Comments on Federal Reserve ANPR Docket No. R-1723 and RIN 7100- AF94

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Question 1. Does the Board capture the most important CRA modernization objectives? Are there additional objectives that should be considered?

More effectively meet the needs of LMI communities and address inequities in credit access, in furtherance of the CRA statute and its core purpose.

> The regulation should implement the statute, and any once-in-a-generation rulemaking process needs to assess and address the effectiveness of the implementation of the rule. It would be helpful for you to be explicit as to how you intend to do that – what steps are being taken to more effectively meet needs and address inequities in credit access - and the criteria you will use to measure the effectiveness of your efforts.
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> This is a very big and complex rule. Few of those for whom CRA is supposed to protect have the time or inclination to review and digest the content of this ANPR, let alone assess the implications of certain actions. Please be conscious of who this rule is intended to benefit and consider the best ways to obtain feedback. Where there is an intended cause and effect in the policy recommendations, please connect the dots. Where you are aiming for improvement, please indicate how you know that will be achieved.
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> From my reading the most consequential implementation change you propose to further the core purpose of the statute is the recognition of areas of need outside of a bank's assessment area, including the so-called CRA deserts – places where there are insufficient facility-based banks to meet credit needs or places where CRA has been ineffective in mobilizing existing credit resources. It would be helpful for you to clarify how you will identify these areas and the changes you propose that will overcome the problems in the current regulations.
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> There are other issues that are in CRA's wheelhouse that could also have clear targeted goals and strategies, such as the persistence of the unbanked and underbanked, persistently low rates of Black homeownership, and extremely low rates of minority small business ownership. With the United States on its way to becoming majority minority, these low levels of credit access represent an existential threat to the economic competitiveness of the country.
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> You note in the preamble a desire to better those who have been disenfranchised as a result of prior policies. It would be helpful to understand how you intend to engage this group, not only in the rulemaking process but also in ongoing implementation of the rule.

Once the goals and strategies to achieve those goals are identified, it would be helpful to have some sort of measurement and reporting regime in place so there would be some way that the agencies could tell if the rules were having their desired impact and so that the general public would have some transparency in how such a complex rule is operating.

Update standards in light of changes to banking over time, particularly the increased use of mobile and internet delivery channels.

There is little doubt that the banking sector has changed since 1977 or 1995, and the sector will continue to evolve. The current CRA regulations apply a community bank evaluation methodology onto banks with very different business models, and clearly that doesn't work for all banks and, importantly, for all Americans. But new banking delivery methods do offer a significant opportunity to improve credit access by lowering transaction costs, improving underwriting, and tailoring financial products. If major rewrites of the regulations are rare, it might be helpful to devote some thinking to how changes in the banking sector can be leveraged to better meet the goal of the statute, which is universal access to the federal financial system.

It is striking that, while there has been considerable discussion of changes in the banking sector, there has been little discussion about the social and economic changes that define the environment in which CRA operates. In the sixties and seventies privileged suburbs, segregated housing markets, and urban disinvestment dominated the discussion. CRA offered a way of slowing the export of capital into the suburbs and putting investment into neglected city neighborhoods. Today those mismatches are numerous: inequality is substantially more pronounced (and the poor pay substantially higher rates for financial services than the poor), and we are seeing significant differences in the performance of regional economies and housing affordability across the country. Much like the different cash flows between cities and suburbs in the sixties, we are now seeing significant differences in cash flows between regions (see EIG research, among others). As a result, parts of American society are marginalized spatially, socially, and economically.

We are also beginning to better understand how much race continues to play in how financial markets function, even where our current enforcement systems are unable to detect discrimination. Appraisals and business loan underwriting, to give two examples, continue to show significant disparities that are not explained by traditional underwriting measures. If we are to have an impact on addressing these issues, it is important that they are identified and understood. If CRA and fair lending examinations assess two perspectives of the same issue, one race-neutral and one race-conscious, then perhaps the two need to be considered simultaneously in the modernization effort.

