October 4, 2023

Community Reinvestment Act (CRA) Proposed Rule

Dear Chair and Members of the Board of Governors, Chair and Directors of the FDIC, and Acting Comptroller of the Currency:

Better Markets' August 7, 2023, supplemental comment letter (SCL)[1] in response to the proposed Community Reinvestment Act (CRA) rule (Proposal) is supported by an extensive and detailed statistical analysis of the Federal Reserve's data. It demonstrates that the Proposal is flawed and will not properly serve low- and moderate-income (LMI) households as required by the law. Unless the changes suggested in the SCL are made, the banks' history of artificially inflated near-perfect CRA examination pass rates will continue and LMI communities and households will continue to be underserved.

Better Markets engaged in a principled analytical deconstruction of the Proposal's Retail Lending Test (RLT) which receives the largest weight in a bank's CRA evaluation. We confronted the RLT with two key adverse scenarios for LMI households: the dramatic decline in bank lending over the last decade, and redlining by banks, which goes to the heart of the CRA. We found the RLT to be blind to these phenomena and identified why. We conducted an exhaustive statistical analysis of the RLT's results ***<u>for the 600+ banks</u>*** for which complete data are available and identified the contribution of each component of the test to outcomes. The analysis revealed that outsize contributions to banks' RLT pass rates come from components with zero economic rationale or no underpinning in the Proposal.

A Letter[2] was recently filed purportedly in response to our SCL, but nothing in it undermines or raises valid questions about the comprehensive analysis and modeling in the SCL. The Letter does not directly challenge any of our analysis or offer an alternative analysis, but instead makes a set of assertions unresponsive to our results and the analytical framework that generated them. Indeed, the Letter itself agrees that the RLT "is imperfect" and that the "solution is to seek improvements." That's exactly what our SCL does. Contrary to the statements in the Letter, Better Markets is not "dismissing an interagency proposal" or suggesting in any way that it be "abandoned."

We agree entirely with the Letter that "[i]n the wake of the pandemic, [LMI] communities need more loans, investments, and services to gain lost ground and to resume their growth and revitalization." To determine whether the Proposal would do that or not, Better Markets alone has undertaken time-consuming and extensive statistical work to apply the Fed's data to the Proposal, analyzed how it will actually work, identified weaknesses, and proposed specific, targeted solutions to be incorporated in the final rule.

We will not address every comment in the Letter but offer the following:

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[1] Better Markets' August 7, 2023 Supplemental Comment Letter is available here: https://bettermarkets.org/wp-content/uploads/2023/08/Better_Markets_Supplemental_Comment_Letter_CRA.pdf.

[2] National Community Reinvestment Coalition Comment Letter, Sept. 22, 2023 ("Letter"), is available here: https://www.regulations.gov/comment/OCC-2022-0002-0689.

- **The Letter agrees that the RLT should be improved but dismisses its weaknesses by claiming that the test parameters can be "adjusted" or "fine-tuned" after finalization and implementation of the Proposal "after a few years" "if inflated ratings remain prevalent."**

  Anyone familiar with bank LMI lending in recent years would point to its dramatic decline in absolute terms, and to its decline as a percentage of banks' home lending overall, against a backdrop of significant increases in both by nonbanks. These trends are at odds with banks' "continuing and affirmative obligation to help meet the credit needs of their local communities, including low- and moderate-income neighborhoods where they are chartered."[3]

  Our systematic analysis of the components of the RLT shows that they are individually and collectively blind to these trends and will not penalize further declines.

  Adjusting thresholds or "fine-tuning" after the fact, as the Letter proposes, would be an ineffective response to this shortcoming. Furthermore, such adjustments will not be as easy or quick as the Letter suggests, likely taking significant effort and time if not an entire re-proposal and rulemaking process. Now is the time to make adjustments before the rule is finalized.

- **The Letter is focused on the banks and their CRA ratings rather than actual lending to LMI communities and families, as demonstrated by the following statements (i) the overall objective is to "reflect distinctions in [bank lending] performance," and (ii) the secondary objective is to judge lending "to a group of borrowers or tracts in relation to peers and demographics."**

  Actually, the objective of the CRA rule is to assess banks actual lending to LMI borrowers, not to separate banks into a range of performance categories. LMI borrowers care about their overall access to credit, not which bank it comes from; if all banks are exiting from lending, how they perform relative to each other is secondary. Yet this is the sole concern of the RLT.

  Better Markets' analysis focuses solely on results for LMI borrowers, which is the intent of the CRA. While undoubtedly unintended, the Letter seems to forgive all banks in an area reducing lending to LMI borrowers because it is "difficult."

- **The Letter says that Better Markets' proposal to remove the community benchmark would result in CRA exams with less local context and less information regarding the extent to which banks are responding to demographic trends and the needs of LMI households.**

  The Proposal says the intention of the community benchmarks is "to measure the opportunities for home mortgage lending in the low-income and moderate-income census tracts of an assessment area," or "to measure the opportunities for banks to lend to low-income or moderate-income families in a specific assessment area." We understand "opportunities for [LMI] home mortgage lending" to mean demand for loans by LMI families. There is no other legitimate interpretation.

