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October 17, 2001

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
Re: Docket No. R-1112
20th Street and Constitution Avenue, NW
Washington DC 20551

Docket No. 01-16
Communications Division
Public Information Room
Mailstop 1-5
Office of the Comptroller of the Currency
250 E St. SW
Washington DC 20219

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments/OES
Federal Deposit Insurance Corporation
550 17th St. NW
Washington DC 20429

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
Re: Docket No. 2001-49
1700 G St. NW
Washington DC 20552

Dear Federal Banking Regulators:

On behalf of ACORN's 120,000 member families, I write regarding the joint ANPR on possible revisions to the Community Reinvestment Act regulations.

As you know, Congress passed CRA in 1977 in response to decades of blatant redlining by banks of low- and moderate-income neighborhoods and communities of color, to require that banks lend in all communities from which they take deposits. In doing so, Congress recognized the tremendous damage being inflicted on those neighborhoods by banks denying residents access to capital. For most American families, homeownership has long been the primary path to building financial stability to allow for a more secure retirement and more flexibility in making life decisions. But bank redlining and discriminatory practices have blocked this path for millions of Americans, as well as greatly limiting their opportunities to start up small businesses. The economic damage is still evident in many communities.

While we still have a long way to go, CRA has helped produce substantial progress in pushing banks to improve their lending performance in underserved communities. Often in cooperation with ACORN and other community organizations, many banks have attempted to remove barriers in their underwriting criteria that excluded credit-worthy low- and moderate-income applicants and to adjust their loan products to meet the needs of those consumers. Many banks have improved their outreach efforts in underserved communities to attract more applicants and have helped create a loan counseling infrastructure that assists first-time homebuyers in overcoming barriers to homeownership. All of the available evidence – as noted in recent studies by the Federal Reserve, the Treasury Department, Harvard's Joint Center for Housing Studies, and others – indicates that CRA has significantly increased economic opportunities in lower-income communities while opening up profitable business for banks and thrifts.

The last revision to the CRA regulations in 1995 has been helpful in shifting the focus of CRA from a process-based evaluation system to one that concentrates on the results achieved. The central problem remains, however, that the standards for evaluating CRA performance need to be upgraded for the law to remain meaningful. Despite what the exams say, it is abundantly clear that 98% of banks and thrifts are not doing a satisfactory or better job of meeting lending needs in all of the communities they serve. In their CRA evaluations, the regulators need to seriously consider problems in individual markets, and to be responsive to the concerns of community organizations and other members of the public where lending needs are not being met. In addition, there are many other improvements to CRA that should be included in the proposed rule – both to adjust to significant changes in the financial industry over the past six years and to implement lessons learned over that time. Our comments on specific items considered in the ANPR follow.

Lending Test

Congress passed CRA with the primary intention of ensuring that banks would provide greater access to loans for residents of redlined communities, and lending should remain the central focus in any new regulations. While progress has been made, the amount of credit banks are providing to low- and moderate-income communities still falls well short of the credit needs of residents living in those areas, as ACORN's members regularly see.

This gap has greatly limited our economic opportunities and opened the way for predatory lenders to come in making high-cost home loans to people who do not see any other available options, regardless of their actual credit records.

As mentioned above, one of the 1995 revision's policy shifts was to base the evaluation system for CRA exams more on a bank's actual lending record than on whether a list of largely bureaucratic steps had been completed. This focus on the quantity of loans made in various communities should be maintained, with the important addition that the quality as well as the quantity of loans must be considered. CRA exams and ratings need to adopt high standards with regard to what constitutes an adequate number of prime loans to underserved communities; they need to ensure that lenders are not engaged in a pattern of making or financing higher cost subprime loans to borrowers who could qualify for prime loans; they need to recognize the difference between prime and subprime loans, and not reward lenders for making or financing subprime loans where they are not also marketing prime loans to qualified borrowers; and they should penalize lenders for making or financing abusive or predatory loans. Failing this, the CRA exams – and the regulators – ratify a bifurcated financial system, with some borrowers routinely paying more, and usually much more, for credit.

