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COMMUNITY REINVESTMENT ACT

Challenges Remain to Successfully Implement CRA

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This report responds to requests concerning the effectiveness of the Community Reinvestment Act. It discusses the major problems with the implementation of the act identified by the affected parties, the extent to which the recent regulatory reform efforts have addressed those problems, and the challenges that regulators need to address as they implement the new CRA regulations. It also discusses initiatives that banks have taken independently or in partnership with others to enhance community lending.

We are sending copies of this report to the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the Acting Director of the Office of Thrift Supervision. We are also sending copies to members of the House and Senate banking committees, other interested committees and subcommittees, and other interested parties.

This report was prepared under the direction of Mark J. Gillen, Assistant Director. If you have any questions, please call me on (202) 512-8678.

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Executive Summary

Purpose

Concerns that banks and thrifts (institutions) were not responsive to credit needs in low- and moderate-income areas prompted Congress to enact the Community Reinvestment Act of 1977 (CRA). CRA requires the federal bank and thrift regulatory agencies (regulators) to encourage institutions to help meet credit needs in all areas of the communities they serve, consistent with safe and sound operations. CRA also requires the regulators to assess institutions' CRA performance during examinations and to consider that performance in their evaluations of institutions' applications for expanding or relocating of their operations. Growing concern about the effectiveness of CRA's implementation and its regulatory burden on institutions recently led to the regulators' major reform effort, which resulted in revised CRA regulations that were issued in May 1995.

The former Chairmen, House Committee on Banking, Finance and Urban Affairs and its Subcommittee on Consumer Credit and Insurance, asked GAO to address four questions: (1) What were the major problems in implementing CRA, as identified by the affected parties—bankers, regulators, and community groups? (2) To what extent do the regulatory reforms address these problems? (3) What challenges do the regulators face in ensuring the success of the reforms and what, if any, actions would help the regulators in facing these challenges? and (4) What initiatives have been taken or proposed to help bankers overcome community lending barriers and enhance lending opportunities, particularly in low- and moderate-income areas?

Background

The debate preceding enactment of CRA was similar to the current debate. Community groups urged its passage to curb what they believed to be a lack of adequate lending in low- and moderate-income areas. Bankers generally opposed CRA as an unnecessary measure that could adversely affect business decisions by mandating credit allocation and cause safety and soundness problems by forcing institutions to make excessively risky loans. More recently, changing market conditions along with increased public disclosure have raised bankers' concerns about the issues of competition and regulatory burden. More specifically, bankers have become concerned about the competitive advantages for nonbank financial institutions, such as mortgage companies, that compete with banks but are not subject to CRA requirements. Bankers also objected that the cost and paperwork burdens imposed by CRA are not offset by positive incentives, such as protection against protests of expansion plans, to encourage CRA compliance. However, community groups have raised

concerns about limited CRA enforcement and insufficient disclosure of information on institutions' community lending performance.

As concerns about CRA increased from all affected parties, both the administration and Congress looked for ways to make CRA more effective and less burdensome. The stated goals of the regulators' reform initiative, announced by the President in July 1993, were to (1) base CRA examinations more on results than paperwork, (2) clarify performance standards, (3) make examinations more consistent, (4) improve enforcement to provide more effective sanctions, and (5) reduce the cost and burden of compliance. Subsequently, the regulators issued two notices of proposed rule-making and, after receiving extensive public comments, promulgated the revised CRA regulations in May 1995. Several legislative proposals have also sought to reduce the burden associated with CRA compliance.

Results in Brief

Through interviews with bankers, community groups, and regulatory officials, GAO identified four major problems with the regulators' compliance examinations and enforcement of CRA that all the affected parties agreed were problems: (1) too little reliance on lending results and too much reliance on documentation of efforts and processes, leading to an excessive paperwork burden; (2) inconsistent CRA examinations by regulators resulting in uncertainty about how CRA performance is to be rated; (3) examinations based on insufficient information that may not reflect a complete and accurate measure of institutions' performance; and (4) dissatisfaction with regulatory enforcement of the act, which largely relies on protests of expansion plans to ensure institutions are responsive to community credit needs. However, the reasons they gave for why they believed the problems adversely affected their interests—which form the basis for their concerns—and the often contradictory solutions they offered to address the problems, showed that the affected parties differed considerably on how best to revise CRA.

The revised CRA regulations address some, but not all, of the major problems. In response to the first problem, the regulations adopt a results-based examination process. The regulators' success in lessening problems related to inconsistent examinations largely depends on how effectively examiners exercise their discretion when implementing the reforms. To alleviate concerns about insufficient information, the regulations clarify the data to be used to assess results against performance-based standards. However, the affected parties disagree

about whether the data collection requirements provide for meaningful performance assessment or are unduly burdensome. The regulations do not address the different enforcement concerns of bankers and community groups.

From its review, GAO believes that some of the difficulties that have hindered past CRA implementation efforts will likely continue to challenge the regulators as they implement the revised regulations. These difficulties include (1) differences in examiner training and experience levels as well as differences in how examiners interpret vague CRA standards; (2) insufficient information to assess institutions' CRA performance and inadequate disclosure in public evaluation reports of the information and rationale used to determine institutions' CRA performance ratings; and (3) insufficient time for examiners to complete all of their responsibilities during CRA examinations. In addition, some regulators were unable to complete CRA examinations for all their banks within their proposed time frames. Furthermore, the regulators estimate that the revised regulations will increase examiner responsibilities, including performing analyses previously required of institutions.

GAO also found from its review that, independent of the regulatory and legislative reform efforts, many bankers, regulators, community groups, and others have taken part in a variety of individual and cooperative initiatives to improve institutions' community lending and reduce related burdens. Through these initiatives, according to participants, institutions have been able to overcome real or perceived barriers to lending in low- and moderate-income areas (community lending). Barriers to community lending and investment may include a variety of economic factors, such as higher costs and risks of community lending compared with other lending and underwriting requirements of major participants in the secondary mortgage markets.

Regulators, to varying degrees, have also played a key role in facilitating cooperation and disseminating information to their institutions about such initiatives through outreach efforts of their community affairs programs. As they further develop these programs and better coordinate their efforts, the regulators' role in this respect should be enhanced.

Congress has considered proposals to amend CRA to reduce the compliance burden and to exempt small institutions from its requirements. In addition, Congress, in recently enacted legislation, has encouraged community development lending. Further, other legislation has been

proposed to encourage community lending through financial subsidies or other positive incentives.

Principal Findings

Affected Parties Agree on Major Problems but Concerns and Solutions Differ

All of the affected parties that GAO spoke with—bankers, community groups, and regulators—generally agreed on the problems with the implementation of CRA. However, the reasons they gave for why they believed the problems adversely affected their interests—which form the basis for their concerns—and the often contradictory solutions they offered to address the problems showed that the affected parties differed considerably on how best to revise CRA. Bankers generally analyzed problems in terms of regulatory burden and wanted regulatory or legislative changes that would reduce the burden of paperwork and data reporting. They also generally supported proposals to increase certainty about performance ratings through regulatory guarantees such as safe harbors that would protect highly rated institutions from CRA-based protests of applications for expansion or relocation. In addition, they believed that CRA performance standards should be flexible enough to consider factors such as an institution's business strategy, financial condition, and its community's credit needs.

Community groups, however, raised concerns about their ability to hold institutions, as well as regulators, accountable for performance and sought changes to increase that accountability. For example, they wanted to improve the disclosure of information in public evaluation reports so that they could assess institutions' community lending performance more easily. Community groups also identified as a problem the fact that enforcement of the act was limited to regulatory denials of applications for expansion or relocations of their operations. Their concern was that no sanctions were available to penalize poor performers that did not have plans to expand or move. To strengthen regulators' enforcement of the act, they advocated use of additional enforcement actions, such as cease-and-desist orders and civil money penalties. They strongly opposed safe harbors.

Revised Regulations Address Some, but Not All, Major Problems

Overall, the revised regulations address some of the major problems of the affected parties but do not wholly satisfy the often contradictory positions of bankers and community groups. The regulations address the problem of

overreliance on documentation of an institution's compliance efforts and processes by shifting the focus of assessment standards from compliance efforts to actual results in three performance areas—lending, investment, and services.

The potential effect of the regulations on some of the other problems is not as clear. Effective implementation of the regulations is key to addressing examination-related inconsistency because examiners are to continue exercising considerable discretion in assessing an institution's performance. In developing the regulations, the regulators tried to balance the need for objective standards with the need for flexibility in assessing different types of institutions operating under differing financial conditions and serving widely different types of communities. The revised regulations have increased examiner responsibilities, created the need for related comprehensive examiner training, and could affect the amount of resources needed to effectively complete examinations.

The revised regulations may not entirely resolve the problem of insufficient data for performing CRA examinations. Although the regulations clarify the data collection requirements to assess institutions' CRA performance, they do not directly address the problems of inaccurate data provided by institutions or the inadequate disclosure of information in the public evaluation reports. Public evaluation reports are the public's primary source of information about institutions' CRA performance and the regulators' consistency in CRA examinations.

Also, the revised regulations do not resolve the widespread dissatisfaction with regulatory enforcement of the act. The initial reform proposals sought to strengthen enforcement by calling for regulators to use existing formal enforcement actions set forth in the banking laws, such as cease-and-desist orders and civil money penalties. However, the Department of Justice issued an opinion in late 1994 that such actions are not within the scope of CRA. The reforms would also have addressed bankers' concerns by specifying how CRA ratings would be considered in applications, i.e., a "satisfactory" or better rating would generally result in the approval of an application. However, many commentors to the proposed rules objected to the perceived restriction on public protests of banks' applications. Consequently, both proposed measures were dropped from consideration by the regulators.

Challenges to Successfully Implementing Regulations

From its review, GAO found several challenges that the regulators face to successfully implement the revised regulations. Inconsistency resulted in

part from examiners (1) exercising considerable discretion in interpreting vague CRA standards and (2) rating institutions' performance differently by focusing on different parts of the examination guidance. Frequent changes in the focus of examinations within the past several years also contributed to inconsistency. Insufficient examiner experience and training was cited by bankers and community groups as further contributing to inconsistency because it led to inadequate expertise on the part of examiners knowing how to properly evaluate institutions' community lending performance.

Some examiners told GAO that they had difficulty assessing compliance when data provided by institutions were inaccurate or incomplete. In addition, some of the regulators reported data quality problems with home mortgage lending data submitted by institutions and used by the regulators to assess performance. Further, the regulators' responses to institutions with poor data quality have been inconsistent.

Information accessibility has been a concern of community groups that monitor institutions' CRA performance and the regulators' CRA examinations. Some of these groups were concerned that publicly available evaluation reports do not provide enough information about institutions' actual lending performance. In addition, inadequate information about the regulators' rationale for how they rate institutions has contributed to concerns by bankers and the public about examination consistency.

Finally, some examiners told GAO that they lacked the time during examinations to perform all of the data gathering and analysis tasks that they are expected to do during CRA examinations, such as making contacts in the community to assess community needs. Some regulatory officials estimate that implementation of the revised regulations will require examiners to do more during examinations. Recognizing this possibility, the regulators are developing new techniques to reduce examination time. If these efforts are not successful, examiners may face situations where they either cannot perform necessary analyses or must shift responsibility for conducting such analyses back to the institutions. Such actions could reduce examination quality as well as increase institutions' regulatory burden.

Initiatives Have Overcome Some Barriers to Community Lending

Successful community lending initiatives have demonstrated that having good communication and cooperation among regulators, bankers, community groups, and others is key to overcoming lending barriers. In

such initiatives, institutions have made community lending an integral part of their business strategies; involved community groups in their plans and programs; and developed targeted underwriting standards, programs, and products to meet community needs. From its review, GAO learned of community lending initiatives that participants believe may overcome perceived or actual barriers to lending in low- and moderate-income areas. Barriers described by bankers included higher transaction costs and credit risks as well as restrictions related to secondary mortgage market underwriting standards. Some bankers have found ways that may lower the relatively high transaction costs and credit risks to individual institutions of community reinvestment loans by sharing those costs and risks through participations in multi-institution programs. In addition, some major participants in the secondary markets have recently undertaken initiatives intended to make them more responsive to community development concerns. Furthermore, Congress has enacted legislation to facilitate community lending through other means, such as the recently enacted Riegle Community Development and Regulatory Improvement Act of 1994, which authorized funds for community partnerships to help finance revitalization projects, and the Bank Enterprise Act, which authorized direct subsidies for certain community lending activities.

GAO also found that banking regulators, to varying degrees, play a key role in helping institutions enhance their community lending programs. Using the available resources of their community affairs programs, some regulators have helped facilitate community development by disseminating information about various community lending techniques and investment opportunities. The resources and longevity of the regulators' community affairs programs differ. For example, the Federal Reserve Board's (FRB) program has a full-time staff of 70 and was established in the early 1980s, while the Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency (OCC) each has fewer than 10 full-time staff in its recently established program. Further development of these programs and better coordination of efforts could enhance the regulators' role in encouraging community development lending.

Congress Has Considered Proposals to Reduce Burden and Encourage Community Lending

Congress has considered proposals that would reduce the burden of complying with CRA and encourage banks to lend to all areas of their community. Many bankers have supported proposals that would amend CRA to exempt small banks from CRA examinations. Bankers and others

have also suggested that CRA be replaced or supplemented with financial subsidies or other positive incentives. Some of their suggested alternatives have included modifying or supplementing CRA with incentives such as tax credits, deposit insurance credits, streamlined or less frequent examinations, and revisions of safety and soundness requirements for CRA lending. Community groups have generally opposed proposals that would reduce CRA obligations for financial institutions, but some groups have supported proposals that would increase incentives for community lending.

The varied positions taken by the affected parties further demonstrate that the debate about how best to achieve the goals of community reinvestment is both complicated and contentious. The approach embodied in the current CRA statute uses the levers of compliance examinations and application aprovals to increase community reinvestment lending. The new regulations are an attempt to generate better results with less regulatory burden. However, given the positions of the different parties, it is not clear that the results will fully satisfy all of those parties.

Matter for Congressional Consideration

If the concerns raised by the affected parties should persist even after the regulators have had sufficient time to implement the revised regulations, Congress may want to consider revisiting and revising the CRA statute to clarify its intent and scope, possibly examining alternative strategies for reaching its goals. Such strategies might include incentives to strengthen positive CRA performance by bankers and additional enforcement authority for regulators to discourage negative performance.

Recommendations

GAO is also making recommendations to the heads of the federal bank and thrift regulatory agencies related to the major challenges identified by GAO that have hindered past CRA implementation efforts. The recommendations on page 66 are intended to ensure the effective implementation of the revised regulations and consistency of CRA examinations.

Agency Comments

GAO received written comments on a draft of this report from the Federal Deposit Insurance Corporation (FDIC), FRB, OCC, and OTS. A discussion of the regulators' comments and GAO's evaluation appears at the end of chapters 3 and 4. Overall, officials from the four banking agencies generally agreed with the report's discussion of major concerns and

problems that the regulators and other affected parties have faced as they sought to build into the revised regulations an appropriate balance between flexibility and consistency for CRA compliance examinations. In general, the regulators acknowledged that GAO's recommendations were considered and have been, or will be, useful to them as they seek to address CRA compliance through the revised regulations. The regulators pointed out actions they plan to take as they implement the revised regulations, including interagency training and development of uniform performance evaluations. These actions focus on ensuring consistent interpretations of the revised regulations.

With regard to the "Matter for Congressional Consideration," FDIC and OCC were concerned that congressional action before sufficient time has passed for full implementation of the revised regulations may be premature and that further revisions to CRA without feedback on the effectiveness of the revised regulations could undermine their implementation. OTS noted that the agencies have already agreed to conduct a full review of the revised regulations 5 years after they are fully implemented. GAO agrees that the regulators have made extensive efforts in revising the regulations to address the diverse concerns raised about the effectiveness of CRA. Consequently, GAO modified the matter for congressional consideration to suggest that Congress may want to consider the results from implementation of the revised CRA regulation in its deliberation as to whether the objectives of community reinvestment are being well served through the CRA statute and regulations.

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Abbreviations

ATM	Automated Teller Machine
BEA	Bank Enterprise Act
BHC	Bank Holding Company
CA	Community Affairs
CAO	Community Affairs Office
CDB Act	Community Development Banking and Financial Institutions Act
CDC	Community Development Corporation
CDD	Community Development Division
CDFI	Community Development Financial Institution
CRA	Community Reinvestment Act
ECOA	Equal Credit Opportunity Act
Fannie Mae	Federal National Mortgage Association
FHA	Fair Housing Act
FHFB	Federal Housing Finance Board
FHLB	Federal Home Loan Bank
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act
FRB	Federal Reserve Board
Freddie Mac	Federal Home Loan Mortgage Corporation
HMDA	Home Mortgage Disclosure Act
MSA	Metropolitan Statistical Area
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
SBA	Small Business Administration

Introduction

Congressional concerns that banks and thrifts (institutions) were not adequately responsive to credit needs of the communities they served, including low- and moderate-income areas, prompted the passage of the Community Reinvestment Act (CRA) in 1977. The act requires each federal bank and thrift regulator—the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) for banks, and the Office of Thrift Supervision (OTS) for thrifts—(regulators) to encourage institutions under its jurisdiction to help meet the credit needs in all areas of the community the institution is chartered to serve, consistent with safe and sound operations. The act also requires the regulators to periodically assess institutions' community lending performance during examinations and to consider that performance in their evaluations of institutions' applications for expansion or relocation of their operations. Growing concern about the effectiveness of CRA's implementation and its regulatory burden on institutions led to the regulators' major reform effort, which resulted in two major proposed CRA revisions, issued in December 1993 and October 1994, and a final revised CRA regulation in May 1995.

This report responds to a request from the former Chairmen, House Committee on Banking, Finance and Urban Affairs and the Subcommittee on Consumer Credit and Insurance asking us to evaluate whether the regulators' reform efforts would improve compliance with the CRA, encourage institutions' lending to their entire communities, and reduce unnecessary burden. The former Chairmen also asked us to evaluate the regulators' implementation of the fair lending laws—the Fair Housing Act (FHA), the Equal Credit Opportunity Act (ECOA), and the Home Mortgage Disclosure Act (HMDA). The result of our work on fair lending will be discussed in a separate report.

Background

The debate preceding enactment of CRA was similar to the current debate. Community groups urged its passage to curb what they believed to be a lack of adequate lending in low- and moderate-income areas. Bank and thrift officials (bankers) generally opposed CRA as an unnecessary measure that could, among other things, unduly affect business decisions by mandating credit allocation and cause safety and soundness problems by forcing institutions to make excessively risky loans.

Amendments to CRA

Since the passage of CRA, the regulatory, economic, and legislative environments have changed. It is therefore useful to review the history of,

and substantive amendments to, CRA to understand its origins and where emphasis has shifted. Table 1.1 briefly illustrates the major amendments to CRA since its passage.

Table 1.1: Amendments to CRA

Year	Amendments
1977	Passed as title VIII of the Housing and Community Development Act of 1977.
1989	Amended by the Financial Institution Reform, Recovery, and Enforcement Act of 1989 (FIRREA) to require that the CRA examination rating and a written evaluation of each assessment factor be made publicly available. FIRREA also established a four-part qualitative rating scale.
1991	Amended by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) to require public discussion of data underlying the regulator's assessment of an institution's CRA performance in the public portion of the CRA evaluation.
1992	Amended by the Housing and Community Development Act of 1992 to provide that the regulators consider activities and investments involving minority- and women-owned financial institutions and low-income credit unions in assessing the CRA performance records of institutions cooperating with such institutions to meet local community credit needs.
1994	Amended by the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 to require that institutions with interstate branching structures receive a separate rating and written evaluation for each state in which they operate and a separate written evaluation of their performance within a multistate metropolitan area where they have branches in two or more states within the area.

Source: GAO's review of the laws.

CRA was passed as title VIII of the Housing and Community Development Act of 1977 (12 U.S.C. 2901 et seq.). CRA requires each federal banking regulator to use its authority, when examining institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered, consistent with the institution's safe and sound operation.[1] In connection with these examinations, the regulators are required to assess an institution's record of lending in its community and

[1]Although the regulations were developed on an interagency basis and are virtually identical, each of the regulators has its own set of CRA regulations. For FRB they can be found at 12 CFR part 228; for OCC at 12 CFR part 25; for FDIC at 12 CFR part 345, and for OTS at 12 CFR part 563e.

take it into account when evaluating any type of application by an institution for a deposit facility.[2]

CRA was amended by FIRREA to require that the regulator's examination rating and a written evaluation of each assessment factor be made publicly available. FIRREA also established a four-part qualitative rating scale so that the publicly available CRA ratings would not be confused with the five-part numerical ratings given to institutions by the regulators on the basis of the safety and soundness of their operations. These safety and soundness ratings are confidential. In 1991, FDICIA further amended CRA to require public discussion of data underlying the regulators' assessment of an institution's CRA performance in the public CRA evaluation. The Housing and Community Development Act of 1992 amended CRA to require that the regulators consider activities and investment involving minority- and women-owned financial institutions and low-income credit unions in assessing the CRA performance of institutions cooperating in these efforts. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 amended CRA to require that institutions with interstate branching structures receive a separate rating and written evaluation for each state in which they have branches and a separate written evaluation of their performance within a multistate metropolitan area where they have branches in two or more states within the area.

The principle contained in CRA, that institutions must serve the "convenience and needs" of the communities in which they are chartered to do business consistent with safe and sound operations, is one that federal law governing deposit insurance, bank charters, and bank mergers had embodied before CRA was enacted. The Banking Act of 1935 declared that banks should serve the convenience and needs of their communities. The Bank Holding Company Act, initially passed in 1956, requires FRB, in acting on acquisitions by banks and bank holding companies, to evaluate how well a bank meets the convenience and needs of its communities within the limits of safety and soundness. Under CRA, the concept of "convenience and needs" was refined to explicitly include extensions of credit.

[2]An "application for deposit facility" is defined as an application to the appropriate supervising regulator for (1) a charter for a national bank or federal savings and loan (S&L); (2) deposit insurance in connection with a newly chartered state bank, savings bank, S&L, or similar institution; (3) the opening of a domestic branch or other facility with the ability to accept insured bank or S&L deposits; (4) the relocation of a home office or branch; (5) the merger or consolidation with, or acquisition of the assets, or assumption of the liabilities of an insured depository institution; or (6) the acquisition of shares or assets of an insured depository institution requiring approval under the Bank Holding Company Act or the National Housing Act.

