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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: First Comment on OCC's CRA ANPR: "Why This ANPR is Unnecessary"

With all due respect, this ANPR and all of the government, industry, community group and other resources that went into It appears to have been UNNECESSARY, since contrary to the intent of the ANPR and past comments by the Comptroller of the Currency, the Community Reinvestment Act (CRA) is NOT broken and it does not need to be fixed.

On the positive side, the roughly 1,000 comments elicited by the Office of the Comptroller of the Currency (OCC) through this ANPR will provide CRA researchers like myself an opportunity to get a current snapshot of different viewpoints on this important law from community groups, bankers, some government representatives and other interested parties.

Rather than a total overhaul of CRA, which is effectively suggested by the nature of the ANPR ("to solicit ideas for building a new framework" for CRA) and previous OCC comments on this topic (e.g., proposing an elimination of the "Assessment Area" concept), all that is needed is a regulatory tune-up. Several such recommended improvements to CRA will be the subject of my second comment.

I will identify summarize here three criticisms of the OCC related to CRA contained in some of the comments to date and from other sources that support the argument as to why this ANPR is unnecessary.

Specifically, the OCC has been criticized as being a biased regulator; a "lone wolf" regulator; and, a CRA non-factually based regulator in terms of CRA as documented below.

OCC Criticism #1: A Biased Regulator

There is a reason the FED and FDIC did not join the OCC on this CRA overhaul effort, and it goes back directly to the Comptroller and his boss at Treasury. Bank regulators, like referees, should be unbiased and base their decisions on facts with input from fellow regulators, just like when referees confer to make the right call.

There are, however, an increasing number of critics, including those who submitted comments on the subject ANPR, who believe that some of the actions by Treasury and its OCC to date on CRA reform may not meet these criteria.

Both the Comptroller and his boss, the Treasury Secretary, worked together at the same bank, OneWest Bank, that faced considerable CRA protests from community groups in a highly contested bank merger. The September 25, 2018 *Wall Street Journal* article titled "Bankers vs. Activists: Battle Lines Form Over Low-Income Lending Rules," reported that the current CRA reform effort is "very much done through the lens of two bankers who came out of California and a battle with communities in which they always put their needs last," according to the community activist who led the opposition.

While this gave the Treasury Secretary and the Comptroller first-hand industry experience with CRA, it unfortunately was not a good experience. According to that same *Wall Street Journal* article, the Comptroller is the first to admit that "I went through a very difficult period with some community groups …And, so I have very strong viewpoints."

Bank regulators have a critical role in balancing the interests of banks and their customers, which is why the Comptroller has also been criticized for viewing banks as his "customers," as reported in the April 25, 2018 *Wall Street Journal* article titled "Financial Deregulation Throws Fuel on Already-Hot Economy."

Such a narrow perspective, if that is in fact the case, would appear to contradict the OCC's mission statement reported at www.OCC.gov to not only ensure banks operate in a safe and sound manner but also provide fair access to financial services and treat customers fairly by complying with applicable laws and regulations. Again, a good regulator like a good ref treats both sides fairly, and there should not be any actual or perceived biases either way.

It is of interest to note that a few ANPR comments called for the Comptroller to recuse himself from this entire ANPR process and any proposed rulemaking, because of his previous involvement with that CRA-challenged merger involving his former bank.

OCC Criticism #2: A "Lone Wolf' Regulator

It is surprising and historically notable that the OCC has acted as a "lone wolf" regulator on several recent CRA and fair lending initiatives, even before the current ANPR, without the traditional interagency effort involving the FDIC and FED. The OCC has gone to great lengths to minimize the importance of this fact.

While the OCC is hopeful that the other regulators will join them in their efforts, the result so far is an unlevel playing field for FDIC- and FED-regulated banks. The near silence of the FDIC and FED on this ANPR is deafening.

The fact of the matter is that the OCC is making CRA regulatory history as a "lone wolf" regulator starting with its October 12, 2017 revised policy on fair lending downgrades of CRA ratings. This policy revision, released by the then acting Comptroller, eased the CRA regulatory burden for OCC-regulated institutions. Since then the new Comptroller, not to be outdone by his placeholder, further eased this regulatory burden with the August 23, 2018 release on this same topic.

That CRA regulatory relief was minor compared to the current Comptroller's June 15 Bulletin, which made several changes easing CRA examination procedures. None of these deregulatory efforts, however, match what is suggested for CRA in the subject ANPR and by previous comments of the Comptroller.

