

EFFECTIVE IMPLEMENTATION OF THE COMMUNITY REINVESTMENT ACT

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HEARING

BEFORE THE

SUBCOMMITTEE ON
GENERAL OVERSIGHT, INVESTIGATIONS,
AND THE RESOLUTION OF
FAILED FINANCIAL INSTITUTIONS

OF THE

COMMITTEE ON BANKING, FINANCE AND
URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

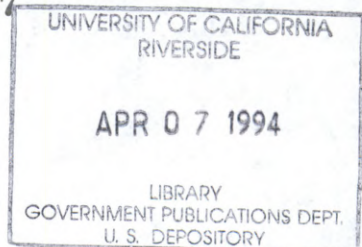
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EFFECTIVE IMPLEMENTATION OF THE COMMUNITY REINVESTMENT ACT

TUESDAY, JUNE 22, 1993

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON GENERAL OVERSIGHT, INVESTIGATIONS, AND THE RESOLUTION OF FAILED FINANCIAL INSTITUTIONS, COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,

Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2253, Rayburn House Office Building, Hon. Floyd H. Flake [chairman of the subcommittee] presiding.

Present: Chairman Flake, Representatives Roth and Ridge.

Chairman FLAKE. Good morning. I would like to call to order the hearing of the Subcommittee on General Oversight, Investigations, and the Resolution of Failed Financial Institutions, and welcome our guest today for this hearing, Mr. Derrick Cephas, the superintendent of banks of the State of New York.

Today's hearing is an important one as we focus on the Community Reinvestment Act and the New York State Banking Department's proposal to revise the manner in which it is administering the CRA requirements. The Community Reinvestment Act was initially developed to counter the practice of redlining.

But unfortunately for this Nation and for too many of its citizens, CRA has fallen significantly short of its goal. I believe now is the time to address this issue at the Federal level as well as at the State level. We look forward to Mr. Cephas sharing his model in the hopes that we will be able to glean from it some of what is necessary for us to be able to create a Federal program.

The recent *Washington Post* articles entitled "Separate and Unequal—Racial Discrimination in Area Home Lending," certainly drove home the point that too many of our Nation's citizens are denied access to affordable credit, home ownership opportunities, small business opportunities, and the ability to establish meaningful relationships with our Nation's financial services industry. Of course, this study is an extension of studies that we have noted, both in Atlanta last year, and the Federal Reserve of Boston study and the HMDA study that many of us want to share as a part of the hearing.

I find it contemptible that government which represents our Nation's citizens and stands behind our Nation's financial institutions would allow the same institutions, using their government backing to alienate and discriminate against certain segments of our society for reasons based solely on skin color, gender, or ethnicity.

As I have stated previously, I believe it is time for Congress to rethink the goals of CRA and to amend it in a manner that allows all individuals equal access to affordable credit. I do not think that we should create a new system of banks designed specifically to meet the needs of lower and moderate-income individuals, but rather, require the existing federally insured depository institutions to fulfill the mandate of serving all Americans.

I cannot begin to fathom the rationale behind the notion that banks should not become involved in community development because they do not know how. The question then becomes, is it that they do not know how, or is it that they do not want to? Whatever the response, I believe it would be in the best interest of the Nation and our insured depository institutions to begin to learn how to work with everyone, regardless of skin color, gender, or ethnicity.

I am appalled that our Nation's banking system declines to make loans to lower and moderate-income families for reasons that I find abysmally absurd. The impact of this kind of discrimination on minority neighborhoods is what causes the overall instability and the continued decline. I believe that it is deplorable that any segment of our society is forced to do business with a private mortgage company, which in many instances is owned by the same bank that refuses to make affordable mortgage loans to creditworthy applicants who fail to meet the standards imposed by the bank.

While I am certainly not criticizing those private mortgage companies at this point, we are all aware that these applicants are charged higher rates, and therefore, are not afforded the same opportunity to purchase a home at the same rate as their nonminority counterparts with a comparable credit history and income.

While most of us would agree that we in the government must address the needs of our distressed communities and their residents, we have yet to agree upon a means by which to do this. All the while, our cities and their residents continue to suffer and to lose ground. Toward that end, I believe that by revising CRA to make it quantifiable, performance oriented, and objective would significantly improve availability of affordable credit to underserved communities in this Nation.

This administration and many of my colleagues in both the House and the Senate have made community reinvestment and development a top priority. It is an issue that I have been involved in for the past 17 years, and last year during the 102nd Congress, Congressman Tom Ridge and I were successful in having the Bank Enterprise Act enacted into law. In the very near future, I will be introducing the Bank Enterprise Act Amendments of 1993, which is designed to be the first step in achieving permanent renewal of America's underserved urban and rural communities.

With that, I would like to again welcome my friend, Mr. Derrick Cephas, superintendent of banks of the State of New York, and look forward to continue working with you as we have done over this last 1½ years of your—is it 2 years?

Mr. CEPHAS. Two years.

Chairman FLAKE. Two years of our administration of Superintendent of New York banks.

At this time I would like to recognize the ranking minority Member of the subcommittee, Mr. Toby Roth of Wisconsin, who will be recognized for his opening statement.

Mr. ROTH. Thank you, Mr. Chairman, and I want to join you in welcoming our witness, Derrick Cephas, to be with us here this morning. I am looking forward to learning New York's plans with respect to proposed changes in the State's Community Reinvestment Act, which at present is almost identical I believe with the Federal CRA.

Most bankers that I know use the CRA sometimes as a swear word. They want to see it repealed. And they say that in community banking, which describes most of our Nation's 13,000 banks, that CRA compliance is irrelevant and therefore, a needless expense to consumers. The banks are particularly angry because they must comply while their competitors do not. Maybe we can touch on that a little bit this morning.

The insured lenders fear what lies ahead for them. Mr. Cephas's proposals to make CRA compliance more objective I think is really a worthy goal and that is why it is so important for us to listen to your experience and what you have learned up in New York to see if we can apply some of that here. It sounds like, you know, credit allocation to some people. If insured lenders are to be held to a higher standard, they say, their competition should have to be held to the same standard. I think this issue of fairness probably is one that we in the Federal level have to look at also. I am talking basically about the consumer finance companies, auto finance companies, insurance companies, security firms, and other nonbanks, I really should say.

The CRA is unfair as long as it is applied only to federally insured institutions. Now we are being told that the CRA will be with us forever. In fact, it is being touted as a major mechanism for encouraging community development lending. Many bankers—I see in some of these periodicals, you have probably read them also I am sure—there are “loans from hell” and so on. I think that is pretty strong. But anyhow, it is something we should be taking a look at.

Our subcommittee held a series of three hearings earlier this spring in which witnesses said in effect that community development lending can be profitable. Some banks and other lenders even said that they had learned to love them. So I think what we want to do is maybe find out from you this morning, you know, why do some bankers like them and why do they work so well, and why don't others have the same experience?

Maybe if the other banks don't like them, maybe if they could role model after the banks who have had success, maybe that would be a solution, I don't know.

But that is one of the reasons I am glad to see you here, Mr. Cephas, because you are a real expert in this area and maybe you can help us out in what we should be doing.

Thank you, Mr. Chairman.

Chairman FLAKE. Thank you very much, Mr. Roth.

At this time we would like to recognize you, Mr. Cephas, and you may make your presentation, since you are the only witness, in whatever manner you deem best to do so. I think in our previous

discussion last week we—you indicated that you would like to do an opening statement and then kind of spend time in some way discussing the 11 points that you would like for us to give consideration to. And so we are happy again to welcome you, and the time is yours.

STATEMENT OF DERRICK D. CEPHAS, SUPERINTENDENT OF BANKS, NEW YORK STATE BANKING DEPARTMENT

Mr. CEPHAS. Good. Thanks very much, Congressman Flake, and Congressman Roth, as well. I appreciate the opportunity to be here.

What I want to do first is just talk generally about CRA and then go into the specifics of our 11 proposals. We spent the last 9 months in New York preparing a proposal to restructure the way CRA is done in New York. I will talk about the current status and then I will give you some idea as to the specifics.

Obviously, it is a very important issue, CRA, and I think the subcommittee, Congressman Flake, your subcommittee, ought to be commended for all of the good work that you have done in the area, and I too look forward to continuing to work together with you however we in New York might be helpful.

First of all, one of the things that makes it difficult to make progress in this area is some of the—first, the inherent complexity of the subject, the tremendous dissemination of misinformation involving CRA and the great opportunities for excessive politicization of the subject. So we have had to work in that environment in dealing with the issues: Complexity, misinformation, and politicization.

We began in New York with the basic premise that the current CRA law is fundamentally flawed. What are the flaws we are referring to? First of all, the system is far too subjective. As has been mentioned already, there really is a paucity of standards by which to measure CRA compliance and far too little objectivity in the rating system.

Second, I think that the current system places too much emphasis on enforcement solely in the context of a regulatory application process. On the face of it, any bank that is FDIC insured is supposed to abide by CRA, but the fact is that the bank's performance is only relevant legally when and if it seeks to open a branch, engage in an acquisition, or need some regulatory approval.

Our point in New York is that CRA compliance should be the ongoing responsibility of banks, whether or not they are looking for regulatory approval. In addition, we think that community groups also ought to be involved in CRA on an ongoing basis, not solely in the regulatory context. Greater emphasis ought to be placed on ongoing compliance by banks and ongoing community group involvement. We think that the current emphasis on the regulatory application process is greatly misguided and should be reduced.

The third point I want to make as an introduction is that the current state of polarized relations between the banks and the community groups should be addressed. Under the current system, community groups, community advocates, and other users of banking services and their representatives are largely the principal enforcers of CRA. They are the ones that press the banks for greater community involvement; they file the regulatory protests, all in an effort to increase bank CRA participation. The banking department

believes—in fact, I would say this is a principal thesis of our entire proposal—we believe that bank regulators, and not the community groups, should bear the principal obligation to ensure that CRA laws are enforced.

The structure of CRA, the current structure of CRA, inevitably produces conflict between banks and community groups. I will give you an example.

If a bank, no matter how stellar its CRA performance, is still likely to be made the subject of a regulatory protest in the event of an acquisition or branch, there is a built-in incentive for a bank to refrain from participating in CRA activities to their full potential. Since in any event, no matter how good a job they have done, more would be required at the time of an application.

On the other hand, from the perspective of the community groups, there is much less need for community groups to pursue bank CRA investments on a consistent basis, since the mechanism of the application process, there is a more bang for the buck for the community groups by simply waiting for the unique opportunities created by the regulatory application process.

There are some community groups in certain cases that have brought substantial economic benefits to their local communities through the regulatory process, but we believe that if CRA were revised to contain quantitative standards and if those standards were enforced on a consistent basis, there would be significant overall increase in the level of CRA investment in local communities and far less need and less justification for regulatory protests.

The last point I want to make in the general statement is that CRA, the current system encourages banks to focus on process, procedure, and documentation at the expense of a more substantive, investment-oriented approach. This is another, I think, unintended result of the regulatory protest mechanism, because even a “one” rated bank, that is an outstanding CRA bank, will be required to produce voluminous documentation to shield itself in the event of a protest. So what we are trying to do, we are trying to shift the focus of CRA enforcement from an emphasis on process and procedure to an emphasis on actual investment in local communities.

The above summarizes generally the broad objectives of our system. The end product, we believe, will be one that is consistent with the interests of banks, community groups, and regulators. We have tried to design a new approach to CRA participation and a new approach to CRA enforcement.

On the whole, I think that bank CRA activity in New York will be increased as a result of our system—of our proposal. For those banks who have already undertaken a serious and consistent effort, our proposal ought to relieve them of a significant degree of regulator burden and regulatory uncertainty.

On the other hand, for those banks that have not seriously pursued fulfillment of their CRA obligations, our proposal will certainly require them to do more. The serious banks desirous of complying, we should facilitate an easier compliance. For those not desirous of complying, the end result will be that their annual ratings are likely to decline.

One more point I want to make before I get to the specifics, and that is I think that the flaws in the current system are not caused

by any particular group. I don't think it would be accurate to blame the banks or the community groups or the regulators. The problem really is in the system itself.

There is little possibility for meaningful improvement in the implementation of CRA under the current system, notwithstanding the significant efforts of the banks, community groups, and regulators. Therefore, we have proposed to restructure the system because we have come to believe that restructuring it is really what is necessary.

Now I will talk about the specifics of our proposal, having said that as background. The original proposal was disseminated in the form of 11 questions issued for public comment last September, September 1992. I have attached a copy of the original proposal to this testimony so that it can be made a part of the official record for the hearing. What I think I will do initially today is just talk about the five most important provisions in our proposal.

Number one is we have created a specific list of categories of CRA investments. We have compiled a list of over 20 broad categories of activities which qualify for CRA credit in New York.

The purpose of the list was to provide a greater range of opportunities for banks to satisfy their CRA obligations. While we believe that direct lending must remain a primary manner in which a bank satisfies its CRA obligations, we also believe that banks are well suited to assist their communities in many other ways. The list is not an exhaustive list; it is merely representative of the types of activities which qualify and is not intended to preclude banks from pursuing other activities which also qualify.

One of the criticisms of the list for those that don't understand it has been that it will stop banks from being exploratory or expanding what they want to do. On the contrary, we are simply saying, this list is available for guidance. If you have some question as to what might satisfy CRA, refer to the list. Although the list is not intended to exhaust all possibilities. In fact, we think that the wholesale banks will find this list particularly useful, both foreign and domestic wholesale banks, although a good number of the retail banks have expressed support for it as well.

Number two in the specific list is the preinvestment opinion on CRA eligibility. If a bank wants to engage in a CRA activity and that activity is not listed on the authorized list of investments, we have established a mechanism by which a bank can apply to the banking department for a preinvestment opinion on whether or not the proposed activity qualifies for CRA. This came about because we found that a good number of banks were reluctant to make loans or engage in CRA activities—or engage in an activity if they were not certain that they would receive CRA credit for it.

So what we are trying to do here is to remove the uncertainty as to whether or not an investment will qualify. What the banking department's role is, we will not endorse an investment, we will not tell a bank to do it, we will not endorse a community group or a specific project. We will not give any opinion on the appropriateness or the suitability or the compliance of safety and soundness standards of any investments.