The Fair Lending Laws Are Related to CRA

CRA and the fair lending laws, while separate, have related objectives. The primary purpose of CRA was to prohibit redlining—arbitrarily failing to provide credit to low- and moderate-income neighborhoods. FHA and ECOA prohibit lending discrimination based on certain characteristics of potential and actual borrowers. The FHA, passed by Congress in 1968 as title VIII of the Civil Rights Act of 1968, among other things prohibits discrimination in residential real estate-related transactions on the basis of an applicant's race, color, religion, gender, handicap, familial status, or national origin. Such prohibited activities include denying or fixing the terms and conditions of a loan based on discriminatory criteria. The ECOA, passed in 1974, prohibits discrimination with respect to any aspect of a credit transaction based on race, color, religion, national origin, gender, marital status, age, receipt of public assistance, or the exercise, in good faith, of rights granted by the Consumer Credit Protection Act.

HMDA was enacted by Congress in 1975 to provide regulators and the public with information so that both could determine whether depository institutions were serving the credit needs of their communities but was expanded over time to detect evidence of possible discrimination based on the individual characteristics of applicants. HMDA established a reporting obligation for depository institutions. Initially, HMDA required depository institutions with total assets of more than $10 million to compile data on the number and total dollar amount of mortgage loans originated or for which the institution received completed applications or purchased during each fiscal year by geographic area and make that data available for public inspection. In 1989, HMDA was amended to require collection and reporting of data on race, gender, and income characteristics of mortgage applicants to provide data to assist in identifying discriminatory lending practices and enforcing fair lending statutes. Amendments to HMDA in 1988 and 1991 expanded the reporting requirements to most mortgage banking subsidiaries of bank and thrift holding companies and independent mortgage companies not affiliated with depository institutions. In 1992, HMDA was amended to require affected financial institutions to make available to the public, upon request, their loan application registers, which maintain data for loans covered by HMDA.

Both HMDA and CRA were originally enacted to remedy a perceived lack of lending by institutions to the communities in which they were chartered to do business by the regulators. HMDA was amended in 1989 to include the collection of data on race, sex, and income of applicants for credit to provide indications of possible lending discrimination. In addition, 2 of the 12 assessment factors, factors D and F, in the current CRA regulation

address the issue of discrimination to be considered in determining an institution's CRA rating. Where available, HMDA data are to be used by examiners when assessing compliance with CRA, FHA, and ECOA.

Examination and Enforcement of CRA

The federal banking regulators have primary responsibility for the examination of CRA performance and enforcement of the act. In addition to their responsibilities for examining institutions for financial condition and safe and sound operations, the regulators have been, since the late 1960s, responsible for examining and enforcing laws and regulations primarily related to matters other than safety and soundness. These include various consumer protection or civil rights laws and regulations intended to ensure that the provision of banking services is consistent with legal and ethical standards of fairness, corporate citizenship, and the public interest. These laws include CRA, and the regulators monitor compliance with them through compliance examinations.

The Regulators Have Approached Compliance Programs Differently

Since the late 1960s, the number of laws and regulations covered by compliance examinations has increased to over 20. Believing that bank operations had become too complex to be adequately covered by a single group of examiners, the FRB established a special compliance examiner program in 1977, which is responsible for performing compliance examinations separately from safety and soundness examinations. The FRB made the compliance examiner program permanent in 1979. A distinct group of compliance examiners, initially established by this program, has remained in place since 1979 and has grown relative to the number of Federal Reserve member banks.

FDIC initiated a compliance examiner program in the late 1970s that established a compliance specialty but did not represent a separate career path and did not preclude examiners from also conducting safety and soundness examinations. FDIC did not establish an entirely separate compliance examiner force exclusively responsible for compliance examinations until 1990. FDIC's compliance examiner program was not fully staffed, however, until the end of 1993. The compliance examiners remained part of FDIC's Division of Supervision until an August 1994 reorganization that consolidated activities formerly divided between the Division of Supervision and the Office of Consumer Affairs into a single Division of Compliance and Consumer Affairs.

Similar to FDIC, OCC established a compliance examination specialty in the late 1970s. The specialty did not represent a separate career path for examiners and often resulted in examiners spending only a portion of their time doing compliance examinations. Junior examiners were usually responsible for doing compliance examinations. The perceived greater attractiveness of safety and soundness work combined with the safety and soundness crisis in the banking industry during the late 1980s and early 1990s rendered the compliance specialty a low priority.

OCC began to develop a separate compliance program with a separate compliance examiner career path in 1993. OCC currently has an operating staff of compliance examiners composed of approximately 170 people. An additional 110 people are to be part-time compliance examiners who will be expected to devote a minimum of 20 percent of their time to compliance examinations. OCC believes that devoting at least 20 percent of these examiners' time to compliance will ensure that they maintain a sufficient level of expertise. This group is to be responsible for compliance examinations of "program" banks, banks with $1 billion or more in assets. Banks with less than $1 billion in assets, approximately 70 percent of OCC's banks, are to continue to be examined by OCC's nonspecialized examiners.

Although OTS supervises thrifts, as opposed to commercial banks, it is responsible for assessing compliance with most of the same compliance laws and regulations as the banking regulators. In 1989, OTS established a separate compliance examiner program in which compliance examinations are to be conducted by specially trained, career professional staffs in the OTS regional offices. The original mandate for establishing such a program came from the Federal Home Loan Bank Board. The passage of FIRREA, which abolished the Federal Home Loan Bank Board and established OTS, slowed the process of establishing the compliance examiner program. The program was fully implemented in 1990 and as of December 1994, OTS had 105 compliance examiners on board.

Table 1.2 shows the number of institutions subject to examination and the number of compliance examiners for each regulator at year end for the period beginning in 1988.

Table 1.2: Number of Banks, Thrifts, and Compliance Examiners Per Regulator From Year-End 1988 to Year-End 1994

	FRB		FDIC		OCC		OTS	
Year	Banks	Examiners	Banks	Examiners	Banks	Examiners	Thrifts	Examiners
1988	1,063	116	8,207	22	4,435	N/A	2,970	N/A
1989	1,047	124	7,975	22	4,170	N/A	2,898	N/A
1990	1,014	137	7,838	22	3,973	N/A	2,541	N/A
1991	982	164	7,630	89	3,801	N/A	2,208	82
1992	957	201	7,431	151	3,598	N/A	1,954	92
1993	968	198	7,206	265	3,321	94	1,730	105
1994	979	246	7,031	300	3,078	170	1,543	105

Note: Where a regulator did not maintain a separate compliance examiner program or was unable to provide data, it is noted in the table by an "N/A." For example, OTS was unable to provide the number of compliance examiners before 1991.

Source: Data provided by FRB, FDIC, OCC, and OTS.

The regulators rely primarily on the examination process to ensure that institutions comply with CRA. The CRA examination is a major component of an institution's compliance examination and in some cases, for example, where an application is pending, it is done independently from the compliance examination. Although they have approached their compliance programs differently, the regulators jointly developed and issued the original regulations for CRA examinations in 1978.

Currently, CRA Examinations Are to Evaluate Institutions on Technical and Qualitative Compliance

When examining an institution's compliance with CRA, an examiner is to evaluate its technical compliance with a set of specific rules, such as recordkeeping requirements, and to qualitatively evaluate the institution's efforts and performance in serving the credit needs of its entire community.[3] The examiner is to do this in a variety of ways, which include using a CRA "examination checklist," reviewing a questionnaire filled out by the institution and returned to the examiner prior to the examination, and reviewing a wide variety of institution records and data. Table 1.3 lists the CRA regulation's technical requirements.

[3]These rules are set forth at 12 CFR part 228 for FRB, 12 CFR part 345 for FDIC, 12 CFR part 25 for OCC, and 12 CFR part 563e for OTS. These rules remain in effect until July 1, 1997, at which time the new regulations concerning performance tests, standards, and ratings become effective.

Table 1.3: CRA Technical Regulatory Requirements

Requirements
CRA statement
The board of directors of each institution must adopt, and at least annually review, a CRA statement which the institution will make available to members of the public upon request. The statement should include a delineation on a map of each local community served by the institution and a list of specific types of credit that the institution is prepared to extend within each local community.
Additional information
The regulation also encourages each institution to include additional information in its CRA statement such as how its current efforts help meet community credit needs, a periodic report regarding its record of helping to meet community credit needs, and a description of its efforts to ascertain the credit needs of its community, including efforts to communicate with members of its community regarding credit services.
A copy of the CRA notice
An institution must provide in each office a CRA Notice, the exact wording of which is prescribed in the regulation.
Public file
Each institution must keep a file that is readily available for public inspection consisting of any CRA Statements in effect in the last 2 years, a copy of the public section of the institution's most recent CRA Performance Evaluation, and any written comments, received from the public within the last 2 years, relating to the CRA Statement, Performance Evaluation, or the institution's record of helping to meet community credit needs.
CRA performance evaluation
After a CRA examination, each institution will receive from its regulator a written, public CRA evaluation. This evaluation must be kept in the Public File. The institution must provide a copy of this evaluation to the public upon request, charging a minimal fee.

Source: FRB, FDIC, OCC, and OTS compliance examination manuals.

Assessing compliance with the technical requirements of CRA is relatively straightforward. An institution either maintains its CRA statement and file or it does not, and the examiner can determine whether the institution complied with the technical requirements by working through the CRA checklist. However, assessing qualitative compliance with CRA is more difficult and subjective.

CRA Compliance Is Currently Assessed Using 12 Assessment Factors

In addition to the technical requirements of the CRA regulations, the regulators are to evaluate each institution on the basis of its efforts to ascertain community credit needs and its determination and performance in helping to meet those needs. When examining an institution, the examiner is instructed to apply the CRA procedures on a case-by-case basis to accommodate institutions that vary in size, type, expertise, and locale.

Regulatory guidance indicates that community credit needs will often differ with the specific characteristics of each local community, and institutions may serve these local credit needs in a variety of ways.

The qualitative aspect of an institution's performance is currently to be assessed according to 12 factors. These factors were developed as part of the original regulations implementing CRA and have not changed. To allow the examiner sufficient flexibility necessary to weigh the factors and categories consistent with their significance in the context of a particular institution, the regulators have not assigned a relative weighting to the factors. However, regulatory guidance notes that compliance with antidiscrimination laws and regulations, including ECOA and FHA, is a significant factor in reaching the overall CRA rating. Moreover, regulatory guidance issued in 1992 also stresses that examiners are to weigh CRA performance over process, i.e., how well an institution helps meet the credit needs of its community over documentation showing how the institution ensures CRA compliance.

Financial institutions are to demonstrate their CRA performance under various assessment factors in several ways. For example, an institution is required to assess the credit needs of its community. To show that an assessment was done an institution might document its discussions with members of the community, such as community groups or civic organizations, regarding credit needs of the community. To show that it lends to all parts of its community, an institution might plot its lending data onto a map to show the geographic locations where the institution has extended credit. A sophisticated form of coding loans according to their location is called geocoding.[4]

The CRA assessment factors are grouped under five performance categories identified in guidance provided by the regulators and published in the Federal Register on May 1, 1990. Table 1.4 lists the assessment factors to be reviewed by compliance examiners during a CRA examination.

[4]The location of a loan may be designated in several different ways for the purposes of geocoding, including census tract, zip code, or other designation of local areas.

Table 1.4: CRA Assessment Factors

Performance categories and related assessment factors
Ascertainment of community credit needs
Assessment factor A
Activities to ascertain credit needs and efforts to communicate with the community, including the extent of the institution's efforts to communicate with members of its community regarding the credit services being provided by the institution.
Assessment factor C
The extent of participation by the institution's board of directors in formulating the institution's policies and reviewing its performance related to CRA.
Marketing and types of credit offered and extended
Assessment factor B
The extent of the institution's marketing and special credit-related programs to make members of the community aware of the credit services offered by the institution.
Assessment factor I
The institution's origination of residential mortgage loans, housing rehabilitation loans, home improvement loans, and small business or small farm loans within its community, or the purchase of such loans originated in its community.
Assessment factor J
The institution's participation in governmentally insured guaranteed or subsidized loan programs for housing, small businesses, or small farms.
Geographic distribution and record of opening and closing offices
Assessment factor E
The geographic distribution of the institution's credit extensions, credit applications, and credit denials.
Assessment factor G
The institution's record of opening and closing offices and providing services at offices.
Discrimination and other illegal credit practices
Assessment factor D
Any practices intended to discourage applications for types of credit set forth in the institution's CRA Statement(s).
Assessment factor F
Evidence of prohibited discriminatory or other illegal credit practices.
Community development
Assessment factor H
The institution's participation, including investments, in local community development and redevelopment projects or programs.
Assessment factor K
The institution's ability to meet various community credit needs based on its financial condition and size, legal impediments, local economic conditions, and other factors.
Assessment factor L

(continued)

Performance categories and related assessment factors
Any other factors that, in the regulatory authority's judgment, reasonably bear upon the extent to which an institution is helping to meet the credit needs of its entire community.

Source: FRB, FDIC, OCC, and OTS compliance examination manuals.

Compliance Examinations Generally Result in Two Ratings

A compliance examination generally results in two ratings: (1) a compliance rating for an institution's overall compliance effort with regard to various laws, other than CRA, covered by the compliance examination and (2) a CRA rating for the institution's compliance with CRA. Although the regulators may do a CRA examination separately from a compliance examination, officials from all four regulators said that they generally do them together. A compliance rating is based on a numerical scale ranging from 1 for top rated institutions to 5 for the lowest rated institutions. The CRA scale is a four-part descriptive scale including "outstanding," "satisfactory," "needs to improve," and "substantial noncompliance."[5]

Although there have been fluctuations over time, approximately 90 percent of all institutions examined for CRA compliance have received a "satisfactory" rating or better since July 1990 when, as a result of amendments to CRA contained in FIRREA, ratings were made public, and the rating scale was changed. Table 1.5 shows aggregate CRA ratings and ratings for each regulator since July 1, 1990, when the regulators began publicly disclosing CRA ratings.

[5]The regulators also rate institutions on the safety and soundness of their operations on the basis of the results of a separate safety and soundness examination.

Table 1.5: CRA Ratings for All Banks and Thrifts Examined From July 1, 1990 Through December 31, 1994

		1990	
Regulators	**Rating**	**Number**	**Percentage**
FRB	Outstanding	35	11
	Satisfactory	239	78
	Needs to improve	30	10
	Substantial noncompliance	4	1
	Total	**388**	**100**
FDIC	Outstanding	78	6
	Satisfactory	1,093	83
	Needs to improve	144	11
	Substantial noncompliance	6	0
	Total	**1,321**	**100**
OCC	Outstanding	13	13
	Satisfactory	73	71
	Needs to improve	15	15
	Substantial noncompliance	2	2
	Total	**103**	**100**
OTS	Outstanding	19	5
	Satisfactory	255	72
	Needs to improve	74	21
	Substantial noncompliance	8	2
	Total	**356**	**100**
All Regulators	Outstanding	145	7
	Satisfactory	1,660	80
	Needs to improve	263	13
	Substantial noncompliance	20	1
	Total	**2,088**	**100**

1991		1992		1993		1994	
Number	Percentage	Number	Percentage	Number	Percentage	Number	Percentage
75	11	80	13	127	20	123	22
544	80	493	78	491	75	430	76
52	8	49	8	27	4	9	2
5	1	7	1	6	1	3	1
676	**100**	**629**	**100**	**651**	**100**	**565**	**100**
240	9	452	14	529	14	587	17
2,286	83	2,668	81	2,939	81	2,638	77
215	8	165	5	168	5	182	5
27	1	15	0	14	0	7	0
2,768	**100**	**3,300**	**100**	**3,650**	**100**	**3,414**	**100**
95	11	89	11	193	15	192	20
674	76	614	77	988	77	736	76
112	13	93	12	99	8	37	4
9	1	2	0	2	0	3	0
890	**100**	**798**	**100**	**1,282**	**100**	**968**	**100**
67	8	90	10	162	15	105	16
594	74	667	74	827	76	515	77
128	16	141	16	90	8	46	7
18	2	5	0	3	0	1	0
807	**100**	**903**	**100**	**1,082**	**100**	**667**	**100**
477	9	711	13	1,011	15	1,007	18
4,098	80	4,442	79	5,245	79	4,319	77
507	10	448	8	384	6	274	5
59	1	29	1	25	0	14	0
5,141	**100**	**5,630**	**100**	**6,665**	**100**	**5,614**	**100**

Note: Ratings for the year 1990 include only those given by the regulators from July 1, 1990, the effective date of public disclosure of CRA ratings, to the end of the year.

Source: FRB, FDIC, OCC, and OTS.

The Applications Process Is the Primary CRA Enforcement Mechanism

Federal regulators are to take an institution's CRA record into account when considering certain types of applications from depository institutions, including most applications for mergers and acquisitions among depository institutions. This requirement is written directly into the CRA. Although CRA compliance is not to be the only issue the regulators consider when reviewing applications, it may play a major role.

Community groups and some members of Congress have described the applications approval process as not being an effective enforcement mechanism for CRA because the regulators do not always deny applications on the basis of an applicant's poor CRA performance. Table 1.6 shows the number of applications denied on the basis of poor CRA performance since 1989.

Table 1.6: Applications and CRA-Related Denials by the Regulators From 1989 Through 1994

	FRB		FDIC		OCC		OTS	
Year	Applications	Denials	Applications	Denials	Applications	Denials	Applications	Denials
1989	761	1	2,056	0	2,782	2	939	1
1990	696	0	2,099	0	3,049	2	893	0
1991	551	1	1,839	0	2,630	0	573	0
1992	619	1	1,891	0	2,610	4	837	0
1993	821	2	2,181	0	3,612	0	785	0
1994	826	0	2,883	3	4,368	0	1,010	0

Source: FRB, FDIC, OCC, and OTS.

Although they have been criticized for denying few applications on the basis of CRA performance, the regulators defend their records by stating that they consider the denial of an application to be a last resort. FRB and FDIC also approve applications with commitments. An example might include increased lending efforts in targeted neighborhoods. This provides the regulators with better enforcement leverage by explicitly tying an application's approval to tangible improvement of the applicant's CRA performance. However, regulatory guidance states that commitments can only remedy specific problems in an otherwise satisfactory CRA record and cannot be the basis for the approval of an application. OCC and OTS do not typically approve applications with commitments but instead prefer to conditionally approve applications, if deemed appropriate. The conditions for such approvals may be similar to commitments; however, the applicant institution must meet the conditions before consummation of the transaction for which it has applied. An example of a condition might be to require an applicant with a "needs to improve" CRA rating who is seeking to open a branch office to upgrade its rating to "satisfactory" before opening the branch. Table 1.7 shows the number of applications approved with commitments since 1989 by FRB and FDIC and shows the number of applications approved with conditions by OCC and OTS.

Table 1.7: Number of Applications Approved With CRA-Related Commitments or Conditions From 1989 Through 1994

	FRB	FDIC	OCC	OTS
Year	Approved with commitments	Approved with commitments	Approved with conditions	Approved with conditions
1989	5	0	15	2
1990	6	0	26	1
1991	7	0	18	1
1992	4	0	20	0
1993	9	0	18	0
1994	22	1	11	1

Source: FRB, FDIC, OCC, and OTS.

The regulators also pointed out that institutions considering expansion plans are aware of the role CRA plays in the approval process. An institution contemplating expansion would likely make sure that its CRA performance is at least satisfactory or reconsider submitting an application. Most institutions would prefer avoiding the adverse publicity and needless expense of filing an application only to be denied. If an institution perceives that its application for expansion is likely to be denied, it may choose to withdraw the application rather than have it formally denied.

Protests Have Played a Major Role in the Applications Process

In addition to potentially having an application denied, institutions wishing to expand must consider another element of the application process—the potential for a protest by community groups or other members of the public. Many bankers have complained that community groups have used protests of applications and the threat of adverse publicity, delay, possible public hearings—and their attendant costs—to force lending commitments from institutions attempting to expand. Because regulators must consider protests in their approval process, these groups have exercised a measure of leverage over institutions wishing to expand and have added an element to the process beyond the potential for an application denial. In some cases, agreements have been reached between bankers and community groups and then protests have been withdrawn and applications approved. In other cases, the regulators have approved the application after evaluating the protest and determining that it did not warrant a denial.

Table 1.8 shows the number of applications from 1989 to 1994 that had protests lodged against them and the number of protested applications that were denied.

Table 1.8: Number of Applications With CRA-Related Protests and Denials, From 1989 Through 1994

	FRB		FDIC		OCC		OTS	
Year	Protested	Denied	Protested	Denied	Protested	Denied	Protested	Denied
1989	16	1	7	0	8	0	10	1
1990	27	0	7	0	6	0	7	0
1991	24	1	4	0	5	0	3	0
1992	28	0	0	0	9	1	7	0
1993	58	1	16	0	14	0	3	0
1994	55	0	13	0	28	0	5	0

Source: FRB, FDIC, OCC, and OTS.

To minimize disruptions to the applications process caused by protests, it is the regulators' policy to encourage and sometimes facilitate meetings between institutions wishing to expand and protestants to help them clarify their areas of dispute and perhaps come to an understanding. They encourage the parties at odds to come together before an application is submitted to the regulator for approval. However, the regulators do not broker agreements between the parties, nor do they monitor or enforce the implementation of such private agreements.

The Public Has Played a Key Role in CRA Enforcement

The public has played a key role in enforcing CRA in both the applications review process and the CRA examination process. This role was strengthened by amendments to CRA enacted by FIRREA in 1989 and FDICIA in 1991. Applications filed by institutions for expansion are a matter of public record, and the regulators invite public comment when they are considering them. Filing an application has the potential for inviting public comment and possibly protest. CRA examination guidance encourages examiners to contact community groups and other members of the public during examinations, and the regulators are expected to encourage interested parties to submit written comments on an institution's CRA performance, which are to be included in the institution's public CRA file. The CRA file is also to be reviewed by examiners during examinations.

When FIRREA made CRA ratings public and FDICIA required more detail in CRA evaluations, members of the public were provided with more information to use in deciding whether to protest an application or patronize an institution. For example, some local governments have established programs in which they have required the deposit of public funds to be made with only institutions having satisfactory or better CRA ratings.

