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Supervision, Regulation and Insurance of the House
Committee on Banking, Finance and Urban Affairs

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It is a pleasure to appear before this distinguished Subcommittee to present the views of the Board of Governors on the Community Reinvestment Act, the Home Mortgage Disclosure Act, the extension of Regulation Q authority, and a central liquidity facility for credit unions.

At the outset, let me say that the general intent of the Congress in enacting the Community Reinvestment Act (CRA) seems reasonably clear. The "convenience and needs" standard has been included for many years in Federal banking statutes, such as the Bank Merger and Bank Holding Company Acts, and this standard has been one of the factors taken into account by the Federal bank and thrift regulators in decisions on applications for expansion by regulated financial institutions. In enacting the CRA, the Congress presumably wished to emphasize to insured financial institutions and their Federal regulators that the convenience and needs of the community include credit as well as deposit and other services. The timing of this emphasis coincides with greater concern over the economic well-being of the inner cities and the need for revitalization of inner city neighborhoods.

Nonetheless, the statute created a number of issues that needed resolution by the agencies responsible for writing regulations to implement the CRA. As you know, earlier this year the four Federal regulators of banks and thrift institutions held joint hearings to obtain public comments and suggestions on how we might best implement the CRA. To provide a focus for the hearings, a series of questions
dealing with the issues that the statute raised were included with the public notice of the hearings. The responses we received during testimony at the hearings and in written comments have been helpful to the agencies in developing regulations to implement the act.

As those questions indicated, the four agencies have been particularly troubled by the absence of statutory definitions for such terms as "entire community," "credit needs," and "low- and moderate-income neighborhoods." The comments received confirmed that the public too was concerned about how the agencies might deal with these terms in the regulations. Numerous definitions for these and other terms in the act were suggested by the witnesses, but no consensus on the definitions emerged at the hearings.

What did emerge from the hearings, however, was the concern of the insured financial institutions that the regulatory agencies, in order to offset the vagueness of various parts of the statute, might impose a heavy reporting and recordkeeping burden on them. In particular, reservations were expressed that the agencies' efforts to define community credit needs could result in an indirect form of credit allocation.

These fears were not entirely without foundation because comments received from some of the community groups did indeed urge that the agencies impose substantial reporting and recordkeeping burdens and include in the regulation a requirement that financial institutions make specific types of credit available to certain parts of the community. Such views, in the Board's judgment, do not conform with Congressional intent. On the contrary, there is clear evidence in the legislative
History of the CRA that no significant reporting or recordkeeping requirements are to be imposed on the regulated financial institutions. It also appears to be the intent of the Congress to avoid any regulatory requirements that might result in credit allocation.

More generally, a number of the witnesses at the hearings and in written submissions interpreted the CRA as placing rather specific requirements on financial institutions. Our reading of the statute suggests that the intent of the CRA is to emphasize to covered financial institutions that they have an obligation to help meet the credit needs of all parts of the communities in which their depository facilities are located, giving special attention to low- and moderate-income neighborhoods. To accomplish this purpose, the operative sections of the CRA place rather specific requirements on the four Federal regulatory agencies. First, they are to "encourage" financial institutions to help meet their local communities' credit needs, consistent with the safe and sound operation of those institutions (§802(b)). Second, they are required to "assess" financial institutions' records of meeting those credit needs (§804(1)). Third, the supervisory agencies are to "take such record[s] into account" in evaluating applications by insured financial institutions for charters, deposit insurance, branches, office relocations, mergers, and holding company acquisitions (§804(2)).

Thus, given the approach called for by the CRA, the Board believes that it would be contrary to both the spirit and letter of the CRA to impose by regulation numerous or burdensome requirements on the financial institutions.
The proposed CRA regulations recently published for public comment by the four Federal financial supervisory agencies are designed to encourage banks and thrift institutions to increase their involvement in community affairs and to take actions, within their changing lending capacities, to help meet the credit needs of their communities. Although some requirements are imposed on the financial institutions in the proposed regulation, those requirements were thought to be the best means by which to provide a reasonable basis for communication among financial institutions, members of their communities, and the regulatory agencies. Providing for that communication will help identify community credit needs and will increase the amount of information flowing to members of the community regarding the types of credit available from the financial institutions.

The "assess" and "take into account" requirements of the statute also pose something of a dilemma for the agencies. Under the act, the regulators must determine after the fact how well a bank, bank holding company, or thrift institution submitting an application has served its community's credit needs. This could tempt the agencies to give the financial institutions elaborate guidelines on how they will be judged in order to help develop a detailed record to assess and to take into account at the time an application is submitted. The danger is that such guidelines can easily become requirements or lead to the perception on the part of regulated institutions that specific types of lending and other community service actions must be conducted.

