LISC
Helping neighbors build communities

THE ENTERPRISE FOUNDATION

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

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

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

Regulation Comments, Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW.
Washington, DC 20552
Attention Docket No. 2001-49

To Whom It May Concern:

The Local Initiatives Support Corporation (LISC) and The Enterprise Foundation appreciate this opportunity to comment on the federal bank regulatory agencies' joint Advanced Notice of Proposed Rulemaking (ANPR) on the Community Reinvestment Act (CRA) regulations.

LISC helps neighbors build communities. In 21 years, LISC and its affiliates have raised from the private sector and provided $4 billion to 2,200 nonprofit low-income community development corporations (CDCs). These CDCs have used our funds to attract an additional $7 billion. This combined $11 billion investment has produced over 110,000 affordable homes and 14 million square feet of commercial and industrial space, 40,000 jobs and numerous childcare facilities, charter schools, youth recreation programs, crime and security initiatives and many other programs.

Founded in 1982 by James and Patty Rouse, Enterprise raises private capital and invests it in a wide range of grassroots-led community revitalization initiatives. We have invested more than $3.5 billion, which has leveraged an additional $4 billion. These resources have helped produce more than 120,000 affordable homes and place 35,000 hard-to-employ people in jobs. Enterprise's network of local partners includes 1,900 community and faith-based groups, public housing authorities and Native American Tribes in more than 700 locations.

The CRA has been indispensable to Enterprise's and LISC's efforts and those of our community-based partners to attract investment in distressed neighborhoods and help low-income people join the economic mainstream. The Act has encouraged banks of all sizes to pioneer innovative partnerships that have brought hundreds of billions of dollars to low-income neighborhoods and generated new business opportunities for financial institutions. A recent Federal Reserve Board report on the CRA found that most CRA lending is profitable for bank and thrifts and that the benefits of CRA lending outweigh the costs associated with it.[1]

LISC and Enterprise are deeply committed to ensuring that the CRA regulations implement the Act vigorously, fairly and effectively. We believe that the current regulations meet that standard for the most part. We applaud the regulators for the 1995 rule. We believe that it generally succeeded in changing the focus of CRA examinations from process to performance. A recent Treasury Department study found that CRA-covered lender and affiliate loans grew the share of home purchase loans within their own portfolios to low- and moderate-income borrowers and areas by 11 percent between 1993 and 1999.[2] Virtually all of this gain occurred after the current CRA regulations became effective in 1995. To be sure, CRA regulations alone did not account for this increase, but CRA—and its sharper regulatory focus—clearly was a contributing factor.

While we would not recommend major changes to the CRA regulations, we would propose modifications to them if the regulatory agencies decide to consider changes in the future. These proposed modifications are based on Congress' dual intent in enacting the CRA in 1977: to combat bank "redlining" of low-income, minority and inner city neighborhoods *and* to increase access to capital in those communities.

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[1] Board of Governors of the Federal Reserve Board System, "The Performance and Profitability of CRA-Related Lending," July 2000.

[2] Litan, Retsinas, Belsky, Leonard and Kennedy, "The Community Reinvestment Act After Financial Modernization: A Final Report," U.S. Department of the Treasury, January 2001.

1) A New Community Development Test for Large Retail Institutions

LISC and the Enterprise Foundation strongly support the creation of a new community development (CD) test for large retail institutions. The CD test for large retail banks should be very similar to the one already in place for wholesale and limited purpose banks. That test requires the federal regulatory agencies to consider: the number and amount of community development loans, qualified investments or community development services; the use of innovative or complex qualified investments, community development loans or community development services and the extent to which the investments are not routinely provided by private investors; and an institution's responsiveness to credit and community development needs.

Consistent with this provision of the current regulations, a new community development test for large retail institutions should combine community development loans, investments, and services. CD lending and services should no longer be elements of the lending test and the service test, and the investment test should be subsumed entirely within the CD test.

We believe that a CD test would improve CRA in several respects.

a) CD activities are currently split among the three tests: lending, investment, and services. This fragmentation impedes what should properly be an integrated approach to low-income communities. An integrated CD test would recognize and encourage institutions that blend lending, investment, and services strategically.

b) CD activities are fundamentally different from the large volume, standardized home mortgage and small business lending that currently dominate the lending test. We hear from many sources that the lending test has essentially become a numbers game, and that may work relatively well for home mortgages and small business lending. However, CD lending fits poorly into this structure. At least as important as the volume of CD activities is their responsiveness to local needs and priorities. Many CD activities require customized financing, are more innovative and complex, involve nonprofit and governmental partnerships and funding, and need to work within a broader revitalization strategy. Although CD activities may be modest in volume compared with home mortgage lending, they often bestow disproportionate benefits on communities, and are often essential to opening the market for more conventional lending.

c) The current separation of CD lending from investments distorts the optimal provision of financing by placing the form of financing over its substance.

