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MEMO

From: Kenneth H. Thomas, Ph.D.

To: Board of Governors of the Federal Reserve System

Date: February 16, 2021

Re: "Fed's CRA ANPR Needs Improvement:" Comment on CRA Reform, Reg. BB [R-1723]

This comment on proposal R-1723, the Advance Notice of Proposed Rulemaking ("ANPR") to reform the Community Reinvestment Act of 1977 ("CRA") by the Board of Governors of the Federal Reserve System ("the Fed"), expands upon my previous Comment ID #137407. That comment, which is dated November19, 2020, referred to the October 28, 2020 *American Banker* article titled *"Fed's CRA plan does too much, too little."*

The ANPR does *too much* by going way past its stated goal of CRA "modernization" by proposing an unneeded total overhaul of CRA and *too little* by failing to propose the simple and obvious 5% Deposit Reinvestment Rule for this needed modernization. Using the same rating scale it applies to banks, the Fed's CRA reform proposal deserves a "Needs to Improve" rating.

This comment concludes that the Fed needs to refocus on its modernization goal with the above-cited solution plus some needed improvements to the existing rule… but no major overhaul. We can call this preferred approach *"CRA Reform Lite,"* which is far different than the major overhaul in the ANPR or Final Rule of the Office of the Comptroller of the Currency ("OCC").

Since there is a possibility that the OCC's Final Rule may be reversed in the courts or by Congress and since the FDIC has done nothing yet, the optimal CRA public policy strategy is for the FDIC, Fed, and OCC to agree to *maintain the status quo with the modernization fix and agreed upon improvements* (i.e., CRA Reform Lite) indefinitely. Then and only then will banks and their regulators be able to totally focus on helping their communities recover from the Pandemic and Recession instead of wasting precious time learning an entire new CRA language.

With all due respect, other than the needed modernization fix and certain needed improvements, *the total CRA overall proposed in this ANPR (or the OCC's Final rule) is unnecessary.* There is no need for a major overhaul of the existing regs, which have been working fine for both banks (with a 98% pass rate) and communities (receiving about $500 billion per year in CRA benefits) since 1995. Modernization and some needed improvements yes, but not a major overhaul.

Before providing more details and documentation on this comment, I will first summarize my relevant background on CRA reform.

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My Relevant Background on CRA Reform

My current and past expertise in CRA in general and its reform in particular are relevant to this comment. In short, I have spent the majority of my professional life since 1977 focused on the CRA. I was greatly honored to have known and spent time with former Senator William Proxmire, the "Father of CRA."

I am proud of the fact that my first book on CRA, Community Reinvestment Performance (Probus Publishing, Chicago, 1993), received the only endorsement he ever gave to any CRA publication:

> *Dr. Thomas' book, Community Reinvestment Performance, is far and away the best analysis of government regulation that I have seen in any field. He spotlights the regulatory problems that continue in CRA and points out precisely how they are being overcome. CRA will benefit enormously from this superlative examination and report.*

I have worked closely with numerous banks, community groups, and regulators on CRA since 1977, including training federal bank CRA examiners. Besides acting as a CRA consultant and being on the boards of various financial institutions, I have launched two different CRA mutual funds devoted primarily to affordable housing.

I had the privilege of testifying before Congress and federal bank regulators several times on CRA and related bank regulatory and public policy issues. Many of the recommendations in my books, including various CRA exam procedures and tests, were directly implemented into current bank regulations, and more details in this regard are found in The CRA Handbook (McGraw Hill, New York, 1998).

I was honored to receive the first "Award of Excellence" for that book from the National Community Reinvestment Coalition (NCRC), along with Representative Joseph P. Kennedy and Comptroller Ludwig.

In summary, I have a vested interest in getting CRA reform "right," which I define as being what Senator Proxmire intended. We got it right in 1995 when I worked with Comptroller Ludwig and his OCC staff on the last major reform of CRA, and that is my goal during the present effort.

Fed's Tortured CRA History

Any discussion of CRA reform or other efforts by the Fed must be mindful of its history regarding this very important law. While the Fed and its Reserve Banks have taken many positive steps regarding CRA in recent years, we must never forget its tortured CRA past.

Although representatives of the Fed and its Reserve Banks say all the right things about CRA, history will show they are more than 40 years late, since the Fed tried to kill CRA during and prior to 1977.

The banking industry, as expected, opposed this new law as a form of "credit allocation," but what was unexpected was the fierce opposition of the Fed. Thus, began the Jekyll and Hyde bank regulator that publicly put on a pro-CRA face but privately encouraged banks and others to lobby Congress to weaken the law. This was a first for a federal bank regulator in modern times.

Then Fed Chairman Arthur Burns, later disgraced in monetary circles for pandering to President Nixon's demands to lower interest rates, was very clear in his opposition to CRA, not only arguing it was unduly burdensome to banks but also that it was a form of credit allocation.

Yes, the same Fed now waving the pro-CRA flag did everything it could to stop it. Fortunately, Senate Banking Committee Chairman Proxmire prevailed when President Carter signed the law in 1977.

CRA remained largely untouched until the S&L Crisis and subsequent laws requiring the publication of CRA ratings and performance evaluation beginning July 1, 1990. With ratings and Performance Evaluations (PEs) public, there was an interest in reforming CRA.

The first December 1993 proposal from the OCC, which was clearly pro–consumer, resulted in over 6,700 comment letters. While everyone expected a conflict between the community and industry positions, no one expected the publicized infighting by the regulators themselves, specifically between the pro-CRA OCC and the generally perceived anti-CRA Fed at that time.

Members of the Fed's Board publicly criticized the OCC's 1993 proposal. One Fed governor stated that he was "perfectly willing to tear it up, throw it into the fireplace, and go back and start again" Other Fed governors condemned the proposal as the "wrong" approach and a "fundamental policy mistake" resulting in not only credit but also "resource allocation."

In addition to concluding that "the time to say no is now," one Fed governor publicly stated that the Fed would oppose the proposal if bankers complained loudly enough. Even the presidents of the Federal Reserve Banks piled on, with the banker–friendly San Francisco Fed arguing against the disclosure of CRA public examination schedules.

The Fed, with the help of the banking lobby that it called to action, was successful in watering down many of the toughest provisions of the 1993 proposal. The OCC was not happy but went back to the drawing board, and its September 1994 proposal generated over 7,200 comments.

The end result of approximately 14,000 total comment letters (on average more than one for every bank and thrift at the time) and seven public hearings was the third and final April 1995 reform proposal. The banking lobby, with the strategic help of the Fed, won almost every CRA reform battle it fought. These regulations went into effect in 1995, and are essentially the ones under which we have been operating since that time.

My research of thousands of CRA PEs in the 1990s concluded that the Fed was, by far, the most lax CRA enforcer, responsible for what I called "CRA Grade Inflation." Much has changed for the better at the Fed and its Reserve Bank since then. Nonetheless, while the Fed can change interest rates and the direction of markets and the economy, they cannot change history, as much as they would like to when it comes to CRA.

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Fed Stakeholder Input of Limited Value

The [Fact Sheet accompanying the Fed's ANPR] states that, by *"building on stakeholders' support"* and *"reflecting stakeholder views*" it *"seeks to provide a foundation for the agencies to converge on a consistent approach that has broad support among stakeholders."*

The Fed further claims that the ANPR *"incorporates views from external stakeholders provided in meetings, roundtables, and comment letters as well as from all three of the banking regulatory agencies responsible for administering the CRA."*

In June, 2019 the Fed released the results of ["stakeholder feedback" on CRA reform], a summary of perspectives from over 400 bankers and community groups at 29 roundtables around the nation.

