



Bank Links

FOR COMMUNITY REINVESTMENT AND ECONOMIC DEVELOPMENT

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The Office of Regional & Community Affairs
of the Federal Reserve Bank of New York

A MESSAGE FROM THE COMMUNITY AFFAIRS OFFICER

In 2002 the Community Reinvestment Act (CRA) will reach two milestones—it will celebrate its 25th anniversary and, once again, be reviewed by the Federal Financial Institutions Examination Council (FFIEC). For those unfamiliar with the regulatory system, the agencies represented on the FFIEC are the Federal Reserve, Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

In preparation for this CRA review, the regulatory agencies that make up the FFIEC will seek comment from financial institutions, community groups and others to determine if CRA, which was last revised in 1995, should be updated in any way. The comprehensive review will assess the effectiveness of the regulation in emphasizing performance over paperwork, promoting consistency in bank evaluations, and eliminating unnecessary burden.

To help banks, community groups and others focus on the CRA topics under evaluation, the Federal Reserve Bank of New York will hold a series of meetings to disseminate information about the review process. The sessions also intend to provide the opportunity to hear bankers and community development practitioners exchange ideas on whether the regulation should be altered. We have also asked the other regulatory agencies to join us in sponsoring these sessions.

To help familiarize you with the CRA topics under discussion, this issue of BankLinks looks at the evolution of CRA over the last 25 years and outlines the topics that the FFIEC is asking for comment on. And, through interviews with respected industry leaders in both sectors this edition will give you insight into the perspectives on the CRA.

Elizabeth Rodriguez Jackson
Community Affairs Officer

Regulators Scheduled to Review the Effectiveness of CRA

INSIDE

Selected CRA Topics Under Discussion.....	2
Industry Reps Discuss Strengths and Weaknesses of CRA	4
History of CRA	8

Selected CRA Topics Under Discussion

Members of the FFIEC are inviting comments on the following issues they will examine when reviewing CRA. Comments on additional topics also are welcome. For a full text of the FFIEC report published in the Federal Register July 19, 2001, please see www.ffiec.gov/cra. Comments are due October 17, 2001.

LARGE RETAIL INSTITUTIONS: LENDING INVESTMENT, AND SERVICE TESTS

Large retail institutions are subject to the lending, investment, and service tests, which consider such things as the number and dollar amount of loans, qualified investments, and services, and the location of and recipients of these activities. The regulations also require examiners to evaluate qualitative factors.

Do the regulations strike the appropriate balance between quantitative and qualitative measures, and among lending, investments, and services? If so, why? If not, how should the regulations be revised?

LENDING TEST

An institution's lending performance is evaluated by the number and amount of loans originated or purchased by the institution in its assessment area; the geographic distribution of the lending, and its use of innovative or flexible lending practices to address the credit needs of low- or moderate-income individuals or geographies in a safe and sound manner.

Does the lending test effectively assess an institution's record of helping to meet the credit needs of its entire community? If so, why? If not, how should the regulations be revised?

INVESTMENT TEST

An institution's performance under the investment test is based on the dollar amount of qualified investments, their innovativeness or complexity, their responsiveness to credit and community development needs, and the degree to which they are not routinely provided by private investors.

Does the investment test effectively assess an institution's record of helping to meet the credit needs of its entire community? If so, why? If not, how should the regulations be revised?

SERVICE TEST

Agencies consider an institution's branch distribution among geographies of different income levels and its record of opening and closing branches, particularly in low- and moderate-income geographies. Also considered are the availability and effectiveness of alternative systems for delivering retail banking services in low- and moderate-income geographies and to low- and moderate-income individuals, and the range of services provided in geographies of all income levels.

Does the service test effectively assess an institution's record of helping to meet the credit needs of its entire community? If so, why? If not, how should the regulations be revised?