The HMDA data clearly shows that banks are not living up to their responsibilities under CRA. ACORN's recent analysis of the 2000 HMDA data,[1] provides further evidence of this economic reality:

- Lending institutions continue to fail to adequately serve low and moderate-income communities of all races. Low and moderate- income neighborhoods comprise 26% of the country, yet these neighborhoods received just 12% of the conventional loans.[2]

- The share of conventional loans made to African-Americans and Latinos continues to lag far behind their shares of the population. African-Americans comprise over 12% of the country's population, yet they received just 5% of the conventional loans. Latinos account for almost 13% of the national population, but received just 6% of the conventional loans.

- Nationally, half of all African-American applicants and more than one-third of Latino applicants for conventional mortgages were rejected in 2000. African-American applicants were over twice as likely to be turned down for a mortgage as white applicants, and Latinos were rejected almost one and a half times more often than white applicants. These figures are of even greater concern because they represent an increase in the disparity between white and minority denials compared to in 1999.

[1] The full report, *The Great Divide: An Analysis of Racial and Economic Disparities in Home Purchase Mortgage Lending Nationally and in Sixty Metropolitan Areas*, may be viewed at http://www.acorn.org/acorn10/communityreinvestment/reports.htm.

[2] For purposes of the study, conventional loans does not include FHA- or VA-insured loans. It is important to note that the disparities noted here would be far worse if subprime loans were not counted as conventional loans.

- The disparity between minority and white denials is present even when comparing minority applicants with white applicants of the same income. In fact, the disparity is even more pronounced at the higher income levels. Nationally, upper-income African-Americans were turned down almost three times more often than upper-income whites, also an increase from 1999. Even more disturbing, upper-income African-Americans were rejected more frequently than moderate-income whites whose incomes were on average about 50% lower.

The evidence is just as clear that subprime lenders are filling the void, regularly making subprime loans to borrowers in low- and moderate-income neighborhoods who have 'A' credit. Fannie Mae, Freddie Mac, and others estimate that 30%, 40% or more of borrowers in subprime loans could have qualified for A loans. Fannie Mae CEO Franklin Raines recognizes the need for banks to address this situation when he stated in an April 2000 press release, "[p]redatory lending violates three basic mortgage consumer rights: the right to access to suitable mortgage credit; *the right to the lowest cost mortgage for which a consumer can qualify*; and, the right to know the true cost of a mortgage [emphasis added]."[3]

When borrowers who could qualify for A loans instead receive subprime loans, at a minimum they are paying interest rates 200 to 300 basis points higher. Over the life of a 30-year mortgage for $100,000, the difference in payments between interest rates of 8% and 10.5% is over $65,000. Too often, however, higher interest rates are not the only additional cost of a subprime as opposed to a prime loan. And where subprime loans contain abusive features, or unfair pricing, these are damaging to all such borrowers, even if they could not have qualified for an A loan.

Borrowers, including those with good credit, are too frequently locked in to the higher rates on subprime loans by prepayment penalties. In the more transparent prime market, applicants are typically in a better position to actually make a choice about whether or not to have a prepayment penalty, and any penalty is accompanied by a reduced interest rate. In the subprime market, where market analysis estimate that 80% of the loans contain prepayment penalties, it is rare to find a borrower in a subprime loan with a prepayment penalty on their loan who was offered any choice of on the matter. Instead, we regularly talk with borrowers in subprime loans who are surprised to hear that their loans contain prepayment penalties – many of whom specifically asked that they not do so – and ended up with penalties despite this. Then these borrowers, often with the five-year prepayment penalties for six months' interest on the remaining balance that are commonplace in the subprime market, are locked into the high rates and face substantial losses of equity if they try and refinance to lower rates.