- For example, a community that needs the construction of owner-occupied homes might benefit most from construction lending. Another community that needs to rehabilitate rental housing may need equity investments based on Low Income Housing Tax Credits. An institution's responsiveness to a community's needs should determine whether it gets a high CRA rating, not the *form* of the financing it provides.

  - Our organizations sometimes encounter institutions eager to make Housing Credit investments in a given community in order to satisfy the investment test, even though the community may have greater needs and opportunities for CD loans. In many cases, an institution's opportunity to make investments is limited by the state's allocation of Housing Credits to a community. An integrated CD test would encourage the right activities for each community.

  - We are sometimes asked to change the form of a financing to fit the investment test or the lending test, even though normal business considerations would otherwise suggest a different structure, in order to accommodate an institution's particular need to bolster its record on the lending or investment test. Such alterations add complexity and cost, which in some cases are prohibitive, without enhancing responsiveness to community needs. An integrated CD test would allow form to follow function.

  - Many institutions assert they have difficulty finding good investment opportunities, and that they sometimes feel compelled to make investments that may not add value or respond to a community's needs merely to satisfy the investment test. An integrated CD test would encourage more financing that truly adds value to communities.

  A combined CD test would eliminate these distortions and encourage institutions to meet CD needs of communities more appropriately.

Because the CD test would include more than investments, the CD test should account for a larger share of the overall CRA rating than the investment test now does. Since the investment test now counts for 25% of the overall CRA rating, the CD test should comprise at least 35%-40% of the overall CRA rating. Moreover, because a CD test would accord more flexibility to institutions than has been possible with the investment test, they will have more opportunities to provide meet CD needs. Accordingly, we believe that examiners should be rigorous in ensuring that institutions are providing an appropriate volume of financing that truly addresses CD needs. The purpose of a new CD test must be to meet the needs of communities better. The net result of the new CD test should be to increase overall resources to communities compared with the current array of CD loans, investments, and services, not to permit institutions to do less.

2) Flexibility for Large Retail Institutions to Earn CRA Credit Outside Their Assessment Areas

Under the CD test now applicable to wholesale and limited purpose institutions, an institution that adequately addresses the needs of its assessment area (including the region that includes the assessment area) receives full recognition for its CD activities nationwide. We strongly urge that this principle be applied to large retail institutions, especially if a new CD test is established.

Capital mobility is a hallmark of the U.S. financial system. This system is extremely efficient at moving capital from those who wish to invest to those who can use it, nationwide and even globally. Yet the current CRA rules actually discourage the extension of this principle to low-income communities. Instead, the CRA rules for large retail institutions generally recognize financing provided within the institutions' assessment areas, and to a limited extent in the region that includes the assessment area. This means that institutions that increasingly do their business on a national basis must develop a different business model for their CD activities. Recognition of CD activities nationwide would allow institutions to integrate CD into their overall business strategies.

The current rules present significant obstacles to financing in under-served urban and rural areas, especially those not served by pro-active or sophisticated institutions. Some institutions have more capacity to provide more CD financing than their assessment areas can absorb. They would be willing to provide financing elsewhere, and the additional volume would make their operations more efficient, but they will not do that unless they receive full recognition under CRA. For example, when LISC sought to arrange an innovative economic development investment for rural Kentucky, no local retail bank had the capacity and commitment to participate, and outside retail banks declined the opportunity because they would not get CRA recognition. Fortunately, a wholesale bank did make the investment and receive full CRA recognition. Allowing large retail institutions the same recognition available to wholesale and limited purpose banks would greatly expand CD financing, especially in smaller cities and rural areas.

In addition, the current geographic restrictions add enormous administrative complexity to national CD financing efforts. In many cases, there are important business reasons to provide specialized financing on a national basis. For example, Enterprise and LISC provide rental housing equity investments on a national basis in order to achieve operational efficiencies.