COMMUNITY DEVELOPMENT ACTIVITIES OF LARGE RETAIL INSTITUTIONS

Under the regulations, "community development" means affordable housing for low- or moderate-income individuals, community services targeted to low- or moderate-income individuals, activities that promote economic development by financing small businesses and farms, and activities that revitalize or stabilize low- or moderate-income geographies.

Are the definitions of "community development" and related terms appropriate? If so, why? If not, how should the regulations be changed?

Are the provisions relating to community development activities by institutions that are subject to the lending, investment, and service tests effective in assessing those institutions' performance in helping to meet the credit needs of their entire communities? If so, why? If not, how should the regulations be revised?

SMALL INSTITUTIONS: THE STREAMLINED SMALL INSTITUTION EVALUATION

A “small institution” is defined as an institution with total assets of less than \$250 million that is independent or is affiliated with a holding company with total bank and thrift assets of less than \$1 billion as of the two preceding year ends.

Do the provisions relating to asset size and holding company affiliation provide a reasonable and sufficient standard for defining “small institutions” that are eligible for the streamlined small institution evaluation test? If so, why? If not, how should the regulations be revised?

Are the small institution performance standards effective in evaluating such institutions’ CRA performance? If so, why? If not, how should the regulations be revised?

PERFORMANCE CONTEXT

The regulations provide that an institution’s performance under the tests and standards is evaluated in the context of information about the institution, its community, its competitors, and its peers. Such information may include demographic data about the institution’s assessment areas, the institution’s product offerings and business strategy, and information about the institution’s past performance and the performance of similarly situated leaders.

Are the provisions on performance context effective in appropriately shaping the quantitative and qualitative evaluation of an institution’s record of helping to meet the credit needs of its entire community? If so, why? If not, how should the regulations be revised?

ASSESSMENT AREAS

The assessment area is the geographic area in which an institution’s record of meeting the credit needs of its community is evaluated. The institution’s assessment area should consist generally of one or more MSA or one or more contiguous political subdivisions, and include geographies where the institution has its main office, branches, and deposit-taking ATMs. The area also includes surrounding geographies where the institution has originated or purchased a substantial portion of its loans.

Do the provisions on assessment areas, which are tied to geographies surrounding physical deposit-gathering facilities, provide a reasonable and sufficient standard for designating the communities within which the institution’s activities will be evaluated during an examination? If so, why? If not, how should the regulations be revised?

ACTIVITIES OF AFFILIATES

Under the lending, investment, and service tests and the community development test, an institution may elect to have activities of its affiliates considered as part of its own record of performance. An “affiliate” is defined as any company that controls, is controlled by, or is under common control with another company. Subsidiaries of financial institutions are considered affiliates.

Are the provisions on affiliate activities, which permit consideration of an institution’s affiliates’ activities at the option of the institution, effective in evaluating the performance of the institution in helping to meet the credit needs of its entire community, and consistent with the CRA statute? If so, why? If not, how should the regulations be revised?

LIMITED PURPOSE AND WHOLESALE INSTITUTIONS: THE COMMUNITY DEVELOPMENT TEST

The community development test is the evaluation method used for limited purpose and wholesale institutions. A limited purpose institution offers only a narrow product line (such as credit cards or motor vehicle loans) to a regional or broader market and must request and receive designation as a limited purpose institution from its regulatory agency. A wholesale institution is not in the business of extending home mortgage, small business, small farm, or consumer loans to retail customers, and similarly must obtain a designation as a wholesale institution.

Are the definitions of “wholesale institution” and “limited purpose institution” appropriate? If so, why? If not, how should the regulations be revised?

Does the community development test provide a reasonable and sufficient standard for assessing wholesale and limited purpose institutions? If so, why? If not, how should the regulations be revised?

Would the community development test provide a reasonable and sufficient standard for assessing the CRA record of other insured depository institutions, including retail institutions? If so, why and which ones, and how should the regulations be revised? If not, why not?

