, but the lending test rating is to carry more weight than the others. An institution must receive a rating of at least "low satisfactory" on the lending test to receive an overall CRA rating of satisfactory. However, ratings on the other two tests are still to have considerable effect on the overall rating as well.

The major elements of the regulators' revised CRA regulations are described as follows:

Lending test: The lending test is to entail a review of an institution's lending record, including originations and purchases of home mortgage, small business, small farm, and, at the institution's option, consumer loans throughout the institution's service area, including the low- and moderate-income areas; the proportion of the institution's lending in its service area(s); the distribution of loans to borrowers of various income levels; the number of loans to small businesses and farms; and the like. If the regulators determine that a substantial majority of an institution's business is consumer lending, then they are to evaluate this lending as part of the lending test whether or not the institution elects to provide consumer lending data. The regulators are to consider loans to individuals of all incomes wherever they reside. The number, amount, and complexity of an institution's community development loans are also to be included in the lending examination. The regulators are to consider the lending of affiliates at the election of the institution or if an institution appears to be attempting to inappropriately influence a CRA examination by conducting activities that would be unfavorably evaluated by an examiner in an affiliate.

Investment test: The investment test is to evaluate an institution's investments in community development activities. In reviewing these investments, the examiner is to take into account the amount, innovativeness, or complexity of the investment as well as the degree to which it responds to community credit and economic development needs. Institutions with limited investment authority, such as thrifts, are to receive a low-satisfactory rating under the investment test, even if they have made few or no qualified investments, as long as they have a strong lending record. A donation, sale on favorable terms, or rent-free occupancy of a branch (in whole or in part) in a predominantly minority neighborhood to any minority- or women-owned depository institution, or a financial institution with a primary mission of promoting community development, is to be considered a qualifying investment.

Service test: The service test is to require the examiner to analyze an institution's systems for delivering retail banking services and the extent and innovativeness of its community development services. The examiner is to review, in addition to the branching information, information regarding alternative service delivery mechanisms such as banking by telephone, mobile branches, loan production offices, automated teller machines (ATM), etc., in low- and moderate-income areas and for low- and moderate-income individuals. The evaluation is to also consider the range of services, including noncredit services, available to, and the degree to which those services are tailored for, the various income level areas. The focus of the test, however, is to be on the institution's current distribution of full-service branches. Alternative systems for delivering retail banking services, such as ATMs, are to be considered only to the extent that they are effective alternatives in providing needed services to low- and moderate-income areas and individuals.

Data collection, reporting, and disclosure: Data reporting requirements on institutions are to be expanded by requiring that originations and purchases of all small business and small farm loans be collected and reported to the regulator. Each institution is required to collect and maintain for each loan in a standardized, machine readable format; the amount at origination, location, and an indicator whether the loan was to a business with $1 million or less in gross annual revenues. The location of the loan is to be maintained by census tract or block numbering area. Each institution is to report in machine-readable form annually, aggregated for each census tract/block numbering area in which the institution made at least one small business or small farm loan during the prior calendar year, the number and amount of loans with original amounts of $100,000 or less, more than $100,000 but less than or equal to $250,000, or more than $250,000, and the number and amount of loans to businesses and farms with gross annual revenues of $1 million or less. The regulators, rather than the institutions, are to annually prepare individual CRA disclosure statements for each reporting institution and aggregate disclosure statements for each metropolitan statistical area (MSA) and the non-MSA portion of each state. The regulators are to make both the individual and the aggregate disclosure statements available to the public at central depositories. The aggregate disclosure statements will indicate, for each geography, the number and amount of small business and small farm loans originated or purchased by all reporting institutions, except that the regulators may adjust the form of the disclosure if necessary, because of special circumstances, to protect the privacy of a borrower or the competitive position of an institution. Institutions are also to include the disclosure statements in their public files. In keeping with the lending test, data collection and maintenance are optional for consumer loans, and there are no reporting requirements.

Streamlined examination for small institutions:\9 Independent banks and thrifts with assets below $250 million and institutions with assets below $250 million that are subsidiaries of holding companies with less than $1 billion in assets are to be evaluated under a streamlined examination method unless an institution affirmatively requests an alternative examination method. The streamlined method is to focus on an institution's loan-to-deposit ratio, degree of local lending, record of lending to borrowers and geographies of different income levels, and record of responding to complaints. An institution's fair lending record is also to be taken into account in assigning a final rating. The regulators are to consider an institution's size, financial condition, and credit needs of its service area in evaluating whether its loan-to-deposit ratio is reasonable. The regulators are to further consider, as appropriate, other lending-related activities, such as originations for sale on the secondary market and community development lending and investment.

Strategic plan option: Every institution is to have the alternative of submitting a strategic plan to its supervisory agency for approval that was developed with community input detailing how the institution proposes to meet its CRA obligation. The strategic plan option is not to relieve an institution from any reporting obligations that it otherwise has. However, small institutions do not subject themselves to any data reporting responsibilities by electing the strategic plan option.

Community development test for wholesale or limited purpose institutions: The regulation is to replace the investment test with a community development test for wholesale or limited purpose institutions. The regulation incorporates into this community development test both community development lending and community development services in addition to qualified investments. Therefore, under the regulation, wholesale or limited purpose institutions are to be subject only to the community development test. Wholesale or limited purpose institutions must be designated as such by the regulators.

Institutions are to continue maintaining a public file that contains (1) all written comments received from the public during the previous 3 years that comment on the institution's CRA performance; (2) a copy of the public portion of the institution's most recent CRA examination; (3) a list of the institution's branches, their street addresses, and geographic areas to be served; (4) a list of branches opened or closed by the institution during the previous 3 years, their addresses, and geographic areas to be served; (5) a list of services generally offered at the institution's branches and descriptions of material differences in the availability or cost of services at particular branches; (6) a map of each assessment area showing the boundaries of the area and identifying the geographic areas to be served within the area; (7) and any other information the bank chooses. In addition, large banks are also to include in their public file (1) any consumer loan data that the institution wishes to have considered as part of its CRA examination; (2) the institution's CRA disclosure statement that it receives from its regulator; and (3) relevant HMDA disclosure statements for the previous 2 years. Small banks are to include their loan-to-deposit ratio for each quarter of the previous year and any additional information that they see fit, including the information required for large institutions if they elect to be evaluated under the lending, investment, and service tests. Institutions that elect to be evaluated under the strategic plan are to include the plan in the public file. An institution that received a less than satisfactory rating during its most recent examination is to include a description of its efforts to improve its performance.

The revised CRA regulations are to amend the current CRA regulations over time, eventually replacing the existing regulations in their entirety by July 1, 1997. However, various elements of the new regulations are to be phased in sooner, some as early as January 1, 1996. Until that time, the regulators will continue to follow the current CRA regulations to examine institutions for CRA compliance.

\7 Community Reinvestment Act (GAO/GGD-94-79R, Jan. 26, 1994).

\8 The six factors to be considered are information or data about (1) the economic and demographic characteristics of the assessment areas; (2) lending, investment, and service opportunities in the assessment areas; (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) information contained in the institution's public CRA file, including written public comments.

\9 According to FRB, the streamlined examination for small institutions will cover approximately 81 percent of total banks in the United States, however, it will cover less than 14 percent of total bank assets.