But the point is, those are all decisions that the bank has to make. But to remove the uncertainty and the delay as to whether

or not a specific investment will qualify, we will impose a mechanism in very simple form; they apply to the banking department, we will issue an opinion yes, this qualifies, no, it does not. At least that will, I think, remove one bottleneck in the whole investment process.

A third specific item in our proposal is the establishment of a rating system which will make use of objective, quantitative data. We will take the annual bank's CRA rating and that rating will be derived by combining the results of a quantitative analysis with the results of a qualitative analysis. Now, understand that there is a certain amount of inherent subjectivity in the CRA system, so we are not attempting to create a system which is solely quantitative.

However, it will be largely, predominantly quantitative. And on the quantitative side, what we will do is we will measure a bank's total CRA activities against a percentage of its deposit liabilities. The one-to-four rating system will be retained. In order for a bank to receive a specific CRA rating, for example, a one, or an outstanding rating, a bank will ordinarily be required to invest a minimum amount of its deposits in CRA-related activities. That tells you how the quantitative side of the analysis goes.

On the qualitative side, we will use—make use of certain subjective factors in arriving at the qualitative score. Again, we will not entirely eliminate the qualitative analysis, although the qualitative or subjective analysis will be relatively insignificant as compared to the quantitative. There are a number of factors which we have to take into consideration on the qualitative side.

The size of the institution, its financial condition, the availability of CRA opportunities in the particular marketplace served by the bank, and one thing that has been pointed out to us, certain types of investments may be very hard to make, like small loans, hard to place loans, loans that are costly, administratively costly. Small loans are CRA projects which in dollar amount may not add up to one large project.

We would want to reflect the fact that this particular bank is reaching a very underserved market, even though the actual dollars may be smaller than building a huge building or a big public works project. So in those kinds of difficult loans to place, on the qualitative side of the computation, we would give some enhanced credit for that kind of an effort. And all of this will be spelled out in some detail in the regulation which comes out in July, on July 22.

Of course, we are aware of the considerable difficulties, both of a conceptual and a public policy nature that hinders the adoption of a CRA system which relies on qualitative—or quantitative analysis. People might question our scoring benchmarks; it may be said that some of our ratings are arbitrary, how we weigh some of the specific investments may be questioned, and another problem will be that those who have learned to do business under the current system and therefore have grown very comfortable with the current system don't want to see it changed, even if they acknowledge the great flaws in the current system.

So I think there is a certain level of comfort that people feel is being disturbed by our effort, although they would agree themselves, the opponents would agree themselves that the current CRA

system does need significant overhaul. Credit allocation I think was mentioned here earlier. That has been a problem that has been raised, and we are aware of some of these criticisms and when we put the amendments—when we put the regulation out and we gain some experience with it, there may be some need here and there to revise it or amend it. But I think on balance, our quantitative system is far preferable to the subjective methodology currently being used.

Under the current system, it is very unpredictable for banks, very unpredictable for community groups, and very unpredictable for regulators. We think that the addition of a quantitative analytical framework will bring a greater degree of fairness and predictability to the whole system. That is the quantitative.

Number four, on the specific list is the safe harbor provision. We intend to institute a so-called safe harbor provision which would shield banks with outstanding CRA ratings from protests in the regulatory application process. Now, how it will work is this: A bank which has received a "one" rating, an outstanding rating for 3 consecutive years will then be entitled to a safe harbor against the regulatory protest for any successive year, so long as they maintain the "one" rating. So once you get 3 years of a "one" rating, so long as you maintain it for the fourth and successive years, CRA performance would not constitute a bar in a regulatory application.

We believe—and there has been some criticism of this, but we believe that a safe harbor would act as a significant incentive for banks to do much more in the CRA context. They would have the ability to shield themselves, if they achieved a one, shield themselves from further regulatory protests. Now, a "one" rating or a "two" rating are both satisfactory ratings, and so from the perspective of a bank, there is no incentive to move from a two to a one. There is no benefit of that from the perspective of a bank.

So what we are trying to do is say if you achieve an outstanding performance, and we will have sufficient rigor in our qualitative standards so that a one is meaningful, if a bank achieves a one, then they would—and does that for 3 years, they would then be protected from a regulatory protest.

The fifth item in the specifics is what we call the enhanced community group participation. This really has two subitems. What we are really trying to do here is increase the level of community group involvement in the CRA process by doing two things.

One, we will formally solicit written comments from community groups as part of our annual CRA examination. The second thing we will do is we will publish annually the CRA ratings for all of the banks which we examine.

Now, on the point about solicitation of community group comment, we have developed a standardized, written questionnaire to facilitate the gathering of information from community groups. In this manner, comments of community groups will be specifically solicited, verified, and formally considered.

One of the things that we found in recent years in our CRA examination process, even as a regulator, we did not have sufficient information to evaluate what was going on out in the communities between the banks and the community groups and the banks and

the consumers. So what this questionnaire is designed to do is just to provide the banking department with basic data on the relationships between a bank and its serviced area.

How many applications are being submitted, how many are being denied, what the—how people are received when they go in a bank; does the bank have justification for denying applications, so that we move from just anecdotal evidence or conjecture or piecemeal evidence to this is really an effort to, in a broad-based way, increase our intelligence gathering so we can have a sense of the relationships between the banks and the communities that they serve that information. Once it is verified and collected, we will then make it part of the annual CRA examination process.

The second part of this community group, the enhanced community group involvement, goes to the question of publishing annually the CRA ratings. Because what we are trying to do here, we think that if the CRA ratings are published on an annual basis, both the banks—this will encourage a dialog between the banks and the community groups. Under New York law right now, a CRA rating is public information, but the community groups have to file a Freedom of Information request in order to get it.

What we found is that that is not often used, and very few of the community groups actually take advantage of that. So what we are trying to do is we make this information public, the community groups as well as the banks will have a very good idea of at least how the regulators view the bank's performance in the various communities. We believe that the role of community groups can be meaningfully and responsibly expanded to encourage a continuing dialog with banks on community credit needs.

Now, the other provisions; there are six other provisions which just in the interests of time I won't cover right now, but they are covered in some detail in the—in my written submission. So if there are questions about that, I can answer it, or people can read it at their leisure.

Just to tell you currently where we are, we are scheduled to issue this regulation for public comment on July 22. The comment period commences with the issuance of the regulation, and in the ordinary course, we expect that we will adopt this regulation in final form in October 1993.

We began work on this project more than 15 months ago. We have reviewed more than 70 written comments from banks, community groups, community advocates, public officials, academics, and other persons in New York and elsewhere. We have conducted over 15 hours of public hearings, with testimony from 44 witnesses. We have met privately with a large number of interested parties, both supporters and opponents of the proposal.

We have incorporated into the regulation a great many of the suggestions which we have received. Many will recognize in the regulation their own contributions to our efforts. We are grateful for all of the assistance and support that we have received from the banks and the community groups in New York. I am personally pleased to say that while there have been sharp disagreements over some of the issues, all the parties involved in the process have been conducting themselves in a responsible and respectful manner.

We believe that our regulation represents a significant improvement over the current system of CRA enforcement. It is not perfect. There may be an occasional oversight and further refinement may well be required. But our rulemaking process in New York is flexible enough to make the necessary adjustments. But I believe that there is little doubt that our proposal will materially increase the amount of local community lending in New York while reducing the regulatory burden and uncertainty currently faced by the banks. Stated simply, that is our goal.

Now, so far I have not specifically addressed safety and soundness issues, although safety and soundness is implicit in all that I have said today. We are obviously not advocating that banks satisfy their CRA obligations by compromising on safety and soundness. That would be bad public policy and bad business judgment.

Banks in New York have been able to make CRA loans without unacceptable risk. As a general matter, CRA loans have not subjected banks in New York to any material repayment or credit risk, although administrative costs have generally been higher for CRA loans. The loans have performed quite well, in part, because of the strict underwriting guidelines often used. In the final analysis, community development loans must be defensible from a business perspective. As more banks obtain greater experience and greater expertise in this area, they will be able to incorporate local community lending into their overall business plans as profit centers, along with all their other products.

In closing, let me say that I hope that my testimony today contributes in some small measure to our common efforts to reform CRA. I also hope that the Congress and the Federal bank regulators work together to revise CRA on a Federal level in a manner that is not inconsistent with the model which we plan to develop in New York. I believe that the day has passed when we might question the advisability of CRA as a concept.

Given our national history and given the current demographic contribution and availability of banking services, government intervention in the form of CRA is necessary. Our task is to reform CRA to make it more responsive to the needs of the banks and to the communities who use it. I thank you very much for this opportunity, Congressman.

[The prepared statement of Mr. Cephas can be found in the appendix.]

Chairman FLAKE. Thank you very much, sir.

Certainly, I think that all of us who have had an opportunity either to talk to you regarding the development of the New York approach to CRA or an opportunity to have heard you or to have read your testimony would agree that this is probably one of the most progressive steps in the right direction. Our concern has to be a question of applicability, and your closing statement raises a desire for the Federal Government to create a CRA regulatory requirement similar to that which you propose here.

Do you think that the best approach to dealing with the CRA issue is done legislatively, or as you are doing it through some regulatory process?

Mr. CEPHAS. In New York we are able to do it on a regulatory basis: One, because the statute is broad enough, the New York

statute is broad enough to permit regulations; and two, there is a will and a desire on the part of the State regulators in New York to use the regulation in this fashion. So in our State we do not need legislation. We are able to do it through our regulation because of the political will; we believe it is the right thing to do and we are doing it under our own regulation.

On the Federal side, I think that with the desire and the intent on the part of bank regulators, something similar could be devised under the regulator scheme without going to legislation as a legal matter. It may be that—and I haven't really explored this—but it may be that legislation on the Federal side may be necessary in order to coordinate as between all of the regulators on the Federal side. Here in New York we just have the State banking department.

We are particularly interested in this issue because in New York you have the State charter banks who are also regulated either by the FDIC, if they are State nonmember banks, or by the Federal Reserve if they are part of a holding company. So where the Federal regulators come out on this issue is of some critical importance to the State of New York.

We would like to be a position where at least what we are attempting to do in New York is not thwarted by Federal regulation or the lack of Federal regulation. So I think that for the States that want to take a progressive position and for those who are interested in seeing something on the Federal side, I don't know how far this effort has gone so far, but in the absence of commitment by the Federal regulators to do something similar, I think legislation may be required.

On the other hand, if there is a commitment on the part of the regulators to do this, I think that the statutory structure and the regulatory structure is there that would allow for regulatory as opposed to statutory response, assuming that the will and the desire is there on the part of the Federal regulators.

Chairman FLAKE. Are you suggesting that if the quantitative and qualitative analysis basis used by Federal regulators is not in some way brought into conformity with the adjustments, the revisions that you propose, then you could have a situation where in fact your State regulators are looking for one thing in an evaluation, your Federal regulators are looking for another thing, and then the bank is kind of left to make a determination of whether or not it is going to follow the State regulation or whether they are going to follow Federal regulation, and who wins in that?

Mr. CEPHAS. Right. That would be a very unfortunate position to find ourselves in. Unfortunate for the State banking department, but also unfortunate for the banks who are trying to comply. We have gotten—I mean we believe that one, it will increase CRA participation in New York significantly. That is our goal, that is what we are trying to accomplish.

On the other hand, the certainty and the predictability and the orderliness of the system for everybody who lives under it, banks, the community groups, is a second objective for us, and you know, we are afraid that we will somehow be prevented from implementing that fully if Federal law is not at least supportive and consistent. So that is a concern of ours.

Chairman FLAKE. So that you are hoping that somehow from the Federal level, whether by regulatory process or by legislative process, we create a mechanism that creates conformity for all of the regulatory bodies?

Mr. CEPHAS. Yes.

Chairman FLAKE. Now, the question then becomes, if you have the conformity, how do you retrain a body of, in many instances, career bureaucrats who have had a history of examining CRA through whatever procedure they have used that have left the marketplace that we are trying to service, the underserved markets in the abysmal state that they are, how do we reeducate them to the reality that the opportunities are so great that if, in fact, they participate and interpret on the basis of this analysis, they can do much more for the whole of the Nation as well as do it without hurting the safety and soundness requirements of the banking community?

Mr. CEPHAS. Well, I think the fact that this has become a significant nationwide public issue, and it was not 2 years ago, is itself tremendous progress. You know, regulators, like everyone else, read the paper and watch CNN and pay attention to what is going on in the rest of society. I think that with added visibility for the issue, added impetus coming from committees like this, coming from the White House, that all of us who are trying to bring about a greater level of investment, bring about a greater level of economic fairness in the communities, I think we all eventually have to pay attention to—like the *Washington Post* study—we all have to pay attention to the data, the information, just the compelling public need for this.

And I think CRA is—one of the things that I have noticed in New York, from the time we put this out last September to now, there has been a remarkable change in the public acceptance by the banks even of our document, because they have now become largely supportive of it, because they believe it is the right approach; they understand that it is not an issue that is going to go away, that the State Banking Department is not discouraged by opposition, that we believe in this, and we think there is a fair amount of substance to it.

It is the right approach. So that the banks in New York now have come to be our supporters in this. Give it a chance to work. Let a State which has kind of thought this thing through and has put forth a practical approach, you know, give us an opportunity to make it work in our own State.

I think there are a number of areas around the country, people that have contacted me, there are a number of areas around the country that are considering something like this. For all of us, what we need is some cooperation on the Federal side.

Chairman FLAKE. One of the areas, and perhaps you have found it, I suspect, that will be the most controversial here in the House will probably be your safe harbor proposals. And I believe that because I guess the reactions we have already gotten from a number of persons in terms of what, particularly community groups in terms of safe harbor, denying them an opportunity to be able to raise questions of banks who have, though they have gotten the number "one" rating during the 3-year period, what precludes them

from beyond that 3-year period going back to what may have been in some instances their historical practices, and does a community group, if we adopt safe harbor provisions as you have them, then lose its ability to be able at some point say in the 3rd, the 4th, the 5th year, the 6th year, to be able to stand at a hearing and give its objections to a merger or whatever other kind of business the bank is expecting to venture into?

