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MEMO

From: Kenneth H. Thomas, Ph.D.

To: www.Regulations.gov RIN: 1557-AE34, Docket ID: OCC-2018-008

Date: November 19, 2018

Re: Second Comment on OCC's CRA ANPR: "Recommended CRA Improvements"

This is the second of two comments on the Office of the Comptroller of the Currency's (OCC's) Advanced Notice of Proposed Rulemaking on CRA Reform. The first comment argued why this entire ANPR effort was unnecessary.

That comment concluded that CRA is not broken and therefore does not need to be fixed. Rather than the major overhaul of CRA suggested by the ANPR and previous comments by the Comptroller, this law only needs to be tuned up in several important areas. This comment will identify the most important such improvements that I have recommended over past years.

Relevant Background on Last Major CRA Reform

My current and past expertise in CRA in general and its last major reform in particular are relevant to this comment. In short, I have spent the majority of my professional life since 1977 focused on the CRA. I was greatly honored to have known and spent time with former Senator William Proxmire, the "Father of CRA."

I am proud of the fact that my first book on CRA, Community Reinvestment Performance (Probus Publishing, Chicago, 1993) received the only endorsement he ever gave to any CRA publication:

> *Dr. Thomas' book, Community Reinvestment Performance, is far and away the best analysis of government regulation that I have seen in any field. He spotlights the regulatory problems that continue in CRA and points out precisely how they are being overcome. CRA will benefit enormously from this superlative examination and report.*

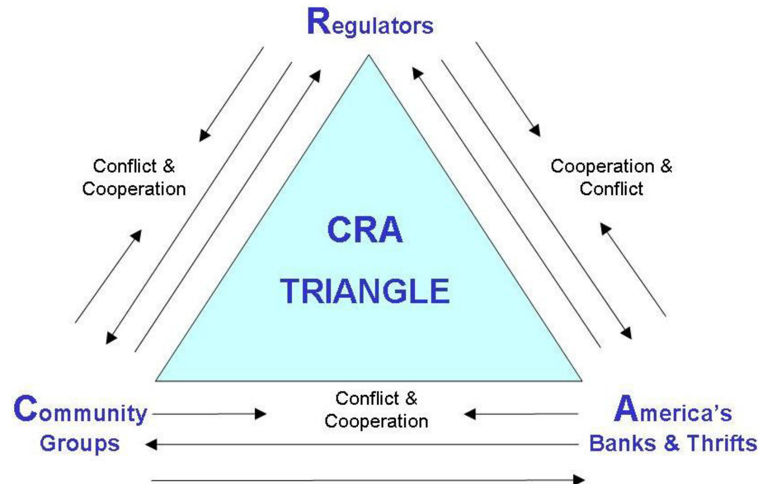
I have worked closely with numerous banks, community groups, and regulators on CRA since 1977, including training federal bank CRA examiners. Besides acting as a CRA consultant and being on the boards of various financial institutions, I have launched two different CRA mutual funds devoted primarily to affordable housing.

I had the privilege of testifying before Congress and federal bank regulators several times on CRA and related bank regulatory and public policy issues. Many of the recommendations in my books, including various CRA exam procedures and tests, were directly implemented into current bank regulations, and more details in this regard are found in The CRA Handbook (McGraw Hill, New York, 1998).

In summary, I have a vested interest in getting CRA reform "right," which I define as being what Senator Proxmire intended. We got it right in 1995 when I worked with Comptroller Ludwig and his OCC staff on the last major reform of CRA, and that is my goal during the present effort.

The CRA Triangle

Critical to understanding CRA and especially considering any reforms of it is an appreciation of the "CRA Triangle." As described in my first book, there are three corners of the CRA Triangle using the CRA acronym: C = Community groups, R = Regulators, and A = America's banks and thrifts:



For CRA to properly work, there must be a constant dynamic of conflict and cooperation among these three corners. This "dynamic tension" or give and take is critical to good CRA public policy. The CRA Triangle (and good CRA public policy) is distorted when two corners get too close to each other.