Industry Reps Discuss Strengths and Weaknesses of CRA

To gain bank and nonprofit perspectives on whether CRA should be revised, BankLinks conducted the following interviews with **Mark A. Willis**, executive vice president and head of the Community Development Group for JPMorgan Chase, **Donna Rawson**, Compliance and CRA officer at Solvay Bank, Solvay, NY, and **Irene M. Baldwin**, executive director of the Association for Neighborhood & Housing Development, Inc. (ANHD).

“I don’t think it makes sense to make major revisions. We have spent five years working and refining the requirements of the revised regulation and a major change would be disruptive to that process.”

At JPMorgan Chase, Mr. Willis supervises a staff of over 200 that annually makes \$500 million of real estate loans, more than \$150 million in home mortgage and small business loans, and manages community relations, philanthropy in the Bank’s markets, the supplier diversity program, and CRA and Fair Lending compliance. Ms. Rawson is responsible for compliance, including CRA and Fair Lending, at Solvay Bank, an independent community bank with six branches in Onondaga County. Ms. Baldwin’s agency is a membership organization of New York City nonprofit neighborhood housing groups whose mission is to ensure flourishing neighborhoods and decent, affordable housing for all New Yorkers.

SHOULD FEDERAL REGULATORS REVISE CRA?

Mr. Willis: I don’t think it makes sense to make major revisions. We have spent five years working and refining the requirements of the revised regulation and a major change would be disruptive to that process. What may be most appropriate is some minor tweaking. No problem in the regulation is big enough to require a complete overhaul.

Whatever the outcome we need to make sure that CRA continues to focus on encouraging activities that strengthen communities and also make good business sense. The types of programs that work best for communities over the long run are those that can be sustained on an economic basis. Otherwise CRA risks being reduced to a philanthropic program or being perceived as simply a tax imposed by federal fiat.

Ms. Rawson: With the reformation of the CRA regulations in 1995, I feel that sufficient time has elapsed to review the standards and context of the requirements enacted. By now most banks have been examined under the new requirements and both bank employees and examiners have adapted to the new procedures. I feel that most banks have put in a substantial degree of effort, time, and work to implement the requirements, particularly those banks, like ours, that went from small bank requirements to large bank reporting requirements. At this time, a complete revision is not essential. However, speaking on behalf of a community bank, I feel that some areas of the regulation need to be critiqued.



Ms. Baldwin: I see CRA as a good tool that needs to be strengthened. It doesn't go far enough. The law is good for what it covers but now banks have expanded their services and these services don't fall under CRA.

CRA has been a success, but not an unqualified success. CRA is responsible for the transformation in New York City neighborhoods since the 1970s. A lot of damage to neighborhoods was caused by bank disinvestment—bank redlining. Whole sections of the city were gutted. However as a result of community representatives working with government and the private sector, with the biggest partners being the banks, they've done some really amazing things. CRA mandated these partnerships and sparked this redevelopment. There are banks in New York City that have outstanding community development records in the area of providing multi-family housing, rehabilitation, and affordable housing, facility, and comprehensive neighborhood development. One problem in New York City, however, is the small consumer has been left out of the mix because the products and services for smaller depositors, such as low-cost checking, are disappearing.

WHAT TARGETED CHANGES IN CRA WOULD YOU PROPOSE?

Mr. Willis: It is essential that CRA stays aligned with and supportive of community development. CRA cannot be allowed to diverge from its original intent or become a checklist that fails to consider the actual impact of lending, investments, and services. At JPMorgan Chase we encourage examiners and senior regulatory officers to spend time in our communities and to talk with local leaders.

We also should look at the overall burden of the regulation in terms of paperwork. The examination process is lengthy and there are ways we could simplify it. One of the goals of the 1995 CRA revision was to simplify compliance with the regulation, but it didn't go far enough. Regulators probably haven't achieved what was intended in terms of reducing the burden on banks and examiners. The time required for the examination and the paper required are far greater now than before the reform.