These unilateral deregulatory efforts of the OCC did not go unnoticed by key Congressional representatives. For example, Congresswoman Maxine Waters noted on August 29, 2018 that:

> *"This week's unilateral decision to reopen the CRA by the Office of the Comptroller of the Currency (OCC) is of great concern given that the agency has recently taken other steps on its own – without coordinating with other regulators or seeking public input – to relax its enforcement of the CRA, including by reducing the frequency of big bank exams and easing the consequences of violating fair lending laws. I urge the OCC to collaborate with the other banking regulators, stakeholders and Congress moving forward."*

The OCC and its staff, in its effort to apparently soft sell this ANPR, repeatedly claim that it is not a "proposal" but rather a set of questions. However, an ANPR is defined as an Advanced Notice for *Proposed* Rulemaking, and it was published in the Federal Register, the government's official journal that contains agency rules, proposed rules, and public notices.

Also, the ANPR must be read in conjunction with previous comments made by the Comptroller about CRA, several of which involved proposals to reform CRA, including the OCC's reported proposal to eliminate the law's critical Assessment Area concept (see below).

Putting aside the critical public policy question of whether the above-cited current and recent OCC regulatory reforms are in the public interest, these existing and proposed deregulatory efforts are being done without the FDIC or FED through the normal interagency process.

By easing the regulatory burden on national banks and federal savings associations, the OCC is placing state-chartered banks and savings associations at a competitive disadvantage. This not only results in an unlevel playing field *within* the banking industry but is also at odds with President Trump's objectives of reducing the regulatory burden for all banks.

This CRA regulatory divide brings back "competition in laxity" memories from the 1970s when banks would "charter shop" to get the friendliest regulator. This was done for safety and soundness reasons related to critical capital or other regs rather than compliance issues.

It is not unreasonable in today's intensified M&A climate to imagine an FDIC- or FED-regulated bank with major merger plans jumping over to the OCC for a more friendly CRA rating to expedite the merger.

The OCC has historically been the friendliest of the three regulators in terms of CRA ratings, even before the new Comptroller came aboard. For example, according to data at www.FFIEC.gov, between 2014 and November 2018, 17% of all OCC ratings were outstanding compared to just 6% at the FDIC and 8% at the FED. At the other end of the ratings scale, the OCC only failed 1% of its regulated banks compared to 2% at the FDIC and 1% at the FED.

The last time regulators could not get their CRA regulatory acts together was in 2004 when OTS Director Gilleran disagreed with the FDIC, FED, and OCC on the asset size threshold for an "Intermediate Small Bank." He later resigned and the regulators adopted a unified approach.

Today, however, things are very different. For the first time we have former bankers running all the federal banking agencies, not to mention the U.S. Treasury. Not surprisingly, one of Treasury's top priorities was reforming CRA.

The Treasury issued its report with recommended reforms, which basically punted this job to the regulators. As expected, the OCC fielded the ball and immediately spearheaded the CRA reform offensive.

But, the Treasury and OCC's bank deregulatory efforts are not stopping there, as we saw with the Treasury report advocating an industry-friendly approach to fintech regulation. This was again immediately followed by the OCC's announcement that it will begin accepting fintech charter applications with a much relaxed "financial inclusion" standard instead of conventional CRA requirements. Again, why would a fintech even consider anything but an OCC charter if it has a much lower compliance standard?

The Comptroller has even taken its "OCC is the Best U.S. Bank Regulator" effort on the road to an international conference in Tokyo where he recently touted the advantages of an OCC charter to foreign banks seeking a U.S. presence, including it being a more "efficient" option (see November 14, 2018 *American Banker* article titled "Otting touts OCC to foreign banks seeking U.S. presence").

The result of the OCC's "competition in compliance laxity" regulatory strategy may be to increase the number of OCC-chartered banks relative to FDIC and FED ones. This would not be that different from a company in an industry composed of three players cutting costs, increasing service, and providing other benefits to gain market share.

But, we are talking about the *public* rather than *private* sector where the success of the former is measured in terms of serving the public rather than private interests. However, to the extent that the new Comptroller considers the banks he oversees as "our customers," his lone wolf approach in this regulatory triopoly is more understandable.

If the FED and FDIC do not flex their regulatory muscle and bring the OCC back in line with them, the OCC may become the leader of the bank regulatory pack. It is possible, though unlikely, that the FDIC and FED will put forth their own eased CRA regulatory reforms to attempt to maintain a balanced regulatory environment, but the resulting regulatory race to the bottom would be suboptimal public policy.

Worse yet, what if the OCC attempts to use this same lone wolf strategy on safety and soundness regs, resulting in an even more unlevel playing field within the industry and likely more charter switches to the OCC?

Since all three bank regulators were appointed by the President, it may be up to Congress to step in and protect the public interest by attempting to level the banking industry playing field before it is even more distorted.

