PA
Low Income
Housing Coalition

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

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

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
1700 G Street, NW
Washington, DC 20552
Attention: Docket No. 2001-49

October 4, 2001

Dear Officials of the Federal Banking Agencies:

In response to the joint advance notice of proposed rulemaking issued by the Department of the Treasury (Offices of the Comptroller of the Currency and of Thrift Supervision), the Federal Reserve System and the Federal Deposit Insurance Corporation seeking comment pertaining to possible new regulations covering the Community Reinvestment Act (CRA); the Pennsylvania Low Income Housing Coalition (PALIHC), Pennsylvania's largest affordable housing advocacy organization, does hereby submit the following comments. In addition to the specific comments made below covering four broad issues that derive from our own direct experience in working with lenders

throughout Pennsylvania, PALIHC also wishes to add its voice of support to the extensive comments submitted by the National Community Reinvestment Coalition, of which PALIHC is a member.

I. The Continuing Effectiveness of the Lending, Investment and Service Tests

In response to the questions of whether the lending, investment and service tests effectively assess an institution's record of helping to meet the credit needs of the entire community; the answer, particularly in regards to larger lenders, in a word, is no.

A critical, common flaw in each of these tests is that it there is only one bank-wide test for each institution. While a bank-wide rating may be appropriate for a locally-owned and operated institution whose market includes relatively few communities, or perhaps a single MSA; this approach, in an era of nation-wide mega-institutions, is now obsolete and inappropriate. The problem is most acutely seen when a lender based in one market acquires a lender in a market far from the acquirer's. In such instances we frequently see that the acquiring lender operating quite differently in its historic service area and in the newly acquired territory; providing differing products and levels of service, which are generally less, in the newly acquired territory. Most importantly, these differences do not derive from differing credit needs in the different markets, but rather from internal operating decisions made by bank managers.

The reasons for service diminution are several and include, the long period of time it takes for even a well-meaning institution to learn about a diverse, far away community; the lack of historic ties to communities; less regard for corporate image in territories far from where bank leaders live and participate in community life and, certainly, the need for the acquiring institution to save money to pay for the acquisition that brought the lender to the new, unfamiliar market.

The current bank-wide rating system abets this diminution in service by enabling lenders to "game" the rating system. Lenders can make assessments as to the number of markets in which they need to be high performers in order to achieve a desired CRA rating (outstanding or satisfactory). However, once a lender provides enough higher quality service in enough markets there is no incentive to provide those additional costly services in less profitable, unknown markets because one's CRA rating is not in jeopardy. Ratings in individual markets are necessary.

For large multi-MSA institutions ratings must occur at the MSA-level and be based upon two, and in many instances, three measures: a) a comparison with what other lenders in the area are offering; b) a comparison

with what the lender is offering in other markets in which it operates; and, c) as appropriate, a comparison with the level of service provided by the recently acquired lender. Only by employing all these measures at the MSA level can an informed judgment regarding lender performance be made.

A second common flaw in the assessment of lender performance is that it is static. Generally, lenders intend to grow their businesses. Yet in the awarding of satisfactory and outstanding CRA ratings there is no measure or requirement of improvement or growth over time. Lenders achieving an outstanding rating can offer the same program year after year and receive the same rating. The notion that CRA activities should grow in ways that are proportional with growth in other areas of the business is absent from the CRA regimen. Indeed, to the extent there is a linkage between overall bank performance and CRA performance it is only on the downside; when the economy is bad, lenders tell us that they cannot afford to do more, but when times are good there is no requirement that they do more.

Opponents of addressing this flaw have raised the specter of federally imposed benchmarks. PALIHC opposes federally established benchmarks. Rather, we support the idea of having lenders set their own benchmarks and develop their own rationales for growing (or not growing) their CRA business. These rationales should then be subject to public comment and regulator review at which time assessments of these benchmarks can be made (not just whether these benchmarks have been achieved). Again, like the issue of banks providing different quality service in different regions, the benchmarks need to be established and evaluated in terms of: a) what other lenders in the area are offering; b) what the lender is offering in other markets in which it operates; and, c) as relevant, by comparing current service with that provided by the recently acquired lender.

By addressing the problem of static CRA performance federal regulators could also address the flawed strategic plan approach to community reinvestment. Although PALIHC generally supports the transaction-based approach to measuring CRA performance, an unintended consequence of this approach is that lenders almost exclusively focus on working with parties capable of bringing them immediate transactions, while ignoring the needs and ideas of those who cannot give them a transaction based upon current lender products and services. The strategic plan process would seem to require lenders to conduct more diverse outreach in developing their CRA product line. Thus the strategic plan process could act as an important counterweight to the transaction-oriented process that now exists; but only if the incentive exists for lenders to commit the extra time that the strategic plan option requires. We suggest that regulators require lenders with substantially static CRA programs to incorporate a strategic plan approach within their transaction-based strategy and require a broad outreach effort throughout each

assessment area to develop new benchmarks that annually broaden and increase CRA activities in order to retain satisfactory or outstanding ratings.

