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Statement by

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Member, Board of Governors of the Federal Reserve System

before the

Subcommittee on Consumer and Regulatory Affairs

of the

Committee on Banking, Housing, and Urban Affairs

of the

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SUMMARY

The Board believes that the purpose of CRA can best be accomplished when the process is, to the extent possible, open to public view and input. Recent action by the financial regulators in issuing the CRA Policy Statement, which encourages institutions to better inform the public regarding CRA activities, underscores the idea that people well-informed about the activities of their local financial institutions are better equipped to participate in the CRA process. We continue to be committed to widening the channels of communication among banks, communities and regulators, but believe this should be done without making the regulatory process for CRA more complicated or costly, or imposing delays on those institutions with good records of performance.

Over the last ten years the Federal Reserve has established a three-faceted program to carry out our mandate under the CRA. The program includes CRA examinations by specially trained examiners approximately every 18 months for most state member banks, Community Affairs Officers at each Reserve Bank, and consideration of the CRA record of banks in connection with applications received under the Bank Holding Company and Bank Merger Acts. A major thrust of the CRA Policy Statement adopted by the federal financial supervisory agencies is to shift the CRA emphasis away from the applications process and to build stronger, enduring mechanisms for outreach and service by institutions to their communities on an ongoing basis

The CRA revisions in S. 909 would require that the numerical ratings and a written assessment of an institution's CRA performance be made available to the public. We support the concept of public disclosure of an assessment of each institution's CRA record of performance as we did in our testimony last September. We would like to emphasize that the written evaluation should be a summary of the examiner's conclusions and support for them, but not the same as the examination report itself. Because of our concern regarding credit allocation, we do not support the concept that the evaluation should place special emphasis on low- and moderate-income housing, small business and small farms loans. Additionally, we are strongly opposed to public disclosure of CRA ratings which, like commercial bank examination ratings, have been treated with strict confidentiality by all the regulators.

Other revisions to the CRA considered late last year comprise a broad spectrum of measures pertaining to CRA examinations, assessment factors for CRA performance, and the treatment of CRA issues in the application process. While we believe that public consideration of the CRA assessment has merit as discussed earlier, we have strong reservations regarding many of the provisions in this proposal that would, in our view, unnecessarily encumber existing administrative procedures for CRA enforcement.

With regard to the government check cashing and basic banking bills, the Board shares the belief that banking services should be widely available and has issued a policy statement to this effect. However, the Board has sponsored surveys that do not appear to reveal a significant decline in account ownership over the years. In addition, while various surveys have reached different conclusions, there is evidence that suggests that check cashing services and basic banking accounts are being made available. Accordingly, it is not clear that a problem that would warrant such legislation is present at this time.

The Board has other concerns with these bills. First, the Board does not believe it is wise for government to require that specific banking services be offered and to set the price for such services. We are also concerned by the potential for fraud that would exist if the check cashing bill is enacted. In addition, the basic banking bill could result in a standardization of account offerings and reduce the likelihood that institutions will offer products that are tailored to the particular needs of their customers. Finally, we believe that alternatives such as electronic delivery of government benefits should be explored instead.

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STATEMENT

Thank you for the opportunity to provide the views of the Board of Governors of the Federal Reserve System on legislation relating to the Community Reinvestment Act (CRA), the Government Check Cashing Act of 1989, and the Basic Banking Services Access Act of 1989.

The CRA revisions in S. 909 would require that the numerical ratings and a written assessment of an institution's CRA performance be made available to the public. In addition, S. 906 would require depository institutions to cash government checks at cost for non-customers provided that such persons have registered with the institution. S. 907 adds the requirement that depository institutions offer, for minimal fees, "basic financial services accounts" that have low minimum balance requirements and permit at least 10 withdrawals per month.

Community Reinvestment Act

To preface our discussion of the legislation pertaining to the CRA, I'd like to underscore our belief that the purpose of the CRA can best be accomplished in an arena which is, as much as possible, open to public view and input. Recent actions by the Board in concert with other regulators have echoed a theme that seems to be at the heart of the proposals before you today -- that people well-informed about the activities of their local financial institutions are better equipped to participate effectively in the CRA process. We are also committed to widening the channels of communication among banks, their

communities and regulators, but we believe this should be done without making the regulatory mechanisms and procedures for the CRA more complicated, costly, or apt to impose delays on those institutions with good records of performance.

