Atlanta Interagency Hearing on Reform of the Community Reinvestment Act

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My name is Peter Skillern, Executive Director of the Community Reinvestment Association of North Carolina, a nonprofit advocacy and community development agency. As a CRA activist for twenty years, I have seen incredible strides by lenders to affirmatively lend, serve and invest in underserved communities for the betterment of families, businesses and neighborhoods. I also see banks withdraw from prior levels of community development investments; withdraw from CRA mortgage lending; increase fees and decrease deposit services; and to resist working with community groups. Reforms are needed in the CRA framework and its enforcement to reverse these trends and to fulfill an affirmative obligation of lenders to serve their communities. My recommendations are specifically to improve CRA in rural areas and broadly for reforms regardless of region.

Specifically for rural areas CRA examinations need to 1) Consider the unique context for performance of rural economy, housing, and nonprofit infrastructure that differ from urban areas. Different context and needs lead to different weighting of bank activities. 2) CRA compliance oversight in rural areas needs to be strengthened. The big banks in North Carolina hold a majority of branches and deposits in rural areas. But the big bank examination process of looking at one rural assessment area for a full scope examination leaves too many communities unexamined. Eighty percent of North Carolina banks are small or intermediate size. Rural small bank examinations can be every 4-5 years. Intermediate bank exams may not include a rural component as only one assessment is selected every two years for a full scope review. The result is a gap in urban vs. rural CRA programs and oversight.

Rural Needs and Context of Performance

CRA examination procedures instruct analysts to consider the context of performance including the local economy and community, lending opportunities and the institution's business strategy and capacity to meet those needs and opportunities. This instruction needs to be strengthened when considering underserved and rural areas. In 2002, CRA-NC wrote a paper on "The Landscape of Rural Lending" (attached) and looked at Bladen County as a case example. And while time has passed, the trends identified have for the most part persisted and strengthened.

* Manufacturing jobs have declined dramatically and rural North Carolina did not recover from the 2001 recession in job replacement before the 2008 recession hit. Lending and investments for job creation and business are critical to rural North Carolina.

* Agriculture plays a large role, but is changing as tobacco farming declines rapidly, giant agribusiness grows and niche farm products like organic foods are developing with unique credit needs.

*	There is also an issue of the different makeup of housing stock in rural areas. Manufactured housing loan demand represents 30% of housing starts in some counties in rural North Carolina. Traditional lenders should compete more aggressively with high cost manufactured housing lenders.

*	There are fewer community development corporations in rural areas and fewer resources to support them. Lender partnerships and investments as grants play a critical role for CDCs and should be incentivized through the evaluation process.

*	Rural areas need infrastructure and capital vehicles such as bonds should qualify for community development CRA credit. Upper income projects in lower income census tracts such as golf resorts are welcomed as long as the lender's overall performance is inclusive of investments, services and lending that also serve LMI households and development.

*	There are many low and moderate-income residents in most rural towns. Simultaneously, these communities are full of check cashers and payday lenders. The need for more access to the payments system is felt throughout America, in big towns and in small. It is acute in rural areas. The provision of deposit services to LMI households is a growing need. Banks should be awarded points for the provision of low cost, no-penalty deposit services that serve the unbanked.

Broaden the evaluation area of large and intermediate lenders test to be inclusive of their entire rural assessment areas. The current practice of selecting one rural area for a full -scale evaluation leaves vast geographical assessment areas unsupervised. While a full scale review is an appropriate tool in some areas, we do not recommend it for every area. We have found in working with lenders that simply identifying those areas that lag in performance compared with their peers based on HMDA analysis and community surveys has the effect of focusing management's effort on problem solving for that area. We strongly urge existing evaluation to use data measurement tools to comprehensively evaluate assessment areas that can be rewarded or identified for improvements. Resea Willis, Executive Director of housing nonprofit in Brunswick County stated "There is no CRA in rural areas. Branch managers say CRA is done from corporate headquarters. Small banks may or may not play. The result is a lack of funding and partnership." Without some greater accountability, CRA is often not translated into rural areas.

CRA Framework Reforms

Reforms of the Community Reinvestment Act regulatory framework are needed 1) to strengthen the enforcement of civil rights laws 2) to provide more accountable and accurate evaluations of performance 3) to be inclusive of a financial institutions affiliate lending and entire assessment area 4) to penalize predatory lending 5) to create an effective community input process that moves away from an adversarial framework and towards accountable lending plans.

I. Civil Rights Enforcement

CRA must include race as an indicator of performance during evaluation and the comment period. While we all aspire to live and work in a society free of racial considerations, race dynamics are an amazingly persistent and pervasive force in our society. Race issues have a different degree and intensity in rural areas where cultural changes have come more slowly than in urban areas. CRA is fundamentally a civil rights law that has been disempowered by removing consideration of race in bank lending performance. Minority inclusion in local advisory boards, staff, and directors is still lacking. African-Americans are underrepresented in the operation of financial institutions and resulting lending and services.