By understanding, and explicitly stating, the environment in which CRA operates the regulatory framework can be better tailored to meet current credit needs.

Question 2. In considering how the CRA's history and purpose relate to the nation's current challenges, what modifications and approaches would strengthen CRA regulatory implementation in addressing ongoing systemic inequity in credit access for minority individuals and communities?

The purpose of CRA, as stated in the statute, is to assess the record of banks in meeting the credit needs of the entire community, including low- and moderate-income, consistent with safe and sound operations. In the ANPR you describe an often repeated and overly simplified origin story that should not obscure the job that needs to be done at this time. Adhering to that origin story has created to numerous distortions, including a decidedly urban focus to the rule, the assumption that all banks are either community banks or can (and should) act like one, and places and populations where CRA works well and places where it does not.

These criticisms should not take away from the enormous impact CRA has had, or from the efforts of many to modify and enhance the structure established in 1995. The point here is that the rule needs some fundamental restructuring in order to be effective now and going forward.

Some needed modifications, described in more detail in later comments, include the following:

It is important to not only assess the performance of individual banks, but also the ability of the entire banking system to meet the credit needs of all Americans. The notion of CRA deserts suggests that the current regulatory framework is missing large swaths of geographies and populations. The ongoing evaluation process of CRA needs a consistent review to uncover systematic problems caused by the administration of CRA or other regulatory processes.

This systematic approach also needs to be extended to an understanding that banks play different roles in the financial system, and can therefore play different roles, and have different responsibilities, in addressing the shortcomings of a purely market-based approach to providing financial services. We need to use the full force of the entire banking system in an appropriate and grounded way.

The color-coded maps of the thirties were not based solely on the racial composition of the neighborhoods, but they did assume that race and economic issues were intertwined. There is a general assumption that the fair lending laws address racial discrimination and the CRA addresses those left out because of economic issues, but that can still be served in a safe and sound manner. Whether or not the two can be separated, for compliance with applicable laws and to overcome historic inequities, is a matter of debate, and I've suggested in a previous comments that perhaps CRA and fair lending should be reviewed simultaneously in the modernization effort. But, if limited to economic issues, CRA encourages banks into what are often less profitable markets where they are expected to understand and effectively manage risks. The public purpose of that encouragement needs to be clear, and not masked by the imprecision of how the terms race and economics are used, or to peddle the assumption that less profitable transactions are the same as higher profit transactions, save discriminatory action. In addition, it is important to understand that many of the economic arguments for not serving certain areas and populations are rooted in historic discrimination patterns that reduced values and limited opportunities.

The evaluation process needs to recognize and reward higher levels of performance, rather than limiting recognition to certain thresholds. It's necessary to establish minimum standards for who graduates high school, but the entire curriculum should not just focus on that minimum standard. It is also important to engage and recognize those with higher talents and ambitions. To do this will involve using more sophisticated measures and evaluation tools that are common to international development and impact investing, at least for some banks and projects. That evaluation process also needs to take into account how community capacity is developed, and how inclusion is built into economic restructuring strategies.

Assessment areas

Question 8. Should delineation of new deposit- or lending-based assessment areas apply only to internet banks that do not have physical locations or should it also apply more broadly to other large banks with substantial activity beyond their branch-based assessment areas? Is there a certain threshold of such activity that should trigger additional assessment areas?

Currently assessment areas are used in the evaluation methodology to assign banks responsibility for serving particular geographies and to serve as the basis for measuring performance. The evaluation methodology is based on the assumption that most banks can be considered as community banks, taking deposits and providing retail services and credit products in defined geography, even if the bank is not a community bank. This methodology has been problematic because it exacerbates the differences between high- and low-resource regions, and because some banks cannot be shoehorned into the community bank model. Non-branch delivery channels are used by all banks, and that trend is accelerating.

