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Remarks by

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Chairman

Board of Governors of the Federal Reserve System

at the

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Good afternoon. In dealing with the Community Reinvestment Act, the Home Mortgage Disclosure Act, discrimination in lending and other consumer issues, the National Community Reinvestment Coalition plays a vital role in many of the most pressing concerns facing financial institutions and their communities. Consequently, I particularly appreciate the opportunity to discuss a few of the many issues surrounding the provision of credit to low- and moderate-income people.

I have little doubt there are many in this audience who have profoundly differing views from those of us at the Federal Reserve on the way CRA should be interpreted and implemented. To be sure, I do not think we disagree on the central objective of CRA: to expand profit-making lending to all elements of the community--including those that have been overlooked in the past.

I do believe, however, that we have significant differences in certain of our approaches. These are disagreements mainly of process and effect. By nature community groups may be less inclined to trust market forces than we do. You may view our caution with regard to the CRA reform proposal as hostility, while we see it as prudent decision making. You may tend to see issues appropriately from your vantage point of community development, while we are required to be looking at the same questions in a somewhat broader economic context. What you may view as ultimately critical short term gains, we may often see as counter-productive in the long run to our common goal. I grant we at the Fed may be wrong on some of this, but so may a number of you. The appropriate approach is debate in a

democracy, before Congress and in open forum. I hope that my remarks today will contribute to that process.

Let me first dwell on the Community Reinvestment Act. As an economist, I suspect I approach CRA a bit differently than many of you. We economists tend to think that what makes good market sense makes good long term social sense as well. CRA can be good business, and can meet that market test.

When conducted properly by banks who are knowledgeable about their local markets, who use this knowledge to develop suitable products, and have adequately promoted those products to the low- and moderate-income segments of the community, CRA can be a safe, sound, and profitable business. This seems to have been proven over the years of our experience since the law was enacted in 1977. CRA has helped financial institutions to discover new markets that may have been underserved before. That has been its great strength.

We at the Federal Reserve have stressed this market aspect of CRA and will continue to do so. Activities developed by banks to meet credit needs in low- and moderate-income neighborhoods should be well-planned and thoughtfully implemented within their overall business plan. Banks should not try to throw money at a problem or "just write the check"--that's not using the market to anyone's advantage. The latter type of activity will not be sustainable over the long haul. If CRA is perceived by banks as a tax or credit allocation, it will fail in the long run. Banks are not philanthropic institutions, and if

approached with this in mind, they are unlikely to be substantial reliable partners over time. They are for-profit entities with obligations to their stockholders, and subject to a regulatory apparatus which protects their depositors from losses due to unsound practices.

This is surely evident to most of you, but I think it bears repeating, for CRA must meet the test of the market if it is to provide the long-term benefits of revitalization that we all desire. It's worth reminding all of us--community groups, policy makers and even bankers--of this fact from time to time, since it's sometimes tempting to emphasize short term benefits at the expense of long term commitments.

Nowhere have the benefits of sound community development lending practices been more evident to me than on a recent community tour which I took in southeast Washington, D.C. There I witnessed low-income multifamily housing and retail projects which have been financed by a local institution with a professional, experienced community development lending group. This bank has forged productive partnerships with local non-profit and for-profit entrepreneurial developers. The result has been an impressive array of projects which provide housing and retail services to large segments of a previously underserved low- and moderate-income community in Washington. The result for the bank has been twofold. It has attained a high degree of visibility for these projects and they have realized a profitable portfolio. Yes, some of this was accomplished with the aid of

special government programs to fill gaps. But on the whole, the role of government was rather inconsequential.

What is uppermost in people's minds these days about the Community Reinvestment Act is the proposal for revised regulations. As you know, the four regulatory agencies were asked by the President to rethink CRA by placing more emphasis on performance, rather than process and documentation. I believe that few bankers or community groups thought that the current system was working at an optimal level. The ultimate goal, according to the President's request, is to "replace paperwork and uncertainty with greater performance, clarity and objectivity." We are in full accord with this objective.

The proposed changes represent a major overhaul of the current procedures and need to be closely examined. The public comment period ends on March 24, and if you have not already done so, I encourage you to submit comments to the regulators. We will be looking very closely at these comments as we draft the final version of the regulation. There is certainly a wealth of CRA experience represented by those in this room and I urge you to share your perspectives with us. These public comments weigh heavily in agency decision making.

Rather than dwell on the specific proposal that has been published, I would like to make some points which I think need to be considered when the agencies adopt a final rule. First, although it's clear that actual performance, not procedures, should be the major emphasis in CRA, the agencies

must not cross the line into credit allocation. By this I mean taking into their own hands the decisions about the best use of credit to meet the needs of localities. Certainly this is done by the Congress from time to time--for example, through the tax code and credit subsidies. But this is not, and should not be, the role of banking supervision. Despite its problems, CRA has had a unique strength in that it has not been a bureaucratic, Washington driven, program that substitutes "inside the beltway" decision making by non-elected officials for the give and take of local community control. Yet it does seem clear that some greater direction from the regulators is needed, and the question is how that guidance should be provided.

This has been one of the most difficult issues that we have tackled in this revision process--trying to maintain some flexibility, yet further quantifying what is required for good performance. Centrally directed credit allocation by administrative agencies would interfere with the flow of credit to a bank's market, and runs the great risk of misallocating funds and underserving some of the unique and critical needs in your own localities. I don't think you'll find any argument on this point from any of the agencies, but it will be important for all of us to remain vigilant to the risk of defacto credit allocation that is not sanctioned by the Congress, at the same time we are disavowing any such intention.