Unlike the preferred approach of publishing written comments from all interested stakeholders, the Fed used an anonymous approach of not identifying which banks or community groups said what, other than Fed-filtered feedback.

Rather than providing specific proposals identifying their authors' rationale, the Fed merely summarized general findings using wide-ranging terms like "many" stakeholders said this (33 times), "several" said that (24 times), and "some" said something else (52 times), leaving readers to speculate who said what and for what reasons? Besides ignoring feedback from academics, consultants, vendors, and other CRA stakeholders, not one of their 29 roundtables were in my home state of Florida, the nation's third largest.

Thus, this claimed stakeholder input is of limited value, especially when the Fed is considering eliminating CRA categories and exam procedures that have been working fine since 2005 (i.e., Intermediate Small Banks or ISBs) and 1995 (Large Bank Exam Procedures).

The ANPR took the extreme and unwarranted action of eliminating ISBs, despite the fact that the referenced Fed stakeholder report cited a 2017 publication from a community coalition titled "Intermediate Small Banks: The Forgotten but Significant Resource for Affordable Housing and Community Development." That report concluded that *"eliminating ISBs' community development test would lead to a loss of $3 billion in annual community development lending and investments."*

The anonymous bankers in the Fed report wanted the asset size thresholds increased, but this is not surprising, since bankers usually ask to reduce their regulatory burden. By eliminating the ISB category and exam procedure, the ANPR clearly listened to stakeholders from the banking industry rather than community groups, despite the latter having a study documenting its position.

With the Fed taking the industry's position rather than that of the community groups as it pertains to ISBs, this was an unfortunate flashback to the early 90s; hence, another reason why CRA history is important.

This same Fed stakeholder report was nearly silent on relevant input regarding the current Large Bank exam procedures, other than bankers, as is usually the case, asking for an increase in asset size thresholds to reduce their regulatory burden.

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If a community or regional bank in the Large Bank category believes they are at a disadvantage relative to larger banks in their CRA examination, as anonymously suggested in the Fed stakeholder report, the real problem is not with the Large Bank Exam Procedures but with the examiners administering them. The Fed needs to look in its CRA mirror.

Experienced and good CRA examiners (as compared to inexperienced and, worse yet, "rogue" CRA examiners), will properly consider the Performance Context and evaluate and rate CRA performance relative to a bank's size, business strategy, and other relevant contextual facts.

As The CRA Handbook documents, many of the problems that banks and community groups have with CRA exams and ratings is not because of the banks or their performance but rather with inexperienced and poorly trained CRA examiners and their resultant PEs and ratings. Improved examiner training consequently should be a top priority at the Fed and other regulators, as was pointed out in The CRA Handbook.

Fed's Big Data Base With Little Information

The biggest and apparently costliest Fed effort to support its CRA modernization effort and ANPR was its review of over 6,000 PEs from some 3,700 banks between 2005 to 2017. This resulted in the creation and publication of CRA Analytics Data Tables. The Fed likely spent millions of dollars on this data base effort in 2019, which reportedly included outsourcing the research to three private vendors.

The stated purpose was to provide CRA stakeholders a better understanding of the historical relationship between bank lending activity and the conclusions and ratings that regulators assigned on PEs. This was the first large scale review of thousands of PEs since The CRA Handbook. While that research *analyzed* the data, this was not the case with the Fed effort.

In a classic example of the difference between "data" and "information," the Fed's effort was nothing more than the creation of a massive database that was not analyzed to provide useful and actionable information for the ANPR. Lots of *data* but little to no useful *information.*

The ANPR, for example, claims that it would tailor bank CRA performance evaluations to bank size, yet it proposes to eliminate the entire category of ISBs which has been in existence since 2005?

Because of concerns over the increased regulatory burden on community banks, generally viewed as those of about $1 billion during the late 1990s and early 2000s, the ISB category was created in 2005 for those banks in the approximate $250 to $1 billion range. Those asset thresholds grew with inflation and now stand at $330 to $1.322 billion.

When something as important as CRA exam procedures are being modified or worse yet eliminated, after being in existence since 2005, it is critical that there is supporting evidence documenting the need for such action.

The Scientific Method and even simple common sense would dictate that such major changes should only be contemplated after a thorough analysis has been done and published for peer review to document why a particular exam procedure should be modified or eliminated after being in existence so long.

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The problem is that there is no Fed analysis that documents or even suggests the need to eliminate the ISB category or its exam procedures. Where are the published statements or comment letters from banks in the $330 million to $1.322 billion range or from community groups benefiting from the Community Development activities of those banks stating that the ISB concept should be totally eliminated as proposed by the ANPR? What "stakeholders" want such a change?

What is the problem with the current ISB exam procedures? Are the asset thresholds appropriate? Are the equally weighted 50% Lending and Community Development Tests not appropriately weighted? Are there too few or too many performance evaluation factors in the Lending Test? Are the three types of Community Development activities in the Community Development Test not properly weighted? Do the published ratings on the two tests and the overall bank rating accurately reflect the CRA performance of the subject banks?

These and similar questions must be asked and answered by analyzing the data in the Fed's huge data base before any exam procedure that has been on the books since 2005 be considered for modification or, worse yet, elimination. Unfortunately, there is no documentation by the Fed that any such analysis was done to justify the elimination of the ISB category and ISB exam procedures (or the Large Bank exam procedures).

Based on my review of tens of thousands of Performance Evaluations since they became public on July 1, 1990, including those of ISBs since 2005, and my discussions with dozens of banks in the ISB category, I have concluded that the ISB category and ISB exam procedures (and Large Bank exam procedures) have served the banking industry and their communities well.

More broadly speaking, other than the needed modernization of CRA to account for internet banks and digital banking and certain improvements generally agreed upon by banks and community groups alike (e.g., the "laundry list" of qualifying Community Development activities), where is the Fed analysis that documents that the present CRA infrastructure needs to be radically overhauled as proposed by the ANPR?

As previously noted, based on the 98% passing rate of CRA exams and the substantial (i.e., approximately $500 billion per year) CRA and community development benefits provided to local communities, it is my considered opinion that *the Fed's entire ANPR and CRA reform effort, other than the needed modernization and improvements discussed below, is totally unnecessary.*

The Simple and Obvious Solution to Meeting the Goal of CRA Modernization

The stated goal of the Fed's ANPR is to invite public comment on an approach to "modernize" the regulations that implement the CRA. There is a difference between modernizing something (or even improving it) vs. totally overhauling it. The Fed's ANPR, unfortunately, does the latter but in the name of the former.

Modernizing CRA to account for digital and branchless banking and related technological advances was the simple goal of its reform according to both the Treasury Department and the Fed. This reform is more important than ever now with so many Fintechs and other giant tech barbarians like Google and Amazon lining up outside the banking gate behind Varo, Oportun, Figure, Monzo and other "challenger" banks.

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The real purpose of "CRA reform" is often forgotten by many regulators, community groups, journalists, members of Congress and even some bankers. Modernization means exactly that, namely adjusting or improving CRA to account for technological advances. Nothing more and nothing less.

Instead of taking 186-pages in an ANPR to try to reinvent the CRA Wheel, the Fed should have merely adopted the 5% Deposit Reinvestment Rule as the OCC's final rule did to modernize CRA. This rule is a variant of a previous reform concept to require banks obtaining deposits from outside their headquarters community to benefit the areas sourcing those deposits.