For example, if a community group or even a coalition of groups get too close to a certain bank and enjoys financial and other benefits from them, this may result in a conflict of interest and suboptimal public policy. The same thing could happen if a bank gets too close to a certain regulator.

Good CRA public policy requires that all three corners of the CRA Triangle be properly balanced and provide their respective input into proposed CRA reform. Listening only to community groups, for example, ignores the realities and regulatory burden of the marketplace that bankers face as well as the complexities of regulatory enforcement.

Also, if the three federal bank regulators are not on the same page, as is the case so far with the current ANPR, this does not bode well for good public policy. Thus, all three corners of the CRA Triangle must be properly represented and considered to result in a balanced view of CRA reform that benefits the public.

Recommended CRA Improvements

Some of the following proposals to improve CRA are found in Community Reinvestment Performance or The CRA Handbook. Also, my 2002 *Public Policy Brief on Optimal CRA Reform* (www.levy.org) contains further background on my research and recommendations for improved CRA public policy.

Some of these recommendations, such as the first two involving credit unions and the CFPB would require legislative action, but most of the others could be done through regulatory actions. While there are other reforms I would recommend, the following are the most important ones that I feel are in the spirit of what Senator Proxmire believed in when he fought so hard to make CRA a reality:

1. *CRA for Credit Unions* - The single most important CRA reform would be to require that all credit unions be covered by this important law. Massachusetts has proven with its state CRA law that different credit unions have markedly different CRA performance, and the citizens of all states rather than just Massachusetts should benefit from the public knowledge of which credit unions are doing the best (and worst) jobs of serving their communities. Credit unions are the beneficiaries of federal deposit insurance for their shares, and this fact alone should justify a CRA requirement for them. I have been told that credit unions are "off limits" for any major taxation or other needed reforms because of their very powerful lobby, but the tens of millions of low-and moderate-income people and small businesses that benefit from CRA should take priority over the lobbying efforts of one industry. Senator Proxmire successfully fought the Federal Reserve to get CRA passed in 1977, and that is a much more formidable opponent than one financial industry.

2. *Transfer the CRA Function to the CFPB* - The entire CRA function (including regulations, examinations, ratings, enforcement, etc.) of the three individual federal regulators should be transferred to the Consumer Financial Protection Bureau (CFPB). This proposal would provide needed uniformity and minimize CRA Grade Inflation or Deflation and examiner subjectivity, which has been documented in my nearly three decades of research on CRA. Furthermore, the CFPB could incorporate input from its Complaint Database in its CRA evaluations to help determine which banks are being most responsive to retail banking services, although only the largest banks are covered by their Complaint Database at this time.

3. *Maintain Senator Proxmire's LMI Focus* – It is well known that Senator Proxmire was very concerned with redlining based on racial factors, but he decided to focus CRA on income factors, leaving the former concerns to fair lending laws. He was very clear in his intention to focus on Low- and Moderate-Income (LMI) communities, which eventually and naturally expanded to include LMI people. Any effort to minimize or reduce this LMI focus of CRA credit would be contrary to

Senator Proxmire's intent. For example, the idea that any bank activity that increases community or economic development, regardless of its LMI focus, should be given CRA credit could effectively include *any* loan, investment or service or other activity of a bank. Even without this proposed ANPR reform, CRA has been gradually expanded in recent years to give credit for activities with little or no recognizable LMI focus. The best example is found in the #1 community credit need throughout the nation, especially in larger cities, namely affordable housing. Bank dollars and resources that might otherwise be devoted to this critical community development effort are now being directed to ancillary activities such as solar panels and broadband for CRA credit. What good are these enhancements to a house if there is no affordable home to begin with? Our focus should be building an affordable home and putting a roof on it rather than putting solar panels or satellite dishes on a roof. Those critics, including some ill-informed regulators, who argue that providing CRA investment test credit for LMI Mortgage Backed Securities (MBS) is "too easy" miss this critical point, since such securitized investments are the most important source of funds for affordable single and multifamily housing. If there is any necessary reform in this area, it should be to refocus CRA's credit on LMI benefits and most notably the critical need for affordable housing.

