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Statement by

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Vice Chairman, Board of Governors of the Federal Reserve System

before the

Committee on Banking, Housing and Urban Affairs

of the

U. S. Senate

September 8, 1988

Mr. Chairman, I appreciate this opportunity to appear before the Senate Banking Committee to address the various consumer provisions of Title IV of H.R. 5094, recently reported by the House Banking Committee. In my testimony, I will place special focus on the Community Reinvestment Act of 1977, which I will refer to as "the CRA", how CRA has been implemented, and how we can improve its administration.

In giving this emphasis to my testimony, I do not intend to convey any lesser degree of concern about other provisions that were included in Title IV of the bill which, in addition to those affecting the CRA, also impose new regulatory requirements in the areas of government check cashing, basic financial services accounts, bank branch closings, equal credit opportunity, and home equity loan requirements. Taken as a whole, these new provisions constitute a massive new burden on the banking system, particularly on smaller banks without the resources to handle these regulatory requirements. I will address our serious concerns about these extensive new regulatory requirements at the conclusion of my testimony, as well as in a staff appendix.

THE CURRENT CRA FRAMEWORK

Before discussing suggestions that have been made for revising the CRA, I think it would be helpful to outline briefly the responsibilities established under the current provisions of the CRA and to discuss the steps taken by the Board to implement these policies. This will provide a useful perspective on the types of bank CRA programs that the Board believes are effective and will serve as a guide for organizing a meaningful discussion of the House bill and other programs that have been suggested for revising CRA in the future.

The CRA gives the Federal financial supervisory agencies a significant role in assuring that financial institutions identify and take steps to meet the credit needs of their local communities. In particular, the CRA provides that the Federal financial supervisory agencies must assess the record of each institution under their supervision in meeting the credit needs of the institution's entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. In addition, the CRA requires that the Federal financial supervisory agencies take this record into account in evaluating an application by the institution for a deposit facility.

The CRA does not impose any specific lending or other requirements on financial institutions. Instead, the purpose of the CRA is to encourage depository institutions to make

meaningful efforts to assure that local communities are aware of available credit facilities and to take steps to meet local credit needs in a nondiscriminatory manner compatible with safe and sound operation. The Board fully supports the purposes of CRA, and strongly believes that all depository institutions should make meaningful efforts to meet these objectives.

THE BOARD'S IMPLEMENTATION OF THE CRA

The Board has taken three broad steps to implement these CRA policies. These steps include conducting specialized CRA performance examinations, a program for informing banks of their responsibilities under the CRA, and a program for reviewing applications that includes consideration of the CRA performance records of the banks and bank holding companies involved. The Board's CRA performance examinations establish a framework for regularly assessing the performance of state member banks in meeting the credit needs of their communities. The outreach program helps inform banks regarding effective methods for assessing the needs of their communities and methods that are available to meet those needs. The applications process acts as an effective check on the performance of banks and bank holding companies that seek to expand and provides a vehicle for public participation in the review of the institution's CRA performance. The public has increasingly taken advantage of its ability to participate in

the applications process, with the number of cases involving CRA comments increasing from only 3 in 1984 to 35 in 1987.

The Board's CRA Examination Process

The first part of our CRA program involves examination of the CRA performance records of state member banks. These examinations are carried out by examiners who are specifically trained in consumer compliance and CRA issues, and are conducted approximately every eighteen months in most cases, and more frequently in the case of banks with less satisfactory records.

CRA examinations conducted by the Board focus on a number of factors, and are designed to identify the general framework of an effective CRA program. They recognize that banks must be permitted the flexibility to meet the credit needs of the community in a way that is compatible with the bank's overall business strategy, and the community's needs.

Among the factors examined by the Board are the bank's efforts to become aware of the credit needs of its community, and to implement marketing and special credit-related programs to inform members of the community of the credit services offered by the bank. In addition, the Board examines the bank's record of making loans within its community, including low- and moderate-income neighborhoods, and the bank's participation in local community development projects, and governmentally insured, guaranteed or subsidized loan programs.

The examination also focuses on the geographic distribution of the bank's credit extensions, and the existence of any evidence of discriminatory or other illegal credit practices by the bank. Finally, the examiners take into account other information that relates to the bank's record of meeting the convenience and needs of its entire community, including the bank's record of opening and closing offices. These assessment factors have been incorporated in the Board's Regulation BB governing CRA matters.

As part of the examination process, our examiners contact members of the communities in which they conduct examinations -- including local government agencies, small businesses, grassroots community organizations, and others -- in an attempt to understand the needs of the community the bank serves. The examiners then discuss the performance of State member banks under the CRA with the bank's management in light of the examiner's contact with the community, and provide both written and oral reports to the management. These examination reports are intended to inform the bank's management of both the strengths and weaknesses of the financial institution's CRA compliance efforts and to suggest particular steps that management may take to enhance that performance. Where deficiencies are noted in the examination, the Reserve Bank continues supervisory attention until improvement has been achieved.

The Board's continued attention to CRA performance by our examiners has, I believe, emphasized to state member banks

that we are serious about CRA and that we expect these banks to maintain responsible CRA programs. We also believe these efforts have been useful to the banks in designing effective CRA programs and, therefore, have resulted in benefits to local communities.

Community Outreach Programs

The second step taken by the Board to implement the policies of the CRA is the establishment at each of the Reserve Banks of Community Affairs Officers who provide information about community development strategies and techniques to banks, bank holding companies, and others. One of the goals of the System's community affairs program is to become familiar with the credit needs of the cities, towns, and rural areas in the Federal Reserve districts through outreach to those areas. Once having identified these needs, our community affairs officers help banks to construct programs that will identify and address community credit needs.

For example, over the last three and one-half years the program has sponsored 120 conferences and seminars on opportunities and techniques for community development lending and other related subjects. In 1987 alone, the Community Affairs Officers at the Reserve Banks sponsored over 60 seminars and workshops that explored a variety of topics related to community investment, community revitalization, and

rehabilitation financing. During 1987 the staff at the Reserve Banks spoke before more than 100 groups, most of which represented bankers, concerning the CRA.

The Reserve Banks have also undertaken additional initiatives, such as publishing periodicals that deal with community lending, producing resource books on the programs for community development lending in which a bank might wish to participate, forming community lenders forums to provide mutual education about community development opportunities and techniques, and producing community profiles designed to help lenders and others in the community know what the needs are, what resources are available and what contribution the various participants might make.

One activity in this area that I would particularly like to mention is our work with community development corporations. Since well before the advent of CRA, the Federal Reserve and the Comptroller of the Currency have allowed and encouraged the creation by bank holding companies and national banks of community development corporations. Community development corporations -- or "CDCs" as they are called -- are corporations chartered to bring the lending, financial packaging and other special talents of the banker to bear on specific community projects. CDCs may focus, for example, on special community needs such as low-income housing or small business revitalization.

These corporations have the potential for making important contributions to community revitalization, in part

because they are given unusual authority, such as authority to take equity positions and own real estate. The Federal Reserve and the Comptroller's office cosponsored a conference in August of 1987 dealing with CDCs, which was attended by about 200 bankers. A pamphlet containing the proceedings of that conference was produced and widely distributed. Since that time we have seen a great deal of interest particularly in the formation of national banks.

Community outreach efforts such as these are, we believe, an essential element of our charge under the CRA to encourage financial institutions to meet the credit needs of their communities.

Consideration of CRA Performance in the Applications Process

The third facet of our approach to implementing CRA involves consideration of the CRA performance records of banks in connection with applications received by the Board under the Bank Holding Company Act and the Bank Merger Act. CRA performance is taken into account along with financial, safety and soundness, managerial, and competitive factors, when the Board reviews these applications.

Through its experience in examining the CRA performance of banks, the Board has found that institutions with the most effective CRA programs share a number of critical elements. These institutions:

1. maintain outreach programs that include procedures to permit regular, ongoing and meaningful communication between all levels of management of the bank and members of the community, community-based organizations, businesses, local agencies and others for the purpose of ascertaining local credit and deposit needs, including, particularly, the credit needs of low- and moderate-income neighborhoods;

2. establish formalized methods for incorporating the findings regarding community credit needs gathered through these outreach efforts into the institution's development and delivery of products and services to all segments of the community;

3. study opportunities for innovative lending programs for low- and moderate-income neighborhoods, including home mortgage neighborhood and residential rehabilitation lending;

4. support community development projects, such as Neighborhood Housing Services Programs, and develop policies to meet specific, identified needs of low- and moderate-income persons;

5. through specifically designed marketing and advertising programs, stimulate public awareness of the bank's services throughout the community, including efforts targeted to low- and moderate-income neighborhoods and groups;

6. establish systems for monitoring the institution's performance at senior management levels and periodically assessing areas for improvement; and,

7. train employees regarding the lending opportunities offered through the institution as well as the availability of community and local development programs.

It has been the Board's practice in the applications process, as a general matter, to work with institutions to improve their CRA performance. The Board's experience has been that a significant and growing number of banks and bank holding

companies have adopted formal and detailed internal policies and programs to address their responsibilities under the CRA.

