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Statement by

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before the

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Resolution of Failed Financial Institutions

of the

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I appreciate the opportunity to appear before this subcommittee to discuss the Community Reinvestment Act and the current efforts of the agencies to strengthen and improve its administration. This statute has become an extremely important part of the landscape of financial institution supervision in recent years. Across our nation it has affected the relationship of thousands of banks and thrift institutions with their communities--particularly low- and moderate-income neighborhoods. Institutions both large and small have struggled with the law's demands. Local groups have aggressively used it--particularly in the applications process--to prompt commitments for increased lending to those who may have been overlooked before. The regulators have sought to enforce the law fairly and fully in the face of the enormous diversity which exists among America's communities and its financial institutions.

Our CRA efforts have seldom been to the satisfaction of either the covered institutions or community groups, and the President has directed the agencies to conduct a thorough reexamination of our supervisory approach. This is a zero based review which will take into account the views of all affected parties. In doing so, it is important to start from a common understanding of where we've come since the statute was enacted in 1977.

While the total impact of the CRA is very hard to measure, I believe a fair assessment would have to conclude that it has generally made depository institutions more responsive to

the needs of their communities. Of course, the level of effort has varied widely among institutions. Certainly it has not totally cured the ills and decline that plague many of our cities. That would be an unrealistic expectation. But CRA has, in my view, been very instrumental in opening channels of communication between banks and thrifts and segments of their communities that were previously underserved. New relationships have been established with community groups and individuals, new products have been designed and marketed, and many thousands of credit applications taken from those who previously had no banking relationship. Most importantly, I am convinced that thousands of loans have been made throughout the country that would not have been made but for the CRA. I have personally traveled to many communities and toured numerous projects that are now helping to stabilize and revitalize communities as a result of CRA. In addition, numerous witnesses from consumer and community organizations at hearings we have held recently have testified to the valuable contributions CRA has made.

But exactly what is the overall level of that lending? I do not know, and I suspect no one does. The community groups who track lending agreements with institutions point to over \$30 billion in commitments for new credit. Many of these commitments cover several years and therefore extend into the future. Moreover, I know of no overall assessment of the extent to which the commitments have been realized. While formal commitments to community groups get considerable media attention, I suspect that

most CRA related activity goes on outside the high profile negotiated agreements that receive so much attention. My own belief is that the true impact of CRA has far exceeded any number derived strictly from the formal commitments. If the figure is, for example, double the committed amount, it is a formidable amount indeed, and this fact should not be overlooked as we evaluate CRA's effectiveness.

Whatever the degree of new lending attributable to CRA, it has not been accomplished without numerous problems, which I will refer to later. But before doing that, there is an important point about CRA that's often lost in the debate about its flaws. If this Federal statute has, in fact, had the considerable impact I have described, it's important to note that this has been accomplished without a huge appropriation of government dollars, and without thousands of bureaucrats to administer the program. These, of course, are very significant and topical matters--as current as last week's announcement of a major campaign to "reinvent" government in ways that emphasize these very characteristics.

CRA established a national goal and put considerable power in both supervisory agencies and the public to enforce it, but left the details of how this goal would be accomplished to local communities and the depository institutions in them. CRA counted on the unique economic needs, and the give and take in the local social and political scene, to define the specifics of the CRA program for each community. No one in Washington has yet

been employed to decide how much or what type of CRA lending should be made in the individual communities you represent. To my way of thinking, that has been a considerable strength of the law. In any review of CRA I believe we must acknowledge the value of this approach, at the same time that we search for improvements.

But all is not perfect as you well know. The flexibility that I've referred to has come with a price. Bankers and many community groups alike complain that the standards are too vague. Our own examiners would be more comfortable as they go about their very difficult job of assessing compliance if the rules of the game were more precise. Despite the ever increasing efforts of the agencies over the years to define more specifically the various levels of performance used in our rating system, we are constantly faced with questions about "how much is enough," what loans get CRA credit, and exactly what "weight" different categories of loans will receive. Living with the current uncertainty makes bankers nervous, community groups dissatisfied with their ability to hold institutions accountable, and everyone concerned about assuring fair and consistent evaluations by the agencies. And believe me, no one would be happier than those in my agency, who are charged with the day-to-day enforcement of the law, if we were "going by the book."