OBJECTIVES, SCOPE, AND METHODOLOGY

-- Chapter 1:4

The objective of this report is to address four questions regarding the federal regulators' implementation of CRA: (1) What were the major problems in implementing CRA, as identified by the affected parties--bankers, regulators, and community groups? (2) To what extent do the regulatory reforms address these problems? (3) What challenges do the regulators face in ensuring the success of the reforms and what, if any, actions would help the regulators in facing these challenges? and (4) What initiatives have been taken or proposed to help bankers overcome community lending barriers and enhance lending opportunities, particularly in low- and moderate-income areas?

We interviewed regulatory officials responsible for bank or thrift examinations to understand and identify the major problems with the current regulatory system used in implementing CRA and to understand the context in which the regulators examine and enforce the law. In addition, we reviewed the legislative history of the CRA to discern its original intent and to see how amendments have changed the law over time. We also collected data from each of the regulators relevant to various aspects of their CRA enforcement. In addition to regulatory officials, we judgmentally selected and interviewed other parties who were located in the areas where we did our work and who are concerned with or active in CRA compliance issues, including bankers, community groups, trade groups, consultants, representatives of the secondary markets, and officials from other federal agencies, including Justice. We also collected data from each of these groups and from Justice regarding CRA examinations and enforcement. In addition to our interviews, we reviewed testimonies and speeches by representatives of the groups described above from a large number of congressional hearings and other forums that have taken place since enactment of CRA. Statements in this report representing the views of the affected parties reflect all of the sources described above.

To identify the major problems in implementing CRA, determine to what extent the regulatory reforms would address these problems, and identify challenges the regulators would face in ensuring the success of the reforms, we reviewed in detail compliance examinations at 40 banks and thrifts located in 4 regions, including the Northeast, Midwest, West, and South Central parts of the United States. At each of the 40 institutions, to the extent possible, we completed a case study using standardized data collection instruments to gather the impressions and experiences of the bankers and examiners.

For our case studies, we judgmentally selected institutions that included a variety of asset sizes; business types; and a mix of rural, suburban, and urban institutions. We selected institutions regulated by each of the four regulators and attempted to select institutions with a variety of good and bad CRA ratings. However, we found that institutions that received low CRA ratings from their last compliance examination were less willing to participate in the case studies than those that had fared better. While 11 of the institutions had received a "needs to improve" rating on their last CRA examination, none had received a "substantial noncompliance." The institutions we studied included 10 from each of the four regions; 6 were examined by FRB, 13 by FDIC, 9 by OCC, and 12 by OTS. Nine of the institutions had assets over $1 billion, 13 had assets of less than $1 billion but more than $100 million, and 18 had assets of $100 million or less.

We also talked to community groups known to be active in each region about their involvement in CRA compliance. In this way, we could identify the positive and negative aspects of the current examination system and verify some of the anecdotal complaints surrounding it. In addition, the case studies afforded us the opportunity to discuss other related issues, such as CRA reform, with a large number of individuals who worked with CRA compliance on a regular basis.

To determine the extent to which the regulators' reform proposals would address the problems we identified from work previously described and to identify the challenges the regulators would face in ensuring the success of the reforms, we evaluated a number of proposals for CRA reform that were put forward from several sources, including the proposals released by the regulators on December 21, 1993, and October 7, 1994, and the final revised CRA regulation, released in May 1995. In addition, we reviewed letters submitted by bankers, community groups, and other concerned parties commenting on the regulators' proposals. We discussed numerous suggestions for improving the CRA examination and enforcement process with participants in our case studies. We also reviewed the transcripts from hearings held by the regulators around the country during their development of the revised CRA regulation.

To identify the initiatives that had been taken to overcome lending barriers and enhance community lending opportunities, (1) we judgmentally selected, on the basis of availability, and interviewed over 20 community group representatives; (2) held a roundtable discussion involving representatives from the Association of Community Organizations for Reform Now, the Center for Community Change, and the Consumer Federation of America; and (3) attended several workshops and conferences sponsored by a variety of industry and community groups, in addition to the regulators covering CRA compliance. We also identified the activities of the regulators' consumer affairs programs and reviewed a large volume of material generated by banks, community groups, and the regulators on their activities to promote community lending.

We conducted work on our case studies in Chicago, San Francisco, Boston, and Dallas, from July 1993 to March 1994 and our work in Washington D.C. continued through June 1995 in accordance with generally accepted government auditing standards.

We obtained written comments on a draft of the report from FDIC, the Federal Reserve, OCC, and OTS. A discussion of these comments and our responses appears at the end of chapters 3 and 4. In addition, the agencies' comments and our additional responses are printed in appendixes I through IV.

REVISED CRA REGULATIONS ADDRESS SOME, BUT NOT ALL, PROBLEMS AND CONCERNS

== Chapter 2

All of the affected parties that we spoke with--bankers, community groups, and regulators--agreed on many of the problems with the implementation of the Community Reinvestment Act (CRA). However, the reasons they gave for why they believed the problems adversely affected their interests--which form the basis of their concerns--and the often contradictory solutions they offered to address the problems showed that the affected parties differed considerably on how best to revise CRA. The revised CRA regulation, if effectively implemented, should focus examinations on results, thereby eliminating a major problem that all parties identified--an overreliance in the regulators' examinations upon an institution's documentation of efforts and processes used to ascertain and meet community needs. However, the revised regulations neither fully address all identified problems nor wholly satisfy the often conflicting concerns or contradictory solutions of bankers and community groups. The success of the reform efforts will depend largely upon how effectively the revised regulations are implemented.

The first section of this chapter discusses the similarities and differences among the groups on the problems they identified as well as their concerns with and solutions to the problems. The second section presents our analysis of the extent to which the revised regulations should address those problems and concerns.

AFFECTED PARTIES AGREE ON MAJOR PROBLEMS, BUT CONCERNS AND SOLUTIONS DIFFER

-- Chapter 2:1

Bankers, community groups, and the regulators generally agreed in interviews and in public testimonies on what they considered to be major problems with the examination and enforcement of CRA. These problems included

- too little reliance on lending results and too much reliance on documentation of efforts and processes, leading to an excessive paperwork burden;
- inconsistent CRA examinations by regulators resulting in uncertainty about how CRA performance is to be rated;
- examinations based on inadequate information that may not reflect a complete and accurate measure of institutions' performance; and
- dissatisfaction with regulatory enforcement of the act, which largely relies on protests of expansion plans to ensure institutions are responsive to community credit needs.

While the affected parties generally agreed on these four problems, their underlying concerns differed significantly and the solutions they offered were often contradictory or incompatible. Generally, bankers' concerns about the problems focused on the regulatory burden of compliance, and they sought to reduce that burden. For example, they sought to increase certainty about examination ratings through use of preapproved strategic plans and guarantees ("safe harbors") that satisfactory and outstanding ratings would protect from CRA protests institutions' applications to move or expand operations. In contrast, community groups were generally concerned about the lack of accountability on the part of institutions to ensure that they meet their community lending obligations. These groups also sought measures to increase regulators' accountability through more public disclosure of institutions' CRA performance and tougher enforcement. The differences in the concerns and solutions reflected bankers' and community groups' different perspectives and constituencies and broader philosophical differences, as discussed in chapter 1.