Where the Board has found inadequacies in a bank holding company's performance or program in the context of an application before the Board, these institutions have made commitments designed to improve the institution's CRA performance and to permit the Board to proceed to review the application. Usually these commitments have addressed many of the concerns raised by public comments, as well as those expressed by the Board in similar applications.

While the commitments vary from case to case depending on the particular facts, commitments generally relate to establishing or improving programs for ascertaining the credit needs of the community; implementing programs to make the community more aware of the institution's credit services through newspaper and radio advertisements, brochures, posters, or officer call programs; improving internal procedures for reviewing and implementing CRA policies; and, finally, in some cases, improving certain types of lending where the record indicated that the applicant had not been active in making loans in areas where the applicant had itself identified a need in its CRA statement. Although protestants sometimes request that the applicant also reduce interest rates or relax credit standards, the Community Reinvestment Act and the Bank Holding Company Act do not authorize the Board to establish the terms or conditions of loans, nor does the Board believe that this was the intent of Congress in enacting the CRA.

An essential part of this process are the affirmative steps that the Board takes to assure that institutions fulfill commitments made during the applications process. In particular, the Board often requires special periodic reports from the applicant regarding progress in implementing the commitments. The Board examiners also review compliance with the commitments during periodic CRA examinations of state member banks. In addition, the Board will check for adherence to the commitments -- and take into account efforts to fulfill these commitments -- the next time the institution submits an application.

In fact, we have observed that banks have improved the attention and resources devoted to the credit needs of their communities, including low- and moderate-income neighborhoods. For example, home mortgage lending in low- and moderate-income areas has increased steadily and substantially during this decade. Despite increasing competition by other financial service providers, banks have maintained their predominant position in the field of small business lending, outstripping other financial service providers by a wide margin. Furthermore, banks have consistently been the predominant lenders in the Small Business Administration's lending programs. Forty-four of the fifty-five national bank and bank holding company community development corporations have been formed since the CRA was enacted in 1977. Banks have been among the primary lenders for projects undertaken under the

Department of Housing and Urban Development's Urban Development Action Grant program, and have been substantial financial contributors to the Neighborhood Housing Services programs around the country.

In our view, the results achieved through our efforts to implement the current provisions of the CRA are substantial. Viewed from the perspective of the objectives of the CRA that I outlined this morning, the Board's implementation program must be viewed as successful. As I said at the outset, the purpose of the CRA is to assure that banks take steps to identify the credit needs of the community, make all segments of the community aware of the credit facilities offered by the bank, and meet the credit needs of creditworthy members of all segments of the community in a nondiscriminatory manner. We believe that our CRA program has made important contributions to achieving these goals.

RECOMMENDED IMPROVEMENTS IN THE CRA

We recognize that improvements in the implementation of the CRA can be made, but we do not see a need for major revision of the CRA. We believe that the current CRA policies and framework are fundamentally sound and workable. Any modification to that system must be carefully tailored not to upset the balance between the needs of local communities and the safe and sound operation of banks, or to raise

administrative obstacles that may tend to erase the gains already achieved by the CRA.

It is from this perspective that the Board believes modifications of the CRA must be viewed. With these objectives in mind, the Board initiated an ongoing study earlier this year of the Board's CRA programs, and established a staff task force to identify model CRA programs and factors that are necessary for the implementation of a sound CRA program. The Board believes that this self evaluation, which is based on 10 years of experience with the CRA, will lead to further improvement in the Board's implementation of the CRA.

The Board has also considered changes in the law that would improve the current CRA process. We believe that changes in CRA should focus on two criticisms of the existing CRA process: that there is not enough opportunity for individuals and community groups to have input into the evaluation of CRA performance of institutions, and that high CRA examination ratings are commonplace. We believe that these criticisms could be fully met by providing a mechanism that would permit the public to participate in the assessment of the CRA performance records of financial institutions.

This could be effectively accomplished through establishment of a two stage procedure. First, the appropriate Federal financial supervisory agencies should publish, approximately every two years, an evaluation of each financial institution's record of performance under the CRA. This

evaluation would provide the public with the basis for the regulatory agency's analysis of the CRA performance of each financial institution. Second, the public should be invited to submit comments regarding this evaluation and the institution's performance record. As an essential part of this program, the Federal financial supervisory agencies would be required to take these public comments into account in reviewing expansion proposals by the institution.

In our view, this approach would provide a meaningful and highly effective method for communication among banks, communities, and regulators regarding the community's needs, the institution's CRA plans and goals to address those needs, and the institution's record of accomplishment in meeting their responsibilities under the CRA on a regular basis.

It would also assure the advantage of increased public participation without establishing a complex system that relies on credit allocation or intricate administrative procedures that are designed to enforce CRA compliance by imposing the possibility of costly delays. Moreover, this approach has the advantage of simplicity, and could be incorporated into the existing framework established by the CRA as an effective substitute for many of the provisions of Title IV of the House Bill.

ANALYSIS OF TITLE IV OF H.R. 5094

I have tried to paint a background that describes current CRA policy and the Board's implementation of that

policy and explains the areas that the Board believes could be improved. I would like to turn now to a discussion of the provisions of Title IV of H.R. 5094 and the Board's concerns regarding the likely effect of these provisions on the existing CRA framework.

I hope the Committee will bear with me while I take a few minutes to explain the complexities of the House Bill, because it is so important that Congress understand the full ramifications of the Bill's exceedingly complex and procedurally burdensome framework of data collection, CRA performance evaluation, and new administrative requirements.

Summary of Title IV

Title IV of the House Bill establishes a framework that includes four basic parts. These parts include:

1. data collection requirements in three specified lending areas;

2. a comparative evaluation of the resources devoted by banks of comparable size to these three lending areas;

3. limitations imposed on both banking and nonbanking expansion proposals based on an institution's numerical CRA rating; and

4. the establishment of a number of complex and protracted procedures for analyzing applications submitted under the Bank Holding Company Act.

The first part of the House proposal requires institutions to collect data regarding their housing loans in low- and moderate-income neighborhoods, small business loans and small farm loans, as well as investments in community

development projects and associated activities in these three specific areas. While data collection alone is only burdensome, when combined with other parts of the bill, these requirements move the CRA away from its present emphasis on expanding awareness of credit granting opportunities toward directed lending for specific purposes.

Second, the bill requires that the Federal financial institutions supervisory agencies prepare and make available to the public evaluations of the record of depository institutions in meeting the credit needs of their communities, placing special emphasis on the specific types of loans for which data collection requirements are set under the bill. The proposal revises the current CRA rating system to provide a comparative system that requires institutions of the same size to devote comparable resources to community investment activities. The system includes five rating categories: two above-average ratings, an average rating, and two below-average ratings.

Third, the House bill would require as a prerequisite to any banking or nonbanking expansion that bank holding companies have an imputed CRA rating that is above average on a comparative basis with institutions of similar size. Institutions with an average CRA rating could be granted preliminary approval to expand their nonbanking and interstate banking activities provided that they commit to implement policies that will improve their CRA performance. The bill establishes a complex procedure for monitoring compliance with

these commitments. Institutions with a below average CRA rating would be prohibited from acquiring other financial institutions on an interstate basis or from expanding their nonbanking activities. A detailed and extended process would be established to permit these institutions to acquire additional banks within their home state provided they commit to improve their CRA performance.

Finally, the bill would revise the applications process under the Bank Holding Company Act in several key respects. The bill would extend to 45 days the period during which the public may submit comments regarding any proposal requiring Board approval under the Bank Holding Company Act except simple reorganizations. In addition, the bill would establish a formidable procedure spanning a course of two years and involving public comment, two stages of Board review and a mandatory public hearing in cases involving acquisitions by bank holding companies with an average or below average CRA performance rating.

MAJOR AREAS OF CONCERN

Although the House Banking Committee has adopted a number of improvements to Title IV that reflect comments made by the federal banking agencies and others, the Board believes that a number of significant problems continue to exist with the House bill. There are five areas of major concern:

1. The provisions of the bill will work together to establish a system of credit allocation.

2. The extended comment period required in the Bill for all applications submitted under the Bank Holding Company Act will impose unnecessary costs and burdens on applicants with no practical benefit to the public.

3. The comparative rating system has the anamolous effect of putting banks in an inappropriate competitive CRA performance race, and by complex procedures prevents so-called "average" performers from undertaking any expansion.

4. The protracted preliminary review and post-approval hearing procedures established by the Bill are excessively burdensome.

5. In contrast to existing CRA provisions, many parts of the new statute do not recognize the existing obligation of banks to make credit decisions consistent with safe and sound banking practice.

Our staff has prepared a more detailed Appendix discussing a number of other difficulties that we see in the implementation of Title IV.