I'll begin by describing briefly the three-faceted program we've established to carry out our mandate in enforcing the CRA. First, the Federal Reserve's specialized consumer compliance examiners conduct examinations of CRA performance about every eighteen months for most state member banks, and more often for those with identified weaknesses in their record. The examination takes a comprehensive look at the bank's activities to address credit needs in its market, including those of low- and moderate-income areas, as well as the kinds of relationships it is forging with specific segments of the community. Second, through the community affairs office at each of the Reserve Banks, we provide information about community development strategies and techniques to banks, bank holding companies, and others. One of our primary goals is to become familiar with the credit needs within the Federal Reserve districts, and then help banks construct programs which respond to those needs. Third, we consider the CRA record of banks in connection with applications received under the Bank Holding Company and Bank Merger Acts; CRA performance is taken into account along with legal, financial, managerial and competitive factors.

Our commitment to enhancing the role the public plays in the CRA process has been a long-standing one. For more than ten

years, we have endeavored to ensure that CRA examinations are not conducted in a regulatory vacuum -- Federal Reserve examiners routinely interview businesspeople, government officials, housing and other community group leaders in the bank's community to learn about the local economic environment and the perceptions these individuals hold of their local financial institutions. We require institutions to keep a file of letters commenting on their CRA performance from members of the community; examiners review those letters, as well as the institutions' responses to them. Careful attention is also given to public comments on CRA performance, or protests, received in connection with an application. Yet our experience with the CRA leads us to believe that more can be done to open up the process -- and that is precisely the direction in which we are moving.

In March of this year the Board, together with the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board adopted a CRA Policy Statement to provide guidance to institutions and to community groups, and to clarify a number of issues which have arisen in enforcing the CRA. For example, institutions are presently required by regulation to prepare, annually update, and make available for public review a CRA Statement listing the loan products they are willing to extend. The new policy statement urges each institution to significantly expand its Statement to paint a picture of the institution's overall approach to CRA, describing strategies for marketing and advertising, credit needs

assessment and new product development, past accomplishments and future plans. Naturally, the size, resources and location of an institution will influence the CRA Statement's degree of detail and its scope. While an expanded statement laying out the details of its CRA efforts may be extremely useful to a large bank in a major city, it may simply not be necessary for a small bank in a rural setting to go into similar detail.

A major thrust of the policy statement is to shift the "CRA spotlight" away from the applications process -- with the pressures imposed by our timetable guidelines for completing the process -- and to build stronger, enduring mechanisms for outreach and service by institutions to their communities. We think the expanded CRA Statement is an ideal vehicle for doing that by focusing the attention of an institution's management, and of the public at large, on the institution's record on an ongoing basis, and on any areas needing improvement. At the same time, we have strongly encouraged community organizations to take advantage of the expanded CRA statements as a starting point for discussion, bringing their concerns to the attention of an institution's management -- to the greatest possible extent -- in the framework of a continuing dialogue, rather than in a protest situation.

A second important policy direction emphasized in the new policy statement should be borne in mind in considering proposed legislation. That is, that institutions desiring to expand their operations should have appropriate CRA policies in place, and

working well, before filing an application. That means that while commitments by applicants for future actions may be used to address specific problems in an otherwise satisfactory record, making commitments to improve in the future should not be seen by applicants as a way to compensate for a seriously deficient past record of performance.

This approach was demonstrated earlier this year in the Board's denial of an application by Continental Illinois Bancorp, Inc., of Chicago, Illinois, to acquire an Arizona bank. In its order, the Board described, and took a positive view of, a plan developed by Continental to correct shortcomings in its CRA performance, which was in initial stages of implementation. Yet the prior record failed to demonstrate, in the words of the Board's order, "a basic level of compliance on which the commitments can be evaluated." The Board's handling of the Continental case should not be interpreted as evidence of any lessened willingness to work with institutions directly, or through their primary regulators, to improve their record. While there were reasons for the Board's denial in addition to CRA factors, the case does give a clear signal that, with respect to the CRA, institutions should "put their houses in order" before considering expansion. It also highlights the importance of an established record of performance under the CRA.