There also appears to be common agreement that too much emphasis has been placed on paperwork and process as opposed to performance. There is undoubtedly some truth to this despite the

agencies' efforts to assure otherwise. But, it is important to keep in mind that, in some sense, the focus on process is a natural outgrowth of leaving the definition of an appropriate level of performance up to the needs of the community and the capacity of its institutions. Nevertheless, the concern about focusing on paperwork rather than results is widespread enough to require careful evaluation.

And, of course, there are other criticisms as well-- that CRA is "too much stick and too little carrot" and that we must search for more incentives to encourage good performance, that too many institutions receive satisfactory or better ratings, and that either too much or too little emphasis is given to CRA in the context of application processing. Suffice it to say that there are numerous areas of controversy where improvements may be desirable.

Thus, we have what to me is a rather confusing scene. On the one hand, we have an important national program that appears to have stimulated considerable lending and revitalization in low-income and minority communities. And it has done so in a period of great shortage of federal dollars, and without the rules and red tape that bedevil so many government efforts. On the other hand, I do not know of any regulatory area in which there is such common agreement that all is not right and that some "reform" is necessary. My overall sense, however, is that in focusing so much on the imperfections of CRA, we may have lost sight of its considerable benefits.

But surely we can do better. And, it was in response to widespread concern that the CRA can be improved that the President issued his charge to the agencies to rethink their administration of this law. In the President's CRA reform request, he asked the agencies to address several specific areas. These include:

- developing new regulations and procedures that replace paperwork and uncertainty with greater performance, clarity, and objectivity;
- developing a core of well-trained CRA examiners;
- working together to promote consistency, and even-handedness, to improve public CRA performance evaluations, to institute more effective sanctions against financial institutions with consistently poor performance, and to develop more objective, performance-based CRA assessment standards that minimize the compliance burden on financial institutions, while stimulating CRA performance.

As you are aware, we are presently working with the other agencies to carry out the President's initiative. Working together, however, is nothing new to us in this area. To promote uniformity in the approach to CRA, the Board, along with the other banking and thrift regulatory agencies have worked through the Federal Financial Institutions Examination Council, or FFIEC, for some time. For example, through the FFIEC the agencies

developed a common approach to the regulation, interagency CRA examination procedures, a uniform format for CRA public disclosures, and other regulatory material. We have a common commitment to cooperation and uniformity, and I am confident that together we can meet the President's goals.

Initially, our focus is on assuring wide public input. The Federal Reserve System, along with the FDIC, the OCC and the OTS, are presently holding public CRA meetings across the country to solicit comments on how to improve the CRA process. To date, we have heard the views of several hundred bankers, community groups, small business owners, as well as members of the general public. From these meetings, we have been told what is working with CRA, what is not working, and what we need to consider to "fix" it. I can tell you that many of the stories I have heard--from bankers, small business owners and community groups--have been compelling. The stories, however, point up as many differences in perspective between the various groups, as they do common concerns.

For example, while many may agree that it's important to find new incentives to encourage better CRA performance, there is great disagreement about what they might be. Very understandably, banks who have sought and achieved an "outstanding" rating would like to see this rewarded with a "safe harbor" from protests. Community groups, to put it mildly, do not favor the idea. While there is common concern about paperwork, there is a growing recognition that any movement

toward more quantifiable standards may require more, not less, data, and this is not a happy thought for many. Likewise, concern about the disproportionate burden on small institutions has caused some to suggest a small institution exemption. Others find this untenable. The idea of more precision in the requirements has widespread support, but there are difficult and controversial issues when it comes to what the specific numbers might be or even the process by which they might be set. Moreover, there is widespread concern that in attempting to be precise we may fall into the credit allocation trap. In short, although there may be widespread agreement that CRA requires some major repairs, there is very little agreement about the appropriate fix.