As I have stressed, the major defect of the Bill is that its proposed information collection requirements, CRA rating system, and limitations on the approval of expansionary programs by banks and bank holding companies will, taken as a whole, have the effect of requiring financial institutions to devote increasing amounts of resources to areas for which data is collected. This is because, under the system contained in the House bill, it is impossible for a bank regulator to give an above average rating to an institution unless the institution has committed an above average level of resources

to three specific types of loans for which data is to be collected.

By tying the data collection and rating system to three specific loan categories, the bill departs from the existing CRA philosophy, which permits banks to meet the needs of the community in a variety of ways, from purchasing low income housing bonds to making business loans in minority areas. It will, thus, stifle the ability of financial institutions to specialize in certain particular banking areas and to shoulder their CRA responsibility in a manner consistent with their business strategy. We are also concerned that credit needs of the community in other areas may go largely unmet by banks because resource commitments in these other areas clearly are given only minor significance under the rating system established in the House bill. Thus, the effect of the bill will be to establish Congressionally mandated direction of credit for specific purposes and to remove the flexibility that banks currently have to identify and meet special needs of their community in a manner that takes advantage of the special skills and resources of individual banks.

This system is made worse by the Bill's use of a comparative CRA rating system that limits the ability of institutions with an average CRA rating to expand. The House bill requires the agencies to grade financial institutions by

comparing the resources devoted by the institution to community investment activities, particularly in the three specified areas for which data is collected, to the resources committed by similar size institutions.

The Bill also establishes a base rating of "average" on this comparative scale and limits the ability of institutions with a performance rating of average or below average from expanding their banking or nonbanking activities. By setting an "average" rating as the centerpiece of a comparative system, the Bill will effectively force financial institutions to bid against similarly sized financial institutions for the above average CRA ratings that are necessary to gain approval of expansion proposals. The Board is very concerned that this comparative rating system will force financial institutions to extend credit without regard to principles of safety and soundness in order to assure that the institution has devoted sufficient resources to the Bill's three specified lending areas in comparison to their peer's in order to obtain an above average CRA rating.

The Board believes that this system is also defective because the complex and protracted application process established by the House bill for proposals involving acquisitions by bank holding companies with an average CRA rating effectively makes the average rating unsatisfactory in all meaningful respects. Any CRA rating that is not "above average" -- whether it is a rating of average or poor -- will,

in practice, have the same result of preventing the institution from taking advantage of opportunities to expand into new geographic locations and new nonbanking areas.

The Board is also concerned that, taken together, the impact of this Bill will act as a tax on financial institutions that will reduce the ability of regulated financial institutions to compete effectively against unregulated entities that provide similar products and services. This would ultimately hurt all segments of the consuming public.

The House Bill also establishes an excessively elaborate system of procedures for evaluating and considering the CRA records of financial institutions. The Bill would establish a minimum public comment period of 45 days for all applications or notices submitted to the Board to acquire banks under section 3 or to expand nonbanking activities under section 4 of the Bank Holding Company Act.

In addition, the procedures established by the House Bill for reviewing applications by bank holding companies with an average CRA rating are also exceedingly complex and would establish an excessively protracted administrative process. In these cases, the Bill establishes a preliminary approval process in which the acquiring bank holding company is permitted to commit to specific proposals designed to improve its CRA performance. In addition to initial public comment and review of the proposal and CRA commitments, the Bill imposes a re-review process of the acquisition and commitments six months

after the acquisition has been consummated, and mandates a public hearing on the proposal two years after the acquisition has been completed.

The Board does not believe that the very small number of cases in which CRA comments are received warrants a significant increase in the public comment period in all cases reviewed by the Board, particularly in view of the added expense and burden that this extended delay would impose. The Board could simply be directed to use its existing authority both to permit members of the public additional time to comment on applications before the Board and to assure that commitments made by bank holding companies during that process are met.

The protracted re-review procedure established by the Bill introduces substantial uncertainty into the approval process and could extend that regulatory review process far beyond the time horizon of most investors. In our view, permitting the public to participate in assessing the CRA performance of the bank holding company in the manner I proposed earlier would provide a better vehicle for permitting public participation in the enforcement of CRA commitments.

Title II of S. 1886 makes significant strides toward streamlining the review process under the Bank Holding Company Act and reducing the costs associated with the applications process. The Board has fully supported these provisions of the Senate bill. The needless extension of the comment period and the complex review procedures established for certain expansion

proposals that have been proposed in the House bill, however, would largely vitiate the gains made by the expedited procedures process established in S. 1886.

Suggestions for Modification of Title IV

Along with the suggestions I have made for increasing public participation in assessing the CRA performance of banks, other improvements are needed to deal with the problems I have raised. First, the specific data collection requirements of the Bill should be eliminated. In place of this rigid format, which has the effect of limiting lending flexibility, financial institutions should be permitted to collect whatever data is appropriate to demonstrate their record of meeting the credit needs of the community that the institution has identified and targeted. The institution could be required to make this data available in summary form for inspection by the public as part of the institution's CRA program.

Second, as a substitute for the comparative rating system proposed in the Bill, the Bill should adopt the procedure for public participation in the process for examining the CRA performance of financial institutions that I have outlined. Clearly, the system that is centered on a rating defined as "average", and on a comparison of resources devoted by financial institutions should be eliminated. Moreover, the Bill must be changed to permit banks to recognize their obligation to make credit decisions consistent with safe and sound banking practice and must permit the federal agencies to

take these principles into account in evaluating the CRA performance of financial institutions.

Third, a 45-day public comment period should not be required in every case reviewed by the Board. Instead, the Board could be instructed to grant extensions of the public comment period whenever a request for additional time has been made and a reasonable showing has been made that an extension is appropriate.

Finally, the complex and burdensome procedural requirements that the Bill would impose on bank holding companies that do not achieve an above average CRA performance rating should be replaced by a specific direction to the Board to use its existing authority to enforce commitments by bank holding companies to improve their CRA performance offered in connection with applications and notices submitted under the Bank Holding Company Act.

COMMUNITY REVIEW BOARDS

The House Bill also makes a number of changes in other areas. I would like to discuss only a few of these. First, the bill would require each Federal Reserve Bank to establish a community review board that would advise each of the Federal depository institutions regulators of the needs of consumers and communities within the Reserve Bank district and would review the agencies' performance in implementing the policies

of the CRA. We believe these boards, as constituted, are not well suited to the mission assigned to them, and would duplicate work already done by the existing Consumer Advisory Council.

The regional focus of these review boards is too narrow to provide meaningful advice on examination standards and practices, which must be uniform across the country. We believe the Board's Consumer Advisory Council already serves this function. These review boards are also ill-suited to advise the Reserve Banks on local issues, which can be effectively surveyed only by an extensive outreach program that includes contact with as many communities as possible. The Board believes that its existing Community Affairs Officers and outreach programs provide the most effective methods of assessing these varied needs. In this regard, we note that the Federal Advisory Committee Act embodies a congressional policy to avoid the creation of new advisory committees where the functions could be performed by an advisory committee already in existence.

GOVERNMENT CHECK CASHING

The House Bill would require financial institutions to establish a program for cashing government checks. The Board does not, in principle, favor a statutory requirement that mandates the provision of certain services at a specified

price. The Board recognizes that many of the changes made in the final version of the Bill are helpful in reducing the potential for fraud that is associated with these programs. But the risk of fraud remains a real concern in a situation in which banks are required to provide immediate cash to where the authentication of the check being offered may be difficult to verify, and the identification procedures are subject to abuse.

The Board questions, however, whether focusing exclusively on check cashing is the best approach to the problem of delivering government payments in a reliable and efficient manner. We believe that electronic alternatives represent a much better long-term solution to problems in this area. Any legislation on the subject should provide some sort of encouragement to develop more innovative ways of delivering government payments.

For example, consideration should be given to the development of arrangements whereby federal, state, and local benefit payments could be electronically transferred to depository institutions that have agreed to participate in a voluntary program. The cost to the banking industry to process an electronic payment is much lower, and, consequently the fee charged to the individual would probably be considerably less than the $2.00 charge now permitted in the House bill for cashing a government check.

BASIC BANKING

Similarly, the Board believes that it is inappropriate to require depository institutions to offer basic transaction accounts at a given price. Our concern is that any mandatory arrangement will be both static and inflexible and that transaction account fee requirements will be extremely difficult to implement in regulations. In light of these problems, the Board believes that voluntary efforts by financial institutions to offer basic low-cost accounts are the appropriate response. Surveys indicate that as many as 50 percent of financial institutions voluntarily offer basic banking services, and that more institutions establish these types of programs every year. The Board believes that the trend will increase and can be encouraged without legislation mandating a specific program of services and fees.

EXPEDITED FUNDS AVAILABILITY AMENDMENTS AND OTHER PROVISIONS

The House bill contains a number of amendments to the Expedited Funds Availability Act. For the most part, these amendments facilitate compliance with the Act's requirements and reduce the risk of fraud in accepting checks that must be given next-day availability. The Board supports these amendments, and believes that Congress should act on them quickly.