The financial services industry has been moving toward digital services, and that trend has quickened during the pandemic, with banks and customers becoming more comfortable with new ways of doing business. Most banks will utilize some hybrid of digital and facility-based services going forward.

Using digital services does not mean a bank has abandoned a community bank model. Some banks will offer digital channels to serve their traditional market. Knowing the location of depositors will be helpful, and the FDIC Summaries of Deposits data should be modernized, but this will insufficient to understand how banks are operating. We need information to distinguish a bank that is able to hang onto a customer that winters in the Sunbelt from a bank that uses digital channels to sell a particular product or services nationwide or that focuses on a particular market (such as those looking for riba-free loans) that may be geographically dispersed. Electronic channels offer entrepreneurial possibilities to better serve all Americans. CRA needs to make sure there aren't gaps in who is being served in this evolving environment.

Conceptually there are two models. One is a geographic market, which is similar to a community bank model. The traditional CRA methodology states that a geographic market can not arbitrarily exclude LMI areas, and that the entire area and population needs to be served, consistent with safe and sound operations. The second is a more segmented market that is not geographically defined. The bank in this case is offering a specialized financial product to serve the convenience and needs of a specific population. That service is competing against those utilizing a geographic model. For the consumer, that may mean a relationship with a variety of institutions where, in one instance, a consumer can get the best deposit rates and services, and in another the consumer can get fast low-interest working capital for a small business.

A bank can have both types of business models in the same institution. The two can be analyzed separately, and beyond a level of de minimis activity there doesn't need to be a high threshold (i.e. 50 percent or more) for consideration of electronic channels.

The question, though, is how to analyze these non-geographic business lines with respect to CRA responsibilities. The ANPR spends a lot of time trying to figure out how to shoehorn these lines of business into the geographic model. Perhaps it is time to consider a different approach? If a bank is really good at serving particular populations with tailored products and services, perhaps they can also devote those talents and resources at reaching certain underserved populations with tailored products and services? This may be an opportunity, instead of a problem. That may be what you are getting at with the notion of a nationwide service area but take it a step further in setting requirements for meeting needs that are not simply geographically determined.

Question 23. Should adjustments to the recommended conclusion under the performance ranges approach be incorporated based on examiner judgment, a predetermined list of performance context factors, specific activities, or other means to ensure qualitative aspects and performance context are taken into account in a limited manner? If specific kinds of activities are listed as being related to “outstanding” performance, what activities should be included?

> Traditionally, CRA has considered community development activities as long as they met some pre-determined criteria of activities that should have some public benefit. This take-from-the-list approach provides up-front clarity and ease of administration, but it misses key elements of the community development process, including community engagement, the development of essential community institutional infrastructure, and the accumulation of strategic activity that will lead to lasting community change.
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> Qualitative assessments do not need to be subjective or opaque. Criteria, such as those listed in the previous paragraph, can be used to guide decision-making. Examiner training and feedback is critical. Attempts to designate “magic bullet” activities upfront, especially those reflecting the latest flavor-of-the-month, are counter-productive to the (unfortunately unstated) goal of community development.

Question 47. Should the Board use impact scores for qualitative considerations in the Community Development Financing Subtest? What supplementary metrics would help examiners evaluate the impact and responsiveness of community development financing activities?

> For many banks, the community development test comes down to the questions of what counts and how much is enough? The emphasis is on reaching minimum quantitative compliance thresholds, which is not the ideal way to incent efficient and effective community development activities.
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> At a minimum, the agencies need to start by being explicit as to the reason that community development activities need to be identified and measured separately from retail activities. This explanatory detail would then put the qualitative analysis in context.
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> The current “definition” of community development isn’t really a definition. Instead, it is four areas of activities that are roughly based on the qualifying criteria for Community Development Block Grant program, which was created about the same time as CRA. The two programs share many similarities, including a goal of transformational community change, a similar theory of what it will take to implement that change, and an assumption that decision-making at the local level is superior to any other. There has been a history of evaluation in the CDBG program, and it might be worth considering those lessons learned when modernizing CRA, especially since both programs have been criticized as failing to adequately incent strategic activities.