So I would like for you, if you can, to kind of give us a bit more of your sense of how the safe harbor provision works. Do you see it as the same problem that many of the Members of this body and many of the community groups will see it as, and in general, just your overall view of will it really work and is it something you think that is so germane to the overall CRA revision, that with or without—what happens with or without it?

Mr. CEPHAS. I will speak for our State. In New York we think the safe harbor provision is a critical, significant portion of the entire package. The way our safe harbor works, and from the perspective of a community group, I understand why they would be opposed to it. Because in order for it to be effective and fair, it is also important that the quantitative system and a scoring system is a rigorous one and is meaningful.

So that if a huge number of banks end up with a safe harbor for doing relatively little CRA investment, that is not a fair system, that is not the system we would be creating. What we are attempting to do is, one, have a rigorous scoring system so that all the gradations, one through four, are actually meaningful. So that if you are able to get a safe harbor, you have earned it.

You would first of all require 3 years of a "one" rating, and after that, the safe harbor is only valid on a 1-year basis. You would have to maintain the "one" on each successive year, so that a community group would not find itself in the position where a bank would be shielded year after year unless the regulators have failed to enforce the quantitative system. If that happens, then the safe harbor falls apart.

If you have enforcement of the quantitative system and the bank has earned a "one" and continues to earn it on an annual basis, then I think as a matter of fairness, the institutions, the financial institutions who have made a commitment to the communities and done their work, spent the money, made the commitment, as I said, then I think it is that as a matter of fairness to them that they ought to be protected from the delay and the uncertainty of going through a protest in the regulatory approval context.

The other thing, of course, is what we are trying to do is we are trying to build in an incentive for banks. Right now, there is no incentive whatsoever to accomplish a "one." You get nothing for it, except, you know, maybe feeling like you are a good corporate citizen.

Apart from that, there is really no incentive for a bank to strive for a "one," and if you look at the scoring system, there is a huge grouping in the middle of the banks. In New York, we had, and these are the 1991 figures, we had 11 percent of the banks achieve "ones"; 1 percent achieved fours. So we had 88 percent, assuming that adds up to 100, I think it does, you had 88 percent of the banks "twos" and "threes."

Eighty percent were "twos," 8 percent were "threes." Now, in my view, a rating system, when you have 80 percent of the banks in one category, "twos," what we are trying to say is, there ought to be some grade differentiation. This is grade inflation, like college or something.

There ought to be some differentiation in the scoring system, so that if under our system, a "one" is a meaningful score, only accomplished by banks that have really done an outstanding job, then I think in all fairness, regulatory efficiency, those banks ought not be subjected to a protest. And we know the history of a regulatory process. They do not result in transactions being denied, largely. They are approved as a matter of fact. Now, that is good or bad; we could discuss that. But in fact, they are approved almost always.

Chairman FLAKE. In spite of the protest?

Mr. CEPHAS. In spite of the protest. Not 100 percent of the time, but I would say, and I haven't researched it, it must be 95 percent of the time they are approved. So it seems to me that this mechanism or this—does not serve a useful function most of the time. And what we are trying to do is really to say, on an ongoing basis, banks and community groups have to get together, have to form partnerships, and have to do together what they need to do to improve investment in these communities on an ongoing basis and remove the focus from the protests, from the regulatory protests.

I don't think it is effective in producing actual dollars and actual investments in communities. It is effective in doing a lot of other things, but it doesn't do that, in my view, the way you could if you had a more consistent, ongoing approach.

Chairman FLAKE. Sort of like the Chicago Bulls, if they were more consistent, they would get a great deal more respect.

Mr. ROTH. And more money.

Mr. CEPHAS. But they have to win it every year.

Chairman FLAKE. Mr. Roth, I yielded myself 10 minutes and I used 15, therefore I yield 15 minutes to you.

Mr. ROTH. Thank you, Mr. Chairman. I basically have five questions and I will run through those five and I know Mr.—

Chairman FLAKE. Give him time to answer, now.

Mr. ROTH. Mr. Cephas, I am sure, really understands this, and I am very impressed by your testimony and your grasp of it.

Mr. CEPHAS. Thank you.

Mr. ROTH. One of the questions I have is, what do you see as the biggest divergence—let me see if I can phrase this right—or deviation between what you are doing on the State level and what you are doing on the Federal level? I mean are we running into a problem? Do we have to be concerned, Chairman Flake, myself, and others, as we craft the CRA so that we don't come into, you know, like we have with product liability, you know, wherever State has their own laws? Are we in danger of something like that with a CRA?

Mr. CEPHAS. I don't think so, Congressman. There are—I don't have exact numbers on the tip of my fingers right now, but I think less than half of the States have a CRA statute at all. A large number of States do not have a State CRA. So for a good number of States, it is only the Federal law.

Mr. ROTH. In—I am sorry for interrupting, but many of the States, you know, when they have adopted State laws and so on, they follow like maybe New York or California or Wisconsin. When the States look for guidance for a CRA, do they look to your State? What State primarily do they look to when they adopt CRA laws?

Mr. CEPHAS. In banking, New York has historically been a State where some of the other States pay attention to what we have done, yes. So I would think, and I would hope in this case that other States in this case look to what we are doing. But I think a nationwide approach—I mean I agree with your point. I think what you are leading to is that you don't want inconsistencies, jurisdictions all going in various directions on CRA. And I think that is a very sound approach.

We took the initiative here in New York because this was, to us, just a glaring example of regulatory need, something that needed to be done. So we have tried to do it, take the initiative. But any time that there are other States who want to cooperate with us, or any time there is some initiative in Washington, we are very happy to get involved in a national effort.

I mean our approach—this may not be ultimately the right answer. We think it is pretty close. It may require adjustment; it may require some discussions, analysis with the Federal regulators or on the Federal side, and whatever the ultimate answer is, we are happy to revise what we have done in the interests of harmony and having one system.

So we do not necessarily have to do this to the letter. But we do think this is the right approach, at least initially, and so that is how we sort of got started on it. But if there is some effort down here to look in the same direction and think about some of these issues, New York State will be there, and we will be cooperative and we would do whatever we needed to do to have one system in place.

Mr. ROTH. I was thinking, you know, now that we are going to this national interstate banking and so on, if a bank has, you know, three ratings in a row of "one," 3 years in a row, and then the same bank in Milwaukee, while the bank takes care of itself out there as they do in New York, they should have three "ones," too, is what I was thinking about.

Mr. CEPHAS. As I understand it, there is only a handful of States where this has become relevant. By the way, New York State passed a reciprocal interstate branching law, as well, this past June. And in our Interstate Branching bill there is a provision that we would do our own CRA review in New York State of an out-of-State branch within the State, so we would make our own analysis on that.

Mr. ROTH. So if you have a bank from North Carolina coming into New York, you are going to determine in New York what their rating is.

Mr. CEPHAS. In New York. Not in North Carolina and in the other States, but in New York, yes. But again, you know, we would be flexible and very happy to work with the other States and to work with the Federal Government to come up with a system that is reasonable and responsive and practical for everybody who is trying to live under it. I mean as I said, we made an effort, and

we believe in our effort, but we are certainly willing to step back and work with others who are trying to go in the same direction.

Mr. ROTH. When you give a "one" rating, does it—I mean what guidelines do you use? Do you have to have a certain amount—percentage of your deposits in CRA, or how does that work? Can you just give us quickly a thumbnail sketch?

Mr. CEPHAS. Congressman, I will tell you that one of the reasons why we started on this process in the beginning was there was very, very little in the way of rigorous guidelines. If you had—now, you might have one or two banks that—it is like, you know, the best guy in the class gets an A, and the worst guy flunks, and then you have a whole bunch of people in the middle. We had some internal standards, but they were very fluid, very flexible, and frankly, not all that rigorous.

And what would happen was, the ones didn't worry me so much, because first of all, they were few in numbers and those banks were really banks that had gone way out of their way to be responsive to the communities, large numbers of investments, tremendous community outreach, really had done a good job.

What first caught my attention was the fact that 80 percent were "twos." And if you look at the 80 percent, they were all over the lot, from having done quite a bit to having done very little, yet they were all "twos." And that is when I started to think and the people in our community reinvestment unit, the consumer services unit, that is when we all sat down and said hey, you know, there ought to be more rigor in the process of the standards because there is such a harmonization in the middle, all of these different banks.

That is what we are trying to do, is distinguish between the "twos." And that is what initially caused us to go to work on a set of quantifiable objective standards, because there was in great measure just an absence of that.

Mr. ROTH. So there is a lot of what we would call Kentucky wind damage in that formula yet.

Mr. CEPHAS. In the current formula, it is very hard to—if you were to ask the examiners, it is very hard to get a good sense of what the standards are. It is probably harder to achieve consistent standards as between examiners.

Mr. ROTH. Yes, I bet.

Mr. CEPHAS. And then if you want to talk about examiners in different agencies, that is another level of subjectivity.

Mr. ROTH. When the banks have these regulatory burdens and the other groups, financing groups do not, are you concerned about fairness among these groups?

Mr. CEPHAS. I can see at some point moving in that direction, broadening CRA to cover other financial service providers. We have not taken this up as an issue for several reasons.

First of all, we thought we would spend the first amount of time we had kind of trying to make CRA—trying to make it work, let's try to get it right, try to fix it for the banks.

Second, you know, given the fact that we have been trying to focus really on trying to increase investment in the communities, and we have no real authority over securities firms, insurance firms, and all the other providers of financial services, we didn't think it was a good use of our time, frankly, getting involved in the

issue, just because we don't regulate those people, and for us, it really is a more theoretical issue than a practical issue. But I can see, I can see the day when that gathers some significant support.

Mr. ROTH. Yes. I think it probably will, otherwise the banks are always going to be here in Congress and saying, look, we have our hands tied with all of these regulations and the other people don't, and then you always have this issue of fairness.

Mr. CEPHAS. Right. I think that is certainly a valid issue, particularly for those institutions that sort of occupy the same role in the society as banks do, sure.

Mr. ROTH. Mr. Cephas, I very much appreciate your testimony this morning. I think we learned a good deal and we appreciate that, and now all we have to do is see how we can apply it here on the national level.

Mr. CEPHAS. Thank you very much.

Chairman FLAKE. Thank you, Mr. Roth. We have been joined by Mr. Thomas Ridge of Pennsylvania. He and I shared the legislation for the Bank Enterprise Act, and certainly we both share a great deal of concern representing communities with much the same kind of problem, interestingly, an urban community like New York and a community like Erie, Pennsylvania, where the rust belt has caused the closing of major industries and the discovery that the closer we look, the more we find that the credit problems are the same.

So I would like to recognize my good friend, Tom Ridge.

Mr. RIDGE. Thank you very much, Mr. Chairman. I apologize to you, sir, for coming in late.

You have given rather extensive testimony, and being a little bit concerned about going, rehashing some of the questions that have already been asked, I would like to ask unanimous consent that I be able to submit some written questions to you for purposes of the record.

Chairman FLAKE. So ordered.

Let me just ask a couple of questions, Mr. Cephas.

This whole question of regulatory burden comes back time and time again, every banker, every banking group I meet talk about regulatory burden, and a great deal of the concern seems to be not just CRA, but it usually becomes a major part of the conversation. But also this layer of regulatory burden, as it relates to the number of entities that various groups are regulated by.

Now I know that in New York State, correct me if I'm wrong, I know in New York State—I believe in New York State you have responsibility also for the foreign banks. The question that I have really is, can CRA be applicable as it relates to foreign banks that do business in this country?

In other words, can they too come under regulation that requires of them that they also make investments in communities that are underserved, and do you have any opinion as it relates to how we deal with the broader question of having numerous regulators, which I am sure in our State you have both your regulators and then as you have indicated earlier, the Federal regulators? How do we decrease that burden in some way?

Mr. CEPHAS. On the foreign banks, we have about, when you add up the branches, agencies, subsidiaries, foreign banks in New York,

we have about 240 foreign banks doing business—doing a banking business in New York, probably another 100 or so representative offices. Of that group—these are rough numbers—I think about 20 are actually FDIC insured, of the 240.

Chairman FLAKE. Foreign banks?

Mr. CEPHAS. Foreign banks, yes. Only about 20 of those are FDIC insured. As to that 20, they are all subject to CRA.

Now, the other—and do a credible job with it. The others are not technically subject to CRA, but what they have done—and it is an interesting thing—what they have done, I guess as a matter of good business and good community relations, the foreign banks in New York have really in some cases taken a leadership role in investing in communities on a volunteer basis.

The list that we put in our regulation was in part a response to a tremendous number of foreign bank inquiries about what qualifies as CRA, what does not; how do we go about getting involved in this kind of a business. And so that was really one of the reasons for us putting together the list.

We have taken the position that under the current system, we would still limit the applicability of CRA to only FDIC insured institutions, which would include the 20 that are currently covered, and not in a legal, technical basis include the others. The others have done a very good job on their own, are very active in the community on their own, and until we got to a position where we felt, I guess similar to Congressman Roth's question about the unregulated, the financial services providers, we have not tried to expand the coverage, the number of institutions that are covered by CRA now so much as we have tried to refine and revise and make CRA more workable. But as a general matter, the foreign banks have done an exceedingly good job in New York, largely working with the wholesale banks, making a great contribution.

On the regulatory burden question, it is—I mean this is an issue in and of itself, this whole question of—I mean we are having a lot of different regulators, poses a problem, the Fed, the FDIC, whether you are State or federally licensed, but that is something that is kind of inherent in the dual banking system. It sort of goes with U.S. banking.

We have tried, in the foreign bank area with the Federal Reserve, we are constantly coordinating with them so that we don't overburden the institutions; we don't have duplicative, conflicting regulations. We do the same thing with the FDIC, with the State nonmember banks, again, trying to work out consistent rules; cutting out the duplication and the overregulation.

In the CRA area, if we were to develop a model where there was a common set of rules, and we have said this before, we will be happy to accept, in lieu of our forms, Federal forms, and if a bank doesn't have to file the same document twice, we are trying right now to work out either concurrent or alternate year examinations so that the banks—and this is on CRA—so that the banks are not examined to death with CRA.