EXAMINATIONS' PERCEIVED OVERRELIANCE ON INSTITUTIONS' DOCUMENTATION OF EFFORTS AND PROCESSES

-- Chapter 2:1.1

Bankers, community groups, and the regulators we contacted generally agreed that a major problem with CRA examinations was that examiners relied too heavily during examinations upon an institution's paperwork. This paperwork was to document the institution's efforts and processes to ascertain and help meet community credit and service needs. All parties also generally agreed that the examination should be based on the results of those efforts and processes, with emphasis on the institution's community lending performance. The parties agreed that a single community lending standard or formula for evaluating those results was unworkable because of the importance of considering such factors as an institution's business strategy, its financial condition, and the specific needs in different areas of the community that the institution served.

Despite these areas of agreement, bankers and community groups had different underlying concerns and offered different solutions. Bankers were most concerned that the focus on their CRA efforts and processes caused them to produce many documents that served no purpose within the institution other than to satisfy the information needs of examiners conducting CRA examinations. They advocated that the CRA reform should eliminate this burden by focusing examinations on performance or results.

However, community group representatives were most concerned that the focus on documentation of efforts and processes had failed to hold institutions accountable for their actual lending and service in communities. They too favored a focus on results with examiners evaluating data on actual lending and services that institutions provided to their communities. In fact, they proposed that community groups be given access to the data evaluated by examiners and be permitted to provide input on an institution's performance.

Regulators supported a performance- or results-based evaluation system to reduce institutions' documentation burden and improve CRA compliance. They also suggested that a performance-based system would promote improved consistency in examinations.

INCONSISTENT CRA EXAMINATIONS

-- Chapter 2:1.2

Bankers, community groups, and regulators all identified inconsistency in performance examinations as a problem with the implementation of the act. It was apparent from our case studies that inconsistency was due in part to examiners using their discretion and focusing on or emphasizing different aspects of the CRA regulations. This inconsistency resulted in uncertainty among the affected parties about how institutions' performance would be evaluated during examinations. Although the affected parties' underlying concerns and solutions tended to differ, the solutions were all designed in one way or another to reduce, or more clearly direct, examiner discretion to provide greater consistency to the examination process.

Generally, bankers were concerned about inconsistency in performance examinations because this led to confusion and uncertainty about what actions were necessary to attain a positive rating. As a result of the uncertainty, many bankers believed that institutions were producing unneeded documentation of their efforts. Some bankers sought to reduce this uncertainty through more specific instructions or lending targets from the regulators, thereby getting more definition to what actions count as CRA activities.

Community groups generally recognized inconsistency as a problem that represented a failure of the regulators to hold institutions accountable for adequately serving all areas of their delineated communities. Some groups said they felt that examiners do little to determine whether institutions are meeting community needs. Many group representatives advocated more emphasis on performance standards as well as increased disclosure of information about institutions' community reinvestment results.

Regulators also recognized that inconsistency in examinations was a problem. Many of the examiners we interviewed said that they thought inconsistency resulted from the subjectivity inherent in examinations due to vague standards, unclear guidance, and frequent changes in the focus of examinations. The examiners' latitude in interpreting standards, such as "the institution's ability to meet various community credit needs based on its financial condition and size, legal impediments, local economic conditions and other factors," resulted in examiners focusing on different parts of the guidance. In addition, since 1989, changes to the guidance for CRA examinations occurred more frequently than before and shifted emphasis from institutions' programs for managing CRA as part of day-to-day activities to the results of their CRA programs. We further discuss the role of examiner discretion in chapter 3.

Another factor cited by the affected parties was insufficient experience and training of examiners conducting CRA examinations. Some community groups pointed out the need to improve the capacity of the regulators for analyzing data in the context of community credit needs and institutions' efforts to satisfy those needs. As discussed in more detail in chapter 3, many examiners sought clearer guidance and better training as a solution to their concern about inconsistency in examinations.

EXAMINATIONS BASED ON INFORMATION THAT MAY NOT REFLECT A COMPLETE AND ACCURATE MEASURE OF INSTITUTIONS' PERFORMANCE

--- Chapter 2:1.3

Bankers, community groups, and the regulators have identified numerous concerns related to whether CRA examinations are based on information that reflects a complete and accurate measure of institutions' performance. Disagreements persist among the affected parties as to what information should be collected and reported by institutions and what information should be disclosed publicly. Bankers generally view most data collection and reporting as burdensome and its disclosure a potential violation of the proprietary nature of their business. Community groups, however, generally believe that information transparency--which includes both obtaining the data and understanding how the examiners move from applying performance data and other information against the standards to arrive at the CRA rating--is key to ensuring accountability and measuring CRA compliance.

Bankers complain that they are forced by the regulators to generate data that (1) may not fully reflect their business activities, (2) would not be produced without the regulatory requirement, and (3) should be kept confidential. For example, some bankers were concerned that data collected under the Home Mortgage Disclosure Act (HMDA) may be misleading without an explanation, as in cases where high loan rejection rates may result from aggressive marketing efforts by institutions seeking low-income applicants. Many bankers opposed existing and new reporting requirements as being burdensome. They were particularly concerned about frequent changes in reporting requirements that require costly changes to their data collection systems. In addition, bankers expressed concern about publicly disclosing information that they believe reveals too much about their business practices and should be kept confidential.

Community groups told us that public availability of data is of great value and that the transparency of institutions' lending performance is what would make it useful. Community groups strongly opposed any reduction in reporting requirements and advocated the collection, reporting, and public disclosure of additional data to better evaluate institutions' performance. These groups said they believe that it is essential that they have access to the data used by CRA examiners in determining regulatory ratings so that they can evaluate both the institution's and the regulator's performance.

Examiners in our case studies said they generally believed that data are necessary for them to examine institutions' compliance with CRA. However, they said that data collected are useful only if they are accurate and appropriately reflect the relevant activities of the institution being examined. Some examiners we interviewed said HMDA data are sometimes limited in their usefulness for a number of reasons, including poor data quality and inconsistent reporting by institutions. They also said that examiners may lack the time or training to perform HMDA analyses. Finally, they said that other information, involving the credit worthiness of the borrower or property, had to be used in conjunction with HMDA data because the data may not accurately or completely portray an institution's lending activity, particularly for institutions that are not heavily involved in home mortgage lending.

DISSATISFACTION WITH REGULATORY ENFORCEMENT OF CRA

-- Chapter 2:1.4

Both bankers and community groups identified regulatory enforcement of CRA as a problem, but members of the two groups generally had different concerns. Most bankers commented that there is no protection against application protests for institutions that regulators have determined are in compliance with CRA and that positive incentives are not in place to promote compliance with CRA. For example, bankers complained that community groups have used protests to needlessly delay the approval of applications. They noted that a satisfactory or outstanding CRA rating means nothing when a community group mounts a protest against expansion plans. Bankers charged that these groups use protests to further their own agendas regardless of an institution's lending record. Many bankers advocate safe harbors that would protect institutions from protests if the regulators have determined, through the examination process, that their CRA compliance is outstanding. Another type of safe harbor would reward good CRA performance with less frequent CRA examinations. In practice, the regulators currently have policies that consider an institution's CRA rating in determining the frequency of examinations, with lower-rated institutions to be examined more frequently.

In addition, bankers have contended that there should be positive incentives in place to encourage CRA compliance in addition to what they see as exclusively negative sanctions to punish noncompliance. Some bankers have proposed that CRA be replaced by or supplemented with direct financial subsidies to those willing to extend credit to low- and moderate-income areas.

