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MEMO

From: Kenneth H. Thomas, Ph.D.

To: Chair Jerome Powell & Vice Chair Lael Brainard via Docket No. R-1769 and RIN 7100-AG29;
Acting Comptroller of the Currency Michael Hsu via Docket ID: OCC-2022-0002; and,
Acting Chairman of the FDIC Martin J. Gruenberg via Docket No. RIN 3064-AF81

Date: August 5, 2022

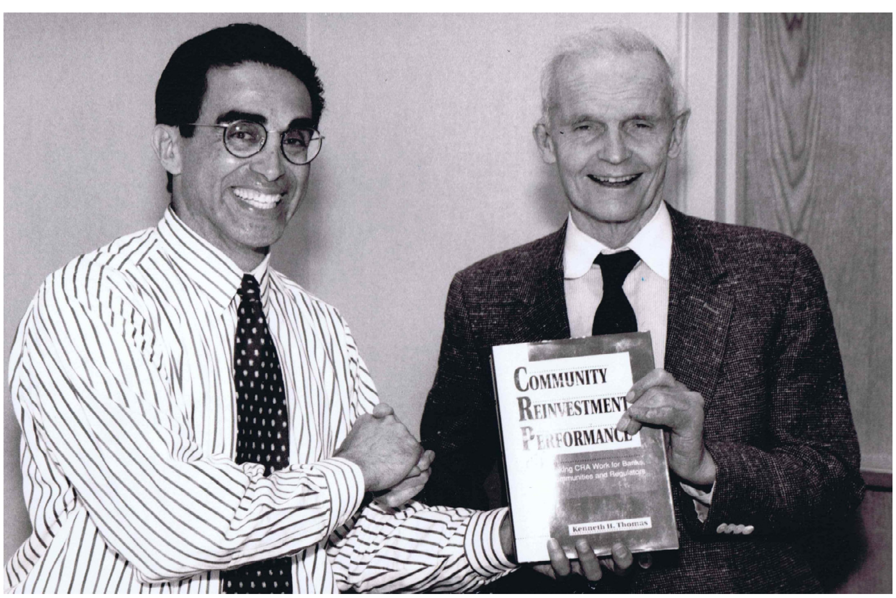
Re: Second CRA NPR Comment on "The Fed's Heavy Hand in this NPR"

This is my second comment on this NPR on CRA Reform, and it is titled *"The Fed's Heavy Hand in this NPR."* Before providing more details on this comment, I will first summarize my relevant background on CRA reform.

My comments represent my personal views and not those of any university, financial institution, company, or other organization with which I am or previously have been associated.

My 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." The following photo was taken in 1995.



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 am a cofounder and founder of two different CRA high impact mutual funds devoted primarily to providing CRA qualified investments to benefit LMI areas and people.

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 at www.CRAHandbook.com in The CRA Handbook (McGraw Hill, New York, 1998).

I was honored to receive the first "Award of Excellence" from the National Community Reinvestment Coalition (NCRC), along with Representative Joseph P. Kennedy and Comptroller Ludwig.

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 Fed's Heavy-Handed Handiwork With the NPR

What is billed as an *interagency* CRA reform proposal is really the heavy-handed handiwork of the Fed, which was not willing to work with the OCC and FDIC in their January 2020 joint reform effort under the Trump Administration. This comment and future ones will refer to the NPR as the "Fed's NPR" for reasons documented below.

The politically-savvy Fed issued a competing September 2020 version, hoping a new Biden Administration would look more favorably on its approach to CRA reform. Their political bet paid off as their Chair, Jay Powell, was not only reappointed but their CRA reform architect, Lael Brainard, was appointed as Vice Chair by the new President. According to published reports (e.g. https://www.americanbanker.com/list/whos-in-line-for-top-fed-jobs), she was not only interested in being appointed as Treasury Secretary but also the Fed Chair; she apparently was satisfied to get the Fed's Vice Chair appointment.