The original proposal would require all banks with 5% or more of their deposits in any area to reinvest a *commensurate portion* of their CRA benefits there. The OCC's Final Rule, however, would limit this 5% Deposit Reinvestment Rule to banks with more than half their deposits from outside their current Assessment Area and not require any commensurate CRA benefit.

This straightforward rule simply requires giant credit card and other branchless banks to define their Assessment Areas where they provide CRA benefits to include any geography sourcing 5% or more of their deposits. This is a critically needed improvement over the current practice of allowing such banks to benefit their home states of Delaware, South Dakota, and Utah with banker-friendly laws.

Under the current regs, branchless banks in those "sanctuary" states can place up to 100% of their CRA benefits in their home office community. As a result, tens of billions of dollars of community development (CD) loans and investments and tens of thousands of hours of CD services have benefited Wilmington, Sioux Falls, and Salt Lake City rather than our large Metropolitan Statistical Areas (MSAs) sourcing their deposits.

Despite containing less than 2% of the nation's population, these three states are reaping nearly 100% of the CRA benefits primarily sourced by our large MSAs. This misallocation of CRA resources is inconsistent with Senator Proxmire's Community *Reinvestment* Act, where he intended that federally-insured deposits be *reinvested* back into their community rather than some credit card-friendly city a thousand miles away.

Any CRA reform proposal that talks about the "intent" of CRA without mentioning such a reinvestment element using deposit-based Assessment Area is not really reform or modernization, but rather a favor to these very large and powerful branchless banks and their local communities that would prefer to continue the status quo. The new crop of Fintech banks that have or will shortly receive banking charters in those same states will also benefit from the status quo.

Most importantly, the 5% rule, with deposit-based Assessment Areas is consistent with CRA's purpose of *reinvesting* federally insured deposits back into their sourced *communities*, hence the "Community *Reinvestment* Act."

Also, there is little regulatory burden with this proposal, since every branchless bank gets regular reports on the geographies sourcing their deposits down to Zip Codes or even Census Tracts. Having worked as a bank consultant and taught banking for decades, I have never met a banker who does not know the geographic source of their deposits. Anyone who says the opposite is just not familiar with basic banking operations.

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OCC-regulated giant banks like American Express, Charles Schwab, and Morgan Stanley will now be required to provide needed CRA loans, investments, and services to benefit low- and moderate-income households, including banking deserts and distressed neighborhoods, in our big cities like New York, LA, and Miami sourcing their deposits.

In its simplest terms, this "Robin Hood rule" takes money from the rich areas (including CRA "hot spots") of those big cities and puts their CRA benefits back into their poor neighborhoods (aka, "CRA deserts").

Who can argue with this rule, other than those who misunderstand it or are presently benefiting from the current regs in one of the three states with banker-friendly laws? Unfortunately, the Fed's ANPR adds to the misunderstanding of deposit-based Assessment Areas by repeating the urban myth that they could *"exacerbate CRA hot spots and deserts"* when the opposite is true.

Instead of carrying out their modernization mission with this practical 5% rule, the Fed proposes to allow giant branchless banks they regulate like Ally and Goldman Sachs to place their CRA benefits *anywhere* with the misguided concept of a *national* assessment area. Why even have a CRA if these giant internet banks can place their CRA benefits wherever they would like?

An even more bizarre Fed modernization idea is their suggestion of a *loan-based* assessment area for such banks. The Fed unfortunately has it backwards, since banks should lend where they take deposits, not where they already lend, since that could reinforce bad banking habits like redlining.

Helping Distressed Communities in Our Forgotten Cities

While the lack of banking services and credit in rural "banking deserts" and Indian Country is an important public policy issue, I am also concerned about banking deserts and other distressed communities in our Forgotten Cities that are being shortchanged by branchless banks. This includes my hometown of Miami, part of the nation's seventh largest metro area, with 40% of the deposits of our third largest state.

My previous concern over what I called "carpetbagger banks", which come to our deposit-rich state to harvest our seniors' savings to lend elsewhere, was mainly directed toward the giant banks that now dominate our state like Bank of America and Wells Fargo with a combined one-third market share.

This has changed somewhat in recent years where many out-of-state regional banks buying our local banks are doing a good job reinvesting in our communities, some of this being the result of the federal law monitoring nonlocal loan-to-deposit ratios for interstate branch banks.

In fact, my recent analysis of PPP lending in Florida documents that many of the large regional banks entering the state are doing a better job in serving local communities than many existing banks based here.

Unfortunately, neither the interstate banking law nor CRA do anything to prevent credit card and other branchless banks from taking our deposits and reinvesting them elsewhere. The 5% Deposit Reinvestment Rule is a critical step in the right direction to correcting this inequity.

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Example of How the 5% Deposit Reinvestment Rule Works

Consider, for example, the roughly $100 billion asset Synchrony Bank, formerly GE Capital Retail Bank, the nation's sixth largest credit card issuer with all reported deposits in its Salt Lake City area main office.

Like many other credit card banks, it regularly advertises its above-market deposit rate in our South Florida newspapers. It is reasonable to assume that with this targeted advertising in an MSA with 2% of the nation's population and even greater share of its wealth that at least 5% of that bank's deposits come from South Florida.

Synchrony Bank's most recent CRA exam as of December 31, 2018 reported $464 million of CD investments and $548 million of CD loans totaling more than $1 billion benefiting their home Salt Lake City Assessment Area within the most recent three-year review period.

There was an additional $250 million of CD investments benefiting undisclosed outlying areas for a grand total of $1.25 billion of CRA benefits, representing more than 2% of their average $60 billion of deposits over this review period.

There is no public information on the portion of their deposits emanating from their home Salt Lake City MSA, but we do know that the entire MSA and state represent just 0.4% and 1.0%, respectively, of the nation's population.

Under the original 5% Deposit Reinvestment Rule, assuming at least 5% of Synchrony Bank's deposits come from the Miami MSA, they would be required to reinvest at least 5% of their reported $1.25 billion of CRA benefits or a total of $62.5 million here over that comparable period.

Even though Synchrony Bank's deposits likely come from Miami's affluent areas like Aventura, Coral Gables, and Coconut Grove, the CRA benefits would accrue to our distressed communities like Overtown, Liberty City, Allapattah, and Little Haiti. Considering that we are Ground Zero for the nation's affordable housing crisis, there is a critical need for such funds.

While that bank may deserve its outstanding CRA rating for their performance in the Salt Lake City MSA, this is certainly not the case for our MSA and other large ones being targeted by these banks and getting little to nothing in return for financing their credit card operations.

For example, the New York MSA, with 6% or our nation's population and even greater share of wealth, probably represents at least 10% of that bank's deposits. This proposal would have entitled New York to at least $125 million in CRA benefits from Synchrony Bank over that same period, and those funds could have helped New York's huge affordable housing and homeless problem, especially in distressed communities such as those in the Bronx.

As long as the credit card and other internet banks meet the reinvestment requirement in those deposit-based Assessment Areas with 5% or more of their deposits, they can allocate the remaining CRA benefits in the Broader Statewide or Regional Area of those Assessment Areas, hopefully focusing on distressed rural communities and Indian Country.

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Most of the large credit card banks plus many other internet and branchless banks are based in one of the three credit card sanctuary states. With just 1.6% of our population and 1.7% of our businesses, these three states together represent a whopping $1.6 trillion in deposits or 12.8% of all FDIC-insured deposits as of June 30, 2019. In fact, South Dakota ranks 3rd largest in total deposits, Utah 6th, and Delaware 10th, despite their respective population rankings of 46th, 30th and 45th.