At this point, we are still gathering information and it would be premature for us to offer any proposals. The Board along with the other agencies will continue this process of assessing the various arguments and concerns in an important public meeting in Chicago next week. Many of the issues which will be under consideration are dealt with in the several bills that you asked us to review in preparation for this testimony. Thus, I am not now in a very good position to express any views on the details of these legislative proposals.

Given the fact that the agency review of CRA is so comprehensive, and is only in midstream, I would counsel against proceeding with legislation until the results of the agency review can be evaluated. There may or may not be a constructive

role for legislation at some point, but it seems premature to make that judgment now. It is also clear that some of the proposals for change in the bills are already within the authority of the agencies. Some provisions that do not affect CRA directly, for example, dealing with the Bank Enterprise concept, may nevertheless be affected by how the agencies ultimately decide to recast CRA. Thus, we will be in a much better position to provide meaningful thoughts on the various legislative proposals at a later date.

Finally, you have asked for information on the present status of the Federal Reserve System's CRA examination and enforcement. In general, the Board's involvement in CRA encompasses consumer compliance examinations, community affairs efforts, and consideration of applications for bank expansion. I would like to tell you a little about these areas.

#### *Compliance Examinations*

The Board supervises approximately 1000 state member banks for compliance with CRA. The Board first established a specialized consumer compliance examination program in 1977. Through this program, the twelve Reserve Banks conduct on-site examinations of state member banks to determine compliance with consumer protection legislation, including CRA, by using a cadre of specially trained examiners, as the President has suggested.

Examiners review twelve CRA assessment factors during the CRA examination. A bank's compliance with these factors,

which are grouped into five rating categories, form the basis of the CRA rating assigned. Some of these factors require an evaluation of the bank's lending and investment within its community. Others require an evaluation of how the bank has decided to meet its community's credit needs--its CRA program. In addition, examiners weigh the bank's fair lending efforts and its capacity to help meet community credit needs.

#### *Examination Improvements*

Our consumer compliance schools for examiners devote considerable time to the CRA and related regulations, such as those covering fair lending and home mortgage disclosure. System compliance examiners currently receive CRA training from three separate schools. One of these, a more advanced compliance school, includes segments on community development lending. Another school, called CRA Advanced Examination Techniques, provides examiners with a week long intensive course in CRA. 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 that they can fairly assess the quality of a bank's reinvestment loans.

In addition to these schools, we have been concerned about providing examiners with better tools to help them get the job done. To this end, on behalf of the 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 and allows the data to be segmented by demographic characteristics such as race, gender, and income levels, or 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 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. We have been holding HMDA training sessions on how to use this system around the country for our examiners, as well as those from other agencies.

System examiners also use HMDA data on a more "micro" level, as well. Recently, the Federal Reserve System developed a computerized model for using HMDA data in connection with the fair lending portion of the examination. This model allows examiners to match minority and nonminority pairs of applicants with similar credit characteristics, but different loan outcomes, for a more extensive fair lending review. Once the pairs are selected, examiners pull the credit files for the applicants to determine if discrimination played a part in the credit granting process. While a comparison of minority and majority applicants has always been a part of the Federal Reserve's fair lending examination, we believe that this computerized selection process

will enable examiners to focus their efforts and spend more time on the actual fair lending review of loan files.

The Federal Reserve has also developed the capability to map by computer the geographic location of a bank's lending products, including mortgage loans. This mapping includes demographic information for the bank's local community. We believe that this type of analysis and presentation will enhance our ability to assess a bank's CRA performance in meeting the credit needs of its local community, including minority areas. It should also be helpful in evaluating a bank's geographic delineation of its local CRA service area to ensure that it does not exclude low- and moderate-income neighborhoods.

Finally, I believe it is important to note that, in response to community concerns heard about CRA and its enforcement, the agencies through the FFIEC, have taken steps to try to improve CRA over the last several years. For example, in June 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 that they are used in the assessment process to support the conclusions reached. When it is available, 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.

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 in 1992, we endeavored to help reduce the amount of paper work and documentation by emphasizing that institutions should retain for examiners' review, only information that leaves an audit trail for CRA activities and related lending, and that 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 it is 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.

