Massachusetts Bankers Association

196

October 17, 2001

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Docket R-1112
e-mail: regs.comments@federalreserve.gov

Robert E. Feldman
Executive Secretary
Attn: Comments/OES
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
12 CFR Part 345
e-mail: comments@fdic.gov

Docket No. 01-16
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Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552
Docket No. 20001-49
Fax: (202) 906-6518

Subject: Advanced Notice of Proposed Rulemaking (ANPR) for the Community Reinvestment Act (66 Federal Register 37602)

Dear Sir/Madam:

The Massachusetts Bankers Association, which represents 240 commercial, savings, co-operative banks and savings and loan associations with over $400 billion in assets, would like to offer its comments on the above referenced joint advanced notice of proposed rulemaking.

In the ANPR, the Agencies frame a fundamental issue for consideration, i.e., whether any change to the regulations would be beneficial or warranted. The following addresses these issues and responds in the affirmative to both questions.

Given the fact that the financial industry, as a whole, not just the federally-insured banking segment, has undergone such enormous change in terms of product offerings and delivery, it would seem that changes to the regulations are essential for the CRA to have value to low- and moderate-income areas in the future.

When enacted, the CRA had and continues to have the noble objective of curbing a lending practice recognized and condemned as being unfair. What has become awkward and the object of so many conflicting viewpoints, however, is less the philosophy of the law than the yardsticks promulgated by the Agencies to evaluate a bank's fulfillment of that philosophy in this day and age of combined financial services being offered not only by banks but also by insurance companies and brokerage firms, and credit unions—none of which are bound by the CRA.

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The CRA is but one congressional enactment that has its place among other equally weighty anti-discriminatory federal measures pertaining to the credit arena. The CRA, enacted in 1977, was preceded by the Fair Housing Act (FHA) enacted in 1968 and amended in 1974, by the Equal Credit Opportunity Act (ECOA) enacted in 1974, expanded in 1976 and further amended in 1991 by the Federal Deposit Insurance Corporation Improvement Act (FDICIA) and, by the Home Mortgage Disclosure Act (HMDA) enacted in 1975.

Senator William Proxmire, chairman of the Senate Banking, Housing and Urban Affairs Committee and principal sponsor of the CRA, pointed out during a committee hearing and to the Senate that CRA would increase the sensitivities of banks to their responsibilities to provide for local community needs. (95 Cong. 1Sess.) He went on to say that the CRA "*... would not inject any significantly new element into the deposit facility application approval process already in place. Instead, it merely amplifies the 'community need' criteria already contained in existing law and regulation and provides a more explicit statutory statement of what constitutes 'community need' to make clear that it includes credit needs...*" (Congr. Rec. vol. 123 (1977), pp. 1202-3)

The content of the ANPR and questions posed, therein, amply demonstrate that the lending, investment and service tests, the definition of community development activity, the standards applicable to large and small institutions, the effectiveness of performance context provisions, the designation of assessment areas, etc., seemingly give rise to a variety of present day difficulties for a wide array of financial organizations with differing business plans and strategies. Therefore it makes sense for the Agencies to re-structure Regulation BB, (12 CFR 228) to make it less ill-fitting for some federally-insured banks and more definitive for others in order to better enable them to fulfill their responsibilities regarding "community needs" without having to be contortionistic about it.

It makes sense for the Agencies, in revising Regulation BB, to do so in a manner that, for bank compliance purposes, re-shapes the objectives of the regulation not only to fit the competitive practices and the technological advancements of the times but also, for supervisory purposes, to interface the relatively narrow original purpose of the CRA imposed only on banks along with the more encompassing anti-discriminatory credit availability measures contained in the FHA, the ECOA, Regulation B and the related Inter-Agency Policy Statement of 1994 applicable to all types of credit grantors including banks.

By adopting this approach, beneficial and warranted changes to Regulation BB can be effected without departing from the philosophy of the Act itself. In response to the Agencies' questions listed below, we are submitting comments based on input from members of the Association's Real Estate Finance and Legal and Regulatory Compliance Committees.