Second, quantifying CRA may be viewed as an improvement in some quarters in that it would add some certainty for bankers

on their rating, and better allow community groups to assess performance. It would also make our examiners' lives much easier by removing the need for them to make judgments on "how much is enough." In the public hearings which were held on CRA reform, many bankers requested that we "just tell them what they need to do." Many community groups echoed this theme. And it's easy to understand the desire for a clearer road map. However, complete quantification could do more harm than good by removing incentives for creativity in the implementation of projects. By allowing some judgment to remain, it increases the chances that banks will look more closely at the specific needs of their communities, as they are influenced by local groups, and develop innovative solutions for addressing those needs. A laundry list of allowable activities may preclude certain distinctive projects. It may cause banks to concentrate all their resources on the more common projects which are known to get so-called "CRA credit". It would be most unfortunate if unique and well thought out projects remain unfunded because they aren't on some list that we in Washington have devised.

Third, let me mention a positive aspect of the reexamination of CRA--a more direct recognition that CRA is not just about housing. Initially when CRA was enacted the emphasis was on housing for several reasons. One, the statute was passed as part of the Housing and Community Development Act of 1977. Second, the major community organizations which lobbied successfully for the passage of CRA were mainly housing advocacy

and development groups. Third, with the existence of HMDA data, housing was the only area for which the public had quantifiable data on an institution's performance. However, the importance of small business financing and development to low- and moderate-income communities and to our economy as a whole, cannot be minimized. The 1990 census data shows that about half of the jobs in our country were contained in small businesses with fewer than 500 employees. I am glad to see that business development is being recognized as a major issue in bank lending under CRA, and I believe the proposed CRA reforms will assure that this important area receives proper consideration.

We have tough work ahead of us. Although there seems to be common agreement that reform of CRA is desirable, there are difficult decisions to be made. Although data based, the rating system being proposed will still--properly in my view--depend on considerable examiner judgment. We should therefore not entertain false hopes of curing the ambiguity problem that engendered so many of the complaints that prompted the review process. The core question is whether the new complicated evaluation system will better advance the cause of CRA for all concerned. We will need to rely heavily on the comment process for this answer, and again I can only urge everyone to participate in that process.

Closely related to changes in CRA are the various proposals for funding community development financial institutions. Without taking a stance on any specific piece of



legislation, as a general principle I think it is very important to utilize existing financial intermediaries and institutions as much as possible. There are hundreds of excellent community development organizations actively operating in our communities, and many more with the potential to substantially increase their contributions if they were given a little assistance. In general, in my view, we should support the capacity building efforts of these existing organizations rather than trying to create a network of new institutions. Such a system could easily become a second class banking structure that serves low-income people, thereby removing the pressure on mainstream depository institutions to recognize the benefits from serving these populations.

Let me turn briefly to a matter of serious concern to us all. That, of course, is the specter of racial discrimination in the mortgage granting process raised by the HMDA data, our own research and enforcement activity, and findings of the other agencies. I know of few issues that need such prompt and decisive action--on behalf of both the regulators and the industry--as do the questions that have arisen about the fairness of the mortgage market.

We simply cannot as a nation tolerate unfair and illegal activity that puts some of our citizens at a disadvantage as they try to participate in the credit markets. We all know that the raw HMDA numbers are not a reliable gauge of whether discrimination is at work or to what degree. But the general

story they tell cannot be encouraging to anyone, and is a strong signal that work needs to be done. We can debate endlessly the fine points of the Boston Federal Reserve Bank study that sought to go beyond the HMDA information, but we must not let this obscure the fundamental findings that race alone appears to be a factor. I know from our own experience that identifying the "smoking gun" in the examination process is a most difficult undertaking, but that problem, too, should not undermine our resolve. The cumulative evidence seems clear to me. We have a problem whose magnitude may be unknown, but whose presence is undeniable.

To be sure, much discrimination, perhaps most, in today's society is subconscious, the result of habit and culture. But whether it is deliberate or not, the consequence is the same. Free market capitalistic systems rooted in individual freedom cannot and should not abide such unjust behavior. To the extent that individual contributions to the market place are judged, and rewarded on any basis other than economic values, the system suffers, and the nation's standard of living is impaired. We may never reach perfection in this regard, but we should never cease to persevere.

Let me assure you of the commitment of the Federal Reserve Board to doing our best to deal with the difficult problem of discrimination. We are augmenting our examination procedures with new more sophisticated techniques--building on some of the statistical procedures developed in the Boston study.

We have been aggressive in our educational efforts with banks, and have reorganized our complaint processing to bring all our best efforts to bear on investigating any allegations of unfair treatment. These independent efforts are being pursued at the same time that we are coordinating activities with the Department of Justice, HUD and the other agencies.

But the solution to these problems will depend on a very significant commitment by the industry itself. We have been encouraged by efforts of individual institutions to review loan processing procedures, reexamine credit granting criteria for unintended unfair consequences, institute special training for loan officers, and establish second review programs. All of these efforts deserve aggressive support, and I would urge each and every institution to undertake a self examination.

In closing, let me say that the existence of the National Community Reinvestment Coalition--conceived to largely represent the views of grass roots organizations --is a welcome addition to the Washington scene. In bringing the views of its constituent organizations to the attention of the Federal Reserve and others, it is playing a most crucial role in the formation of our nation's policy on the critical issues of economic development. Despite our differences, I very much appreciate having the opportunity to address you.