As part of this reform we would also open the benchmark setting process to public comment and require that regulators review the appropriateness of the benchmarks established by the lender according to the two or three measures suggested above, and not just certify whether benchmarks have been met.

Finally there is a problem that is unique to the lending test. This issue is the "counting" of mortgages purchased. In Pennsylvania, recently, two large banks PNC and Mellon have greatly changed their operations. PNC, while it is keeping its branch banking business, no longer underwrites mortgages, having sold this business to Washington Mutual. Mellon Bank is on the verge of getting out of the branch banking business. As a result of these decisions, Pennsylvania consumers will have less choice and less opportunity to deal with institutions that have any historic commitment to their local communities. As noted above, distant lenders behave differently in distant communities than they do in their "home towns." Federal regulators by treating purchased and originated mortgages the same have allowed PNC and perhaps Mellon and other lenders, to shed their more costly mortgage origination operations; operations that have historically been sensitive to local needs, because they can get the same CRA credit through the purchase of mortgage loans.

Simply put, there is no important "value added" benefit that can be attributed to a lender's purchase of mortgages. The U.S. secondary mortgage market is large and efficient and there is no shortage of purchasers willing to buy mortgages and mortgage backed securities. That a lender's purchase of mortgages is in some way aiding a community in a way equal to that of a lender originating mortgages is simply not correct, if for no other reason that the decline in originating institutions (and particularly portfolio lenders) diminishes competition among lenders which is bad for consumers. Moreover, lenders seek to "game" the CRA examination system by purchasing mortgages as examination time approaches and selling them later.[1] The purchasing of basic, conventional mortgages should not be a "creditable" CRA activity.

[1] A larger lender in eastern Pennsylvania approached PALIHC about how it might be able to purchase a large quantity of state housing finance agency mortgages which it believed it needed to "balance" a portfolio of suburban mortgages that it acquired as part of a recent acquisition of a moderately-sized suburban bank system.

II. Rewarding Discrimination

In theory lenders make great efforts to underwrite single-family mortgages in non-racially discriminatory ways. When these efforts fail federal regulators, are charged to take enforcement actions to correct this problem. However, when a lender makes a multifamily loan (and gets extra CRA credit for making a rental housing loan) no one in the lending or regulatory process considers whether the building being financed meets federal Fair Housing Act accessibility requirements, and evidence is mounting that lenders are financing buildings that do fail to fulfill the disability requirements of the Fair Housing Act. **Discrimination by disability is not more acceptable than discrimination by race.** Additional regulation is needed to guard against this form of discrimination. We call for new regulations requiring lenders to seek positive certification from licensed consultants to certify that a proposed multi-family project meets federal Fair Housing Act disability standards. Any building not so certified should be denied financing and, of course, should not be positively counted as part of a lender's CRA examination.

This suggestion is not only the decent course of action, it is also one that protects the safety and soundness of the loan made. This is because aggrieved renters and fair housing groups may have to sue the building owner in order to address illegal conditions and that owner will have to expensively retrofit the building and pay damages, thus potentially jeopardizing the ability of the original loan to be repaid. With a small regulatory change federal regulators can extinguish a whole class of discrimination against the disabled. *It is time for this action to be taken.*

III. Broadening the Investment Test

Some have raised the concern that the investment test for larger retail institutions can be difficult to fulfill due to a lack of qualified investments in which to participate. Others have noted that it is difficult to compete for investments, especially federal Low Income Housing Tax Credits, with the mega-lenders that have considerable expertise in structuring LIHTC deals. A solution to this "lack of product" issue that federal regulators have incompletely considered in the past is the ability of lenders to "count" the contracting of services with small and minority owned businesses as an investment activity. We believe that lenders contracting with small, new, minority owned business are taking a chance in much the same way the lender is in making a loan to these businesses and PALIHC urges this issue be more broadly reconsidered than it has in the past by regulators.

Current regulation limits the extent to which contracting for services can be counted, requiring that these services be explicitly tied to a lending function. This severely limits the applicability of using contracts as a way of

fostering small and minority business activities. For new and small businesses operating in communities with limited economic activity, the purchasing power of even a smaller bank may dwarf the purchasing power of other businesses in a neighborhood. Moreover, by having service contracts with a lender, the small business may be able to secure additional financing against the value of the contract (from that lender or another) and use this contract as a base from which to grow a business. Current regulatory requirement creates little incentive for lenders to parcel out printing, catering, janitorial and other building maintenance services and other activities that are now principally contracted out to large regional or national firms instead of to smaller developing businesses. With proper regulatory support the buying power of banks can, and should be harnessed as an engine of economic revitalization and jobs in distressed communities.

