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Statement by
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Governor
Board of Governors of the Federal Reserve System
before the
Subcommittee on Consumer Credit and Insurance
of the
Committee on Banking, Finance, and Urban Affairs
of the
U.S. House of Representatives

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*Statement presented
by Ms. Garwood
for Governor Lindsey*

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Mr. Chairman, I appreciate the opportunity to provide the Federal Reserve's perspectives on the current status of the Community Reinvestment Act (CRA). I will include a few comments on the Home Mortgage Disclosure Act and Fair lending laws, but they are extensive subjects in their own right.

It is no secret that the CRA continues to be the source of concern and frustration. Many in the banking community see CRA as unnecessary, vague, burdensome and unfair. Community and consumer groups often view enforcement as weak and have suggested a number of changes, including new disclosure provisions, to help ensure that banks and supervisory agencies approach their CRA responsibilities effectively.

We as regulators are often caught in the middle. Despite a dramatic increase in resources and efforts devoted to CRA, we continue to receive brickbats from all sides. Bankers think we grade too harshly and that we focus on process and paperwork instead of assessing "real" community lending. Community groups say our grades are too high, and our effort is lax.

Over the years, critics have made many other charges about bank and supervisory agency performance, some of which have little foundation in CRA's intent, actual provisions, or regulations. For example, some believe that an institution's record of making mortgage loans in minority areas should be the only CRA criteria, while others think if a bank has a community development corporation (CDC), it should automatically get a "pass" on CRA. We take both home lending and CDCs into account,

but CRA is more complex than this.

Hearing this cacophony of divergent critiques, ideas and proposals over the past few years, it wouldn't be surprising to me if you have concerns that CRA may not be working as intended. In considering this, I would like to cover several related areas in my testimony today. First, as a basis for my comments, I want to provide an overview of the Act and its implementing regulation. Second, I would like to bring the subcommittee up to date on recent activities undertaken by the supervisory agencies to strengthen our CRA assessment programs. Third, I would like to touch on some of the recurring issues affecting CRA that are of concern to bankers, community representatives, and the supervisory agencies. Finally, I want to share with you some thoughts on CRA's impact--which we believe has been quite considerable.

I want to make it clear, however, that agencies other than the Federal Reserve are also deeply involved with CRA. In fact, from an examination perspective we have by far the smallest number of supervised institutions--less than 10 percent of the total. I caution the subcommittee, therefore, that a serious exploration of CRA would require testimony from others. This, of course, would also be true with regard to HMDA and Fair lending.

What CRA Says and Requires

Let me begin by reviewing the Act and its implementing regulations. Given what seems like a blizzard of recent

proposals to change the CRA, increase its scope, provide safe harbors, or reduce its burden, it is especially important that the discussion be grounded in a clear understanding about the objectives of the Act, and its current requirements.

On its face, the CRA is a short, rather simple law, as banking laws go. It's only a few pages. It reminds financial institutions that they have a continuing obligation to help meet the credit needs of their entire community, including those of low- and moderate-income neighborhoods. These obligations stem from bank charters which say that banks should meet the convenience and needs of the communities they serve.

But CRA also emphasizes that the obligation to help meet community credit needs, including those of low- and moderate-income areas, is an affirmative one. CRA's fundamental message is simply that each financial institution should, as part of its day-to-day business functions, be as attentive to the credit needs of low- and moderate-income areas of its community as it is to other areas.

When considering CRA's overall message, I think it's important to recognize that the actual legislative language contains few directives and virtually no requirements that fall directly on financial institutions.

The CRA does not require an institution to make any specific types of loans, to make any quantity of loans to particular types of persons or businesses, or to make any

specific number of loans in any targeted geographic area. Congress has wisely avoided mandating credit allocation. CRA does not require institutions to make housing loans, nor does it require them to make loans with below-market interest rates, or loans with other terms and conditions that would be inconsistent with safe and sound lending. None of these things are required, or in my view, even implied by the CRA.

