NAAHL

NATIONAL ASSOCIATION OF AFFORDABLE HOUSING LENDERS

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October 19, 2001

Ms. Jennifer Johnson
Secretary, Board of Governors of
The Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1112 – Advance Notice of Proposed Rulemaking Regarding the Community Reinvestment Act Regulation

Dear Ms. Johnson:

The National Association of Affordable Housing Lenders (NAAHL) represents more than 200 organizations, including more than 85 insured depository institutions, and 800 individual community investment practitioners who are committed to increasing the flow of private capital into low- and moderate-income communities. As you know from our ongoing dialogue with all of the bank regulators, our experience suggests the importance of several mid-course corrections to the rule, both to ensure the sustainability of this business, and encourage meaningful community investment in this new millennium. Our thoughts on the specific issues are as follows.

Large Retail Institutions: Lending, Investment, and Service Tests
Do the regulations strike the appropriate balance between quantitative and qualitative measures, and among lending, investments, and services? If so, why? If not, how should the regulations be revised?

It is important to restore some balance between consideration of quantitative and qualitative factors to ensure both that CRA business is not over-subsidized in a non-sustainable way, and to permit the institution to do what is right for the community rather than for the call report.

The Problem
While the 1995 regulation made great progress in bringing credibility to CRA performance, some aspects of it have gone too far in the quantitative direction. The emphasis on statistical information -- to provide the public with information about the extent to which insured depository institutions make loans and investments -- can be so great as to obscure the community needs, performance context, and business case for some loans and investments. This

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overemphasis also obscures the fact that all communities do not have the same needs, just as all institutions do not have the same expertise. This inevitably results in some unintended distortions. For example, a community may not have much demand for investments or even certain types of loans, such as mortgages for multifamily housing. Nonetheless, examiners are reluctant to acknowledge the performance context in which institutions operate, requiring that institutions make their "numbers". This can result, at best, in non-productive resources being spent finding the needle in the haystack, or at worst, in perverse economic consequences when too many lenders are chasing the same deal. It focuses institutions on competing where markets are well served, when it would be more valuable for the community for institutions to address unmet needs.

In addition, many practitioners' experience with the investment test leads them to question whether it should continue as a standalone test, as well as the weight given to it. Most NAAHL members believe that mid-course corrections are particularly important for the long-run effectiveness of CRA. Various proposals for reform seem to reflect differences both in assessment area needs and an institution's market niche, as well as the proliferation of some hyper-competitive market areas, along with the extent to which an institution's examiners appreciate the performance context.

It is clear that the quantitative emphasis, combined with low or no demand for viable investments in some communities, results in pricing distortions and unsustainable business in some markets. In addition, where there is high demand for loans but little or no need for investments in an assessment area, the pressure to find "investments" causes non-productive bank resources to be spent twisting a straightforward business opportunity like a loan into a qualifying "investment". Finally, many investments, such as in small tax credit deals, are largely illiquid, yet regulators are reluctant to continue to give CRA credit for the period in which the bank's capital is tied up in these deals.

It is understandable that examiners find it difficult to evaluate activities that are not easily measurable. Initiatives that are truly innovative or complex are very resource-intensive, and because they often address the most acute needs in a community, generate low numbers. Nonetheless, careful, qualitative assessment of these initiatives, such as lending on tribal lands or stimulating new commerce in Appalachia, is critical to encouraging institutions to address the greatest needs.

Recommendations
To address the imbalance between quantitative and qualitative factors in assessing CRA performance, we have several suggestions. First, both non-profit organizations and insured depository institutions suggest that all of the qualitative aspects of CRA performance be reorganized into a single, separate community development test. This new test would incorporate all community development lending, community development investments, and community development services.

Such a regrouping should not only provide a better balance, but also afford more flexibility to institutions to design CRA programs that match community needs with their business strategies. It should be simpler to analyze an institution's community development activity as a whole. Most important, it should make it easier for an institution to make the greatest effort where the greatest need exists, without a requirement to meet artificial ratios, twist loans into "investments", or make "investments" that are written off as grants.

The purpose of the combined test would be to follow the format of the wholesale/limited purpose Community Development Test, whereby an institution can choose to focus on one or more of the three components. This type of flexibility will allow an institution to target its resources to areas of need based on their local communities and synergies with the institution's areas of expertise and operational infrastructure.