They don't get two regulators in the same year or at the same time looking at the same set of documents. So any kind of efforts we need to take in terms of coordination with the other regulators we are happy to do. With filings, with examinations, submissions

of information, because this is increasingly a very burdensome issue for the institutions.

Chairman FLAKE. So that in this instance, if I am hearing you correctly, you are saying you would accede to Federal law, if, in fact, it meets your objectives and standards as it relates to regulation, rather than continuing having State regulators to come in and look at the same thing that the Federal regulators have already looked at?

Mr. CEPHAS. That is correct, Congressman. We have worked out something in New York with regard to the foreign banks; that is in the process right now. We have a very good arrangement in New York with the domestic State-chartered banks, with the nonmember banks, with the FDIC, and with the Fed member banks with the Federal Reserve. We have a very workable, practical system of coordinating our efforts there in those two areas. So in CRA, I am sure we could, with some effort, come to the same place.

Chairman FLAKE. Do you have an opinion on the incentive-based regulatory system that was included in myself and Mr. Ridge's Bank Enterprise Act, and do you think that BEA could be used as a part of a vehicle to help to incentivize banks to make investments and working together with our traditional CRA, in fact, make more capital available to make investments in those communities?

Mr. CEPHAS. No, I think that is a very good approach.

Chairman FLAKE. I mean you don't have to say that just because we both are here.

Mr. RIDGE. Is the door locked?

Mr. CEPHAS. Just because you both happen to be here, right. I think it is a good approach, because in some ways what we find is that banks need the initial impetus, they need the incentive and they need to see that some of these investments can be profitable, if they are not risky, they can be made to fit in with other of their businesses that they currently engage in, and once you get them involved and once you get them off in some of these projects, I think over time, the incentives will be less necessary, at least with the banks that are involved in it, and they will go and take it up on their own.

But as a way of getting it started, I think it is a very good idea.

Chairman FLAKE. One of the problems last year when we introduced this, and I talked to some local newspapers, particularly in New York, the question that they raised was, isn't this rewarding the banks? Isn't this giving the banks monies or the credit we put in for their Federal deposit insurance reduction? Isn't this rewarding them for something that they were mandated by law to do anyway? What is your opinion, if any, on what kind of response do you give to that?

Mr. CEPHAS. I think that—this is a complicated system, as we all know, the bank regulatory system, and if there is something that the Congress or the State legislatures or the Congress can do in order to improve bank performance in these communities, I don't see any problem with—I really don't see any problem with doing it, even though, I mean from a perspective you could argue that it is rewarding them. But incentives is an American way of getting some things accomplished, and I don't think it is inappropriate in

this context, even with that criticism from the press. I don't think that is an inappropriate approach, if you get results.

Chairman FLAKE. Thank you. Mr. Ridge.

Mr. RIDGE. Mr. Chairman, I appreciate you asking a few additional questions. I didn't want to keep our witness any longer, but I have had an opportunity to go over his testimony briefly, and I do have a few questions if you don't mind.

Chairman FLAKE. Not at all. That is why I mentioned the Bank Enterprise Act. I knew that would stimulate you.

Mr. RIDGE. I figured you already had that covered by the time I got here.

I am intrigued by the process that you used to reexamine and to redirect internally New York CRA requirements. When we speak of CRA changes in Washington, that normally is a red flag to many people who would suggest that those of us who want to look differently at CRA are somehow not as interested in focusing on the bank's commitment to low- and moderate-income areas, to urban economic development, that somehow we are trying to make it easier for banks to do less, when in fact we are interested in encouraging them to do far more.

That is why Congressman Flake and I thought that human nature being as it is, you can take a punitive approach and get minimal compliance, or you can take a proactive, positive approach and potentially get far more than the minimum. And in your analysis, you talked about the banks doing the minimum for a lot of different reasons.

And so we came up with the Bank Enterprise Act, and hopefully it would be that kind of activity, being 1 of the 20 broad categories that you have mentioned for CRA approval. But I am interested in the process that you have undertaken, because you have to deal with a variety of constituencies, not only the financial institutions, but those who would monitor outside your department what banks do: Citizens groups, the watchdogs, as it were, of the local communities.

Could you tell us a little bit about their input as you designed your new CRA approach?

Mr. CEPHAS. Sure. What we did at first was we submitted for public comment last September this document which is attached to my testimony, these 11 questions. We had a 2-month comment period where people could submit written comments. So we got about I think 75 or 80 written comments from the whole spectrum, community groups, banks.

We then read through those very carefully, the staff people collated the answers to each of the questions so we had kind of a community group answer and a bank answer, and we had to cover a third category really, the public officials, a lot of the public officials comments. So we had a community group answer, a bank answer, and a public official consensus on each of the 11 questions. So we went through that process.

Then we started meeting with the banks and the community groups on an individual basis, getting some further illumination on some of the things they had said in their written document.

Then last March we had 2 days of public hearings. We had a pretty good sense by March of where we were going to come out

on some of the questions. We now were to focus 2 days of public hearings in March where we again had about 44, 45 witnesses publicly; they all submitted written documents, written documentation as well.

Then we spent a fair amount of time going through the transcript of the public hearing and reading through all those comments again, and we have not gotten uniform agreement on all of these 11 questions. Surprise, surprise. But what we did—we accomplished the following thing.

That is that the community groups I think and the banks both agree that we have tried to be fair. We have tried to be reasonable. We have said up front, we intend to increase the overall amount of investment in the communities. That is what we are trying to do. So the banks understand that. There is no mistake on that. The safe harbor provision was not well received by the community groups.

Mr. RIDGE. I was going to follow up on that.

Mr. CEPHAS. But we have said to the community groups, these proposals work as a package, and if you trust us, and if you believe us when we talk about the quantitative system that will have some teeth and really will require the institutions to do something in communities; if you believe that is true, then, you know, you ought to be in a position where you can find the safe harbor acceptable.

Because the result will be the enormous improvement, increase in the community investment. What you give up is the safe harbor. What the banks get from that is a sense of repose. If they have done all they should do and more, then, in the context of the regulatory application, we think they should be left alone; through the protest system. So that was kind of the package.

Now, and we have also said that we did not want to handle these 11 items on a piecemeal basis. They work together as a system, these 11 fit together as a system, so we are not going to do two of them and not do the other, that kind of thing. But it was a very, very time-consuming process of trying to include—I mean the documents would be 5 feet high, if you looked at just all the submissions, and we read them all two or three times and people came in and we discussed with them what their various positions were. It was a very inclusive process. And I think you will be hard-pressed to find somebody in New York who said they had an opinion on this and didn't have the opportunity to meet with us at least once.

Mr. RIDGE. Well, the safe harbor approach to many people is forward-looking and progressive; to others, it is absolutely anathema to their view of how CRA should operate. And it seems to me, in my brief review of your testimony, you set a fairly high threshold for these institutions to obtain and retain that safe harbor rating.

Mr. CEPHAS. Right.

Mr. RIDGE. Am I correct, it is three consecutive "ones"?

Mr. CEPHAS. Three consecutive "ones" before you even qualify for it.

Mr. RIDGE. Right.

Mr. CEPHAS. And then each year you have to maintain that "one" in the subsequent annual examinations in order to continue to enjoy the protection. So it is a serious hurdle.

Mr. RIDGE. I like the—I take comfort in your trying to promote this holistic view as an entire package as well, because there are a lot of things that these institutions have to do before they get their first “one,” let alone do it thrice before they qualify for that safe harbor and that is very encouraging. I am also encouraged because you as a regulator have echoed an expression of concern and probably a public embrace of your approach by a witness that Congressman Flake invited about a month ago from one of the leading banks, NationsBank.

A witness testified that they wanted to do more, were going to do more, felt that CRA should be rewritten so that it was at least as much quantitative, now challenge us, test us, put the standards out there, make sure we meet the standards, but if we do, then acknowledge it and reward us in a way, because if we are promoting more economic development and more capital into these communities, which is something we want to do, we would like to be recognized and rewarded.

So it is encouraging, Mr. Chairman, that there are some people out there thinking differently than we have heard before. Because I will tell you, when you tamper with CRA in the Banking Committee, the chairman will tell you, I will tell you, the slightest deviation from the norm, the slightest change there, just a punitive approach is just enough to bring a lot of protest, a lot of the community groups before us saying, with strong voices and expressing strong objections, and that is why I think you are really on the leading edge.

I very much appreciate your testimony and your courage and the process that you have taken, because I think if we do something like that in Washington, we are going to have to be prepared to go about it the same kind of way, and to sell it as a package, not holistically.

It is just not a safe harbor provision. That is really—that is the end. That is the pot of gold at the end of the rainbow and you have a lot of work to do before you can get it.

So I still would like to submit a few additional questions in writing, but I appreciate your taking the time to respond to these few.

Mr. CEPHAS. Thanks very much.

Chairman FLAKE. Thank you very much. Just one final thing. I guess on the safe harbor question still, and I guess the reason we spent so much time on it, we took such a beating on our BEA, and fortunately we got it passed.

Mr. CEPHAS. I did, too.

Chairman FLAKE. You did, too. And I guess we are here to share together.

But the real issue is clearly what you have done in terms of putting together some rigorous, full disclosure requirements, the 3-year requirement, which I think is great, and ongoing community investment for development, and community investment. I think you have covered just about every single spectrum, and I think it is a good approach. I think it is one that ought to be marketable.

Now, I am going to ask you, because you have gone through the process at least enough to go through the hearings, what is your sense, having dealt with the legislature and the senate in New York of the political palatability of this if it has to be done legisla-

tively at the Federal level as opposed to being able to be done regulatorily?

Mr. CEPHAS. In Washington?

Chairman FLAKE. Yes.

Mr. CEPHAS. I'll—not being—

Chairman FLAKE. We will just use yours as a microcosm.

Mr. CEPHAS. If we had to go through the State legislature in New York, I think we could pass this. I think we could pass this, because again, following up Congressman, your point, we have been extremely inclusive with the number of groups that we have brought into this process, and while everybody will have a criticism maybe of a particular piece of it, there is enough in that for everybody so that I think that even the people might oppose one item or another item, the package is something that they all want, because people have come to think in New York anyway that this—CRA is not going away, and it is an issue that everybody has to live with, but on balance, this is a far better approach, far better approach, than they have now. I think the banks think that and I think the community groups think that.

Chairman FLAKE. And clearly we do. I mean I think Congressman Ridge and I—

Mr. CEPHAS. I think it would pass.

Chairman FLAKE. There are so many people here though who punitively want to beat up on the banks, so much so sometimes that it is to the detriment of what we are trying to achieve. And I think we have kind of been out front on it, and I think we can use what you have done to help us not only to advance the BEA, but certainly help us to advance whatever modifications are going to be necessary.

The administration obviously is looking at this and hopefully we will also be able to work with them through a process that will be equally palatable at the Federal level and we don't get all of the downside that would cause it to be soft, which happens a lot of times here.

So I am looking forward to us being able to move forward with some, either CRA legislation or taking, if the administration can adopt portions of what you have already done, I think it would be very helpful, and would help us to move this process along much more rapidly, particularly if we could get the Fed and the FDIC and other regulatory bodies on board with it. So I want to thank you because I know it has taken a lot of your time, and you obviously feel it not only intellectually, but from your heart, and I am thankful for that and for the opportunities that we have had to share in talking to get ready not only for the hearing, but I look forward to us continuing to do that.

As we move along at this level, certainly I would hope that we might maintain communications, because there are certainly parts of this that I think can be most helpful to us.

Thank you for the sacrifice of your time, and I think in the long run, we will all be better for it, because CRA has been on the books 15 years, and these urban communities look like a Third World nation. I tend to think that anything we try, even as radical as some may think this is, moves us closer to some solutions for development of small businesses and commercial strips and continued

building of housing in these communities. I think that is important to all of us, and to the best benefit and the good of the Nation. Thank you very much.

Mr. CEPHAS. Thanks for your support.

[Whereupon, at 11:30 a.m., the hearing was adjourned.]

APPENDIX

June 22, 1993

STATEMENT OF

DERRICK D. CEPHAS
NEW YORK STATE
SUPERINTENDENT OF BANKS

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON GENERAL OVERSIGHT,
INVESTIGATIONS, AND THE RESOLUTION OF
FAILED FINANCIAL INSTITUTIONS

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

JUNE 22, 1993
WASHINGTON, D.C.

Good morning Chairman Flake, members of the Subcommittee on General Oversight, ladies and gentlemen. My name is Derrick Cephas and I am the Superintendent of Banks of the State of New York. I greatly appreciate the opportunity to be here today to present the views of the New York State Banking Department regarding the Community Reinvestment Act. We have spent the last 9 months preparing a proposal to restructure the manner in which CRA is enforced in New York State. I would like to share with you the current status of our proposal and make some additional observations regarding CRA in general.

GENERAL BACKGROUND

CRA is a very important issue and I commend Chairman Flake and the entire Subcommittee for the significant contribution that you have made in this area. As we all know, exploring CRA raises enormously complicated issues. In addition to the inherent complexity of the subject, the area is clouded further by the dissemination of significant misinformation. Finally, the various ancillary issues arising out of CRA lend themselves to excessive politicization. It is against that context -- intrinsic complexity, proliferation of misinformation and politicization -- that we in New York have attempted to restructure the CRA process.

We began with the basic premise that the current CRA law is fundamentally flawed. What are its flaws? First, the rating system is far too subjective. There is a paucity of standards by which to measure CRA compliance, and far too little objectivity in the rating system. Second, the current system places far too much emphasis on enforcing CRA solely in the context of the regulatory

approval process. While a bank ostensibly is required to comply with CRA if its deposit accounts are FDIC insured, a bank's CRA performance becomes relevant legally only when and if it seeks regulatory approval to open a branch, to make an acquisition or to engage in some other legitimate business objective covered by CRA.