Almost every CRA-NC oppositional comment to a bank application includes evidence of racial disparities in applications, declination rate, and quality of loans and volume of loans made. And every regulatory response has been unsatisfactory in addressing our concerns.

Discrimination by commission is an act based on prima facie cause "We don't lend to blacks"; or disparate treatment in providing rules or standards between white and protected classes; or adverse and disparate impact where the policy is on the face neutral but in implementation has an adverse and disparate impact on protected classes.

Discrimination by omission is achieved by a failure to affirmatively provide services to protected classes and thus excluding the population. By excluding race from CRA federal regulators take away a fundamental evaluation of whether lenders are serving the entire delineated community. Racial disparities in lending are found even when controlling for income. Race should be a factor in determining bank's lending performance.

The federal regulators position is fundamentally different than the established precedent of the Department of Justice that has found seven cases of redlining based on race, not income. Combined with a practice of few referrals to the Department of Justice, regulators have not done their jobs to enforce civil rights laws. Attached is our challenge to Fifth Third's application to acquire First Charter. It is an example where the lender's bank branch location, minority mortgage application rates, denial rates and loan approvals to minorities met the redlining precedents established by DOJ. But the Federal Reserve found no cause, made no referral to DOJ, and would not explain its position other than to refer to the bank's CRA evaluation.

We strongly recommend that existing policy on fair lending complaints identified through the comment period or evaluations be better enforced to conduct independent investigations and enforcement action where merited. All regulators have established precedent for referral of fair lending concerns to enforcement agencies such as Department of Justice and Housing and Urban

Development. Yet, the GAO report of July 2009 on Fair Lending documents low referrals from federal regulators to enforcement agencies of HUD and DOJ. As an example, the OCC referred one fair lending case from 2005-2008. We have filed our own complaints with the Department of Justice Civil Rights Division when the Federal Reserve did not based on our comments.

II. Accountable and Accurate Evaluations

We recommend that evaluations better use HMDA data to provide an effective evaluation of performance. When CRA-NC examines bank mortgage lending performance, we measure percent of applicants by category of race and income to determine effectiveness of outreach; declination rate of applicants by category to identify concerns in the underwriting process; and by percent of loan volume to determine the effectiveness serving underserved households and communities. We then compare these data points to the market overall and to a bank's peer group to determine where successes and shortcomings can be identified. Using this method for all lenders allows an evaluation based on a standard criterion that is representative of the market. Grades can be assigned allowing for a refinement in performance descriptions.

We recommend greater accountability in CRA performance evaluations and that there be a community appeal process to ensure that individual regulator discretion is an accurate reflection of bank performance.

Some CRA evaluations of lenders are not representative of the actual performance. Ephrata Bank of Pennsylvania received an Outstanding rating despite making no community development loans, no loans in LMI census tracts and having no branches in LMI census tracts. First National Bank of Audrain of Mexico Missouri made no loans to LMI borrowers but received an Outstanding. First Merit Bank was cited for being well below the market in loans for select LMI areas, but received an Outstanding. Pacific Capital Bank received an Outstanding despite being under represented in LMI mortgage lending as well as providing controversial high cost refund anticipation loans. That 98% of lenders receive a satisfactory or outstanding evaluation makes this scoring system meaningless.

III. End Predatory Lending

CRA evaluations should include an overview of the type and quality of loans. Lending that is positive and responsible should be rewarded and harmful lending should be penalized. Historically and in the current credit environment, access to credit is central to the determination of how well a lender meets the credit needs of a community. The subprime mortgage crisis devastated communities underserved by traditional lenders and over served by predatory lenders. Regulators avoided making judgmental calls on what is good or harmful lending preferring a neutral analysis. This position has been discredited in the resulting financial crisis and the legislative response to create the Consumer Finance Protection Bureau.

In 2005, both National City and World Savings Bank received an “outstanding,” even though both were flooding the market with option ARMs, negative amortizing loans, and other dangerous credit products. As if to underscore their shortcomings, neither is still solvent. The same story (poor lending and subsequent insolvency) can be told about Washington Mutual, Banco Popular, GMAC, and Wachovia in 2006. The CRA is not about safety and soundness, but it is about impact on communities. These loans and the lenders that made them have harmed communities through the systematic destruction of housing equity.

Regulators have discretion under CRA to reward and punish harmful practices and should do so. We highlight the FDIC’s CRA evaluation of Republic Bank of Kentucky as a positive example that discerned the difference between positive regional CRA programs and concerns about the bank’s national refund anticipation lending.