Personnel resources allocated to CRA examination have increased significantly since 1989. In addition to conducting examinations, our examiners and Reserve Bank staff 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 a more demanding and time-consuming job for examiners.

For more than a decade, we have examined state member banks with a satisfactory or better record of past CRA performance every eighteen to twenty-four months. "Problem banks," or those with demonstrated weaknesses, are examined every six to twelve months. Since the public disclosure provisions became effective in 1991, the Federal Reserve has examined every bank it supervises at least once for CRA purposes, 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.

The Board has authorized its Division of Consumer and Community Affairs to hire an individual whose primary job responsibility will be to work in the area of fair lending enforcement. This person will help to coordinate our efforts in this area and assist our examiners in analyzing the complex issues associated with detection of credit discrimination. We hope to have this person on board shortly.

#### *Fair Lending Initiatives*

In May of this year, the agencies sent a letter to the chief executive officer of each federally regulated bank and thrift in the country. In this letter, the heads of the four agencies said they expect all financial institutions to do their part to design programs to ensure access to credit on a non-discriminatory basis. The letter urged special attention to eleven specific fair lending activities, including enhanced employee training, internal second review programs for loan applications that might otherwise be denied, participation in multi-lender mortgage review boards, and affirmative marketing and call programs.

Then, in June, the agencies undertook a number of fair lending initiatives to enhance our ability to detect lending

discrimination at each of our institutions. In particular, these efforts include:

- providing additional fair lending training to examiners;
- developing a fair lending seminar for industry executives;
- developing alternative discrimination detection methods;
- implementing referral procedures to the Department of Justice for violations of the Equal Credit Opportunity Act; and
- improving the agencies' consumer complaint programs.

#### *Community Affairs Program*

The Board believes that ensuring fair access to credit can also be advanced by focussing on positive actions that a lender may take to address such concerns. Consequently, through its Community Affairs program, the Federal Reserve conducts outreach, education, and technical assistance activities to help financial institutions and the public understand and address community development and reinvestment issues. During 1992, resources devoted to Community Affairs activities at the Reserve Banks were increased to enable the Federal Reserve System to respond to the growing number of requests for information and assistance from banks and others on the Community Reinvestment Act, fair lending, and community development topics. Efforts were expanded to work with financial institutions, banking associations, governmental entities, businesses, and community groups to develop community lending programs that help finance

affordable housing, small and minority business, and other revitalization projects. For example, the Federal Reserve Bank of Kansas City sponsored a conference for bankers on "Credit and the Economically Disadvantaged," focusing on barriers faced by minority borrowers and steps banks can institute to ensure that credit is offered on an equitable basis. The Boston and New York Reserve Banks cosponsored a conference on credit issues affecting economic development programs for Native Americans, especially those living on reservations. And, here at the Board, we recently held a meeting for Washington area bankers which focused on successful programs in other parts of the country. In this meeting, which was co-sponsored by the Federal Reserve Bank of Richmond, bankers discussed the Delaware Valley Mortgage Plan and other successful models for multi-bank efforts to combat mortgage lending disparities in low-income and minority areas. These are but an example of a comprehensive community affairs program at work throughout the Federal Reserve System.

#### *Applications Process*

Applications for bank expansion that present CRA issues, such as those affected by poor CRA ratings or CRA protests, have grown more numerous in recent years. Since 1989, the Board has denied five applications in whole or in part based on CRA concerns. Although the Federal Reserve Board has denied few applications on CRA grounds, it should be kept in mind that it denies relatively few applications generally. In 1992, only

six applications were turned down, one of them because of CRA deficiencies. This record does not, however, fully reflect the influence that the CRA has had. Institutions with poor CRA records often do not file an application with their supervisory agency. Others take concrete steps to address weaknesses in their CRA performance before filing an application. Still other applications are withdrawn if applicants anticipate an adverse finding after the agency's preliminary review. Through the applications process, just as through our examinations and community affairs program, we have sought to maintain a strong approach to CRA enforcement.

In conclusion, I appreciate the opportunity to appear before you today to testify on the important and complex issues regarding the Community Reinvestment Act. The Board shares your concerns about these issues and looks forward to working with the Congress and others to address this important topic.