Community groups, however, identified as a problem the fact that regulatory enforcement of CRA was limited to the denial of applications by a depository institution for expansion (including applications for a merger or acquisition) or negative publicity from a low CRA rating. They pointed out that institutions with no plans for expansion and no fear of adverse publicity from a low CRA rating may not feel the need to commit significant resources to CRA compliance. To strengthen enforcement of the act, community groups have advocated regulator use of more stringent enforcement actions, such as cease-and-desist orders and civil money penalties. Although some cease-and-desist orders and formal agreements between regulators and institutions have included CRA performance as one of many issues, no such actions have been taken solely to address noncompliance with the act or poor CRA performance.

The regulators have recognized the general dissatisfaction with CRA enforcement by bankers and community groups as well as by some Members of Congress.

REVISED CRA REGULATIONS FOCUS EXAMINATIONS ON RESULTS BUT MAY NOT FULLY ADDRESS OTHER PROBLEMS

-- Chapter 2:2

From our review of the reform proposals and the revised CRA regulations, it appears that the regulators have thoroughly assessed the problems related to CRA examinations and the revised regulations attempt to address the problems and concerns raised to us by the affected parties. However, the revised regulations will not wholly satisfy the often contradictory concerns of bankers and community groups. Bankers and community groups continue to have fundamentally different expectations about institutions' CRA obligations.

If effectively implemented, we believe the revised regulations will significantly reduce the first problem of overreliance on documentation of community reinvestment efforts and processes by focusing the examination standards on results. However, the regulators success in addressing the second problem of examination inconsistency and uncertainty will depend upon implementation, especially how effectively examiners use their discretion. This, in turn, will depend on the effectiveness of the guidance and training examiners are provided. In response to the third problem of data usefulness, the final regulations have clarified the information to be used to evaluate performance, but the affected parties disagree about whether the data to be collected under the revised regulations will appropriately reflect lending results or be too burdensome. The reform proposals related to the fourth problem of CRA enforcement were dropped by the regulators (1) because of Justice's opinion stating that the regulators do not have authority to take stronger enforcement action for CRA and (2) because of community groups' concerns that safe harbors would preclude them from protesting applications of those institutions they determine to be poor performers. Consequently, the revised regulations do not resolve the affected parties' divergent concerns with CRA enforcement.

REVISED REGULATIONS FOCUS EXAMINATIONS ON RESULTS, THEREBY REDUCING INSTITUTIONS' DOCUMENTATION BURDEN

-- Chapter 2:2.1

The revised regulations address the problem of overreliance on documentation of efforts and processes by shifting the focus of examination standards to an institution's community reinvestment results. Under the revised regulations, an examiner is to analyze an institution's community reinvestment results in three performance areas--lending, investment, and services. Although all the affected parties generally agreed with the shift to results-based examinations, the revised regulations may not address community groups' desire to hold institutions more accountable for the results of their community lending activities. The regulators initially proposed, and later dropped, the use of more quantifiable performance measures in the first CRA proposal as part of the "market share test" described in chapter 1. While community groups generally supported this test, many bankers were concerned that it would not accurately reflect their lending performance and could lead to unsafe and unsound lending. Disagreements continue between the affected parties about the use of quantifiable measures to examine CRA performance, but they generally agreed that some flexibility is needed in CRA examinations. In developing the revised regulations, the regulators attempted to balance the need for objective standards with the need for flexibility in examining different types of institutions operating under differing financial conditions and serving widely different types of communities.

REVISED REGULATIONS MAY NOT FULLY ADDRESS THE PROBLEM OF INCONSISTENT EXAMINATIONS

-- Chapter 2:2.2

We believe that the success of the revised regulations in addressing the problem of inconsistent examinations will depend upon how effectively the examiners exercise their discretion when implementing the new regulations. This problem has been, and may continue to be, difficult for examiners to overcome because examinations involve subjective, case-by-case judgments about an institution's performance. For example, examiners will still be required to judge the "innovativeness" of loans and investments and differentiate between "excellent" and "good" responsiveness to credit needs.

The regulators recognized the need to improve examination consistency in the revised regulations and indicated that they intend to improve guidance and training for examiners before implementing the new regulations. While it is too soon to evaluate their progress in these areas, we agree that clear guidance and comprehensive training in community development techniques are critical for consistency in examinations. Chapter 3 further discusses the issues that need to be addressed to ensure successful implementation of the revised regulations.

The revised regulations also include an option that responds to bankers' concerns that inconsistency in examinations contributes to uncertainty about what is needed to ensure a positive rating. Institutions may submit to regulators a strategic plan for community reinvestment that sets standards of performance. Although institutions could experience some uncertainty when the plan is submitted to the regulator for approval, this option may help alleviate uncertainty at the time of an examination. This "strategic plan" option includes a requirement that institutions make public their plans for comment prior to the plans being approved by the regulators. For this reason, this option has not been favorably received by all institutions. Many bankers have raised concerns that making the plan public may have anticompetitive effects, since they would have to disclose their strategic business objectives and goals. However, banks would not have to publicly disclose proprietary information.

REVISED REGULATIONS HEIGHTEN THE NEED FOR A COMPLETE AND ACCURATE MEASURE OF BANK PERFORMANCE

-- Chapter 2:2.3

To fulfill their examination responsibilities, the regulators have explained that assessing performance against results-oriented CRA examination standards will require complete and accurate measures of performance in the areas of lending, investment, and service to delineated communities. The issue of what data should be collected and reported to the regulators and disclosed publicly has been among the most controversial issues surrounding the CRA reform efforts. The regulators have tried to balance the contradictory calls by bankers to reduce regulatory burden with the community groups' call for additional data reporting and public disclosure to increase institutions' accountability.

The regulators' attempt to strike a balance in the revised regulations among the competing points of view has led to (1) exempting small institutions from additional data reporting requirements, (2) increasing data collection and reporting requirements for large institutions, and (3) shifting data analysis responsibilities to the examiners. The regulators also increased public disclosure of aggregate loan information for small business, small farm, or community development lending but not information on individual loans. In addition, the revised regulations permit voluntary collection and disclosure of consumer loans, although reporting is not required. The revised regulations will not completely satisfy all parties, some of whom continue to disagree about whether the data collection requirements are appropriate or burdensome.

Although the revised regulations address the issues of what information will be collected to examine CRA performance under the new standards and what information must be disclosed, they do not address the other information problems identified in our case studies related to data inaccuracies and the need for clearer explanations of how performance ratings are determined. To fully respond to the problems raised by the affected parties, these remaining issues will need to be addressed as the regulators implement the new regulations. Chapter 3 discusses the actions that the regulators have taken thus far to improve data reliability, specifically related to HMDA data accuracy.

REFORMS INCLUDED MEASURES TO ADDRESS REGULATORY ENFORCEMENT, BUT WERE DROPPED FROM THE REVISED REGULATION

-- Chapter 2:2.4

The proposed reforms included measures to address concerns of both bankers and community groups regarding CRA enforcement. However, those measures are not included in the revised regulation. Both the December 1993 and the October 1994 reform proposals would have addressed the community groups' call for stricter enforcement by clarifying institutions' CRA obligations and providing that a bank that receives a rating of "substantial non-compliance" would be subject to enforcement actions authorized by the Federal Deposit Insurance Act.\10 However, Justice opined in December 1994 that CRA did not provide the regulators with the legal authority to use such enforcement actions to enforce CRA.