Second, greater emphasis must be given to the Performance Context in evaluating banks' performance. All communities do not have the same needs, and all institutions do not have the same business strategies. Examiners must consider unique community needs as well as how well markets are being served and legitimate barriers to real needs.

Third, our members also are concerned about consistent application of the rules across all regulators and all geographic areas. Inconsistent interpretation and application of the rules has been a continuing problem and should be addressed by regulators in the context of the CRA rewrite.

Does the Lending Test effectively assess an institution's record of helping meet the credit needs of the entire community?

Yes -- to an extent. However, as we described above, the undue emphasis on quantitative measures compels lenders to focus on products and services that produce the right "numbers", rather than consider – and respond to – the greatest needs of the community. The pressure to satisfy quantitative measures leads to uneconomic business in more and more markets, thereby jeopardizing the sustainability of the business. Too often, examiners tend to equate activities that are "innovative" or "flexible" with "unprofitable". Based on the considerable experience practitioners now have with the 1995 rule, we believe that the rule needs to provide institutions with greater flexibility both to respond to each community's unique needs and to align their CRA activities with their business expertise, rather than just play the "numbers" game.

We also believe purchased loans should be given equal weighting to loan originations because loan purchases are equally important in providing liquidity, which helps to lower the cost of mortgage lending.

Does the Investment Test effectively assess an institution's record of helping to meet the credit needs of an entire community?

Investments can be critical to meeting the credit needs of some low- and moderate-income (LMI) individuals and communities. Nonetheless, the overarching measure of a lender's performance in meeting the credit needs of the local community should be how well the institution addresses that community's unique needs, and not an artificial requirement to achieve certain volumes.

Unfortunately, the Investment Test has had many unintended results, some of which we described above. While this test undoubtedly was intended to increase a lender's flexibility in addressing community needs, it has increasingly become something of a millstone. Different communities require a different mix of loans, services and investments to meet their unique credit needs. This separate test and the quantitative emphasis to performance undermine the institution's ability to choose whether investments will help it to meet the credit needs of a particular community.

In some communities, there are very limited opportunities for sustainable business investments. Many so-called investments are, in fact, grants with no expectation of a yield or principal repayment. And, in some affluent communities, there are actually no legitimate investments that benefit low- and moderate-income persons. As a result, "junk" investments have been created and marketed, which provide "numbers" for institutions, often carry high risk and very low yield but do not, in fact, address the real credit needs of the community.

In addition, the current regulations result in little or no credit for investments that occurred prior to the review period that are still on a bank's books. Institutions that are attempting to meet important credit needs with long-term, largely illiquid or below-market-rate investments in local affordable housing or other eligible activity should receive continued credit for such investments.

Does the Service Test effectively assess an institution's record of helping to meet the credit needs of its entire community?

The test has been effective, but now needs to be updated to be more flexible. The rapid growth of alternative delivery methods, such as the internet, telephone and mail, allow delivery of services in new and important ways. If an institution makes effective and extensive use of these alternatives to meet the credit needs of its community, they should be weighed heavily in the exam. Banks should be given credit for *all* they are doing to serve a community beyond just specific branches – for example, establishing a presence in a community facility, maintaining a mortgage lending office, or providing ATMs.

Similarly, the "finance related" tie in the current regulations is too restrictive. Bank employees volunteering with community-based organizations should not be restricted to finance, investment or other finance-related functions for an institution to receive CRA benefit. Institutions should receive CRA credit <u>for all volunteer activities related to community building and development</u>, such as helping to build a home in Habitat for Humanity projects, which contribute to building sustainable communities.

Are the definitions of Community Development appropriate?

Today, community development is a dynamic and innovative business, but the current rules discourage an innovative response to a community's credit needs. The definitions should be expanded to allow more flexibility in responding to a community's needs. The application of the "primary purpose" concept is too restrictive. We recommend that, going forward, consideration of community development include, but not be limited to, activities such as the following:

- loans to LMI individuals or communities;
- loans or investments in projects that provide housing, jobs or other benefits to LMI individuals or communities;
- provision of financial services to LMI individuals or communities;
- grants to organizations that engage in community development activities;
- equity investments in organizations or projects for the purpose of community development;
- related activities, such as letters of credit or other credit enhancements supporting community development projects or applications to the Federal Home Loan Bank for supporting community development projects.