4. *Revised Assessment Areas for Branchless Banks* – One of the most important elements of the Community Reinvestment Act is its focus on a bank's local community or communities where it operates. Senator Proxmire did not call it the "Bank Reinvestment Act" or any other title, since he wanted the focus to be first and foremost on the community or communities in which a bank operates. The law is very flexible in that it allows banks rather than their regulators to define their Assessment Area (AA). This is an important benefit to a bank, since its performance is being evaluated in the area which it defines. This critical feature of CRA must not change, since no one knows their own community or communities better than the bankers who live, work and operate there. That being said, there is a need to update the AA concept in our digital world, especially for branchless banks that operate on the internet. My 8/22/2017 article in the *American Banker* titled "Keep CRA for fintech, but lose its geographic boundaries," provides an outline of my recommended approach to AA reform not only for fintech banks but also for any branchless bank with a national footprint such as internet or credit card banks. Further details on my recommended approach for fintech banks are found in the public comments I submitted on the proposed SoFi, Square, and Varo Bank fintech applications to the FDIC, OCC and the Utah Department of Financial Institutions. Under this recommended approach, an internet or credit card or fintech bank with no branches could meet its CRA obligations anywhere in the nation, its *Primary AA*, but it would be required to provide a commensurate portion of CRA benefits to any Metropolitan Statistical Area generating 5% or more of deposits or other business, its *Secondary AA.* This approach would eliminate the current situation where 100% of the CRA benefits of such banks are reinvested in their artificially small AA based on the location of their single office, usually in Salt Lake City, Sioux Falls, or Wilmington. Those three MSA have, in total, less than 1% of our country's population, yet they receive 100% of the CRA benefits of those banks, and this is not good public policy. Going back to Senator Proxmire's intent, the reason why the law was named the "Community Reinvestment Act" rather than

the "Community Investment Act" was to insure that banks *reinvested* their federally-insured deposits, their "raw material" and the basis for their profits, back into the communities from which the deposits emanated. Again, this would be a regulatory tune-up of the AA concept to improve CRA for such banks, using a digital rather than branch footprint, as compared to a major overhaul of CRA.

5. *Quantitative Guidelines for CRA Ratings* – There is, unfortunately, considerable confusion among many commenters about the appropriate use of metrics to improve CRA. Some, but not all of this confusion, is a result of commenters reading CRA regs or hearing CRA exam "war stories" from bankers without reading the actual Performance Evaluations (PEs) completed by the regulators. Reading a few dozen or even a hundred PEs gives a flavor of how CRA works, but reading thousands of them over decades provides a true understanding of CRA. The proper approach to the metric issue is to first differentiate between the *qualitative* and *quantitative* factors that go into CRA performance evaluations and individual test and overall exam ratings. The relevant *qualitative* factors include the extent to which various community development or other activities are responsive to community credit needs, innovative, creative, complex, and the degree to which the activities are available through other sources. I strongly recommend the publication of specific *quantitative* guidelines for certain quantifiable performance activities, but I would leave the qualitative evaluation to the CRA examiners. That way, the examiners would still have some subjectivity and flexibility in the final rating on the qualitative side, but bankers would have some needed guidance on the critical question of "How much is enough?" on the quantitative side. Following are the specific quantitative guidelines I have recommended based on my reading of thousand of PEs over the last few decades. These recommended quantitative guidelines include the critical loan-to-deposit and in-out AA penetration ratios within the Lending Test. However, they do not include the LMI borrower or LMI geography lending ratios, since the appropriate levels of those ratios depend on many factors unique to each bank and its AA and performance context. My recommended quantitative guidelines also include community development lending, investing, and service activities (with an example for such services):

CRA Handbook Loan-to-Deposit Ratio Guidelines©:

These guidelines are based on reviewing thousands of PEs ...but are NOT accepted or endorsed by any regulator:

Loan-to-Deposit Ratio Rating	Loan-to-Deposit Ratio
Outstanding	80% or higher
High Satisfactory	65 - 79%
Low Satisfactory	50 - 64%
Needs to Improve	25 - 49%
Substantial Noncompliance	0 - 24%