Public disclosure of CRA ratings has also made the regulators more accountable by allowing interested members of the public to see how the regulators were rating various institutions.

The Regulators Have Used Other Enforcement Mechanisms for CRA Violations

Each of the regulators has taken enforcement actions, such as supervisory agreements, memorandums of understanding, and cease and desist orders, to address CRA violations. Few such actions have been taken to date, and those taken have only been with the consent of the affected institutions. Those institutions were advised in the consent actions that in the event they did not comply, the regulators could take more stringent enforcement actions. The regulators have not taken any more stringent actions thus far. Moreover, in a December 1994 opinion, the Department of Justice determined that the regulators lack authority to use any enforcement mechanism for CRA other than measures taken in the context of an application.

The extent to which the regulators have used enforcement actions for CRA purposes is unclear because such actions generally include a variety of issues needing institution management attention in addition to CRA issues. FRB reported that 14 of the enforcement actions that it issued in 1993 included provisions related to technical CRA violations. OCC reported that 9 actions it issued included CRA provisions while OTS reported that it issued 8 such actions. FDIC does not currently track this information but said that it issues enforcement actions that include provisions for CRA violations.

Persistent Controversy Over CRA Led to Reform Effort

CRA has remained one of the most controversial banking laws. From its beginning, bankers have generally said they disliked the law, suggesting that it leads to credit allocation and imposes an unreasonable regulatory burden. Community groups, however, have maintained that the law is critical but has not been effectively enforced by the regulators and that institutions could do more to provide credit to underserved communities. Meanwhile, there has been a renewed call by some in Congress for more effective enforcement of CRA and less regulatory burden on institutions.

Early Debate Preceded Passage of CRA and Has Continued Since

In the mid-1970s, many Members of Congress said that too many institutions accepted deposits from households and small businesses in inner cities while directing a disproportionate amount of lending and investment elsewhere. They said that given this disinvestment, credit needs for urban areas in decline were not being met by the private sector.

Moreover, they said the problem was worsening because public resources were becoming increasingly scarce.

In January 1977, the original Senate bill on community reinvestment was introduced. Opponents of that bill voiced serious concerns that the bill could result in credit allocation based on the volume of deposits coming from certain areas, without regard for credit demand or the merits of loan applications. They argued that the law would therefore disrupt the normal flow of capital from areas of excess supply to areas of strong demand and undermine the safety and soundness of depository institutions.

Proponents of the bill stated that it was meant to ensure only that bankers did not ignore good borrowing prospects in their communities and that they treated credit worthy borrowers even-handedly. Senator William Proxmire, the bill's sponsor, said that it would neither force high-risk lending nor substitute the views of regulators for those of bankers. He said that safety and soundness should remain the overriding factor when regulators evaluate applications for corporate expansion. Meeting the credit needs of the community was to be only one of the criteria for the regulators to evaluate when considering applications.

Since enactment of CRA, the debate has continued. Many bankers still regard CRA as an unwelcome statute that limits their flexibility in business decisions and mandates relatively low-profit lending that could cause safety and soundness problems. Bankers complain that CRA regulations are unclear and burdensome, reducing their competitiveness with other lenders who are not subject to CRA. CRA was among the major complaints by bankers in all major studies of regulatory burden, including our report.[6] We found that bankers' complaints included CRA-based documentation, reporting, and geocoding requirements as well as lack of recognition of banks' different characteristics, examination emphasis on form over substance, and a variety of other examination-related issues. In addition, bankers argued that other financial intermediaries, such as insurance and securities firms and credit unions, compete with banks for funds and loans but are not subject to CRA. Bankers said this results in a double standard that puts them at a competitive disadvantage.

Many community groups, however, have complained that too many institutions are receiving satisfactory CRA ratings without actually lending to their communities. They complained that CRA examinations are more

[6] Regulatory Burden: Recent Studies, Industry Issues, and Agency Initiatives (GAO/GGD-94-24, Dec. 13, 1993).

concerned with an institution's CRA process, while ignoring whether it has engaged in actual lending to its community. In addition, they have complained that while over 90 percent of all institutions receive at least satisfactory CRA ratings, there continue to be large geographic areas that suffer from an inability to obtain credit from these institutions. These groups have called for an examination process that stresses actual lending performance over process. They have also called for better public disclosure of the information and the rationale used to assess institutions' lending performance.

Although arguments for and against CRA and various aspects of its implementation have often been presented as belonging to bankers or community groups, it is important to note that there have also been disagreements among members of these groups, further complicating efforts to satisfy all sides of the controversy. The interests of large and small institutions have at times diverged. For example, bankers from small institutions have often been more concerned with regulatory burden associated with documentation requirements of CRA while bankers from larger institutions, which can more easily absorb the expense of documentation requirements, have been more concerned with the role application protests have played in delaying their expansion plans. There have also been instances where some community groups have defended particular institutions that were accused of poor performance by the regulators or other community groups. Some community groups have said they prefer to work with institutions to reach agreements on community needs and how those needs should be met, while others said they rely more on protests to get institutions to make commitments to the community. There have also been differences among regulators about how to properly implement CRA, with some advocating stronger enforcement and others raising concerns about credit allocation.

CRA Reform Became a Top Administration Priority

On July 15, 1993, the President announced his initiative to facilitate low- and moderate-income community economic development. In addition to other measures, the President called for a revision to the current CRA regulation that would move CRA examinations toward a performance-based system focusing on results rather than process and paperwork—especially results in low- and moderate-income areas of institutions' communities. He instructed the regulators to make examinations more consistent, improve enforcement to provide more effective sanctions, and reduce the cost and burden of compliance. The four regulators jointly released their proposed revision to the current CRA

regulation for comment on December 21, 1993. The proposal would have replaced the current qualitative CRA examination system, including the 12 assessment factors, with a more quantitative system based on actual performance as measured through the use of three tests: the lending, service, and investment tests. A key element of the December 1993 proposal was the "market share test," which would, as part of the lending test, compare an institution's lending relative to other lenders in low- and moderate-income neighborhoods, with its lending in other parts of its service community. Collectively, the regulators received over 6,700 comment letters on the December 1993 proposal from representatives of the banking industry, community groups, Congress, and state and local governments. Reaction to the proposal was mixed and generally polarized based on the interests of the individual or organization commenting. On January 26, 1994, we submitted our analysis of the regulators' proposal in a letter[7] to the former Chairmen, House Committee on Banking, Finance and Urban Affairs and the Subcommittee on Consumer Credit and Insurance.

In response to comments received on their first proposal, the regulators released a second proposed CRA regulation that was published in the Federal Register on October 7, 1994. This proposal reflected comments received on the December 1993 proposal and the regulators' further internal considerations. While still striving for a system that measured performance and not efforts or processes, the new proposal made revisions to the first proposal that would increase the role of examiner discretion in CRA examinations. For example, the lending test would no longer be based on the market share test. Collectively, the regulators received over 7,200 comment letters on the October proposal.

In May 1995, FRB, OCC, OTS, and FDIC released the new revised CRA regulations. The final regulations retained, to a significant extent, the principles and structure of the December 1993 and October 1994 proposals but made changes to some details to respond to concerns raised in the comment letters and further regulator consideration.

The final revised regulation eliminates the previously discussed 12 assessment factors and substitutes a three-part, performance-based evaluation system for institutions that do not qualify as small institutions. The regulation defines small institutions as independent retail institutions with total assets of less than $250 million and holding company affiliates with total assets of less than $1 billion. The revised regulation includes a streamlined examination for small banks and the option for all institutions

[7]Community Reinvestment Act (GAO/GGD-94-79R, Jan. 26, 1994).

to have their CRA performance examined according to a regulator-approved strategic plan.

To take into account community characteristics and needs, the revised CRA regulation makes explicit the performance context against which the tests and standards set out in the proposed regulation are to be applied. This performance context includes consideration of six factors concerning the unique characteristics of the institution under examination and the market in which it operates.[8] To determine a performance context, the regulators are to request any information that the institution has developed on lending, investment, and service opportunities in its assessment area(s). The regulators have stated that they will not expect more information than what the institution normally would develop to prepare a business plan or to identify potential markets and customers, including low- and moderate-income persons and geographies in its assessment area(s). The regulators are to consider this information from the institution along with information from community, government, civic, and other sources to enable the examiner to gain a working knowledge of the institution's community. The revised CRA regulation gives particular attention to the institution's record of helping to meet credit needs of low- and moderate-income communities and individuals based on community characteristics and needs.

In general, the regulators are to rate an institution's performance under each of the tests, but the lending test rating is to carry more weight than the others. An institution must receive a rating of at least "low satisfactory" on the lending test to receive an overall CRA rating of satisfactory. However, ratings on the other two tests are still to have considerable effect on the overall rating as well.

The major elements of the regulators' revised CRA regulations are described as follows:

Lending test: The lending test is to entail a review of an institution's lending record, including originations and purchases of home mortgage, small business, small farm, and, at the institution's option, consumer loans throughout the institution's service area, including the low- and

[8]The six factors to be considered are information or data about (1) the economic and demographic characteristics of the assessment areas; (2) lending, investment, and service opportunities in the assessment areas; (3) the institution's product offerings and business strategy; (4) the institution's capacity and constraints; (5) the prior performance of the institution and, in appropriate circumstances, the performance of similarly situated institutions; and (6) information contained in the institution's public CRA file, including written public comments.

moderate-income areas; the proportion of the institution's lending in its service area(s); the distribution of loans to borrowers of various income levels; the number of loans to small businesses and farms; and the like. If the regulators determine that a substantial majority of an institution's business is consumer lending, then they are to evaluate this lending as part of the lending test whether or not the institution elects to provide consumer lending data. The regulators are to consider loans to individuals of all incomes wherever they reside. The number, amount, and complexity of an institution's community development loans are also to be included in the lending examination. The regulators are to consider the lending of affiliates at the election of the institution or if an institution appears to be attempting to inappropriately influence a CRA examination by conducting activities that would be unfavorably evaluated by an examiner in an affiliate.

Investment test: The investment test is to evaluate an institution's investments in community development activities. In reviewing these investments, the examiner is to take into account the amount, innovativeness, or complexity of the investment as well as the degree to which it responds to community credit and economic development needs. Institutions with limited investment authority, such as thrifts, are to receive a low-satisfactory rating under the investment test, even if they have made few or no qualified investments, as long as they have a strong lending record. A donation, sale on favorable terms, or rent-free occupancy of a branch (in whole or in part) in a predominantly minority neighborhood to any minority- or women-owned depository institution, or a financial institution with a primary mission of promoting community development, is to be considered a qualifying investment.

Service test: The service test is to require the examiner to analyze an institution's systems for delivering retail banking services and the extent and innovativeness of its community development services. The examiner is to review, in addition to the branching information, information regarding alternative service delivery mechanisms such as banking by telephone, mobile branches, loan production offices, automated teller machines (ATM), etc., in low- and moderate-income areas and for low- and moderate-income individuals. The evaluation is to also consider the range of services, including noncredit services, available to, and the degree to which those services are tailored for, the various income level areas. The focus of the test, however, is to be on the institution's current distribution of full-service branches. Alternative systems for delivering retail banking services, such as ATMS, are to be considered only to the extent that they are

effective alternatives in providing needed services to low- and moderate-income areas and individuals.

Data collection, reporting, and disclosure: Data reporting requirements on institutions are to be expanded by requiring that originations and purchases of all small business and small farm loans be collected and reported to the regulator. Each institution is required to collect and maintain for each loan in a standardized, machine readable format; the amount at origination, location, and an indicator whether the loan was to a business with $1 million or less in gross annual revenues. The location of the loan is to be maintained by census tract or block numbering area. Each institution is to report in machine-readable form annually, aggregated for each census tract/block numbering area in which the institution made at least one small business or small farm loan during the prior calendar year, the number and amount of loans with original amounts of $100,000 or less, more than $100,000 but less than or equal to $250,000, or more than $250,000, and the number and amount of loans to businesses and farms with gross annual revenues of $1 million or less. The regulators, rather than the institutions, are to annually prepare individual CRA disclosure statements for each reporting institution and aggregate disclosure statements for each metropolitan statistical area (MSA) and the non-MSA portion of each state. The regulators are to make both the individual and the aggregate disclosure statements available to the public at central depositories. The aggregate disclosure statements will indicate, for each geography, the number and amount of small business and small farm loans originated or purchased by all reporting institutions, except that the regulators may adjust the form of the disclosure if necessary, because of special circumstances, to protect the privacy of a borrower or the competitive position of an institution. Institutions are also to include the disclosure statements in their public files. In keeping with the lending test, data collection and maintenance are optional for consumer loans, and there are no reporting requirements.

Streamlined examination for small institutions:[9] Independent banks and thrifts with assets below $250 million and institutions with assets below $250 million that are subsidiaries of holding companies with less than $1 billion in assets are to be evaluated under a streamlined examination method unless an institution affirmatively requests an alternative examination method. The streamlined method is to focus on an institution's loan-to-deposit ratio, degree of local lending, record of lending

[9]According to FRB, the streamlined examination for small institutions will cover approximately 81 percent of total banks in the United States, however, it will cover less than 14 percent of total bank assets.

to borrowers and geographies of different income levels, and record of responding to complaints. An institution's fair lending record is also to be taken into account in assigning a final rating. The regulators are to consider an institution's size, financial condition, and credit needs of its service area in evaluating whether its loan-to-deposit ratio is reasonable. The regulators are to further consider, as appropriate, other lending-related activities, such as originations for sale on the secondary market and community development lending and investment.

Strategic plan option: Every institution is to have the alternative of submitting a strategic plan to its supervisory agency for approval that was developed with community input detailing how the institution proposes to meet its CRA obligation. The strategic plan option is not to relieve an institution from any reporting obligations that it otherwise has. However, small institutions do not subject themselves to any data reporting responsibilities by electing the strategic plan option.

Community development test for wholesale or limited purpose institutions: The regulation is to replace the investment test with a community development test for wholesale or limited purpose institutions. The regulation incorporates into this community development test both community development lending and community development services in addition to qualified investments. Therefore, under the regulation, wholesale or limited purpose institutions are to be subject only to the community development test. Wholesale or limited purpose institutions must be designated as such by the regulators.

Institutions are to continue maintaining a public file that contains (1) all written comments received from the public during the previous 3 years that comment on the institution's CRA performance; (2) a copy of the public portion of the institution's most recent CRA examination; (3) a list of the institution's branches, their street addresses, and geographic areas to be served; (4) a list of branches opened or closed by the institution during the previous 3 years, their addresses, and geographic areas to be served; (5) a list of services generally offered at the institution's branches and descriptions of material differences in the availability or cost of services at particular branches; (6) a map of each assessment area showing the boundaries of the area and identifying the geographic areas to be served within the area; (7) and any other information the bank chooses. In addition, large banks are also to include in their public file (1) any consumer loan data that the institution wishes to have considered as part of its CRA examination; (2) the institution's CRA disclosure statement that it

receives from its regulator; and (3) relevant HMDA disclosure statements for the previous 2 years. Small banks are to include their loan-to-deposit ratio for each quarter of the previous year and any additional information that they see fit, including the information required for large institutions if they elect to be evaluated under the lending, investment, and service tests. Institutions that elect to be evaluated under the strategic plan are to include the plan in the public file. An institution that received a less than satisfactory rating during its most recent examination is to include a description of its efforts to improve its performance.

The revised CRA regulations are to amend the current CRA regulations over time, eventually replacing the existing regulations in their entirety by July 1, 1997. However, various elements of the new regulations are to be phased in sooner, some as early as January 1, 1996. Until that time, the regulators will continue to follow the current CRA regulations to examine institutions for CRA compliance.

Objectives, Scope, and Methodology

The objective of this report is to address four questions regarding the federal regulators' implementation of CRA: (1) What were the major problems in implementing CRA, as identified by the affected parties—bankers, regulators, and community groups? (2) To what extent do the regulatory reforms address these problems? (3) What challenges do the regulators face in ensuring the success of the reforms and what, if any, actions would help the regulators in facing these challenges? and (4) What initiatives have been taken or proposed to help bankers overcome community lending barriers and enhance lending opportunities, particularly in low- and moderate-income areas?

We interviewed regulatory officials responsible for bank or thrift examinations to understand and identify the major problems with the current regulatory system used in implementing CRA and to understand the context in which the regulators examine and enforce the law. In addition, we reviewed the legislative history of the CRA to discern its original intent and to see how amendments have changed the law over time. We also collected data from each of the regulators relevant to various aspects of their CRA enforcement. In addition to regulatory officials, we judgmentally selected and interviewed other parties who were located in the areas where we did our work and who are concerned with or active in CRA compliance issues, including bankers, community groups, trade groups, consultants, representatives of the secondary markets, and officials from other federal agencies, including Justice. We also collected data from each

of these groups and from Justice regarding CRA examinations and enforcement. In addition to our interviews, we reviewed testimonies and speeches by representatives of the groups described above from a large number of congressional hearings and other forums that have taken place since enactment of CRA. Statements in this report representing the views of the affected parties reflect all of the sources described above.

To identify the major problems in implementing CRA, determine to what extent the regulatory reforms would address these problems, and identify challenges the regulators would face in ensuring the success of the reforms, we reviewed in detail compliance examinations at 40 banks and thrifts located in 4 regions, including the Northeast, Midwest, West, and South Central parts of the United States. At each of the 40 institutions, to the extent possible, we completed a case study using standardized data collection instruments to gather the impressions and experiences of the bankers and examiners.

For our case studies, we judgmentally selected institutions that included a variety of asset sizes; business types; and a mix of rural, suburban, and urban institutions. We selected institutions regulated by each of the four regulators and attempted to select institutions with a variety of good and bad CRA ratings. However, we found that institutions that received low CRA ratings from their last compliance examination were less willing to participate in the case studies than those that had fared better. While 11 of the institutions had received a “needs to improve” rating on their last CRA examination, none had received a “substantial noncompliance.” The institutions we studied included 10 from each of the four regions; 6 were examined by FRB, 13 by FDIC, 9 by OCC, and 12 by OTS. Nine of the institutions had assets over $1 billion, 13 had assets of less than $1 billion but more than $100 million, and 18 had assets of $100 million or less.

We also talked to community groups known to be active in each region about their involvement in CRA compliance. In this way, we could identify the positive and negative aspects of the current examination system and verify some of the anecdotal complaints surrounding it. In addition, the case studies afforded us the opportunity to discuss other related issues, such as CRA reform, with a large number of individuals who worked with CRA compliance on a regular basis.

To determine the extent to which the regulators’ reform proposals would address the problems we identified from work previously described and to identify the challenges the regulators would face in ensuring the success

of the reforms, we evaluated a number of proposals for CRA reform that were put forward from several sources, including the proposals released by the regulators on December 21, 1993, and October 7, 1994, and the final revised CRA regulation, released in May 1995. In addition, we reviewed letters submitted by bankers, community groups, and other concerned parties commenting on the regulators' proposals. We discussed numerous suggestions for improving the CRA examination and enforcement process with participants in our case studies. We also reviewed the transcripts from hearings held by the regulators around the country during their development of the revised CRA regulation.

To identify the initiatives that had been taken to overcome lending barriers and enhance community lending opportunities, (1) we judgmentally selected, on the basis of availability, and interviewed over 20 community group representatives; (2) held a roundtable discussion involving representatives from the Association of Community Organizations for Reform Now, the Center for Community Change, and the Consumer Federation of America; and (3) attended several workshops and conferences sponsored by a variety of industry and community groups, in addition to the regulators covering CRA compliance. We also identified the activities of the regulators' consumer affairs programs and reviewed a large volume of material generated by banks, community groups, and the regulators on their activities to promote community lending.

We conducted work on our case studies in Chicago, San Francisco, Boston, and Dallas, from July 1993 to March 1994 and our work in Washington D.C. continued through June 1995 in accordance with generally accepted government auditing standards.

We obtained written comments on a draft of the report from FDIC, the Federal Reserve, OCC, and OTS. A discussion of these comments and our responses appears at the end of chapters 3 and 4. In addition, the agencies' comments and our additional responses are printed in appendixes I through IV.

Revised CRA Regulations Address Some, but Not All, Problems and Concerns

All of the affected parties that we spoke with—bankers, community groups, and regulators—agreed on many of the problems with the implementation of the Community Reinvestment Act (CRA). However, the reasons they gave for why they believed the problems adversely affected their interests—which form the basis of their concerns—and the often contradictory solutions they offered to address the problems showed that the affected parties differed considerably on how best to revise CRA. The revised CRA regulation, if effectively implemented, should focus examinations on results, thereby eliminating a major problem that all parties identified—an overreliance in the regulators' examinations upon an institution's documentation of efforts and processes used to ascertain and meet community needs. However, the revised regulations neither fully address all identified problems nor wholly satisfy the often conflicting concerns or contradictory solutions of bankers and community groups. The success of the reform efforts will depend largely upon how effectively the revised regulations are implemented.

The first section of this chapter discusses the similarities and differences among the groups on the problems they identified as well as their concerns with and solutions to the problems. The second section presents our analysis of the extent to which the revised regulations should address those problems and concerns.

Affected Parties Agree on Major Problems, but Concerns and Solutions Differ

Bankers, community groups, and the regulators generally agreed in interviews and in public testimonies on what they considered to be major problems with the examination and enforcement of CRA. These problems included

- too little reliance on lending results and too much reliance on documentation of efforts and processes, leading to an excessive paperwork burden;
- inconsistent CRA examinations by regulators resulting in uncertainty about how CRA performance is to be rated;
- examinations based on inadequate information that may not reflect a complete and accurate measure of institutions' performance; and
- dissatisfaction with regulatory enforcement of the act, which largely relies on protests of expansion plans to ensure institutions are responsive to community credit needs.

While the affected parties generally agreed on these four problems, their underlying concerns differed significantly and the solutions they offered

were often contradictory or incompatible. Generally, bankers' concerns about the problems focused on the regulatory burden of compliance, and they sought to reduce that burden. For example, they sought to increase certainty about examination ratings through use of preapproved strategic plans and guarantees ("safe harbors") that satisfactory and outstanding ratings would protect from CRA protests institutions' applications to move or expand operations. In contrast, community groups were generally concerned about the lack of accountability on the part of institutions to ensure that they meet their community lending obligations. These groups also sought measures to increase regulators' accountability through more public disclosure of institutions' CRA performance and tougher enforcement. The differences in the concerns and solutions reflected bankers' and community groups' different perspectives and constituencies and broader philosophical differences, as discussed in chapter 1.

