NOT RELEASED

Remarks by

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Today I am going to talk about the Community Reinvestment Act and some of the intended and unintended results of its progressive augmentation and implementation.

Certainly among bankers and community group and civil rights leaders the CRA is one of the hottest topics around and the level of controversy has sustained and heightened the interest and participation of Members of Congress. The public disclosure of CRA ratings, mandated by Congress, has sharpened the focus on the CRA performance of banks and provided the media a potentially controversial topic for exploitation. And banks, already bent under a heavy burden of overregulation, have focused much of their lobbying efforts against what they see as a crushing and unnecessary burden of record keeping in order to prove CRA compliance.

All of this creates a highly charged environment which is probably not going to go away in the near term for several reasons which I will get to a bit later. For now, let's step back a bit from the controversy and take an objective look at CRA -- what it is and what it is not.

At first glance the CRA is a rather simple straightforward statute only a few pages long. The law formally establishes the obligation of banks to help meet the credit needs of the entire community. That obligation is inherent in the charters granted to banks which require that they meet the convenience and needs of the communities in which they operate. CRA makes that obligation an affirmative one by requiring banks to deliberately and specifically assess and help satisfy the legitimate credit needs in low and moderate income neighborhoods just as they presumably do in more affluent ones.

But it is just as important to understand what CRA does <u>not</u> require.

-- It does not require banks to make bad loans.

-- It does not require banks to make loans at rates below market.

-- It does not require banks to make charitable contributions.

-- It does not require banks to make every type of loan or to try to meet all of a community's credit needs by itself.

-- It does not require a specific number of loans or specific percentages of loans to various kinds of borrowers.

-- It is not an attempt at credit allocation.

Those "it is nots" need to be remembered by both bankers and regulators if we are to keep CRA in perspective.

I am sure most of you are aware of Peter Uberroth's efforts to organize the rebuilding of the devastated neighborhoods in Los Angeles. He has appealed for broad corporate support and investment on the grounds that it is "good business" to rehabilitate the physical structures and assist the inhabitants of the neighborhoods and the operators of local businesses.

I am personally firmly convinced, based on my own direct experience in New York and Boston, that an intelligently managed CRA compliance effort is good business and can be satisfactorily profitable. Now, let's examine that statement in the context of what the statute and related regulations require banks to do.

1. Make a conscious assessment of community credit needs by contacting individuals and organizations in the

targeted community, including low and moderate income neighborhoods.

2. Develop products designed to help meet those particular needs.

3. Market those products throughout the community, including to low and moderate income areas.

4. Establish mechanisms for senior management and the board of directors to monitor and oversee the CRA program as they do other parts of the bank's operation.

That doesn't sound like heavy lifting. In fact, it sounds like normal business practice. The difference is that it is specifically directed at that part of the community often overlooked -- the low and moderate income sector. Many banks, including both of the ones I have been associated with, have followed those good business practices and in the process have generated good profitable business with no greater incidence of loss than in other business lines.

Conferences, like this one sponsored by the Federal Reserve Bank of Dallas and other Reserve Banks across the country, have helped bankers to get acquainted with a variety of approaches to sound lending programs in low and moderate income neighborhoods.

A particularly effective way to address CRA issues is through community development lending and investment. Public-private partnerships are useful tools which enable banks to share loan and investment participation with local, state, or federal agencies. Those partnerships often make possible projects which neither the public nor the private sector could accomplish alone. Partnerships sometimes offer special access to credit enhancements which can make the project work.

-- Loan guarantees, interest rate subsidies, blended rate loans, and equity investment options improve loan quality and the partnership concept enables a bank to share costs as well as risks.

-- You have heard a lot about community development here. It works in rural development as well as low and moderate income housing and small business financing.

-- Another technique being used more frequently now is the consortium. Banks, corporations, and government join together to create pools of loan and investment funds for small businesses or low and moderate income housing. These are attractive vehicles of participation for lenders who lack experience themselves in these specialized fields. Massachusetts, Florida, California, Washington, and New York all have successful examples of community lending consortia.

-- In addition to partnerships and consortia, CDCs are useful vehicles for some banks and bank holding companies. Recently this technique has been more widely used to focus on small business development and economic revitalization to create local jobs.

The variety of mechanisms to create programs with greater clout and more safety for the lender put affirmative CRA programs within reach of almost every bank. But, like all bank lending programs, any CRA effort will fall short or will be disappointing as to profitability if it does not have behind it a firm commitment of financial and management resources and the participation and oversight of senior management and the directors.

The quality of the corporate citizenship of banks has become a topic of interest to the Congress, the media, and the general public. That interest has been fueled by public disclosure of CRA ratings and HMDA data, just at a time when confidence in banks and bankers is badly shaken by scandals, bank and S&L failures, and the cost of the Resolution Trust Corporation, and refinancing the Bank Insurance Fund.