While we do not favor the imposition of extensive and rigid guidelines, it is helpful to provide covered financial institutions
with suggested assessment factors as guidelines to enable them to comply with the act. In the proposed regulations, the agencies have provided a list of factors that may be considered in assessing the record of financial institutions in meeting the credit needs of their communities. Given the great variety of local conditions, the list of factors is intended to be illustrative. Considerable latitude is given to the banks and thrifts to choose the ways in which they will fulfill their obligations to their communities.

Overall, the Board expects that the regulations that have been published for comment will meet the intent of the Congress in passing this statute, while avoiding the imposition of credit allocation or burdensome recordkeeping or reporting requirements on Federally-insured financial institutions.

It should be recognized, however, that precise measures of performance cannot be achieved in dealing with a matter as complex as a financial institution's record of service to its community. Rather, in making an assessment of this kind, a considerable element of judgment necessarily enters into an agency's deliberations. This kind of evaluation is not capricious, however, and banks are accustomed to this type of regulatory review. It is based on years of experience in dealing with financial institutions and assessing their strengths, weaknesses, and capabilities. It is the same type of judgment that comes into play when financial regulatory agencies evaluate an institution's capital level, portfolio quality, and caliber of management.

The necessity of making judgments becomes even more apparent when we consider that an institution's record under the CRA is only
one factor that must be weighed in evaluating an application. By law, the agencies must also take into account an institution's financial condition, future prospects, management, and any competitive implications. The agencies, therefore, must balance these factors not only against each other, but against the newly emphasized CRA factor.

In addition, the Board wishes to note that it plans to consider any views expressed by State bank supervisors on the extent to which State-chartered, member banks involved in applications have been serving the credit needs of their communities. Also, since we routinely provide copies of our examination reports to State supervisors, the State authorities will be apprised of the Federal Reserve's assessments of the extent to which State member banks are meeting the credit needs of their communities.

The second topic on which the Subcommittee requested comment is the Home Mortgage Disclosure Act of 1975 (HMDA). This act is an experiment to discover if public disclosure by depository institutions of mortgage and home improvement lending patterns in metropolitan areas will, as the preamble to the act states,

"provide . . . citizens and public officials . . . with sufficient information to enable them to determine whether depository institutions are filling their obligations to serve the housing needs of the communities and neighborhoods in which they are located . . . ."

Midway through the experiment, no definitive judgment regarding the act's usefulness can be made since relevant evidence is still being collected and analyzed. Three studies are currently under way. The Federal
Home Loan Bank Board and the Federal Deposit Insurance Corporation are jointly sponsoring a study to determine the accuracy, completeness, cost, and usefulness of disclosure data based upon disclosures made in three metropolitan areas—Buffalo, Chicago, and San Diego. The Federal Reserve is conducting a study of the feasibility and usefulness of extending the act's disclosure requirements to non-metropolitan areas. Finally, the Department of Housing and Urban Development is funding a study of the uses to which disclosure information has been put by community groups and local governmental units. The results of these studies should be available by the end of the year and will greatly enhance our understanding of how well the act serves its stated purpose.

In the interim, however, several general observations can be offered based upon what is now known. The initial disclosures, which were available in September 1976, drew a flurry of interest. There were a number of media reports and analyses prepared by community-consumer organizations across the country. Since then, from a national perspective, there has been a very limited degree of interest in disclosure statements.

For example, the United States League of Savings Associations reported in May 1977 that, of 1,725 members out of 2,775 responding to a questionnaire, 1,039 (60 percent of the respondents) did not receive any requests to review their disclosure reports and another 369 (21 percent) received only one or two requests. The limited degree of interest also was confirmed in an informal survey of lenders in ten major cities in
January 1977 (American Banker, January 24, 1977, p.1). This conclusion was also reinforced by several members of the Board's Consumer Advisory Council at its recent meeting on June 1.

There has been little use of disclosure data by the act's intended beneficiaries—public and private depositors who are deciding where to deposit their funds. While there have been isolated instances, we know of no concerted effort by non-governmental depositors to persuade banks or thrifts to change their credit policies through "greenlining", that is, shifting deposits based upon disclosure statements. The few State and municipal governments—for example, California and Chicago—that have instituted "greenlining" programs have adopted their own disclosure schemes tailored to meet their needs and have not relied upon the Federal act.