CRA's actual requirements are really directives to the financial institution supervisory agencies. First, CRA requires these agencies to encourage each financial institution they supervise to help meet the credit needs of its entire community, including the credit needs of low- and moderate-income neighborhoods, in a way that is consistent with safe and sound banking practices. Second, the CRA requires the supervisory agencies to assess the performance of financial institutions in meeting community credit needs. We do that primarily through CRA examinations which use 12 assessment factors outlined in the CRA regulation. Third, as a result of 1989 and 1991 amendments to the CRA, the supervisory agencies are required to prepare for each institution examined, a public written CRA Evaluation that includes the CRA rating and provides supporting facts and data. Finally, the CRA requires the agencies to consider the CRA performance of each financial institution when reviewing its applications for expansion of depository facilities through branching, mergers, or acquisitions.

In performing their responsibilities, the agencies have issued regulations which do impose a few specific requirements on banks and thrifts, but these are essentially technical and procedural in nature. For example, each bank must develop and update a CRA Statement which delineates its community with a map and describes services offered within that community. Institutions also must post CRA Notices in the lobbies of depository facilities, and maintain a Public Comment File which may be inspected by the public and the banking agencies.

Nature of the Law

I believe that virtually everyone affected by CRA senses that this is clearly an unusual law. It encourages, but does not require action by financial institutions. It reminds banks and thrifts about their charter obligations, but does not mandate any particular activities. It says banks should be encouraged to "help" to meet community credit needs, but does not specify how such encouragement is to be provided, or how much help in meeting credit needs is expected.

Further, the CRA directs the supervisory agencies to assess bank performance in helping meet community credit needs, but it does not define good CRA performance. The Act also implies potential punishment for institutions with poor performance--in the form of denials of applications to expand--but provides no particular incentives to encourage institutions to seek outstanding performance. With the exception of

requirements for such things as CRA Statements or CRA Notices, lack of action by institutions does not constitute a "violation" of the law.

And most importantly, the fundamental approach of the Act, and perhaps the primary source of most concerns and issues, is that CRA's focus is on assessments of performance. That is, CRA at its very heart, is "valuative." It requires judgements based on a set of facts and circumstances that vary greatly among communities and institutions.

Supervisory Agency Roles and Actions

Under CRA, the supervisory agencies are charged with encouraging financial institutions to help meet community credit needs, and with evaluating their performance. At the Federal Reserve, we provide "encouragement" in two primary ways: by conducting CRA examinations; and by carrying out a comprehensive set of educational, technical assistance and informational programs, primarily through our Community Affairs program.

Over the years, the Federal Reserve System has strengthened its CRA-related activities on a number of fronts. My impression is that in all the talk about the problems with CRA, not enough information has been conveyed about the many positive things that are happening. Let me first talk about the examination side.

Examination Improvements

First, examiner training has been expanded and significantly enhanced. Our consumer compliance schools for examiners devote considerable time to CRA, and related regulations, such as those covering Fair Lending, and Home Mortgage Disclosure. A more advanced compliance school also includes segments on community development. In addition, we regularly conduct a unique, one-week, intensive course for examiners, called "CRA Advanced Examination Techniques." Over the past three years, virtually all of our consumer compliance examiners have completed this course. We are also taking steps to help our safety and soundness examiners understand the essentials of the community development market so they can fairly assess the quality of a bank's reinvestment loans.

Second, in addition to enhanced training for our examiners, we have been concerned about providing them with better tools to help them get the job done. To this end, on behalf of the Federal Financial Institutions Examination Council ("FFIEC") the Federal Reserve has developed a computerized system for analyzing the expanded data collected under the Home Mortgage Disclosure Act ("HMDA"). The system is extremely versatile, allowing the data to be segmented by demographic characteristics such as race, gender and income levels, or by geographic boundaries. Examiners can now sort through vast quantities of data to focus attention on specific lending markets, and draw

comparisons between an individual HMDA reporter's performance and that of all lenders in the area. With these capabilities, examiners can more readily determine whether a bank is effectively serving all segments of its market, including low- and moderate-income and minority neighborhoods.