With fewer than 2% of the nation's population and businesses in these three states, it is reasonable to assume as much as 95% of their reported deposits or $1.5 trillion originate from other states.

Assuming roughly 1% of deposits of these banks are regularly used for CRA loans and investments, which is not unusual for many credit card banks, this would mean *as much as $15 billion would be regularly reinvested in the distressed communities in our Forgotten Cities rather than these three credit card sanctuaries.* To put this into perspective, the OCC recently estimated that all banks provided $482 billion of CRA (CD and non-CD) lending in 2017, representing some 4.1% of bank deposits.

This proposal would not impose an undue regulatory burden, since it is standard operating procedure for branchless banks to geocode their deposits at least down to the zip code level. Also, these banks would now have many more CD options around the country, instead of competing with other giant banks for limited opportunities in those sanctuary states. Moreover, community banks there would likewise benefit, since they often find it difficult to compete for CRA credits with the giant banks headquartered there.

The distressed communities in our Forgotten Cities deserve their fair share of CRA benefits from banks targeting them for funding. This will happen only if all such banks are required to proportionally reinvest their deposits in the spirit of CRA as originally proposed with 5% Deposit Reinvestment Rule.

This rule alone, even assuming nothing else changes with CRA, is well worth all the current CRA reform efforts, because it truly modernizes this law consistent with Senator Proxmire's intent.

The Fed should take notice and likewise make the originally proposed 5% Deposit Reinvestment Rule the cornerstone of its CRA reform proposal, if it really wants to make it true to the law's core purpose and middle name.

Fed "Mission Creep" Neither Wanted Nor Justified

In addition to failing to modernize the law using the simple and obvious 5% solution, the Fed, in a classic example of Beltway "mission creep," decided to totally reform a law that has been working fine for banks and communities since the 1995 reforms.

As noted above, the Fed, which prides itself on being data driven in its monetary policy, put forth a CRA reform scheme that snubbed the Scientific Method. This is because it failed to provide any proof that the current regs are not working, other than needing to be modernized and tuned-up with some generally accepted improvements.

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Again, with its recent review of thousands of CRA exams *"in support of the Board's CRA modernization analysis,"* where is the proof that the current Large Bank exam procedures with a 50% weighted Lending Test and 25% weighted Investment and Service Tests are not working?

Are there too few or too many performance factors in the Large Bank Lending Test? Are they being weighted properly? What about the other two tests? What is wrong with those tests or those weightings that have worked since 1995, and how are they related to CRA performance?

As noted above, the Fed failed to put forth any evidence that there is anything wrong with the ISB exam procedures and designation they decided to abolish, despite their claim of tailoring reforms to bank size.

The closest the Fed's CRA reform got to being right was by leaving most of the current exam procedures for small, special purpose, and Strategic Plan banks in place. Yet, they failed to propose some critically needed improvements in the Strategic Plan exam procedures (see below).

My research on tens of thousands of CRA exams since 1995 has concluded there is absolutely no need for a total overhaul of CRA. Modernizing and tuning it up with some needed improvements, like a laundry list of what counts for CRA credit, yes, but not a major overall.

The fact of the matter is that the 1995 reforms are working fine with a 98% pass rate and a relatively low regulatory burden for banks. For example, a study by the Federal Reserve Bank of St. Louis identified CRA as just the sixth most costly compliance reg, at only 7% of all compliance expenses, compared to BSA ranking first at 22%. Banks needed regulatory relief on CRA in the early 90s rather than now; today, they need regulatory relief with BSA.

As previously noted, CRA has resulted in several trillions of dollars of benefits to communities, at a rate of about $500 billion per year. Neither the banking industry nor community groups ever called for a major overhaul of CRA, even in the Fed's own stakeholder feedback.

Bottomline, the Fed has proposed a costly and complex fix for something that is not broken.

A major overhaul of CRA will end up costing banks unnecessary millions in compliance expenses, when they should be helping our communities rebuild from the Recession and Pandemic

And, what about the cost to regulators and community groups trying to understand and apply complex new rules? Some CRA examiners, especially the rogue ones, are still having trouble understanding and properly applying the existing regs, so why give them new ones to learn?

The Fed has its hands full trying to rescue our economy from this Recession and Pandemic. The last thing we need is an agency trying to unnecessarily reform a law they tried to kill in the first place and then did everything they could to weaken it prior to the 1995 reforms.

Milton Friedman, the greatest economist of the last century, best summarized the Fed: *"There is no institution in the United States that has such a high public standing and such a poor record of performance; it has done far more harm than good."* While Professor Friedman was referring to the Fed's monetary policy record over many decades, the same can be said about their CRA public policy record.

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The Fed's ANPR states that *"Both banks and community organizations have expressed support for the strategic plan option, but banks have asked for more flexibility in developing goals and a streamlined strategic plan process."*

This support for Strategic Plans ("SPs") is not surprising since the roughly 50 banks with approved SPs benefit from what I consider the largest "CRA loophole." This is because banks with SPs are almost always guaranteed a passing rating, as long as they have some friendly community groups that support the plan and the bank's own performance goals.

The CRA Handbook argued against the SP option from Day One for many reasons which were summarized in a 1997 *ABA Banking Journal* article titled "CRA Strategic Plan Option: A Bad Idea Gone Wrong."

The most important public policy concern with Strategic Plans is that they effectively represent a *self-regulating* CRA exam procedure. Self-regulation is the first cousin of NO regulation, and this is not consistent with the fact that banking in the U.S. is the most heavily regulated industry in the world.

Because of the public policy importance of CRA, and since CRA ratings and PEs are the only ratings and exams made public in the banking industry, it absolutely requires supervisory regulation rather than anything close to self-regulation.

The primary basis for the self-regulation argument is because a bank with a Strategic Plan sets its own benchmarks for failing or passing an exam, primarily requiring community support before the respective regulator provides their final approval, which is almost always given.

A critical reason why we must evaluate the SP option is the fact that some of the nation's largest banks use them, and more and more banks, especially Fintechs, are following suit. If, for example, these banks, which have substantial assets under their control, have submitted unrealistically low performance standards for passing CRA ratings, this could adversely impact their respective Assessment Areas. This would certainly be contrary to good CRA public policy.

The following banks, which are among the nation's 50 largest based on September 30, 2020 assets according to the Federal Reserve Board, have approved Strategic Plans:

Bank Name	State	National Rank	Assets (000,000)	Domestic Offices
Charles Schwab Bank, SSB	TX	13	$307,945	1
Ally Bank	UT	17	$174,591	1
Morgan Stanley Bank, N.A.	UT	18	$ 169,782	1
MUFG Union Bank, N.A.	CA	26	$132,479	348
Discover Bank	DE	27	$ 122,784	2
Morgan Stanley Bank Private Bank, N.A.	NY	30	$ 110,164	1
Silicon Valley Bank	CA	33	$ 95,182	4

Source: Federal Reserve Board

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These seven of the roughly 50 banks with approved SPs have *over $1 trillion in assets*. They include some of the nation's largest banks, each with very close to or over $100 billion of assets; one of these banks, MUFG Union Bank, N.A., is a traditional retail bank with 348 branches in eight states.

My review of a sample of SPs found that outstanding goals for combined CRA investments and loans range from .37% to 1.60% of assets, *a difference of more than four times for the same rating*. There is a similar wide difference between the bank-designated goals required for an upgrade from a Satisfactory to an Outstanding rating for SP banks.