The regulators also tried to address the bankers' interest in positive incentives or protection against protests in the application process in their December 1993 proposal. The regulators attempted to clarify how various CRA ratings would affect decisions on applications filed by institutions for expansion or relocation of their deposit facilities. In particular, absent other information regarding CRA performance, the proposal stated that

- an "outstanding" rating would be given extra weight in reviewing applications;

- a "satisfactory" rating would generally be consistent with approval of the application;

- a "needs to improve" rating would generally be an adverse factor and, absent demonstrated improvement in the institution's CRA performance or other countervailing factors, would result in denial or conditional approval of the application; and

- a "substantial noncompliance" rating generally would be so adverse as to result in denial of the application.

However, community group comments submitted to the regulators on this measure strongly protested that it constituted a safe harbor, and it was dropped in the October 1994 proposal. Because the regulators' proposed measures to resolve the enforcement concerns of both bankers and community groups have been unsuccessful, these concerns will likely continue.

\10 Section 8 of the Federal Deposit Insurance Act provides enforcement mechanisms to the regulators for violations of banking law. Among the mechanisms are cease and desist orders and civil money penalties.

CONCLUSIONS
-- Chapter 2:3

Although the regulators have attempted to address the major problems with the implementation of CRA identified by the affected parties, the revised regulations will not satisfy all of the sometimes conflicting concerns of these parties. For example, the revised regulations do not require the level of data reporting or disclosure that has been called for by community groups, nor do they provide for more stringent enforcement actions for CRA. Although many community groups see the revised CRA regulations as an improvement over the current system, many also believe that they do not go far enough in compelling institutions to fulfill their community lending obligations. Some concerns of bankers also will likely continue. Although the burden associated with documenting efforts and processes is to be eliminated, many bankers consider additional data reporting requirements to be burdensome.

In addition, the regulators' success in addressing the problem of examination inconsistency will depend upon how effectively they implement the revised regulations. The regulators have recognized the need to improve examination consistency and plan to improve guidance and training for examiners as they implement the new regulations. The regulators also attempted to strengthen enforcement and introduce a level of certainty into the enforcement process, by clarifying how CRA ratings would be considered in application decisions and for enforcement actions, but the effort was unsuccessful.

THE REGULATORS FACE MAJOR CHALLENGES IN IMPLEMENTING CRA REGULATORY REFORMS
== Chapter 3

The regulators face significant challenges in successfully implementing the revised Community Reinvestment Act (CRA) regulatory reforms, many of which they have had difficulty addressing in the past. From our case studies, we identified several areas that are key to implementing the revised CRA regulations. To minimize the problems of uncertainty and inconsistency associated with CRA assessments, the regulators will need to (1) provide clear guidance and comprehensive examiner training that address how examiners should conduct performance-based assessments, (2) ensure that data used to assess performance is accurate by increasing the priority and consistency of actions taken to ensure data accuracy, and (3) improve disclosure in public evaluation reports on how examiners determined institutions' performance ratings. In addition, the regulators acknowledge that the revised regulations will increase examiner responsibilities and may thereby require additional examination techniques and resources.

REGULATORS HAVE PREVIOUSLY
TRIED TO REDUCE UNCERTAINTY AND
INCONSISTENCY
-- Chapter 3:1

The regulators have previously tried to address the challenges of achieving greater certainty and consistency in compliance examinations. Some of the difficulties that have hindered past efforts will likely continue to challenge the regulators as they implement the regulatory reforms. These difficulties have included the subjectivity inherent in examiners' interpretation of vague CRA standards, frequent shifts in the regulatory focus of examinations, and differences in the levels of examiners' CRA compliance evaluation experience and training. In addition, inadequate information and disclosure about institutions' CRA performance and the basis for their ratings have contributed to concerns about examination consistency.

Although the revised CRA regulations are more objective and performance-based, examiners will have to continue to exercise discretion in interpreting the CRA standards. Differences in levels of examiner experience will also continue because of the recent hiring of additional CRA examiners by some regulators over the past 2 years. Training will be particularly important during implementation, as all CRA examiners will need comprehensive training in new examination standards and procedures that regulators will be issuing. Moreover, accurate and accessible data will continue to be critical for effective results-based assessments. Finally, examination consistency will be judged by the public through the information on institutions' performance provided in the evaluation reports. The success of the CRA regulatory reforms will ultimately depend on how effectively these issues are addressed by regulators in implementing the revised regulations.

EXAMINATION GUIDANCE AND
TRAINING COULD ADDRESS
CAUSES OF INCONSISTENCY
-- Chapter 3:1.1

The regulators stated in the revised regulations that they intend to ensure consistency in assessments by providing more guidance in minimizing unnecessary subjectivity, improving examiner training, and increasing interagency coordination. These goals are consistent with the suggestions made by bankers and examiners in our case studies and in public comments to the proposed regulations before they were finalized. However, we also found that the regulators' previous attempts to ensure consistency by revising their examination guidance and training programs have not achieved consistent implementation.

We found from our case studies that inconsistency resulted in part from examiners having had considerable discretion and assessing institutions differently because they focused on different parts of the examination guidance. These differences were particularly evident in examiners' assessment of factors that involved the most discretion, such as the factors relating to ascertainment of community credit needs and development of marketing and advertising programs. To illustrate, one of the more problematic factors has been judging the reasonableness of institutions' delineation of their service communities. Some bankers have been confused about how they should define their service community because they received conflicting direction from examiners. One banker said that he was told by one examiner not to include loan production offices in the bank's delineated community, but the next examiner told him that the offices should be included. Other bankers were asked by examiners to change the size of their delineated communities and were confused about whether the service area delineation should be based on definitive geographic boundaries, location of deposit facilities, or where the preponderance of loans were located. Under the revised regulations, examiners will spend less time assessing the reasonableness of an institution's delineated service community. However, examiners will continue to use discretion in determining whether an institution arbitrarily excludes areas, particularly low- and moderate-income areas.

Both bankers and examiners have cited frequent changes in the focus of examinations as a reason for inconsistency. From the time CRA was enacted in 1977 to 1989, there were not many changes in the way CRA was implemented by the regulators. However, during the period 1989 through 1992, the regulators issued several policy statements with new guidance regarding CRA examinations.

Among other things, a March 1989 statement focused examinations on the processes and efforts needed by institutions for a well-managed CRA program.

Guidelines issued in May 1990 focused on implementation of requirements for public disclosure of CRA ratings, written examiner evaluations of institutions' CRA performance, and examiner use of a new four-tiered descriptive rating system mandated by the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA).

A December 1991 policy statement established the need for institutions to analyze the geographic distribution of their lending patterns as a part of their CRA planning process.

In March 1992, in an effort to achieve consistency in CRA evaluations, the regulators provided guidance on the inclusion of numerical data in public CRA evaluations, consistent with the Federal Deposit Insurance Corporation Improvement Act (FDICIA).

Additional guidance provided in June 1992 shifted the focus of CRA examinations to performance or results, rather than the documentation of efforts. Despite the emphasis on performance over efforts, however, the same 12 assessment factors, which were largely process-oriented mixed with some lending measures, continued to be used as tools for measuring performance.

Although the recent regulatory reforms will once again change the focus of examinations, the comprehensiveness of the reform's detailed review of the problems in CRA examinations and the overall agreement to focus on performance should help to improve consistency and reduce the need for major changes in the near future.