The Board continues to be concerned, however, about the treatment of payable through drafts under the Act. The House bill contains an amendment that would explicitly codify a recent decision by the U.S. District Court that credit union share drafts that are payable through another bank be treated as local or nonlocal checks based on the location of the credit union, rather than the payable through bank.

The Board believes that under this approach, it is difficult for consumers to understand when the proceeds of credit union payable through share drafts are available for withdrawal, it is difficult for depository institutions to comply with the Act, and the risk associated with accepting these drafts for deposit is increased. Therefore, the Board recommends that Congress adopt an amendment clarifying the Act to provide that, in the case of payable through drafts that are payable by a depository institution, the determination of whether the draft is local or nonlocal be based on the location of the payable through bank.

With regard to the provisions on Truth in Savings, home equity lines of credit, and the Equal Credit Opportunity Act, which are discussed in the attached Appendix, the Board supports the need for full disclosure to consumers about the terms of their deposit and credit accounts, but we question the need for substantive limitations on institutions practices.

CONCLUSION

Our criticism today of some of the provisions of Title IV of the House Bill stems from our judgment that the policies and framework established by the CRA are sound and workable. The Board fully supports the basic purpose of the CRA of encouraging financial institutions to meet the credit needs of all segments of their local communities in a manner that is nondiscriminatory and consistent with the principles of safe and sound banking practice. We believe that our current system of examinations, community outreach programs, and review of applications is well suited for this purpose and has been successful in encouraging banks to increase their commitment of resources to community needs including low- and moderate-income neighborhoods.

The changes in the CRA that are proposed in the House Bill go far beyond the alterations that we believe can be justified by our experience in administering and reviewing compliance with the CRA. These changes upset the balance established in the CRA between the responsibility of financial institutions to serve the needs of all segments of their communities and the principles of safe and sound banking. In the process, the House Bill establishes a framework that tends toward credit allocation and erects formidable procedural obstacles.

We recognize that some improvements can still be made in the implementation of the policies of the CRA. In particular, we have offered detailed recommendations that include a new system of public participation in assessing a bank's CRA performance, elimination of rigid data collection requirements, adoption of provisions for granting requests by members of the public for extensions of the public comment period on applications, and use of the Board's authority to enforce bank commitments to improve CRA performance. The objective of these suggestions is to improve communication between banks and all segments of the communities they serve, and to assure that credit is available on a nondiscriminatory basis to creditworthy customers.

We stand ready to provide any assistance that we can in this area.

Appendix to

the Statement by

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APPENDIX TO GOVERNOR JOHNSON'S TESTIMONY
ON COMMUNITY REINVESTMENT ACT

Title IV of H.R. 5094 contains numerous technical problems and provisions that are cumbersome, excessively complex, and, in several cases, inconsistent. This appendix attempts to identify these problem areas.

Subtitle A

1. Section 11(a)(3)(B) in Section 403

A. The provisions of this section of the bill require the Board to issue public written findings regarding all factors that the Board is required to take into account in considering all applications under the Bank Holding Company Act ("BHC Act"). That provision would require the Board to make these findings within 15 days following the close of the public comment period on any application or notice in which no public comments are received by the Board regarding the CRA performance of the bank or bank holding company involved in the acquisition. The Bill permits additional processing time for cases in which the Board receives comments regarding the CRA performance of banks involved in the application or notice.

However, the Bill provides no similar exception for cases involving significant managerial, financial, competitive or other issues that are the subject of substantial comment. Thus, under this section of the Bill, the Board would be required to make findings regarding the financial, managerial, competitive and other factors the Board must consider under the BHC Act within 15 days of the close of the comment period in spite of the fact that the Board may have received substantial comments on these issues. This short period simply does not permit the Board sufficient time to consider and analyze these issues in a responsible way.

In addition, a requirement that the Board issue written findings in addition to its written statement in the final order regarding the case would cause needless duplication and may encourage disruptive and untimely litigation regarding these findings before the Board has issued its final order deciding the merits of the application or notice.

B. The Bill also requires the Board to act within 90 days of the start of the public comment in cases in which the Board holds a public hearing on CRA matters. This 90 day period also permits only an unreasonably short period of time for holding a full public hearing. Because comments are often received at the end of the comment period, the provisions of the Bill would require the Board to investigate, organize, and hold a hearing, as well as issue its findings following the hearing, within 45 days.

2. Section 11(a)(1)

The provisions of the Bill apply only to acquisitions that are subject to the Bank Holding Company Act, and do not apply to acquisitions that are subject to the Bank Merger Act. Consequently, a bank may acquire control of another bank through merger without complying with the CRA provisions of Title IV. The provisions of section 11(a)(1)(A)(ii) of section 403, which apply to applications by any bank to acquire control of another bank, would not reach bank-to-bank mergers because those mergers are not subject to section 3 of the Bank Holding Company Act. That section of Title IV would apply only in the event that a bank were to itself become a bank holding company by acquiring shares of another bank.

3. Section 11(a)(1)(B)

This section applies the provisions of Title IV to any application or notice by a bank holding company to acquire any company or engage in any activity described in "any paragraph of section 4(c) of the BHC Act." This provision inappropriately reaches not only acquisitions and expansion proposals but other matters as well. For example, this provision may be read to apply the CRA provisions of Title IV to a request by a bank holding company under section 4(c)(2) of the BHC Act for an extension of time to retain shares of stock acquired in satisfaction of a debt previously contracted. This would also require the Board to apply the CRA provisions to

proposals by a domestic bank holding company to make an investment entirely outside of the United States under section 4(c)(13) of the BHC Act. In addition, it would require application of the CRA rules to an application by a foreign organization for an exemption under section 4(c)(9) of the BHC Act from the nonbanking restrictions of the BHC Act to engage in nonbanking activities outside the United States.

4. Section 11(a)(1) & (3)

A. Two provisions of section 11 imply that applications are required under the BHC Act where in fact no application is required. First, section 11(a)(1)(A)(i) applies the CRA provisions to any application under section 3(a) "to acquire control of another bank (other than a bank described in [section 2(c)(2) of the BHC Act] . . . ." Institutions defined in section 2(c)(2) of the BHC Act are not "banks" for purposes of section 3 of the BHC Act by definition, and no application under section 3(a) is required by a bank holding company to acquire these institutions. Rather, the acquisition of these institutions is subject to section 4 of the Act. By giving an express exemption to the acquisition of these institutions in section 11(a)(1)(A), Title IV implies that these institutions are "banks" subject to section 3 of the BHC Act.

B. Similarly, section 11(a)(3)(A) provides an exception for any notice by a bank holding company to engage in

certain bank servicing or safe deposit box activities under the Board's regulations. Bank holding companies are expressly authorized by section 4(c) of the BHC Act to engage in these activities without prior Board approval. Inclusion of an exemption from the CRA title for these provisions suggests that the Board should require an application in these cases and should review the other non-CRA factors in these cases, when in fact the statute already provides that no application is required to engage in these activities.

5. Section 11(b)

The provisions of section 11(b) permit the Board to grant preliminary approval of applications involving acquisitions by bank holding companies with an imputed CRA of 3 where the bank holding company has made commitments that would improve its CRA performance to one of the above average ratings. The Board must re-review this determination at the end of the 180 day period following the preliminary approval, and must hold a public hearing regarding the application two years following the preliminary approval.

This procedure is excessively complex and protracted, and introduces severe burdens and uncertainty into the applications process. There appears to be no useful purpose for requiring the Board to re-review the sufficiency of commitments to improve CRA performance 180 days after the Board has originally reviewed and approved these commitments.

Moreover, requiring a public hearing regarding an acquisition two years following its consummation eliminates the ability of interested members of the public to introduce evidence that would permit denial of the application. The prospect of a public hearing after such an extended period of time is also likely to discourage bank holding companies that would be subject to this process from ever beginning the process because of the implication that the transaction may be subject to continued review over a protracted period of time.

The Board believes that its existing procedures are adequate in this area. First, the Board has long experience in reviewing the adequacy of commitments offered to improve the CRA record of organizations involved in an expansion proposal. The Board's ability to review these commitments is not enhanced by having two opportunities, 180 days apart, to review these commitments.

Second, the Board has ample authority to enforce commitments accepted by the Board in connection with an application under the BHC Act. The Board regularly requires organizations that make CRA commitments to submit special reports to the Board demonstrating their compliance with the commitments. These special reports, coupled with the Board's enforcement authority under the BHC Act, are adequate to assure that organizations comply with commitments they have made with the Board.

6. Section 11(a)(7)

A. Section 11(a)(7) establishes a procedure for certain acquisitions involving banks with CRA ratings of less than 3. Paragraph (B) of this subsection would permit "any bank holding company [to acquire] control of any bank with a community reinvestment rating of less than 3", if the acquiring bank holding company provides commitments that would improve the CRA rating of the organization. This provision, by its literal terms, would permit a bank holding company with a CRA rating that is below average to acquire a bank with a CRA rating that is below average, while prohibiting that same bank holding company from acquiring a bank with an excellent CRA rating. It would also penalize bank holding companies with the highest CRA rating by subjecting them to protracted administrative procedures, including preliminary review, re-review by the Board and public hearing at the end of a two year period, if that bank holding company seeks to acquire a bank with a CRA rating less than 3.