S. 909

In light of these developments, let me now turn our attention to S. 909, which would amend the Community Reinvestment

Act to require the regulatory agencies to prepare written evaluations of institutions' performance under the Act, and to make those evaluations public. We support the concept at the core of Senator Metzenbaum's proposal; in fact, you may recall that Governor Johnson endorsed the idea of regularly publishing an assessment of each institution's CRA record by our examiners in testimony before this Committee last September.

But one point is especially worthy of emphasis with regard to the nature of the written evaluations for public release that we support. Though the public evaluations we support would summarize the examiner's conclusions, together with supporting information related to the CRA assessment factors, these evaluations would not be the same as the examination reports themselves. Neither would they divulge material contained in the examination report which is important for supervisory purposes, but must be treated confidentially -- such as information about the financial condition of the institution, and any sensitive information about its employees, customers or members of the community. We believe the relevant provisions of S. 909 should be written to recognize the distinction between the examination report that is given to the bank and the summary assessment that we believe can usefully be made public.

The objective of that proposal was to tell people at the community level in a concise, straightforward and timely way how well their local institutions are doing under the CRA. Doing so should facilitate exactly what we are endeavoring to do through

the Policy Statement just described -- promote the early start of a constructive dialogue about CRA achievements and goals. Those concerned about affordable housing, minority businesses, inner city reinvestment and many other areas will have the benefit of knowing how these factors have been weighed in assessing the record, and what areas for improvement have been identified.

We do, however, have serious concerns about two aspects of the proposal. First, the written evaluations of each institution's performance would be required to emphasize three specific types of credit -- loans for low- and moderate-income housing, small business and small farms. We believe this is inconsistent with the intent of the Act itself, which does not impose any specific lending requirements. Rather, institutions have a responsibility to help meet local credit needs utilizing their own expertise and resources.

Because needs vary widely from community to community, we would be remiss in rigidly focusing on these three credit categories in making our evaluations. CRA examiners aim to take a broad picture, instead of a snapshot, of all activities by an institution that foster community revitalization -- principally direct loans of all kinds, but also, for instance, participation in the secondary market, purchase of state or municipal bonds, and investment in or technical assistance to community development projects. Examiners do look at the amounts and distribution of credit extended for housing, small business and

small farms, not with the intent of making a quantitative analysis of an institution's lending, but in order to gain a full, balanced view of its service to the community.

Secondly, the bill would mandate public disclosure of the numeric ratings assigned during examinations. Historically, CRA ratings, like commercial examination ratings, have been treated with strict confidentiality, as required by procedures adhered to by all regulators. The ratings were designed as a kind of supervisory shorthand to help us monitor those institutions needing closer attention; the numeric rating is in no way a self-explanatory indicator of performance. Moreover, a rating assigned at a particular date in the past can be misleading, given that CRA performance should be seen as a process developing over time, rather than a static state of affairs. At the very least, release of the rating number would divert attention from the substance of examination findings. Of even greater concern is the potential for the undermining of public confidence in the safety of deposits in an institution, if an adverse CRA rating were to be misunderstood as a reflection on its financial soundness. Much more can be achieved by making public only the narrative evaluation, as suggested by Governor Johnson last September.

CRA Amendment to H.R. 176

Your letter asked that we address other CRA changes proposed in an amendment to H.R. 176 late last year. This proposal comprises a broad spectrum of measures pertaining to CRA

examinations, assessment factors for CRA performance, and the treatment of CRA issues in the applications process. Here again, we believe the aspect of the proposal dealing with a public CRA assessment has merit. Our overriding concern, however, is that many of its provisions unnecessarily encumber existing administrative procedures for CRA enforcement.

First the bill requires in Section 804(b) that the agencies give public notice prior to commencing CRA examinations. Presumably this would be done through newspaper advertisements, since it must be given "in a manner reasonably designed to reach members of the community served by the institution under examination" -- although the use of lobby notices in the institution, or publications currently disseminated by each Reserve Bank which list pending applications might also be envisioned.