We believe that CRA compliance should be the ongoing responsibility of banks. Concomitantly, community groups should be involved in the CRA process on an ongoing basis, again not solely or primarily in the context of the regulatory application process. We believe that greater emphasis should be placed on ongoing bank compliance and community group involvement, and that the current emphasis on using the regulatory application process to enforce CRA is misguided and should be greatly reduced.

Third, we believe that the current state of polarized relations between banks and community groups should be addressed. Under the current system, community groups, consumer advocates and other users of banking services and their representatives are, to a large extent, the principal enforcers of CRA. They press the banks for greater community investment, they file the regulatory protests and they engage the banks in verbal combat in an effort to increase bank CRA participation. We believe that -- indeed a principal thesis of our proposal is that -- bank regulators, and not community groups, should bear the principal obligation to ensure that the CRA laws are enforced.

Indeed, the structure of the current system inevitably produces conflict between banks and community groups. If a bank,

no matter how stellar its CRA performance, is still likely to be made the subject of a regulatory protest if it seeks to make an acquisition or open a branch, then there is a built-in incentive for that bank to refrain from participating in CRA activities to its full potential since more will be required at the time of a regulatory application. Similarly, there is less need for community groups to pursue bank CRA investments on a consistent basis, since there is more "bang for the buck" by waiting for the unique opportunities created by the regulatory application process.

It is true that some community groups have used the regulatory application process to bring substantial economic benefits to their local communities. But we believe that if CRA were revised to contain quantitative standards, and if those standards were enforced on a consistent basis, there would be a significant overall increase in the level of CRA investment in local communities and far less need or justification for regulatory protests.

Finally, we believe that the current CRA system encourages banks to focus on process, procedure and documentation at the expense of a more substantive, investment-oriented approach. This is another unintended result of the regulatory protest mechanism, because even a "1" rated bank will be required to produce voluminous documentation to shield itself in the event of a protest. We are attempting to shift the focus on CRA enforcement from an emphasis on process and procedure to an emphasis on actual investment in local communities.

The above summarizes, generally, the broad objectives of New York State's CRA proposal. The end product, we believe, will be one that is consistent with the interests of banks, community groups and regulators. We have tried to design a new approach to CRA participation and CRA enforcement. We expect that, in the aggregate, banks will be required to increase their level of CRA activity in New York. For those banks who have already undertaken a serious and consistent effort to meet their CRA obligations, the New York proposal should relieve them of a significant degree of regulatory burden and regulatory uncertainty. On the other hand, for those banks who have not seriously pursued fulfillment of their CRA obligations, our proposal will require them to do more. For those banks desirous of complying, our proposal should facilitate easier compliance; for those who are not desirous of complying, their annual ratings are likely to decline.

Let me say that the flaws in the current system were not caused by any particular group. It would be inaccurate to blame the banks and, similarly, we do not believe that the community groups or the regulators are at fault. The problem is the system itself. There is little possibility for meaningful improvement in the implementation of CRA under the current system, notwithstanding the significant efforts of the banks, community groups and regulators. Therefore, we have proposed to restructure the system because we have come to the conclusion that that is what is necessary.

SPECIFIC PROVISIONS

With the foregoing as background, I would now like to explain certain of the specific provisions of our proposal. The original proposal, which was disseminated in the form of 11 questions, was issued for public comment in September of 1992. A copy of the original proposal is attached to this testimony so that it can be made a part of the official record of this hearing. Because of time considerations today, I will address the 5 most important provisions in the proposal:

A Specific List of Categories
of CRA Qualified Investments

We have compiled a list of over 20 broad categories of activities and investments which qualify for CRA credit in New York. The purpose of creating the list is to provide a greater range of opportunities for banks to satisfy their CRA obligations. While direct lending must remain the primary manner in which a bank meets its CRA obligations, we believe that banks are well suited to assist their communities in many other ways. The list is not an exhaustive list; it is merely representative of the types of activities which qualify for CRA credit and is not intended to preclude banks from pursuing other CRA activities not set forth on the list. In addition, banks are not required to engage in any of the activities set forth on the list. The list is for guidance only and will be useful insofar as providing banks with a range of alternatives to direct community lending. We expect that the wholesale banks (both foreign and domestic) will find the list particularly helpful, although retail banks have expressed support

for the list as well.

Pre-Investment Opinion on CRA Eligibility

In those cases wherein a specific activity or investment does not fit within any of the categories on the list of authorized CRA investments discussed in the preceding paragraph, we have established a mechanism pursuant to which banks have the ability to seek a pre-investment opinion from us as to the CRA eligibility of the proposed investment. We have found that uncertainty as to CRA status will sometimes inhibit a bank from making an investment that it would otherwise be inclined to make if the bank knew that such investment was CRA eligible. This pre-investment opinion option, coupled with the authorized list discussed above, would to a significant extent alleviate this uncertainty. Our pre-investment opinion will not endorse any particular investment, project or community group. We will not opine as to the appropriateness, suitability or compliance with safety and soundness standards of any proposed CRA investment. As in all other cases, the banks have to make those decisions. We will simply state whether or not the investment, if made, will entitle the bank to CRA credit.

Quantitative Scoring System

We will establish a CRA rating system which will make use of objective, quantitative data. A bank's annual CRA rating will be derived by combining the results of a quantitative analysis with the results of a qualitative analysis. The results of the quantitative analysis will comprise the predominate portion of the final rating and will be arrived at by measuring a bank's total CRA

activities against its deposit liabilities. It will be extrapolated from a numerical computation, which computation will measure the percentage of a bank's deposits which are invested in CRA related assets. The 1-4 rating system will be retained. In order to receive a specific CRA rating (for example, a "1" or "outstanding" rating), a bank will ordinarily be required to invest a minimum specified amount of its deposits in CRA related activities.

The results of the qualitative analysis will be arrived at by making use of subjective factors. Inescapably, a CRA examination is to some extent inherently subjective and no reasonable system of CRA evaluation, no matter how quantitative, should completely eliminate the qualitative (and therefore subjective) nature of the CRA review. The qualitative analysis will take into consideration several other relevant factors, such as the size of the institution, its financial condition, the availability of CRA opportunities in and the demographic characteristics of the marketplace served by the bank, the unique nature of certain types of CRA activities engaged in by the bank which might not be fully reflected in the size of the investments, and other similar considerations.

We are aware of the considerable difficulties -- of both a conceptual and a public policy nature -- that hinder the adoption of a system of CRA scoring which relies on quantitative analysis. Critics may question the validity of the scoring benchmarks and may argue that our rating gradations are arbitrary. Our weighting of

certain CRA investments may cause some to question the appropriateness of our public policy determinations. Those who have learned to do business under the current system and have therefore grown comfortable with it may oppose our proposal, even as they acknowledge the great flaws in the current system. The spectre of credit allocation may be revived. Let me acknowledge that there may be some validity to these criticisms, and we may well have to revise or amend our regulation from time to time as the need arises in order to address these concerns, although we are least troubled by the credit allocation criticism.

On balance we believe that a quantitative system is far preferable to the excessively subjective "methodology" currently employed to determine CRA ratings. Under the current system, it is very difficult for banks to reasonably predict their ratings, or to predict reasonably the manner in which the regulators will view their CRA performance in the context of a regulatory application. Moreover, the bank examiner's task of analyzing CRA compliance relies far too heavily on subjective judgments. The addition of a quantitative analytical framework will bring about a greater degree of fairness and predictability in the CRA scoring system.

Safe Harbor Provision

We intend to institute a so-called "safe harbor" provision which would shield banks with "outstanding" CRA ratings from protests in the regulatory application process. A bank that has received an outstanding ("1") rating on its last three CRA examinations (which must include one on-site examination) would be

assured that its past CRA performance would not constitute a bar to regulatory approval of an application. Once a bank has qualified for the "safe harbor" by achieving three successive "1" ratings, the "safe harbor" would exist so long as the bank maintained a "1" rating. A "safe harbor" would serve as an incentive for banks to strive for an outstanding CRA performance. Under the current system, there is no incentive for banks to put forth the extra effort required to receive a "1" rating.

The Banking Department recognizes that the creation of a "safe harbor" may be perceived as having the effect of reducing community group involvement in the CRA process. However, we believe that the impact of community group involvement in the CRA process will actually be enhanced if community group comment is solicited in a formal and continuing manner as part of the CRA examination process.

Enhanced Community Group Participation

We plan to institute measures to increase the level of community group involvement in the CRA process by (i) formally soliciting written comments from community groups as part of our annual CRA examination and (ii) publishing the annual CRA ratings for each of the state chartered banks which we examine. Community groups currently do not play an active role during the CRA examination process in New York. With regard to the solicitation of community group comments, we have developed a standardized, written questionnaire to facilitate the gathering of information from community groups. In this manner, the comments of community

groups will be specifically solicited, verified and formally considered, as appropriate, by the Banking Department in arriving at the annual CRA ratings.

With regard to publication of CRA ratings, the Department believes that periodic publication of all ratings will be useful to community groups and may encourage ongoing dialogue between banks and the community. Currently, community groups may obtain bank CRA ratings by filing a Freedom of Information Law Request with the Department's Public Information Officer. Despite the fact that CRA ratings have been publicly available in New York since 1984, this information has not been widely used by community groups to address particular bank deficiencies prior to the filing of bank applications for regulatory approval. The Department believes that the role of community groups can be meaningfully and responsibly expanded to encourage a continuing dialogue with banks on community credit needs.

Other Provisions

The original proposal contained six other provisions, the following three of which will be implemented in our July 22 regulation:

- a revision of the methodology used by banks to define their service areas to insure that service area delineations are more consistent with market realities and local credit needs;
- to take into consideration the activities of a bank's non-bank affiliates as well as the bank itself in determining the bank's CRA performance; and

- to provide banks with a formal procedure for reviewing the Banking Department's preliminary conclusions before the annual CRA rating is finalized.

The other three original proposals, which involve (i) expanding the number of regulatory applications subject to CRA, (ii) considering past (as opposed to current) CRA performance in the annual evaluations and (iii) repealing certain reporting requirements for banks with less than \$100 Million in assets are not being implemented.

CONCLUSION

The State Banking Board is scheduled to issue the regulation for public comment on July 22, 1993. The comment period commences upon issuance of the regulation and, in the ordinary course, the regulation would be adopted in final form in October of 1993.

We began work on this project more than 15 months ago. We have reviewed more than 70 written comments from banks, community groups, community advocates, public officials, academics and other residents of New York and elsewhere. We conducted over 15 hours of public hearings, with testimony from 44 witnesses. We have met privately with a large number of interested parties, both supporters and opponents of the proposal. We have incorporated into the regulation a great many of the suggestions which we have received. Many will recognize in the regulation their own contributions to our efforts. We are grateful for all the assistance and support that we have received from the banks and the community groups in New York. While there have been sharp

disagreements over certain of the issues, all parties involved in the process have conducted themselves in a responsible and respectful manner.

We believe that our regulation represents a significant improvement over the current system of CRA enforcement. It is not perfect. There may be an occasional oversight and further refinement may well be required. Our rule-making process is flexible enough to make the necessary adjustments. But I believe that there is little doubt that our proposal will materially increase the amount of local community lending in New York while reducing the regulatory burden and uncertainty currently faced by the banks. Stated simply, that is our goal.

I have not specifically addressed safety and soundness issues, although the issue is implicit in all that I have said today. We are obviously not advocating that banks satisfy their CRA obligations by compromising on safety and soundness. That would be a bad public policy and bad business judgement. Banks in New York have been able to make CRA loans without unacceptable risk. Indeed, as a general matter, "CRA loans" have not subjected banks in New York to any material repayment or credit risk, although administrative costs have generally been higher for "CRA loans". The loans have performed well, in part because of the strict underwriting guidelines often used. In the final analysis, community development loans must be defensible from a business perspective. As more banks obtain greater experience and expertise in this area, they will be able to incorporate local community

lending into their overall business plans as "profit centers" along with all of their other products.

In closing, let me say that I hope that my testimony today contributes in some small measure to our common efforts to reform CRA. I also hope that the Congress and the federal bank regulators work together to revise CRA on the federal level in a manner that is not inconsistent with the model which we plan to develop in New York. I believe that the day has passed when we might question the advisability of CRA as a concept. Given our national history and given the current demographic distribution and availability of banking services, government intervention in the form of CRA is necessary. Our task is to reform CRA to make it more responsive to the needs of the banks and the communities who use it. Thank you very much.



STATE OF NEW YORK
BANKING DEPARTMENT
2 RECTOR STREET
NEW YORK, NY 10006

DERRICK D. CEPHAS
SUPERINTENDENT OF BANKS

September 9, 1992

**TO THE CHIEF EXECUTIVE OFFICER OF THE INSTITUTION OR TO THE
EXECUTIVE DIRECTOR OF THE COMMUNITY GROUP ADDRESSED:**

Enclosed with this letter is a document requesting public comment on a Banking Department proposal to revise the manner in which the Community Reinvestment Act is administered in New York. While the Banking Department has been encouraged both by the CRA contributions of a great many of the banks which we regulate and by the commitment shown by the community groups and other beneficiaries of community reinvestment, we nonetheless believe that the Community Reinvestment Act has not fully lived up to its promise.

The specific proposals set forth herein are offered for public comment in an attempt to suggest an alternative approach to CRA participation and enforcement. We believe that the reach of CRA has not kept pace with either the changing nature of the banking system or the evolving needs of local communities. We have found that measuring CRA performance involves too little analysis of quantifiable, objective data. Further, the focus of CRA compliance and enforcement centers too greatly on the regulatory application process, with too little emphasis on ongoing compliance by banks and ongoing participation by community groups.

As originally enacted, CRA was rather narrow in its scope. It was intended to counter the effects of "redlining" and disinvestment, principally in inner-city neighborhoods. It has been expanded over the years, properly so we believe, to embrace a much wider range of issues relating generally to the availability of credit and other financial services to low and moderate income persons and the communities in which they live. As any other instrument of government, community reinvestment is and should be a dynamic and evolving concept that is responsive -- within the bounds of legislative authority -- to the changing needs of society. It is as a consequence of this belief that the Banking Department proposes for public consideration and comment the enclosed policy statement.