OCC Criticism #3: A CRA Non-factually Based Regulator

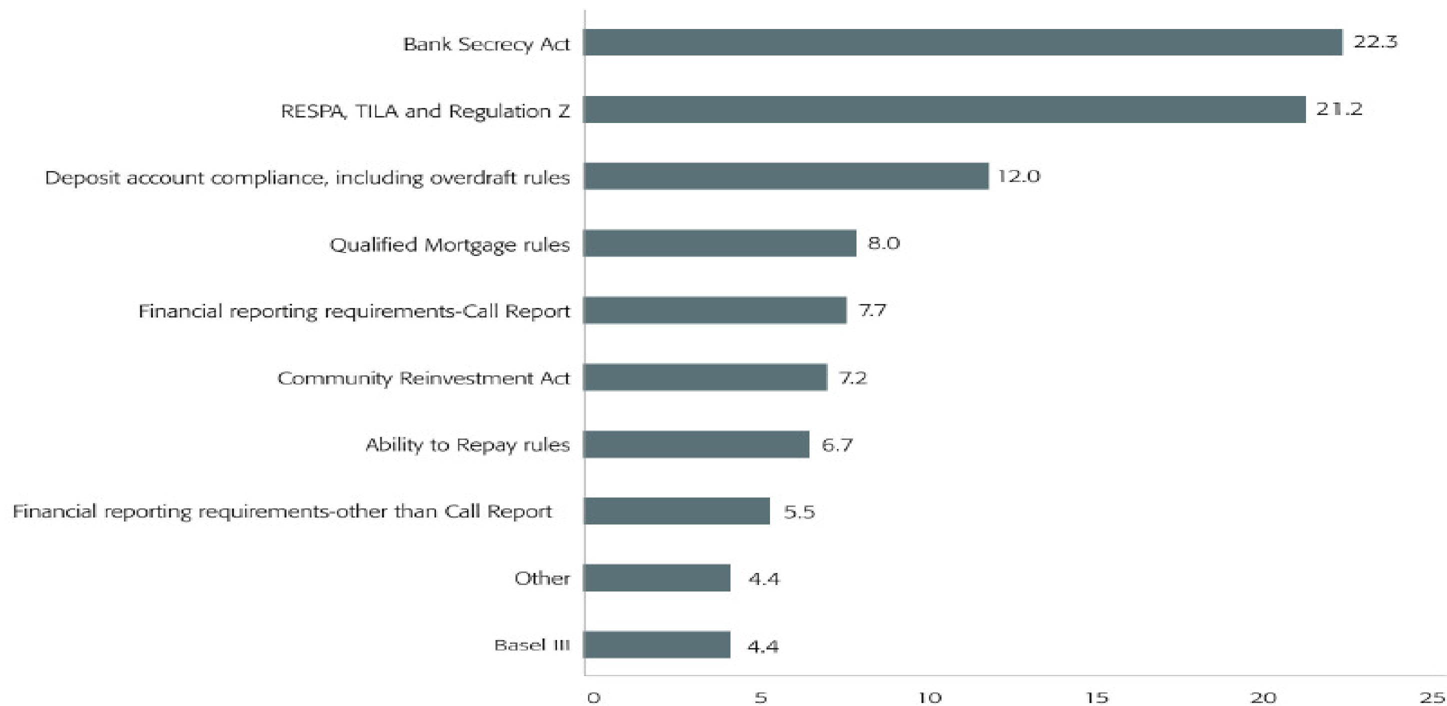
There appears to be some factual inconsistencies with the Comptroller's recently stated rationale for his current CRA reform effort in his October 2, 2018 Senate testimony:

> *"Despite the best of intentions, the CRA regulatory framework, which has been pieced together over the past 40-plus years, is outdated, ambiguous, overly complex, and unnecessarily burdensome. These problems hinder banks' ability to fulfill the statute's goals."*

Let's look at the facts:

1. Bank's do not have *problems fulfilling CRA's goals* since 98% of banks pass their CRA exams and only 2% fail. This was, in fact, an issue in the 1980s when 9% to 16% of banks and thrifts failed their CRA exams, but the 1995 reform helped reverse this trend.