IV. Include Affiliates and Entire Assessment Areas

CRA evaluations should be inclusive of a bank’s affiliates to determine overall performance and impact on communities and households. Banks should not be allowed to avoid CRA regulatory coverage by segregating functions into affiliates. Wells Fargo, NA’s mortgages were counted for CRA credit in their assessment areas, but the subprime loans originated through the Wells Fargo Finance affiliates were ignored. Wachovia NA’s mortgages counted for CRA in North Carolina in 2008, but those of their subsidiary World Savings Bank were not. Countrywide Bank, FSB had a CRA obligation, but Countrywide Home Loans did not.

Morgan Stanley, the sixth largest bank in the country has CRA obligations in only three counties in Utah, New Jersey and New York. It provides banking services in more than 500 Morgan Stanley branches in 50 states. The use of affiliates and segregated financial services allows the company to advertise and provide a full range of retail services, but legally avoid CRA obligations.

The assessment areas of lenders should consider service and deposits provided outside of branch locations. This evaluation should consider how lenders affirmatively meet the needs of communities where they take deposits as well as whether the products and services are positive or negative. As an example, Metabank based in Iowa is a small bank that is on the cutting edge of providing prepaid and reloadable cards. Metabank is a provider of Visa based prepaid cards branding the product under various names. Prepaid cards offer a tremendous opportunity for the use of technology to provide deposit; payment and savings function for the unbanked, as well as a lower cost alternative to mainstream bank services. This is a positive service that should earn CRA credit. Unfortunately, MetaBank's operations demonstrate how the technology can be used to undermine state consumer protections by providing high cost consumer credit. MetaBank provides electronic transfer services in partnership with Netspend, a retail distributor of financial card products. Netspend partners with payday lenders, pawnshops and car title lenders in distributing MetaBank prepaid cards. These cards can add an option to access consumer credit that is high cost, secured by the direct deposit of a paycheck and renewable every 35 days. This is essentially a new delivery mechanism for payday loans. The 2007 CRA evaluation of MetaBank gave a satisfactory rating for lending, investments, services and community development for the 13 branches in its assessment areas. The evaluation makes no mention of the banks prepaid card activities, even though Metabank, as of its 2010 10-k, had $422.1 million in deposits with their debit cards, and only $231.6 million in deposits from their regular bank branch consumers. This product has national scope in taking deposits and providing credit to low and moderate-income families but the bank's CRA evaluation is silent on the product. (See attached comments on MetaBank.)

V. Improve enforcement and create new community input process

A new mechanism to provide incentives and disincentives for CRA performance needs to be established. According to existing rulings on CRA, enforcement of any penalties or orders based on CRA can only be implemented in the application and comment process. Regulators are placed in a position of either approving or denying an application. They rarely exercise the option of providing conditions for approval based on improvements in CRA that may be evaluated for compliance in the future. Directives, penalties and incentives should be utilized in the evaluation and comment periods. Otherwise, CRA is all evaluation without consequence.

We recommend that the CRA comment period require lenders to provide a CRA plan for mergers to demonstrate how the bank will serve the community and that groups can substantively comment on. We recommend that regulators weight community input as merited.

CRA agreements at one time were effective tools for catalyzing change in bank lending practices and policies. No longer. These agreements are not binding and federal regulators do not consider them in CRA evaluations. The Sunshine law laudably sought greater transparency, but in context was intended to chill CRA activism. The Federal Reserve states that the acquiring bank's CRA record is the determinative factor in determining the convenience and needs of the review of a merger application. In practice, community comments are not given weight. Protest appeals of an approval order are made to the same Federal Reserve staff and governors that made the original decision. Key issues such as race, affiliate practices and bad lending are omitted from the regulatory context. The regulatory decision process is neither transparent nor accountable. CRA performance evaluations are 98% satisfactory or outstanding and have no enforcement component. The result is a withdrawal of banks from CRA participation and is seen in a reduction of CRA staffing, loans and investments.

As a rule community groups do not want to deny a merger, they want to improve bank services. We need a new framework that is not based on an adversarial context of community challenges nor a regulatory process that makes community comments irrelevant. We recommend banks propose a community reinvestment plan that shows how the community will benefit from greater loans, investments and services as a result of a merger. The plan would demonstrate community input and be given consideration in future CRA evaluations.

Conclusion: We recommend regulators act as fair arbitrators in providing direction and accountability of lenders' CRA performance.

Fundamentally, the most important reform is that within the context of fair and effective CRA, both lenders and community groups trust that regulators will enforce the law for the common good. We look forward to a new era under financial regulatory reform where the spirit and law of CRA receive renewed attention and commitment.