Another frequently cited reason for inconsistency in CRA examinations has been insufficient examiner experience and training. Some community groups commented that there is not a sufficient level of expertise within the regulatory community about what constitutes an analysis of a community's credit needs, what constitutes a loan program that would actually meet credit needs, how time-consuming an analysis would be, and what is adequate performance. Some bankers also commented that examiners need to understand how credit needs can vary based on the characteristics of a specific community, particularly between urban and rural communities, and how institutions may meet community credit needs and their CRA obligations in different ways.

The experience levels of the examiners have varied considerably among regulators. The Federal Reserve Board (FRB) has had a separate core of CRA compliance examiners since 1979, while the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) established such cores in 1989, 1990, and 1993, respectively. From 1992 to 1994, FDIC significantly expanded its compliance examination staff to about 300 examiners. From 1993 to 1994, OCC increased its examiner staff dedicated to compliance examinations from 94 to approximately 170 examiners, while about 110 OCC examiners will continue to perform both safety and soundness and compliance examinations. In addition, from 1991 to 1993, OTS increased its separate compliance examination staff from 82 to 105 compliance examiners.

The amount of examiner training also has varied among regulators and by experience level--ranging from none to advanced training specific to CRA and the Home Mortgage Disclosure Act (HMDA). Even within regulators, we were told that training availability differed by region or district and that some regulators supplemented classroom training through newsletters or self-study, computer-based courses. Although most examiners in our case studies said they have had instruction on CRA assessments as part of general entry-level training, many examiners commented that much of their training was on the job. Training needs that examiners identified included

additional training in the use of HMDA and census data;

regular seminars or refresher courses to provide updates and guidance on regulatory changes;

more advanced training for experienced examiners;

more training on fair lending laws and new discrimination detection techniques;

more focused training on skills such as data collection, computer analysis, and reading property appraisals;

training with a focus on lenders' communities, safety and soundness issues, and new examination techniques;

regular conferences or seminars where new and experienced examiners from different agencies can exchange information on examination techniques and experiences; and

external training that includes perspectives of lenders' and community groups.

The regulators have acknowledged that training is important to the success of the reforms and have indicated their intention to work together to improve examiner training. Some examiners told us that they would welcome more interagency training, which could help improve consistency among regulators. Past attempts to develop interagency training programs have had mixed success. Some regulators explained that interagency training did not always meet their different training needs because some regulators had examiners strictly devoted to CRA compliance examinations, while others had examiners perform both safety and soundness and compliance examinations. Recently, FRB's interagency training has included the specialized course on HMDA data analysis. Generally, however, each of the regulators has developed its own core CRA examination training programs.

The magnitude of the changes in the CRA reforms, as well as the resulting increase in examiner responsibilities, created the need for clear guidance and comprehensive training for all examiners performing CRA examinations and thereby implementing the revised CRA regulations. Consistency in training would help to improve examination consistency among all regulators. Under the revised regulations, examiners will have additional responsibilities in areas such as analyzing performance information. Further, examiners will have to make judgments relating to various types of community development lending and investment activities. Community groups have said these areas need better examiner understanding.

DATA ACCURACY REMAINS A PROBLEM

-- Chapter 3:1.2

The recent shift to performance-based examinations should increase the reliance on quantified data to assess institutions' performance. Inaccurate data used by various affected parties may lead them to inappropriate conclusions about an institution's CRA performance. Bankers, regulators, and community groups interviewed in our case studies identified concerns about data quality that resulted in limiting the usefulness of some data collected. Some of the regulators have also acknowledged data quality problems, particularly with HMDA data, and have taken steps to improve the accuracy of HMDA data. However, while examination guidelines include procedures to assess HMDA data accuracy, they do not address the quality of other kinds of data used to assess performance, like other lending data or financial statistics. Moreover, the regulators do not have a uniform policy on what actions should be taken against institutions with poor data quality, and they have not been consistent in the actions they have taken to date.

Bank management is primarily responsible for ensuring that data provided by the institution are accurate, and examiners are responsible for verifying data accuracy during examinations. Bankers and examiners in our case studies commented that some data problems are due to unclear reporting requirements, difficulties in determining correct geographic codes, incomplete data, and human and technical errors. Among the four regulators, FRB has done the most detailed analysis of HMDA data quality. From March 1993 to February 1994, the Federal Reserve District Banks participated in a survey to determine the quality of HMDA data submitted by state member banks for the year 1992 by cross checking each institution's HMDA Loan Application Register with its 1992 HMDA data submission. This survey confirmed FRB's long-standing concerns about HMDA data accuracy during this time period. As a result, FRB required one out of every five banks to resubmit its HMDA data for 1992. The most significant errors found in these examinations involved the loan applicant's reported income. Over half of all income-related errors were the result of banks reporting income figures from unverified application information. The other half consisted mostly of clerical errors. FRB staff said these high error rates are because, in most institutions, HMDA reporting is done by insufficiently trained clerks, with little review from more senior management. FRB amended the HMDA regulation (regulation C) in December 1994 to help improve HMDA data quality by clarifying and simplifying the reporting requirements.

OTS officials said they have also taken action to address HMDA data quality problems. For 1992 data, the directors of OTS regional offices sent letters of reprimand to institutions with the worst data quality. For 1993 data, the Financial Reporting Division sent detailed logs of reporting accuracy and timeliness to the regional compliance managers for use in examinations. In addition, an OTS official noted that the regulators' interagency examination council, through its HMDA Subcommittee, has made recommendations to improve the examination of data quality, which are likely to be reflected in forthcoming revised HMDA examination procedures.

Poor HMDA data quality was mentioned in some of the examination reports from our case studies. Some of these institutions were required to resubmit their data, while others were not. FRB officials stated that they generally require institutions with a 10 percent or greater error rate to resubmit their HMDA data. Other regulators did not have a specific policy on when resubmissions would be required. The FRB also recently announced that the institutions it supervises will be subject to the same monitoring and enforcement rules that are currently in place for other types of reports, such as Call Reports.\11 Similarly, OTS stated in its comments to this report that it recently adopted guidelines for the assessment of civil money penalties against institutions that submit late or inaccurate HMDA data. Only FDIC has actually penalized institutions for not submitting their HMDA data on time.\12 While these types of actions taken by regulators have helped to increase HMDA data reliability for the affected institutions, they do not ensure uniform or consistent reliability across the industry.

Current compliance examination procedures include steps to check the accuracy and completeness of HMDA data. Similar data quality checks for any other data used to assess performance would, if effectively implemented, help to ensure that data used in assessments are accurate. For example, procedures could be established that require examiners to check for data deficiencies during examinations. However, some examiners told us they did not always have time to complete the required procedures and such additional procedures may increase examination time. Notwithstanding the possible issue of timeliness, if data accuracy is not checked by the regulators during examinations, it may not be viewed as important by the institutions.

\11 Such penalties would include civil money penalties for institutions that repeatedly submit late, incomplete, illegible, or inaccurate data.

\12 In June 1994, FDIC announced that it had fined six institutions for late submissions of 1992 and 1993 HMDA data. The fines ranged from $2,000 to $4,000. It also announced that other institutions may have fines imposed for late or inaccurate reports as its review process continues.