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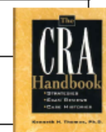
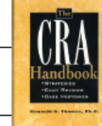


CRA Handbook AA Penetration Ratio Guidelines©:

These guidelines are based on reviewing thousands of PEs ...but are NOT accepted or endorsed by any regulator:

Assessment Area (AA) Penetration Ratio Rating	Assessment Area (AA) Penetration Ratio
Outstanding	80% or higher
High Satisfactory	65 - 79%
Low Satisfactory	50 - 64%
Needs to Improve	25 - 49%
Substantial Noncompliance	0 - 24%



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CRA Handbook Investment Test Guidelines©:

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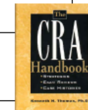
Investment Test Rating	Qualified Investments/Assets Ratio
Outstanding	1% or higher
High Satisfactory	.66 - .99%
Low Satisfactory	.26 - .65%
Needs to Improve	.11 - .25%
Substantial Noncompliance	0 - .10%



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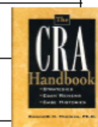
CRA Handbook Community Development Loan Guidelines©:

These guidelines are based on reviewing thousands of PEs ...but are NOT accepted or endorsed by any regulator:

Community Development (CD) Loan Rating	CD Loans/Assets Ratio
Outstanding	1% or higher
High Satisfactory	.66 - .99%
Low Satisfactory	.26 - .65%
Needs to Improve	.11 - .25%
Substantial Noncompliance	0 - .10%



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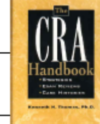
CRA Handbook CD Services Guidelines©:

These guidelines are based on reviewing thousands of PEs …but are NOT accepted or endorsed by any regulator:

Community Development (CD) Service Test Rating	Number of CD *Services* per $1 Billion of Assets per Review Period Year
Outstanding	12
High Satisfactory	8 - 11
Low Satisfactory	6 - 7
Needs to Improve	3 - 5
Substantial Noncompliance	0 - 2



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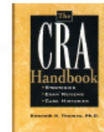
CRA Handbook CD Services Guidelines Examples©:

Bank Asset Size	Amount of CD Services per Review Period Year Needed for an Outstanding Rating*
$100 Million	1
$500 Million	6
$1 Billion	12
$10 Billion	120
$100 Billion	1,200

*Based on previously proposed CD Services Guidelines. These guidelines are NOT accepted or endorsed by any regulator. Also, this guideline does not consider important *qualitative* and other relevant factors.



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6. *Financial and Other Incentives for Outstanding Ratings* – Good CRA public policy by the federal regulators should encourage Outstanding rather than just Satisfactory performance through one or more of the following approaches:

   a. Banks with Outstanding CRA ratings should be publicly commended in separate monthly regulatory releases similar to the current ones on enforcement or similar adverse regulatory actions where banks are criticized. If banks are publicly criticized by their regulators for bad performance, why can't banks be publicly commended by them for good performance? (See my 9/13/2016 *American Banker* article titled "Banks Learn the Price of 'Satisfactory' CRA Grades.")

b. The heads of the three regulatory agencies should send separate congratulatory letters to the CEOs of those institutions complementing their Outstanding CRA performance. Good CRA and other corporate activities by banks that are in the public interest should be encouraged by regulators. My efforts in this regard to date have been rebuffed by the regulators.

c. Real CRA reform should mean a *dollar and cents motivation* for Outstanding CRA performance, because it costs a bank money to get and maintain an Outstanding rating. This financial motivation could be in the form of reduced FDIC deposit premiums, reduced FHLB or FED borrowing costs, and/or even tax credits. Conversely, a bank with a failing CRA rating (either Needs to Improve or Substantial Noncompliance) would be penalized in the opposite direction, so CRA's teeth would bite into the income statement of banks that have no expansion or M&A plans.

d. Outstanding banks should have an additional year between exams as is presently the case for small banks. (See my 4/19/2014 *American Banker* comment titled: "Comptroller Curry: How About some Real CRA Reform?")