1. *Do the lending, investment and services tests (individually and/or collectively) effectively assess an institution's record of helping to meet the credit needs of its entire community?*

As mentioned in the proposal, an institution's CRA rating reflects the principle that lending is the primary vehicle for meeting a community's credit needs. In 1980, lenders were primarily banks, most of which were in-state, with a number of out-of-state banks and full service mortgage companies. In the early 90s, competition between lenders exploded as the number of out-of-state banks and mortgage companies expanded rapidly in Massachusetts and other major cities throughout the United States. The numbers of lenders continue to expand including the new e-lenders on the Internet. This surge of competition for loans has virtually eliminated gaps in meeting a community's credit needs of borrowers. Creditworthy borrowers from all income levels including traditionally underserved borrowers may pursue many options to meet their credit needs. Despite these facts, lenders are required to continually find ways to meet CRA benchmarks (i.e., the lending, service and investment tests) established by the regulations.

A review of the top 25 lenders in Massachusetts revealed that the number of purchase mortgages originated by in-state banks decreased from 37 percent in 1997 to 19 percent by the end of 2000. Out-of-state bank loan originations increased from 10 percent to 27 percent during the same time period. Other lenders including mortgage companies, finance companies and credit unions originated about half of the loans in Massachusetts (see Exhibit A). These changes in the marketplace make the lending test a challenge for banks to continue to meet CRA requirements under the confines of the existing regulations. Examination guidelines should be modified to include flexible options for meeting CRA requirements—providing examiners with the ability to accommodate management preferences that take institutional and community characteristics into account.

One way to provide regulatory flexibility in meeting CRA requirements is to eliminate the investment test as a required benchmark. The investment test was originally designed to provide flexibility for boutique financial institutions which did not participate in traditional mortgage lending activities. Therefore, the investment test became the key CRA measurement for these institutions. We would assert that requiring traditional lenders to lend, as well as invest bank capital in housing-related projects could be viewed as not only unfair but a safety and soundness concern.

Similarly, many small- to medium-sized institutions often find it difficult to compete against larger regional banks for qualified CRA investments. In 2000, low-income borrowers obtained 19 percent of their loans from big Boston banks, as compared to 6.2 percent of loans from smaller community banks. The lower figure in no way represents an unwillingness on the part of small banks to make CRA loans but rather an inability to offer products that are as competitive as those offered by larger banks.

Accordingly, the employment and weighting of the investment test should be at the discretion of management. Also, the utilization—or non-utilization—of the investment test during one examination should have no bearing on its utilization and weighting in subsequent examinations. Bank management understands the credit needs that exist in their community therefore, they should have significant leeway in determining the weightings assigned to the lending and service tests. Therefore a universal weighting structure should be eliminated.

In the majority of cases, it is expected that initiatives measured via lending and service test criteria will be paramount. The investment test would then be secondary, optional and sometimes unnecessary. However, at some institutions the providing of targeted investment capital—directly or via intermediary structures—can be a very effective means of addressing the financial needs of local populations. At these banks, the investment test could be of prime importance—and would be a reasonable and meaningful supplement to the lending and service tests. Similarly, subjective criteria such as "complex and innovative" should only be used when it will improve an institution's performance rating on an examination.

2. *Are the definitions of "community development" and related terms appropriate, and are the community development activities provisions effective in assessing the CRA performance of those institutions subject to the lending, investments and services tests?*

Under current regulations, "community development" is a concept applied to lending, services and investments—the three components of a large bank's CRA performance. We recommend that its applicability is restricted to the investment test and to charitable contributions that benefit low- and moderate-income residents of designated communities. In this way, community development needs could be met via targeted investments; those with expected financial returns, as well as via community based contributions.

3. *Do the provisions on "assessment areas," which are tied to geographies surrounding physical deposit-gathering facilities, provide a reasonable and sufficient standard for designating communities within which an institution's activities should be evaluated during an examination?*

The consensus view of our members on this issue is that the concept of "assessment area" is neither useful nor practical in the evolving world of financial services. The idea that a bank should have an assessment area made up of geographical places proximate to physical branches is increasingly irrelevant in an era where society is more mobile and more banking is done electronically. In addition to geographical considerations, customers choose financial service providers by convenience, rate, services offered, and other relationships such as business or affinity groups.

Moreover, mortgage companies and brokers that do not have CRA obligations, are permitted to solicit customers from any and/or all geographical locations where they are licensed. In recent, years, they have acquired an ever-larger share of the home loan market including many of the loans that would qualify for credit within a bank's CRA assessment area. In the Greater Boston market, mortgage companies increased their market share to 56.9 percent of all home loans in 2000, up from 23.5 percent in 1990.