Rather than a tough in-class exam, the SP is like a take-home test. Since 1990, 42% of SP banks have received outstanding ratings, compared to 14% of all banks. This does not mean that SP banks are three times better at CRA than other banks; oftentimes, it means the reverse.

Some banks with "split CRA exams," both traditional and SP procedures *over the same review period,* failed under former but got an Outstanding rating under the latter. How could this be possible? Moreover, SP banks even have a "fail safe" option, allowing a traditional evaluation if they don't meet their goals. Bottomline, the Strategic Plan is the closest thing to a "Get Out of CRA Jail Free Card."

The well-financed wizards at Fintech banks wanting bank charters, with their high-priced lawyers and CRA consultants, quickly latched onto the SP loophole but took it to a new level to ensure an outstanding rating at the least possible cost and effort.

Consider, for example, the recently approved Strategic Plan of Varo Bank, the first Fintech to receive a national bank charter:

- Instead of their San Francisco home, they chose the nation's branchless bank capital of Salt Lake City as their main office.

- They received NO comments on their postage-stamp sized "public notice" buried in the local newspaper's classifieds, after failing to reach out to someone commenting on their application.

- Instead of multiple CRA lending goals like most other SP banks, they focused on CRA investments with some community services.

- They based their SP goals on a handpicked sample of *just four* of the approximately 50 SP banks with some of the lowest goals to help guarantee a passing rating.

- Rather than an Outstanding goal of 2% of average assets recommended in a 2017 application comment and used by several SP and other banks, they used a very low average .45% goal reaching .60% by the fifth year.

- Starting out with two million users, $600 million of deposits, and easy access to capital, average assets should be $5 billion after five years. Instead of a realistic $100 million of investments (2% of assets), they would only need $30 million of investments (.60% of assets) for an Outstanding rating, thus shortchanging their communities by $70 million.

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CRA reform as finalized by the OCC and proposed by the Fed retained the SP option likely at the behest of some of the largest banks using them like Charles Schwab, Ally, MUFG Union, Discover, Morgan Stanley, and UBS Banks.

Instead of working with these and other SP banks to try to make the SP goal-development and approval process more flexible, streamlined, and banker friendly, the Fed should consider the following improvements to help close this CRA loophole:. "

1. Provide specific ratings guidelines for Community Development (CD) loans, investments, and services using a five-tiered system with High and Low Satisfactory ratings.

    a. The recommended CD loan guidelines from The CRA Handbook are 1% for Outstanding, .66% for High Satisfactory, and .26% for Low Satisfactory ratings.

    b. The comparable CRA investment guidelines from The CRA Handbook are similar at 1% for an Outstanding rating and .66% and .26% for High and Low Satisfactory ratings, respectively;

    c. This means that the *combined* CD loan and investment guideline for Strategic Plans comparable to the goals in most plans would be 2% for an Outstanding rating, 1.32% for a High Satisfactory rating, and .52% for a Low Satisfactory rating.

    d. The CRA Handbook recommends using the *number* of CD services, often referred to as "instances" by the FDIC, as the appropriate metric for measuring CD service performance. This metric is preferred to other possible metrics such as the number of hours, the number of employees or officers involved, the number of organizations contacted, or the number of LMI individuals or small businesses impacted.

    e. Using the number of CD services as the preferred metric, an Outstanding rating in accordance with The CRA Handbook would require 12 CD services per $1 billion of assets per Review Period year; 8 to 11 for a High Satisfactory rating; and, 6-7 for a Low Satisfactory rating.

2. Depending on a bank's ascertainment of the credit and banking needs in its Assessment Area(s), the bank would determine the most appropriate mix of the three community development activities that would best meet those needs using the above-cited guidelines.

    a. For example, a Strategic Plan bank setting its Outstanding performance goals under this revised approach might prefer a balanced activity goal of CD loans representing 1% of assets, CD investments representing 1% of assets, and 12 CD services per $1 billion of assets per Review Period year.

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b. However, if that bank does not have the staff to conduct CD services, it may opt for a goal of CD loans at 1.5% of assets and CD investments at 1.5% of assets for that same rating.

c. Moreover, if that same bank does not have the willingness or ability to make CD loans or CD services, it could set an annual goal of CD investments amounting to 3% of assets for an Outstanding rating, because such investment are always available to any bank.

3. The "right" mix of CD activities for a bank would be based on its evaluation of community credit and other needs and its desired CRA rating. Community input and performance context would be important considerations in determining the mix of CD activities, but this decision ultimately would be made by the bank rather than the regulator or any community group.

4. Regulators should require SP banks to have a common template similar to those in other exam procedures so there is the ability to compare goals among SP banks as to their reasonableness. For example, all SP banks should be required to report, at a minimum, the dollar amount of their CD loan and investment goals relative to assets for each year of their plan.

5. The current fail-safe option should be eliminated. Small, intermediate, large, limited purpose and wholesale banks are not provided this fail-safe option by the regulators, so it is time to eliminate this advantage from an already bank-friendly exam procedure.

6. There should be full transparency on any and all material submitted to regulators regarding anything related to the development of the Satisfactory and Outstanding goals; banks should not be allowed to have confidential exhibits explaining the development of such goals. There are far too many confidential exhibits in existing Strategic Plans.

7. The approved SP for every bank should be attached to the published PE by the regulator and the bank, so the reader has the proper context and understands how the goals and plan were developed. Also, all public comments, support letters, and nonconfidential regulatory correspondence to the SP should be included in this public SP package.

8. Banks submitting SPs should be required to disclose if they have given any direct or indirect financial or non-financial aid to any community group or other organization that submitted a letter or comment in support of a bank's Strategic Plan.

9. All banks submitting Strategic Plans should be subject to the same data collection, recordkeeping, and reporting requirements as other banks (except small banks), so there is a level playing field with other banks not using the Strategic Plan option.

10. Instead of burying the public notice of a Strategic Plan in the classified section of a local newspaper, it should be on the website of the subject bank and its regulator, so any interested member of the public anywhere is notified and is able to submit a comment. Just as regulators currently publicize quarterly CRA exam schedules, the public should likewise be notified every quarter of any public comment periods for SP bank, regardless of its location.

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Assuming these necessary improvements are made in the Strategic Plan option, it would be preferable to maintain this option and allow banks the flexibility to determine the most appropriate exam procedure to evaluate its CRA performance.

If this is not the case, the best public policy alternative would be to simply eliminate the Strategic Plan option as I proposed 20 years ago, since it is the one used by the fewest banks in the nation (roughly 50 or just 1% of all banks), and there is really no place for a self-regulating exam procedure in CRA.

Needed CRA Improvement: Specific CRA Ratings Guidelines

The one simple question bankers always ask about CRA but regulators or examiners will never answer is *"How much is enough?"* Bankers need and deserve to have specific CRA ratings guidelines, rather than general policy statements.

Any discussion of CRA ratings guidelines must first distinguish between *qualitative* and *quantitative* guidelines. The first set of guidelines are necessarily subjective, and the second set are objective. The relevant Performance Context of each bank must, however, take precedence over either set of guidelines.

All guidelines must be properly considered over the entire Review Period for each bank being examined. The fairest evaluations consider performance from the date of the previous exam to the current one, rather than just using the most recent annual HMDA or other data that happen to be the most convenient for the examiners.