To gauge the implications of this proposal, Reserve Banks surveyed local newspapers to estimate the costs involved in running the 26,500 notices which we estimate would be required every two years for the examinations by all the federal regulators, assuming every institution is examined at least every two years. The total bill would be on the order of $1.24 million biannually, taking into account price differences in urban and rural areas. Time involved in identifying suitable newspapers and making publication arrangements could add considerably to the price tag.

As stated in the proposed statutory language, the reason for the provision is to allow any person to submit comments on an institution's record in connection with CRA examinations. Actually, this has long been our practice. In the Federal Financial Institutions Examination Council's A Citizen's Guide to CRA, for example, community members are encouraged to discuss their concerns with the institution's regulatory authority, particularly through the public file, the maintenance of which is one of the CRA's statutory requirements. As indicated in the Guide, persons who request to speak to a Federal Reserve examiner in letters to the public file will be contacted during the next scheduled examination.

In reality, we go far beyond this provision, in that we welcome comments about any institution's performance at any time, not just in connection with examinations, and we take them very seriously. We also seek out public input each time we conduct a CRA examination through the community contact interviews I mentioned earlier. In 1988, Federal Reserve examiners alone interviewed some 925 consumer advocacy groups, housing coalitions, local business and trade associations, as well as local government officials, and factored their comments into their assessments of CRA performance. Given the totality of these efforts, we do not believe this additional expense for soliciting public comments in the examination process is necessary.

The bill's Section 804(e) calls upon the agencies to prepare and make public its assessment of each institution's performance under the CRA. This concept has our support, for the reasons already discussed in connection with Senator Metzenbaum's proposal. There is, however, a need to clarify that the assessment would be separate and distinct from the examination report and the numeric rating.

Provisions of the bill's Section 805 regarding the consideration of CRA performance in the application process are troubling to us. We note that it would require the agencies to rely on the "most recent assessment of such record" in considering an applicant institution's performance. Experience has shown us that the most recent assessment may not always be the only, or most reliable, indicator of current performance, especially when the examination report is outdated, or when an institution has undergone a major internal change, such as turnover in management. In such instances, the flexibility to look beyond the latest examination report for up-to-date information accurately reflecting present performance is essential.

Section 805(e) sets out timing requirements for agencies to complete their assessments of CRA records in the framework of applications that we think are unnecessary and unwise. You may be aware that under Regulation Y, the Board has imposed on itself a 60-day guideline for processing applications. The vast majority of domestic bank and bank holding company applications

are processed well within the 60-day goal; in both 1987 and 1988, the average processing time for over 4,000 domestic cases, including those with CRA issues, was 39 days.

Under the Board's Rules of Procedure, the presence of a CRA protest or an adverse assessment by any agency makes the case a matter for Board attention -- though it may be returned to the Reserve Bank after Board staff review. It also can make the process more complex, requiring a thorough, and frequently time-consuming, analysis of the issues. In many instances, it is necessary for us to seek out additional information from the applicant, or its primary regulator, to fully address these issues. This is why we are not always able to meet the 60-day target, although delays have generally not been inordinate; in 1987, average processing time for the 37 CRA-protested cases was 73 days and in 1988, for 32 cases, it was 87 days.

At the outset, we would question whether imposing statutory timeframes on applications processing would achieve the desired end. They would seem to hamper, rather than help, our efforts to give appropriate attention to convenience and needs considerations in applications, especially where an applicant's performance has been marginal, or where the applicant is not readily able to provide detailed information about its record.

Apart from our general concern about these requirements of the bill, other aspects of the bill's timing provisions are unclear. CRA is only one of many issues considered as part of these applications. The Board also considers legal, financial,

managerial, and competitive issues, as well. The draft seems to speak only of those cases where CRA issues are brought forward through a protest. In fact, CRA issues may also be uncovered by Federal Reserve Bank or Board review, when any of the banks party to an application have been assigned adverse CRA examination ratings by any of the agencies' examiners. In addition, the draft appears to require that the CRA assessment in an application be completed by a certain time in the application process, whether or not the analysis of any other issues the case might raise have been completed and the overall case is ready for final decision.