While the Congress' rationale for using the banking system for social engineering is based on the public backing for deposit insurance and other aspects of the federal safety net, there is also the practical reality that most governments lack the fiscal resources to do it by themselves. In addition, there is a sobering realization in recent years that public housing projects on balance have been a dismal failure.

To put local teeth in the federal requirements many state and local governments have linked their own deposit and finance activities to banks who are active participants in community lending for housing and job-producing revitalization.

And the incentive carrots are not just being used by governments. The American Bar Association has decreed that its funds will only be deposited in banks with a satisfactory CRA rating. The U.S. Postal Service now advises postmasters of the CRA rating of the local banks. That information is to be used as one of the criteria in choosing which bank the local post office will choose to deal with.

The HMDA data which were released last fall were broadly interpreted as confirming long-held beliefs that banks discriminated against minorities in mortgage lending. This still unconfirmed conclusion led many to question whether, in fact, banks are serving their communities properly since minorities are certainly a vital part of those communities.

There was an immediate outcry from interested parties for testing and investigations to determine if illegal discriminatory practices were denying minorities of access to mortgage credit. However, the evidence of the HMDA data is inconclusive since it establishes only differences in denial rates between whites and minorities and not the underlying reasons.

Several efforts are under way to obtain the additional analytic information to determine whether discrimination is responsible for the disparity in the statistics. One study under the guidance of the Federal Reserve Bank of Boston is examining detailed information from applications and bank records to determine reasons for denial. Results will not be available for some months, but when available they may suggest additional data to be collected in the HMDA exercise or give clear direction to examiners to be on the alert for discrimination in some institutions.

Banks themselves have initiated some investigative and remedial actions. Some have shopped or tested their own mortgage lending operations and others, disturbed by the data, have gone into their own records to determine if decisions on mortgage applications were unfair and discriminatory.

The new cycle of HMDA data will be released to the banks this month and will undoubtedly be closely scrutinized by the public and the Congress as well. It will be important for banks to analyze their data and look into the underlying internal information in order to understand fully what is going on in their own institution. The process may be painful for some institutions, but in the final analysis it will help pinpoint where and whether discrimination is practiced and enable the banks where it exists to clean up their act and fully comply with the laws of the land.

To say that all of this is of interest to Congress is probably a gross understatement. Over the past three years the Federal Reserve has testified at more hearings on CRA issues than in the entire ten-year history of the Act prior to that. The 1989 FIRREA Act required public disclosure of CRA evaluations and ratings and FDICIA requires reporting by banks of small agricultural and small business loans. All of these initiatives reflect heightened concern over the banks' role in supporting their community and now Senate Banking is scheduling a round of hearings to review recent changes to the Act and how they have been implemented.

Included in FDICIA is a section called the Bank Enterprise Act which would give banks lower FDIC insurance premiums if they increased their lending to low and moderate income borrowers. And lower premiums would be assessed on those banks which started or increased lifeline banking services for low income depositors. The effect of these changes on funding for the Bank Insurance Fund is potentially significant.

Another initiative of Senator Riegle, chairman of Senate Banking, called the Community Development Demonstration Act, would provide federal funding to help bank holding companies capitalize chartered "development banks," community development corporations, or other institutions focused exclusively on lending to low and moderate income borrowers. That bill is in the very early stages of consideration.

Congressional interest, then, is heightened rather than diminished and my guess is that if banks can't demonstrate that they are aggressively tackling the credit-related problems of minorities and low and moderate income citizens, Congress will legislate new specific requirements for banks to meet.

In that context, the role of bank supervisors is clear. We must assure compliance with existing law and regulation and we must assist the banks in understanding their obligations and how best to satisfy regulatory requirements. Obviously, an audit trail is essential and this has created a heavy burden on banks large and small. On June 17th the regulatory agencies issued revised examination procedures designed to relieve some of the burden -- particularly by lessening record keeping for smaller banks. It is our job to make examiners understand and comply on their part as well. There have been other proposals to relieve smaller banks from CRA formalities and to relieve top-rated banks from application protests. But neither of these initiatives, in my opinion, will fly very far in Congress.

The odds are 10-1 that if we were to conduct a survey of bankers asking what federal statute and regulations they found most distasteful and burdensome, the answer would overwhelmingly be that CRA is unwanted, unneeded, and staggeringly burdensome in terms of record keeping. It would also be pointed out that applications are routinely protested by community groups, even though the bank may have a satisfactory rating, in the hope of gaining additional commitments in return for a withdrawal of the protest. This prolongs the application process, increases costs, and in the end accomplishes very little.

I am sympathetic to much of the bankers' reaction. But I would argue that it is the mandatory nature of the requirement which makes bankers contentious. I would also argue strongly that, conducted properly, CRA lending can be damn good business and, once the systems are established, the record keeping requirements are essentially routine.

In any case, CRA is here to stay. Compliance is a major public benefit and can be a profitable business for banks. The Federal Reserve System stands ready to help banks understand what is required and how to meet those requirements. We appreciate your interest and your attendance at this conference and I appreciate your courtesy in listening to my views on this important subject. Thank you.