Another substantial additional cost is the huge differences in the amounts of fees – with subprime lenders regularly financing into loans up to 7% or more of the loan amount, compared to the fees of 1% to 1.5% of the loan amount typically charged by banks for providing the same service. On an individual loan, these higher fees often mean that an extra $10,000 in equity can be stripped away immediately upon signing, plus all of the

[3] See http://www.fanniemae.com/news/pressreleases/0710.html.

additional accumulated interest. With such gains to be made from transaction costs alone, unscrupulous lenders have an incentive to make refinance loans where there is no benefit for the borrower. And the list of predatory features regularly included in subprime loans goes on – from single-premium credit insurance policies that strip away additional equity to mandatory arbitration clauses that make it financially prohibitive for borrowers to take legal action. It is easy to get caught up in the terms and the data and lose sight of the real impact that these loans are having on people across the country – families already living on tight budgets who now have to find an extra $200, 300, 400 a month for their mortgage payment, and senior citizens who are forced to sell homes they've lived in most of their lives.

We have heard the argument that the market will take care of these problems and sort borrowers out into loan products that are appropriate for their credit records and financial situations, but multiple kinds of evidence dispute this claim. First, as we have said, Fannie and Freddie have stated that 30%, 40% or more of borrowers in subprime loans should be qualifying for prime loans, which is backed up by other sources. The trade publication *Inside Mortgage Finance* published a poll of the 50 most active subprime lenders which also found that up to 50 percent of their mortgages could qualify as conventional loans. In an investigation of subprime lenders, the Department of Justice found that approximately 20% of the borrowers had FICO credit scores above 700, significantly higher than the minimum score of 620 which is usually required to receive a prime interest rate. Second, it is important to remember that much of the subprime lending market is driven by aggressive and sometimes deceptive marketing techniques, and involves products and practices that make it virtually impossible to 'shop around' for a loan. There are many more moving parts on these loans, and the fees and other terms can change substantially from the initial discussions to the final paperwork at closing, which the lender always understands much better than the borrower. It can be difficult for even trained loan counselors to understand all the terms and conditions and damaging bells and whistles in many subprime loans – let alone borrowers trying to look out for their own interests. The average borrower who expects reasonably honest dealing usually gets that in the A market; the same average borrower is likely to face an entirely different situation in the subprime market, often with severe, long-term financial consequences. That should not be how getting a home loan should work.

The sale of subprime loans, often loaded down with predatory terms, to households with excellent credit records is especially damaging because subprime loans are typically concentrated in low- and moderate-income and minority communities where people can least afford them. In our analysis of the 1999 HMDA data comparing the patterns of prime and subprime lending, we found the following:

- Minorities are much more likely than whites to receive a subprime loan when refinancing. In 1999, 45% of all conventional refinance loans, excluding loans for manufactured housing, received by African-Americans were from subprime lenders, as were 20% of the refinance loans received by Latinos, compared to just 12% of the refinance loans received by whites. In comparative terms, African-Americans were

3.7 times more likely to receive a subprime loan, and Latinos were 1.6 times more likely.

- The concentration of subprime loans is greatest among lower-income minorities. Not including loans for manufactured hosing, 61% of conventional refinance loans received by low-income African-Americans were from subprime lenders, and 53% received by moderate-income African-Americans were from subprime lenders.

- The racial disparity is still present when comparing minority borrowers with white borrowers of the same incomes, and it persists among higher income borrowers. 31% of the refinance loans received by upper-income African-Americans were from subprime lenders, as were 13% of the refinance loans received by upper-income Latinos. In contrast, only 8% of the refinance loans received by upper-income whites were from subprime lenders. In addition, upper-income African-Americans were more likely than low-income whites to receive a subprime loan when refinancing.

- African-Americans received a much larger share of subprime refinance loans than of other refinance loans. In 1999, African-Americans received 14% of all the subprime refinance loans made in the United States, compared to the 4% they received of all other refinance loans.

- From 1993 to 1999, the rate of growth in the number of subprime refinance loans to minorities was larger than the growth to whites. The number of subprime refinance loans made to African-American homeowners rose by 959% and by 695% to Latino homeowners, compared to by 569% for white homeowners.