Let me mention briefly our policy regarding extensions of the comment period since misperceptions about our policy may have sparked interest in the statutory timeframes. We believe it is incumbent on persons desiring to comment on an applicant's CRA record to do so within a 30-day period; otherwise, we may be unable to give their comments the attention they deserve, and still carry out our responsibility to process applications in a timely manner. In a very few circumstances we do find an extension of the comment period is warranted -- where the application has not been promptly made available for inspection by the parties, for example, or in the rare event there has been inadequate public notice of the application. But we do not think it is appropriate to extend the comment period -- and possibly delay the Board's decision on the case -- simply because the commenter wants more time to pursue negotiations with an

institution under the pressure of a pending application. The agencies' recent Policy Statement stresses this point.

In summary, the amendment to H.R. 176, in our view, poses a number of problems. Most importantly, it would make more rigid and cumbersome procedures which for the most part are already in place for enforcing the CRA, without presenting any really new approaches to make the process work better. We stand ready to answer any questions you may have, and to continue working with the Committee in this key policy area.

Check Cashing and Basic Banking

Let me turn now to the government check cashing and basic banking bills that are under consideration. These result from concerns that are similar to those that motivate the Community Reinvestment Act. Not only are some questioning whether banks are meeting the credit needs of their communities, but concerns have also been raised that low- and moderate-income persons may not have ready access to banking services. In particular, the focus has been on the need to cash government checks and to have an account for making a limited number of payments to third parties.

The Board is quite familiar with these concerns. Since 1977, we have sponsored four surveys that determined, among other things, the number of families that do not have depository accounts. While the General Accounting Office has reported a higher number, our research suggests that the overall percentage of families without accounts has remained fairly constant at

about 8-12% between 1977 and 1986. This research has also indicated that roughly 30% of the families whose income falls in the lowest quintile do not hold accounts. Although the percentages for this latter group have fluctuated, the numbers were more or less the same in 1986 as in 1977. Thus, while many low-income families do not have accounts, the fact that the percentage has remained relatively constant suggests that the increase in fees and minimum balance requirements in recent years has not caused a significant decline in account holding. There are probably more fundamental reasons for much of the lack of account ownership. For example, the convenience of check cashing alternatives, the fact that these families may have few bills to pay, and the difficulties in managing an account with limited resources may explain, to a large degree, why some low-income families do not have an account relationship. Also, it may be some people simply do not trust banks and prefer not to deal with them.

Nevertheless, we share the belief that banking services should be widely available to all. Several years ago, the Board adopted a Joint Policy Statement on Basic Financial Services with the other federal financial regulatory agencies and with the state financial institution regulatory associations. The Policy Statement encouraged financial institutions to recognize the need of consumers for a safe and accessible place to keep money, the need to obtain cash (including cashing government checks), and the need to make payments to third parties. The Policy Statement

encouraged institutions to continue to develop account products that are responsive to these needs.

In the Policy Statement, the Board supported a voluntary rather than a mandated approach so that institutions could have flexibility in developing account products that meet the particular needs of their customers. That remains our preference, and we oppose legislation to require institutions to offer specific banking services.

First, it is not clear that these services are so widely unavailable at present that legislation is warranted. Over the last several years, a number of surveys have been conducted to assess the availability of basic banking and check cashing services. While results vary, there is evidence that a widespread problem does not exist. For example, in its recent report to Congress on government check cashing, the GAO reported that, as of 1985, 86% of banks and 55% of thrifts cashed U.S. Treasury checks for non-customers. The American Bankers Association reports that over half of all banks, and over 70% of large banks, offer basic banking accounts and that the number of institutions offering such accounts has increased dramatically over the years. Following a survey of virtually all financial institutions in New York state, the New York State Banking Department found that low-cost banking services are widely available and that the vast majority of low- and moderate-income persons have ready access to such accounts. In a 1987 report,

the GAO found that a 74% of financial institutions provide low-cost accounts to senior citizens.

These surveys suggest that check cashing services are often available to non-customers who choose to use them and that a substantial and increasing number of financial institutions voluntarily offer basic banking accounts. Consequently, the Board does not believe that enough of a problem has been demonstrated to justify sweeping legislation.

