TESTIMONY OF

RICKI TIGERT HELFER
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

ON

INTERAGENCY EFFORTS TO REVISE REGULATIONS
IMPLEMENTING THE COMMUNITY REINVESTMENT ACT

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
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INTRODUCTION

Madam Chairwoman and Members of the Subcommittee, I appreciate and welcome this opportunity to testify before you today on the Community Reinvestment Act (CRA) and the interagency proposal to reform implementation of the Act. The Federal Deposit Insurance Corporation (FDIC) is strongly committed to carrying out its responsibilities under the CRA. The regulatory agencies on this panel have spent the last 21 months in an extensive effort to reform CRA regulations. This effort has included a series of seven public hearings across the country where hundreds of witnesses addressed some of the same issues and concerns addressed in your letter of invitation. While I am relatively new to the process, I want to commend my colleagues on this panel for their intensive efforts to make the CRA regulations less burdensome and more effective.

Federally-insured financial institutions perform a vital intermediary role in the communities in which they operate: In making loans with the money that depositors leave with them, they fuel economic growth. The CRA was enacted to encourage banks to make the oppportunity for economic growth available to qualifiying borrowers throughout their communities, by expanding the "convenience and needs" criteria that regulators have long used in weighing charter and branch applications to cover credit.

The record shows that the CRA has improved access to credit in communities across the country. The regulations implementing the CRA have encouraged many institutions to make substantial commitments to increase lending and services to all income levels.

I support the goals of the CRA, and I subscribe to efforts to focus attention on meaningful performance by banks and thrifts instead of on building unproductive paper trails.

LEGISLATIVE HISTORY

In introducing the Community Reinvestment Act 18 years ago, former-Senate Banking Committee Chairman William Proxmire said that it was: "intended to establish a system of regulatory incentives to encourage banks and savings institutions to more effectively meet the credit needs of the localities they are chartered to serve, consistent with sound lending practices." In somewhat less formal language at hearings on the legislation three months later, he said: "What this bill would do would be to try to make the banks more sensitive than they have been in the past to their responsibilities to provide for local community needs." These needs, he had noted when introducing the bill, included "domestic economic development, housing, and community revitalization."

The built-in latitude in the CRA -- the legislative directive to "encourage" but not "require" and the lack of specificity on how to go about it -- prompted regulators to hold public hearings around the country in 1978 for guidance prior to drafting implementing regulations.

The legislative history is clear, however, that the CRA was not intended to force banks to make unprofitable loans. The law specifically states, "In connection with its examination of a financial institution, the appropriate Federal financial supervisory agency shall assess the institutions's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution."

The banking agencies have found the CRA a difficult law to administer, in large part because it was intended to change the attitudes of lenders -- not simply draw distinctions between legal and illegal behavior -- and thereby increase lending for community development, a broadly defined target.

OVERVIEW

This testimony addresses the effectiveness of the CRA in fulfilling its purpose of meeting the credit needs of the communities in which financial institutions operate. It discusses the problems that lenders and community representatives see with the current system for evaluating CRA compliance, and it describes how the proposal of the federal banking agencies addresses these problems. The testimony also discusses concerns about credit allocation and addresses how the CRA relates to equal credit and fair housing laws. Finally, it comments on recently introduced legislation affording certain institutions a "safe harbor" protection against denial of applications. As agreed by the Subcommittee, the agencies are submitting a separate, joint interagency statement, which discusses in detail the history of the CRA and the efforts underway to reform the regulations implementing the CRA.

THE EFFECTIVENESS OF THE CRA

Concern about redlining, in large part, motivated enactment of the CRA in 1977. As mentioned earlier, access to credit is essential to the financial viability of every community; this viability is threatened to the extent that artificial limits based on geographic location, demographic composition, or personal attributes not relevant to lending risk are imposed by lenders. The CRA is a statute that promotes community development by stipulating that financial institutions should serve the credit needs of their entire communities. It complements, but is different than federal fair lending laws, such as the Fair Housing Act (FHA) and the Equal Credit Opportunity Act (ECOA), which specifically prohibit discrimination by all lenders, not just insured financial institutions, in a broader range of housing and credit transactions.