B. The provisions of subsection (7) also permit bank holding companies with a CRA rating of less than 3 to acquire banks under section 3 of the BHC Act, but do not permit these institutions to expand their nonbanking activities under section 4 of the Act. Institutions should be permitted to expand their nonbanking activities if appropriate commitments are made to improve their CRA performance. Many of the approved nonbanking activities, such as mortgage banking,

consumer lending, community development, leasing and similar activities, may provide vehicles that would assist a bank holding company in improving its CRA record.

C. In addition, subsection (7) provides that an application by a bank holding company with an imputed CRA rating of less than 3 must be approved by the bank's primary federal regulator in addition to approval by the Board. Currently, these applications are subject to approval by the Board in consultation with the primary federal regulator. Imposing a dual approval process will greatly lengthen the administrative process and increase application costs, without any perceivable benefit.

7. Section 11(c)(1)

A. This section requires the Board to disapprove applications and notices submitted under the BHC Act if the applicant exhibits a pattern of opening or closing deposit facilities, or acquiring or chartering insured depository institutions, in a manner that tends to exclude low- and moderate-income neighborhoods. This provision may require the automatic denial of applications by bank holding companies and banks that devote their resources to commercial banking activities at a single location and do not provide a significant amount of retail banking services to any sector of the community.

These banks and bank holding companies are able to meet their responsibilities under the CRA by providing business credit, in particular small business loans, and by acquiring housing bonds or shares of community development corporations that provide housing and other credit to the community. However, because they limit their banking activities to a single location that is often in a commercial district and provide only limited retail operations, these institutions may be deemed to have established a pattern of refusing to open branch offices in low- and moderate-income areas.

B. This draft of the bill, unlike its predecessor, permits the Board to take safety and soundness issues into account when considering an applicant's record of branch closings. This may not go far enough, however. For example, it is not clear whether a bank or bank holding company would be justified in closing costly or unprofitable branches even before they threaten the safety and soundness of the bank or parent holding company.

Finally, this provision appears to establish an absolute bar to approval of an application involving an institution that has exhibited a pattern of branch closings. This fact would thus supercede factors that the Board must consider under the BHC Act, such as financial, managerial, competitive, and legal factors.

8. Section 11(f)

A. This section defines the imputed CRA rating for bank holding companies. Under this provision, most bank holding companies would receive the CRA rating assigned to the bank subsidiary with the least favorable CRA rating. An exception is made for bank holding companies with five or more depository institutions in a single state. These bank holding companies receive a CRA rating that is one grade higher than the lowest rating of their subsidiary banks, provided that not less than 80 percent of all the bank subsidiaries have a higher CRA rating and that the largest bank in the bank holding company has a higher CRA rating. Bank holding companies with five or more bank subsidiaries in several states also receive a CRA rating that is one grade above the lowest rating received by any of the bank subsidiaries, provided that the bank subsidiaries representing 93 1/2 percent of the assets of the holding company have CRA ratings that are greater than the lowest CRA rating of any of their bank subsidiaries.

It is inherently unfair to attribute the lowest CRA rating received by a multi-bank holding company to the bank holding company. This system penalizes bank holding companies that have a majority of banks with excellent CRA ratings and rewards banks that have an average rating at all of their banks.

B. There is no reason to distinguish between bank holding companies that own several banks in a single state and bank holding companies that own several banks in several states. Our banking system is increasingly becoming national in scope with most states permitting interstate bank acquisitions. Distinguishing between holding companies according to the number of subsidiaries that they own in a single state gives preference to bank holding companies located in unit banking states where bank branching has been prohibited and penalizes bank holding companies located in states where acquisitions are less prevalent because state-wide branching is permitted.

9. Section 11(f)(4)(B)

This section provides an exemption from the imputed rating system for thrifts acquired by bank holding companies in emergency transactions, for banks with a camel rating of 4 or less, and for de novo banks. In each case, the exemption is available only if the acquiring bank holding company submits a plan to the Board, within 90 days following the acquisition of such an institution, that will permit the institution to receive a community reinvestment rating of one or two. Permitting the submission of a plan in these cases following approval and consummation of the transaction is of very little purpose.

10. Section 11(f)(5)

This provision would exclude the rating of agricultural banks under $50,000,000 in assets and the rating of all banks with less than $25,000,000 in assets from being taken into account in determining the imputed rating of the parent holding company. This provision would include in the definition of "agricultural bank" any bank that makes 25 percent of its loans in real estate loans in its market area. Consequently, it would define as "agricultural" any bank that meets the 25 percent criteria even if it is located in a major metropolitan area.

11. Section 11(g)

This provision requires the Board to publish notice of the submission of an application or notice under the BHC Act "in the manner prescribed in regulations prescribed by the Board as in affect on June 5, 1985." The effect of this provision is to adopt the Board's procedures for requiring newspaper notice in local areas as well as federal register notice for each case involving the acquisition of a bank or the establishment of a nonbanking activity under the BHC Act.

This reference in the statute does not permit the public to be certain of what procedures should be followed for applications and notices submitted under the BHC Act. In addition, it removes all flexibility from the Board in adjusting its procedures to conform to its experience in processing applications and to exengencies that may arise in particular cases.

12. Section 11(h)

This section requires the Board to provide the public at least forty-five days in which to submit comments regarding any application or notice under the BHC Act. This public comment period would begin following the later of the date that notice is published regarding the application or notice, or the date the Board publishes its weekly bulletin identifying the application or notice. Imposing a forty-five day comment period in every case under section 3 and section 4 of the BHC Act would impose costly and arbitrary time delays on the vast majority of applications with no public benefit.

The Board's experience has been that public comments are received in less than five percent of all applications and notices considered by the Board. Where a member of the public has expressed interest in commenting on an application or notice and provided a reasonable showing that additional time in which to comment on that application is warranted, the Board has granted additional time in which to submit comments. This procedure permits the Board to grant additional time to commenters in cases where there is a public interest and otherwise to process efficiently the vast majority of cases in which no public comment is expressed.

13. Section 405

Section 405 of Title IV involves amendments to the Community Reinvestment Act of 1977. In particular, this

section requires public notice of CRA examinations and establishes a rating system that the federal banking agencies must follow in setting the rating for each financial institution under its supervision.

Section 405 would amend Section 807(a) of the CRA to provide that the Federal depository institutions regulatory agency publish notice of any contemplated CRA the examination on the same day that examination is scheduled to begin. This presents logistical problems for both the federal banking agencies and members of the public that are interested in participating in the examination. First, it is difficult for the Board to coordinate the examination day with the exact day of newspaper publication of notice of the exam, particularly in areas where a daily newspaper is not circulated. Most importantly, publishing notice on the same day that the examination begins does not give the public adequate notice or opportunity to assemble information regarding the institution's CRA performance that may be relevant to the examination.

14. Section 808

A. This section establishes a framework for data collection by the banks that requires banks to maintain CRA performance data demonstrating, at a minimum, the amount of resources the institution has committed to housing loans in low and moderate income neighborhoods, small business and small farm loans, as well as financial investments in community

development projects in these three areas. The Board is required to place special emphasis on the depository institution's record of serving the credit needs of the community in these three areas in establishing the CRA rating for the institution. The CRA rating is also based on a comparison of the amount of resources devoted in these three areas by the institution with institutions of similar size, with a base rating of average.

This system will entrench housing loans, small business loans, and small farm loans as the perferred, and perhaps only acceptable, means of meeting the CRA requirements of the BHC Act. These data collection requirements coupled with a comparative rating with a base rating of average would effectively require banks to allocate credit in these three areas in amounts that will exceed that amounts devoted in these three areas by institutions of similar size, in order that the institution may obtain the CRA rating necessary to gain approval to conduct its expansion plans.

This system is undesirable and counter to the public interest. In addition, this system may have the perverse result of encouraging banks not to devote financial resources to legitimate needs of the community in other areas and not to attempt to obtain an above average CRA rating unless the bank has expansion proposals in mind.

This rating system does not permit banks to take into account safety and soundness principles in serving the credit

needs of their communities or allow the Board to consider these principles in evaluating the commitment of resources by a financial institution to loans in these areas.

B. This section of the Bill attempts to make a distinction between large and small banks in imposing this data collection burden. It seems to miss the mark in several respects. The Committee Report makes the assertion that most larger banks "maintain such data on sophisticated computer systems." It is not clear that this is true. Even in those institutions that do have computerized data systems, the data is unlikely to be organized to easily retrieve the data required by this provision or in the format that is to be developed. Further, there will ultimately have to be uniform standards and definitions (e.g., what constitutes a small business loan) imposed to make the data useful in making comparisons. Analysis of data collection costs for the Home Mortgage Disclosure Act suggests that the cost to banks in collecting and maintaining data regarding the geographic location of individual loans is very expensive. For example, HMDA data collection costs about $7 to 9 million.