The new President Biden, however, tapped a former Fed Chair, Janet Yellen, as Treasury Secretary who, in turn, tapped a Fed official, Michael Hsu, as Acting Comptroller of the Currency, resulting in him being an FDIC director. One of his first actions was to rescind the previous Comptroller's final rule on CRA and publicly support working with the Fed and FDIC on interagency reform. The Fed is definitely the dominant bank regulatory agency at the present time.

This background is relevant, as this is the same Fed that tried to kill CRA during and prior to its establishment in 1977 and then did everything it could to undermine the 1993-1995 joint CRA reform efforts by the OCC, FDIC, and OTS. More on the Fed's tortured CRA history is in the following section.

The Fed fortunately kept its heavy hand off CRA since those 1995 regs. Banks with their 98% CRA passing ratings and communities with their $500 billion of annual CRA benefits and $100 billion M&A Community Benefit Agreements are apparently doing well with the existing regs.

In my opinion, community groups, banks, and their CRA examiners are generally comfortable with them, as they do not have to learn the complicated new procedures and formulae in the roughly 700-page proposal that looks hauntingly familiar to the Fed's previous proposal. Yes, a Fed proposal in interagency clothing.

The FDIC's Acting Director properly acknowledged the *"leadership"* of the Fed's Vice Chair and staff in this reform effort. In fact, the Fed's staff released an April 26 internal memo to the Fed's Board detailing the proposed reform a week before it was jointly announced by the agencies.

The Fed's Tortured CRA History

Interagency CRA reform is an admirable goal, and it is probably the only positive feature of this nearly 700-page NPR. Interagency disagreement, however, may be better than an unnecessary and complicated major overhaul by a heavy handed Fed with a tortured CRA history cloaked as an interagency effort.

Any discussion of CRA reform or other efforts by the Fed must be mindful of its history regarding this very important law. While the Fed and its Reserve Banks have taken many positive steps regarding CRA in recent years, we must never forget its CRA past.

Although representatives of the Fed and its Reserve Banks say all the right things about CRA, history will show they are 45 years late, since the Fed tried to kill CRA during and prior to 1977.

The banking industry, as expected, opposed this new law as a form of "credit allocation," but what was unexpected was the fierce opposition of the Fed. Thus, began the Jekyll and Hyde bank regulator that publicly put on a pro-CRA face but privately encouraged banks and others to lobby Congress to weaken the law. This was a first for a federal bank regulator in modern times.

Then Fed Chairman Arthur Burns, later disgraced in monetary circles for pandering to President Nixon's demands to lower interest rates, was very clear in his opposition to CRA, not only arguing it was unduly burdensome to banks but also that it was a form of credit allocation.

Yes, the same Fed now waving the pro-CRA flag did everything it could to stop it. Fortunately, Senate Banking Committee Chairman Proxmire prevailed when President Carter signed the law in 1977.

CRA remained largely untouched until the S&L Crisis and subsequent laws requiring the publication of CRA ratings and performance evaluation beginning July 1, 1990. With ratings and Performance Evaluations (PEs) public, there was an interest in reforming CRA.

The first December 1993 proposal from the OCC, which was clearly pro–consumer, resulted in over 6,700 comment letters. While everyone expected a conflict between the community and industry positions, no one expected the publicized infighting by the regulators themselves, specifically between the pro-CRA OCC and the generally perceived anti-CRA Fed at that time.

Members of the Fed's Board publicly criticized the OCC's 1993 proposal. One Fed governor stated that he was *"perfectly willing to tear it up, throw it into the fireplace, and go back and start again"* Other Fed governors condemned the proposal as the *"wrong*" approach and a *"fundamental policy mistake"* resulting in not only credit but also *"resource allocation."*

In addition to concluding that *"the time to say no is now,"*one Fed governor publicly stated that the Fed would oppose the proposal if bankers complained loudly enough. Even the presidents of the Federal Reserve Banks piled on, with the banker–friendly San Francisco Fed arguing against the disclosure of CRA public examination schedules.