The CRA does not require that institutions make specific types or amounts of loans and does not allocate loans to particular persons or geographic areas. Consequently, there are no hard data to quantify how much lending and investment is directly attributable to the CRA. There is, nevertheless, evidence that suggests the CRA has focused attention on lending opportunities that otherwise might have been overlooked. Since the passage of the CRA, FDIC compliance examiners report that lenders have demonstrated a willingness to offer new lending products and services that benefit low-income households. Financial institutions have expanded their marketing, often advertising through the use of media targeted to specific underserved neighborhoods and in some cases in languages other than English. Many FDIC-supervised institutions identify lending opportunities by working closely with community groups and state and local governments, often participating in special programs in conjunction with these groups. The FDIC has 24 Community Affairs Officers in eight regional offices that try to be catalysts for encouraging this interaction.

The banking industry has acknowledged that CRA has helped to put billions of dollars into low- and moderate-income communities, as indicated by the Consumer Bankers Association (CBA) in its 1993 testimony at interagency public hearings. In addition, CBA stated that, the CRA has allowed many financial institutions to recognize that there is a market in the revitalization of their communities and has led to creative ways to address the needs of underserved neighborhoods.

Despite positive results, the CRA examination process has long been the subject of criticism from both the banking industry and community organizations. Bankers repeatedly have claimed that guidance from the agencies is unclear, examination standards are applied inconsistently, and the current evaluation system is burdensome and emphasizes paperwork rather than a bank's record of making loans. Community organizations have complained that the current evaluation system is inconsistent and focuses too much on paperwork rather than performance. Overall, almost all of the comments called for change, although there was much disagreement about the specifics of how change should be accomplished.

ADDRESSING THE PROBLEMS WITH THE CURRENT SYSTEM

In July, 1993, these concerns gave rise to a letter from the President to banking and thrift regulators that called for reform of CRA regulations. In response to that letter and to widespread criticism, the regulators have put substantial effort into reforming CRA regulations. In 1993, the agencies held a series of public hearings around the nation in order to understand the criticisms and concerns of interested parties, including representatives from financial institutions, the business community, consumer and community groups, and state and local government officials.

Following the hearings the banking agencies in December, 1993, issued a proposed rule (the "1993 proposal") that substituted a more performance-based evaluation system for the twelve assessment factors in the existing CRA regulations. Under the 1993 proposal, the agencies would evaluate an institution based on the results of actual lending, service, and investment performance rather than the method or process used to determine credit needs as is too often the case under the existing regulation. The agencies received over 6,700 written comments on the 1993 proposal. The FDIC alone received almost 2,400 comment letters.

On October 7, 1994, the agencies published a revised proposal (the "1994 proposal"). This proposal addressed concerns raised in the public comments, while retaining the basic structure of the 1993 proposal. Many of the revisions incorporated in the 1994 proposal would lessen burdensome requirements on financial institutions. In general, the revisions simplified the 1993 proposed data reporting requirements and modified the tests for evaluating a bank's lending, investment and service performance to focus on community development. The comments received -- 7,100 by the agencies altogether, 2,059 by the FDIC alone -- are discussed in detail in the agencies' joint statement. I would like to highlight a few elements of the current proposal.

Like the 1993 proposal, the 1994 proposal would replace the existing twelve factors for assessing CRA performance, which focus largely on process and paperwork, with performance standards based on results. The proposal would eliminate the requirement that institutions prepare CRA statements, review them annually and document them in the minutes of the board of directors' meetings. Further, the agencies would no longer require institutions to justify the basis for community delineations or to document efforts in marketing or in ascertaining community credit needs. Resources formerly devoted to such procedural requirements -- time, money, and personnel --

would be available for making loans and investments and providing services in the community.

Both the 1993 and the 1994 proposals contain a streamlined examination procedure for small institutions. Both proposals define a small institution as an independent institution with total assets of less than $250 million or an affiliate of a holding company with total bank and thrift assets of less than $250 million. The current proposal would evaluate a small institution under a streamlined assessment method to answer the question: Are its loan-to-deposit ratio and lending record reasonable relative to the institution's size, financial condition, and management expertise, and to the credit needs of its community?

In addition, to provide institutions flexibility in meeting their CRA obligation, the proposals would give all institutions the option of being evaluated on the basis of a Strategic Plan rather than on the lending, service and investment tests, or under the small institution assessment standards, discussed above. An institution's plan would have to specify measurable goals for helping to meet the credit needs of its service area, particularly the needs of low- and moderate-income individuals. The proposal requires giving the public 30 days to comment on the plan, lets the institution take account of the comments, and then provides for agency approval of the completed plan. Thereafter, the institution's CRA evaluation and rating would be based on how well the institution meets or exceeds the goals it has established for itself.