15. Section 809

This section would require the agencies to make their examination reports and ratings public. Examination reports often contain confidential financial information regarding the

company and individuals that should not be made public. The recommendation contained in Chairman Greenspan's letter to Chairman St Germain of July 21, 1988, for making an assessment, which would include a summary of this information, available to the public would accommodate the same interest for public access to CRA performance evaluation information without violating the principles of confidentiality of examination materials.

16. Section 812

This provision requires the agencies to submit annual reports to Congress by March 1 of each year on the data collected under the House Bill. This section also requires reports at 6 month intervals containing, among other things, detailed reasons for the number of institutions that had not been examined since the date of enactment and the number of extensions that had been granted. It seems, however, that under this bill these questions are relevant only after two years have passed and only if all institutions have not been examined. Before two years has passed, the answer to the question regarding extensions will always be "none" and the reason for not having completed some of the examinations will typically be that they are not yet due to be completed -- they will not be "late" until two years has passed.

17. **Section 411**

This section would require the establishment by each agency of a division to be known as the "consumer division" and would stipulate specific responsibilities for this division. The charge to all the agencies to "develop proposed regulations to implement all applicable laws relating to consumer protection" is inappropriate given the Board's responsibility for writing rules for Truth in Lending, ECOA, EFTA, HMDA, etc.

This section would prescribe an examination frequency for consumer examinations. Such subjects seem best left to the judgment of the agencies as opposed to being inflexibly codified in a federal statute. Finally, this section permits a holding company to request an examination before the next scheduled application to expedite an application. This provision has the potential to seriously impair the agencies' ability to schedule examinations in an orderly way to meet the bills two year examination frequency requirement. Further, should a large holding company request an examination of some or all of its banks, the request may simply be impossible to accommodate due to resource constraints.

18. **Section 106 of Title I**

A. There are a number of technical amendments that should be made in other areas of the Bill. For example, section 106 of Title 1 of the Bill establishes expedited procedures for bank holding companies seeking approval to

engage in nonbanking activities under the BHC Act. Section 106(a) would amend the BHC Act by adding a new section that provides that "no bank holding company shall engage, directly or indirectly, in any activity or acquire the shares of any company pursuant to any paragraph of subsection (c) which requires an application or notice to the Board other than paragraph (15), either de novo or by an acquisition," unless the Board has been given 60 days prior written notice. Paragraph (15) authorizes the acquisition of shares of qualified securities subsidiaries. Section 102 of Title 1 would amend section 5 of the BHC Act to provide that "no bank holding company may form a company, or acquire any shares of any existing company, for the purpose of establishing a qualified security subsidiary unless the Board approves a written application . . . ."

The combination of an exclusion in section 106 for applications under paragraph (15) and the limited application requirement in section 102 has the affect of providing that a bank holding company must obtain the Board's approval prior to establishing a qualified security subsidiary, but need not obtain the Board's approval if that qualified security subsidiary subsequently acquires shares of an additional securities company or acquires the assets of an additional securities company. These provisions do not make clear that additional acquisitions of securities companies by bank holding companies of going concerns require prior Board approval and

are subject to the concentration of resources competitive and safety and soundness analysis that the Board must conduct under the provisions of Title 1.

B. The provisions of section 106 also amend the notice procedures to provide that the Board may request additional information in connection with a notice submitted under section 4 of the BHC Act to engage in nonbanking activities provided that the information is relevant to at least one of the list of criteria specified in paragraph (i)(6).

The list of criteria in paragraph (i)(6) does not include consideration of the CRA performance of the parent bank holding company or its bank subsidiaries other than those involved in the proposed acquisition. As a result, the Board is prohibited under the amendments contained in section 106 of Title I from requesting additional information regarding the CRA performance of the bank holding company involved in the expansion proposal or from obtaining an extension of time in which to consider CRA information provided in connection with that application.

COMMENTS ON GOVERNMENT CHECK CASHING
(Subtitle C of Title IV of H.R. 5094)

The House bill requires federally insured banks, S&Ls, and credit unions to cash government checks in an amount of $1,500 or less for non-account holders, provided that the individual is registered with that depository institution. These requirements are in response to concerns that recipients of government payments that do not have an established banking relationship often pay unfair or excessive fees to cash government checks. The House bill would limit the check cashing charge to no more than $2.00. Congress could consider an alternative approach that would meet the objective of the Bill that recipients of government payments be able to readily, and at reasonable cost, cash their payments.

The Congress could direct the Federal Reserve to work with the banking industry, consumer groups, and government agencies to develop a model program in which banks could voluntarily agree to participate. Under such a program, banks could provide a direct deposit service for federal, state, and local government payments to individuals that do not hold an account at the bank. The deposit would be made to a non-interest bearing account and banks would charge a fee that would be considerably less than the $2.00 maximum fee permitted

under the House bill. The service would allow the individual to withdraw funds at least once per payment period at an ATM or staffed teller station.

A direct deposit alternative for non-account holding recipients of government payments would provide many benefits. The recipients that currently receive payments by check would no longer have to worry about having a check lost, stolen, or delayed. The potential problems from electronically transmitting a direct deposit payment are far fewer than from mailing a check. Accurate routing information virtually assures that the payment will be deposited at the correct bank and in the correct account.

Direct deposit also assures that payments are available on the payment date. In contrast, delays in receiving checks in the mail are not uncommon and there is always the potential for checks to be stolen or lost. The Treasury Department has reported that for every 1,000 payments made by check, a problem will be reported by a beneficiary. In contrast, only one problem in 9,000 payments is reported for payments made by direct deposit. In addition to reducing the likelihood that a payment will be delayed, problems with direct deposit are corrected much faster. Problems related to direct deposit payments are generally resolved within five days. Problems related to check payments, however, take an average of

two weeks to resolve, if the check has not yet been paid, and up to three months to resolve, if the check has already been paid.

Depository institutions volunteering to participate in the direct deposit program would be motivated to make the program more attractive than check cashing. Direct deposit reduces operational costs to the institution. Studies have shown that processing direct deposit payments is considerably less expensive than cashing checks over-the-counter. The depository institution may also realize an increase in deposits if the entire proceeds of the payments are not withdrawn on the payment date.

The government also realizes operational cost savings with direct deposit. It is estimated that it costs the federal government about $0.34 to issue a check and only $0.03 for a direct deposit payment. The government also benefits from using direct deposit due to the fact that it provides a more dependable and reliable payment method, and problems are more quickly and easily resolved.

Direct deposit continues to gain increased acceptance. Since 1981, the use of direct deposit for individuals receiving Social Security benefits has increased approximately 63 percent. Today, 46 percent of all Social Security payments are made by direct deposit. If the

government agencies and depository institutions promote direct deposit to non-account holders, participation in the program should be quite high.

Individuals could initiate the direct deposit option through the agency making the payments and direct the payments be sent to a bank that participates in the program. The Federal Reserve would provide each agency a list of banks in the area that are participating in the program.

The Board recognizes that not all state and local governments offer direct deposit. Although few states currently offer direct deposit of welfare and unemployment compensation benefits, 39 states currently make direct deposit available to employees or retirees and three additional states plan to offer this payment option. The Federal Reserve and the Treasury could work with state and local governments to develop a direct deposit option for the recipients of these benefit payments.

There are direct deposit programs of the nature being suggested currently in operation. The most notable and successful program is the New York City Department of Human Resources benefits distribution system for welfare and food stamp recipients. In 1986, the Electronic Payments Funds Transfer System (EPFT) had 350 outlet locations, 850 terminals, over 500,000 recipients, and processed over 1,000,000 transactions per month valued at over $2 billion annually. In

the EPFT System, recipients obtain access to their funds using a magnetically encoded, signed photo identification card, which is inserted in a terminal operated by a cash teller. The machines are generally located in non-bank locations.

The Treasury plans to start two pilot programs for Social Security payments similar to the New York City's EPFT program. In fact, one pilot program will piggyback onto the New York program. Under the other pilot program, which will be conducted in Baltimore, master accounts into which payments will be deposited will be established at participating banks. Recipients of these payments will be able to withdraw their funds at ATMs.

Comments on the Truth in Savings Bills

(Title VI of S. 1886; Subtitle E of Title IV of H.R. 5094)

1. Section 608(a) of the Senate bill provides that depository institutions (except credit unions) shall calculate interest using the average daily balance method. This provision should be deleted. Substantive regulation of deposit accounts, such as mandating the method of determining the balance on which interest is calculated, is an area best suited to the states. Furthermore, the balance calculation method is but one of several features consumers may examine in comparing accounts, and disclosure of the particular method used by an institution will permit consumers to shop for the account which best meets their needs.

2. Section 443(a)(3) of the House bill and section 604(a)(3) of the Senate bill should be amended to delete the references to more than one annual percentage yield (APY). As written, these advertising provisions require providing a second APY for accounts that pay a lower rate of interest if a minimum balance requirement is not met. These provisions also require a second APY if a time requirement is not met. Requiring multiple APYs is likely to confuse consumers since a single figure is the best means of comparison shopping for deposit accounts.