7. *Retrain CRA Examiners to Eliminate or Minimize Ratings Subjectivity and "Rogue" Examiners* – My decades of research on thousands of CRA PEs has concluded that the biggest problem with this law, using the previously cited CRA Triangle model, is not with the banking industry or even the community groups but, rather, the regulators themselves. The extent of examiner subjectivity within and across federal banking agencies in making individual test and overall ratings is shocking, even at different regions within the same regulator. The nightmare scenario for a bank, however, is the "rogue" CRA examiner, who fashions his or her own interpretation of the regs and what activities should or should not be eligible for CRA credit. The previously recommended transfer of the entire CRA function to the CFPB and the recommended quantitative guidelines noted above will help reduce such subjectivity. In any case, CRA examiners should be required to regularly undertake enhanced training and certifications to make sure they are following published regs and exam procedures. Far too many CRA examiners are only capable of completing a "cookie cutter" review of a traditional retail bank with HMDA and small business lending using their regulatory templates and software. Unfortunately, these examiners and their superiors are often unwilling and/or unable to properly evaluate the CRA performance of a niche lender. For example, a bank in a major city specializing in critically needed affordable multifamily lending should have the borrower income section of the Lending Test evaluated on the basis of the estimated income of the tenants using a documented "Rent Roll Analysis" in accordance with exam procedures. Unfortunately, far too many examiners ignore this section of the exam procedures and fail to give any credit whatsoever, since there is no income information available on the tenants (or the LLC borrower which is irrelevant). Also, banks that specialize in multifamily affordable housing *construction* lending, should be given "double credit" like banks making multifamily affordable housing *permanent* lending, since there is much more risk on the construction side; also, there are no permanent loans if there is no construction to begin with.

8. *Retrain CRA EICs and Regional CRA Supervisors to Eliminate or Minimize CRA Grade Inflation and Deflation* – The required enhanced CRA training and certification should not stop with examiners but also be required of their regional and national supervisors, including Examiners In Charge (EICs), to make sure they are likewise following published regs and exam procedures. My first book on CRA coined the phrase "CRA Grade Inflation" and proceeded to quantify this term. While CRA Grade Inflation refers to the practice of regulators giving out far too many passing ratings (about 98% of the total at present) and far too few failing ones (about 2%), there is another equally serious problem on the other side of the scale. Specifically, some regulators are failing to assign an Outstanding rating where it is rightfully due, thus reducing or eliminating the incentive for banks to exceed standards for Satisfactory performance. Specifically, since 2014, 17% of all OCC ratings have been Outstanding compared to only 6% at the FDIC, a roughly threefold difference. In my home state of Florida, the third largest in the nation, the FDIC has given out *just one Outstanding rating since 2013*. That bank, however, was downgraded there years later, despite arguably Outstanding performance. Meanwhile, the OCC has given out 14 Outstanding ratings in Florida since 2013, yet the OCC regulates roughly *half* the number of banks in Florida (about 50 vs. 100 at the FDIC). What incentive do FDIC-regulated banks in Florida have to go above and beyond, when they know they will most likely not be properly rewarded with an Outstanding rating? This is an example where the regulators themselves can thwart Outstanding CRA performance. Federal regulators who effectively refuse to award Outstanding CRA ratings when they are appropriate should be examined by an independent federal body such as the GAO or CBO to determine if their "Grade Deflation" efforts are disincentivizing banks from achieving their best CRA performance.

9. *Eliminate Unofficial M&A "CRA Plan" Requirement* - I support the practice of banks having CRA Audits and CRA Plans to regularly monitor and gauge their CRA activities, especially when they result in Outstanding performance. However, an official or unofficial requirement of a published "CRA Plan" or "Community Benefits Plan" with public review and input for banks planning M&A activity may impose an unnecessary, costly, and time-consuming regulatory burden on banks. Most of these plans involve substantial donations or other financial benefits to community groups, which may or may not do a good job of serving their communities. The fact is that some community groups are apparently focused more on their *group* rather than their *community*. (See my article titled "Hold Community Groups Accountable, Too" in the 8/10/2015 *American Banker.*) Please note my following comment in the 9/26/2018 *Wall Street Journal* article titled "Bankers vs. Activists: Battle Lines Form Over Low-Income Lending Rules:"