Considering the large number of these borrowers who should be receiving prime loans as well as the frequency of predatory terms in subprime loans for those borrowers who do have damaged credit, these data signify an incredible drain of equity from those communities that can least afford it. The same general patterns also exist for home purchase loans, which comprise a much smaller segment of the subprime mortgage market.[4]

Given the tremendous financial costs inflicted by subprime loans being inappropriately made to borrowers with A credit, regulators need to separate out subprime loans from prime loans when making evaluations about how well an institution is meeting the lending needs of traditionally underserved communities. A lender making subprime loans where they could be making prime loans is not fulfilling their CRA responsibilities, indeed, they are doing harm and not good. CRA ratings on the lending test should reflect the goal of fairly meeting the credit needs of all communities with credit priced at fair terms: A loans for those who qualify for A loans, and fairly priced subprime loans where these are appropriate. Making or financing predatory or abusive loans must count against a lender in its CRA evaluation.

[4] The full report, *Separate and Unequal: Predatory Lending in America*, may be viewed at: http://www.acorn.org/acorn10/predatorylending/reports.htm.

Loans with high rates and/or high fees[5] that also contain features which are abusive in connection with high-cost loans, or loans that violate HOEPA, UDAP, or state or local regulations should be considered as a negative factor in an institution's CRA exam. We recommend the following features or practices would cause any loan made above high-cost thresholds to be considered predatory:

- financing of fees beyond 4% of the loan amount
- making loans which the borrower cannot repay
- flipping, or repeated refinancing, which drains equity and does not provide benefit to the borrower
- prepayment penalties
- mandatory arbitration clauses
- home improvement loans with the proceeds going directly to the contractor
- call provisions
- financing single-premium credit insurance policies, or similar products such as a debt-suspension agreements, into any home loan
- loan promotion or sales techniques involving deception, fraud, or unfair business practices on any home loan.

Any bank that itself or through an affiliate is found to be making predatory loans should not be able to receive a satisfactory or outstanding rating on the lending component of their CRA exam. Also, institutions that purchase predatory loans should not receive a satisfactory or above rating on the relevant test.

When the regulators are making evaluations about the impact of an institution's lending in low- and moderate-income communities, they need to make sure to obtain the perspective of community residents and community-based organizations because they will have the best sense on whether neighborhood needs are being met. If the regulators do not include a perspective other that of the bank on what the local needs are, it is impossible to provide any real evaluation of how banks are performing.

<u>Activities of Affiliates</u>

Since the last review of the CRA regulations in 1995, we have witnessed tremendous and continuing concentration in the financial industry, spurred on by the promise, and then enactment, of "financial modernization" legislation. The most relevant aspect of this trend for the CRA regulations has been the growing involvement of insured depository institutions in the subprime mortgage market, which had previously been dominated by independent mortgage companies. Presently, the country's largest subprime lender (Citifinancial, after Citi's purchase of The Associates) and many of the industry's other major players are affiliated with banks and thrifts, and the CRA regulations should be updated to deal with the changed conditions.

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[5] We suggest that the thresholds for what are considered high-cost loans for this purpose on points and fees might be 4% of the loan amount (again, excluding the fees themselves) and on the interest rate for a first mortgage exceeding 300 basis points above the Fannie/Freddie rate and 500 basis points above that rate on second mortgages.

Currently, banks have the option of choosing whether or not to count loans made by their affiliates toward CRA performance. This option is a hold-over from an era when the vast majority of loans were made through the depository institutions and should be eliminated by the regulatory agencies. With bank affiliates now making large numbers of loans, their lending activity must be counted a bank's overall performance in order to obtain an accurate picture of an institution's overall impact on various communities.