The Fed, with the help of the banking lobby that it called to action, was successful in watering down many of the toughest provisions of the 1993 proposal. The OCC was not happy but went back to the drawing board, and its September 1994 proposal generated over 7,200 comments.

The end result of approximately 14,000 total comment letters (on average more than one for every bank and thrift at the time) and seven public hearings was the third and final April 1995 reform proposal. The banking lobby, with the strategic help of the Fed, won almost every CRA reform battle it fought. These regulations went into effect in 1995, and are essentially the ones under which we have been operating since that time.

My research of thousands of CRA PEs in the 1990s documented that the Fed was, by far, the most lax CRA enforcer, responsible for what I then called "CRA Grade Inflation." Much has changed for the better at the Fed and its Reserve Banks since then. Nonetheless, while the Fed can change interest rates and the direction of markets and the economy (unfortunately, too often in the wrong direction as we have seen lately), they cannot change CRA history.

Fed Stakeholder Input of Limited Value

The Fact Sheet accompanying the Fed's previous ANPR stated that, by *"building on stakeholders' support"* and *"reflecting stakeholder views*" it *"seeks to provide a foundation for the agencies to converge on a consistent approach that has broad support among stakeholders."*

The Fed further claimed that the ANPR *"incorporates views from external stakeholders provided in meetings, roundtables, and comment letters as well as from all three of the banking regulatory agencies responsible for administering the CRA."*

Several comments by Fed Board members and other Fed officials about the current NPR likewise cite stakeholder input, but what exactly is this input?

In June, 2019 the Fed released the results of "stakeholder feedback" on CRA reform, a summary of perspectives from over 400 bankers and community groups at 29 roundtables around the nation.

Unlike the preferred approach of publishing written comments from all interested stakeholders, the Fed used an anonymous approach of not identifying which banks or community groups said what, other than Fed-filtered feedback.

Rather than providing specific proposals identifying their authors' rationale, the Fed merely summarized general findings using wide-ranging terms like "many" stakeholders said this (33 times), "several" said that (24 times), and "some" said something else (52 times), leaving readers to speculate who said what and for what reasons. This again demonstrated the banker-friendly Fed.

Besides ignoring feedback from academics, consultants, vendors, and other CRA stakeholders, not one of their 29 roundtables were in my home state of Florida, the nation's third largest. Thus, this claimed stakeholder input by the Fed is of limited value. The anonymous bankers in the Fed report wanted the asset size thresholds increased, but this is not surprising, since bankers will almost always ask to reduce their regulatory burden.

With the Fed taking the industry's position of substantially increasing Small Bank, Intermediate Small Bank (ISB), and Large Bank asset thresholds in the current NPR, this is an unfortunate flashback to the early 90s. Hence, another reason why CRA history is important.

For example, the Fed stakeholder report indicated that some banks in the current Large Bank category anonymously suggested that they are at a disadvantage relative to much larger banks in their CRA examinations. The real problem, however, is not with the Large Bank Exam Procedures but with the examiners administering them. The Fed needs to look in its CRA mirror.

Experienced and good CRA examiners (as compared to inexperienced ones) will properly consider the Performance Context and evaluate and rate CRA performance relative to a bank's size, business strategy, and other relevant contextual facts.

As The CRA Handbook documents, many of the problems that banks and community groups have with CRA exams and ratings is not because of the banks or their performance but rather with inexperienced and poorly trained CRA examiners (the worst being "rogue" examiners) and their resultant PEs and ratings. Improved examiner training consequently should be a top priority at the Fed and other regulators, as was pointed out in The CRA Handbook nearly 25 years ago.

The Fed's CRA Political Calculus

It is widely known that the Fed has become increasingly political, as first documented by the analysis of former Fed Chair Alan Greenspan's calendar dating back to 1996. That and the subsequent analysis of Ben Bernanke's calendar concluded they were two of the three most political Fed Chairs in recent times. Calendars of Fed Chairs and other top officials are now public without requiring painstaking FOIAs.