BETTER DISCLOSURE IN PUBLIC EVALUATION REPORTS WOULD ENHANCE THEIR CREDIBILITY
-- Chapter 3:1.3

The credibility of the revised CRA examinations will also depend upon the explanations provided in the public evaluation reports about how ratings are determined. Community groups cited their perception that examiners were inconsistent and that the bases for ratings were unclear from the information provided in past evaluation reports. They emphasized the importance of the public evaluation reports, because these reports are the groups' primary source of information about institutions' CRA performance, and they viewed transparency about institutions' lending performance as the best form of regulation. More specifically, they cited the need to provide more information in the public evaluation reports about institutions' actual lending performance including the data used to support conclusions and clear explanations about how an institution's performance was assessed. Bankers have also stated that they do not always understand the bases for their ratings. The regulators have acknowledged that bankers and the public will learn what is expected under the regulations and judge whether examination consistency has improved on the basis of the rationale provided by the regulators on how the revised regulatory standards have been applied to determine institutions' ratings.

Although the revised CRA regulations included specific instructions to institutions on what information must be included in the public CRA files, they did not address the contents of the public evaluation reports. We recognize that the regulators have taken steps to include more performance data in public evaluation reports, as required by FDICIA. However, we believe the regulators can better demonstrate their move towards performance-based CRA examinations by designing and submitting public CRA reports that establish a basis for the given evaluations supported by objective data analysis and indicators. Some regulatory officials have indicated that they would like to develop a uniform interagency report format, but past interagency efforts to develop uniform evaluation reports have not succeeded.

INSUFFICIENT RESOURCES TO IMPLEMENT REVISED CRA REGULATIONS COULD POSE A PROBLEM

-- Chapter 3:2

The regulators have indicated in the revised regulations that examiners will relieve some of the burden on institutions by assuming greater responsibility for areas such as analyzing data collected. Even without the additional responsibilities under the current system, some of the regulators have had difficulty meeting their goal of conducting CRA examinations for all institutions at least once every 2 years. In addition, some examiners in our case studies told us that they have not had sufficient time to complete all of their responsibilities during examinations. They said that this generally resulted in one of three outcomes: (1) the time needed to complete examinations was lengthened; (2) the institutions were asked to provide more information or analyses; or (3) some activities, such as making community contacts to assess community needs, were not completed.

The regulators have varied in the resources devoted to conducting CRA examinations, as shown in chapter 1, table 1.2. Until 1993, the FRB had the largest CRA examination force and the fewest number of institutions to examine. It has generally been able to examine all of its institutions within a 2-year time frame. FDIC has the largest number of institutions and increased its CRA examination force by 75 percent from 1992 to 1993. FDIC, OTS, and OCC have not been able to examine all of their institutions within a 2-year time frame. OCC does not anticipate beginning a 2-year examination schedule until

1997, when it plans to have a sufficient number of trained examiners.

Also, examiners told us that they did not always have time to complete all required procedures or analyses. Some examiners mentioned that, for various reasons, making community contact was not always accomplished. Examiners were generally encouraged to make contacts during each examination but said they often relied on previously gathered information. Under the revised regulations, the examiners' responsibilities for consulting community sources will be increased. Another area in which examiners will be expected to do more is the analysis of institutions' lending performance data. Our case studies indicated that responsibilities in this area were not always clear and were sometimes shifted back and forth between institutions and examiners.

Another related resource issue involves the implementation of the recently passed legislation, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, that may involve changes to CRA examinations for institutions with interstate branches. The act requires that an interstate institution's public CRA evaluation report include a state-by-state summary evaluation of the CRA performance for its branches in each state. In addition, the report is also to include an evaluation of a bank's performance within a multistate metropolitan area where the banks have branches in two or more states within the area. The regulators are not certain if they would be required to review all of an institution's branches at the same time to complete the CRA examination. If so, the resource requirements could be problematic for examining large institutions located in many states with many branches. The regulators have not yet fully implemented the provisions of the act but said they are considering their potential implications as they develop examination procedures for the revised CRA regulations.

To address their CRA responsibilities, the regulators, for the most part, have increased the number of CRA compliance examiners in the last 2 years. They have fewer institutions to examine due to mergers, acquisitions, failures, or other industry consolidation. Moreover, some of the regulators have begun testing new procedures to streamline CRA examinations and reduce examination time. While the revised CRA regulations have a goal to reduce bankers' regulatory burden, they will also clearly increase examiners' responsibilities. Currently, it is difficult to determine exactly what resources will be needed and how the regulators' current resources will change over the next 2 fiscal years. Therefore, the regulators will need to closely monitor implementation of the revised regulations and determine if further actions are needed to ensure that examiners can meet their responsibilities within the appropriate time frames. If regulatory efforts are not successful, examiners may be faced with the situation of not performing necessary data analyses or shifting the responsibility for conducting such analyses back to institutions. Such examiner behavior could reduce CRA examination quality or increase institutions' regulatory burden.

FDIC, OCC, and OTS officials believe that efficiencies will be gained by both bankers and regulators in implementing the revised regulation through, among other things, the elimination of process oriented factors and use of more sophisticated software in examinations. They believe that such efficiencies, in the long run, may actually reduce the overall time needed for CRA examinations. FRB, on the other hand, suggested that the regulators' costs may increase in assessing CRA compliance under the revised regulations.

CONCLUSIONS

-- Chapter 3:3

The success of the newly adopted CRA reforms will likely be judged largely by whether the regulators can address lingering concerns about the certainty and consistency of CRA examinations. The regulators have had difficulties in meeting these challenges in the past. Some of the challenges will likely continue as the regulators implement the revised CRA regulations-- including examiners' use of discretion, differences in examiner experience and training, data quality, ratings justifications provided in public evaluation reports, and regulatory resource limitations. The regulators have indicated in the revised regulations that they intend to work together on improving examination guidance and training to ensure that examiners consistently interpret and apply the new CRA standards. In addition, examiners cannot adequately conduct performance-based evaluations without accurate data. Long-standing concerns about data quality will likely be reduced only if the regulators identify and ensure that the institutions correct inadequate data for future CRA examinations. Examination consistency will ultimately be judged by the information and explanations provided in public evaluation reports on how performance ratings have been determined. Finally, by closely monitoring their resource needs and their ability to accommodate their increased CRA responsibilities, the regulators may be better able to ensure that the requirements of the revised CRA regulations will be met.

RECOMMENDATIONS

-- Chapter 3:4

We recommend that the heads of FRB, FDIC, OCC, and OTS work together to take the following actions to better ensure the effective implementation of the revised regulations and consistency of CRA examinations:

Develop or revise regulatory guidance and training programs by clarifying how examiners should interpret the performance standards, and require that all examiners receive comprehensive training necessary to implement the new regulations.

Improve data accuracy by (1) requiring examiners to assess the accuracy of data used in performance evaluations and (2) developing a uniform policy on what actions will be taken against institutions with poor data quality.

Improve disclosures in publicly available evaluation reports by clearly presenting performance information and the rationale used to assess institutions' performance against the revised performance-based examination standards.

Assess agency resources and examination techniques to determine what resources and techniques are needed to meet the requirements of the revised CRA regulations.