The CRA rules often give additional consideration to activities that are taken in conjunction with a local plan, but there is little or no evaluation of the inclusiveness, quality, or timeliness of that plan. Better evaluation of the plan will get to this issue of strategy, but also to the core purpose of community development activities. You cannot help disenfranchised populations by disenfranchising them further.

While the term “community development” can have many meanings in common usage, in the context in which CRA was created the term refers to a set of practices and values that are undertaken to overcome the legacy of past marginalization and discrimination. Stakeholders, including those the activities are intended to benefit, work together to design and implement strategies to overcome decades of segregation, discrimination, disinvestment, and poverty. Community development transactions almost always involve public or philanthropic subsidies (otherwise they would be simple retail transactions) with the bank providing private leverage into the transaction. While there may be considerable publicity on large “transformational” projects that may ultimately fail to deliver their promise, transformational change is more often achieved through the accumulation of comprehensive and more fundamental activities that follow and complete a strategy (as opposed to single projects that could be considered part of a strategy but fall far short the volume of activities needed for community change). CRA needs to recognize those that see a strategy through.

Key for community development to operate is an infrastructure of civic institutions that engage stakeholders, develop and implement strategies, and bring in subsidies and other financing to be used in implementation (see The Capital Absorption of Places). The ANPR notes that CRA deserts often lack the institutional capacity to generate “community development [financing] opportunities”. The Urban Institute has done work showing the unevenness of performance among regions in attracting development subsidies. This work can serve as an important component of the information used to define areas of need. Obviously, investments in civic infrastructure needs to be a priority where performance is weak.

As for individual projects and strategies, there are a variety of off-the-shelf products that can be used to evaluate, in an objective way, the value of a project to its intended beneficiaries and its efficient use of subsidies. The international development field has a variety of simple tools that have been used extensively. More recently, a team of organizations led by Georgetown University developed a tool to evaluate Opportunity Zone investments. The Urban Institute also developed a tool for Opportunity Zone investments that could be repurposed for a broader range of uses. The impact investing field also has been using several tools to guide their investment strategies.

In summary, there are existing tools that banks and the agencies could use to evaluate community benefit and efficacy. That evaluation process can be objective and transparent. In order to be effective, however, the so-called "qualitative" assessment needs to be considered an integral component of the evaluation and to do so may require more fundamental changes in how the community development test is conceptualized and implemented. Some banks might not want to go through the effort to document the social impacts of their financing, either at all or for some projects, which would be their choice. But if they are looking for a qualitative assessment, the data needs to be there.

Question 57. What other options should the Board consider for revising the economic development definition to provide incentives for engaging in activity with smaller businesses and farms and/or minority-owned businesses?

The definition of community development in the CRA rule states that economic development is achieved through small businesses. In seventies, neighborhood development of distressed urban business districts primarily involved building renovations and small business development. By the eighties, however, entire regions were struggling. These regions needed to significantly improve their economic competitiveness and, in some instances, reinvent regional economies. This issue affects urban as well as rural regions.

Regional economic reinvention strategies are focused on export industries, often involving technologies that allow industries to compete on the world stage. A successful regional economy is a necessary but not sufficient activity for broad-based economic success within a region. The opportunity here is for CRA to help connect the disenfranchised into these regional economic development strategies, so those strategies are more inclusive in the types of investments that are made and where those investments are made. Limiting CRA consideration to the financing of small businesses that primarily benefit LMI people and places has failed to do that.

As for recommendations to encourage investment in smaller businesses, as well as those owned by minorities, you can't manage what you can't measure. Implementing Section 1071 of Dodd-Frank would be a good start.