The Board has a number of other concerns with this legislation. First, as a general matter, we question whether it is wise for the government to mandate the services that financial institutions must provide. This is particularly so when the legislation involves setting the fees for such services. If there are problems in the way government funds are delivered to recipients, then it seems that the government should itself assume more responsibility for addressing the difficulty. For example, it might be useful to explore the possibility of using federal post offices to provide check cashing services to holders of government checks since they offer other financial services such as money orders. Electronic delivery of government benefits is another avenue that could be vigorously pursued. Successful electronic benefits delivery systems are currently operating, including programs in New York City and St. Paul, Minnesota. The advantages of these systems -- for beneficiaries, government agencies, and financial institutions -- are numerous. They include eliminating problems with delayed, lost, or stolen

checks, providing quicker resolution of problems concerning payments and lowering costs to all parties.

A more specific concern involves the mechanism for setting fees for the services. The bills require the Board to study financial institutions' "actual" costs and to set the fees permitted to be charged for these services to recover these costs. In addition to the many difficulties of trying to determine such costs, any fees set by the Board would almost certainly be an average and, as such, could never reflect the actual differences among institutions. As a result of a federally-established fee, some institutions would fail to recover their costs, while other institutions could exceed them under the national fee standard. Finally, it appears inequitable that financial institutions would be required to offer these services at cost while other entities, such as check cashers, could continue to offer them at a profit.

The Board is also concerned that financial institutions would increasingly fall victim to fraud if check cashing legislation is enacted. Checks can easily be stolen, and identification cards can easily be forged. Giving the Board the authority to suspend the check cashing requirement for certain classes of checks, as the bill does, is small comfort. It would take a relatively long period of time for the Board to learn of any patterns of fraud and, by then, significant losses may already have been suffered. Also, while fraud levels may now be low for U.S. government checks, this may not continue to be the

case following legislation. Institutions can now keep fraud losses low by establishing procedures, based on their own experiences, that are adequate to address their own risks. Mandatory standards may eliminate their ability to continue using methods that have been successful for them and may leave them far more vulnerable.

The Joint Policy Statement I mentioned had the benefit of putting the Federal government behind providing basic services, while leaving the implementation to the creativity of individual institutions. Conversely, a single federally-mandated banking service may stifle innovation and experimentation. A number of different account products have evolved as a result of voluntary efforts by financial institutions. Some, for example, involve savings accounts with money orders used for third-party payments. Others, based on a "pay-as-you-go" idea, have fees for each check, rather than the monthly maintenance fee contemplated by the legislation. Either of these could be better and more economical for the person who writes fewer than 10 checks a month. The basic banking bill will likely result in the standardization of accounts, and it runs the risk of thwarting the continued development of different services, such as these, to address varying and changing needs of low income and elderly individuals. Institutions may have much less incentive to offer additional, and potentially cheaper, basic banking accounts once they offer the standard service required by law.

Other innovative arrangements are being investigated that would eliminate many of the problems with delivering government benefits by paper checks. The Board strongly supports the facilitation of electronic alternatives for the delivery of government payments (known as "electronic benefits transfer" or EBT). These arrangements are probably a better long term solution to the problems that motivate the check-cashing legislation.

Since the Board testified on similar legislation last fall, interest in electronic benefits transfer has increased. A number of meetings have been held among representatives of government agencies, financial institutions and consumer groups to discuss the feasibility of such arrangements. In addition, several programs are now operating and others are about to be initiated. The Board agrees with the GAO's conclusion that electronic delivery provides several advantages over a paper-based government benefits system. Consequently, we are very encouraged about the increased momentum in EBT activity over the last several months. We urge the Congress to foster these efforts, rather than imposing burdensome new requirements on financial institutions.

Finally, in our experience, well-intentioned legislation and regulations, particularly as they pyramid on one another, can cumulatively be overwhelming -- especially for small institutions. This bears particular note when it is not clear that a compelling need for the legislation has been demonstrated.

The Board believes that voluntary efforts by financial institutions will continue to be successful in meeting many of the concerns that have been expressed without the burden and cost that rules and regulations inevitably impose. Alternatives such as EBT, in particular, merit future exploration. For all the foregoing reasons, the Board opposes the basic banking and check cashing bills now being considered by the Senate.