In reality, if a lender is servicing the needs of the low- to moderate-income population it should not matter where in the state the need exists. In an era of record level homeownership for minorities and subprime product offerings to help extend credit to low- and moderate-income households, it seems contradictory to conclude that the credit of these households are not being met.

In addition, the banking industry continues to evolve, as does the Internet, which brings with it a completely new set of challenges for community banks. Internet banking by its very nature renders the assessment area a meaningless concept. An assessment area that encompasses all of the United States would be impossible to evaluate from the perspective of lending because a single office bank in one state can obtain deposits anywhere. The assessment area concept should be flexible enough to ensure that it is not so finely construed by geography that it neglects marketplace realities.

4. *Does the "asset size" provisions provide a reasonably sufficient standard for defining "small institutions" eligible for the streamlined small institution evaluation test, and whether those tests and standards are effective in evaluating CRA performance?*

Clearly to some extent, asset size does provide a standard for "small institutions." It is important, however, that flexibility be included in this definition. In order to survive in an increasingly competitive marketplace, many smaller banks have had to create niches for themselves in order to prosper. Some banks, as a result, must find customers—especially loan customers, where they can, since their physical location gives them no added advantage as it may have had 20 years ago when the local bank dominated the local market.

As an example, one of our member banks is located in an almost exclusively low-income area. While mortgage and consumer borrowers are actively sought, these activities have not generated sufficient volume for the bank. We would note that one significant reason for this is that large complex organizations have targeted these areas for part of their CRA program. In order to resolve this dilemma, the smaller community bank had to hire mortgage originators who specialize in part, in lending to low- and moderate-income individuals. While this approach has been successful, there is a downside. Specifically, as a consequence a sizeable portion of these loans have been generated outside of the bank's assessment area because they hire commissioned originators whose base of business is often past customers, which may not be in the bank's assessment area.

The bank's primary federal regulator has repeatedly refused to give the bank any CRA credit for loans generated to low- and moderate-income borrowers outside of the bank's designated assessment area. It is difficult to understand why the regulator has taken this position when the bank has actively sought these types of loans in their own assessment area and when that proved fruitless, they sought to meet the CRA's objective where they could. We believe this evaluation process should be revised. Assuming the regulators do not want to eliminate the assessment area concept, an alternative solution would be to designate regional or statewide assessment areas.

Separately, the Association believes that there should be an increase in the threshold for "small banks." Currently, banks under $250 million are deemed small institutions for purposes of CRA. It seems illogical that a $250 million bank would be reviewed in the same class as a $50 billion dollar bank. There is widespread agreement amongst our members consisting of primarily small- to medium- sized institutions that this should be reconsidered. The Association recommends that the small bank class be extended to $1 billion.

5. ***Are the provisions requiring large institutions to collect and record data on small business, small farm and community development lending, etc., effective and efficient approaches for assessing CRA performance while minimizing burden?***

CRA was originally designed to require bank examiners to evaluate each bank's performance regarding reinvesting deposits into the community without excluding low- and moderate-income areas. There was no intent to require additional recording keeping and reporting. However, banks found that they had to maintain significant records to receive a satisfactory CRA evaluation. The previous revision to CRA was designed to reduce paper work and increase the emphasis on actual performance. The requirement to collect and record data on loans to small businesses and farms is contrary to the goal to decrease paper work. Moreover it provides data of little analytical value. In addition, this requirement is not an effective and efficient approach to assessing CRA performance for the following reasons:

- Banks with little activity in the small business area must maintain data that would be of little benefit to them in a CRA evaluation.
- The requirement can serve to provide a basis for compliance exam violations without providing any customer benefit.
- There is no requirement to collect and record data on consumer lending. Therefore consumer-oriented banks may not be accurately evaluated.
- Since only large banks collect data, the aggregate data is not a complete picture of all small business and small farm lending. Also, other sources of business financing are not included in the aggregate data.

We believe that any collection and recording of data on lending, other than HMDA requirements, should be optional. We strongly oppose any additional data collection requirements.

Conclusion

In our view, any revisions to the CRA regulations should take into account today's dramatically different landscape of the mortgage lending industry, including the breadth of the financial intermediaries, the widespread availability of credit, changes in technology and the competition that exists between CRA and non-CRA lenders. While we have presented a few of the most important issues in our comment letter, we would be willing to work with the Agencies revising these regulations.