Question 63. What types of activities should require association with a federal, state, local, or tribal government plan to demonstrate eligibility for the revitalization or stabilization of an area? What standards should apply for activities not requiring association with a federal, state, local, or tribal government plan?

Inclusive: Has the plan involved traditionally disenfranchised populations in its development, and will it result in tangible benefits for them?
Timely: Has the plan developed or significant reviewed lately?
Reasonable: Is the theory of change likely to lead to the desired outcome? What are the risks that the benefits will not be achieved?

For community development activities without a plan, the development of the project should have an LMI benefit, involved the people who are the intended beneficiaries in the planning process, and there is a reasonable likelihood that the intended beneficiaries will realize the benefit. Some of the impact investing tools, including some developed to evaluate Opportunity Zone investments, get at these questions.

Question 67. Should banks receive CRA consideration for loans, investments, or services in conjunction with a CDFI operating anywhere in the country?

As noted previously, there are extreme economic differences among regions across the U.S. Allowing CRA consideration outside of a bank's assessment area in order to address shortfalls in other regions makes sense.

Allowing CRA consideration for banks working through intermediaries like CDFIs can also make sense in some circumstances, particularly when the CDFI is able to bring additional resources into a region that would not be available without that particular institution. But in terms of customers that could be served by a bank or a CDFI, I would think that CRA would prefer the bank providing the service directly, or at least be agnostic about the delivery method, but the rule seems to favor delivery through CDFIs. A bank loan and a CDFI loan to the same borrower for the same purpose are, under the proposal, treated differently under CRA. In addition, the ANPR suggests additional incentives to further magnify the CRA credit given to the loan through the CDFI. This could have unforeseen consequences, including fewer services to the people who need them and banks devoting little or no resources toward understanding significant parts of the population.

It is currently unclear that if a bank made the effort to, say, reach small businesses requiring relatively modest amounts of credit, something that would require the bank to gain a good understanding of their borrowers and that possibly could be done at scale, that the effort would receive much recognition in the exam. The loans would simply be counted as small business loans and compared to peers and other standards. The loan to the CDFI, however, would be considered community development, receive additional qualitative consideration, and there would be no scrutiny of the loans made by the CDFI.

Equal consideration of bank lending and CDFI lending would be easier if what and how bank and CDFI lending were evaluated were the same but, unfortunately, they are not. It would be ideal if the two federal policies were aligned, not only for effective use of community development subsidies, but also to minimize record keeping, reporting, and examination costs. Unfortunately, we are not there at this time.

Question 69. Should the Board expand the geographic areas for community development activities to include designated areas of need? Should activities within designated areas of need that are also in a bank's assessment area(s) or eligible states and territories be considered particularly responsive?

As noted previously, there are significant variations in cash flows among regions. Efforts to overcome these disparities are welcome. Banks of different sizes and business models have varying capacities and approaches to community development and applying this diversity of capacity to underserved areas can have a significant impact.

It is important to understand the nature of the disparities. Some areas lack retail banking services, which means that along with a lack of banking facilities there is also little effort to understand local banking needs.

There are also significant variations in access to public subsidies (the Urban Institute has done some good work in identifying these areas). This is important in a community development situation because in CD transactions banks provide private funding that leverages public subsidies. Without the public subsidies there is no opportunity for private leverage. In areas where access to public subsidies is below what would be expected based upon need, the effort needs to focus on developing the institutional infrastructure necessary to attract and use public and philanthropic subsidies.

It's also important to recognize where the public allocation of subsidies is deliberate. For example, consider the LIHTC allocation process. States allocate the tax credits based on a careful and deliberate process of balancing various needs and priorities. Some in the affordable housing industry have complained that the CRA incentive has created CRA hot and CRA not spots, where either too many investors are chasing too few deals in some areas and there is little interest from investors for deals in other areas, particularly in rural areas. In cases such as this, CRA should not get in the way of public allocation efforts. Banks should receive consideration for investments anywhere in the state. Side letters should not be necessary or encouraged.