The increasing number of loans being made by affiliates also have major implications for how the regulators monitor fair lending compliance. As we have seen with Citigroup and other financial conglomerates, the tendency is for the unit making prime loans to focus on wealthier and whiter neighborhoods while leaving lower-income and more heavily minority areas to be targeted by the subprime unit. For example, according to the 1999 HMDA data for Baltimore, Citigroup's prime lenders originated only 6 out of 228 – or 3% – of their refinance loans in majority-minority census tracts although those areas comprise 23% of all census tracts in the MSA. In contrast, Citi's subprime lenders concentrated their refinance loans in Baltimore's minority neighborhoods. Citifinancial and Associates originated 242 out of 695 – or 35% – of their total refinance loans in majority-minority census tracts. In the Baltimore market as a whole, 11% of all refinance loans went to minority census tracts.

Given how high the costs of steering to subprime or higher cost loans are for both individual households and whole neighborhoods with high concentrations of subprime loans, it is more important than ever for the regulators to strongly enforce banks' fair lending responsibilities. The regulators must ensure that the kind of loan and the cost of credit which a borrower is provided by a given lender and its affiliates does not depend on the color of their skin, their age, what neighborhood they live in, or what branch of the institution their community is targeted by. A reasonable fair lending standard demands that similarly situated borrowers should be offered credit at the same price regardless of which affiliate of a lender they approach or are approached by, and the regulators must enforce this basic principle. They should follow the lead established by the OCC when it required First Union as part of its purchase of the Money Store to make the same loans available no matter where the consumer applied.

Credit for Purchasing Loans

Currently, banks receive the same amount of CRA credit for the purchase of a loan as for the origination of a loan. While the purchase of a loan provides some additional liquidity, it does not require nearly the same amount investment of resources as originating a loan and should not be rewarded at the same level. Therefore, purchases should count much less than originations in the awarding of CRA credit, preventing lenders with poor origination records from gaming the system by simply purchasing loans made by other lenders. This will result in a more accurate assessment under the lending test of the bank's actual performance in meeting credit needs.

Sadly, many banks and thrifts that are careful to avoid the origination of predatory loans do not exhibit the same degree of caution in monitoring their purchases of loans. Just as lenders' origination of subprime loans should not be treated as the equivalent of originating a prime loan, purchasing a subprime loan is not the same as purchasing a prime loan, and the purchase of predatory loans should hurt, not help, an institution's CRA rating.

Small Bank Test

We believe that the current definition of small banks as those which have less than $250 million in assets and which are unaffiliated with any bank holding company over $1 billion in assets should be maintained. The current threshold means that over 80% of banks are considered small banks and eligible for the streamlined procedure. Banks above the $250 million level have a substantially larger impact on the communities they serve and should be subject to more careful scrutiny. Banks with ties to a bank holding company that has over $1 billion in assets have access to much greater resources and should not be treated as banks for CRA purposes. At the same time, more should be required of banks under the small bank exam procedures. The exams should go beyond the current focus on loan-to-deposit ratios to look at the distribution of loans by borrower income and neighborhood income classification.

Service Test

The availability of financial services in low- and moderate-income communities is important to the well-being of residents, but the current weighting of the service test under CRA adequately responds to those needs. The test itself, however, could be significantly improved to do a much better job of determining whether low-cost financial services are actually reaching the intended audience. In many cases, banks have decent products that would meet important needs but do so little marketing of those items that they miss the opportunity to bring more consumers into the mainstream financial world. A revised test should grade institutions according to quantifiable measurements of how many consumers are using their low-cost banking services, such as lifeline banking accounts.

The regulatory agencies also need to consider any relationships a bank or thrift maintains with other companies that provide financial services, especially higher-cost fringe products. The most common abuse involves payday lenders that use national bank charters to make payday loans in circumvention of state consumer protections against outrageous rates. Several national banks continue to receive satisfactory CRA ratings at the same time they offer the use of their charters to companies marketing 400%, 500% or higher APR payday loans in low- and moderate-income neighborhoods. In this regard, we are encouraged by the OCC's recent amicus brief filed on *State of Colorado v. Ace Cash Express,* which we hope marks a reevaluation of the agency's position.