The following *qualitative* guidelines, which are part of our current exam procedures, are most commonly used in evaluating and rating community development loans, investments, and services:

- Responsiveness
- Innovativeness
- Creativity
- Complexity
- Degree to which the activity is available through other banks or private investors

Specific quantitative guidelines are preferred when it comes to the Lending Test ratios and especially community development activities. The first consideration in developing appropriate quantitative guidelines is deciding on the most relevant benchmark or denominator in the equation.

Possible quantitative benchmarks include assets, deposits, capital, total loans or investments, and even income measures. Based upon the analysis described in The CRA Handbook, the preferred benchmark is assets, since it represents the footprint of resources a bank brings to a community.

Capital is a misleading denominator, since it puts stronger banks with high capital levels at a disadvantage, and this is contrary to good banking public policy. Whereas high capital levels are always preferred from a safety and soundness perspective, why should thinly capitalized banks benefit from inflated CRA measures based on their relatively low capital levels?

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The second consideration in developing guidelines is that they must be based not on hundreds but rather *thousands* of actual CRA exams (PEs) of different sized banks in different markets over different time periods under different exam procedures.

There have been about 77,000 PEs to date, so there are more than enough PEs to review in different areas, over different time periods, with different exam procedures, and for banks of different sizes and with different business strategies.

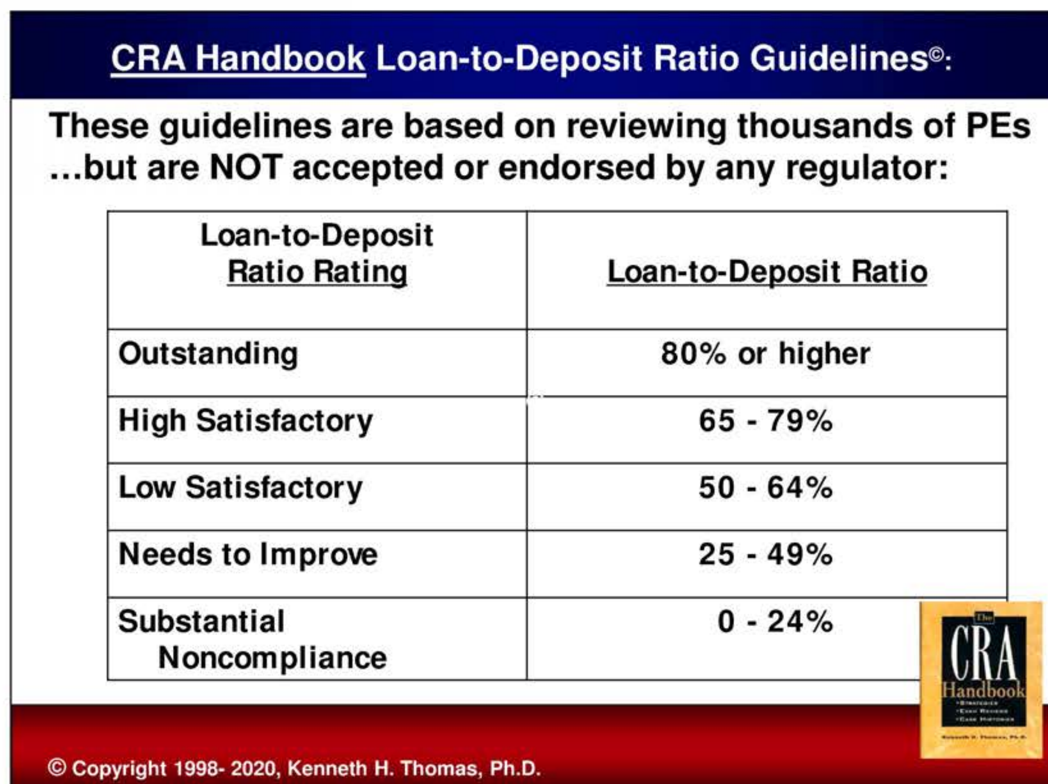
The guidelines recommended below are based on analyses of thousands of PEs going back to 1990. The Fed's recently released data base has the potential to be useful for this purpose, but such raw data is only helpful if it can be converted to useful information through proper analysis.

The CRA Handbook strongly recommends creating separate High and Low Satisfactory ratings, similar to that existing in Massachusetts, which has its own CRA regulations for state-chartered banks, credit unions, and even mortgage companies. [However, as a concession to their financial institutions, that state refers to "Low Satisfactory" ratings as just "Satisfactory."]

1. Recommended Loan-to-Deposit Ratio Guidelines

The first set of guidelines below are for the Loan-to-Deposit (LTD) Ratio. These guidelines result in "presumptive" ratings, which must be evaluated relative to the above-mentioned qualitative factors and, most importantly, a bank's Performance Context.

For example, there are many cases where an LTD ratio below 50% or even 25% may be Satisfactory depending on a bank's Performance Context, especially such contextual factors as the local economy, competition, or a unique or targeted business strategy. A proper Performance Context evaluation must be done on case-by-case basis.


CRA Handbook Loan-to-Deposit Ratio Guidelines©:

These guidelines are based on reviewing thousands of PEs ...but are NOT accepted or endorsed by any regulator:

Loan-to-Deposit Ratio Rating	Loan-to-Deposit Ratio
Outstanding	80% or higher
High Satisfactory	65 - 79%
Low Satisfactory	50 - 64%
Needs to Improve	25 - 49%
Substantial Noncompliance	0 - 24%

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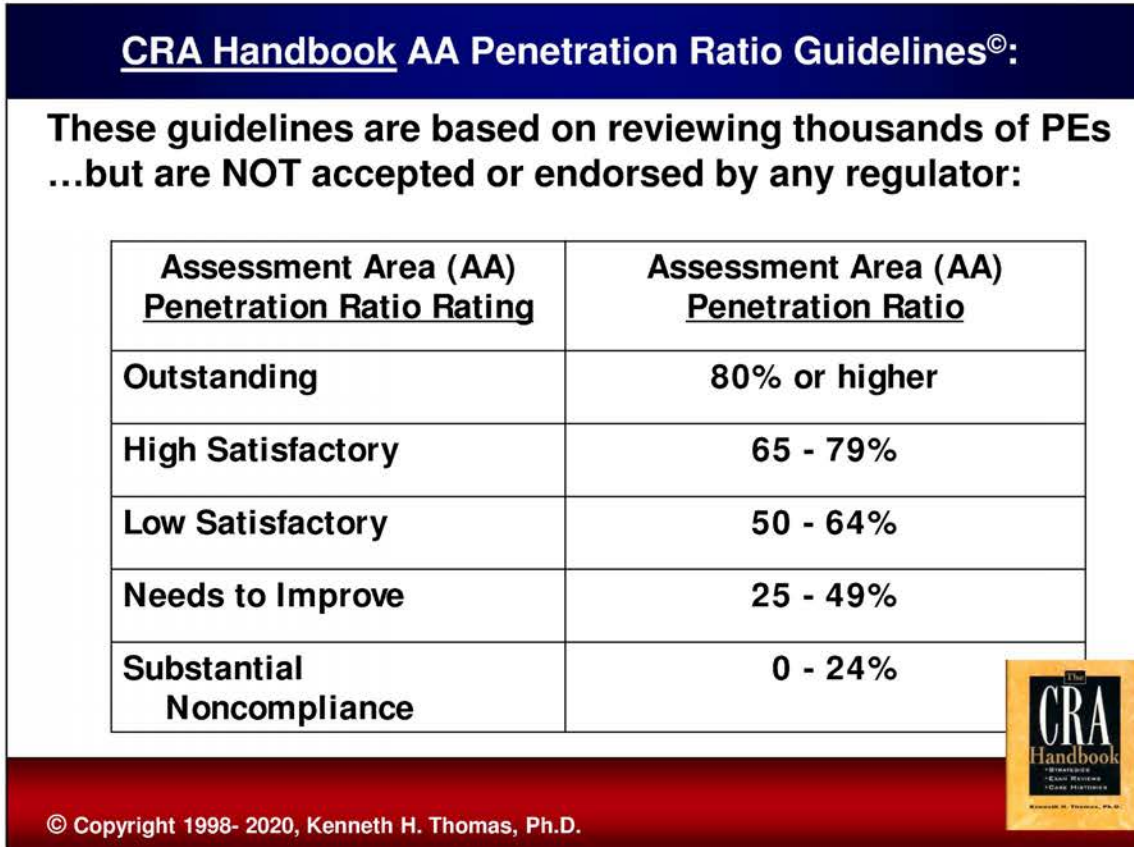
2. Recommended Assessment Area Penetration Ratio Guidelines:

The guidelines below are for a bank's Assessment Area Penetration Ratio. Again, there are many cases where such a ratio below 50% or even 25% may be Satisfactory. This would again depend on a bank's Performance Context, especially such contextual factors as the local economy, competition, a unique or targeted business strategy, or Community Development activities outside the Assessment Area(s) or the Broader Statewide or Regional Area. A proper Performance Context evaluation must be done on case-by-case basis.



CRA Handbook AA Penetration Ratio Guidelines©:

These guidelines are based on reviewing thousands of PEs ...but are NOT accepted or endorsed by any regulator:

Assessment Area (AA) Penetration Ratio Rating	Assessment Area (AA) Penetration Ratio
Outstanding	80% or higher
High Satisfactory	65 - 79%
Low Satisfactory	50 - 64%
Needs to Improve	25 - 49%
Substantial Noncompliance	0 - 24%

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3. Recommended LMI Borrower and Geography Considerations

The CRA Handbook carefully researched the feasibility of adopting LMI borrower and LMI geography guidelines for Assessment Areas (AA), but it was concluded that specific metrics are really not feasible.

This is again a case where we must rely on examiner judgment, as is presently done, since the exclusive use of metrics relative to demographic and peer data as proposed by some regulators may lead to suboptimal results. For example, using a fixed ratio such as 65% of relevant peer data may understate a bank's potential to serve its community, since it may encourage a bank to merely meet that goal rather than motivating them to exceed it.

Examiners are in the best position to evaluate a bank's willingness and ability to meet the LMI borrower and geographic needs by considering Performance Context rather than simple ratios. Examiners also have more discretion in terms of a deeper dive into these two LMI ratios.

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Consider, for example, the following possible LMI ratio examiner considerations from The CRA Handbook:

- Preference for LMI Borrower over LMI Geography
- Discretionary use of *Low* vs. Moderate Income within LMI
- Discretionary use of *Middle* vs. Upper Income
- Discretionary use of # of loans vs. dollar volume
- Similar approach for Small Businesses/Farms

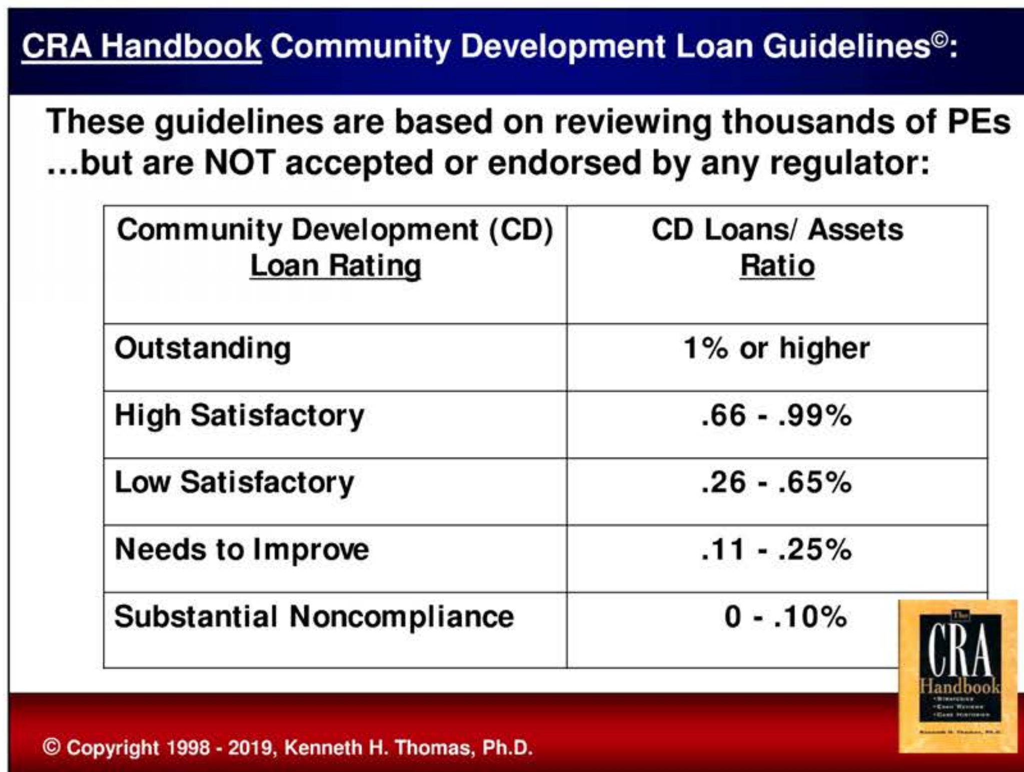
Examiners also exercise discretion in comparing a bank's current LMI ratios to:

- Previous Review Period ratios (discretionary focus more on recent years)
- "Peer" or competitive banks (discretionary focus on a few "similarly situated" banks)
- HMDA or other aggregates
- AA Demographics (e.g., % LMI census tracts, residents, households, or small businesses)

4. Recommended Guidelines for Community Development Activity

There are three sets of recommended guidelines for the different community development activities in the charts in this section.

a. The chart below is for Community Development Loans, and an annual ratio of CD Loans to Average Assets as described in The CRA Handbook of 1% would qualify for an Outstanding rating.



Community Development (CD) Loan Rating	CD Loans/ Assets Ratio
Outstanding	1% or higher
High Satisfactory	.66 - .99%
Low Satisfactory	.26 - .65%
Needs to Improve	.11 - .25%
Substantial Noncompliance	0 - .10%