The financial services marketplace is experiencing increasing competitiveness, consolidation and globalization. We believe that these trends are beneficial to the financial system as a whole and will bring substantial benefit to the public generally. Yet, as the focus shifts increasingly to the creation of a multi-state and a world-wide financial marketplace, it is all the more important that critical issues within the local service areas of these multi-state and global banks continue to receive adequate attention. The New York State Banking Department has over the years attempted to strike an appropriate balance between the needs of banks to compete locally and worldwide and the credit and other financial services needs of local communities. The policy statement issued today is but a continuation of that effort.

Over the last year or so, we toured a good number of low and moderate income communities throughout New York State and learned first-hand a great deal about the specific banking needs of those communities. We have been both impressed with the substantial contributions made by a great many of our banks in those communities and heartened by the commitment and determination of the local residents to enhance the quality of life in those same communities. While it is clear that the problems of low and moderate income communities extend well beyond the ability of the banking system to correct, it is equally clear that the active participation of our privately owned financial institutions -- including the banks -- is a necessary ingredient to any meaningful community revitalization and development. Implementation and enforcement of the Community Reinvestment Act institutionalizes this active participation.

We invite the public to submit written comments regarding the enclosed proposed policy statement. All comments should be submitted to the Banking Department no later than November 9, 1992 to Denise L. Pease, Deputy Superintendent of Banks - Consumer Services Division, New York State Banking Department, 2 Rector Street, New York, N.Y. 10006. After review of all written comments, we intend to recommend to the Banking Board the issuance for public comment under the State's Administrative Procedure Act ("SAPA") formal proposed regulations implementing, in whole or in part, the proposals discussed herein. The proposed regulations will be distributed for public review and comment in accordance with the applicable provisions of SAPA prior to final adoption. We anticipate final adoption to be effective in early 1993, with adequate "phase-in" periods where appropriate.

Very truly yours,

Denick Apha



STATE OF NEW YORK
BANKING DEPARTMENT
2 RECTOR STREET
NEW YORK, NY 10006

DERRICK D. CEPHAS
SUPERINTENDENT OF BANKS

September 9, 1992

NEW YORK STATE BANKING DEPARTMENT
PROPOSED COMPREHENSIVE POLICY
STATEMENT RELATING TO THE
NEW YORK STATE COMMUNITY REINVESTMENT ACT:
REQUEST FOR PUBLIC COMMENT

As part of its periodic review of the statutes and regulations which it administers, the Banking Department has undertaken to review and evaluate its role in defining, implementing and monitoring compliance with New York State's Community Reinvestment Act ("CRA"), codified in Section 28-b of the New York Banking Law and implemented by Part 76 of the General Regulations of the Banking Board. CRA, which dates back to the 1970's, has not undergone a comprehensive review on the state level since its original enactment.

It is the Banking Department's view that the objectives of CRA have been only partially met to date. Accordingly, the Banking Department is publishing this policy statement today in an effort to propose an alternative to the shortcomings of the present CRA evaluation system. From its preliminary review, the Department has identified several broad areas within CRA which may require reform.

They are as follows:

- (1) the need to employ objective standards (i.e., numerical and/or other quantifiable data) in monitoring bank CRA compliance;
- (2) the need to expand the types of applications for which bank CRA performance is a factor to be considered by the Banking Department in granting regulatory approval;
- (3) the need to create a list of specific categories of investments, services and activities which constitute reinvestment in the community as required by CRA; and
- (4) the need for an overall policy with respect to ongoing community involvement in the CRA evaluation process.

Within these four broad categories, there are a number of more specific questions, the answers to which will guide the Banking Department in the formulation of its proposed policy statement on CRA and any subsequent regulations. These questions, as to which the banking industry, the public and other regulatory agencies are invited to comment, are set forth below:

- whether to create a list of specific categories of investments, services and activities which fulfill the purposes of CRA and whether to create a category of "Special CRA Products" which will entitle the offering bank to substantially increased CRA credit;
- whether, and under what circumstances, the Banking Department should render its prior opinion as to the eligibility of specific investments and projects for CRA credit;
- whether separate standards should be adopted for retail and wholesale banks respecting the delineation of their service areas for CRA purposes;
- whether, in an effort to reduce subjectivity in evaluating CRA compliance, the Banking Department should establish a quantitative system to evaluate compliance with CRA;
- whether, in the case of bank holding company structures, the activities of the holding company or affiliated

companies should be taken into account in evaluating the bank's CRA performance;

- whether, at the conclusion of a CRA examination, the Department's tentative findings should be reviewed with the bank, and the bank afforded an opportunity to be heard with respect to such findings prior to their adoption by the Department;
- whether, and to what extent, the Banking Board should exercise its authority to expand the list of applications the evaluation of which must take into account a bank's CRA performance;
- whether, in passing upon applications for regulatory approval subject to CRA, the Department should take into account both the institution's current CRA rating as well as its rating for previous years;
- whether it is appropriate to establish a so-called "safe harbor" in connection with the evaluation of applications for regulatory approval for banks which have achieved an outstanding ("1") rating for a period of at least 3 years preceding such application;
- whether the Department should encourage community group participation in its evaluations of CRA performance by establishing a formal community group comment period for each individual bank and by publishing CRA ratings on a quarterly basis; and
- whether the Department should accept the appropriate federal bank regulatory agency's annual CRA examination report in lieu of requiring banking organizations with assets of less than \$100 million to submit responses to the Banking Department's Annual CRA Information Request.

BACKGROUND

The federal Community Reinvestment Act was enacted by Congress in 1977. One year later, New York State enacted its own community reinvestment statute which has been codified in Section 28-b of the New York Banking Law and implemented by Part 76 of the General Regulations of the Banking Board. The requirements of the New York statute and the federal statute are practically identical (the

federal act and the state act are collectively referred to herein as the "Act" or "CRA"). The Act is designed to encourage banks to help meet the credit needs of their local communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of those banks.

The original sponsors of CRA were primarily concerned with the exportation of local deposits which, they argued, threatened the health and vitality of local neighborhoods. Data presented to the Committee on Banking, Housing and Urban Affairs (95th Congress, 1st Session) indicated that many banks exported to other neighborhoods ninety percent or more of the deposits received locally, while at the same time denying loans to qualified residents living in the neighborhoods from which such deposits were exported. The sponsors of CRA believed that banks identified certain limited neighborhoods in which to lend and that their failure to serve qualified borrowers in excluded areas contributed to the decline of those areas.

Many banks and regulators opposed adoption of CRA on the grounds that the Act would result in credit allocation and would therefore interfere with legitimate private credit decisions. As a result, CRA struck a compromise by requiring regulators to encourage banks to meet the credit needs of their entire communities but not directing banks to make specific investments or target specific lending.

Implementation of the federal CRA is shared by the four federal regulators and the state CRA in New York is implemented by

the Banking Department. The Act directs the regulators to assess each bank's CRA record, which is accomplished through the examination process, and to take such record into account when considering whether to approve a number of expansion-related applications. The regulators may, but are not required to, reject an application if a bank fails to demonstrate that it has satisfied the requirements of CRA.

New York and federal regulations require banks to delineate the geographic areas which constitute their "communities" or "service areas", to develop and keep current so-called CRA statements which identify the services offered by the bank, to maintain a public comment file, to post a public notice in each branch which alerts the community to the bank's CRA responsibilities, and to make public a portion of their CRA evaluations by their regulators.

The federal regulators have issued several joint statements to provide guidance concerning CRA compliance. The statements include the "Statement of the Federal Financial Supervisory Agencies Regarding the Community Reinvestment Act", the "Interagency Questions and Answers About Community Reinvestment", and the "Uniform Interagency Community Reinvestment Act Final Guidelines for Disclosure of Written Evaluations and Revised Assessment Rating System". These statements provide useful guidance by articulating methods for banks to develop effective CRA programs and by describing different methods banks have employed successfully to fulfill their CRA responsibilities.

In August 1989 Congress amended the federal CRA as part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"). The amendments provided for public disclosure of the federal regulators' written evaluations of each bank's performance under CRA. In New York, CRA ratings and summary assessments have been made public since 1984. The amendments also reduced the number of performance ratings from five to the current four ratings, "outstanding", "satisfactory", "needs to improve" and "substantial non-compliance". In 1990, New York also reduced its number of performance ratings from five to four to be consistent with the federal ratings. Finally, in December 1991, the Federal Financial Institutions Examination Council issued a CRA policy which addressed the need for banks to analyze at least annually for CRA purposes the geographic distribution of their lending.

In an effort to make CRA more effective, regulators have also tried independently to assess community needs to supplement bank lending efforts. In 1980, the Board of Governors of the Federal Reserve System ("FRB") established a Community Affairs Program to develop expertise in the methods and techniques of sound community development lending. The Federal Deposit Insurance Corporation ("FDIC") has a similar program. The FRB also contacts community groups during the CRA examination process to assess the community's own perception of its credit needs.

Soon after CRA was adopted, the New York State Banking Department established the Community Reinvestment Monitoring Unit, which is part of the Consumer Services Division. The unit is

generally responsible for evaluating bank CRA efforts and must make recommendations on all applications which contain a CRA component. In addition, the Department's Urban Analysts, as well as senior policy personnel, meet with community groups on an ongoing basis to assess community credit needs independent of the data submitted by banks.

Regulators have also acted to establish incentives for strong CRA performance. From 1985 to 1988, New York Banking Board General Regulations Part 88 granted banks the authority to invest in real estate equity and rewarded a strong CRA performance by tying such authority to a bank's CRA rating.¹ The permissible amount of the investment depended upon the bank's CRA rating. Discussions with banking industry representatives suggest that the objectives of the regulations were not fully realized because the banks were concerned that the federal regulators would act to prohibit such direct real estate investments on safety and soundness grounds.

A recently enacted federal law, the Bank Enterprise Act ("BEA"), which comprises Sections 231-234 of the Federal Deposit Insurance Corporation Improvement Act of 1991, offers banks an incentive to lend and/or provide certain services in distressed communities. The BEA provides for a reduction in deposit insurance

¹ In 1988, the authorizing legislation terminated in accordance with its terms and was not re-enacted by the State Legislature.

assessments for banks that make certain loans in low-income areas or to banks that offer low-cost banking services to low-income persons.²

QUESTIONS FOR PUBLIC COMMENT

Question 1.

Whether to create a list of specific categories of investments, services and activities which fulfill the purpose of CRA and whether to create a category of "Special CRA Products" which will entitle the offering bank to substantially increased CRA credit.

The purpose of proposing the list set forth below is to provide a greater range of opportunities for banks to satisfy their CRA obligations. This expanded list is expected to be of particular usefulness to the "wholesale" banks in New York which, because of the nature of their businesses, have had in the past a limited range of CRA opportunities. While the investments and services set forth on the list are available to "retail" banks as well, it remains the expectation of the Banking Department that the "retail" banks will continue to meet their CRA obligations principally by making credit available, either directly or through community development corporations, to all residents of their service areas, including low and moderate income persons.

The Banking Department stresses the fact that the proposed

² The Banking Department is in general agreement with the granting of incentives (for example, expanded powers) for outstanding CRA compliance and would have included such a proposal herein if such an approach were not largely prohibited by the recent passage of federal banking legislation which severely limits the ability of the states to authorize new powers without the concurrence of federal bank regulators.

list is merely representative of the types of activities which qualify for CRA credit. It is not an exclusive list; nor are banks required to engage in any of the activities set forth on the list. Each bank must decide for itself how it will satisfy the requirements of CRA, consistent with its own particular business objectives and consistent with safe and sound banking practices. CRA must be interpreted to permit banks with different business plans to meet CRA objectives in ways that are consistent with such business plans.

List of Specific Investments

Section 28-b of the Banking Law identifies twelve factors that the Superintendent shall consider in assessing a banking institution's record of CRA performance. These factors are substantially identical to those adopted by the federal regulators, with the exception of the Department's consideration of the geographic distribution and use of automated teller machines. The factors include banks' efforts to ascertain community credit needs, marketing efforts undertaken, boards of directors involvement in formulating CRA policies, practices intended to discourage applications for credit, geographic distribution of credit extensions, evidence of discriminatory credit practices, records of opening and closing branches, participation in local community development projects, origination of residential mortgage loans, housing rehabilitation loans, home improvement loans and small business or farm loans within their communities, and participation in governmentally-insured, guaranteed or subsidized loan programs

for housing, small businesses or small farms. The Superintendent may also consider a bank's financial condition in relation to its ability to meet its community's needs and any other factors that reasonably bear upon the extent to which the bank is helping to meet the credit needs of its entire community. The Department believes that the broad language of CRA permits consideration of a wide range of activities, services and investments in addition to direct lending.

The Department is considering further defining and expanding the performance factors to provide additional guidance. Traditionally, banks have been primarily involved in activities which employ direct lending as a means to fulfill their CRA responsibilities. In recent years, however, alternative mechanisms, often in joint venture or consortium form, have been successfully utilized in New York.³ The Department believes that banks can participate in the creation of such alternative mechanisms and invest in them to accomplish their CRA goals. The activities, services and investments that the Department proposes to further define and clarify eligibility for CRA credit include the following:

- investments in or loans to community development corporations or not-for-profit corporations that focus on

³ Several important organizations, such as the Community Preservation Corporation and the New York City Housing Partnership, are making substantial contributions in the creation of affordable housing in and around New York City. Others have followed. A more recent initiative, known as GRAND, involves a consortium of fifteen foreign banks that have together made commitments to a partnership that has created a \$39.5 million loan pool for affordable housing construction in New York City.

helping to meet the credit needs of low and moderate income persons;

- investments in the securities of, or grants to, community development finance intermediaries or consortia serving primarily low and moderate income neighborhoods;⁴
- investments in state and local government agency housing bonds or other bonds that benefit low and moderate income areas;
- charitable contributions or grants that specifically aim at helping low and moderate income persons and communities;
- origination of or participation in low and moderate income housing, community or economic development loans, or participations in such loans or loan pools from other institutions or nonprofit community-based development corporations;⁵
- origination of or participation in SBA-guaranteed loans or loan pools, MESBICs, FmHA-guaranteed farm, business or housing loans, or FHA-insured loans;
- origination of or participation in economic development agency-guaranteed loans;
- provision of bridge financing to small businesses (including minority vendors) that provide goods or services on a contractual basis to governmental entities and bridge financing to community groups the projects of which are approved for public financing but awaiting receipt of financing;
- the provision of pro-bono financial advice to financially distressed municipalities and school boards and other political subdivisions which serve low and moderate income areas;
- providing loans, grants and/or pro-bono financial and/or legal advice to non-profit organizations, community groups and small businesses that provide services to low and moderate income areas;

⁴ For example, Community Preservation Corporation, Community Lending Corporation and Neighborhood Housing Services of New York.

