Board of Governors of the Federal Reserve System
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Comments re: Advance Notice of Proposed Rulemaking, Community Reinvestment Act Regulations, Docket No. R-1723 and RIN 7100-AF94

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Introduction

Fahe writes respectfully in response to the Federal Reserve Board's request for comments on the Advance Notice of Proposed Rulemaking (ANPR) on the Community Reinvestment Act (CRA). Fahe is a Network of 50+ organizations building the American Dream in Appalachia. Since 1980, Fahe has invested $1.05B, generating $1.61B in finance, directly changing the lives of 687,183 people. This investment was channeled through our Network of more than 50 organizations working in some of the hardest-to-reach places in Appalachia.

The CRA, enacted in 1977, is a critical tool throughout much of the country to ensure banks lend, invest, and provide services to low-income people. The CRA was brought about in part in response to the history of banks refusing to lend in what they deemed as the riskiest communities, often where many people of color lived. The history of redlining and other discriminatory lending practices kept communities and generations of Black and brown Americans from having equal access to loans and mortgages. These actions left a negative ongoing legacy on homeownership rates and wealth-building across race and class. Moreover, because banks traditionally serve the areas around their branches, the legacy of banking discrimination has harmed certain geographies including but not limited to the Mississippi Delta, Appalachia, American Indian reservations, and predominantly Black and brown communities in our many American cities.

The CRA has the potential to help us correct the history of discriminatory banking practices in our nation. Fahe is supportive of the idea of modernizing the CRA. We particularly support the CRA being expanded to better serve existing beneficiaries with additional investment and to channel investments to Black, brown, and low-income people in areas where banks make loans but do not have branches or carry out community development-type investments. We understand that the CRA, on its own, cannot undo the concentration in the banking industry or the financialization of the economy that has been permitted. Nor can the CRA alone undo these two developments' enabling of structural preferences in accessing capital and investment for powerful and well-connected entities. Yet the CRA, if reinvigorated with these recommendations, can encourage banks to triple their lending and investment activities in underserved communities, and can be a meaningful step to move resources towards a more equitable economy. The Federal Reserve Bank's ANPR shows a focus on transparent data analysis with the necessary addition of an analysis of qualitative measures through the retail and community development tests.

Notably, many parts of the Appalachian region, like other small town areas in our country, face greater challenges making the CRA work for them. While the CRA intended to improve access to economic tools and services in underserved areas, it has continued to fall short in many low-income, and predominantly Black and brown communities. Currently, over 98% of banks have a passing grade, while our communities face persistent disinvestment. Study after study indicates that people living in large swaths of the Appalachian region, which includes both cities and small rural towns, lack banking institutions in their communities. In all of these places, communities cannot build wealth without access to investment, and cannot overcome systemic barriers and histories that have left them with fewer opportunities for economic development. Fahe works to incentivize bank activity and investment in underbanked and underserved areas.

Example

For an example of how CRA investment has failed to reach our areas in the past, several years ago Fahe worked to raise a $15.5 million multi-investor equity fund for workforce and recovery housing projects at scale to leverage Low Income Housing Tax Credits in small town and rural Appalachia. Fahe attempted to raise the capital from a few large investors, but could find no participation from large banks serving the region for whom the proposed projects were outside their assessment areas: BB&T, 5/3 Bank, PNC, and others all declined. Our understanding was that because the housing was located outside of these larger banks' CRA assessment area, they passed on the opportunity to invest in small town and rural Appalachia, despite the fact that they frequently make loans in these areas. The new CRA needs to focus on challenged areas, rather than allowing banks to continue investing where it is most profitable to them, which is almost never the lower-wealth smaller cities and towns. Regions like Appalachia, lacking branches and money to deposit, will continue to be least prioritized unless the incentives are revised.

Fahe ended up raising that equity fund from eleven smaller state-based financial institutions, some who had CRA assessment areas in the three small town or rural areas where the housing would be located. We are glad for those eleven institutions' investment, but working with eleven financial institutions on a $15.5 million deal complicated and raised its cost. We therefore have not attempted this kind of larger project fund again. Even the small banks who invested did so largely for return rather than CRA because they were small enough in size not to be motivated by CRA (i.e. weren't subjected to a CRA exam). These institutions were also small enough that they did not need to invest regularly. Without the larger institutional investors we could not create the consistency of sustained funds needed to continue this work. If the larger regional and national banks had engaged in community development activities in smaller towns in the region, we may have been able to replicate a successful investment strategy that could bring additional investments into small town and rural America today and for decades to come.

In fact, this story is representative of the challenge in furthering economic development in our region. With notable exceptions like Knoxville, Birmingham, Huntsville, and a few others, economic stagnation and out-migration seems to settle in with each passing month: with CRA we have an important opportunity for investment to be directed to knit our country back together, jumpstart Appalachian women and men seeking to grow small businesses and achieve economic independence, and build the American Dream in Appalachia and nationwide. With this example in mind, we ask that the ANPR incorporate the following recommendations to incentivize and maximize community development impact.

Recommendations

Encourage banks to triple their lending, services and investment in underserved markets for underserved people

Many of our comments deal with the distribution of CRA-motivated resources, however, with expanded ability and incentive to invest in areas of need and modernized assessment areas, it is important that the level of investment overall increase. Updated metrics to receive “satisfactory” and “excellent” ratings for retail services and community development tests should be calibrated with the approaches outlined in our other recommendations to encourage that triple the overall resources be deployed. This means that communities currently served by CRA would continue to be served in the ways that work for them. They should not be deprived by an additional focus on the needs of the most deeply underserved people in this nation we focus on in our comments.