Examinations' Perceived Overreliance on Institutions' Documentation of Efforts and Processes

Bankers, community groups, and the regulators we contacted generally agreed that a major problem with CRA examinations was that examiners relied too heavily during examinations upon an institution's paperwork. This paperwork was to document the institution's efforts and processes to ascertain and help meet community credit and service needs. All parties also generally agreed that the examination should be based on the results of those efforts and processes, with emphasis on the institution's community lending performance. The parties agreed that a single community lending standard or formula for evaluating those results was unworkable because of the importance of considering such factors as an institution's business strategy, its financial condition, and the specific needs in different areas of the community that the institution served.

Despite these areas of agreement, bankers and community groups had different underlying concerns and offered different solutions. Bankers were most concerned that the focus on their CRA efforts and processes caused them to produce many documents that served no purpose within the institution other than to satisfy the information needs of examiners conducting CRA examinations. They advocated that the CRA reform should eliminate this burden by focusing examinations on performance or results.

However, community group representatives were most concerned that the focus on documentation of efforts and processes had failed to hold institutions accountable for their actual lending and service in communities. They too favored a focus on results with examiners evaluating data on actual lending and services that institutions provided to

their communities. In fact, they proposed that community groups be given access to the data evaluated by examiners and be permitted to provide input on an institution's performance.

Regulators supported a performance- or results-based evaluation system to reduce institutions' documentation burden and improve CRA compliance. They also suggested that a performance-based system would promote improved consistency in examinations.

Inconsistent CRA Examinations

Bankers, community groups, and regulators all identified inconsistency in performance examinations as a problem with the implementation of the act. It was apparent from our case studies that inconsistency was due in part to examiners using their discretion and focusing on or emphasizing different aspects of the CRA regulations. This inconsistency resulted in uncertainty among the affected parties about how institutions' performance would be evaluated during examinations. Although the affected parties' underlying concerns and solutions tended to differ, the solutions were all designed in one way or another to reduce, or more clearly direct, examiner discretion to provide greater consistency to the examination process.

Generally, bankers were concerned about inconsistency in performance examinations because this led to confusion and uncertainty about what actions were necessary to attain a positive rating. As a result of the uncertainty, many bankers believed that institutions were producing unneeded documentation of their efforts. Some bankers sought to reduce this uncertainty through more specific instructions or lending targets from the regulators, thereby getting more definition to what actions count as CRA activities.

Community groups generally recognized inconsistency as a problem that represented a failure of the regulators to hold institutions accountable for adequately serving all areas of their delineated communities. Some groups said they felt that examiners do little to determine whether institutions are meeting community needs. Many group representatives advocated more emphasis on performance standards as well as increased disclosure of information about institutions' community reinvestment results.

Regulators also recognized that inconsistency in examinations was a problem. Many of the examiners we interviewed said that they thought inconsistency resulted from the subjectivity inherent in examinations due

to vague standards, unclear guidance, and frequent changes in the focus of examinations. The examiners' latitude in interpreting standards, such as "the institution's ability to meet various community credit needs based on its financial condition and size, legal impediments, local economic conditions and other factors," resulted in examiners focusing on different parts of the guidance. In addition, since 1989, changes to the guidance for CRA examinations occurred more frequently than before and shifted emphasis from institutions' programs for managing CRA as part of day-to-day activities to the results of their CRA programs. We further discuss the role of examiner discretion in chapter 3.

Another factor cited by the affected parties was insufficient experience and training of examiners conducting CRA examinations. Some community groups pointed out the need to improve the capacity of the regulators for analyzing data in the context of community credit needs and institutions' efforts to satisfy those needs. As discussed in more detail in chapter 3, many examiners sought clearer guidance and better training as a solution to their concern about inconsistency in examinations.

Examinations Based on Information That May Not Reflect a Complete and Accurate Measure of Institutions' Performance

Bankers, community groups, and the regulators have identified numerous concerns related to whether CRA examinations are based on information that reflects a complete and accurate measure of institutions' performance. Disagreements persist among the affected parties as to what information should be collected and reported by institutions and what information should be disclosed publicly. Bankers generally view most data collection and reporting as burdensome and its disclosure a potential violation of the proprietary nature of their business. Community groups, however, generally believe that information transparency—which includes both obtaining the data and understanding how the examiners move from applying performance data and other information against the standards to arrive at the CRA rating—is key to ensuring accountability and measuring CRA compliance.

Bankers complain that they are forced by the regulators to generate data that (1) may not fully reflect their business activities, (2) would not be produced without the regulatory requirement, and (3) should be kept confidential. For example, some bankers were concerned that data collected under the Home Mortgage Disclosure Act (HMDA) may be misleading without an explanation, as in cases where high loan rejection rates may result from aggressive marketing efforts by institutions seeking low-income applicants. Many bankers opposed existing and new reporting

requirements as being burdensome. They were particularly concerned about frequent changes in reporting requirements that require costly changes to their data collection systems. In addition, bankers expressed concern about publicly disclosing information that they believe reveals too much about their business practices and should be kept confidential.

Community groups told us that public availability of data is of great value and that the transparency of institutions' lending performance is what would make it useful. Community groups strongly opposed any reduction in reporting requirements and advocated the collection, reporting, and public disclosure of additional data to better evaluate institutions' performance. These groups said they believe that it is essential that they have access to the data used by CRA examiners in determining regulatory ratings so that they can evaluate both the institution's and the regulator's performance.

Examiners in our case studies said they generally believed that data are necessary for them to examine institutions' compliance with CRA. However, they said that data collected are useful only if they are accurate and appropriately reflect the relevant activities of the institution being examined. Some examiners we interviewed said HMDA data are sometimes limited in their usefulness for a number of reasons, including poor data quality and inconsistent reporting by institutions. They also said that examiners may lack the time or training to perform HMDA analyses. Finally, they said that other information, involving the credit worthiness of the borrower or property, had to be used in conjunction with HMDA data because the data may not accurately or completely portray an institution's lending activity, particularly for institutions that are not heavily involved in home mortgage lending.

Dissatisfaction With Regulatory Enforcement of CRA

Both bankers and community groups identified regulatory enforcement of CRA as a problem, but members of the two groups generally had different concerns. Most bankers commented that there is no protection against application protests for institutions that regulators have determined are in compliance with CRA and that positive incentives are not in place to promote compliance with CRA. For example, bankers complained that community groups have used protests to needlessly delay the approval of applications. They noted that a satisfactory or outstanding CRA rating means nothing when a community group mounts a protest against expansion plans. Bankers charged that these groups use protests to further their own agendas regardless of an institution's lending record.

Many bankers advocate safe harbors that would protect institutions from protests if the regulators have determined, through the examination process, that their CRA compliance is outstanding. Another type of safe harbor would reward good CRA performance with less frequent CRA examinations. In practice, the regulators currently have policies that consider an institution's CRA rating in determining the frequency of examinations, with lower-rated institutions to be examined more frequently.

In addition, bankers have contended that there should be positive incentives in place to encourage CRA compliance in addition to what they see as exclusively negative sanctions to punish noncompliance. Some bankers have proposed that CRA be replaced by or supplemented with direct financial subsidies to those willing to extend credit to low- and moderate-income areas.

Community groups, however, identified as a problem the fact that regulatory enforcement of CRA was limited to the denial of applications by a depository institution for expansion (including applications for a merger or acquisition) or negative publicity from a low CRA rating. They pointed out that institutions with no plans for expansion and no fear of adverse publicity from a low CRA rating may not feel the need to commit significant resources to CRA compliance. To strengthen enforcement of the act, community groups have advocated regulator use of more stringent enforcement actions, such as cease-and-desist orders and civil money penalties. Although some cease-and-desist orders and formal agreements between regulators and institutions have included CRA performance as one of many issues, no such actions have been taken solely to address noncompliance with the act or poor CRA performance.

The regulators have recognized the general dissatisfaction with CRA enforcement by bankers and community groups as well as by some Members of Congress.

Revised CRA Regulations Focus Examinations on Results but May Not Fully Address Other Problems

From our review of the reform proposals and the revised CRA regulations, it appears that the regulators have thoroughly assessed the problems related to CRA examinations and the revised regulations attempt to address the problems and concerns raised to us by the affected parties. However, the revised regulations will not wholly satisfy the often contradictory concerns of bankers and community groups. Bankers and community groups continue to have fundamentally different expectations about institutions' CRA obligations.

If effectively implemented, we believe the revised regulations will significantly reduce the first problem of overreliance on documentation of community reinvestment efforts and processes by focusing the examination standards on results. However, the regulators success in addressing the second problem of examination inconsistency and uncertainty will depend upon implementation, especially how effectively examiners use their discretion. This, in turn, will depend on the effectiveness of the guidance and training examiners are provided. In response to the third problem of data usefulness, the final regulations have clarified the information to be used to evaluate performance, but the affected parties disagree about whether the data to be collected under the revised regulations will appropriately reflect lending results or be too burdensome. The reform proposals related to the fourth problem of CRA enforcement were dropped by the regulators (1) because of Justice's opinion stating that the regulators do not have authority to take stronger enforcement action for CRA and (2) because of community groups' concerns that safe harbors would preclude them from protesting applications of those institutions they determine to be poor performers. Consequently, the revised regulations do not resolve the affected parties' divergent concerns with CRA enforcement.

Revised Regulations Focus Examinations on Results, Thereby Reducing Institutions' Documentation Burden

The revised regulations address the problem of overreliance on documentation of efforts and processes by shifting the focus of examination standards to an institution's community reinvestment results. Under the revised regulations, an examiner is to analyze an institution's community reinvestment results in three performance areas—lending, investment, and services. Although all the affected parties generally agreed with the shift to results-based examinations, the revised regulations may not address community groups' desire to hold institutions more accountable for the results of their community lending activities. The regulators initially proposed, and later dropped, the use of more quantifiable performance measures in the first CRA proposal as part of the

"market share test" described in chapter 1. While community groups generally supported this test, many bankers were concerned that it would not accurately reflect their lending performance and could lead to unsafe and unsound lending. Disagreements continue between the affected parties about the use of quantifiable measures to examine CRA performance, but they generally agreed that some flexibility is needed in CRA examinations. In developing the revised regulations, the regulators attempted to balance the need for objective standards with the need for flexibility in examining different types of institutions operating under differing financial conditions and serving widely different types of communities.

Revised Regulations May Not Fully Address the Problem of Inconsistent Examinations

We believe that the success of the revised regulations in addressing the problem of inconsistent examinations will depend upon how effectively the examiners exercise their discretion when implementing the new regulations. This problem has been, and may continue to be, difficult for examiners to overcome because examinations involve subjective, case-by-case judgments about an institution's performance. For example, examiners will still be required to judge the "innovativeness" of loans and investments and differentiate between "excellent" and "good" responsiveness to credit needs.

The regulators recognized the need to improve examination consistency in the revised regulations and indicated that they intend to improve guidance and training for examiners before implementing the new regulations. While it is too soon to evaluate their progress in these areas, we agree that clear guidance and comprehensive training in community development techniques are critical for consistency in examinations. Chapter 3 further discusses the issues that need to be addressed to ensure successful implementation of the revised regulations.

The revised regulations also include an option that responds to bankers' concerns that inconsistency in examinations contributes to uncertainty about what is needed to ensure a positive rating. Institutions may submit to regulators a strategic plan for community reinvestment that sets standards of performance. Although institutions could experience some uncertainty when the plan is submitted to the regulator for approval, this option may help alleviate uncertainty at the time of an examination. This "strategic plan" option includes a requirement that institutions make public their plans for comment prior to the plans being approved by the regulators. For this reason, this option has not been favorably received by

all institutions. Many bankers have raised concerns that making the plan public may have anticompetitive effects, since they would have to disclose their strategic business objectives and goals. However, banks would not have to publicly disclose proprietary information.

Revised Regulations Heighten the Need for a Complete and Accurate Measure of Bank Performance

To fulfill their examination responsibilities, the regulators have explained that assessing performance against results-oriented CRA examination standards will require complete and accurate measures of performance in the areas of lending, investment, and service to delineated communities. The issue of what data should be collected and reported to the regulators and disclosed publicly has been among the most controversial issues surrounding the CRA reform efforts. The regulators have tried to balance the contradictory calls by bankers to reduce regulatory burden with the community groups' call for additional data reporting and public disclosure to increase institutions' accountability.

The regulators' attempt to strike a balance in the revised regulations among the competing points of view has led to (1) exempting small institutions from additional data reporting requirements, (2) increasing data collection and reporting requirements for large institutions, and (3) shifting data analysis responsibilities to the examiners. The regulators also increased public disclosure of aggregate loan information for small business, small farm, or community development lending but not information on individual loans. In addition, the revised regulations permit voluntary collection and disclosure of consumer loans, although reporting is not required. The revised regulations will not completely satisfy all parties, some of whom continue to disagree about whether the data collection requirements are appropriate or burdensome.

Although the revised regulations address the issues of what information will be collected to examine CRA performance under the new standards and what information must be disclosed, they do not address the other information problems identified in our case studies related to data inaccuracies and the need for clearer explanations of how performance ratings are determined. To fully respond to the problems raised by the affected parties, these remaining issues will need to be addressed as the regulators implement the new regulations. Chapter 3 discusses the actions that the regulators have taken thus far to improve data reliability, specifically related to HMDA data accuracy.

Reforms Included Measures to Address Regulatory Enforcement, but Were Dropped From the Revised Regulation

The proposed reforms included measures to address concerns of both bankers and community groups regarding CRA enforcement. However, those measures are not included in the revised regulation. Both the December 1993 and the October 1994 reform proposals would have addressed the community groups' call for stricter enforcement by clarifying institutions' CRA obligations and providing that a bank that receives a rating of "substantial non-compliance" would be subject to enforcement actions authorized by the Federal Deposit Insurance Act.[10] However, Justice opined in December 1994 that CRA did not provide the regulators with the legal authority to use such enforcement actions to enforce CRA.

The regulators also tried to address the bankers' interest in positive incentives or protection against protests in the application process in their December 1993 proposal. The regulators attempted to clarify how various CRA ratings would affect decisions on applications filed by institutions for expansion or relocation of their deposit facilities. In particular, absent other information regarding CRA performance, the proposal stated that

- an "outstanding" rating would be given extra weight in reviewing applications;
- a "satisfactory" rating would generally be consistent with approval of the application;
- a "needs to improve" rating would generally be an adverse factor and, absent demonstrated improvement in the institution's CRA performance or other countervailing factors, would result in denial or conditional approval of the application; and
- a "substantial noncompliance" rating generally would be so adverse as to result in denial of the application.

However, community group comments submitted to the regulators on this measure strongly protested that it constituted a safe harbor, and it was dropped in the October 1994 proposal. Because the regulators' proposed measures to resolve the enforcement concerns of both bankers and community groups have been unsuccessful, these concerns will likely continue.

Conclusions

Although the regulators have attempted to address the major problems with the implementation of CRA identified by the affected parties, the

[10]Section 8 of the Federal Deposit Insurance Act provides enforcement mechanisms to the regulators for violations of banking law. Among the mechanisms are cease and desist orders and civil money penalties.

revised regulations will not satisfy all of the sometimes conflicting concerns of these parties. For example, the revised regulations do not require the level of data reporting or disclosure that has been called for by community groups, nor do they provide for more stringent enforcement actions for CRA. Although many community groups see the revised CRA regulations as an improvement over the current system, many also believe that they do not go far enough in compelling institutions to fulfill their community lending obligations. Some concerns of bankers also will likely continue. Although the burden associated with documenting efforts and processes is to be eliminated, many bankers consider additional data reporting requirements to be burdensome.

In addition, the regulators' success in addressing the problem of examination inconsistency will depend upon how effectively they implement the revised regulations. The regulators have recognized the need to improve examination consistency and plan to improve guidance and training for examiners as they implement the new regulations. The regulators also attempted to strengthen enforcement and introduce a level of certainty into the enforcement process, by clarifying how CRA ratings would be considered in application decisions and for enforcement actions, but the effort was unsuccessful.

The Regulators Face Major Challenges in Implementing CRA Regulatory Reforms

The regulators face significant challenges in successfully implementing the revised Community Reinvestment Act (CRA) regulatory reforms, many of which they have had difficulty addressing in the past. From our case studies, we identified several areas that are key to implementing the revised CRA regulations. To minimize the problems of uncertainty and inconsistency associated with CRA assessments, the regulators will need to (1) provide clear guidance and comprehensive examiner training that address how examiners should conduct performance-based assessments, (2) ensure that data used to assess performance is accurate by increasing the priority and consistency of actions taken to ensure data accuracy, and (3) improve disclosure in public evaluation reports on how examiners determined institutions' performance ratings. In addition, the regulators acknowledge that the revised regulations will increase examiner responsibilities and may thereby require additional examination techniques and resources.

Regulators Have Previously Tried to Reduce Uncertainty and Inconsistency

The regulators have previously tried to address the challenges of achieving greater certainty and consistency in compliance examinations. Some of the difficulties that have hindered past efforts will likely continue to challenge the regulators as they implement the regulatory reforms. These difficulties have included the subjectivity inherent in examiners' interpretation of vague CRA standards, frequent shifts in the regulatory focus of examinations, and differences in the levels of examiners' CRA compliance evaluation experience and training. In addition, inadequate information and disclosure about institutions' CRA performance and the basis for their ratings have contributed to concerns about examination consistency.

Although the revised CRA regulations are more objective and performance-based, examiners will have to continue to exercise discretion in interpreting the CRA standards. Differences in levels of examiner experience will also continue because of the recent hiring of additional CRA examiners by some regulators over the past 2 years. Training will be particularly important during implementation, as all CRA examiners will need comprehensive training in new examination standards and procedures that regulators will be issuing. Moreover, accurate and accessible data will continue to be critical for effective results-based assessments. Finally, examination consistency will be judged by the public through the information on institutions' performance provided in the evaluation reports. The success of the CRA regulatory reforms will

ultimately depend on how effectively these issues are addressed by regulators in implementing the revised regulations.

Examination Guidance and Training Could Address Causes of Inconsistency

The regulators stated in the revised regulations that they intend to ensure consistency in assessments by providing more guidance in minimizing unnecessary subjectivity, improving examiner training, and increasing interagency coordination. These goals are consistent with the suggestions made by bankers and examiners in our case studies and in public comments to the proposed regulations before they were finalized. However, we also found that the regulators' previous attempts to ensure consistency by revising their examination guidance and training programs have not achieved consistent implementation.

We found from our case studies that inconsistency resulted in part from examiners having had considerable discretion and assessing institutions differently because they focused on different parts of the examination guidance. These differences were particularly evident in examiners' assessment of factors that involved the most discretion, such as the factors relating to ascertainment of community credit needs and development of marketing and advertising programs. To illustrate, one of the more problematic factors has been judging the reasonableness of institutions' delineation of their service communities. Some bankers have been confused about how they should define their service community because they received conflicting direction from examiners. One banker said that he was told by one examiner not to include loan production offices in the bank's delineated community, but the next examiner told him that the offices should be included. Other bankers were asked by examiners to change the size of their delineated communities and were confused about whether the service area delineation should be based on definitive geographic boundaries, location of deposit facilities, or where the preponderance of loans were located. Under the revised regulations, examiners will spend less time assessing the reasonableness of an institution's delineated service community. However, examiners will continue to use discretion in determining whether an institution arbitrarily excludes areas, particularly low- and moderate-income areas.

Both bankers and examiners have cited frequent changes in the focus of examinations as a reason for inconsistency. From the time CRA was enacted in 1977 to 1989, there were not many changes in the way CRA was implemented by the regulators. However, during the period 1989 through

1992, the regulators issued several policy statements with new guidance regarding CRA examinations.

- Among other things, a March 1989 statement focused examinations on the processes and efforts needed by institutions for a well-managed CRA program.
- Guidelines issued in May 1990 focused on implementation of requirements for public disclosure of CRA ratings, written examiner evaluations of institutions' CRA performance, and examiner use of a new four-tiered descriptive rating system mandated by the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA).
- A December 1991 policy statement established the need for institutions to analyze the geographic distribution of their lending patterns as a part of their CRA planning process.
- In March 1992, in an effort to achieve consistency in CRA evaluations, the regulators provided guidance on the inclusion of numerical data in public CRA evaluations, consistent with the Federal Deposit Insurance Corporation Improvement Act (FDICIA).
- Additional guidance provided in June 1992 shifted the focus of CRA examinations to performance or results, rather than the documentation of efforts. Despite the emphasis on performance over efforts, however, the same 12 assessment factors, which were largely process-oriented mixed with some lending measures, continued to be used as tools for measuring performance.

Although the recent regulatory reforms will once again change the focus of examinations, the comprehensiveness of the reform's detailed review of the problems in CRA examinations and the overall agreement to focus on performance should help to improve consistency and reduce the need for major changes in the near future.

Another frequently cited reason for inconsistency in CRA examinations has been insufficient examiner experience and training. Some community groups commented that there is not a sufficient level of expertise within the regulatory community about what constitutes an analysis of a community's credit needs, what constitutes a loan program that would actually meet credit needs, how time-consuming an analysis would be, and what is adequate performance. Some bankers also commented that examiners need to understand how credit needs can vary based on the characteristics of a specific community, particularly between urban and rural communities, and how institutions may meet community credit needs and their CRA obligations in different ways.

The experience levels of the examiners have varied considerably among regulators. The Federal Reserve Board (FRB) has had a separate core of CRA compliance examiners since 1979, while the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) established such cores in 1989, 1990, and 1993, respectively. From 1992 to 1994, FDIC significantly expanded its compliance examination staff to about 300 examiners. From 1993 to 1994, OCC increased its examiner staff dedicated to compliance examinations from 94 to approximately 170 examiners, while about 110 OCC examiners will continue to perform both safety and soundness and compliance examinations. In addition, from 1991 to 1993, OTS increased its separate compliance examination staff from 82 to 105 compliance examiners.