Activities that enable community development also should count as qualified investments. For example, all of an investment in a mixed-income development where the market rate units *enable* affordable units should count (not just the portion which is affordable) because the investment meets the community's need for credit to integrate LMI households.

In addition, we support the need for a simplified method of determining whether a multifamily project is "affordable housing for LMI individuals", thereby meeting the definition of "community development". One method we support was recommended in Fannie Mae's 1999 comment letter to the FFIEC (see the attached copy).

Small Institutions

Do the provisions relating to asset size and holding company affiliation provide a reasonable and sufficient standard?

These provisions would provide a reasonable and sufficient standard if they followed the asset size of the bank, as opposed to the current practice of following the holding company's asset size.

Limited Purpose and Wholesale Institutions: The Community Development Test

Are the definitions of "wholesale" and "limited purpose" institutions appropriate? If so, why? If not, how should the regulations be revised?

The definition of limited-purpose bank should be expanded to include retail banks that have no branches or that have branches that are incidental to the primary business strategy of the bank. We support expanding the availability of the Community Development Test, allowing a large retail institution to choose the option that best addresses the community's needs and the institution's strengths.

Performance Context

Are the provisions of the performance context effective in appropriately shaping the quantitative and qualitative evaluation of an institution's record of helping to meet the credit needs of its entire community?

The Performance Context should be an important element of the CRA evaluation but, in many instances, it has been extremely difficult to persuade examiners to acknowledge the specific, external environment in which each bank operates. Even in extremely high-cost areas, like New York City, or credit surplus areas, like Wilmington, examiners often seem unable or unwilling to acknowledge the operating environment.

We recommend that the regulators reinforce the critical importance of this necessary, intellectual framework with which to evaluate institutions.

Examiners should receive needed training and resources to enhance their expertise in this work. To the extent possible, regulators should pool resources and data to provide all examiners across all agencies with readily accessible information. The examiners should share with their regulated institutions their assessment of the external environment, and the institution should have the opportunity to review and comment in a productive dialogue with its examiners.

<u>Assessment Areas</u>

Do the provisions on assessment areas, which are tied to geographies surrounding physical deposit-gathering facilities, provide a reasonable and sufficient standard for designating the communities within which the activities will be evaluated during the examination?

If a bank is adequately meeting the credit needs of its assessment area, then all qualified lending, investing and services outside its assessment area should be given favorable consideration. This important flexibility should help communities with unmet needs, and reduce economic distortions in hyper-competitive markets.

<u>Data Collection</u>

Are the data collection and reporting and public file requirements effective and efficient approaches for assessing an institution's CRA performance while minimizing burden?

Collecting the required data, making sure that it is accurate, and maintaining the public file is an increasingly burdensome and expensive undertaking. As more and more institutions operate in many states, and with the recent addition of disclosures mandated by the Sunshine regulations, a tremendous amount of labor and paper goes into this work. The cost/benefit relationship of these requirements should be re-evaluated. It is also important to note that every change in data collection requirements necessitates substantial systems changes and costs at every institution, and further reduces the ability to track trends in lending over time. We suggest that it should be an accepted principle that such changes should only result from a major need in furtherance of CRA.

In this new millennium of technological communications and multi-state financial institutions, the current rules requiring multiple public files now kill way too many trees for little or no benefit. Very few people go into branches and ask for CRA file information. Each institution should provide one paper set of data only, and each branch office should be required to have written contact information to respond to inquiries that tells people the various ways to access all of the institution's information.

Finally, race and ethnic data should not be included in the CRA exam. Fair lending is about fair treatment of protected groups, including racial and ethnic minorities, many of whom are not of low- or moderate-incomes.

We appreciate all of the effort the agencies have made to eliminate unintended barriers to meeting the credit needs of low- and moderate-income persons and communities. We hope that you will take this opportunity to make corrections to the 1995 rule to further increase the flow of private capital and strengthen institutions' ability to meet these credit needs in the new millennium, and we look forward to working with you on these goals.

Sincerely,

Judy Kennedy

Judith A. Kennedy