The current Fed Chair, after many very public disagreements with the former President, understandably wanted to keep his job under the new President. In my opinion, he obligingly kept rates at record lows last year despite unprecedented fiscal stimulus and money supply growth.

This dreadfully dovish policy further overheated the stock market and economy, but he was reappointed. It is my further opinion that Fed Chairs, often considered the second most powerful people in the Beltway, will do what they can, like most politicians, to maintain personal power, even at the expense of the dollar's purchasing power.

This Death of Fed Independence resulted in considerable "mission creep" causing it to lose focus on its main mission of maintaining price stability and full employment. The Fed was recently criticized for research on "social policy topics" like climate change and social justice reflecting political and normative views of unelected officials in what is supposed to be an independent agency.

In addition to the previously cited politicking by Fed chieftains to keep their jobs, the Fed came up with some clever political moves to try to get the NPR approved. I am referring to the NPR's significant but unnecessary increases in asset thresholds of both Small Banks and Intermediate Small Banks (ISBs) and even Large Banks to hopefully get industry approval, especially from the ICBA that mainly represents smaller banks.

The Fed's NPR not only safe harbors Small Banks and ISBs to a great extent to hopefully get their approval, but they also left the controversial Strategic Plan option and Wholesale and Limited Purpose Bank exam procedures largely untouched to get the approval of larger banks that currently or may potentially use those exam procedures..

The Fed therefore put most of the NPR's regulatory burden on Large Banks over $2 billion in assets and especially on a new category of Very Large Banks with more than $10 billion in assets. Those 135 banks represent 88% of industry assets. Why not just the 32 banks with more than $100 billion in assets, thus capturing 75% of industry assets? There is no documentation whatsoever for these increased asset thresholds and the new category of banks.

The Fed's political calculus of hopefully dividing and conquering the industry to get the NPR into a Final Rule was clever, but probably not enough when ISBs realize they are subject to the new complicated Retail Lending Test and Small Banks realize the regulatory "trickle down" effect may likely impact their simple Lending Test.

The CRA NPR: The Fed's Next Big Mistake

Milton Friedman, one of the two greatest economists of the last century, best summarized the Fed: *"There is no institution in the United States that has such a high public standing and such a poor record of performance; it has done far more harm than good."*

While Professor Friedman was referring to the Fed's monetary policy record over many decades, the same can be said of their CRA public policy record. It is my opinion that the NPR, the true handiwork of the Fed, will be its next big public policy mistake.

The 30-page 4/26/2022 Memo from the Fed Staff to the Fed Board and the 700-page NPR (https://www.federalreserve.gov/consumerscommunities/files/board-memo-20220505.pdf) resemble the work of Ph.D.'s with little to no real-world banking or examining experience.

Actually, the 700-page NPR with 180 questions reads like a Ph.D. dissertation, but this is not surprising since the Fed has over 400 Ph.D. economists, including those who predicted "transitory inflation" last year.

Based on my review of tens of thousands of Performance Evaluations since they became public on July 1, 1990, including those of Small, Intermediate, and Large Banks, I have concluded that the current asset thresholds and exam procedures have served the banking industry and their communities well.

As noted above, the NPR clearly places the greatest regulatory burden on banks with assets over $10 billion, but there is no justification for that new category or the increase in asset thresholds for the existing bank categories. A subsequent comment will document why the NPR should have focused on the largest banks with assets over $100 billion, as they control three-fourths of all industry assets.

Consequently, other than the needed modernization of CRA to account for branchless banks and digital banking using the recommended 5% Deposit Reinvestment Rule and certain improvements generally agreed upon by banks and community groups alike (e.g., the "laundry list" of qualifying community development activities), there is no need for the radical overhaul proposed by the NPR.

As previously noted, based on the 98% passing rate of CRA exams and the substantial (i.e., approximately $500 billion per year) CRA benefits provided to local communities, it is my considered opinion that the Fed's entire NPR and CRA reform effort, other than the above-referenced modernization and improvements, is a mistake and therefore totally unnecessary.