The amount of examiner training also has varied among regulators and by experience level—ranging from none to advanced training specific to CRA and the Home Mortgage Disclosure Act (HMDA). Even within regulators, we were told that training availability differed by region or district and that some regulators supplemented classroom training through newsletters or self-study, computer-based courses. Although most examiners in our case studies said they have had instruction on CRA assessments as part of general entry-level training, many examiners commented that much of their training was on the job. Training needs that examiners identified included

- additional training in the use of HMDA and census data;
- regular seminars or refresher courses to provide updates and guidance on regulatory changes;
- more advanced training for experienced examiners;
- more training on fair lending laws and new discrimination detection techniques;
- more focused training on skills such as data collection, computer analysis, and reading property appraisals;
- training with a focus on lenders' communities, safety and soundness issues, and new examination techniques;
- regular conferences or seminars where new and experienced examiners from different agencies can exchange information on examination techniques and experiences; and
- external training that includes perspectives of lenders' and community groups.

The regulators have acknowledged that training is important to the success of the reforms and have indicated their intention to work together to improve examiner training. Some examiners told us that they would welcome more interagency training, which could help improve consistency among regulators. Past attempts to develop interagency training programs have had mixed success. Some regulators explained that interagency training did not always meet their different training needs because some regulators had examiners strictly devoted to CRA compliance examinations, while others had examiners perform both safety and soundness and compliance examinations. Recently, FRB's interagency training has included the specialized course on HMDA data analysis. Generally, however, each of the regulators has developed its own core CRA examination training programs.

The magnitude of the changes in the CRA reforms, as well as the resulting increase in examiner responsibilities, created the need for clear guidance and comprehensive training for all examiners performing CRA examinations and thereby implementing the revised CRA regulations. Consistency in training would help to improve examination consistency among all regulators. Under the revised regulations, examiners will have additional responsibilities in areas such as analyzing performance information. Further, examiners will have to make judgments relating to various types of community development lending and investment activities. Community groups have said these areas need better examiner understanding.

Data Accuracy Remains a Problem

The recent shift to performance-based examinations should increase the reliance on quantified data to assess institutions' performance. Inaccurate data used by various affected parties may lead them to inappropriate conclusions about an institution's CRA performance. Bankers, regulators, and community groups interviewed in our case studies identified concerns about data quality that resulted in limiting the usefulness of some data collected. Some of the regulators have also acknowledged data quality problems, particularly with HMDA data, and have taken steps to improve the accuracy of HMDA data. However, while examination guidelines include procedures to assess HMDA data accuracy, they do not address the quality of other kinds of data used to assess performance, like other lending data or financial statistics. Moreover, the regulators do not have a uniform policy on what actions should be taken against institutions with poor data

quality, and they have not been consistent in the actions they have taken to date.

Bank management is primarily responsible for ensuring that data provided by the institution are accurate, and examiners are responsible for verifying data accuracy during examinations. Bankers and examiners in our case studies commented that some data problems are due to unclear reporting requirements, difficulties in determining correct geographic codes, incomplete data, and human and technical errors. Among the four regulators, FRB has done the most detailed analysis of HMDA data quality. From March 1993 to February 1994, the Federal Reserve District Banks participated in a survey to determine the quality of HMDA data submitted by state member banks for the year 1992 by cross checking each institution's HMDA Loan Application Register with its 1992 HMDA data submission. This survey confirmed FRB's long-standing concerns about HMDA data accuracy during this time period. As a result, FRB required one out of every five banks to resubmit its HMDA data for 1992. The most significant errors found in these examinations involved the loan applicant's reported income. Over half of all income-related errors were the result of banks reporting income figures from unverified application information. The other half consisted mostly of clerical errors. FRB staff said these high error rates are because, in most institutions, HMDA reporting is done by insufficiently trained clerks, with little review from more senior management. FRB amended the HMDA regulation (regulation C) in December 1994 to help improve HMDA data quality by clarifying and simplifying the reporting requirements.

OTS officials said they have also taken action to address HMDA data quality problems. For 1992 data, the directors of OTS regional offices sent letters of reprimand to institutions with the worst data quality. For 1993 data, the Financial Reporting Division sent detailed logs of reporting accuracy and timeliness to the regional compliance managers for use in examinations. In addition, an OTS official noted that the regulators' interagency examination council, through its HMDA Subcommittee, has made recommendations to improve the examination of data quality, which are likely to be reflected in forthcoming revised HMDA examination procedures.

Poor HMDA data quality was mentioned in some of the examination reports from our case studies. Some of these institutions were required to resubmit their data, while others were not. FRB officials stated that they generally require institutions with a 10 percent or greater error rate to resubmit their HMDA data. Other regulators did not have a specific policy on when resubmissions would be required. The FRB also recently

announced that the institutions it supervises will be subject to the same monitoring and enforcement rules that are currently in place for other types of reports, such as Call Reports.[11] Similarly, OTS stated in its comments to this report that it recently adopted guidelines for the assessment of civil money penalties against institutions that submit late or inaccurate HMDA data. Only FDIC has actually penalized institutions for not submitting their HMDA data on time.[12] While these types of actions taken by regulators have helped to increase HMDA data reliability for the affected institutions, they do not ensure uniform or consistent reliability across the industry.

Current compliance examination procedures include steps to check the accuracy and completeness of HMDA data. Similar data quality checks for any other data used to assess performance would, if effectively implemented, help to ensure that data used in assessments are accurate. For example, procedures could be established that require examiners to check for data deficiencies during examinations. However, some examiners told us they did not always have time to complete the required procedures and such additional procedures may increase examination time. Notwithstanding the possible issue of timeliness, if data accuracy is not checked by the regulators during examinations, it may not be viewed as important by the institutions.

Better Disclosure in Public Evaluation Reports Would Enhance Their Credibility

The credibility of the revised CRA examinations will also depend upon the explanations provided in the public evaluation reports about how ratings are determined. Community groups cited their perception that examiners were inconsistent and that the bases for ratings were unclear from the information provided in past evaluation reports. They emphasized the importance of the public evaluation reports, because these reports are the groups' primary source of information about institutions' CRA performance, and they viewed transparency about institutions' lending performance as the best form of regulation. More specifically, they cited the need to provide more information in the public evaluation reports about institutions' actual lending performance including the data used to support conclusions and clear explanations about how an institution's performance was assessed. Bankers have also stated that they do not always understand the bases for their ratings. The regulators have

[11]Such penalties would include civil money penalties for institutions that repeatedly submit late, incomplete, illegible, or inaccurate data.

[12]In June 1994, FDIC announced that it had fined six institutions for late submissions of 1992 and 1993 HMDA data. The fines ranged from $2,000 to $4,000. It also announced that other institutions may have fines imposed for late or inaccurate reports as its review process continues.

acknowledged that bankers and the public will learn what is expected under the regulations and judge whether examination consistency has improved on the basis of the rationale provided by the regulators on how the revised regulatory standards have been applied to determine institutions' ratings.

Although the revised CRA regulations included specific instructions to institutions on what information must be included in the public CRA files, they did not address the contents of the public evaluation reports. We recognize that the regulators have taken steps to include more performance data in public evaluation reports, as required by FDICIA. However, we believe the regulators can better demonstrate their move towards performance-based CRA examinations by designing and submitting public CRA reports that establish a basis for the given evaluations supported by objective data analysis and indicators. Some regulatory officials have indicated that they would like to develop a uniform interagency report format, but past interagency efforts to develop uniform evaluation reports have not succeeded.

Insufficient Resources to Implement Revised CRA Regulations Could Pose a Problem

The regulators have indicated in the revised regulations that examiners will relieve some of the burden on institutions by assuming greater responsibility for areas such as analyzing data collected. Even without the additional responsibilities under the current system, some of the regulators have had difficulty meeting their goal of conducting CRA examinations for all institutions at least once every 2 years. In addition, some examiners in our case studies told us that they have not had sufficient time to complete all of their responsibilities during examinations. They said that this generally resulted in one of three outcomes: (1) the time needed to complete examinations was lengthened; (2) the institutions were asked to provide more information or analyses; or (3) some activities, such as making community contacts to assess community needs, were not completed.

The regulators have varied in the resources devoted to conducting CRA examinations, as shown in chapter 1, table 1.2. Until 1993, the FRB had the largest CRA examination force and the fewest number of institutions to examine. It has generally been able to examine all of its institutions within a 2-year time frame. FDIC has the largest number of institutions and increased its CRA examination force by 75 percent from 1992 to 1993. FDIC, OTS, and OCC have not been able to examine all of their institutions within a 2-year time frame. OCC does not anticipate beginning a 2-year examination

schedule until 1997, when it plans to have a sufficient number of trained examiners.

Also, examiners told us that they did not always have time to complete all required procedures or analyses. Some examiners mentioned that, for various reasons, making community contact was not always accomplished. Examiners were generally encouraged to make contacts during each examination but said they often relied on previously gathered information. Under the revised regulations, the examiners' responsibilities for consulting community sources will be increased. Another area in which examiners will be expected to do more is the analysis of institutions' lending performance data. Our case studies indicated that responsibilities in this area were not always clear and were sometimes shifted back and forth between institutions and examiners.

Another related resource issue involves the implementation of the recently passed legislation, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, that may involve changes to CRA examinations for institutions with interstate branches. The act requires that an interstate institution's public CRA evaluation report include a state-by-state summary evaluation of the CRA performance for its branches in each state. In addition, the report is also to include an evaluation of a bank's performance within a multistate metropolitan area where the banks have branches in two or more states within the area. The regulators are not certain if they would be required to review all of an institution's branches at the same time to complete the CRA examination. If so, the resource requirements could be problematic for examining large institutions located in many states with many branches. The regulators have not yet fully implemented the provisions of the act but said they are considering their potential implications as they develop examination procedures for the revised CRA regulations.

To address their CRA responsibilities, the regulators, for the most part, have increased the number of CRA compliance examiners in the last 2 years. They have fewer institutions to examine due to mergers, acquisitions, failures, or other industry consolidation. Moreover, some of the regulators have begun testing new procedures to streamline CRA examinations and reduce examination time. While the revised CRA regulations have a goal to reduce bankers' regulatory burden, they will also clearly increase examiners' responsibilities. Currently, it is difficult to determine exactly what resources will be needed and how the regulators' current resources will change over the next 2 fiscal years. Therefore, the

regulators will need to closely monitor implementation of the revised regulations and determine if further actions are needed to ensure that examiners can meet their responsibilities within the appropriate time frames. If regulatory efforts are not successful, examiners may be faced with the situation of not performing necessary data analyses or shifting the responsibility for conducting such analyses back to institutions. Such examiner behavior could reduce CRA examination quality or increase institutions' regulatory burden.

FDIC, OCC, and OTS officials believe that efficiencies will be gained by both bankers and regulators in implementing the revised regulation through, among other things, the elimination of process oriented factors and use of more sophisticated software in examinations. They believe that such efficiencies, in the long run, may actually reduce the overall time needed for CRA examinations. FRB, on the other hand, suggested that the regulators' costs may increase in assessing CRA compliance under the revised regulations.

Conclusions

The success of the newly adopted CRA reforms will likely be judged largely by whether the regulators can address lingering concerns about the certainty and consistency of CRA examinations. The regulators have had difficulties in meeting these challenges in the past. Some of the challenges will likely continue as the regulators implement the revised CRA regulations—including examiners' use of discretion, differences in examiner experience and training, data quality, ratings justifications provided in public evaluation reports, and regulatory resource limitations. The regulators have indicated in the revised regulations that they intend to work together on improving examination guidance and training to ensure that examiners consistently interpret and apply the new CRA standards. In addition, examiners cannot adequately conduct performance-based evaluations without accurate data. Long-standing concerns about data quality will likely be reduced only if the regulators identify and ensure that the institutions correct inadequate data for future CRA examinations. Examination consistency will ultimately be judged by the information and explanations provided in public evaluation reports on how performance ratings have been determined. Finally, by closely monitoring their resource needs and their ability to accommodate their increased CRA responsibilities, the regulators may be better able to ensure that the requirements of the revised CRA regulations will be met.

Recommendations

We recommend that the heads of FRB, FDIC, OCC, and OTS work together to take the following actions to better ensure the effective implementation of the revised regulations and consistency of CRA examinations:

- Develop or revise regulatory guidance and training programs by clarifying how examiners should interpret the performance standards, and require that all examiners receive comprehensive training necessary to implement the new regulations.
- Improve data accuracy by (1) requiring examiners to assess the accuracy of data used in performance evaluations and (2) developing a uniform policy on what actions will be taken against institutions with poor data quality.
- Improve disclosures in publicly available evaluation reports by clearly presenting performance information and the rationale used to assess institutions' performance against the revised performance-based examination standards.
- Assess agency resources and examination techniques to determine what resources and techniques are needed to meet the requirements of the revised CRA regulations.

Agency Comments and Our Evaluation

Generally, agency officials agreed with our report message and recommendations to help ensure effective implementation of the revised CRA regulations. FDIC commented that while it agrees that examination consistency is a major priority for the regulators, which it is pursuing through enhanced interagency training, examiner judgment is still critical to implementation of the revised regulations as each community and each institution has unique characteristics that must be considered. OTS commented that although the revised regulations still call for examiner judgment, they provide for reasoned conclusions to be drawn from objective data under a clearer set of performance standards. FRB acknowledged that one of the biggest challenges faced by the agencies in the implementation of CRA is the ongoing challenge to achieve the appropriate balance between desired certainty and the need for flexibility in implementation to reflect unique community banking circumstances.

With regard to resource needs for the regulators to implement the revised regulations, FDIC, OCC, and OTS suggested that the revised regulations should reduce the overall time devoted to CRA evaluations in the long run due to the elimination of process oriented factors, coupled with use of enhanced, more sophisticated software that they are currently introducing. OTS also suggested that the small bank and strategic plan

options may further reduce examination resource requirements. FRB, on the other hand, has publicly recognized in its impact analysis of the revised regulations that implementation of the regulations may increase regulators' costs in assessing CRA compliance.[13]

FRB and OTS responded to our recommendations by describing what they are doing or plan to do. Some of the actions include revised guidance and initiation of training programs (which covers interagency training begun in September 1995), measures to improve data accuracy, better supported conclusions in public CRA evaluations, and monitoring of compliance examination resources. In its efforts to improve data accuracy, FRB commented that it is establishing enforcement mechanisms. In addition, FDIC and OCC acknowledged that interagency training and other efforts would further regulators' plans to improve disclosures in public CRA evaluation reports by developing uniform and accurate CRA performance evaluations and emphasizing the need to fully support related conclusions. These actions, if effectively implemented, should be helpful in enabling the regulators to fulfill the intent of our recommendations.

[13]"Final Regulator Impact Analysis of Proposed CRA Regulations," Glenn Canner, Division of Research and Statistics, Board of Governors of the Federal Reserve System, April 13, 1995.

Various Initiatives Have Addressed Barriers to Lending in Low- and Moderate-Income Areas

Many public and private sector efforts have reduced various barriers to community lending in low- and moderate-income areas. Through individual activities and cooperative efforts, institutions and community groups have used the flexibility of the CRA statute and addressed important cost-related barriers and market impediments to enhance community lending opportunities. While we did not assess individual initiatives as a part of this review, we present examples that bankers, regulators, and community groups we contacted considered to be successful techniques in helping to lower costs and risks for institutions participating in community development lending strategies. The secondary mortgage markets have also taken steps to broaden opportunities for institutions to sell community loans on those markets. In addition to bankers calling for certain compliance incentives, local, state, and federal governments have provided incentives for lending in low- and moderate-income communities.

The federal bank regulators have also been able to play a key role in facilitating institutions' community lending activities by providing forums for educating bankers and disseminating information about successful initiatives. Each of the regulators has established a community affairs program to encourage and promote community lending and investment initiatives among bankers. As they further develop these programs and better coordinate their efforts, the regulators could enhance their role in this respect.

Barriers May Inhibit Community Lending

Comments from some of the bankers we interviewed confirmed the contention of some industry observers that private sector efforts to meet the credit needs of low- and moderate-income communities may be limited by the perception that such lending is likely to entail relatively high credit risk and relatively small potential returns. Many bankers tended to believe that the profits of such activities are lowered by relatively high credit risk—that is, the risk of financial loss due to the possibility of borrower default—and high transaction costs. The transaction costs for community lending may be higher than for other commercial or consumer lending because of, among other factors, additional time and effort necessary to ascertain the creditworthiness of the borrower or the related property in certain low- or moderate-income areas. Another significant barrier faced by bankers is the opportunity cost of community lending. The primary objective of a bank is to maximize profits for its shareholders. To the extent that community lending is believed to be inconsistent with that objective, community lending expenditures represent lost opportunities to

achieve greater returns through more profitable activities. Closely aligned with the cost factors is the issue of safety and soundness policies and regulations, which some bankers we interviewed believe are inherently in conflict with community lending because of the perceived greater risks involved in such lending.

The Perception of High Credit Risk Can Be a Barrier to Community Lending

As evidenced by our case studies, a matter of concern frequently mentioned by bankers about community lending is the issue of high credit risk, which represents one element in the cost of lending. When a banker extends a loan, some possibility exists that the borrower will not repay the loan or will delay payment. Bankers making a large number of loans expect a small percentage to be nonperforming. To cover expected losses, they may structure their loan rates accordingly and also voluntarily set aside loan loss reserves.[14]

The concern about credit risk is understandable in that community lending is made to low- and moderate-income borrowers who may not meet normal creditworthiness standards such as debt-to-income ratio.

However, according to a 1993 Federal Reserve report to Congress,[15] available evidence was insufficient to determine the extent to which credit risk is associated with different income, racial, or ethnic characteristics across neighborhoods.

Transaction Costs Can Create a Barrier to Community Lending

A significant cost element in any type of lending by an institution is the cost of originating, processing, and servicing loans, also known as transaction costs. Transaction costs rise and fall with the volume of lending. They include, among other costs, expenses related to evaluating an applicant's credit history and ability to pay off the debt as scheduled; obtaining appraisals and surveys of properties offered as collateral; and processing loan payments, including monitoring borrowers who have fallen behind on their payments. The amount of time and effort expended on these activities may vary considerably from loan to loan, depending upon the type and complexity of the loan and characteristics of the borrower. Generally, the larger the loan amount and the smaller the transaction costs, the more profitable the loan for the institution. More

[14]An amount of capital held back from investment by a bank considered to be adequate to cover estimated losses in the loan portfolio.

[15]Report to the Congress on Community Development Lending by Depository Institutions, the Board of Governors of the Federal Reserve System, (Washington, D.C.: Oct. 1993).

specifically, since transaction costs do not usually rise in proportion to the loan amount, larger loans are generally more profitable.

According to bankers we interviewed, community loans are less profitable for institutions than many other types of loans because the loan amounts are relatively low, while loan transaction costs are relatively high. High transaction costs may be due to greater time and care required to qualify borrowers for loans by gathering additional information to help better identify the lender's credit risk. According to a banker from a medium-sized Texas bank, loans to low- and moderate-income individuals are not profitable because their small size nets a low return to the bank's fixed costs.

Regulatory Safety and Soundness Policies Can Be a Barrier to Community Lending

One of the perceived issues surrounding CRA is whether community lending reduces an institution's safety and soundness. There are those who believe that CRA regulations encourage "high loan-to-value ratio" mortgage loans[16] in local communities, which could also lead to incurring greater risk. According to some bankers we interviewed, community lending has added costs resulting from loss reserves required by safety and soundness examiners. Both bankers and community groups have said that safety and soundness examiners do not understand many of the techniques institutions use to reduce credit risk of community loans—such as, for example, the "layering of loans with state and city financing."[17] As a result, they require institutions to set aside loan loss reserves that bankers, community groups, and even compliance examiners may view as unnecessary. Two examples illustrate noted concerns about the perceived problem pertaining to safety and soundness.

- The Chairman of the California League of Savings Institutions testified at the public CRA hearings that members of the League support strong capital regulations, but Congress and the regulatory agencies must recognize that current risk-based capital regulations have an unavoidable impact on an institution's ability to fulfill community needs. The treatment of (capital requirements for) rehabilitation loans, apartment loans, and equity participations makes them too "expensive" in capital costs for many institutions.

[16]A loan in which the amount advanced by the lender is close to the appraised value of the property. Generally, any mortgage loan with a loan-to-value ratio above 80 percent is considered high and may require mortgage insurance.

[17]State and city subsidy loans, grants, or other equity financing that are used in conjunction with bank loans to provide the right mix of financing needed as an economic stimulus for a particular business.

- During CRA hearings in 1993, an official of a large nationwide bank stated that over time her bank has learned that community development lending is not unsafe and that the bank's community development lending portfolios perform as well or better than its general market loans. The banker pointed out that community development loans look different from so-called traditional loans in that the sources of equity and debt-to-income or loan-to-value ratios are different, and the appraised value is often no measure of real value. Recognizing that these variables do not make for unsafe community development loans, the banker noted that such loans are viewed adversely from a safety and soundness perspective, and, thus, are more heavily reserved against, more heavily monitored, and, at best, more expensive to make.

During our review, we frequently heard concerns or complaints from bankers about possible or perceived safety and soundness risks in the implementation of CRA. We did not independently verify the accuracy of these claims.

Innovative and Cooperative Initiatives Have Overcome Some Lending Barriers

Various individual and cooperative efforts among institutions, community groups, and others have provided the means to lower credit risk and reduce transaction costs in community lending. Although the lack of specific performance criteria in CRA has complicated compliance and enforcement of the law, it has allowed institutions flexibility in designing and implementing programs to better serve the credit needs in low- and moderate-income areas. Bankers taking a proactive approach have used the law's flexibility to create innovative programs and strategies that allow them to expand lending opportunities and increase or cultivate new markets. Also, those bankers who gain experience or develop expertise in community lending and make it a part of their normal business operations find that CRA obligations need not be perceived as a regulatory burden. Many cooperative ventures have also permitted community groups to play an important role in reducing barriers to community lending.

CRA Flexibility Allows Bankers to Enhance Community Lending

Bankers who are committed to serving the credit needs of their communities have taken advantage of CRA's flexibility and carved out ways to make loans that other bankers might not find attractive. Regulators have found, and our case studies revealed, that a more effective CRA program was generally evident when bank management exhibited certain types of proactive approaches to CRA implementation. These bankers took action to get their board members involved, reached out to members of

the community to determine the needs of their communities, developed marketing and advertising strategies, and established sound CRA plans designed to address community needs. The types of initiatives implemented by bankers and found by regulators to have effective CRA performance included education and counseling seminars, community outreach efforts, flexible underwriting standards or policies, participation in government-sponsored lending programs, and implementation of special programs offering unique products or using specialized staff to better meet the needs of customers. Also, some banking associations have developed programs to inform bankers of these different types of initiatives.[18]

In some cases, greater financial and staff resources of larger institutions have allowed them to create designated CRA departments that can devote time to developing and promoting various unique product lines to attract consumers. However, some smaller or rural bankers who serve predominantly low- and moderate-income areas, by necessity, have succeeded in meeting CRA goals during their normal course of business with customers. Considering their clientele and the special needs that many require, these bankers have found that to make a profit and satisfy community needs, it was necessary for them to create specialized programs and develop flexible policies. Some examples of the types of programs or initiatives that bankers have implemented to meet their CRA goals are presented in table 4.1.