Given the limited use of HMDA information to date, there remains the question whether the data will be helpful to the agencies in assessing a regulated institution's community investment efforts. Two limitations in the HMDA reports suggest that these data may not be of significant help in that task. First, the CRA requires an assessment of the degree to which a bank or thrift is helping to meet the broad range of a community's credit needs, not just housing credit needs. In the case of commercial banks, however, residential mortgage lending is only one of many lending activities. Second, the required disclosures reveal nothing about effective loan demand by geographic area, and we know of no satisfactory way of accurately measuring that demand without expending substantial resources.
Assuming that the Federal bank and thrift regulators encourage their supervised lenders to develop outreach programs pursuant to the CRA, the focus will be on how well the lender sells its credit services to the community and whether it actively seeks to engage in a partnership with community residents, businessmen, and local public officials to help tackle the community's problems. We believe that fostering positive outreach on the part of financial institutions, tailored to local circumstances, is a much better way to help the nation's communities than devoting resources to determining the significance of limited disclosure data or to collecting additional data.

In our view, community investment programs and monitoring schemes, such as residential mortgage disclosure, are best developed at the local level, where they can be fashioned to meet local circumstances. In accord with this policy of fostering local solutions to community credit problems, the Board has granted exemptions under the Home Mortgage Disclosure Act in situations where State-chartered depository institutions comply with State disclosure laws that are comparable in purpose to the Federal act, even if the details of disclosure vary. Similarly, the Board endorses the continuation and expansion of the Urban Reinvestment Task Force's Neighborhood Housing Services and Neighborhood Preservation programs. These programs, operating as of June in 56 neighborhoods in 47 cities, owe their success to the broad-based cooperation of financial institutions, local government, and neighborhood residents. We believe that these localized services should serve as a model of the type of approach that should be taken in community investment endeavors.
Turning to the extension of the current deposit ceiling rate authority, the Board continues to believe that such rate ceilings—and the mandated deposit rate differentials between banks and thrifts—should be removed over the long run to promote equity for small savers and economic efficiency. Although in practice rate ceilings probably can be removed only gradually, growing competitive inequities under the present rate structure make it imperative that the process of removing artificial rate and differential restrictions begin soon. For example, more and more thrift institutions are offering some type of third-party payment services and are competing actively and effectively with commercial banks for these services. Mutual savings banks and other thrifts in New England, New York, Pennsylvania, and elsewhere have been successful in offering checking or check-like transaction accounts. The ceiling rate differential favoring nonbank depository institutions with transactions account powers is likely to produce further competitive distortion in our institutional structure.

While the Board recommends that the current Regulation C rate authority be extended for one year, the Board believes that action also should be taken by the Congress to eliminate the competitive inequities that have developed as a result of thrifts offering transactions-type accounts. The Board urges that legislation be adopted to require rate-ceiling parity among all depository institutions, including credit unions, on any interest-bearing transactions accounts and on savings-type accounts that are tied to third-party transfer accounts. The appropriate rate ceiling for such accounts at this time would be the ceiling on commercial bank savings accounts.
Such an approach would be similar to that in effect for NOW accounts in New England, and would also be similar to the proposal on rate ceilings in the nationwide NOW account bill approved by the Senate Banking Committee last year. With that modification to existing law, a one-year extension would provide time for the Congress to review other basic issues involved in deposit rate ceilings and the rate differential between commercial banks and thrifts.

On the broader issue, the Board continues to believe that it would be desirable to restore to the agencies the flexibility to prescribe and adjust deposit rate ceilings without Congressional approval of changes in differentials. The Board believes that consideration of this basic issue by the Congress can await broad review of the deposit rate structure. However, steps should be taken now to eliminate the disparity in treatment that exists because of differentials among institutions that are offering comparable transactions account services.

Finally, the Board supports the establishment of a credit union central liquidity facility. We believe that there is a need for a lending fund to deal with temporary liquidity problems experienced by credit unions. The possibility of such difficulties arises partly because, under the common-bond principle, the membership of an individual credit union tends to be subject to similar economic pressures. In many cases, the members of a credit union work for the same employer, so that a plant closing or seasonal swing in employment or hours can result in sizable deposit outflows at the same time that loan demand rises and loan repayments lag.
The Board has discussed a few modifications and clarifications to the proposed legislation with the National Credit Union Administration. During those discussions, the Administrator of the NCUA indicated that he agrees that these changes would improve the bill. One amendment would clarify that the private borrowings of the facility would not have the U.S. Government's guarantee. Another would reduce the borrowing leverage on capital to ten times capital, which would make the facility's size more reasonable in relation to industry assets. We especially commend the very limited purpose of meeting liquidity needs for which funds may be advanced, but also believe that the bill should be clarified to reflect that limitation expressly.

That concludes my statement. Thank you for this opportunity to appear before the Subcommittee on behalf of the Board.