IV. Subprime and Predatory Lending

Evidence is continuing to mount that poorer, but not riskier, borrowers, particularly those living in poorer communities, are being steered into subprime loans even though they may qualify for prime lending products. Regulators must take action to protect borrowers from this practice. Fortunately, federal regulators have a track record of fighting this type of price discrimination. We point to First Union National Bank's (now Wachovia) purchase of The Money Store. As part of that purchase the Office of the Comptroller of the Currency required that consumers calling The Money Store be "steered" to the least cost product for which they were qualified. If one called the Money Store in the belief that one was only eligible for a subprime loan, and it became apparent during underwriting process that borrower was eligible for a prime product an offer of the prime product had to be made. The effect of this requirement was to end many of the egregious practices of The Money Store and ultimately to put it out of business; as this business, like many subprime lenders, largely profited on the basis of a lack of consumer information. When lenders are not permitted to mislead or misinform consumers the purpose of CRA is better fulfilled.

PALIHC calls on federal regulators to universalize the OCC precedent by requiring the "up streaming" of loan applicants when the credit history of the applicant supports this. However, requiring lenders to offer loan applicants the lowest cost product for which they are eligible, is just one of the actions that regulators need to take to ensure that the cost structures of subprime lending reflect real risk and not discriminatory imperfections in the market place.

As a matter of broad policy the federal regulators need to clearly indicate that the growth of prime lending and conventional bank services in low and moderate income communities is preferred over the growth of subprime lending and fringe banking services. Lenders who are growing

subprime operations without commensurately increasing their prime activities to low and moderate income households and within low and moderate income communities and who cannot document their ability to move loan recipients out of fringe banking services and products and into mainstream products cannot expect to receive an examination rating equal to those lenders that are finding ways to lend mainstream products to lower income households and within lower income communities.

To facilitate and monitor the attainment of this goal regulators must examine subprime and fringe services separate and apart from conventional products and services. To do this will require new data from lenders, including:

- the extent of the lender's subprime lending and service operations, including lines of credit and loans purchased from third-party subprime originators.
- the reporting of fees and interest rates on individual loans and when used credit scores. [2]
- collecting mortgage lending, delinquency and default data by race and income level by neighborhood.[3] This data should be organized so as to permit a comparison between the relative delinquency and foreclosure rates of prime and subprime products as this permits and assessment of whether loans are being made on the basis of the ability to pay or the value of the underlying asset, a key test as to whether a loan is predatory or not.
- an accounting by geographic dispersion of prime and subprime loans by lending category (first and second mortgages for home purchase, home repair loan, other loans secured by a lien on the home, etc.).
- data on the number of loans that have been "flipped" to either new prime or subprime loans. A subprime loan made by a regulated lender should be an avenue through which borrowers can ultimately access the prime market based upon a successful lending history. Regulators need to be concerned that some borrowers are being permanently assigned to the subprime ghetto, regardless of loan performance. Lenders who start questionable borrowers out with subprime products and are able to wean these borrowers into the prime market should be positively acknowledged. Those that don't should be sanctioned with lower CRA scores.
- the relative growth of other fringe banking services such as payday lending, check cashing and the like must be contrasted with the growth

[2] This item was included as part of the Pennsylvania Low Income Housing Coalition's agreement with First Union National Bank that was reached at the time First Union was acquiring CoreStates Bank. First Union ultimately refused to make this data available to PALIHC in explicit violation of our agreement. Based on this experience it is evident that lenders will not turn over this information, even when they say they will, on a voluntary basis, and thus federal regulation is required.
[3] Ibid.

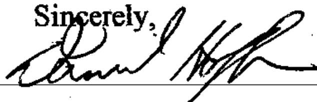
of "life-line" checking and other basic banking services. Growing a fringe banking business is not the purpose of receiving a federal bank charter and lenders who are clearly concentrating on fringe business at the expense of mainstream business should not be receiving the same CRA consideration as lenders who are making efforts to draw low and moderate income consumers into mainstream banking. Lenders should be required to document the extent to which their fringe business is feeding customers into the mainstream business.

While lenders opposing these new reporting requirements will doubtlessly complain about "new paperwork and regulatory burdens" the fact is that there is no requirement that lenders engage in subprime activities and no requirement that dubious subprime lending be backed by public banking charters and deposit insurance.

Finally, rooting out predatory lending and inappropriate subprime lending will be enhanced by making safety and soundness exams concurrent with fair lending exams, as concentrated predatory lending (and evidence is growing that predatory lending is concentrated in particular neighborhoods) can simultaneously impact both issues. Moreover, as we have noted above, other fair housing violations may also impact the safety and soundness of lending activities.

Each day it is evident that the increased integration of the nation's capital sectors and markets are creating new opportunities for economic growth, but the question of whether this growth will be broadly or narrowly accessible remains to be answered. Narrow accessibility may mean vast wealth for some, but broad accessibility will result in the greatest amount of economic growth and the best opportunity to create a strong, stable society. The recommendations made by PALIHC and the National Community Reinvestment Coalition are ones that seek to broaden fair access to capital and bring the hope of improved economic opportunity to all of our nation's communities. The members of the Pennsylvania Low Income Housing Coalition trust that you will strongly consider the immediate need for capital in distressed urban and rural communities and the long-term need of all Americans for a strong, stable society in which no community is left behind and decide to adopt the recommendations that we have put forth.

Sincerely,



Daniel Hoffman
Policy Director