Third, in June of 1992, the FFIEC issued revised, uniform CRA examination procedures that clarify CRA examination policies. For example, they emphasize the importance of using numerical data in the public CRA Evaluation, to the extent they are used in the assessment process and support the conclusions reached. Our examiners now routinely factor into their CRA assessments "hard data" derived from HMDA tables, the supervisory "call reports," bank lending records and other sources.

Fourth, we have been mindful of the widely shared perception, often vocalized by bankers, that the CRA entails an undue amount of paperwork. In developing the new examination procedures, we endeavored to help reduce the amount of paperwork and documentation by emphasizing that institutions should retain for examiners' review only such information as is useful to the institution's own management needs. We have emphasized to our examiners that CRA documentation will generally be less formal and less extensive in small and rural banks than in larger, urban banks. We want to reduce as much as possible the paperwork burden on bankers so that they can focus on the lending side.

Fifth, there's been a significant increase since 1989

in personnel resources allocated to CRA examinations. Our examiners and Reserve Bank staff also spend considerable time in follow-up to the examinations through correspondence, advisory visits, and educational activities directed to the industry as a whole. The frequency of CRA examinations by the Federal Reserve System has been maintained, despite the fact that CRA examinations have become more demanding and time-consuming job for examiners. For over a decade, we have examined state member banks with a satisfactory or better record of past CRA performance every 18 to 24 months. "Problem banks," or those with demonstrated weaknesses, are examined every 6 to 12 months.

Sixth, the agencies have successfully implemented the public disclosure of CRA Evaluations and ratings. Written, public evaluations of CRA performance have been a reality for well over two years. We and the other supervisory agencies have devoted substantial time and effort to developing the system and training examiners for what was, in fact, an unprecedented change in the way they do their jobs.

Since the disclosure provisions became effective, the Federal Reserve has examined for CRA purposes every bank it supervises at least once, and many twice, and has presented its findings to the public. We believe that this process has proceeded relatively smoothly and has had a positive impact on financial institutions and their responses to their CRA obligations.

Expanded Information, Education and Technical Assistance

In addition to examinations, a second key way the supervisory agencies fulfill our CRA "encouragement" responsibilities, is through educational, information and technical assistance activities. These activities are conducted both by the agencies jointly and through programs administered in each agency. At the Federal Reserve, we provide these educational and information services primarily through our Community Affairs program at each of the twelve Federal Reserve Banks.

To help educate both the public and the banking community about CRA and community development lending, the Reserve Banks sponsor Community Affairs conferences, seminars and workshops. Over the last four years, we sponsored or cosponsored over 400 conferences, seminars and workshops for bankers and others focusing on such topics as CRA and HMDA compliance, options for bank participation in low- and moderate-income housing development, downtown and neighborhood revitalization, small and minority business lending, the formation of community development corporations, and housing finance in rural areas. During this past year, several Reserve Banks put on workshops on CRA targeted for members of bank boards of directors and bank senior executives. Community Affairs staff developed community development lending curricula and have conducted numerous community development workshops for bankers.

In addition, during this same four-year period, Community Affairs staff of both the Board and the Reserve Banks made over 1,000 formal presentations at conferences, seminars and meetings of banking, community and other organizations on community development, CRA and other related topics. They have responded to thousands of inquiries and requests for information about CRA.

Community Affairs staff also provide CRA-related technical assistance and advice to individual banks, and some are conducting special visitations to bank holding companies to discuss directly with senior management, CRA issues and opportunities. Community Affairs staff have helped a number of banks and banking groups structure lending consortia or community development corporations. They have helped mediate disputes between banks and community organizations. They produce a variety of publications, from Community Profiles that outline CRA-related opportunities for banks--such as one recently prepared on South Central Los Angeles--to compendiums of programs that banks can use to complement their CRA programs. Nine of the Reserve Banks publish their own community affairs newsletters, which reach a combined total of over 40,000 bankers, community representatives and others.

Increasingly, the Community Affairs program is providing direct support to our examination staff, helping them identify community contacts to meet with during examinations, or

helping examiners identify community programs in which banks could be involved.

Overall, we believe that the Federal Reserve's Community Affairs program has greatly strengthened our efforts to "encourage" and help institutions to meet their CRA obligations.

