Community Reinvestment Act

Interagency Questions and Answers Regarding Community Reinvestment

Dear Sirs,

I have been advising banks with respect to their CRA responsibilities since 1994 and in that time have advised approximately 700 banks in that capacity. I applaud the Agencies efforts to add clarity to Regulations whose application may be unclear to bankers and which may be inconsistently applied by examiners. I offer my comments about some of the proposed changes to the CRA Q&A's published by the Agencies.

- Changes to current Q&As §II.12(h)–6 and §II.12 (h)–7 - With few exceptions the CRA emphasizes the performance of financial institutions within their communities., aka "assessment areas". The proposed changes attempt to clarify (1) under what conditions a bank may receive credit for lending or investing activities associated with an organization that provides qualified community development activity in an area that is broader than the institution's assessment area(s) and (2) under what circumstances a bank may receive community development credit for activities that do not benefit the Assessment Area or LMI persons in the Assessment Area.
- **§II.12(h)–6** - this revision will clarify that a bank may receive credit for supporting an activity that "covers an area that is larger than, but includes, the institution's assessment area(s). It is not required that the assessment area receive a direct or immediate benefit provided that the function of the organization or activity includes serving "geographies or individuals" located within the assessment area.
    - **Comment**: since CRA requires that service be rendered primarily to LMI persons this should be clarified in the language to read "low- or moderate-income individuals".
- **§II.12(h)–6 -** the revision also is intended to allow community development credit for "certain other community development activities" which is explained to be applied even if "they will not benefit the institution's assessment area"; however, such activities "may not be conducted in lieu of, or to the detriment of, activities in the institution's assessment area(s)."
    - **Comment**: The problem is that as long as an institution's assessment area needs are not completely fulfilled the institution may be accused of substituting activity outside the community in lieu of meeting the needs within the community (which is where its primary responsibility lies).

The current language that allows credit towards an outstanding rating for community development activity outside an assessment area when the institution already is doing an adequate job of fulfilling its community development responsibilities within the assessment area is more appropriate. Granted, there is ambiguity in the current situation, but the standard of "satisfactory" performance is based on the what the institution is already doing (and where it also may have reference to previous examinations about how the adequacy of its community development performance), whereas in the proposed change a bank could be accused of substituting outside assessment area activity under any circumstances except when all of its assessment area's community needs have been fulfilled. The proposed wording is far more open ended than the current wording. A bank always will be reluctant to reach beyond its community if it always can be charged with substituting that activity in lieu of the opportunities that exist within the assessment area. Finally, the emphasis on reinvesting in the community is the number one priority under CRA. The proposed wording would undermine that emphasis, good intentions notwithstanding.

- **§II.12 (h)–7: "What is meant by the term 'regional area?"** - this attempts to clarify the term, "Regional areas typically have some geographic, demographic and/or economic interdependencies . . ."
    - **Comment**: Why not limit the term to an easily identified geographic term, such as "MSA" or other terms applied by OMB? The geographic entities and hierarchical structure used by the Census also would add more specific meaning and remove the ambiguity of "regional area". The Regulation relies on these very same geographic entities that have precise meaning and allows for some flexibility in the configuration of an assessment area (e.g., assessment areas may not ordinarily encroach on a MSA boundary). Why not rely in this approach?
- **§II.12(g)(2)–1** Community Services Targeted to Low- or Moderate-Income Individuals
    - **Comment**: I think the addition of specific references to School Lunch program and Medicaid are helpful
- **§II.22(b)(4)–2: Community Development Lending in the Lending Test Applicable to Large Institutions.** How do examiners consider community development loans in the evaluation of an institution's record of lending under the lending test applicable to large institutions?
    - **Comment** The proposed change recognizes the different treatment applied to Community Development lending under the Large Bank