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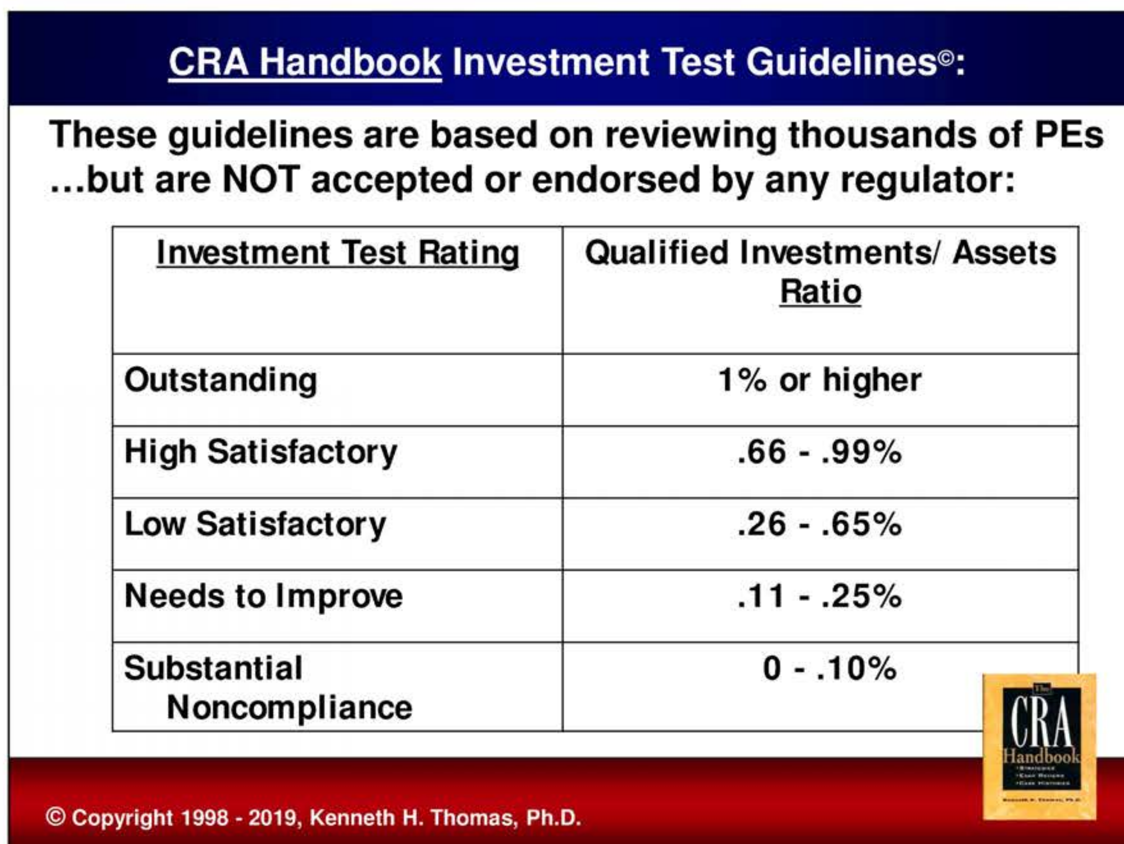
b. The chart below is for Community Development Investments. The comparable annual CRA investment guidelines from The CRA Handbook are similar at 1% for an Outstanding rating and .66% and .26% for a High and Low Satisfactory rating, respectively.



Investment Test Rating	Qualified Investments/ Assets Ratio
Outstanding	1% or higher
High Satisfactory	.66 - .99%
Low Satisfactory	.26 - .65%
Needs to Improve	.11 - .25%
Substantial Noncompliance	0 - .10%

c. The chart below is for Community Development Services. The CRA Handbook recommends using the *number* of CD services, often referred to as "instances" by the FDIC, as the appropriate metric for measuring CD service performance.

This metric is preferred to other possible metrics such as the number of hours, the number of employees or officers involved, the number of organizations contacted, or the number of LMI individuals impacted.

The basis for this preference is discussed in The CRA Handbook. For example, the number of hours for CD services can be easily inflated: should a banker count the hours in prepping for and driving to and from the CD service location, especially if the banker is stuck in traffic?

The chart below identifies the number of CD services per billion dollars of average assets per Review Period year that are consistent with different CRA ratings:

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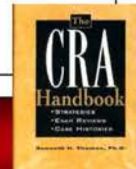
<u>CRA Handbook</u> CD Services Guidelines©:

These guidelines are based on reviewing thousands of PEs ...but are NOT accepted or endorsed by any regulator:

Community Development (CD) Service Test Rating	Number of CD *Services* per $1 Billion of Assets per Review Period Year
Outstanding	12
High Satisfactory	8 - 11
Low Satisfactory	6 - 7
Needs to Improve	3 - 5
Substantial Noncompliance	0 - 2



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Additional Needed Improvements to Existing CRA Regulations

The following improvements to existing regulations should be considered for implementation by the Fed as well as by other regulators:

1. Separate High vs. Low Satisfactory ratings for individual tests and the overall rating.

2. Cost-savings benefits for Outstanding rated-banks such as an extended period between exams; for example, four years for Outstanding banks, three years for Satisfactory banks, two years for Needs to Improve banks, and one year for Substantial Noncompliance banks. Also, there should be a personally signed "congratulations" letter to the CEO of every bank with an Outstanding CRA rating from the head of the FDIC, Fed or OCC as appropriate that can be displayed by the bank.

3. No credit for CRA investments secured by loans to middle- or upper-income borrowers or benefiting middle- to upper-income renters in LMI Census Tracts, otherwise known as Gentrification Investments.

4. Online and regularly updated "Sunshine" disclosures by regulators of all direct and indirect financial or nonfinancial assistance or benefits provided to community groups and coalitions by banks, especially those with M&A, branching, or other corporate activity to help understand why some community groups and coalitions challenge and protest the activities of certain banks but not others.

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5. *Anonymous* Hot Line and Chat Room staffed by experienced examiners for CRA questions, in addition to the OCC's "CRA Qualifying Activities Confirmation Request" procedure

6. Credit for all Community Development activities outside Assessment Areas(s), starting with the Broader Statewide or Regional Area, as long as a bank has satisfactorily met legitimate credit needs within its Assessment Area(s).

7. CRA appeals heard only by the other two federal regulators vs. the primary one of the appealing bank.

8. Published examiner ratings (like UBER ratings) to help identify "rogue" CRA examiners. Also, improved education and training of CRA examiners is needed at all three regulators to minimize the likelihood of rogue examiners.

9. Regularly revised online "laundry list" of qualifying CRA and Community Development activities with an LMI focus similar to the OCC's " *CRA Illustrative List of Qualifying Activities"*

10. Regulators must explicitly state that M&A "CRA Plans" or "Community Benefits Plans," which are automatically expected by community groups on large deals, are NOT required under CRA.

Broader Public Policy CRA Recommendations

The following CRA recommendations by the author were made in The CRA Handbook and expanded upon since then:

1. Expansion of CRA to cover all Credit Unions at a minimum and possibly even mortgage companies. Critics of this recommendation should look at the experience of Massachusetts, where credit unions and mortgage companies, both with CRA obligations, have vastly different CRA ratings. Also, the California Organized Investment Network (COIN) should be encouraged as a model in other states to provide leadership in increasing insurance industry investment in underserved and rural communities.

2. An objective cost vs. benefit public policy analysis of the continuation of state CRA examinations and ratings for FDIC-insured banks and thrifts (e.g., in Connecticut, New York and Massachusetts), when they almost always use the same exam procedures and ratings as their federal counterparts. If there is no expansion of CRA to cover credit unions or even mortgage companies at the federal level, then all states should be encouraged to follow the Massachusetts CRA statute to cover credit unions and mortgage companies, with the exclusion of FDIC-insured banks and thrifts already examined at the federal level.

3. Expansion of CRA to cover all Fintechs operating with bank charters, including OCC Special Purpose bank charters without FDIC insurance.

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4. Lower taxes, FDIC assessments, and/or FHLB/Fed borrowing costs for banks with Outstanding ratings, since banks need a *real financial incentive* for that rating not just an internet posting.

5. Transfer all CRA and Fair Lending activities to a restructured CFPB (originally recommended for the FFIEC) to insure exam and ratings consistency and avoid regulatory infighting as well as providing a consistent CRA public Performance Evaluation (PE) search engine and examination schedule.

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