Beyond payday lenders, the regulatory agencies should also take a look at relationships banks maintain with check cashers. The most disturbing aspect of such relationships is the likely possibility that the bank is effectively supporting the distribution of more expensive financial products to meet consumer needs created by the bank's own failure to provide consumers with lower-cost mainstream financial services. No bank engaged in partnership with firms offering fringe banking services should receive a satisfactory or higher rating under the service portion of their CRA exams.

Investment Test

The investment test should continue as a separate test with the same weighting, but, like the service test, it should be implemented much more effectively. The main problem is that the current test does not make any distinction among different types of investments. There are substantial differences in the community impact and level of commitment required, for instance, between grants, deposits in eligible institutions, and investments in development projects. Most notably, grants or commitments that support effective community efforts to improve the availability of quality loans in low- and moderate-income communities should be given more weight than other investments.

There have been rumors that some in the financial industry want to do away with a *separate investment test because they say it discourages investments in certain cases.* We have yet to see any convincing evidence of this assertion. Unfounded claims should not be allowed to overturn a general requirement that is based on the law and important to the well-being of lower-income communities.

Any investments in mortgage-backed securities should be monitored for predatory features. As is suggested above for the lending portion of the exam, the purchase of securities backing subprime loans must not be treated in the same way as securities backing prime affordable housing loans. The purchase of securities backed by predatory loans, or the purchase of such securities in the absence of real standards to ensure that the loans are not predatory, and that they are not the result of inappropriate steering of A borrowers to subprime loans, should count against, rather than in support of, a good CRA rating. Any investments that back predatory loans should disqualify an institution from receiving a satisfactory or outstanding rating on the investment test.

Assessment Areas

Banks' assessment areas should include the entire MSA for metropolitan areas where they do business. Either by making loans or failing to make loans available, banks have an impact on a wide range of communities in a given metro area. Banks that are highly specialized should not be allowed to abrogate their CRA responsibilities as they continue to enjoy the range of benefits of the federal banking system, including deposit insurance. Such banks divert resources that would otherwise be used at least in part to make loans to the significant portion of the local population residing in low- and moderate-income neighborhoods.

Non-traditional banks and thrifts pose a special challenge for regulators that has not yet been adequately addressed. At present, the assessment areas for insurance companies like State Farm that provide banking products through their networks of agents, internet banks, and other banks that do substantial amounts of business over the internet are based on the physical location of their businesses, which have little relevance for what communities are being impacted. Instead, the assessment areas should include the locations of communities where they are making a substantial share of the loans – perhaps 0.5% of the total number of loans made in a particular MSA or non-metro county – as well as any communities where they are accepting deposits.

Separate Community Development Test

We oppose proposals that have been circulating to draw items out of the lending, investment, and services tests to create a separate new 'community development' test that would be heavily weighted. While the ways in which regulators conduct CRA evaluations could and should be improved, CRA's basic structure of measuring lending, investment, and services performance represents the best approach to gauging an institution's impact on low- and moderate-income communities.

CRA Data Collection

The CRA data now being collected is not made publicly available until it is already at least nine months old, which makes it of limited value. We recommend that the data be reported quarterly, if possible, and made available to the public on much quicker timeline. In addition, the data should be reformatted so that it can be easily understood by the public and allow for meaningful comparisons of the CRA performances of individual banks. Data on prime mortgage loans should be compiled and reported separately from subprime mortgages – as the Federal Reserve is considering in its proposed changes to the HMDA regulations – so that the public and government officials have a better sense of the nature of banks' lending activities. Small business loan data should be reported in the same format that those loans currently are reported under HMDA. Also, on the service test, we recommend including the additional items that should be included in the data reported under the services test regarding the actual use of low-cost banking services by residents of low- and moderate-income communities. Finally, in a related matter, it is critical that the Federal Reserve move forward as soon as possible with a final rule on its revisions to HMDA to improve the public's understanding of the impact of financial institutions' lending activities on our communities.

Thank you for your consideration of our comments. Please do not hesitate to contact us if you have any questions. Any changes you propose will have a significant implications for the financial health of low- and moderate-income communities all across the country.

Sincerely,

Maude Hurd
National President, ACORN