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MEMO

From: Kenneth H. Thomas, Ph.D.

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Re: First Comment on OCC/FDIC CRA NPR: "The 5% Deposit Reinvestment Rule"

The OCC and FDIC are to be commended for making the 5% Deposit Reinvestment Rule the cornerstone of their CRA reform proposal. This is because the primary motivation for CRA reform was to *modernize* the law to account for technological advances such as digital banking and branchless banks.

This simple fact is often forgotten by many regulators, community groups, journalists, members of Congress and even some bankers. Modernization means exactly that, namely improving CRA to account for technological advances. Nothing more and nothing less.

Modernizing and Tuning Up CRA Rather Than Overhauling It

This modernization goal implies that a CRA regulatory *tune-up* is in order rather than a *major overhaul* of a law that has functioned fairly well for the last 25 years since the 1995 reforms. Let's look at some basic facts.

Most bank's do not have *problems fulfilling CRA's goals,* since 98% of banks pass their CRA exams and only 2% fail. Also, a recent study by the Federal Reserve Bank of St. Louis identified CRA as just the sixth most costly compliance reg, at just 7% of all compliance expenses, compared to BSA ranking first at 22%.

So, where is the problem? Instead of coming up with elegant and complicated solutions in search of a problem, we need to remember that the primary goal is to modernize CRA to account for technological advances, and that is exactly what the 5% deposit reinvestment rule does. Unfortunately, the Fed's recent CRA reform proposal by Governor Brainard is silent on this critical issue.

Instead of using the CRA modernization argument as a Trojan Horse to totally reform (deform?) this successful and effective law, we must focus on how Assessment Areas must be changed for branchless and other banks obtaining deposits from distant markets with little to no CRA reinvestment of those deposits.

This is the first of several comments I will submit on this NPR on CRA Reform. Before providing more details and documentation on this comment, I will summarize my relevant background on CRA reform.

Relevant Background on CRA Reform

My current and past expertise in CRA in general and its 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.

Background on the 5% Deposit Reinvestment Rule

The only part of the joint Notice of Proposed Rulemaking by the OCC and FDIC that really addresses the modernization issue is the adoption of a variant of a previous reform concept to require banks obtaining deposits from outside their headquarters community to benefit the areas sourcing those deposits.

This reform is more important than ever now with so many fintechs and other giant tech barbarians like Google and Amazon lining up outside the banking gate.

The previous proposal would require all banks with 5% or more of their deposits in any area to reinvest a commensurate portion of their CRA benefits there. The NPR, however, would limit this 5% deposit rule to banks with more than half their deposits from outside their current Assessment Area and not require any commensurate CRA benefit. Hopefully, the final rule will be changed to be consistent with the original proposal relevant to all banks with a commensurate CRA benefit.

Under the current regs, these branchless banks can place up to 100% of their CRA benefits in their home office community. In the case of credit card banks, the primary beneficiaries are three "sanctuary states," namely Delaware, South Dakota, and Utah that provide a safe harbor from state usury ceilings.

As a result, tens of billions of dollars of community development (CD) loans and investments and tens of thousands of hours of CD services have benefited Wilmington, Sioux Falls, and Salt Lake City rather than our large Metropolitan Statistical Areas (MSAs) sourcing their deposits. Despite containing less than 2% of the nation's population, these three states are reaping nearly 100% of the CRA benefits primarily sourced by our large MSAs.

This misallocation of CRA resources is inconsistent with Senator Proxmire's Community *Reinvestment* Act, where he intended that federally-insured deposits be *reinvested* back into their community rather than some credit card-friendly city a thousand miles away.

Any CRA reform proposal that talks about the "intent" of CRA without mentioning such a reinvestment element is not really reform or modernization. This is unfortunately the case with the Fed's recent CRA reform proposal by Governor Brainard in a speech titled "Strengthening the Community Reinvestment Act by Staying True to Its Core Purpose," since that proposal is silent on this critical reinvestment issue which is at the core of CRA.

America's Forgotten Cities

While the lack of banking services and credit in "banking deserts" and Indian Country are important public policy issue, I am even more concerned about our Forgotten Cities being shortchanged by branchless banks. This includes my hometown of Miami, part of the nation's seventh largest metro area, with 40% of the deposits of our third largest state.

My previous concern over what I called "carpetbagger banks", which come to our deposit-rich state to get our seniors' savings to lend them elsewhere, was mainly directed toward the giant banks that now dominate our state like Bank of America and Wells Fargo with a combined one-third market share.

This has changed somewhat in recent years where many out-of-state regionals buying our local banks are doing a good job reinvesting in our communities, some of this being the result of the federal law monitoring nonlocal loan-to-deposit ratios for interstate branch banks.