Ms. Rawson: One of the areas I would like to see reviewed would be the area of investment. As a community bank with assets of \$355 million, we must follow the investment test for large bank criteria. This often becomes very difficult since we are competing with the larger institutions that have greater resources to invest.

I would like to see a review of the threshold for a small bank. Some consideration should be given to increasing the \$250 million threshold to \$500 million, or developing a program that would be appropriate for the

mid-sized bank. I find it very difficult to see how a bank that has just met the threshold or is slightly over can compete on the same lending, servicing, and investment criteria of the billion dollar banks.

In addition, the revised regulations were supposed to reduce the burden of paperwork. We find that there appears to be a great deal more paperwork now for us to complete, maintain, and provide to examiners.

Ms. Baldwin: I have two problems with CRA as it is now written. One problem is the scope of the law. CRA should be expanded beyond banks and cover investment banks and insurance companies and other financial players. The second problem is how it is enforced. Some banks are getting satisfactory and outstanding CRA valuations that shouldn't be. That's an enforcement issue. The regulation needs to have more teeth and regulators need to be better educated about community credit needs.

HOW HAVE CHANGES IN THE BANKING INDUSTRY SUCH AS BANK MERGERS AFFECTED CRA?

Mr. Willis: The merger between J.P. Morgan and Chase combined a wholesale bank and a retail bank. As a result I would suggest further aligning the wholesale and retail banking tests. For example, there are loans and investments made by J.P. Morgan that could not be counted under the CRA test for retail banks. Regulators should give some thought to allowing retail banks to have the same flexibility, mainly with geography, that the wholesale banks have.

Ms. Rawson: From our standpoint as an independent community bank, we have seen a decline in the smaller banks since many of them have merged or have been purchased by larger institutions over the years. I feel that this may affect CRA since many of the smaller banks tend to cater to the low- and moderate-income small business owner who is just starting up or the true "mom and pop business."

Ms. Baldwin: Bank mergers are a mixed bag. Even though there are a lot of banks in New York City, fewer and fewer serve the lower income market. The larger they get, the less concerned they are about the lower income consumer. On a positive note, as the banks grow larger, they have more resources available to support community development in a meaningful way.

DO YOU THINK THAT THE REQUIREMENTS FOR ASSESSMENT AREAS SHOULD BE CHANGED?

Mr. Willis: Under the wholesale bank test, banks get credit for loans and investments made beyond their assessment areas, if the banks adequately address the



needs of their assessment areas. I think that this option to lend and invest outside one's assessment areas should be available for large retail banks. While our commitment to our assessment areas remains undiminished, we should be able to take advantage of opportunities where we can have an impact outside of these areas.

Casting a broader net also helps us create a more sustainable business that fits better with our corporate strategy. Such an approach helps us spread our exposure across multiple markets and regions and allows us to utilize our staff and resources as productively as possible.

Ms. Rawson: I feel that the requirements for assessment areas should remain unchanged. As a community bank, our goal is to meet the needs of our community where we have branch offices by providing services that attract all segments of our assessment area and promote economic growth. We incorporate the entire County of Onondaga in Central New York for servicing, lending, and investing, which is an area where we are known and where we know our customers and their needs.

Ms. Baldwin: Assessment areas should be expanded beyond physical locations to incorporate all areas where banks generate a certain amount of business. Such an expansion would address the concerns that many activists have about fairly determining assessment areas for Internet banking activities or in cases where banks have offices in only one city but are generating loans all around the country. However, I believe retail banks shouldn't get credit for activities outside their assessment because that would dilute the assess-

ment area. New York City banks say that the competition within New York City is so tough that they want to go outside of their assessment areas and get credit. I have a problem with that. That means they believe they should be held to a lesser standard in New York City where other banks are located. By giving them credit outside their assessment area, it would dilute their activity in New York City. These banks have an obligation to serve the community where they have a bank.

ARE PROVISIONS RELATING TO COMMUNITY DEVELOPMENT ACTIVITIES IN THE LENDING, INVESTMENT, AND SERVICE TESTS ADEQUATE OR SHOULD THEY BE UPDATED?