AGENCY COMMENTS AND OUR EVALUATION

-- Chapter 3:5

Generally, agency officials agreed with our report message and recommendations to help ensure effective implementation of the revised CRA regulations. FDIC commented that while it agrees that examination consistency is a major priority for the regulators, which it is pursuing through enhanced interagency training, examiner judgment is still critical to implementation of the revised regulations as each community and each institution has unique characteristics that must be considered. OTS commented that although the revised regulations still call for examiner judgment, they provide for reasoned conclusions to be drawn from objective data under a clearer set of performance standards. FRB acknowledged that one of the biggest challenges faced by the agencies in the implementation of CRA is the ongoing challenge to achieve the appropriate balance between desired certainty and the need for flexibility in implementation to reflect unique community banking circumstances.

With regard to resource needs for the regulators to implement the revised regulations, FDIC, OCC, and OTS suggested that the revised regulations should reduce the overall time devoted to CRA evaluations in the long run due to the elimination of process oriented factors, coupled with use of enhanced, more sophisticated software that they are currently introducing. OTS also suggested that the small bank and strategic plan options may further reduce examination resource requirements. FRB, on the other hand, has publicly recognized in its impact analysis of the revised regulations that implementation of the regulations may increase regulators' costs in assessing CRA compliance.\13

FRB and OTS responded to our recommendations by describing what they are doing or plan to do. Some of the actions include revised guidance and initiation of training programs (which covers interagency training begun in September 1995), measures to improve data accuracy, better supported conclusions in public CRA evaluations, and monitoring of compliance examination resources. In its efforts to improve data accuracy, FRB commented that it is establishing enforcement mechanisms. In addition, FDIC and OCC acknowledged that interagency training and other efforts would further regulators' plans to improve disclosures in public CRA evaluation reports by developing uniform and accurate CRA performance evaluations and emphasizing the need to fully support related conclusions. These actions, if effectively implemented, should be helpful in enabling the regulators to fulfill the intent of our recommendations.

\13 "Final Regulator Impact Analysis of Proposed CRA Regulations," Glenn Canner, Division of Research and Statistics, Board of Governors of the Federal Reserve System, April 13, 1995.

VARIOUS INITIATIVES HAVE ADDRESSED BARRIERS TO LENDING IN LOW- AND MODERATE-INCOME AREAS
== Chapter 4

Many public and private sector efforts have reduced various barriers to community lending in low- and moderate-income areas. Through individual activities and cooperative efforts, institutions and community groups have used the flexibility of the CRA statute and addressed important cost-related barriers and market impediments to enhance community lending opportunities. While we did not assess individual initiatives as a part of this review, we present examples that bankers, regulators, and community groups we contacted considered to be successful techniques in helping to lower costs and risks for institutions participating in community development lending strategies. The secondary mortgage markets have also taken steps to broaden opportunities for institutions to sell community loans on those markets. In addition to bankers calling for certain compliance incentives, local, state, and federal governments have provided incentives for lending in low- and moderate-income communities.

The federal bank regulators have also been able to play a key role in facilitating institutions' community lending activities by providing forums for educating bankers and disseminating information about successful initiatives. Each of the regulators has established a community affairs program to encourage and promote community lending and investment initiatives among bankers. As they further develop these programs and better coordinate their efforts, the regulators could enhance their role in this respect.

BARRIERS MAY INHIBIT COMMUNITY LENDING

-- Chapter 4:1

Comments from some of the bankers we interviewed confirmed the contention of some industry observers that private sector efforts to meet the credit needs of low- and moderate-income communities may be limited by the perception that such lending is likely to entail relatively high credit risk and relatively small potential returns. Many bankers tended to believe that the profits of such activities are lowered by relatively high credit risk--that is, the risk of financial loss due to the possibility of borrower default--and high transaction costs. The transaction costs for community lending may be higher than for other commercial or consumer lending because of, among other factors, additional time and effort necessary to ascertain the creditworthiness of the borrower or the related property in certain low- or moderate-income areas. Another significant barrier faced by bankers is the opportunity cost of community lending. The primary objective of a bank is to maximize profits for its shareholders. To the extent that community lending is believed to be inconsistent with that objective, community lending expenditures represent lost opportunities to achieve greater returns through more profitable activities. Closely aligned with the cost factors is the issue of safety and soundness policies and regulations, which some bankers we interviewed believe are inherently in conflict with community lending because of the perceived greater risks involved in such lending.

THE PERCEPTION OF HIGH CREDIT RISK CAN BE A BARRIER TO COMMUNITY LENDING

-- Chapter 4:1.1

As evidenced by our case studies, a matter of concern frequently mentioned by bankers about community lending is the issue of high credit risk, which represents one element in the cost of lending. When a banker extends a loan, some possibility exists that the borrower will not repay the loan or will delay payment. Bankers making a large number of loans expect a small percentage to be nonperforming. To cover expected losses, they may structure their loan rates accordingly and also voluntarily set aside loan loss reserves.\14

The concern about credit risk is understandable in that community lending is made to low- and moderate-income borrowers who may not meet normal creditworthiness standards such as debt-to-income ratio.

However, according to a 1993 Federal Reserve report to Congress,\15 available evidence was insufficient to determine the extent to which credit risk is associated with different income, racial, or ethnic characteristics across neighborhoods.

\14 An amount of capital held back from investment by a bank considered to be adequate to cover estimated losses in the loan portfolio.

\15 Report to the Congress on Community Development Lending by Depository Institutions, the Board of Governors of the Federal Reserve System, (Washington, D.C.: Oct. 1993).

TRANSACTION COSTS CAN CREATE A BARRIER TO COMMUNITY LENDING

-- Chapter 4:1.2

A significant cost element in any type of lending by an institution is the cost of originating, processing, and servicing loans, also known as transaction costs. Transaction costs rise and fall with the volume of lending. They include, among other costs, expenses related to evaluating an applicant's credit history and ability to pay off the debt as scheduled; obtaining appraisals and surveys of properties offered as collateral; and processing loan payments, including monitoring borrowers who have fallen behind on their payments. The amount of time and effort expended on these activities may vary considerably from loan to loan, depending upon the type and complexity of the loan and characteristics of the borrower. Generally, the larger the loan amount and the smaller the transaction costs, the more profitable the loan for the institution. More specifically, since transaction costs do not usually rise in proportion to the loan amount, larger loans are generally more profitable.

According to bankers we interviewed, community loans are less profitable for institutions than many other types of loans because the loan amounts are relatively low, while loan transaction costs are relatively high. High transaction costs may be due to greater time and care required to qualify borrowers for loans by gathering additional information to help better identify the lender's credit risk. According to a banker from a medium-sized Texas bank, loans to low- and moderate-income individuals are not profitable because their small size nets a low return to the bank's fixed costs.

REGULATORY SAFETY AND SOUNDNESS POLICIES CAN BE A BARRIER TO COMMUNITY LENDING

-- Chapter 4:1.3

One of the perceived issues surrounding CRA is whether community lending reduces an institution's safety and soundness. There are those who believe that CRA regulations encourage "high loan-to-value ratio" mortgage loans\16 in local communities, which could also lead to incurring greater risk. According to some bankers we interviewed, community lending has added costs resulting from loss reserves required by safety and soundness examiners. Both bankers and community groups have said that safety and soundness examiners do not understand many of the techniques institutions use to reduce credit risk of community loans--such as, for example, the "layering of loans with state and city financing."\17 As a result, they require institutions to set aside loan loss reserves that bankers, community groups, and even compliance examiners may view as unnecessary. Two examples illustrate noted concerns about the perceived problem pertaining to safety and soundness.

The Chairman of the California League of Savings Institutions