[18]For example, the increased emphasis on CRA has prompted the American Bankers Association, a national trade association of commercial banks, to establish a Center for Community Development. The primary purpose of the center is to provide information and technical assistance to its members to help them achieve their CRA goals. Most of the center's activities have focused on educational efforts, such as publishing an educational guide and a compendium of community lending agencies and organizational contacts.

Table 4.1: Examples of Community Lending Initiatives

Type of institution	Type of community lending initiative
Large, urban Boston bank	Initiated a leadership role in programs that provide affordable housing and rehabilitation projects in low- and moderate-income areas. Bank's chairman was one of the founders of the Massachusetts Bankers Housing Partnership, which has provided millions of dollars for affordable housing in its 10-year history.
Suburban, medium-sized Illinois bank	Developed a "second look" program, which provides that any denied application from an individual within its delineated community receives a loan officer review the next day.
Small, urban Dallas bank	Developed products aimed at the low- and moderate-income market. The deposit product is a low cost (minimal balance/service charge), low-volume checking account designed to help individuals establish a credit history by enabling them to write a few checks a month. A loan product was developed in conjunction with some local groups, and it enables individuals with no prior credit history to obtain secured consumer loans.
Small, rural California bank	Promoted fair and increased access to credit within the community by: advertising in Spanish, having a flexible (no minimum) loan amount, expanding the types of products offered (i.e., credit cards, special equity lines, Small Business Administration (SBA) loans) and evaluating loans so that seasonal employees were not disadvantaged.
Large, urban California bank	Promoted credit access through its loan agent operations. For example, it has special agents soliciting 95 percent loans (5 percent down payment). Bank also has outreach coordinators in the community who uniformly try to determine the needs and how they can be met.

Source: Information obtained from GAO case studies.

Initiatives Taken to Reduce Credit Risk and Transaction Costs for Community Lending

Bankers use various mechanisms to lower credit risk and transaction costs on community loans. They have found that losses can be reduced by screening out the riskiest applicants and by supporting successful applicants before and after loans are extended. Two approaches that bankers use to help keep credit losses on community development lending to a minimum include (1) screening, counseling, and monitoring borrowers and (2) risk-sharing arrangements. Cooperative efforts also help to share costs, so costs for individual bankers may be reduced.

Screening, Counseling, and Monitoring

Based on roundtable discussions, many bankers agree that thorough applicant screening, applicant education and counseling prior to loan extension, and diligent monitoring of borrowers after loans are granted

help lower the risks of lending in low-income areas and to low-income borrowers. Bankers and other organizations that support lending use various techniques to screen potential borrowers, including home buyer and small business education, credit counseling, and extensive direct contact with loan officers.[19] Many institutions provide technical assistance and grants to nonprofit housing counseling groups and community groups that help with loan packaging. The groups screen potential borrowers, help assemble documentation, and make sure that applicants meet the institution's underwriting criteria.[20] They also help market and promote loan programs and minimize institution processing costs. These activities are done to allow the bankers to become familiar with the applicants and their communities.

Spreading Risks Through Consortia

Lending consortia may be either formal or informal, for profit or nonprofit. Consortia often consist of institutions that pool lending money or collect equity stakes for low- and moderate-income housing and community development. The types of participants, bankers, and funding involved vary from program to program. In all cases, consortia allow institutions to spread risk and transaction costs to avoid high concentrations of credit risk in individual projects or in limited geographic areas. Risk sharing allows institutions the opportunity to expand lending through various means to nontraditional borrowers whose risk characteristics are difficult to quantify or assess. For example, they can save member institutions time and money by gathering information and developing expertise about public and private subsidy programs, the past performance of real estate developers and property management companies, and the characteristics of targeted communities and local community groups. They can attract staffs that are knowledgeable about matters such as underwriting and property appraisal. Loan consortia also provide an opportunity for smaller institutions to participate more in community development lending, because such institutions, on their own, are less able to bear the cost and develop the expertise for community development lending.

[19]As an example, completion of a prepurchase home-buyer education program is a requirement for loan applicants who wish to participate in the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) community home-buyer programs. The sessions, which are conducted by either a mortgage lender or a nonprofit group, cover information, such as applying for a mortgage, budgeting household expenses, and shopping for, inspecting, and maintaining a home. The purpose of the requirement is to mitigate the risks of lending within the community home-buyer programs.

[20]Some community groups with whom we spoke have been active in providing credit counseling to help low- and moderate-income consumers prequalify for loans and show them how to effectively maintain their loan payments. During our study we learned that the Association of Community Organizations for Reform Now, a community group, was given a grant by a large, urban thrift to service and counsel loans financed through a property rehabilitation program initiative.

Several of the bankers included in our review said that they have participated in various consortia or multibank activities in meeting their CRA goals. Examples of some of the consortia organizations named by institutions in our sample review are included in table 4.2.

Table 4.2: Examples of Lending Consortia

Organization	Purpose of organization
California Community Reinvestment Corporation (San Francisco, CA)	A nonprofit mortgage banking consortium, which was created in 1989 by California banks to increase quality affordable housing in California. Since its creation, the 58 member banks have pooled over $100 million for community lending.
Community Investment Corporation (Chicago, IL)	An organization composed primarily of savings associations, which provides mortgage funding to rehabilitate and purchase multifamily housing.
Savings Associations Mortgage Company, Inc. (Santa Clara, CA)	A company that consists primarily of numerous savings associations which pool their resources to fund a variety of housing projects for the poor.
Southern California Business Development Corporation (Los Angeles, CA)	A multibank community development corporation that was organized to operate in South Central Los Angeles for the purpose of making loans and equity investments in small businesses that do not qualify for conventional bank financing.

Source: GAO case studies and the Consumer Bankers Association.

Initiatives to Address Bankers' Concerns About Safety and Soundness Regulations

Regulators and bankers have taken steps to address potential conflicts with regulations designed to help ensure safe and sound operations. In January 1994, the Federal Deposit Insurance Corporation (FDIC) adopted changes to its risk-based capital standards that were intended to facilitate prudent lending for multifamily housing purposes. Similar action was also taken by the other federal regulators. The risk-based capital final rule lowered from 100 percent to 50 percent the "risk weight" accorded loans secured by multifamily residential properties that meet certain criteria as well as securities collateralized by such loans. The effect of this ruling is that an institution making or acquiring these loans or securities can hold less capital than required in the past under the risk-based capital standards. However, to be eligible for the lower risk weight, the loans must satisfy certain loan-to-value and debt service coverage requirements.

To ensure that appropriate and affordable financing can be provided for community development projects, institutions have often found it necessary to depart from traditional standards of credit extension. We found bankers who created ways to make secure, profitable loans while

sharing costs and risks through their own individual initiatives or by employing such techniques as government loan guarantees, interest rate subsidies, or blended-rate loans with participation from public and private lenders. Examples of individual policy initiatives used by institutions are included in table 4.3.

Table 4.3: Examples of Flexible Underwriting Policies

Type of Institution	Type of underwriting flexibility
Large, urban Illinois bank	Decided that instead of selling loans to the secondary market, it would hold more loans in portfolio in an effort to reach more low- and moderate-income applicants.
Medium, suburban Texas thrift	Reviewed and changed underwriting standards as necessary to ensure maximum flexibility in approving loans. Also, a minimum loan amount is not required.
Small, urban California thrift	Worked with borrowers in making loans by considering "mattress" money, income from renting a room, or minimal down payment and no mortgage insurance.

Source: Information obtained from GAO case studies.

Barriers Posed by Secondary Market Standards and Some Initiatives Designed to Address Them

During our review, we often heard complaints that secondary market standards made it difficult for institutions to sell some of their more nontraditional loans that did not meet normal underwriting standards. Similar complaints have been made at focus group meetings sponsored by secondary market entities. The secondary market provides the mechanism for existing loans, marketable securities, and other assets to be sold to investors, either directly or through an intermediary. More specifically, the secondary mortgage market represents the national market where residential mortgages are assembled into pools and sold to investors. This market, which originated with such corporations as Fannie Mae and Freddie Mac, supplies additional liquidity to mortgage lenders.

The single most important contribution of the secondary mortgage market is the creation of a national market for resale of residential mortgages. This ensures that mortgage originators, regardless of where they are located, have access to pools of capital managed by pension funds, insurance companies, and other institutional buyers of mortgage-backed securities. Home buyers are assured an adequate supply of mortgage financing as the secondary market sales provide lending institutions with a constant source of new funds to make more home loans. Banks receive CRA credit for originating loans to particular low-income communities or individuals whether they sell the loans in the secondary market or hold

them in their portfolio. Our interviews with bankers disclosed several concerns pertaining to the secondary market underwriting standards that some bankers believed pose a barrier and tend to restrict lending in low- and moderate-income areas. One primary concern was that institutions do not want to deviate from the secondary market standards because they want to be able to sell all their loans to the secondary markets. As one of the regulatory officials noted, if the secondary markets will not accept a loan, an institution is forced to keep the loan in its portfolio and assume the market and interest rate risk for the full life of the loan. Therefore, some institutions look for loans that do not have any nonconforming provisions or any questions about collateral. Other concerns raised included the following:

- A thrift regulatory official noted that one of the secondary market standards that can reduce flexibility is the requirement that no more than 36 percent of the borrower's salary can be used for loan payments. In an area with high housing costs, such as the San Francisco Bay area, these standards are very limiting. He said many people already pay 40 to 50 percent of their salary for rent and are probably able to continue to pay a high percentage in house payments.
- A bank management official of a large urban Chicago thrift said that Fannie Mae formulas or ratios represent the industry standard; however, he noted that he was not aware of empirical evidence that an applicant who does not meet these ratios cannot service the debt.

Initiatives Designed to Address Secondary Market Barriers

Some of the players in the secondary market have begun to recognize the problems associated with the underwriting standards and have initiatives under way that are intended to help alleviate some of these problems. We did not assess the effect of these initiatives as part of this review. Fannie Mae and Freddie Mac have both announced initiatives in recent years to purchase loans with underwriting guidelines or payment terms that do not meet their more traditional loan purchase programs. Congress has encouraged these corporations to support low- and moderate-income loans by setting specific volume goals over a 2-year period, which began in 1993. For example, for all the loans they purchase, 30 percent of the units financed must be for low-and moderate-income borrowers, 30 percent must be located in central cities, and $3.5 billion ($1.5 billion for Freddie Mac, $2 billion for Fannie Mae) must finance loans to low-income and very low-income home buyers.[21]

[21]The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 established the 30-percent target goals and called for the Secretary of Housing and Urban Development to establish interim goals for each enterprise for the 2-year transition period, which began in 1993 and 1994.

In announcing its initiatives in February 1994, Freddie Mac cited the potential effect of these initiatives on mortgage lending in inner cities as well as its efforts to broadly redefine creditworthiness. Officials of Freddie Mac stressed the fact that the clarifications do not represent a lowering of its standards but an effort to dispel misconceptions among originators of mortgage loans. Through meetings with lenders, appraisers, mortgage insurers, and others, the corporation was able to identify more than a dozen underwriting issues that were causing originators to needlessly deny credit in the belief that some particular factor would make a loan ineligible for a Freddie Mac pool. For example, numerous people thought that Freddie Mac did not want to purchase any loans extended to borrowers with one or two 30- or 60-day delinquencies in their credit histories. While recognizing that such a history could indicate a bad risk, Freddie Mac officials said that they now tell lenders that they may focus on the borrower's history of housing payments as well as consider explanations for the delinquencies. Acknowledging that the initiatives could reduce the quality of loans in its pools, Freddie Mac officials plan to vigilantly monitor the performance of the loans.

In March 1994, Fannie Mae announced its $1 trillion plan to help finance affordable housing loans by the year 2000. Significant among the 11-initiative program were 2 initiatives, 1 involving the clarification of guidelines and the other testing an approach for underwriting loans, which were intended to help break down the barriers pertaining to secondary market criteria. In clarifying the guidance, Fannie Mae officials tried to ensure that the underwriting guidelines are clear and flexible and are applied equally to everyone. To ensure appropriate use by lenders, Fannie Mae plans to

- maintain a constant dialogue with mortgage lenders to identify the loan characteristics and underwriting procedures it thinks need clarification;
- develop a comprehensive training program for mortgage industry underwriters;
- develop easy-to-use reference tools for underwriters, including on-line access to Fannie Mae guidelines;
- establish regional hotlines that lenders can call for instant guidance on underwriting;
- establish an internal Fannie Mae loan review board to review loans initially rejected by its underwriters; and
- make an automated underwriting system available to lenders that will use artificial intelligence to analyze loans, ensure consistency, and free up time for underwriters to work on complex applications.

Additionally, through a separate initiative, Fannie Mae announced its commitment of $5 billion to conduct experiments in new underwriting approaches designed to probe and test ways to underwrite loans to make credit more accessible to minorities, low- and moderate-income families, central city and rural residents, and people with special housing needs.

Governments Have Provided Incentives to Encourage Community Lending

In line with the administration's emphasis on reforming CRA and improving community development, several governmental agencies or entities have initiated activities, or revised guidance governing ongoing programs, to enhance community investment in low- and moderate-income areas. Many of these program activities are geared towards rebuilding communities within inner cities and small, rural areas by providing affordable housing and facilitating small business lending.

State and Local Efforts to Encourage Community Development Lending

Some local governments have sought to encourage community lending in underserved areas by recognizing and rewarding institutions that demonstrate performance and commitment in helping to meet the needs of residents in these areas. Such rewards might result in better service delivery through branch expansions or increased investments or deposits. Some state governments require commitments to community reinvestments before out-of-state institutions can operate in their localities. They premise entry on a standard of net new benefits to the state, such as increased in-state lending and investments. A California County Board of Supervisors approved a community reinvestment policy that would rank institutions on the basis of their performance in making loans to minorities and in depressed neighborhoods. Those ranked in the top half would then reap the benefits of the county's investment business.

To encourage community reinvestment and development, some municipalities condition their placement of deposits upon the institution making specific types of loans. For example, in Chicago, institutions must file reports on their residential and commercial lending in the Chicago metropolitan area before they can qualify for the city's deposits. Similarly, during our case studies, we learned that the city of Boston has a Linkage Program that ties deposit of city funds to an institution's CRA rating. A Boston national bank branch located in a depressed area of the city was rewarded with a $5 million deposit by the city.

States also encourage community development through deposit subsidies. For example, Iowa's State Treasurer's Office offers several "linked deposit" programs that support below-market rate and small business and agricultural loans. Below-market rate deposits are placed with institutions that, in turn, use them to match fund lower rate loans, with a spread over the deposit rate. This approach provides two unique, highly targeted programs through participating Iowa institutions. One is targeted for minority- and women-owned small businesses and provides below-market rate financing for a variety of business purposes. The other is focused on helping diversify Iowa's rural economy and increasing employment. It offers linked deposits as incentives for institutions to fund below-market rate loans for horticultural and agricultural projects that involve products not typically found on Iowa farms.

Federal Efforts and Suggested Incentives Have Helped Influence Community Development Lending

Federal efforts to encourage community development lending have included government subsidized programs, changes in regulatory requirements, and legislation promoting investment incentives, some of which correspond with the suggested incentives offered by bankers. Government subsidies, such as those provided by Small Business Administration (SBA), can significantly affect the profitability of lending by making it easier for the borrower to qualify for a loan or, through a guarantee, cushion anticipated losses from a loan, allowing the lender to set aside a smaller amount of funds against this contingency. In accordance with the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), the Federal Housing Finance Board (FHFB)—which regulates the credit advance (loan) activities of the Federal Home Loan Banks (FHLB)—was required to develop regulations establishing standards of community investment or service for member institutions to maintain continued access to long-term FHLB advances.[22] Through the Bank Enterprise Act (BEA, P.L. 101-242) and the Riegle Community Development and Regulatory Improvement Act of 1994, (P. L. 103-325), Congress took action to increase financial services provided to underserved and distressed areas and to low- and moderate-income individuals.

Small Business Administration

SBA is an independent federal agency chartered in 1953 to provide financial assistance to small businesses. SBA makes direct loans to borrowers who are unable to obtain conventional financing, participates in loans originated by financial institutions, and also guarantees loans (typically, a

[22]The primary credit mission of the FHLBs is to enhance the availability of residential mortgage credit by providing a readily available, economical, and affordable source of funds, in the form of advances, to their member institutions.

guarantee of 85 percent of a small business loan) made by institutions. This agency has efforts under way to foster small business community lending through various pilot programs or initiatives.

SBA has initiated a pilot program in several southwestern states to test a new short-form loan application, which should benefit both bankers and borrowers. Under this pilot, for loans under $50,000, bankers must now provide SBA with only a one-page document. Loans between $50,000 and $100,000 require the one-page summary document plus the applicant's business tax returns for the previous 3 years, a personal financial statement, and the institution's internal credit memorandum. A national bank official said the shorter form decreases the time it takes to finalize the loan from as long as 6 weeks to 1 or 2 weeks. Also, he said the shorter form makes borrowers feel more comfortable about the application process and bankers more willing to make smaller loans because the previous paperwork made small loans unprofitable.

The Rhode Island Area SBA Program has $13.1 million in initial commitments for business loans of up to $50,000 with maturities of 1 to 7 years. The program was developed by SBA's Providence office and the Ocean State Economic Development Authority, a private entity. Besides offering SBA guarantees, the program virtually eliminates paperwork and "hand holding" burdens for institutions.

Federal Home Loan Bank System

While the FHLB System[23] has sponsored special community development initiatives in the past, the passage of FIRREA in 1989 has contributed to the system taking on a more active leadership role in the development of community lending programs. To encourage the flow of funds into low- and moderate-income areas, FIRREA required the FHFB to develop regulations that condition access to long-term FHLB advances on member institutions meeting certain standards of community support. Congress specified that the regulations were to take two factors into account—an institution's CRA performance and its record of lending to first-time home buyers. This provision thereby created an additional CRA enforcement mechanism by tying an FHLB member's access to long-term advances used to finance residential mortgage lending to the institution's CRA performance. FIRREA also established an Affordable Housing Advisory Council at each of the FHLBs. The councils are to meet periodically to advise the FHLBs on low-income housing needs in each region.

[23]A system of 12 regional banks established by the Federal Home Loan Bank Act of 1932 which acts as a central credit system for savings and loan institutions.

Through its Affordable Housing Program and Community Investment Program, the FHLB system is to provide assistance to its member institutions by supporting their CRA activities. It is to advance funds or subsidize below-market-rate loans originated for low-and moderate-income families and for businesses in low- and moderate-income areas. The Affordable Housing Program is to provide home lending funds to support housing for people whose income does not exceed 80 percent of an area's median income, and rental housing funds where at least 20 percent of the units are occupied by low-income tenants. Its Community Investment Program is to provide home lending funds to projects aimed at individuals with incomes of up to 115 percent of an area's median income.

Positive Incentives Have Been Suggested to Encourage Community Lending

To encourage institutions to lend to all parts of their community, some bankers have suggested that CRA be replaced or supplemented with financial subsidies or other positive incentives. Others have called for modifying or supplementing CRA with incentives such as (1) tax credits, (2) deposit insurance credits, (3) streamlined or less frequent examinations, (4) revisions of safety and soundness requirements for CRA lending and (5) broadening the base of institutions and organizations that can buy low-income housing tax credits, and (6) permitting below market financing for community development lending programs with supporting funds coming from FDIC or other regulatory premiums. Past, as well as current legislative matters for congressional consideration have included some of these proposals, as described in the next section.

Recent Legislative Proposals

Over the years, Congress has been concerned about how to provide adequate financial services to distressed rural and urban areas throughout the country. In the past, to address the problem, Congress has enacted numerous legislative provisions, such as those included in FIRREA, which created the Community Investment Program under the FHLB system described earlier. However, because this is a complex and far-reaching problem, Congress has continued to seek workable solutions and recently enacted legislative provisions aimed at enhancing community development in underserved areas. In 1991, Congress enacted BEA, and, in September 1994, the Riegle Community Development and Regulatory Improvement Act was passed.[24]

BEA was designed to provide banking institutions with incentives to offer more services to low-income communities. Originally, it was to provide for

[24]Also, Congress has debated numerous legislative proposals to amend CRA in an effort to reduce the compliance burden.

reductions in the deposit insurance premiums that institutions pay on deposits placed in lifeline accounts—checking accounts for low-income individuals. In addition to encouraging lending in poor communities, the act was to establish a deposit insurance premium credit system for lending or establishing branches in these communities. Institutions engaged in such activities would have their deposit insurance premiums reduced. Although BEA was enacted in 1991, funds were not authorized until passage of the Community Development Banking and Financial Institutions Act of 1994 (CDB Act) in September 1994. Along with the funding came modifications to BEA. Instead of institutions receiving deposit insurance rebates as provided under the original BEA, the CDB Act calls for money to be paid directly to institutions to provide financial incentives for lending in low-income communities. The funding level for BEA was eliminated in the recently passed fiscal year 1995 rescissions act (P.L. 104-19).

Serving as the umbrella legislation, the Riegle Community Development and Regulatory Improvement Act of 1994, H.R. 3474, includes a number of separate legislative proposals that were added as it proceeded through the legislative process. The CDB Act (known as title I of the Riegle Community Development and Regulatory Improvement Act) creates a fund for forming and expanding community development financial institutions (CDFI) by providing financial and technical assistance for development services, lending, and investment in distressed urban and rural areas. The act authorizes $382 million to be distributed over a 4-year period, under the administration of an independent board. One-third of this amount has been earmarked to fund BEA. Financial assistance may be provided as loans, grants, equity investments, deposits, or credit union shares on a competitive, matching basis. Institutions, local and state governments, and other community organizations may form community partnerships with CDFIs to work cooperatively to revitalize communities. Assistance must be matched dollar for dollar (allowing a reduced match for CDFIs with severe constraints on available matching funds). Selection for assistance is to be based on several factors, including community need and representation, ability to leverage private funds, extent of targeting to low-income individuals, and strength of the revitalization plan.