examination standards. The current approach as contained in OCC examiner manuals states that community development lending can affect a CRA rating only positively, not negatively. This is inconsistent with the intent of the CRA. *But this treatment in Large Bank exams is only a small part of a much larger inequity between Large Bank examination standards and Intermediate-Small Bank (ISB) examination standards*. Under the CRA revisions adopted in 2005 ISB's must pass a two-part CRA examination consisting of the Lending Test and the Community Development Test. ISB's must earn a satisfactory performance rating on both parts of the examination or they will fail to receive a composite "satisfactory" performance rating. However, Large Banks not only have the luxury of escaping any penalty for poor community development lending performance, they also can attain a composite "satisfactory" performance rating even with very low Community Development investing and services. That is because the Large Bank examination standards are based on a 24 point system consisting of 12 points for lending (remember no negative points for lack of community development lending), 6 points for community services and 6 points for community development investments. To attain a composite "satisfactory" performance rating a bank needs to accumulate only 11 points of a maximum of 24 points. If a bank has a strong lending test performance and earns 9 points *(this could be done with zero community development loans because the manuals don't allow for a negative impact of lack of community development lending on the lending test*). This means that a large bank could earn just 1 point on community development investing and 1 point on community services and it would have the 11 points necessary to earn a composite satisfactory rating. In other words, a large bank could do very poorly on its community development responsibilities and pass a CRA exam but a much smaller bank, an ISB would fail the exam with the same performance. Why are we burdening small banks with a disproportionate emphasis on community development in contrast to what is expected of Large Banks? There needs to be a much broader change with this aspect of the enforcement of the CRA to at least level the expectations between ISB's and large banks.

There are many more important areas of CRA enforcement that are pressing for reform and improvement. With respect to Community Development, ***I would suggest that banks be required to geo-code, classify the community development***

purpose, and report the individual community development loans reported under CRA. Currently, the reporting of this important element of performance is incredibly superficial. Only composite community development lending is reported without any geographic attributes. The only thing that can be extracted from the current reporting is the number and value of community development loans claimed by an institution. No one knows where those loans are located or which community development purpose is being satisfied. Requiring the additional information would be a very minimal burden. Most institutions don't extend more than a dozen or so community development loans annually. They have the geo-coding capability and the software to add this important additional information with little or no extra time or cost. Providing this information is vital to helping develop the performance context that is so important to judge community needs and compare the performance of lenders. I urge the Agencies to initiate reporting of these extra fields of information regarding community development for 2014.

The prudential regulators rightly emphasize complete and accurate data for CRA and HMDA reporting purposes. ***But the current reporting requirements actually require the inaccurate reporting of small business lending by reporters***. CRA is supposed to be all about "meeting the need for credit services" but when it comes to reporting that activity millions of loans for small business purposes are not reported because of technicalities in the enforcement of the Regulations. A good example is the reporting of "renewed" loans. Many banks renew small business lines of credit, but if they use demand notes for revolving lines of credit all this lending activity is forbidden to be reported. But if a lender employs time notes, they do report the activity. The current enforcement thereby requires the understatement of significant volumes of small business lending activity and the distortion of the credit market data pertaining to small business loan markets.

Another way in which the reporting of small business loans understates the real market activity is the disqualification of loans secured by residential real estate. A large volume of small business lending is based on personal guarantees that are secured by liens on residential real estate. The collateral indirectly secures the loan by securing the guarantee of the loan. This is a critical distinction addressed in the HMDA Q&A's which forbid the reporting under HMDA of mortgages that secure the guarantee of a loan. But CRA regulations and Q&A's are silent about this. The Agencies should issue a Q&A on this topic similar to the Q&A published for HMDA reporting purposes. ***But the Agencies should state that any such business loan indirectly secured by residential real estate should be reported under CRA***. This means these loans will not be double counted (which I believe was a concern of the Agencies for loans secured by residential real estate) and will be recognized for CRA purposes.

Aside from these issues, I would have many more suggestions to the Agencies to improve reporting and measuring performance under CRA. I would be pleased to provide a detailed memo if requested.

Thank you for your efforts to address the community development issues in your proposed changes to the Q&A's.

Respectfully submitted,

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