Effects on Applications

The number of applications that present CRA issues, which include both those affected by poor CRA ratings, as well as by CRA protests, have grown in recent years. During 1992, adverse CRA ratings were an issue in forty-four applications received by the Federal Reserve from banks and bank holding companies. This compares with thirty-one such applications in 1991. Protested applications also increased to thirty in 1992 from twenty-four in 1991.

Although there have been relatively few outright denials of applications on CRA grounds, we would urge caution in using this as a significant measure of CRA's impact. We have found that institutions are taking this aspect of CRA quite seriously. They do not want poor CRA examination results, which are afforded great weight in our consideration of applications, to reduce their expansion options or impede the timing of their applications. This gives them added incentive to have good programs in place. Some undoubtedly avoid filing applications, or decide to withdraw them, when faced with potentially adverse findings. Through the years, many institutions have made

substantial commitments to the agencies or to protestants during the application process.

Coupled with our examination and educational efforts, I think that the application procedures have also contributed to overall CRA performance.

Recurrent Issues

As should be apparent from this summary of recent agency activities, CRA continues to consume an increasing amount of our time and resources. Despite our belief that things are much better than many realize, we also recognize that there continue to be a number of controversies related to the structure and administration of the CRA. Let me touch on a few.

Consistency

One of the recurring issues involves the consistency or, lack thereof, in the way CRA Evaluations are written and ratings are assigned. Both community groups and bankers have alleged that the Evaluations of the agencies are not equally comprehensive, and that in some cases, the CRA ratings assigned are not always the same for banks that appear to have similar performance.

Let me say that the supervisory agencies have spent an awful lot of time and energy, both on an interagency basis, and within each agency, to deal with inconsistencies in Evaluation write-ups. We have an extensive program within the Federal Reserve to review reports across Federal Reserve Districts to

promote uniformity. In May 1991, the FFIEC convened a working group of field examiners and senior staff from each of the agencies to review Evaluations across agencies to help insure a common approach. We have also received input from the Federal Reserve's Consumer Advisory Council, national community organizations and many others on how we can enhance the quality and consistency of the information we make public. We believe that these issues are being resolved.

It should be recognized, however, that it will probably always be somewhat difficult to make all ratings read consistently, simply because we are rarely comparing "apples to apples." Each financial institution is unique with respect to its business strategy, size, geographical market reach, product mix and organizational structure. Even banks of the same size in the same communities may offer very different products and services. Each community also is different with respect to its economic condition, credit needs, organizations and resources.

Process vs. Product

Both bankers and community groups continue to charge that the agencies appear more interested in ensuring that institutions have the appropriate CRA procedures and documentation, than actual lending programs in their communities. I believe, however, that if that were the case at one point, it most certainly is not the case now. However, as I will indicate, this is not as simple an issue as it may first appear.

In conducting CRA examinations, we do not focus on process to the exclusion of lending. We have cautioned our examiners about just this issue in our revised examination procedures, and discuss this regularly in examiner training and other meetings. This does not mean however, that we consider certain basic business processes to be irrelevant to CRA. Most successful institutions understand that if they do not have a well-thought-out CRA program, they may be less effective when it comes to finding good lending opportunities in their communities, or being able to take credit for their lending activities at examination time.

We do not believe that most larger institutions, especially those with large branch networks, can reasonably claim that they know what the credit needs are in their diverse communities, unless they have an effective program in place to find out. Similarly, they probably cannot truly know whether they are meeting the credit needs with loans unless they have a process in place that would provide them with this information. But this involves, after all, basic types of information that most bank managements regularly want to see for all products and services. For smaller institutions, the process is much, much simpler, and usually should involve use of day-to-day information that bank management collects in any case.

However, this "process versus product" debate is not an easy one for one fundamental reason--the agencies were not given

the task, nor have they assumed the role, of providing rules that allocate credit. Certainly, it would make everything much easier if we had lists of "blessed" loans and customers and mathematical ratios of loans by category that would match various ratings under CRA--then we would simply count the product and be done with it. In fact, CRA--wisely in my view--provides flexibility for institutions to meet their obligation in many different ways, depending on their strengths and the specialized needs of their community. This means that there will always be considerable focus on having an adequate process in place which, in fact, delivers product.