⁵ For example, see the two programs referred to above in footnote 3.

- providing loans, grants and/or pro-bono financial and/or legal advice to non-profit health care facilities, including clinics, hospitals and long term care facilities for the elderly, serving primarily low and moderate income neighborhoods;
- providing loans, grants and/or pro-bono financial and/or legal advice to non-profit job training facilities that serve primarily low and moderate income persons; and
- providing loans, grants and/or pro-bono financial and/or legal advice to non-profit day care facilities that serve primarily low and moderate income neighborhoods.

Special CRA Products

The Banking Department believes that, among the many investments and services by which banks may appropriately satisfy their CRA obligations, there are certain such investments which are of such current critical importance that a special category of investments should be identified and created. Therefore, the Banking Department proposes to establish a category of "Special CRA Products" which, if offered, will entitle the offering bank to substantially enhanced CRA credit. (See the analysis relating to Question 4 on page 20 below for a discussion regarding the "enhanced" CRA credit to be offered.) These products are:

- the provision of "lifeline" or "basic banking" services, with particular emphasis on the provision of such services to low and moderate income persons;⁶
- the development and implementation of affordable housing initiatives, which should include the consideration of alternative underwriting standards and provisions for retaining an appropriate amount of such loans within the

⁶ By "lifeline", the Department means an account with savings and checking features which provides for a minimum number of monthly transactions at a nominal cost.

lending banks' portfolios;⁷

- the maintenance of branches (including mobile branches) in low and moderate income neighborhoods and the maintenance of ATM machines at such branches and at other non-bank locations;
- investment in joint venture projects with state economic development agencies;
- investment in the equity capital of "community" banks or banks which are owned or controlled by members of minority groups which are located in and which serve primarily low and moderate income neighborhoods;⁸ and

⁷ Initiatives which will enhance the availability of mortgage financing to increase private homeownership are central to any serious CRA effort. The Department believes that much more needs to be done in this area, and that much more can be done without violating safety and soundness standards. For example, we believe that the standard housing debt and total debt to gross income ratios, taken alone, may not be valid indicators of a borrower's ability and/or willingness to repay a home mortgage loan. This is especially true in the New York City and the surrounding metropolitan housing markets, where housing costs often exceed 28% of gross income and total debt often exceeds 33% of such income. Indeed, the most anomalous circumstance frequently exists in which renters who can demonstrate years of consistent responsible payment of rent in excess of 28% of gross income find themselves unable to qualify for a home mortgage, even when the total housing costs (including the mortgage payments) may be less than the rental payments (with or without considering the tax benefits of home ownership). Other efforts should be made to provide financing for a portion of the traditional "down payment". Banks could participate in affordable housing initiatives either directly or through consortia. The Banking Department discussed this issue in detail in a letter, dated December 9, 1991, from the Superintendent addressed to the Chief Executive Officers of all New York state-chartered banks, a copy of which letter is attached hereto as Appendix A.

⁸ The Department believes that it is unrealistic at this time to expect any appreciable number of existing banks to establish new brick and mortar facilities in low and moderate income neighborhoods. However, there is the greater possibility that "community banks" or other small banks formed to serve low and moderate income communities will increase in number. The larger banks can greatly assist the efforts of these smaller community banks or minority owned banks by investing in their equity capital and/or by purchasing home mortgage loans originated by such smaller banks.

- investment in the equity capital and/or debt instruments of consortia owned by banks, insurance companies and other financial services providers which are organized for the purpose of making small business loans in low and moderate income communities.⁹

Question 2.

Whether, and in what circumstances, the Banking Department should render its prior opinion as to the eligibility of specific investments and projects for CRA credit.

Over the past several years, the Department has been contacted by a number of different entities seeking confirmation of their projects as CRA-qualified. In the past, the Department has

⁹ We believe that there is a shortage in the availability of small business loans. Without providing herein a specific definition of "small business", we propose that loans in amounts ranging from \$50,000 to \$300,000 be the focus of this initiative. Of course, the size of the loans and other credit related terms would be established by the participating banks themselves, consistent with safety and soundness concerns and the needs of the borrowers. At least in the New York City market, few banks are in the business of offering these types of loans. There are several reasons for this. The loans tend to be costly to originate, costly to administer and inherently risky. Given these facts, it has proven difficult for individual banks to actively participate in the small business loan market, at least in New York City.

Accordingly, we again refer to the consortium structure as a desirable vehicle to enhance small business lending. For example, a not-for-profit entity could be formed (similar to Community Preservation Corporation or Community Lending Corporation). It could be capitalized by the banks, professionally staffed and managed and would engage in small business lending on behalf of its member banks. The underwriting standards and costs associated with making the loans would necessarily reflect the realities of the marketplace. Underwriting standards would emphasize prudence, and interest rates (in the absence of government subsidy) would, from the borrower's perspective, seem high. The return on investment for the participating banks would probably be less than the average for its entire portfolio, but the risks of making small business loans, given the consortium structure, would be greatly reduced. And importantly, there would be a substantial increase in the availability of credit to small businesses. Perhaps second only to housing lending, the need for small business lending is most important to the revitalization of low and moderate income communities.

reviewed these requests on an informal basis and is now considering whether, and in what circumstances, the Department should render formal pre-investment opinions as to CRA qualification. The goal of a pre-investment qualification policy is to increase the overall investment by banks in low and moderate income communities.

In general, the Banking Department proposes to consider whether one or both of the following criteria are met in evaluating an activity or investment for which a pre-investment opinion is sought:

- (1) whether the proposed program primarily benefits low and moderate income areas within a bank's delineated service area; and
- (2) whether the proposed program or project is responsive to needs identified and documented by the bank through its CRA ascertainment process.

In the case of community supportive service investments and activities which do not involve extensions of credit, the Department proposes to consider whether the proposed projects exhibit sufficient positive economic impact on a low or moderate income communities.

If this pre-investment CRA qualification proposal is adopted, the Banking Department would, upon request, issue a letter advising the applicant solely as to whether or not the proposed investment would at its consummation entitle the bank which is the subject of the inquiry to CRA credit. The letter would specifically disclaim any recommendation or endorsement with respect to the appropriateness, suitability or creditworthiness of the proposed investment for any potential bank investor.

Question 3.

Whether separate standards should be adopted for retail and wholesale banks respecting the delineation of their service areas for CRA purposes.

CRA requires lenders to delineate their service areas without arbitrarily excluding low and moderate income neighborhoods. The delineation is extremely important because it determines the geographic area in which the bank's record of providing services will be evaluated for CRA purposes. Federal regulations provide that a bank's community consists of the contiguous areas surrounding each office or group of offices, including any low and moderate income neighborhoods in those areas. Existing boundaries such as those of standard metropolitan statistical areas or counties in which the bank's office or offices are located may also be used to delineate its community. In addition, a bank may choose to use as its service area its effective lending territory, which is defined as that local area or areas around each office or group of offices where it makes a substantial portion of its loans. Finally, a bank may use any other reasonably delineated local area that meets the purposes of CRA and does not exclude low and moderate income areas. The reasonableness of the delineation is reviewed by the appropriate regulator.

It has been maintained that some banks either unjustifiably narrow their delineations and exclude low income neighborhoods or designate such large areas that attention to low income areas suffers. In addition, others have claimed that banks have been required unfairly to include low income areas in their community

delineations even though they have no branches located in those areas. To address these issues, the Department is considering revising the manner in which service area delineations are made, for both wholesale and retail banks.

Wholesale banks

In a 1990 comment letter submitted to the FRB, two wholesale banks stated that the typical wholesale bank community includes one or more business districts and a few upper-income neighborhoods. The comment stated that these areas properly constitute the wholesale bank's delineated area because that is in fact where most of the bank's borrowers are located. Accordingly, those banks proposed that "the community delineation factor be revised to recognize that wholesale institutions may have CRA service areas which lie outside or beyond their delineated communities but within the same municipality." The Department believes this proposal has merit and has favorably viewed CRA investments by wholesale banks in community development projects which are outside the institution's effective lending territory, but are within the scope of its larger community responsibility. We propose to formally adopt this approach with regard to wholesale banks.

Retail banks

Retail banks have questioned the inclusion of low and moderate income areas in such banks' community delineation when the banks have no branches located in those areas. Specifically, the question has arisen as to whether banks which have a presence in Manhattan but do not have branches north of midtown must include

low income areas in northern Manhattan in their community delineations. In evaluating the reasonableness of retail banks' service area delineations, the Department is considering the extent to which the coverage of a retail bank's service area is affected by the presence or absence of geographically proximate competing banks. Stated another way, the scarcity of competing institutions may effectively enlarge a retail bank's service area well into contiguous underserved locations. For example, in cases involving metropolitan areas in New York State, the Department is considering the appropriateness of recognizing the expansion of service areas by banks located in the central business districts to encompass underserved areas of the same municipality on the theory that a substantial portion of the banking business conducted by residents of underserved areas of the municipality is conducted at branch locations near such persons' places of employment, which are likely to be in the central business districts.

The goal is to expand retail banks' service areas in those cases in which they have been drawn too narrowly. In those cases wherein the service areas have been delineated broadly enough to satisfy Banking Department concerns regarding breadth of coverage, the Department would insure that the low and moderate income areas within such service areas are the principal beneficiaries of CRA investment within such service areas.

Question 4.

Whether, in an effort to reduce subjectivity in evaluating CRA compliance, the Banking Department should establish a quantitative system to evaluate compliance with CRA.

The Department's examination process is the cornerstone of its enforcement program. One major shortcoming of the CRA examination process, however, is the scarcity of quantitative standards by which to measure CRA performance. Without objective, quantifiable standards, the bank examiner's task of analyzing CRA compliance relies far too heavily on subjective judgments. In addition, the current subjective nature of the CRA examination makes it difficult for banks to predict reasonably their ratings, or to predict reasonably the manner in which the regulators will view their CRA performance in the context of an application. The Department believes that a bank compliance officer should be able to perform a CRA self-assessment and reach a reasonable conclusion as to how the bank examiner will evaluate the bank's CRA record. To increase the level of predictability, a CRA evaluation system which places greater reliance on quantitative analysis is being considered.¹⁰

The proposed quantitative system would utilize CRA investment targets which, if such targets were met, would comprise a significant component of an institution's ultimate CRA rating. The Department is considering a proposal in which a bank's annual CRA rating would be derived in large part by measuring its total assets invested in CRA qualified activities against its deposit

¹⁰ It should be noted, however, that a CRA examination is to some extent inherently subjective and no reasonable system of CRA evaluation, no matter how "quantitative", will completely eliminate the qualitative (and therefore subjective) nature of the CRA review. This point will be reflected in any proposed new standards.

liabilities. A significant portion of the CRA rating would be extrapolated from a numerical computation, which computation would make use of raw data reflecting the bank's actual CRA activities and its deposit liabilities for the year to which the computation relates.

The numerical calculation would measure the percentage of a bank's deposits which are invested in CRA related assets." The 1-4 rating system would be retained. In order to receive a specific CRA rating (for example, a "1" or "outstanding" rating), a bank would ordinarily be required to invest a minimum specified amount of its assets in CRA related activities.

Not all CRA-related investments would receive equal weight. For example, the "Special CRA Products" described on pages 12 through 14 would receive substantially greater or "enhanced" CRA credit. In addition, activities and investments which have a direct ameliorative impact on low and moderate income communities (such as housing finance, job training activities, small business lending and other similar community development activities) would be accorded greater weight. In-kind CRA benefits provided pro-bono by banks would be valued at the bank's cost of providing such benefits and would be weighted accordingly.

The Banking Department believes that the creation of a quantifiable system will provide banks with useful information concerning the weighing of different assessment factors as well as

" Only those deposit liabilities which are subject to the FDIC insurance premium assessment would have a CRA obligation attached thereto.

with information concerning the relative importance of direct impact lending and investment activities and other activities which are more auxiliary to CRA. The Department is seeking comment on the general issue of the advisability of adopting a quantitative evaluation system, as well as on the more specific issues related to the most appropriate methodology which might be employed in devising such a system. In addition, the Department seeks comment on the advisability of (i) allowing a bank's required CRA performance to be adjusted due to the asset size or financial condition of the bank and (ii) making provision in the CRA regulations which would allow for flexibility when general market conditions inhibit banks from meeting the CRA targets.

Finally, it should be noted that the implementation of such a quantitative system presupposes that geographical breakdowns of a bank's investments are readily available, not merely in relation to a bank's mortgage portfolio as presently required by HMDA but in relation to the entire loan and investment portfolio. The Department recognizes that this may impose additional recordkeeping responsibilities on banks and believes that the cost of such additional recordkeeping must be weighed against the benefits thereof. Comment is requested with respect to the costs which may be associated with these recordkeeping requirements.

Question 5.

Whether, in the case of bank holding company structures, the activities of the holding company or affiliated companies should be taken into account in evaluating the bank's CRA performance.

The Department is considering whether, in the context of a

bank holding company structure, a bank should receive CRA credit for the activities of its affiliates not subject to CRA if the activities would have entitled the bank to CRA credit had such activities been performed in the bank's service area by the bank itself. The point has been made that if a bank initiates CRA activities and investments through, for example, a community development corporation or other affiliate, then the bank should receive CRA credit for this activity. The Department concurs in such an approach and proposes to give credit to the bank for investments and activities actually performed by an affiliate thereof which, if performed by the bank directly, would receive CRA credit.

Question 6.