   > *In the years before the [CRA] regulations became more stringent, if you were doing a deal, you'd call your investment banker and the Federal Reserve. Now, the first thing you do is call the community groups to see how much this will cost you. It has become an unwritten law.*

10. *Revise CRA Appeals Process* - The entire CRA rating appeals process should be revamped, because there is an inherent conflict of interest when senior officials at any of the three federal banking agencies regularly "circle the wagons" and blindly defend their "rogue" examiners who have given out improper ratings in violation of published exam procedures. The appeals process should be given to an independent outside agency like the CFPB or, at a minimum, be jointly given to the other two federal regulators, since all three of them supposedly follow the same interagency regs and exam procedures. Thus, for example, if a bank is appealing an improperly downgraded rating by the FDIC, the process should be handled by an appeals committee made up of both FED and OCC representatives without any FDIC officials involved.

11. *Public ("Uber" Style) Examiner Ratings* - Bank examiners should be routinely rated as to their performance not only by their agency superiors but also by the bankers who are being rated. These ratings should be made available to all bankers (without the disclosure of any personal or confidential information), as is presently the case with Uber drivers where they rate passengers and passengers rate them. Professors routinely get evaluated by their students, and the ratings are made public, and this procedure ultimately benefits both the professors and the students. Also, more and more professionals, such as doctors, are routinely being evaluated online by patients, and this ultimately benefits both the doctors and the patients.

12. *Anonymous CRA Credit Hot Line or Chat Session With Regulators* - The three federal regulators need to provide banks with many more examples of what does and does not qualify as a community development loan, investment or service activity. The OCC's *Community Developments Fact Sheet* from 2014 titled "CRA: Community Development Loans, Investments, and Services" is a good start, but it needs to be expanded. There are far too many examples in published PEs of one bank getting full credit for a certain CRA activity but another bank getting limited or no credit, oftentimes from the same regulator in the same region. This often happens with the improper treatment of prior period CRA investments but most often in the categorization of CD loans and services. The most banker-friendly approach would be a toll free "CRA Credit Hot Line" or "Chat Session" on a new regulatory website such as www.CRAcredit.com run by an interagency team of the most senior regulators that would allow banks to remain anonymous if desired.

13. *More Timely Published Ratings and PE* - The regulators themselves, not just the banks they supervise, need to be more responsive to community needs. I am referring to the glaring need for them to develop a specific timeline and schedule for WHEN a CRA public PE becomes public. I have seen many examples in recent years where either the regulators and/or banks have strategically caused significant delays in the publication of a downgraded or failing CRA rating, thus benefiting the bank with a shorter time of public knowledge of the lower rating until the new (upgraded) rating is available. This practice is most serious when the delayed PE contains a downgrade or serious fair lending violation, that would have otherwise scuttled an approved corporate expansion activity or M&A deal during that delayed period. (See my article titled "Regulating BB&T Is Too Big a Job for the FDIC," in the 9/14/2015 *American Banker*.) Also, the concept of a "retroactive downgrading" by some regulators makes little sense and should be eliminated.

14. *High and Low Satisfactory Overall CRA Rating* - The regulatory agencies should adapt a High and Low Satisfactory rating for overall bank ratings. This would return us to the five overall CRA rating system that existed prior to July 1, 1990. This is the case today for state banks, credit unions and even licensed mortgage lenders in Massachusetts, although they graciously refer to "Low Satisfactory" banks as just "Satisfactory" vs. those with a High Satisfactory rating.

15. *Required Community Group Financial Disclosures* - Any non-profit community group representing itself to financial institutions as being associated with CRA or testifying to Congress in this regard should be required to disclose whether any officers or Board members have any direct or indirect relationships with for-profit vendors that sell CRA products to financial institutions. Further, all direct and indirect monetary transactions between the for-profit and non-profit entities should be fully disclosed. Most importantly, there should be a complete disclosure of what, if any, financial or other benefits are received by community groups or coalitions involved in initiating or negotiating all past, present and future CRA Plans or Community Benefit Plans of banks involved in M&A activity, as these plans have involved tens of billions of dollars.