During the past several years, other legislative proposals have been introduced (but not enacted), which offered various approaches to supporting development in economically disadvantaged communities. Although the proposals shared the primary goal of revitalizing low-income areas, they varied in the type and scope of assistance provided, administration of programs created, and other areas. For example, the

proposed Community Banking and Economic Empowerment Act of 1993 (H.R. 1699), which was to provide money for loans and technical assistance, had a goal of making credit and credit-related services available to low-income families and others not adequately served by traditional lending institutions. More recently proposed legislation would encourage community development or reinvestment by amending CRA. In a proposed amendment to CRA, the Community Reinvestment Improvement Act of 1995 (H.R. 1211) seeks to enhance the availability of investment capital for low- and moderate-income housing in low- and moderate-income neighborhoods. The proposed Microenterprise Opportunity Expansion Act (H. R. 1019, February 1995) sets forth criteria and describes how microenterprise loans[25] and grants would be treated as an investment in a regulated financial institution's community.

Regulators Have Played a Key Role in Facilitating Initiatives to Improve Community Lending

Through their various consumer affairs offices or outreach programs, regulators have established a mechanism to encourage and support community development. Many of their responsibilities and promotional efforts are carried out primarily through guidance, educational forums, information dissemination, and technical assistance activities.

The experience levels and the amount of resources the regulators have devoted to their respective community affairs programs and operations vary. The Federal Reserve Board (FRB) and FDIC established programs in 1980 and 1990, respectively, while the Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency (OCC) began staffing their programs as recently as 1994. Despite the different levels of operation, development, and resources, all of the regulatory programs have a general goal of encouraging financial institutions to increase the flow of credit to low- and moderate-income applicants and areas. However, the effectiveness of the regulators' programs in providing community affairs activities or participating in community outreach efforts is largely dependent upon the availability of resources.

Interagency Regulatory Guidance Highlights Effective CRA Programs

One mechanism used by regulators to facilitate community lending is through guidance highlighting "best practices" that are characteristic of effective CRA programs. The regulators issued interagency guidance in

[25]Described by the act to mean a loan (1) to a commercial enterprise with five or fewer employees, with one or more of those employees owning the enterprise; (2) in amounts not less than $100 and not more than $10,000; and (3) the interest rate on which is comparable with the interest rate charged on secured commercial loans offered by financial institutions to their most preferred commercial customers.

March 1989, acknowledging that an institution that has (1) ongoing programs or methods to identify community needs, (2) the ability to develop and extend products and services to meet the credit needs identified through the ascertainment process, and (3) a comprehensive marketing program that reaches all segments of its delineated community will generally be in compliance with CRA. The guidance further acknowledges regulators' belief that to secure an effective CRA program, an institution's management should be actively involved, maintain policy oversight, and regularly review the community reinvestment compliance program. Such actions can help to ensure that the products and services offered and extended by an institution (1) will meet community credit needs, (2) can be modified when those needs change, and (3) will be available to all segments of the community. The regulators also are to use the expertise of their community affairs staff to counsel and assist institutions that do not have good compliance programs.

FRB Has the Most Developed Community Affairs Program

FRB, which has the most developed outreach program, operates a community affairs office (CAO) in each of its 12 Federal Reserve districts. The staffing level for this program has grown from 14 in the mid-1980s to a current level of approximately 70 employees. According to an FRB official, the staff hired often have some background in housing or the community development area. The principal responsibility of the CAO is to perform outreach work wherein staff contact people in local governments and community organizations to find out what types of unmet needs exist in different communities. The CAO staff develops education and information programs to help meet the community needs identified.

Through interviews with FRB officials, we learned that CAO staff are involved in various types of activities that promote community outreach and provide support to examiners. All 12 Federal Reserve regions publish newsletters that discuss different programs and various community development issues. In addition to sponsoring conferences and publishing newsletters, some CAO staff conduct research and issue community profiles (which provide bankers with information on perceived credit needs, existing community development initiatives, and programs within regions that might be duplicated on a local level). Furthermore, they provide assistance to examiners by maintaining a database of community group contacts and may help to analyze home mortgage data. When an institution receives a less than satisfactory rating, the examiner is to refer the institution to the CAO staff for consultation and guidance. The CAO staff

may transmit information on community needs through examiner training or by circulating written reports.

Being locally based, the administration of the CAO program is left to the discretion of the individual reserve banks. Consequently, although all of the reserve banks are involved in community outreach activities, the methods used for disseminating information may vary. For example, a FRB official told us that an approach used by the Kansas City CAO is to develop a road show presentation and travel to designated areas and present the show. This approach allows institutions and community organizations (which may be located in small, rural areas with limited budgets) to take advantage of the FRB's outreach efforts. The San Francisco CAO helped to develop a state-wide lending consortia by convening bankers and experts. The CAO in Dallas encouraged community lending by sponsoring geocoding seminars and small business lending workshops. These sessions are designed to teach institutions how to analyze geographic data to help ensure that the institution serves all areas of its community. The Philadelphia CAO established bankers' councils, which are to meet three or four times a year. By organizing a network of bankers into Community Affairs Officers Councils, the Philadelphia CAO has not only provided a forum for its staff to disseminate CRA information and offer education but also provided a means for encouraging bankers to come together to discuss issues and opportunities for reinvestment in their communities. A FRB official pointed out that the primary strength of CAOs is that they are effective in providing communication forums.

FDIC Enhances Staffing for Community Affairs

FDIC has reached its goal of having at least three community affairs (CA) positions (CA officer, CA assistant, and fair lending specialist), in each of its eight regions. FDIC operates its regional community affairs activities with a staff of 26 who report to regional management with program oversight being provided by headquarters. Similar to FRB, FDIC's staff has some background experience in housing and community development, and although the program staff's operations may vary by region, they perform a variety of functions, which are coordinated centrally. For example, the CA officers provide training and information to examiners and develop community reports similar to, but less detailed than, the FRB's community profiles. The fair lending specialist analyzes home-mortgage data and handles consumer complaints. FDIC headquarters office coordinates functions with community affairs staff through quarterly meetings. Also, centrally coordinated projects, such as a recently published paper on Native-American issues, may be directed by the Washington, D.C. office.

FDIC anticipates that its newly created division of compliance and consumer affairs will allow the agency to broaden its outreach initiatives and be more responsive to consumers and bankers.

Emerging Community Affairs Programs of OCC and OTS

OCC plans to have 12 community affairs staff working in conjunction with its new compliance program. As part of this staffing goal, OCC intends to have one community affairs officer located in each of its district offices. The officers are to be responsible for outreach and communication with community groups and other members of the public. As of February 1995, staffing of these positions had not been completed.

Although its community affairs program is in the early stages of development, OCC has had a Community Development Division (CDD) to (1) oversee community development corporations (CDC) and investment programs and (2) approve applications by national banks to invest in CDCs[26] in accordance with the National Bank Act. The role of the CDD is to provide policy guidance to the OCC on community development issues that affect national banks, their customers, and banking community and consumer organizations. The division is responsible for (1) developing initiatives related to the creation of affordable housing for low- and moderate-income individuals; (2) the provision of technical assistance and financing for small, minority, and women-owned businesses; and (3) the economic redevelopment of low- and moderate-income areas.

In February 1993, the CDD published the 1992 National Bank Community Development Survey Report, which highlighted the types of community development activities in which national banks participate. The report was distributed to more than 7,500 national banks, community representatives, and other interested parties. The CDD also publishes a quarterly newsletter, Community Developments, which is designed to provide national banks and others with information on innovative bank community development programs, regulatory updates on community issues, and news of federal and state programs that might be of interest to national banks.

In February 1994, OTS announced the appointment of five experienced senior staff members to fill positions in the consumer affairs area. In making the announcement, OTS said that the appointments are part of

[26]CDCs are organizations funded by banks and bank holding companies (BHC) which are authorized to make investments that may not otherwise be permitted for banks or BHCs. For example, CDCs may make equity investments in local real estate and business projects if such investments result in public benefits, such as economic development, jobs for low- and moderate-income individuals, affordable housing, and capital for small businesses.

agency initiatives emphasizing community reinvestment, nondiscrimination in lending, and other consumer-oriented goals for thrift institutions.

According to OTS officials, during 1994, the community affairs liaison officers in each of its five regions were actively involved in outreach and support efforts related to affordable housing, community development, and related fair lending and CRA matters. For example, these activities included (1) training programs for industry and staff, (2) assistance to institutions with poor CRA ratings, (3) the establishment of a community contact database for examiners, (4) meetings with local government agencies and community organizations to ascertain community credit needs and community development programs, (5) forums for thrift institutions and local community organizations to discuss local credit needs and community development programs for thrift participation, and (6) policy work on regulatory barrier and safety and soundness issues related to community development and affordable housing. A National Community Affairs Coordinator was appointed in February 1995, in Washington, D.C., to oversee the function of and coordinate the activities among the regional community affairs liaisons.

OTS officials also noted that in 1994, they issued a guide on the federal laws and regulations governing community development activities of savings associations, entitled Community Development Investment Authority. In addition, OTS officials said they began a new training program for safety and soundness examiners on understanding and evaluating multifamily affordable housing loans/projects.

Interagency Coordination Could Be Enhanced Through a More Systematic Approach

Coordination of community affairs activities among the regulatory agencies is not something that is required by regulations or mandated by legislation. In practice, however, much of the interagency coordination of the regulators' community affairs activities that occurs is done through joint training and meetings or established councils. According to an FRB official, FRB holds many conferences jointly with the FHLB Board and has cosponsored conferences with FDIC. Now that OCC and OTS have separate compliance offices, FRB anticipates working more closely with these two agencies. On a regional level, FRB and other government agencies sponsor joint interagency programs, such as training or conferences dealing with community affairs issues.

Information is also shared through regulatory publications, such as newsletters or community reports and community contact forms. Upon request, newsletters and community reports containing information such as community lending techniques and investment opportunities are generally disseminated to the public and shared among the regulators. During the examination process, if examiners find that recent contact has been made with community representatives and the results documented, examiners who are assigned to assess an institution's CRA performance in identifying and/or addressing community needs in that same general neighborhood or community can save time by taking advantage of information obtained from shared community contact forms. These methods of information sharing are generally done on an ad hoc basis. Consequently, the overall benefits to be gained by the regulators as well as the community may not be as far reaching as they could be under a more systematic, coordinated approach to information sharing.

Interagency coordination in the use of regulators' resources can expand or broaden the effectiveness of these resources in helping bankers to understand and implement various initiatives that have proven successful in meeting CRA goals, while providing much needed credit assistance to communities that may require revitalization or redevelopment. To the extent that regulators can apply a systematic, coordinated interagency approach to providing community outreach services that are commonly provided by all regulators—such as community contact information or databases—institutions, community groups, government entities, and others who benefit from such services could be more efficiently served despite the limited resources of regulators.

Conclusions

While some bankers perceive an inherent conflict between safety and soundness and CRA goals and are concerned about the secondary market requirements and/or higher transaction costs and smaller loan amounts associated with CRA lending, others have worked to overcome such barriers through individual and/or collective innovative and creative initiatives. Because lending and community development in low- and moderate-income areas often involve different and more complex methods of financing, successful initiatives tend to require the cooperative efforts and expertise of multiple financial partners.

Given the recent emphasis on CRA reform and sparked by the need to remove perceived barriers and provide additional compliance incentives, program initiatives have been taken by the secondary market,

governments, and Congress to provide financial and other incentives to promote community development and revitalization. The banking regulators have also played a key role in facilitating community lending by providing educational forums and disseminating information to encourage cooperative working relationships among banks and thrifts, other financial entities, community groups, and various government agencies. In this current climate of CRA reform and limited government resources, the regulators' role of encouraging institutions to meet the needs of all segments of their delineated communities will be a key factor in continuing and expanding upon workable and successful CRA initiatives. Given the differences in resource availability among the regulators, more systematic coordination could help to better utilize limited resources and enhance the regulators' role in encouraging community development lending.

The varied positions taken by the affected parties further demonstrate that the debate about how best to achieve the goals of community reinvestment is both complicated and contentious. The approach embodied in the current CRA statute uses the levers of compliance examinations and application approvals to increase community reinvestment lending. The new regulations are an attempt to generate better results with less regulatory burden. However, given the positions of the different parties, it is not clear that the results will fully satisfy all of those parties.

Matter for Congressional Consideration

If the concerns raised by the affected parties should persist even after the regulators have had sufficient time to implement the revised regulations, Congress may want to consider revisiting and revising the CRA statute to clarify its intent and scope, possibly examining alternative strategies for reaching its goals. Such strategies might include incentives to strengthen positive CRA performance by bankers and additional enforcement authority for regulators to discourage negative performance.

Agency Comments and Our Evaluation

With regard to the "Matter for Congressional Consideration" FDIC and OCC were concerned that congressional action before sufficient time has passed for full implementation of the revised regulations may be premature, and that further revisions to CRA without feedback on the effectiveness of the revised regulations could undermine their implementation. OTS noted that the agencies have already agreed to conduct a full review of the revised regulations 5 years after they are fully

implemented. We agree that the regulators have made extensive efforts in revising the regulations to address the diverse concerns raised about the effectiveness of CRA. Consequently, we modified the matter for congressional consideration to suggest that Congress may want to consider the results from implementation of the revised CRA regulations in its deliberations as to whether the objectives of community reinvestment are being well served through the CRA statute and regulations.

Comments From the Federal Reserve System

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551-0001

LAWRENCE B. LINDSEY
MEMBER OF THE BOARD

September 20, 1995

Mr. James L. Bothwell, Director
Financial Institutions and Market Issues
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Bothwell:

We appreciate the opportunity to comment on the August 1995 draft of your agency's report on the Community Reinvestment Act (CRA) entitled "Challenges Remain to Successfully Implement CRA." In general, the draft fully and accurately discusses the history of CRA and the backdrop of the recent interagency regulatory reform initiative, and contains constructive recommendations designed to assure effective implementation of the new CRA regulation. In fact, virtually all of the draft report's recommendations were considered during the process of revising the regulation, or in other recent contexts, either collectively or by the individual agencies, and have been or will be addressed either in the regulation or in further planned guidance.

In particular, an interagency effort to provide examination guidelines and training is well under way. Five week-long interagency examiner training sessions are already scheduled for this fall. Efforts to improve data accuracy have been made (and will continue) and enforcement mechanisms are being put in place by the Federal Reserve.

The issue of improving the public evaluations, and the data in them, has been critical in the development of the examiner guidance under the new regulation. Though that effort is not yet complete, we expect that more informative public evaluations will result as you recommend.

As pointed out by GAO, we have been acutely aware of the potential impact that this new approach to CRA will have on our examination program and its resources. Although it is too early to tell with any precision what that long term impact will be, we will monitor it carefully and make any necessary adjustments going forward. At the Federal Reserve, we believe we are well positioned, with respect to the numbers and quality of resources available, to effectively begin the implementation effort.

Mr. James L. Bothwell
September 20, 1995
Page 2

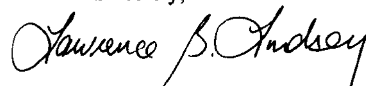
We believe one aspect of your report deserves additional comment. That relates to the way it deals with the seemingly unavoidable tension between the sometimes conflicting desires for certainty, through the provision of precise rules, and the need for flexibility in implementation to take account of unique local circumstances. As you suggest, this problem was identified in various ways by the industry, the community groups, and the agencies, themselves. Generally speaking, the draft report indicates that finding the right level between these two goals in the examination process under the new regulation is one of the biggest challenges facing the agencies, and we would agree.

Obviously, striking the right balance between consistency and flexibility is a fundamental issue and was a central concern to the agencies' efforts to revise the regulation. As the draft notes, early drafts of the regulation contained more quantifiable measures of performance in an attempt to bring more objectivity and, therefore, consistency to bear in the process. As the draft report also notes, however, many in both the banking industry and among community development groups were opposed to this level of quantifiable certainty.

In response, the final regulation was written with the notion foremost in mind that use of examiner discretion is essential to the CRA examination process. Consequently, judgmental results are inevitable. The GAO's draft's prescription for addressing the potential for inconsistency is to further refine the process as we provide examiner guidance and training, and that is our goal as well. However, the draft does not address the issue of where on the spectrum between complete flexibility and complete consistency the balance should be struck. We take this as confirmation of the difficulty of the issue, and recognition that the matter does not lend itself to sharp definition, given the conflicting objectives. We raise the point simply to observe that, in our view, the GAO report should not be read to suggest that a solution to the problem has either been overlooked by the agencies to date or is likely to be identified to everyone's satisfaction in the future. As long as CRA remains on the books we are likely to be faced with this core dilemma and it might be well for the GAO to acknowledge this directly in the report.

Again, the report is a thoughtful exploration of the CRA reform process, and the recommendations are consistent with our analysis of what needs to be done to successfully complete this process.

Sincerely,



Comments From the Federal Deposit Insurance Corporation

FDIC
Federal Deposit Insurance Corporation
Washington, DC 20429

Office of the Director
Division of Compliance and Consumer Affairs

August 29, 1995

Mr. James L. Bothwell
Director, Financial Institutions
and Market Issues
General Government Division
United States General Accounting
Office
Washington, D.C. 20548

Dear Mr. Bothwell:

This letter provides our comments on the General Accounting Office's (GAO) draft of the proposed report entitled, Community Reinvestment Act: Challenges Remain To Successfully Implement CRA (GAO report). We appreciate the opportunity to provide comments prior to your finalizing the report.

The GAO report broadly outlines several issues and concerns about the implementation of the revised rule that was published May 4, 1995. Many of the issues are those that motivated the President to request the agencies to revise the CRA supervisory process, including development of the revised rule. These, as well as many other issues, were studied and debated as we went through the extensive process of developing the final rule. We believe most of these issues have been adequately addressed in the revised rule. Others will be addressed through examination procedures and training of examiners.

A few major issues noted in the draft report, however, warrant specific comment:

Consistency in the Examination Process

The revised rule provides for a performance driven evaluation that allows examiner judgment and recognizes differences in sizes and types of financial institutions. This approach is designed to provide greater standardization and fairness in the examination process while allowing financial institutions more flexibility in complying with the regulation. Consistency in the examination process, inter- and intra-agency, is a major priority for financial institution regulators. Examination procedures are being developed through an interagency process to eliminate inconsistency in the examination process. Intensive week-long interagency training sessions, which begin in mid-September, will focus on consistent enforcement and interpretation of the revised rule. Every effort is being made by regulators to provide a standardized framework for CRA examinations industrywide. However, examiner

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judgment remains critical to implementation of the rule as each community and each institution has unique characteristics that must be considered.

Congressional Action Prior to Implementation of the Final Rule

The GAO report suggests that Congressional action may be necessary to address industry and consumer concerns about the implementation of the CRA. This suggestion, before the revised regulation becomes effective, does not appear to acknowledge extensive interagency efforts to more effectively implement the CRA through the new rule. With uniform examination procedures and comprehensive interagency training, the concerns of the industry and community groups are expected to be addressed. For this reason, Congressional action prior to implementation of the revised rule may be premature in that it would not allow the agencies the opportunity to address real or perceived issues in the implementation process. Revisions to the CRA, not prompted by actual agency, industry, and community group feedback on the effectiveness of the new rule, could engender continuing speculation on the viability of the CRA as a whole and its implementation through the revised regulation.

Public Disclosures for CRA Performance Evaluations

The GAO report recommends improving public disclosures for CRA performance evaluations (PEs). Developing a uniform and accurate PE is a central feature of the interagency efforts to implement the final rule. Our interagency training will emphasize the need to fully support conclusions and performance ratings in the PEs.

Examination Schedule and Staffing Considerations

Implementation of the new CRA examination procedures is not expected to increase the FDIC's resource needs for examinations. Examiners will be analyzing performance data. However, analyzing data has always been a part of the CRA evaluation. The elimination of the examination of the process oriented factors, coupled with use of data integration software that the FDIC is currently implementing, should, in fact, reduce the overall time devoted to CRA evaluations.

Again, thank you for the opportunity to comment. If you have any questions, please contact Bobbie Jean Norris of my staff at (202) 942-3090.

Sincerely,

Paul L. Sachtleben
Director

Comments From the Office of the Comptroller of the Currency

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

September 20, 1995

Mr. James L. Bothwell
Director, Financial Institutions and Markets Issues
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Bothwell:

We have reviewed your draft audit report titled Community Reinvestment Act: Challenges Remain to Successfully Implement CRA. The report was prepared in response to Congressional requests for the GAO to identify problems in implementing the Community Reinvestment Act (CRA) and to assess how effectively implementation issues will be addressed by regulatory reform efforts. The audit found that affected parties agree on major problems but the concerns and solutions of these parties differ; revised regulations address some, but not all, major problems; challenges to successful implementation of regulations remain; and industry initiatives have overcome some barriers to community lending. The report suggests that the Congress consider revisiting and revising the CRA if concerns raised by the industry and the public persist after the regulators have implemented the revised regulations.

General Comments

The Office of the Comptroller of the Currency (OCC) believes that, for the most part, the GAO report represents a substantial achievement in reviewing the problems that gave rise to the revised CRA regulation. As the report acknowledges, banks and community groups often have contradictory concerns about CRA that cannot be reconciled. We believe that the text of the report supports a conclusion that the revised regulation addresses all of the problem areas and conflicting views that can be addressed within the regulatory framework.

Having reviewed the more than 4,000 comment letters received by the regulators on two proposed CRA regulations, the OCC agrees with the report's implicit conclusion that there can never be complete agreement between the affected parties of the CRA. Readers might find it helpful to have that point included in the discussion of matters for consideration in the report's executive summary.

Further, as the text of the report recognizes, many existing problems and concerns can only be addressed through implementation of the revised CRA regulation. The OCC concurs with the GAO's suggestion that Congress defer consideration of revisiting or revising the statute until after the regulators have fully implemented the revised regulation. However, the GAO does not specify anywhere in the report a time frame to assess the adequacy of the rule implementation. This leaves the implementation effort open to potential criticism or charges of failure before it has run its course. It would be helpful if the GAO acknowledged that no objective assessment of the effectiveness of the new rule is possible until a full examination cycle has been completed under the rule's new procedures.