Thank you for the opportunity to present our views. If you have any questions, please call me at (617) 523-7595.

Sincerely,

Tanya M. Duncan

Tanya M. Duncan
Director, Federal Regulatory and
Legislative Policy

Enclosure
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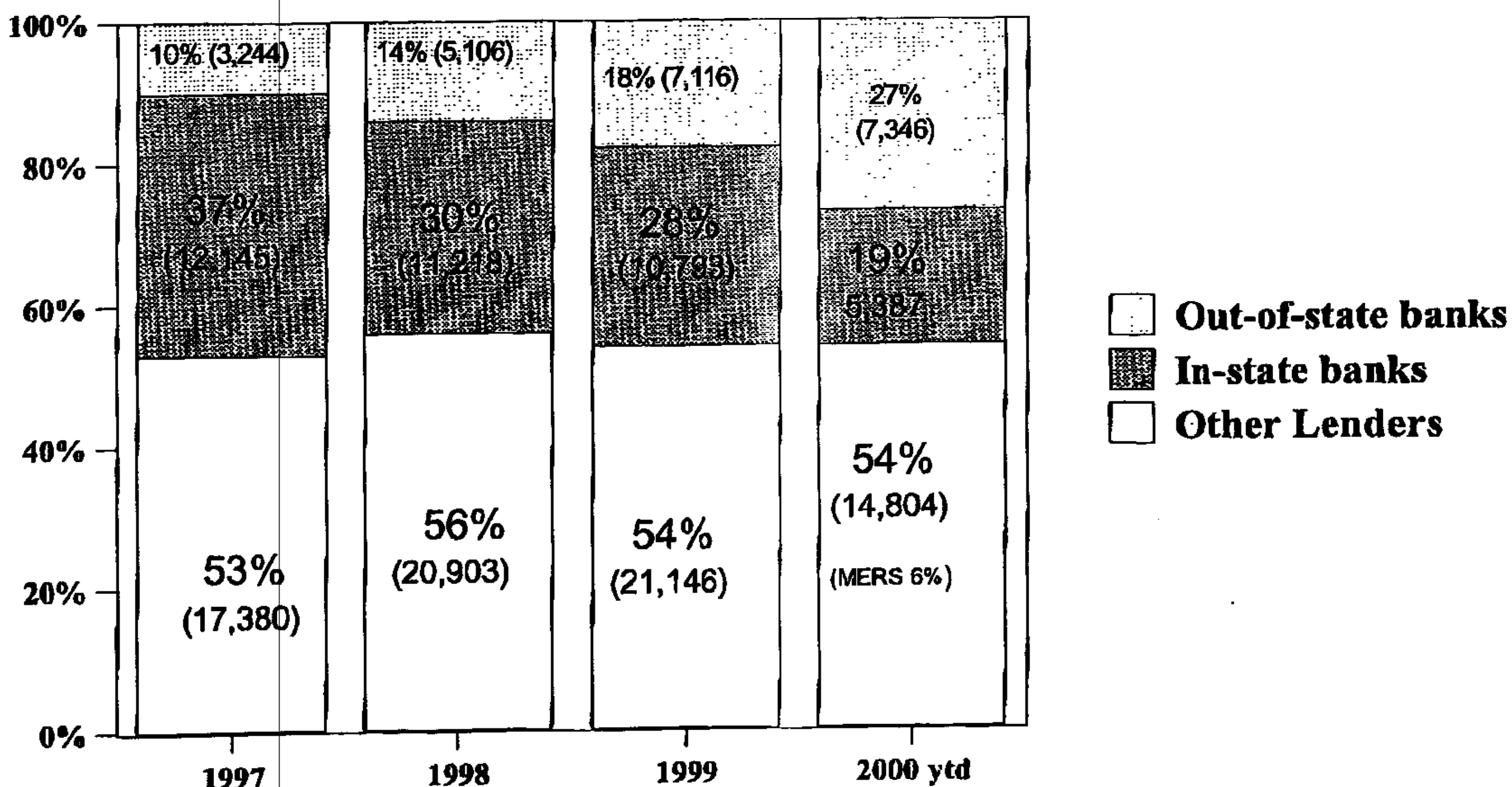
Purchase Mortgages of Top 25 Lenders
Banks vs. Other Lenders in Massachusetts
% of Purchase Mortgages Originated 1997- 2000



Source: Banker & Tradesman
Ranked by number of loans