Mr. Willis: It's important to consider giving large retail banks the option of a community development test that combines community development lending and investment, and replaces the separate investment test. My concern is the investment test has taken on a life of its own. Investments are very important in strengthening and rebuilding communities, but the returns are often sub-par or highly speculative and the regulatory agencies expect us to continually increase our portfolios. It would be better for us to be free to determine what mix of community development lending and investing works best.

Ms. Rawson: In my opinion, activities in the investment area need to be reviewed and updated. Currently, there are no definite guidelines for banks to follow to determine the adequate number of investment activities needed to fulfill what is expected by examiners. This can make it difficult for many of the banks that are under say the \$500 million level and are limited in their investment resources.

Consideration should be given to incorporating the investment test into the provisions of the lending test.

Ms. Baldwin: CRA should ensure that lower income individuals get access to credit and deal with the disinvestment that has affected neighborhoods.

We need educated regulators who know the needs of the community the bank is serving and can determine if the bank is supporting the neighborhood with services such as direct lending in the neighborhood, affordable home mortgages, and credit to community organizations.

Among the 100 communities ANHD represents, each neighborhood has very specific community development needs. We need an assessment criteria that acknowledges those different needs while at the same time protects the CRA's core mandate of ensuring access to credit by low- and moderate-income people. For example, some of our neighborhoods in places like Harlem and central Brooklyn are seeking to attract middle-income families so as to insure economic inte-

gration into their communities. This is a legitimate community development goal in some neighborhoods, and financing for middle-income housing in those communities should be somehow acknowledged in the CRA evaluation process. But at the same time, this should not diminish a bank's responsibility to finance low- and moderate-income housing in those same neighborhoods. And in other New York City neighborhoods, such as Hell's Kitchen and Williamsburg, we are seeing rampant gentrification and displacement of low-income residents; in those neighborhoods, financing middle-income housing is not a legitimate community development goal. So we somehow need to come up with an evaluation standard that is sensitive to the neighborhoods' trends and priorities without relaxing the obligation to serve low-income communities.

IS THE PERFORMANCE CONTEXT SECTION OF THE EXAMINATION EFFECTIVE?

Mr. Willis: The performance context part of the exam should be used more proactively by banks and regulators. For example, the place to explore local market conditions would be in the performance context. To the extent that pricing in a market is being artificially depressed because of CRA pressures, it might not make sense for regulators to force every bank to increase its market share and further depress pricing. For a business to be sustainable and to attract additional private capital into communities, the business has to make good financial sense. From this perspective we need to eliminate any notion of a market share test in those localities where the market is well served by other players. In these markets there is no need to force every institution to move heaven and earth to try to achieve its "fair share."

I am proposing that we get away from rigid formulas and explore up front and in a constructive way what is the best way to serve the community development needs of the community. We should guard against regulations or interpretations that lead to a deterioration in pricing and credit quality and so undermine the viability of the business.

Ms. Rawson: I feel that the performance context is effective as is. Examiners are provided with a great deal of information to assess a bank under the performance context. As long as examiners are trained

on the same guidelines for an examination and are familiar with the area where the bank is located, I see no changes necessary at this time.

Ms. Baldwin: Whatever is in place now, it isn't working. All loans aren't "good" loans and this doesn't seem to weigh into the process. I recently read a performance evaluation of a bank that received an "Outstanding" evaluation, where the evaluation placed great emphasis on the level of multi-family lending the bank made in low-income Bronx neighborhoods. However, this bank was notorious among our Bronx membership for holding the paper on a large quantity of over-financed, seriously deteriorating properties. The bank was very much a part of the problem, not the solution, yet it received an "Outstanding" rating based in part on those troubling loans. Using another example, I mentioned a need for financing for middle-income housing in some of our neighborhoods. Banks are interested in providing these middle-income loans, but the danger is that these loans might be used in place of low-income lending. We need criteria that are sensitive to the community context, but even if we come up with terrific criteria, they can only be used effectively if we have informed, educated examiners.