See comment 1.

Implementation of the Revised Regulation

Guidance and Training

The report consistently implies that the presence of discretion in the examination process is a cause for concern and corrective action. Although one of the goals of the new rule is to reduce the use of discretion that has contributed to inconsistency and uncertainty in the CRA examination process, differences in the circumstances of individual banks require that examiners be able to exercise some judgment and flexibility within clearly defined parameters. Complete reliance on inflexible standards to assess all banks' CRA performance could result in credit allocation and unfair or inaccurate CRA ratings for many banks. The report should acknowledge the value of properly exercised examiner discretion.

See comment 2.

The report correctly stresses the importance of comprehensive examiner training to improve implementation of the CRA. However, there is no reason to believe that the need for examiner training will increase as a result of the new regulation because the revised rule provides answers to previously unanswered questions, greater definitional clarity, and increased guidance to examiners on what constitutes adequate bank compliance. Further the agencies are addressing the need for comprehensive, consistent examiner training in a series of interagency examiner training sessions planned for September through December 1995. These training sessions will include examiners from each of the four federal regulators and some state regulatory agencies as well.

Performance Information

See comment 3.

Currently, HMDA data for all institutions are submitted to the Federal Reserve, which processes the data for all the agencies, including checking for inaccuracies in the data. Accordingly, the Federal Reserve is the only agency that requires institutions to resubmit HMDA data when errors are found. However, under the new joint CRA examination procedures currently being tested, all the agencies will check the accuracy of all new data proposed to be reported.

The new examination procedures will also provide for standardized and more detailed performance evaluations for the public. New performance evaluation formats will be tailored to the type of supervised institution under evaluation (i.e., community bank, large retail bank,

- 2 -

wholesale bank, or limited purpose bank), and will include separate assessments for different states and areas within states as appropriate.

Resource Requirements

See comment 4.

The report states that the new regulations will increase the amount of resources needed to effectively complete examinations. At present, the OCC does not expect the revised regulation to increase resources needed to complete examinations. In fact, the OCC believes the new regulation, when fully implemented, could require fewer resources. Examiners will have to analyze performance data, but examiners who were performing comprehensive examinations under the existing regulation were already doing so. Further, the expected use of CRA analysis software will substantially reduce the time necessary for examiners to perform that analysis. In addition, the small institution examination, which applies to approximately 80 percent of banks and thrifts, will require fewer examiner resources and will further offset any additional resources that may be required for examinations of large institutions.

Regulatory Enforcement of CRA

Corporate Applications

The report should characterize OCC's actions on corporate applications as **conditions** rather than commitments. The typical condition we impose is worthy of discussion in the report, because it translates into a denial for a national bank that does not improve its CRA performance up to the Satisfactory or Outstanding level. The typical condition requires that, prior to consummation of the transaction subject to the application, the bank must receive a new CRA examination that results in the bank receiving a Satisfactory or Outstanding CRA rating. Thus, for example, a bank with a Needs to Improve CRA rating that applies for a branch, if there are no other concerns, will normally receive conditional approval. The condition will require that the bank upgrade its CRA performance, and have OCC confirm that it has done so in an examination, before it can open the branch. If the bank does not improve actual performance to a satisfactory level that is substantiated by an examination, it cannot open the branch. This condition is routinely imposed on banks that file expansion applications and have Needs to Improve CRA ratings.

The report does not make clear that a bank's CRA rating has a significant correlation with the OCC's decision on an application. Just as most expansion applications from banks with Needs to Improve CRA ratings received conditional approvals, most applications from banks with Satisfactory or Outstanding CRA ratings are approved without CRA conditions.

Enforcement Actions

See comment 5.

The draft report somewhat overstates the impact of the Justice Department opinion on CRA's enforceability. Justice did conclude that the agencies lack authority under CRA to provide by regulation that financial institution that do not meet the credit needs of their communities may be subject to enforcement actions under 12 U.S.C. 1818. This conclusion was based on the fact

- 3 -

that CRA does not impose an obligation to meet community credit needs on financial institutions. However, Justice also concluded that the agencies may promulgate regulations placing reasonable requirements on financial institutions to enable the agencies to assess their performance in helping to meet the credit needs of their community. Because these regulatory requirements are authorized by CRA, they are enforceable under 12 U.S.C. 1818.

Barriers to Community Reinvestment Lending

Transaction Costs

See comment 6.

Chapter 4 of the report discusses transaction costs of CRA-type loans. The conclusion of the section is that higher transaction costs of "community loans" result in less profit to banks. It is true that loans with lower balances often have equivalent, and sometimes higher transaction costs, in relative terms, than do larger loans. However, the GAO report leaps from transaction costs to profitability and in doing so skips over all other financial factors that affect the profitability of individual loans and loan portfolios. Assessing the profitability of community loans requires a more sophisticated model that takes into account all financial factors. It is misleading to suggest that the economic value of community loans begins and ends with transaction costs.

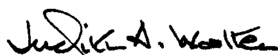
Safety and Soundness Policies

See comment 7.

Chapter 4 also discusses safety and soundness concerns of CRA loans. The GAO observes that, because safety and soundness examiners do not understand many of the techniques used in the credit risk management of community lending, financial institutions are required to set aside loan loss reserves that bankers, community groups and even compliance examiners may view as unnecessary. No support is provided for this claim.

Thank you for the opportunity to review and comment on the draft report. We provided technical comments to the evaluators separately.

Sincerely,



Judith A. Walter
Senior Deputy Comptroller for Administration

- 4 -

The following are GAO's comments on OCC's letter dated September 29, 1995.

GAO Comments

1. OCC concurs with us that Congress defer revisiting or revising the CRA statute until after the regulators have fully implemented the revised regulations, but OCC points out that we are not specific about how much time is sufficient for full implementation. We agree with the regulators that they have made extensive efforts to address the diverse concerns raised about the effectiveness of CRA, but also recognize that if Congress identifies issues of concern, it may want to revisit CRA to determine whether community reinvestment objectives are being satisfied. We believe that the results of the regulators' planned evaluation of the revised regulations 5 years after their implementation could be useful for any reconsideration of CRA issues by Congress, but also agree with OCC that the completion of a full examination cycle would be needed for Congress to objectively assess the adequacy of the revised regulations to address industry concerns and Congress' mandate for community reinvestment. We have, therefore, modified our matter for Congressional consideration to reflect the need for a sufficient amount of time to implement the revised CRA regulations.

2. OCC suggested that we acknowledge the value of properly exercised examiners' discretion and expressed the belief that the need for training has not been heightened as we report. On page 60 of our report, we recognize the fact that examiner judgment will continue to play an important role in CRA evaluations, and we call for clear guidance and comprehensive examiner training to achieve consistency in examinations. Also on page 60, we changed our discussion on training from its need being "heightened" to "created" to ensure the revised CRA regulations are consistently implemented. Unless examiners understand how to interpret and apply the guidance, given differences in banking activities and community needs, examination consistency may not otherwise be achieved.

3. On performance information, OCC pointed out that only FRB received and checked HMDA data accuracy but that under new joint CRA examination procedures all agencies will check data accuracy. Our discussion of the regulators' efforts to ensure that the institutions they supervise maintain and submit accurate HMDA data is based on our understanding that the regulators are required to do this during compliance examinations. We believe that the regulators' experience in this area suggests a need to

establish clear guidance to examiners for ensuring accurate data maintenance and reporting by institutions, which OCC suggests will be provided for in the new joint CRA examination procedures.

4. OCC does not, at present, expect increased examiner resource requirements to be needed to implement the revised regulations due to various efficiencies being introduced to the examination process. We believe that more sophisticated CRA analysis software and training are examples of the resources required to assist agencies in successfully implementing an efficient CRA examination process. We also agree that over time, experience with the revised regulations could result in some reduction in the time required to do CRA examinations, but at this time it is unclear what effect this will have on total resources dedicated to CRA examinations, compared with what is required under the current regulations and considering the additional responsibilities placed on examiners.

5. OCC indicated in its comments that we overstate the impact of the Department of Justice opinion on CRA's enforceability. Our discussion describes the Justice opinion, which resulted in the regulators removing from the revised regulations provisions to use formal enforcement actions for CRA compliance.

6. OCC pointed out that transaction costs and profitability for community lending require sophisticated models that take into account all financial factors. We agree with OCC and deleted our statement on page 70 about transaction costs and profitability since it did not reflect all relevant financial factors. The primary purpose of our discussion of transaction costs is to present some bankers' concerns that such costs affect institutions' profitability and, thereby, serve as a barrier to community reinvestment lending. We believe a sophisticated model that takes into account all financial factors affecting the profitability of community loans can best be developed by a bank that knows the facts and circumstances specific to the products and services it offers to prospective borrowers.

7. OCC questioned the basis for our claim that bankers are required to set aside additional loan loss reserves for community lending based on examiners' assessment of the safety and soundness of such loans without fully understanding the related credit risk. The discussion pertaining to loan loss reserves as it relates to credit risk management represents the opinions or views of some bankers and community groups. On pages 70 and 71 of this report, we attribute this discussion to these parties as a

safety and soundness concern about CRA lending, and on page 71 we state that we did not independently verify the accuracy of these claims.

Comments From the Office of Thrift Supervision

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6000

September 12, 1995

Mr. James L. Bothwell
Director, Financial Institutions
and Markets Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Bothwell:

Thank you for your letter dated August 7, 1995 inviting comments on a draft of the GAO's report entitled Community Reinvestment Act: Challenges Remain To Successfully Implement CRA. Enclosed is an Office of Thrift Supervision staff paper containing suggestions that we believe will strengthen the presentation of information in the draft report.

Much of the draft report discusses the challenges still facing the agencies as we proceed with our work to implement the recently promulgated Community Reinvestment Act (CRA) regulations. We agree that those challenges exist. We intend to meet them through interagency initiatives currently underway and, where appropriate, our own initiatives.

If you have any questions regarding our suggestions or comments, please contact Larry A. Clark at (202) 906-5628.

Sincerely,

Timothy R. Burniston

Timothy R. Burniston
Assistant Director
for Compliance Policy

Enclosure

OTS Staff Suggestions and Comments on Draft GAO Report:
"Community Reinvestment Act: Challenges Remain To Successfully Implement CRA"

Executive Summary

Now on p. 3.
See comment 1.

Page 6 states that three difficulties hindered past CRA implementation efforts and will likely continue to challenge regulators: (1) differences in examiner training and experience levels; (2) insufficient information to assess CRA performance; and, (3) insufficient time for examiners to complete CRA examinations. A statement to the effect that the regulators acknowledge these difficulties and are working together to address them would, in our opinion, round out the discussion.

Now on p. 5.

Page 9, as well as subsequent sections of the draft report, indicates that the revised CRA regulations address some of the major problems associated with CRA but do not wholly satisfy the "often contradictory positions of bankers and community groups." One of the other messages contained in the report is that not all of these problems can be addressed through regulations. An example of one such problem that the agencies could not address through regulation was the inclusion of specific provisions related to the use of formal enforcement measures (Cease and Desist Orders and the like) to address performance-related CRA weaknesses in financial institutions. As the GAO is aware, the U.S. Department of Justice opined that the CRA statute does not support the use of such actions in this context. Consequently, we suggest that the draft report develop a clearer explanation of the problems addressed and not addressed by the revised regulations so the reader will not conclude that the agencies should have, but did not, address those problems.

See comment 2.

Now on p. 6.

Page 10 states that the regulations "have increased examiner responsibilities, heightened the need for comprehensive examiner training, and increased the amount of resources needed to effectively complete examinations." We believe it may be somewhat premature to make these assertions with absolute certainty for the following reasons:

See comment 3.

- Initially, examination time under the revised regulations might increase. But over a longer period, examination time may actually decrease as institutions and the agencies adjust to the new regulatory requirements and better understand expectations.
- Once we are beyond the initial examiner training phase of our overall implementation effort, we are hopeful that the breadth and depth of the revised regulations and examination procedures will lead to a reduction in the time needed for training. Although the revised regulations still call for examiner judgment, they provide for reasoned conclusions to be drawn from objective data under a clearer set of performance standards.

- It is not readily apparent to us at this early stage that the new regulations will necessitate a significant increase in examiner resources. In fact, we are hopeful that resource requirements will remain reasonably constant and may even decrease over time, once examiners are provided with detailed guidance and enhanced examination tools and the industry adjusts to the revised regulations. The confluence of new examination procedures that emphasize performance over paperwork, more sophisticated software programs to help examiners analyze CRA performance, the streamlined small institution examination, and the strategic plan option, may serve to reduce resource requirements or, at least, to offset any increase resulting from other factors.

For these reasons, the GAO may wish to qualify the draft report's existing language or expand the discussion along the lines noted above. We also believe it is important for the report to indicate that the agencies are aware of, and are addressing those issues.

Now on p. 9.

See comment 4.

Page 17 of the draft report suggests that Congress may want to consider revisiting and revising the CRA statute if the concerns raised by the industry and community organizations persist after the revised regulations are implemented. We believe it is important to note that the agencies have already agreed to conduct a full review of the final rule in the year 2002, five years after it is fully implemented (See, 60 Fed. Reg. 22177).

Chapter One

Now on p. 19.

See comment 5.

Page 26 contains a subsection entitled "The Fair Lending Laws are Related to and Overlap With CRA." This subsection may, in our opinion, leave the reader with an inaccurate impression. We believe CRA and the fair lending laws complement one another rather than overlap. Evidence of prohibited discrimination and other illegal credit practices is considered when formulating an institution's CRA rating. This is because an institution that is violating the fair lending laws should not be considered to be helping to meet the credit needs of its entire community in an acceptable manner. The revised CRA regulations and the draft implementing examination procedures do not attempt to determine whether discrimination exists, however. That determination is made in the fair lending portion of a compliance examination, which is generally conducted at the same time as a CRA examination.

We do not agree with the first sentence in this subsection that states that the enforcement of CRA and the fair lending laws "by the regulators often overlaps." The same examiner may review for compliance with the fair lending laws and CRA during the same examination, but the tools available to the agencies to initiate formal enforcement actions are very different. As you note elsewhere in the draft report, CRA enforcement is limited to the applications process. Fair lending laws are enforced under the agencies' authority contained in 12 USC 1818.

- 3 -

Now on page 21.

See comment 6.

Page 31 contains a discussion of the OTS specialized compliance examination program that does not accurately reflect the development of that program. We suggest the first full paragraph be revised to read: "OTS established its specialized compliance examination program in 1989. Under this program, which was fully implemented in 1990: (1) compliance examinations are conducted by specially trained and career professional staffs in the five OTS regional offices; (2) a separate compliance examination report is presented to an institution's board of directors; and (3) a separate rating system evaluates an institution's overall level of compliance and triggers the frequency of subsequent examinations."

The sixth sentence on page 41 should be revised to read: "OTS does not typically approve applications with commitments but instead will conditionally approve applications, if appropriate (emphasis added).

Now on p. 33.

See comment 7.

Page 46 notes that enforcement actions taken against institutions for CRA violations have been issued with their consent, and then states that the regulators have not taken more stringent actions thus far. This statement could leave the impression that the agencies should have taken more stringent actions. We do not agree. As the draft report points out, such further action would be taken only in the event the institution did not comply with the initial enforcement action. We suggest modifying the sentence to indicate that the regulators have not considered it necessary to take any more stringent actions against institutions already subject to a formal enforcement action. As an alternative, the sentence could be omitted since we are not sure what value it adds to the discussion.

Now on p. 33.
See comment 8.

The last sentence on page 46 states that OTS does not currently track information on enforcement activities that include CRA violations. This is incorrect; we do track that information and have supplied it to the GAO. We suggest revising the sentence to read: "OTS reported that 8 of the enforcement actions it issued in 1993 included provisions related to CRA violations."

Chapter Three

Page 89 discusses the number of examiners committed to the compliance function by each respective agency. To ensure equitable treatment between the agencies, we suggest the last sentence in the first paragraph on page 89 be revised to read: "OTS has a separate compliance examination staff with about 105 compliance examiners, which represents a 21 percent increase in staff allocated to the compliance program since 1991."

Page 94 addresses agency supervisory procedures for late or inaccurate HMDA filings. Since the GAO report was drafted, OTS has adopted specific guidelines for the imposition of Civil Money Penalties to address HMDA data problems as well as problems with other financial reports submitted to the agency. Therefore, we suggest adding the following to the discussion on page 94: "Similarly, OTS recently adopted guidelines for the assessment of

Civil Money Penalties against institutions that submit late or inaccurate HMDA data. Having identified candidates for Civil Money Penalties, OTS has begun a final review of individual HMDA reporters as a first step toward assessing penalties."

See comment 9.

Page 98 notes that "FDIC, OTS, and OCC have not been able to examine all of their banks within a 2-year timeframe." We are concerned that this statement may be misleading and, further, that it does not sufficiently differentiate the performance of the agencies in the same way that is done in other sections of the report. Under OTS policy, the timeframe for conducting CRA examinations is generally driven by the rating assigned at the previous examination, with a range of six months to two years depending upon an institution's performance. Thus, a more accurate measure for determining adherence to established frequency guidelines is the extent that required examinations were completed within established timeframes. OTS completed 96 percent of its required examinations in 1992, 91 percent in 1993, and 89 percent in 1994.

Page 101 begins a discussion of GAO's recommendations. We agree with the four recommendations and believe the draft report should note that we have already initiated measures to implement them, some in conjunction with the other agencies. Because the CRA reform effort has been ongoing for many months, we recognize the difficulty involved in keeping abreast of the agencies' most recent developments when preparing a report such as this one. Consequently, we offer for your consideration some of the steps taken with respect to the four recommendations since we reviewed your previous draft report. We believe their inclusion would strengthen this report:

- Develop or revise regulatory guidance and training programs. First, an interagency group has completely overhauled existing examination procedures, including the public CRA evaluation report. The agencies plan to release this information to the public once they have received final internal approval. Second, interagency training on the revised regulations and procedures will be conducted for approximately 1,000 personnel from the agencies, beginning September 18. Among other things, this training will emphasize consistency in examinations between and among the agencies.

- Improve data accuracy. The CRA implementation program will address data accuracy. The agencies are looking at measures such as providing input software to the industry to help ensure that accurate data is submitted to the agencies. In addition, as we indicated on page 3, OTS has issued a new policy on actions it will take relative to institutions that submit late or inaccurate data.

- Improve disclosures in publicly available evaluation reports. As noted above, the form and content of CRA public evaluations is being revised as part of the larger effort to revise examination procedures, and will be included in the upcoming interagency training. The agencies fully intend to meet

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existing statutory mandates that call for conclusions in public evaluations to be supported by relevant facts and data.

- Assess agency resources and examination techniques. We will be monitoring our compliance resources in light of the revised CRA regulations. We believe, however, that we should gain some actual examination experience under the revised regulations before we make any adjustments to our staffing levels or compliance examination program.

Finally, the discussion of the OTS community affairs programs on page 140 states that six experienced senior staff members were appointed in February 1994. That number should be five, representing one Community Affairs Liaison in each of our five regional offices.

# # # # #

The following are GAO's comments on OTS' letter dated September 12, 1995.

GAO Comments

1. OTS suggested we add a statement to round out the discussion on page 3 of the executive summary that the regulators acknowledge these three challenges and are working together to address them. We believe OTS' point is made through the agency responses and our comments to those responses.

2. OTS pointed out that various sections of the draft report indicate that not all industry problems can be addressed through regulations and suggested we provide a clearer explanation of the problems addressed and not addressed in the revised regulations. We acknowledge, on page 54 of the report, that the regulators' draft regulations included provisions to use formal enforcement actions, such as cease and desist orders, to enforce CRA compliance. However, we also point out that in December 1994, the Department of Justice issued an opinion that CRA did not give regulators legal authority to use formal enforcement actions to enforce CRA. We do not take issue with the regulators' proposal nor do we take issue with Justice's opinion. The result, however, is that the bankers and community groups concerns about CRA enforcement were not addressed in the final regulations.

3. OTS suggested that our statement that the revised regulations have increased examiner responsibilities, heightened the need for comprehensive examiner training, and increased the amount of resources needed to effectively complete examinations may be premature due to the efforts OTS is undertaking to address those issues. In our discussion of resource requirements under the revised regulations, we point out that examiners have additional responsibilities which may increase OTS' examiner resource needs. We believe that more sophisticated software, training, and other similar tools are examples of the additional resources that will be required if regulators are to successfully achieve the anticipated efficiencies in CRA examinations. The regulators are initiating action to implement new procedures and make their CRA compliance systems more efficient. However, it is not clear what impact such action will have on examination time and resource needs.

4. OTS pointed out that the regulators have agreed to conduct a full review of the revised regulations in the year 2002, 5 years after they are fully implemented. We believe that the regulators' plan to conduct a full review

of the revised regulations is a positive step. The results of this review could be useful for any reconsideration of the CRA by Congress.

5. OTS expressed concern over our statement on page 19 that the fair lending laws overlap with CRA. Our discussion of the fair lending laws and their relationship to CRA has been modified. We determined that the use of the term "overlap" may distract the reader from the major point of the subsection, which is to point out that the objectives of the laws and some of the tools used to evaluate compliance with them are similar.

6. OTS stated that our discussion of the OTS specialized compliance examination program did not accurately reflect the development of that program. Discussion of the OTS compliance program on page 21 has been changed to reflect the suggested clarification of the program's development.

7. OTS suggested that our discussion on page 33 of the regulators' use of enforcement actions for CRA violations implies that the regulators should have taken more stringent actions. The purpose of our discussion of enforcement actions is to objectively present the facts. It does not attempt to make an assessment of what regulators should do.

8. OTS pointed out that we incorrectly stated that it does not track information on enforcement actions that include CRA violations. We changed our discussion of OTS' use of enforcement actions for CRA to reflect the information provided.

9. OTS was concerned that our discussion, on page 63, of the regulators' success in examining their institutions for CRA compliance was misleading and did not sufficiently differentiate the performance of the regulators in the same way as was done in other sections of the report. Our discussion of the regulators' success in examining institutions within a 2-year time frame was meant to make the point that they have not been successful in examining all of their institutions within their established time frames under the current CRA regulations and that this problem could worsen under the revised regulations in light of increased examiner responsibilities. The figures provided by OTS in its comments, that it completed 96 percent of its required examinations in 1992, 91 percent in 1993, and 89 percent in 1994, in our view, support this point.

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