Similarly, with regard to disclosures, the reference to paragraph "1" in sections 444(c)(7) and 444(c)(9) of the House bill and the reference to paragraph "1" in sections 605(c)(6) and

Comments on the Home Equity Loan Bills

(Title VII of S. 1886; Subtitle F of Title IV of H.R. 5094)*

1. Section 127A(d) in the Senate version and section 137 in the House version would substantively regulate aspects of home equity lines dealing with a creditor's choice of an index for rate changes, the ability of a creditor to terminate an account and require immediate payment of any outstanding balance, and the ability of a creditor to change the terms of the plan. The Board strongly opposes these provisions and asks that they be deleted from the bill. In the absence of abuse in these areas, these matters should not be the subject of federal regulation. States have responsibility for, and have taken an active role in, regulating substantive aspects of credit transactions, and we believe this arrangement is appropriate. Furthermore, under the disclosure provisions of the bill consumers would be made aware of any provisions dealing with these issues.

2. Sections 127A(a)(1)(B) and 127(A)(d)(3) in the Senate version and sections 127A(a)(6)(B) and 137(d) in the House version give the consumer a new right of cancellation with a

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*References in the following comments, unless otherwise indicated, are to sections of the Truth in Lending Act as it would be amended by the Senate and House versions of the Home Equity Loan Consumer Protection Act of 1988.

refund of fees if the terms offered change after the early disclosures have been given. The Board questions the need for the new right of cancellation. Under current law, the consumer already has a right to cancel with a full refund for three days after opening the account.

3. Section 703 of the Senate Home Equity Act and section 467 of the House Home Equity Act do not provide the Board with sufficient time to adopt regulations implementing the new provisions. The substantive limitations on certain terms and conditions are to become effective 90 days after the date of enactment under the Senate version. The House version gives the Board only 60 days to adopt regulations implementing the act. We urge that the Board be given six months to promulgate regulations implementing the provisions of any new home equity law, and that creditors then be required to comply with the new regulations six months after regulations are adopted.

4. Section 127A(a)(2)(F) in the Senate version and section 127A(a)(2)(G) in the House version provide that the minimum periodic payment amount shall be provided for each year in the 15-year historical table. This requirement should be deleted since it would be of little value to consumers. Open-end credit plans, such as home equity lines, contemplate repeated advances which will change the applicable minimum periodic payment amount. Furthermore, other provisions of both the Senate and House

versions call for disclosure of the minimum periodic payment based on a $10,000 balance and a recent annual percentage rate as well as the payment that corresponds to the maximum annual percentage rate that may be imposed under the plan. These payment disclosures should adequately alert the consumer to the possibility of payment fluctuations under the plan due to rate changes.

5. Section 127A(a)(1)(B) in the Senate version and section 127A(a)(6)(C) in the House version require a disclosure that the consumer should make or retain a copy of the disclosures. It is our understanding that this disclosure is required since the creditor is not required to give the new, early home equity disclosures in a form that the consumer may keep. The bills should be modified to provide that the creditor must give the disclosures to the consumer in a form that the consumer may keep. This would be consistent with the other similar disclosure requirements currently in the Truth in Lending law. If the law does not ensure that the consumer will have a copy of the required disclosures, it is questionable how much value the extensive disclosures will be to consumers.

6. Section 127A(a)(9) in the House version requires creditors to disclose an example, based on a $10,000 outstanding balance and an interest rate recently in effect under the plan, showing the minimum monthly or periodic payment required under the plan

and the time it would take for the consumer to repay the entire $10,000 by making the minimum payments. This requirement should be deleted since it may be confusing or misleading. Open-end credit plans, such as home equity lines, contemplate repeated advances which will change the applicable minimum periodic payment amount and the balance outstanding on the plan. In addition, the consumer is free to pay more than the minimum payment at any time.

7. Section 127A(b)(2)(B) in the House version requires segregation of the disclosures from all other information. This standard should be modified to permit elaboration of any of the disclosed items. For example, section 127A(a)(7) requires a statement that, under certain circumstances, the creditor may terminate the account. Creditors should be permitted to list, with the disclosures, the circumstances under which they may terminate the account. The current provision would not permit such elaboration. The language in section 127A(b)(3) in the Senate version is preferable.

8. Section 127A(c) in the House version and section 127A(b)(1)(C) in the Senate version appear to require third parties to make disclosures, in addition to those provided by the creditor. This provision seems unnecessary in light of the requirement that the creditor must give the same disclosures generally under the same timing rules.

9. Section 462(d) of the House Home Equity Act should refer to section "127A(b)(2)" rather than section "127A(b)(3)." In addition, the Senate version should contain a similar provision amending section 122(b), which deals with inclusion of additional information in Truth in Lending disclosures.

10. Both the Senate and the House versions impose new disclosure requirements for advertisements. These extensive disclosures may discourage advertising of home equity programs and should be deleted. The new disclosure scheme for home equity lines of credit should ensure that consumers receive full disclosure of the terms and conditions of home equity plans very early in the credit process.

Expedited Funds Availability Act Amendments

Payable Through Draft Amendment

Section 471 of the House bill would amend the Expedited Funds Availability Act (the Act) to require depository institutions to treat credit union share drafts that are payable through another bank as local or nonlocal checks based on the location of the credit union, rather than the payable through bank, for a three year period. Regulation CC, which implements the Act, originally provided that the determination of whether a payable through draft is local or nonlocal be based on the location of the payable through bank (where the check is actually sent for collection), rather than the location of the credit union.

The Credit Union National Association (CUNA) brought suit against the Board regarding this provision of the Board's regulation, arguing that institutions should look to the location of the credit union, and not the payable through bank, to determine whether a share draft is local or nonlocal. The U.S. District Court ruled in CUNA's favor. In mid-August, the Board adopted interim amendments to Regulation CC implementing the court order. The amendments require institutions to determine whether a check is local or nonlocal based on the location of the credit union, and not the payable through bank, for the purposes of the determining the permissible hold that may be placed on the check. In addition, the amendments address the disclosure of

bank availability policies with respect to these payable through drafts. Institutions that place holds on checks based on whether the checks are local or nonlocal must either describe how to determine whether a payable through draft is local or nonlocal, or inform their customers that they may inquire regarding the availability of particular checks that are payable through another bank.

The Board recognized that this approach does not provide customers with a ready means to determine the availability of payable through drafts they deposit to their accounts. The Board considered alternative disclosure schemes, but concluded that the alternative schemes would not be workable. Under the rule required by the court order and the House amendment, it is impractical to disclose to customers how to determine whether payable through share drafts and other checks written on an account at one institution and payable through another depository institution are local or nonlocal, and consequently the time those funds will be available for withdrawal. The Act defines local and nonlocal based on Federal Reserve check processing regions. The only practical way to determine whether a particular check is local or nonlocal is by referring to the routing number on the check, which indicates the check processing region to which the check is sent for payment.

Because the routing number on payable through share drafts is that of the payable through bank, and not the credit

union, customers cannot rely on the routing number to determine whether the check is local or nonlocal, and thus cannot determine the hold applicable to that check. There are no other practical methods of disclosing whether a check is local or nonlocal. An institution cannot simply disclose which states are contained in its check processing region, because 44 of the 48 regions include only portions of particular states. In order to disclose the locations in a particular region, the institution would have to list not only the states in its region, but also all the cities and towns in states only partially contained in the region. For some regions, this would entail the listing of hundreds of different municipalities. This disclosure alternative is made even more unworkable by the fact that some credit unions do not include their location on the face of their share drafts.

The benefits of expedited availability are greatly diminished if customers are unable to determine when they may withdraw their funds. The court order and the House amendment make it difficult to fashion disclosures that fully and clearly inform customers of their rights under the Act. In addition to the disclosure difficulties, both the court order and the House amendment make it difficult for many depository institutions to comply with the Act, and increase the risk inherent in accepting certain payable through drafts.

The approach taken in the court ruling and House amendment cause operational difficulties for depository

institutions in their efforts to comply with the availability requirements of the Act, because reliance on the routing number is the only mechanism that can be used to determine whether a check is local or nonlocal in an automated manner, and is thus the only efficient means for institutions to ascertain the length of the permissible hold under the Act. If an institution that places holds on its customers' check deposits were not able to rely on the routing number to determine the length of the permissible hold, determination of the hold that may be placed on a check would have to be made manually, rather than on an automated basis.

The institution would have to first separate the payable through share drafts, and certain other payable through drafts, from all other checks for which the routing number can still be used to determine availability. This is a manual, time-consuming procedure, since other checks written on accounts at the payable through bank may bear the same routing number as credit union share drafts payable through that bank. In addition, certain payable through drafts do not indicate on the face of the draft that it is payable through another bank, adding to the complexity of this task. Moreover, the information on the payable through share drafts will often not be sufficient for a person to determine whether the credit union is local or nonlocal to the receiving institution; the institution's employees may have to refer to a list of municipalities to determine whether

the credit union is located in the receiving institution's check processing region.