The 1994 proposal requires large insured depository institutions to collect and report race and gender data on loans to small businesses and small farms. In contrast, the proposal does not require small institutions to collect or report additional data.

Nearly every financial institutions that commented on the mandatory collection and reporting of race and gender data opposed it. A limited number of institutions did, however, express interest in having the option to collect such data for their own assessments of compliance with fair lending laws. Many institutions commented that fair lending enforcement should be handled under the ECOA and the FHA and proposed amending Regulation B, the Federal Reserve's regulation implementing the ECOA, to allow, but not require, institutions to collect or report the data.

Regulation B prohibits discrimination on the irrevelant, prohibited grounds of sex, race, color, religion, national origin, marital status, age, receipt of public assistance or the exercise in good faith of rights granted under the Consumer Credit Protection Act. Regulation B also currently prohibits a creditor from collecting information on the prohibited bases on any loan, except housing-related loans covered by the statutory requirements for data collection in the Home Mortgage Disclosure Act (HMDA), or unless otherwise required by statute, regulation, or an order issued by a court or a federal or state enforcement agency.

Comments from community organizations were overwhelmingly in favor of the collection and reporting of data on loans to small businesses and small farms owned by women and minorities. They contended that the data are necessary to assess adequately an institution's performance in meeting the credit needs of its community.

The collection of race and gender data on small business and farm borrowers could be used to support elements of the fair lending component of the CRA assessment, one of several factors used to evaluate whether an institution is helping to meet the credit needs of its "entire community." Concerns have been expressed, however, about the anomaly of requiring large banks and thrifts to collect data that Regulation B prohibits all other creditors from collecting. Removal of the restrictions in Regulation B would permit institutions to assess compliance with fair lending laws on all the prohibited bases, not only race and gender. The four agencies are giving serious consideration to the arguments both for and against collection of this data before deciding how to deal with the issue in the final regulation.

EXAMINATION AND SUPERVISION

The FDIC is the primary federal supervisor of approximately 7,100 insured financial institutions. Between 1990 and 1994, the FDIC conducted an average of 3,200 examinations per year for compliance with the CRA.

Last year the FDIC strengthened its examination and supervision efforts in the compliance area through the creation of the Division of Compliance and Consumer Affairs. The new division consolidates the compliance examination and enforcement responsibilities previously carried out by the Division of Supervision with the community outreach, consumer protection and civil rights oversight functions of the former Office of Consumer Affairs.

The FDIC has sought to assure that bankers receive consistent supervisory treatment from compliance and safety and soundness examiners. To that end, the FDIC has detailed 150 safety and soundness examiners to the compliance examination program. In addition, half of our consumer compliance examinations are conducted concurrently with safety and soundness examinations. Efforts are being made to increase the percentage of concurrent examinations to reduce the burden on financial institutions of multiple examinations and to increase the coordination and consistency among compliance and safety and soundness examiners.

Going forward, in an effort to ensure consistency among the regulatory agencies, we will issue joint examination guidelines on the new CRA regulation, and provide interagency training to examiners under the auspices of the Federal Financial Institutions Examination Council. Further, the FDIC is developing a community development course that will be attended by both compliance and safety and soundness examiners to increase examiner understanding of community development lending within the context of safety and soundness standards.

CONCERNS ABOUT CREDIT ALLOCATION

The 1993 proposal would have required an assessment of an institution's market share in low- and moderate-income neighborhoods compared to its market share in other parts of the institution's community. A number of comments characterized this comparison of market share as a form of credit allocation.

The 1994 proposal eliminated this market share component from the lending test. The lending test would continue to give significant weight to the geographic distribution of an institution's lending within the community it seeks to serve. It does not, however, require examiners to use a ratio to measure market share, nor does it mandate that a financial institution must make loans to every neighborhood in the area it serves. Rather, examiners would be required to evaluate a bank's efforts to provide credit and service to low- and moderate-income members of its community and to look at geographic dispersion of lending to determine that low- and moderate-income areas are not specifically excluded. The proposal makes clear at the same time that there is no magic lending ratio banks must meet and that all lending must be done in a safe and sound manner.