2. CRA is not *unnecessarily burdensome*, except perhaps to those who had a bad experience with it. A major reform of CRA, as suggested by the ANPR and some public comments of the Comptroller, could have the perverse effect of creating a new regulatory burden for banks, since they would have to learn and adjust to a new CRA regulatory infrastructure. Banks today have software, templates, data gathering activities, audits and other procedures based on the current CRA regs, and any major reform of them, other than some needed improvements, will necessitate a new and potentially costly compliance effort. But, let's focus on the extent of the current CRA "regulatory burden." An April 2018 study by the Federal Reserve Bank of St. Louis titled "*Compliance Costs, Economies of Scale and Compliance Performance"* identified CRA as just the *sixth* most costly compliance reg, at just 7% of all compliance expenses, compared to the Bank Secrecy Act (BSA) ranking first at 22%. That means BSA is THREE TIMES as costly to banks as CRA! The chart below summarizes the results of this recent landmark study, which should be a guiding light for bank regulators charged by President Trump with reducing the regulatory burden on banks. If Treasury and its OCC really wanted to help banks with "unnecessarily burdensome" regs, they should have started with BSA rather than CRA. Has anyone asked the Treasury Secretary or the Comptroller why they didn't make BSA regulatory reform their #1 focus instead of CRA? When will we see a similar ANPR from the OCC on BSA Reform? Below is a key chart from the landmark Federal Reserve Bank of St. Louis study.



Source: Compliance Costs, Economies of Scale and Compliance Performance, Division of Bank Supervision, Federal Reserve Bank of St. Louis, April 2018

3. The current CRA regulatory framework has not been "*pieced together* over the past 40-plus years." Rather, there was one major and very effective overhaul of this 1977 law in 1995, and several targeted improvements since then. I believe most bankers, community groups and regulators (the current OCC excepted) have learned to live with CRA for the most part, again evidenced by its 98% pass rate.

4. The 1995 reform and the subsequent 2005 enhancement with separate rules for midsized bank are far from *complex*. There are several specific and straightforward exam procedures and tests for different sized banks: a four-pronged lending test for small banks, equally-weighted lending and community development tests for intermediate sized banks; and lending, investment and service tests for large banks. There are also optional exam procedures for special purpose and other banks with unique business models. Again, if CRA is overly complex, why are 98% of banks passing their exams?

5. What is true about CRA is that there are a few aspects that are *ambiguous*, such as what counts as a "community development" activity, but these are usually but not always clarified through interagency Q&As and public performance evaluations. So, yes, some of CRA's subjectivity can be reduced through more specific guidance and examples as well as examiner and supervisory training that would benefit bankers and regulators alike (see my second comment). This would be a regulatory tune-up rather than a major overhaul.

6. It is also true that there are a few aspects of CRA that are *outdated* in our digital banking world, the most important one being the definition of the appropriate "Assessment Area" or AA for branchless banks. The AA is the local area that a bank, not its regulator, defines as the basis for its performance evaluation. While the current focus on the branch footprint of a traditional retail bank is appropriate, the best way of viewing an AA for a branchless bank, like an internet, credit card, or fintech bank, would be to consider its *digital footprint* based on the underlying geocoded physical addresses of its internet customers. For example, 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*. (see my second comment). Again, this would be a regulatory tune-up to modernize CRA in a digital world for such banks rather than a major overhaul. An example of a major overhaul is the ill-conceived proposal to entirely eliminate the AA concept. For example, consider the following comments from the April 27, 2018 *Wall Street Journal* article titled "Shake-Up Considered on How Banks Lend to the Poor" and subtitled "Top bank regulator floats idea of eliminating geographic assessments as business shifts online:"

> *In recent weeks, the comptroller's office sent the Federal Reserve and Federal Deposit Insurance Corp., two other regulators that enforce the law, a draft document soliciting public input on potential rule changes, the people familiar with the matter said. The draft includes the idea of eliminating assessment areas in favor of a broader definition of banks' customer base, they said.*

Summary

CRA can certainly be improved, but it is not broken as some detractors and the OCC and their ANPR would have us believe.

Improving CRA through the aforementioned recommended AA definitions for branchless banks as well as quantitative guidelines and other enhancements I have recommended over the years (see my second comment), represent a needed regulatory *tune-up* rather than a total *overhaul* of the law as suggested by the OCC's ANPR and the Comptroller's public comments.

The overriding public policy concern with CRA expressed by critics of the current reform process is that a biased and nonfactual view of CRA by a lone wolf regulator could weaken it and perhaps even effectively repeal it.

Many critics fear that a deemphasizing of a bank's local community, by substantially expanding or even eliminating the AA concept (as proposed by the OCC), plus allowing almost any bank loan or activity that supports community and economic development (which arguably could be almost anything) to be counted for CRA credit, without consideration of CRA's intended Low-and Moderate-Income (LMI) focus, would effectively render the law meaningless.

The fear is that if virtually *everything* a bank does *everywhere* counts for CRA credit, the law will have been effectively repealed. That is, *repeal through reform.*

Good public policy suggests that it is time for the FDIC and FED to work with their fellow OCC referee to make sure the goal is to improve and modernize CRA in an impartial and fair way rather than totally overhaul it. Otherwise, Congress must step in and get this reform right, the way Senator Proxmire, the Father of CRA, envisioned it.