  In our SCL and subsequent policy brief,[4] we demonstrate with two independent sets of examples, how the community benchmarks have **no relationship** to demand for home loans by LMI groups.

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[3] These are quotes from the FRB and OCC webpages explaining the CRA. https://www.federalreserve.gov/consumerscommunities/cra_history.htm. https://www.occ.gov/publications-and-resources/publications/community-affairs/community-developments-fact-sheets/pub-fact-sheet-cra-reinvestment-act-mar-2014.pdf

[4] The Banking Regulators' Proposed Community Reinvestment Act Rule Will Not Work, But Dramatically Improving It Is Not Complicated, September 18, 2023, available here: https://bettermarkets.org/wp-content/uploads/2023/09/BetterMarkets_CRA_Rule_Will_Not_Work_09-18-2023.pdf.

Knowing whether the community benchmark in an assessment area exceeds or falls below the market share of LMI loans tells us nothing about banks' response to the needs of LMI households.

Importantly, there is a significant difference between CRA pass rates for banks when the community benchmarks are included and pass rates when they are not included. As our analysis documents, when the RLT includes community benchmarks in conjunction with the "best of" clause, there is a 37- percentage point increase in banks' RLT pass rate. In other words, when the irrelevant measure that is said to represent demand is present, it is much easier for banks to have a passing score on the overall CRA exam.

- **The Letter disagrees with Better Markets assertion that the agencies' proposed 60% pass rule is arbitrary.**

  Better Markets' concern is with the "cliff" or binary form of the 60% rule, rather than its economic substance. The 60% rule discourages banks from concentrating their lending efforts in large areas, because the rule weights each (facility-based) assessment area equally. It also has the unwanted side effect of incentivizing a binary response from banks: to focus on the areas that are most likely to get them to 60%, and to ignore other areas. (We are not suggesting that this would occur for nefarious reasons – this is merely the rational response to the incentives in the Proposal.) The proposed "70% rule" would surely exacerbate the incentive problems of the 60% rule.

  A better way to disincentivize concentration in large assessment areas without adverse side effects is to make aggregation weights a smooth "diminishing returns" function of loan (and deposit) volume, rather than the simple aggregate currently used. The smoothness of this function, as opposed to a cliff, is the key feature. Determining its shape is a matter of discretion, but this is the same with any component of the rule. Again, simulating outcomes on actual bank data, as Better Markets has done, would seem a natural component of this process.

- **The Letter says that Better Markets ignores research literature that concludes that the CRA has had positive impacts on lending in LMI communities.**

  Better Markets understands the research literature conclusions to be more mixed on the CRA's effectiveness, which is one of the reasons Better Markets conducted independent, original analysis, created a model, and applied the Fed's data to its Proposal.

  For instance, while the title of a study that the Letter cites says there is evidence of significant positive impact of the CRA, the study's conclusions are actually much more nuanced than the title suggests and disappear when examined with more detailed analysis such as at a census tract level. Furthermore, the study authors offer several possibilities that would explain bank lending activity that falls outside the bounds of the CRA, such as pre-existing lending to borrowers in newly eligible LMI tracts or broader changes in loan underwriting.

  There is additional academic research, such as this study (forthcoming in the Harvard Law Review) that share similar concerns about the flaws in the proposed rule, which are not referenced. The study is consistent with Better Markets, saying that the CRA has failed to reduce the prevalence of "banking deserts" in low-income communities.

- **The Letter says the Proposal "would likely increase reinvestment."**

  While we wish it were the case, it is unclear how the Letter arrives at this conclusion. Better Markets' analysis shows that the Proposal offers banks ways to reduce lending and maintain positive CRA ratings, if other banks in the area also reduce lending. This is inconsistent with the CRA's intent to promote lending in LMI areas.

- **The Letter's claim that Better Markets is misunderstanding and mischaracterizing redlining is incorrect.**

  Better Markets explicitly addressed the ability of the RLT to detect redlining because redlining is front and center in the framing of the law, and in the banking agencies' current description of the CRA's objectives. At a minimum, the RLT should be able to detect paradigm cases of redlining. We demonstrate that it cannot.

  The Letter instead focuses on one of the several components of the RLT, the Loan/Deposit ratio, and, while agreeing with our redlining analysis, asserts without reference or citation that it was not intended to address redlining. This is an example of the many places where the Letter does not dispute our analysis or reasoning, but our understanding of the purpose of the Proposal and the CRA, which is: (1) redlining is central to the CRA, (2) the RLT is designed to enforce the CRA, (3) the RLT cannot detect the most basic form of redlining.

We hope these comments are helpful and we would be pleased to discuss them with you further.

Sincerely,

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