"CRA should ensure that lower income individuals get access to credit and deal with the disinvestment that has affected neighborhoods."

Comments on the CRA 2002 proposed rulemaking can be sent to:

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Comments should refer to Docket No. R-1112

Mail: Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Delivery: Comments addressed to Ms. Johnson may also be delivered to the Board's mailroom between 8:45 a.m. and 5:15 p.m., and to the security control room outside those hours. Both the mailroom and the security control room are accessible from the Eccles Building courtyard entrance, located on 20th Street between Constitution Avenue and C Street, NW.

Electronic: regs.comments@federalreserve.gov.

History of CRA

Congress enacts Community Reinvestment Act (CRA) in 1977.

- CRA encourages depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods.
- Only financial institutions insured by the FDIC are subject to CRA. Other financial intermediaries, such as credit unions, brokerage firms and uninsured foreign banks have no CRA obligation.
- CRA requires the periodic evaluation of each depository institution's record in helping meet the credit needs of its entire community. In addition, the record is evaluated each time a bank makes an application to establish a domestic branch, merge with another institution, acquire the assets of another institution, assume the liabilities of another institution, or do anything requiring approval under the Bank Merger Act of the institution's federal regulator.

Home Mortgage Disclosure Act (HMDA), enacted by Congress in 1975, influences CRA. HMDA provides public data on real estate loans that can be used to assist in determining whether financial institutions are serving the housing needs of their communities. HMDA requires certain financial institutions, including banks, savings associations, credit unions, and other mortgage lending institutions to publicly report on their mortgage lending activity each year.

Congress passes Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) in 1989, which affects CRA.

- FIRREA expands coverage of the HMDA to include mortgage lenders not affiliated with depository institutions or holding companies, and requires reporting of data regarding the disposition of applications for mortgage and home improvement loans in addition to data regarding loan originations and purchases. It requires most lenders to identify the race, sex, and income of loan applicants and borrowers, and amends CRA to require public release of the examination reports.

- FIRREA mandates public disclosure of the examination reports, now called public evaluations, and consistency among regulators in their evaluations. As a result, the Federal Financial Institutions Examination Council (FFIEC), made up of the four federal financial regulatory agencies, adopts 12 assessment factors to be used as the basis for all CRA examinations and to be discussed in all public evaluations.

- Bankers complain that the paperwork burden of maintaining records to support their activities with regard to the 12 assessment factors is overwhelming. Community activists argue that banks could pass CRA evaluation by completing the paperwork without actually making loans in low- and moderate-income neighborhoods.

In 1992, the Clinton Administration asks the FFIEC to rewrite the regulation implementing CRA. After extensive consultation with banks and the public, the FFIEC issues a new regulation in July of 1995 to accomplish three things: promote consistency across regulatory lines; reduce the paperwork burden on banks, and emphasize performance over process.

- In addition to complaints about the paperwork burden, banks say that the old regulation treats all banks the same. In order to recognize the differences in institutions, the FFIEC prepares four sets of procedures for examining institutions under the new regulation: small retail banks; large retail banks; wholesale and special purpose banks, and strategic plans.

Comments by community activists and others and their success in pressuring banks to commit more assets to CRA causes a majority in Congress to support the “sunshine” provision of the recent Financial Modernization Act of 1999, also known as the Gramm-Leach-Bliley Act.

- In general terms, the sunshine provision, which took effect April 1, 2001, requires that individuals or organizations that are parties to agreements and receive funds or other resources from banks report annually on how they used those funds or resources. Individuals and organizations that are not parties to the agreement don't have to report the funds received and parties to the agreement that do not receive funds don't have to report annually.

When the FFIEC published the revised 1995 CRA regulation, it agreed to review it again in seven years. The seven years will be up in 2002 and the FFIEC has started its review.



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