Whether, at the conclusion of a CRA examination, the Department's tentative findings should be reviewed with the bank, and the bank afforded an opportunity to be heard with respect to such findings prior to their adoption by the Department.

Banking Department regulations require banks to file annual reports of their CRA activity and the Department conducts on-site and off-site CRA examinations in order to arrive at numerical CRA ratings which are assigned annually to each bank. CRA examinations are conducted by examiners in the Department's specialized Community Reinvestment Monitoring Unit. These examiners are assisted by the Department's Urban Analysts who meet with many community group representatives on an ongoing basis.

As part of the examination process, examiners conduct a so-called "exit meeting" with banks upon the conclusion of the examination at which the examiner identifies for the bank, among

other things, the weaknesses in the bank's CRA program. The Department then assigns a numerical rating which is sent to the bank along with a copy of the Department's report of examination. The bank must present the report of examination and the numerical rating to its board of directors at the board's next meeting.

The Department proposes to adopt a policy of providing banks with a 45 day period in which to discuss and review with the Department the report of examination and numerical rating prior to the Department's formal adoption of such rating. This proposal would further the Department's goal of maintaining an ongoing dialogue with the banking industry on CRA matters, which the Department believes to be critical to the success of CRA.

Question 7.

Whether, and to what extent, the Banking Board should exercise its authority to expand the list of applications the evaluation of which must take into account a bank's CRA performance.

The Banking Department is considering expanding the types of applications that require a CRA review. For example, Section 28-b currently provides that the Department must review a bank's CRA record when the bank makes application to open a branch office or to effect a business combination either through a merger or a purchase of assets. The Department is now considering whether to recommend to the Banking Board that it exercise its authority under Section 28-b to expand the CRA review to include the following applications:

- (a) conversions of savings banks and savings loan associations from mutual to stock form in cases in which

a failure to convert would not threaten the viability of the institution;

- (b) the formation of one bank holding companies pursuant to Section 143-a of the Banking Law; and
- (c) other expansion-related applications.

Extending CRA's coverage to additional applications is consistent with the purposes of CRA, namely to reaffirm the connection between a bank's receipt of regulatory approvals for expansion and its record of serving the credit needs of the communities it serves, consistent with its size, capital and resources.

Question 8.

Whether, in passing upon applications for regulatory approval subject to CRA, the Department should take into account both the institution's current CRA rating as well as its rating for previous years.

CRA requires the Department to assess a bank's record of helping to meet the credit needs of its entire community, including low and moderate income areas. The Department's review of the CRA portion of an application for regulatory approval includes consideration of the bank's entire CRA record, including the most recent report of examination, an analysis of any branch closings, a review of the comments received both by the bank and the Department from residents of and institutions and community groups located in the bank's service area and any other relevant facts which have come to the attention of the Department. Generally, this review is limited to a bank's CRA performance for the periods

reflected in and subsequent to the last CRA examination. The Department is considering adopting a policy which would require a review of a bank's CRA performance for the 3 years preceding the filing of an application.

Question 9.

Whether it is appropriate to establish a so-called "safe harbor" in connection with the evaluation of applications for regulatory approval for banks which have achieved an outstanding ("1") rating for a period of at least 3 years preceding such application.

The Department is considering the establishment of a "safe harbor" in the context of the application process. Specifically, a bank that has received an outstanding ("1") rating on its last three CRA examinations (which must include one on-site examination within the last 18 months) would be assured that its CRA performance would not constitute a bar to regulatory approval of an application. The goal would be to encourage banks to make CRA a part of their overall business plans and to strive for an outstanding CRA performance rather than an issue to be considered only in the context of pending applications and to encourage community groups to develop an ongoing dialogue with banks on matters relating to CRA.

The Banking Department recognizes that the creation of a safe harbor may be perceived as having the effect of reducing community group involvement in the CRA process in some limited cases. However, the Department believes that if community group comment is solicited in a continuing manner and as part of the CRA examination process, as provided in Question 10 below, and not limited to the

application context, the value of community group comment will be greatly enhanced.

Question 10.

Whether the Department should encourage community group participation in its evaluations of CRA performance by establishing a formal community group comment period for each individual bank and by publishing CRA ratings on a quarterly basis.

In an effort to facilitate greater community group involvement on a continuing basis, the Banking Department proposes to (i) publish at the end of each calendar quarter a list of the banks for which the Banking Department will conduct a CRA examination during the next succeeding quarter and to (ii) formally solicit written comments from the community groups during such quarter with respect to such banks as part of the CRA examination process. A standardized questionnaire will be developed by the Banking Department to facilitate the solicitation of community group comments. Therefore, the comments of the community groups will be specifically solicited and formally considered by the Banking Department in arriving at the annual CRA rating.

Further, the Department is considering publishing CRA ratings at the end of each calendar quarter with respect to every bank which received a rating during the preceding quarter. Currently, community groups may obtain bank CRA ratings by filing a Freedom of Information Law Request with the Department's Public Information Officer. The Department believes that periodic publication of all ratings will be useful to community groups and may encourage ongoing dialogue between banks and the community.

Currently, community groups do not play an active role during the CRA examination process. Despite the fact that CRA ratings have been publicly available in New York since 1984, this information has not been widely used to address particular bank deficiencies prior to the filing of bank applications for regulatory approval. The Department believes that the role of community groups can be meaningfully and responsibly expanded to encourage a continuing dialogue with banks on community credit needs.

Question 11.

Whether the Department should accept the appropriate federal bank regulatory agency's annual CRA examination report in lieu of requiring banking organizations with assets of less than \$100 million to submit responses to the Banking Department's Annual CRA Information Request.

It has been asserted that CRA reporting requirements pose an undue burden on small banks and that their ratings are unfavorably affected more by their inability to document their CRA performance than as a result of any deficiencies in their actual CRA performances. While the Department believes that adequate documentation is essential to enable it to examine a bank's CRA performance, the Department also supports eliminating requirements that tend to unreasonably duplicate a bank's compliance efforts. Accordingly, the Department is considering permitting small banks to achieve compliance with the Department's Annual Information Request reporting requirement in cases where the Department is provided with a copy of the bank's federal CRA examination report.

This proposal would eliminate a reporting requirement, not the requirement to comply with CRA. We believe that this proposal will not result in reduced CRA compliance because (i) banks in New York State with assets of \$100 million or less tend to be "community banks" which make a large percentage of their loans in their service areas, (ii) the information reported on the federal forms will likely be sufficient to inform the Banking Department of any material CRA deficiencies which require further investigation and (iii) the Department will retain the authority to reimpose the reporting requirement on banks which, based upon complaints received and upon our own analysis, appear to have reduced their commitment to CRA to a less than satisfactory level.



STATE OF NEW YORK
BANKING DEPARTMENT
1 RECTOR STREET
NEW YORK, NY 10006

DERRICK D. CEPHAS
SUPERINTENDENT OF BANKS

December 9, 1991.

TO THE CHIEF EXECUTIVE OFFICER OF THE INSTITUTION ADDRESSED:

Since the release of the Home Mortgage Disclosure Act data last month, a great deal of concern has been expressed about the findings that minorities were rejected for mortgage applications at a rate far greater than that of whites, even when both white and minority applicants had similar incomes. While we recognize that there are legitimate factors in addition to income, such as debt ratios, credit history and employment, that play a significant role in banks' decisions on mortgage applications, we believe that it would be helpful if banks were to consider taking constructive measures in this area. These would include re-examining your bank's underwriting standards, reviewing how these standards are actually applied to mortgage applicants, re-evaluating your community outreach programs and considering the offering of FHA loans.

Underwriting Standards

It might be helpful if banks reviewed their mortgage underwriting standards to make certain that their requirements are not more restrictive than are reasonable and necessary for prudent lending. This is particularly important for those loans intended to be kept in portfolios since they are not required to conform to secondary market guidelines. For example, among the factors that might be considered are whether there can be more flexibility regarding the sources of funds for down payments and closing costs, greater emphasis on the applicant's income stability rather than length of employment with a particular employer and permitting a higher than customary ratio of housing costs to gross income if the applicant has had a long and sustained good record on rent payments which exceeded such customary ratio.

Applying Underwriting Standards

The manner in which underwriting standards are applied is of vital importance for ensuring equitable treatment of all applicants. It might be useful in this regard to institute a procedure for a second review of all rejected applicants by a

senior bank officer before such applicants are denied financing to ensure that complete and careful consideration has been given to these applications. As you know, applications are often approved even when they do not, strictly speaking, meet a bank's formal standards, provided there are offsetting financial strengths. The applications which would otherwise be turned down should be analyzed as carefully as the approved applications to determine whether they too may have other favorable characteristics that would warrant approval.

Community Outreach Programs

Banks should re-evaluate their outreach programs to ensure that their local communities are made aware of the bank's interest in serving the credit needs of minority persons in these communities. This can be accomplished by:

- placing of advertising in local minority media;
- informing real estate brokers in minority areas that your bank welcomes and seeks applications from such persons and areas;
- meeting periodically with local community and housing groups;
- providing credit counseling and information about the essentials of mortgage financing to community groups in minority areas who can then offer these services to local residents.

FHA Loans

Consideration should be given to offering FHA loans. The limits on the maximum size of a loan which FHA will insure were increased last year and we have been informed that FHA has substantially reduced the "red tape" and processing time for such loans. Because of FHA's low down payment requirements and more liberal terms, offering FHA loans could help attract creditworthy minority and lower income applicants.

* * *

We realize that many banks are already engaged in some of these constructive activities and we appreciate such efforts to make equal credit opportunity a reality in New York State. It is hoped that the measures outlined in this letter will strengthen the belief that New York State-chartered institutions are actively seeking to serve the mortgage needs of all creditworthy applicants, including minority persons, in their local communities.

Very truly yours,

Derrick Aphan

New York State
**BANKING
 DEPARTMENT**



**NEWS
 RELEASE**

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**NEW COMMUNITY REINVESTMENT ACT (CRA) POLICY IS OFFERED
 FOR PUBLIC COMMENT BY THE NEW YORK STATE BANKING DEPARTMENT**

NEW YORK, September 9, 1992 -- A new proposal to promote and measure compliance of 168 FDIC-insured, state-chartered banks with New York's Community Reinvestment Act (CRA) was offered for public comment today by Superintendent of Banks Derrick D. Cephas.

Describing the proposal as "an alternative approach to CRA participation and enforcement," Mr. Cephas disclosed the Banking Department's CRA reforms in a policy statement which included a series of questions and commentary to elicit the views and support of the banking industry, consumer advocacy groups and the public. The cornerstone of the new policy is a proposal to incorporate into CRA, for the first time, a formula to measure compliance by means of objective and quantifiable data.

Both state and federal Community Reinvestment Laws require banks to reinvest in the communities and neighborhoods they serve, particularly low and moderate income areas, by extending credit to individuals and businesses in disadvantaged areas and by funding community housing programs.

The Superintendent added: "We believe that the reach of CRA has not kept pace with either the changing nature of the banking system or the evolving needs of local communities. We have found that measuring CRA performance involves too little analysis of quantifiable, objective data. Further, the focus of CRA compliance and enforcement centers too greatly on the regulatory application process, with too little emphasis on ongoing compliance by banks and ongoing participation by community groups."

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Mr. Cephas continued: "As originally enacted, CRA was rather narrow in its scope. It was intended to counter the effects of "redlining" and disinvestment, principally in inner-city neighborhoods. It has been expanded over the years, properly so we believe, to embrace a much wider range of issues relating generally to the availability of credit and other financial services to low and moderate income persons and the communities in which they live. As with any other instrument of government, community reinvestment is and should be a dynamic and evolving concept that is responsive -- within the bounds of legislative authority -- to the changing needs of society."

The Department's proposed policy attempts to meet these new needs by expanding the scope of applications subject to CRA review, by creating a list of approved investment categories, by nurturing continued community involvement in the CRA evaluation process, and by developing a more objective and quantifiable compliance examination process.

The Banking Department is taking the unusual step of seeking public comment prior to publication of its formal regulations in an effort to fully inform the public as to the proposed reforms.

Mr. Cephas invited the public to submit written comments regarding the proposed policy statement, addressed to Denise L. Pease, Deputy Superintendent of Banks - Consumer Services Division, New York Banking Department, 2 Rector St., New York, NY 10006. The deadline for receiving comments is November 9.

"After review of all written comments, we intend to recommend to the Banking Board the issuance for public comment under the State's Administrative Procedure Act ("SAPA") formal proposed regulations implementing, in whole or in part, the proposals," Mr. Cephas said. "The proposed regulations will be distributed for public review and comment in accordance with the applicable provisions of SAPA prior to final adoption. We anticipate final adoption to be effective in early 1993, with adequate "phase-in periods where appropriate," he added.

Other key proposals include:

- creation of a list of specific categories of investments, services and activities that fulfill the purposes of CRA and development of a category of "Special CRA Products" that would entitle the offering bank to substantially increased CRA credit.

- participation by community groups in bank CRA evaluations by establishing a formal community group comment period prior to an individual bank's CRA examination, and by publishing CRA ratings quarterly.

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-- preparation of prior opinion letters as to the eligibility of specific investments and projects for CRA credit.

-- creation of separate CRA compliance standards for wholesale and retail banks based on their service area delineations.

-- consideration of the activities of holding companies or their affiliates in evaluating a subsidiary bank's CRA performance.

-- expansion of the list of bank applications for regulatory approval that are subject to CRA evaluation.

-- establishment of a "safe harbor" or exemption from CRA protests, in connection with the evaluation of applications from banks that have achieved outstanding ratings for a period of time preceding such applications.

-- consideration of both current CRA ratings and those of previous years in passing on bank organization applications that are subject to CRA review.

-- permission for banks to review the Department's preliminary CRA examination findings and affording them an opportunity to be heard with respect to such findings prior to the Department's formal adoption.

-- acceptance of federal bank regulatory CRA examination reports in lieu of requiring banking organizations with assets of less than \$100 million to submit responses to the Banking Department's annual CRA Information Request.

The Banking Department's policy statement was distributed beginning today to its 168 state-chartered, FDIC-insured institutions, community groups, members of the State Legislature and Congress, and Federal regulators.

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