Modernize assessment areas to address historic underinvestment

While Fahe operates in urban and in rural areas, we are acutely aware of the consequences that a weak CRA can have on struggling rural communities. We recommend expanding the definition of CRA assessment areas to include anywhere where banks lend (including credit cards and other alternative products) and take deposits from consumers. We think the Federal Reserve should apply its resources to determine the best lending/deposit approach for assessment areas beyond bank branches, testing approaches that reach persistent poverty areas, particularly those that are rural and reaching people of color. We oppose the sole use deposit-based assessment areas, given that it will continue to leave low-income, rural communities behind.

Fahe and our partners have long been supportive of the idea of allowing banks to make investments outside of assessment areas, and support the inclusion of a proposal to try to target investments to underserved areas. To promote additional investment into the communities we serve, the CRA should outline specific designated areas of need. Without specific targeting of designated areas of need, banks will not be incentivized to push their activity outside of their current assessment areas. For establishing designated areas of need, Fahe recommends a model of evaluating counties and census tracts through targeted, intentional metrics.

Fahe also supports awarding CRA credit for community development activities outside of a bank’s current assessment area, in designated areas of need, as defined by a metric that analyzes the number of mortgages per housing unit in a county, and the number of small business loans per operating business in that same designation. This proposal is derived from a white paper from the National Community Reinvestment Coalition (NCRC). This national mortgage and small business loan data can be categorized into quintiles based on the relevant z-scores. The NCRC recommends focusing on the lowest quintile, but Fahe suggests that labeling the bottom two quintiles as areas of low lending opens up more counties where CRA investment will be more heavily incentivized outside of the wealthier assessment areas. We recommend the counties in the bottom two quintiles can be identified as "underserved communities." This will help regulators ensure that small town, rural, American Indian reservations, and persistently poor counties become the sites for additional CRA investment outside of banks' traditional assessment areas.

We recommend that assessment areas for small banks continue to include the entire relevant county area based on branch or ATM locations, and not allow "cut-outs." Otherwise, there is a risk that banks will be able to carve out wealthier parts of a county, or areas with higher density population, and neglect to serve lower-income or more rural areas of the same county. In many rural areas, counties can be quite large and have a wide range of incomes within one county.

We acknowledge the need for CRA to address online banks differently than traditional brick-and-mortar establishments, but we should avoid online banks including the whole nation in their assessment areas. Online banks can be subject to their local headquarters-based assessment area plus where they lend according to the above test. They can also receive credit in designated areas of need. Creating a national assessment area for online banks reduces the accountability on these banks to serve the hardest to reach communities, and may set a bad precedent for the assessment areas of traditional banks in the future.

<u>Ensure investments, lending, and banking services comprise community development activities</u>

Fahe asks that only investments and banking activity be counted towards community development activities. We oppose the suggestion in the ANPR that volunteering or serving on boards of directors may count as community development activities in rural areas. While these are important gestures, the influence of volunteering or serving on a board does not mirror the impact that actual dollars can have in underserved communities. Additionally, serving on a board is beneficial to the reputation and connections of the banking officer, in part why these officers already engage in this service. The types of investments that qualify for CRA credit should be ones that deliver direct, meaningful economic change in communities, such as equity, secondary capital, or equity equivalents.

<u>Bank size can be categorized in a way that protects investments in the diversity of American communities</u>

The ANPR presents the options of $750M or $1B for the small bank threshold. Fahe disagrees with the premise because it represents a regulatory agency proposing to exempt many of the intermediate-sized institutions that actually serve more of the harder-to reach people and places in the country. Fahe instead recommends the Federal Reserve designate the "small bank" threshold at less than $400M, therefore not substantially reducing the number of banks subject to both the retail and the community development tests.

CDFIs themselves have different access to wealth, bank investments, and deal sizes

The current ANPR treats all community development financial institutions (CDFIs) relatively the same, when in reality, these institutions operate in greatly different areas that have different proximity to wealth, banking centers, and deal size options. It is important that the CRA continues to reward bank investments in CDFIs. As long as banks are scored equally for funding one large project in a large city, as they are for funding many smaller projects in harder to reach areas, banks will continuing prioritizing investment in high capacity CDFIs who fund large projects in large cities. This incentive structure will not do enough to direct capital to too many of the underserved people that aren't seeing enough of it.

We recommend leveraging CRA to reward bank investment in CDFIs located in and with long track records of serving these hard-to-serve regions. We suggest a system that awards more CRA credit for banks that increase lending to CDFIs that have a track record of service within designated areas of need, as defined above, within the past two years.

Conclusion

Our region is one of beauty, talent, and potential, and is an important contributor to this country. The current CRA does not serve our region well, and the Fed's ANPR represents a move towards a more responsive and equitable CRA. To achieve this, we state our aforementioned recommendations, and offer our expertise as a CDFI in one of the most economically underserved regions in the country. Fahe has been working for 40 years to build the American Dream in Appalachia. CRA could be a much more constructive part of that effort, and we look forward to working with our federal agency partners to make sure the CRA delivers investment to communities whose great potential is not currently being met with sufficient attention and investment.