THE CRA's RELATIONSHIP TO FAIR LENDING LAWS

The focus of the CRA is on community development through access to bank credit and services. The CRA applies to federally-insured banks and savings associations. The fair lending laws, which include the Equal Credit Opportunity Act (ECOA), the Fair Housing Act (FHA), and the Home Mortgage Disclosure Act (HMDA), were enacted to address specific concerns. The ECOA contains absolute prohibitions against lending decisions, as outlined above, with respect to any aspect of a credit transaction. The FHA prohibits discrimination on similar grounds as the ECOA in any aspect of the sale or rental of housing, including the financing of housing. Both the ECOA and the FHA apply to all lenders and others involved in the extension of credit, not just depository institutions. Denial of credit on the grounds of a personal trait, which in no way relates to whether a borrower will be able to repay a loan, is not only repugnant to fair-minded Americans, it calls into question the soundness of the credit judgments a lender is making. The FDIC takes seriously its responsibility to monitor compliance with fair lending laws. In the past three years it has referred 26 cases to the Department of Justice under the ECOA and 97 cases to the Department of Housing and Urban Development (HUD) under FHA.

In the HMDA, the Congress imposed specific data collection requirements with respect to home purchase and home improvement loans. The agencies use this data to assist in determining if institutions are in compliance with the ECOA and the FHA with respect to home mortgage loans. In determining compliance with the CRA, the HMDA data are used to assist in determining whether financial institutions are serving the housing credit needs of their communities.

I view effective enforcement of the fair lending laws as necessary to assure the creditability and fairness of the banking system. When we examine an institution for CRA compliance, we take into account the institution's record with respect to illegal discriminatory credit practices, particularly where they suggest a pattern or practice of illegal conduct. Wholly apart from our obligations to refer violations of ECOA and FHA to the

Justice Department and to HUD, respectively, the institution's record in this area is a key factor considered in our determination of how well the institution has met the credit needs of its community.

SAFE HARBOR PROVISIONS IN RECENTLY INTRODUCED LEGISLATION

The Community Reinvestment Improvement Act of 1995 (H.R. 317), introduced by Representative McCollum, creates an explicit "safe harbor" for institutions seeking approval of an application for a deposit facility. Under the bill, if the institution receives a Satisfactory or Outstanding CRA rating from the appropriate federal financial supervisory agency within the previous 24 months, an institution's application for a deposit facility cannot be denied on CRA grounds, unless an institution's CRA compliance has materially deteriorated since the evaluation.

The Federal Deposit Insurance Act outlines various statutory factors that must be considered by the FDIC in deciding whether to approve an application by a state-chartered insured institution for a deposit facility. The statutory factors include, but are not limited to, the financial history and condition of the institution, the general character and fitness of the management of the institution, and the convenience and needs of the community to be served. Although an institution's

CRA rating is important in this process, particularly in assessing the degree to which the institution is serving the convenience and needs of the community, it is not conclusive. The effect of H.R. 317 would be to protect institutions from having applications delayed in the case of public protest. As a practical matter, such protests are rare at the FDIC. By way of illustration, of 2,749 applications on which the FDIC took action in 1994, only eight were protested on CRA grounds.

Our experience has shown that the lending strategies and performance of institutions can change appreciably, for better or worse, during a 24-month period. An institution receiving a CRA rating of "Needs to Improve" may thereafter begin to perform satisfactorily, while the performance of an institution receiving a rating of "Satisfactory" may deteriorate.

We find merit in the concept of providing incentives or rewards to banks for robustly meeting the credit needs of their communities. In light of the current efforts to reform CRA evaluations, however, it may make more sense to see how the reforms work before including a safe harbor provision.

CONCLUSION

Over the past 21 months, the federal banking agencies have worked to reduce regulatory burden on banks and to produce clearer and more objective standards, both to guide institutions in their CRA compliance and to assess their performance. My participation in the process since October has led me to conclude that the FDIC and the other agencies represented here today are making a serious effort to wrestle with all the difficult issues that CRA reform has presented.

We are working to find a way to accomplish an effective and meaningful evaluation of an institution's CRA performance without burdensome paperwork and recordkeeping requirements on the one hand, and without undue reliance on ratios or formulas on the other.

We must make very clear that the objective of CRA is for financial institutions to provide credit and service to customers throughout their communities, not to build a mountain of paperwork to justify their efforts. No interest is served if bankers spend more time filling out forms or printing brochures than they spend in making sound loans in their communities.

While our examination standards need to be consistently applied, we must have the flexibility to assess the performance of an institution based on its capabilities and the needs of the community it serves. Each institution -- like each community -- is unique.

We need to ensure that everyone understands the laws and standards under which institutions will be evaluated. To accomplish this, we must continue to provide our examiners with the resources and training they need.

Finally, we regulators must keep in mind we have a dual responsibility: To encourage institutions to help meet the credit needs of their entire communities, while at the same time assuring that they meet the standards for safety and soundness.

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