The requirement that credit union payable through share drafts be considered local or nonlocal based on the location of the credit union, rather than the payable through bank to which the draft is sent for collection, may increase the risk to the receiving institution. Today, payable through share drafts are often treated as nonlocal checks, due to the fact they must be sent to a distant bank for collection, and thus generally take longer to collect and return to the receiving institution if unpaid. Since payable through share drafts deposited in most receiving institutions are not returned within the availability schedules for local checks, they may become attractive vehicles for check fraud.

For these reasons, the Board urges the Congress to not adopt the amendment contained in the House bill (section 471), but instead adopt an amendment to the Expedited Funds Availability Act overturning the decision of the U.S. District Court. Such an amendment should provide that:

> The term "originating depository institution' means the branch of a depository institution on which a check is drawn or through or at which a check is payable, as prescribed by regulations of the Board.

Other Amendments to the Act

Section 472 of the House bill contains several important amendments to the Expedited Funds Availability Act. These amendments:

(a) Expand the applicability of the exceptions to the availability schedules to checks that must be given next-day availability. Under the Act, a depository institution must make the entire proceeds of certain check deposits available for withdrawal at the start of the next business day following deposit, irrespective of the amount of the deposit, the fact that the check being deposited had previously been returned unpaid, or (except in the case of depository checks) the fact that the institution has reasonable cause to believe the check is uncollectible. The Board believes that the exceptions to the schedules, which are available for other check deposits, should also apply to next-day checks in order to control the risks of fraud that may result from the unavailability of these exceptions.

(b) Limit the next-day availability requirement for Treasury checks and "on us" checks to checks deposited at a staffed teller facility. Congress required cash and most other deposits be deposited at staffed teller facilities in order to receive next-day availability, because it recognized the difficulties in ascertaining the contents of deposits at ATMs and other unstaffed facilities in time to update a depository institution's books so that it can make funds available for withdrawal at the start of the next business day. These same considerations should apply to Treasury checks and "on us" checks.

(c) Provide greater flexibility in the manner of giving notice to the depositor that an exception has been invoked. The Act requires notice to be provided to the customer each time an exception is invoked. In certain cases, it would be more efficient and less costly to depository institutions, as well as more useful to the customer, if the Board had the flexibility to tailor the notice requirement to the exception invoked. For example, under the amendment a single notice to repeated overdrafters describing the special schedules applicable to the account for the time that the exception is in effect may be appropriate.

(d) Explicitly subject state and local governments on which checks are drawn to liability rules for violations of the Board's check collection and return requirements. State and local governments often issue warrants drawn directly on themselves to pay employees, vendors, pensioners, and those receiving public assistance. However, the Act does not clearly authorize the Board to allocate liability for losses, such as those resulting from the mishandling of a returned check, among entities such as states or local governments.

(e) Defer civil liability for violations of the Act's disclosure and notice requirements from September 1, 1988 to January 1, 1989. Given the relatively short lead time from the adoption of the final regulations in May to the effective day of the Act on September 1, and the complexity of the availability

requirements that must be disclosed, the Board believes it is appropriate to provide a several month grace period from civil liability for depository institutions, to provide them additional time needed to ensure that they are in compliance with the requirements of the Act and Regulation.

The Board supports the adoption of these amendments, contained in section 472 of the House bill. Section 907 of the Senate bill contains an amendment similar to amendment (a) of the House bill, expanding the applicability of the exceptions to the schedules to checks that must be given next-day availability. The Senate amendment, however, does not fully expand the use of all of the exceptions to every check deposit subject to next-day availability. The Board believes that all of the exceptions to the schedules should be available to all check deposits that are subject to next-day availability. In addition, the Senate amendment provides an additional notice requirement to the purchaser (who is often not the depositor) of a depository check, disclosing the fact that the amount of the check in excess of $5,000 may be subject to a longer hold period. The Board believes that this additional notice will be of little benefit to the depositors of these checks. For these reasons, the Board prefers the House version of this amendment.

Comments on Amendments to the Equal Credit Opportunity Act (Title IV, Subtitle H, and Title VIII of H.R. 5094)

1. The Equal Credit Opportunity Act (ECOA) makes it unlawful for creditors to discriminate against an applicant in a credit transaction on the basis of race, sex, and other prescribed factors. Section 703(a) of the ECOA establishes the Board's rulewriting authority for implementing the act, and authorizes the Board to provide for exceptions from the act's coverage. In particular, the Board may exempt from the ECOA any class of transactions not primarily for consumer purposes, if the Board makes an express finding that the application of a provision or provisions of the act would not contribute substantially to carrying out its purposes. Pursuant to that authority, the Board has provided limited exemptions from some of the ECOA's requirements for business credit and certain other transactions.

Subtitle H, §481, of Title IV would modify the Board's rulewriting authority under section 703(a). The proposed amendment provides that the Board could continue to exempt certain transactions from the act's requirements; however, the Board would have to hold a public hearing in accordance with the Administrative Procedures Act (APA) prior to granting an exemption applicable to consumer credit transactions or business purpose loans. (In the absence of a statutory requirement for a hearing, a notice and comment period ordinarily satisfies the APA requirements.) An exemption would end after five years and the

Board could extend it only after conducting another public hearing.

The proposed amendments also would establish two specific requirements for business loan transactions not exempted by the Board. Creditors would have to maintain records on business loan applications for a minimum period of one year and would have to give rejected loan applicants a written notice of their right to receive a written statement of the reasons for a credit denial.

The Board opposes the procedural requirement of a public hearing as a prerequisite to the granting of an exemption for a number of reasons. First, while a hearing might focus attention on small business lending generally -- the area of primary concern to the sponsors of the proposed amendments -- a hearing is not likely to serve any rulemaking purpose that cannot be satisfied just as well by the APA's written notice and public comment procedures. Second, although the bill sponsors' area of concern relates to business credit, the hearing requirement (as the bill is drafted) also would affect other existing exemptions in Regulation B for securities credit, public-utilities credit and incidental consumer credit (credit extended by a doctor or a dentist, for example). These are categories whose treatment under the current regulatory exceptions has never been at issue. Third, the sunset provision -- requiring another public hearing after five years to determine the need for a continued exemption -- is an unnecessary procedure given that the Board already has

in place a policy for the reevaluation of regulations at five-year intervals.

And finally, if Congress enacts the proposed record retention and notification requirements for certain business transactions, little would remain to be addressed in a hearing. The two other regulatory exceptions now applicable to business credit -- the rules on furnishing credit information to third parties (which are not relevant in the business context) and the rule concerning marital status inquiries -- can be eliminated by the Board under the notice and comment procedures customarily followed in the rulemaking process. In light of all this, it appears even more unlikely that administrative procedures in the form of public hearings would add in any significant way to an evaluation of exemptions for business purpose loans, or that they would provide for a more effective rulemaking process. The Board therefore strongly recommends the elimination of the public hearing requirement from the bill.

On the other hand, the Board has no particular objection to the substantive provisions of the bill relative to record retention and notification requirements, so long as an appropriate exemption can be provided for transactions in which the application of these provisions would not contribute substantially to effecting the purposes of the ECOA. For example, an exemption from the record retention and notification requirements could be provided for business loans based on dollar amounts. The Congress could establish a statutory limitation of

a certain dollar amount (such as loans under $100,000), or it could set a cutoff based on the size of the borrower. If instead the Congress chooses to leave that determination to be made by the Board through implementing regulations, it would be helpful for the legislative record to delineate clearly the factors to be taken into account in setting the cutoff.

Finally, the Board believes that, as a technical matter, some redrafting of the proposed amendments is needed. For example, the substantive requirements dealing with record retention and written notice more appropriately belong as part of section 701 of the ECOA rather than in the provision on rulemaking authority.

2. Title VIII of H.R. 5094 would expand the coverage of the ECOA. Currently, Section 701(a) of the ECOA makes it unlawful for a creditor to discriminate in a credit transaction on the basis of race, color, national origin, religion, age, sex, marital status, and certain other bases. Section 804 of the House bill would amend the Act to also make it unlawful for a creditor to discriminate "on the basis of any course of study pursued or intended to be pursued by the applicant."

The Board does not support this amendment. The ECOA, in the tradition of other civil rights legislation, outlaws credit discrimination that as a matter of national policy the Congress has found to be offensive because it is based on factors such as race and religion. In the Board's view, "course of study" does

not rise to this level of significance; indeed, its inclusion among the "prohibited bases" would in a sense belittle the importance of the existing factors.

The Board also believes the amendment is unnecessary. Last spring a great deal of media attention was given to one card issuer's practice of taking a student's course of study into account. Stories about the creditor's rejection of liberal arts students received wide circulation. Based on the negative publicity the creditor soon announced the abandonment of this policy, and the Board believes it is unlikely that other creditors would now adopt it.