Easy Grading

Another recurring issue is the distribution of ratings. Community groups say the CRA grades are much too high and they contend that the banking agencies are much too lenient. And roughly 90 percent of the institutions do get a satisfactory or better rating. Some bankers, of course, argue that because an institution would be out of business if it did not meet the needs of its community, all should pass.

When haggling over the grade distribution, we should remember that CRA ultimately involves performance evaluations. There will always be disagreements over such assessments, whether it involves a teacher or professor grading a paper, a music critic judging a recital, or an employer evaluating an employee. No matter how well the criteria are understood,

different people--reasonable people--often can make different judgments based on the same information.

But clearly few institutions fail. I think there are several good reasons for the current distribution. First, all banks pledge to meet the "convenience and needs" of their communities when they are chartered. This was long before CRA came on the scene. Second, we've been examining them for compliance since 1977 and one would expect this to have had a positive effect. Third, it should be recognized that the "satisfactory" category in which about 80 percent fall--is a very broad one--and it includes some with good performance and some with more marginal records.

Discrimination and Home Mortgage Lending

Finally, a highly sensitive and recurring issue involves the relationship of CRA to both the Home Mortgage Disclosure Act (HMDA) and Fair Lending laws, such as the Equal Credit Opportunity Act. Although CRA assessments incorporate the objectives of these civil rights laws, CRA also is much broader in scope.

It is well known that regulators have faced considerable difficulties in identifying instances of discrimination. It is extremely difficult to find conclusive evidence of discrimination through inspection of individual loan files during examinations. Lenders usually can demonstrate that the applicant was denied because certain credit standards,

involving such elements as debt ratios or credit history, were not met.

But we have learned much from the intensive study on mortgage denials conducted by the Federal Reserve Bank of Boston and from the Justice Department's recent case involving Decatur Federal Savings and Loan. We are very concerned about the results of the Boston Study and have taken a number of steps that we hope will help strengthen the capacity of our examiners to detect and deter discriminatory treatment of applicants. Fortunately, we are seeing a significant growth in affirmative marketing of mortgage and other loan products in minority areas, as well as development of special mortgage products that meet the needs of low- and moderate-income persons. Institutions that are making positive efforts to offer and extend credit in minority communities are helping fulfill CRA's aims.

CRA'S Impact

How well is CRA working? Frankly, I think a lot better than is often recognized. By any measure it's had a major impact on reinvestment activity by financial institutions throughout the country. In recent years, we've seen real momentum in financial institution responses to the needs of their communities, especially in lower-income areas. I believe that a good part of that momentum is due to CRA.

CRA has helped stimulate loans for home mortgages, housing construction and rehabilitation, and small and minority

business development in low- and moderate-income communities. More banks and thrifts are seeking and participating in public/private partnerships, in both urban and rural communities, than ever before. A growing number of bank-led community development corporations or multi-bank lending consortia are supporting projects benefitting low- and moderate-income areas. Included with my testimony is a sample of such activities gathered from across the nation by our community affairs officers.

Although there are sometimes adversarial beginnings, banks and community groups in many cities have proven that they can work together to promote the goals of the CRA process. I think bankers generally are viewing the world a little differently because of CRA, and the world views bankers a little differently as well. For many institutions, CRA is becoming increasingly important. Good CRA performance enhances their ability to take advantage of opportunities afforded by mergers and interstate banking. Many bankers also are discovering that good CRA performance also helps them compete for customers. Finally, a growing number of bankers are seeing that CRA-related activities can lead to just good, profitable business.

Conclusion

Mr. Chairman, I would conclude from all of this that despite its weaknesses, CRA is indeed working, and working quite well. The supervisory agencies have stepped up their activities.

We continue to strengthen our CRA examination, education and technical assistance programs. The banking community is responding positively, though certainly more can be done. CRA is a simple and unusual law. Its lack of specificity--the source of many of its frustrations--may be its strength. In view of this I would counsel that radical changes to CRA be approached cautiously.