Unfortunately, neither this law nor CRA do anything to prevent credit card and other branchless banks from taking our deposits and reinvesting them elsewhere. The proposed reinvestment rule in the NPR is a step in the right direction to correcting this inequity.

Synchrony Bank Siphoning South Florida Deposits

Consider, for example, the roughly $100 billion asset Synchrony Bank, formerly GE Capital Retail Bank, the nation's sixth largest credit card issuer with all reported deposits in its Salt Lake City area main office.

Like many other credit card banks, it regularly advertises its above-market deposit rate (e.g., 2% for a one-year CD) in our South Florida newspapers. It is reasonable to assume that with this targeted advertising in an MSA with 2% of the nation's population and even greater share of its wealth that at least 5% of that bank's deposits come from South Florida.

Synchrony Bank's most recent CRA exam as of December 31, 2018 reported $464 million of CD investments and $548 million of CD loans totaling more than $1 billion benefiting their home Salt Lake City Assessment Area within the most recent three-year review period. There was an additional $250 million of CD investments benefiting undisclosed outlying areas for a grand total of $1.25 billion of CRA benefits, representing more than 2% of their average $60 billion of deposits over this review period.

There is no public information on the portion of their deposits emanating from their home Salt Lake City MSA, but we do know that the entire MSA and state represent just 0.4% and 1.0%, respectively, of the nation's population.

Under the proposed CRA reform for such banks, assuming at least 5% of Synchrony Bank's deposits come from the Miami MSA, they would be required to reinvest at least 5% of their reported $1.25 billion of CRA benefits or a total of $62.5 million here over that comparable period. Considering that we are Ground Zero for the nation's affordable housing crisis, there is a critical need for such funds.

While that bank may deserve its outstanding CRA rating for their performance in the Salt Lake City MSA, this is certainly not the case for our MSA and other large ones being targeted by these banks and getting little to nothing in return for financing their credit card operations.

For example, the New York MSA, with 6% or our nation's population and even greater share of wealth, probably represents at least 10% of that bank's deposits. This proposal would have entitled New York to at least $125 million in CRA benefits from Synchrony Bank over that same period, and those funds could have helped New York's huge affordable housing and homeless problem.

Three Sanctuary States Are Receiving Disproportionate CRA Benefits

Most of the largest credit card banks plus many other internet and branchless banks are based in one of the three credit card sanctuary states. With just 1.6% of our population and 1.7% of our businesses, these three states together represent a whopping $1.6 trillion in deposits or 12.8% of all FDIC-insured deposits as of June 30, 2019. In fact, South Dakota ranks 3rd largest in total deposits, Utah 6th, and Delaware 10th, despite their respective population rankings of 46th, 30th and 45th.

With fewer than 2% of the nation's population and businesses in these three states, it is reasonable to assume as much as 95% of their reported deposits or $1.5 trillion originate from other states.

Assuming roughly 1% of deposits of these banks are regularly used for CRA loans and investments, which is not unusual for many credit card banks, this would mean *as much as $15 billion would be regularly reinvested in our Forgotten Cities rather than these three credit card sanctuaries.* To put this into perspective, the OCC recently estimated that all banks provided $482 billion of CRA (CD and non-CD) lending in 2017, representing some 4.1% of bank deposits.

This proposal would not impose an undue regulatory burden, since it is standard operating procedure for branchless banks to geocode their deposits at least down to the zip code level. Also, these banks would now have many more CD options around the country, instead of competing with other giant banks for limited opportunities in those sanctuary states. Moreover, community banks there would likewise benefit, since they often find it difficult to compete for CRA credits with the giant banks headquartered there.

Our Forgotten Cities deserve their fair share of CRA benefits from banks targeting them for funding. This will happen only if all such banks are required to proportionally reinvest their deposits in the spirit of CRA as originally proposed with the 5% reinvestment rule.

The current NPR is the first meaningful step in this direction. The originally proposed 5% reinvestment rule should be adopted ASAP, so our Forgotten Cities can begin to regularly receive as much as $15 billion of deserved reinvestment rather than these CRA benefits being commandeered back to the three sanctuary states.

This reinvestment rule alone, even assuming nothing else changes with CRA, is well worth all the current CRA reform efforts, because it truly modernizes and improves this law consistent with Senator Proxmire's intent.

The Federal Reserve, the same agency that did everything it could prior to and during 1977 to try to kill the law and then disrupted the previous 1995 CRA reform process led by the OCC, should take notice and likewise make the originally proposed reinvestment rule a cornerstone of its CRA reform proposal, if it really wants to make it true to the law's core purpose ...and middle name.