Similarly, developing new financing products, such as for economic development, requires a national scope in order to generate a critical mass of activity. Yet, many retail institutions report they receive limited CRA recognition for investing in national funds. These institutions are increasingly insisting in local, regional, or even single-investor or "brand-name" funds that they can direct to specific assessment areas. Such narrow geographic targeting of CD financing often creates problems. A given area may not need certain kind of activity or financing, or may not have ripe financing opportunities, or it may need more financing than "local" institutions can provide. Moreover, the administrative burden of tracing funds from local institutions to local CD transactions is heavy, and we believe unnecessary from a policy perspective. Removing geographic restrictions on CD loans and investments would greatly relieve these problems.

We appreciate that the FFIEC's CRA Questions and Answers do broaden the concept to include community development loans and investments within a broader region that includes the assessment area. However, even that guidance warns that "With larger regional areas, the benefit to the institution's assessment area(s) may be diffused, and thus less responsive to assessment area needs."[3] This warning applies only to retail institutions, and not to wholesale or limited purpose banks. Many large retail institutions are still reluctant to make regionally targeted CD loans and investments because examiners can and do award less credit for them. Retail institutions should have the same flexibility available to wholesale and limited purpose banks.

3) **Performance Context**

Our final comment may not require a change to the CRA regulations, but may be accomplish through less formal policy guidance and examiner training. In general, we urge that an institution's performance context – and most especially the needs and opportunities of the communities it is serving – become the starting point for evaluating the institution's CRA performance. Otherwise, we doubt it will be possible to evaluate properly whether an institution is truly helping to meet the credit needs of its entire community. While we recognize that examiners do consider demographic data, the full performance context should reflect many factors and the input of community organizations and financial institutions.

a) Many institutions no longer market mortgage loans and other financing products to discrete local communities through a traditional branch network, but rather use other marketing strategies. While internet banks are an obvious example, securities and insurance companies are acquiring or establishing banks or unitary thrifts that will serve their parents' current customers or use their parents' marketing systems to

[3] Federal Financial Institutions Examination Council, "Community Reinvestment Act; Interagency Questions and Answers; Notice," *Federal Register*, July 12, 2001, page 36627.

deliver banking services. Similarly, credit card banks and other limited purpose banks do not rely on branch networks, but rather serve a broad range of communities. It is essential that the CRA rules keep pace with these fundamental industry trends. The performance context for these institutions must recognize their full geographic presence, the product lines they offer, and the range of opportunities available to them to meet communities' needs. Intermediary organizations like Enterprise and LISC offer important distribution networks through which non-traditional institutions can provide CD financing.

b) An institution's market share of loans in low-income communities can reflect either great or little responsiveness to a community's credit needs, depending on the performance context. For example:

- In a credit surplus area, even a below-average market share may reflect excellent performance in a highly competitive market.
- In a credit under-served area, even an above-average market share may reflect poor performance in an uncompetitive market.
- In an area with extremely high housing costs, there may be few opportunities to make home purchase mortgage loans to low-income buyers. It could well be appropriate for an institution in such a community to focus its efforts on other products.

c) An institution should receive the same recognition for meeting a community's needs regardless of whether the institution provides the financing directly or indirectly through a third party intermediary. We sometimes hear that some examiners will recognize the innovative or complex aspects of a CD loan or investment only if an institution makes it directly, and not if the institution provided funds to a third party intermediary that actually made the loan or investment.

For example, we sometimes hear of examiners fully recognizing only direct lending or investments, discounting the same activities generated through intermediaries like LISC or Enterprise as "too easy". Similarly, we hear that many examiners discount Low Income Housing Tax Credit investments as too routine and insufficiently innovative or complex, ignoring the wide variation among the resulting housing developments with regard to responsiveness to community needs, complexity, and innovation.

In our view, such treatment mistakenly suggests that meeting a community's needs is less important to some examiners than whether a bank or another party does the work. CD activities routinely involve more intensive involvement than most institutions are willing or able to provide.

If an institution finds it more efficient to engage a third party to perform this function on its behalf, the CRA rules should not penalize that decision. What should matter is the volume of activities an institution is financing and whether they are responsive to a community's needs and innovative or complex. If the presence of a third party results in less CRA recognition and institutions are unable to undertake the most difficult deals directly, then communities will surely suffer.

Conclusion

This concludes our comments. We appreciate the opportunity to comment on these issues and look forward to working with all of the regulatory agencies as the review of CRA regulations continues. Please feel free to contact Benson Roberts at LISC (202-739-9264) or Stockton Williams at Enterprise (202-543-4599) for further information.

Sincerely,

Michael Rubinger
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