NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

# Testimony of the National Community Reinvestment Coalition (NCRC)

## Senate Committee on Banking, Housing and Urban Affairs

## On

## "Examination of the Gramm-Leach-Bliley Act Five Years After its Passage"

**Submitted by**

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# Gramm-Leach-Bliley – Communities Cannot Afford Another Five Years

Good morning Chairman Shelby and Ranking Minority Member Sarbanes. I am honored to be testifying this morning and representing the views of community organizations regarding a law that revolutionized the banking industry. My name is John Taylor; I am the President and CEO of the National Community Reinvestment Coalition (NCRC).

NCRC is the nation's economic justice trade association of 600 community organizations and public agencies dedicated to increasing access to capital and credit for minority and working class communities. NCRC was founded to protect and strengthen the Community Reinvestment Act (CRA) since CRA increases access to credit by insuring that banks have an affirmative obligation to serve all communities in which they are chartered.

It is particularly fitting that NCRC is testifying today because the Gramm-Leach-Bliley Act (GLBA) has directly and indirectly weakened CRA. If the flaws of GLBA are not fixed soon, Americans' access to credit and capital will diminish dramatically. The United States' banking system is the envy of the world. In great part, this is directly attributable to our extensive regulatory oversight, which ensures adequate capital reserves, safety and soundness, and fair and equal access to credit. GLBA has failed to ensure that regulations relating to fair and equal access to credit and capital have kept pace with safety and soundness regulation.

In order for fair lending regulation to keep pace with the changes in the financial industry unleashed by GLBA, CRA must be updated and applied to more institutions as one of GLBA's authors, Rep. James Leach, supported. In particular, community reinvestment obligations must apply to all affiliates of holding companies and to lending institutions that are not part of holding companies. Data disclosure requirements also must be enhanced. In addition, the harmful aspects of GLBA that must be repealed immediately are CRA Sunshine and the reduction in frequency of small bank CRA exams.

**CRA Sunshine**

The one area of strong consensus among community leaders and the lending industry is that the so-called CRA sunshine requirements of GLBA must be repealed. The CRA sunshine provision sought to quantify the amount of bank dollars granted to community groups. It was believed that such grants were used for operating support rather than for the direct provision of financial services and products. Five years later, we now know that the facts do not support this theory.

In the fall of 2002, NCRC released a report called *CRA Sunshine Reveals Benefits of Bank-Community Group Partnerships*. In this report, NCRC used the Freedom of Information Act (FOIA) to obtain 707 CRA agreements made during 1999 through 2001 subject to the CRA sunshine disclosure requirements. As defined by GLBA, a CRA agreement is a commitment in writing by a bank to a non-governmental enterprise exceeding $10,000 in grants or $50,000 in loans. If the non-governmental enterprise such as a community group commented to the bank or a regulatory agency about the CRA performance of the bank, the bank and community group must disclose the initial CRA agreement to federal regulatory agencies and must disclose subsequent expenditures of funds received by the community group under the agreement.

NCRC found that of the $3.6 billion in the 707 agreements, only $11.8 million or less than three tenths of one percent was grants or other funding for community groups (I have submitted a copy of our report for the record). These grants supported the vital missions of nonprofit homeless shelters, housing developers, and other neighborhood-based groups engaged in housing and economic development. The grants also helped lenders meet community credit needs and increase their lending, investing, and services in low- and moderate-income neighborhoods, as required by CRA.

CRA sunshine frustrates the essential purpose of CRA, which is to ensure that banks affirmatively meet credit needs. Further, CRA sunshine increases paperwork burden on banks and community groups with no tangible net benefit to the public. The repeal of this ill-advised and useless section of GLBA must occur immediately.

**Less Frequent Exams for Small Banks**

Another direct harm of the GLBA is the reduction in frequency of small bank CRA exams. Under GLBA, small banks with assets of under $250 million are examined only once every four years if they have a Satisfactory CRA rating and once every five years if they have an Outstanding rating.

When small banks are examined that infrequently, they have little incentive to affirmatively and continually adhere to their reinvestment obligations. They will have reduced incentives to make sufficient numbers of loans to low- and moderate-income borrowers during the entire four or five year time period between exams, and may only focus their efforts during the last year or two before exams. It is commonsense that infrequent examinations lead to infrequent commitments to reinvestment, while more frequent examinations lead to more consistent commitments to reinvestment.

NCRC's 600 community organization members have reported that less frequent exams have reduced the amount of lending by small banks to low- and moderate-income borrowers. NCRC would have preferred to present quantifiable evidence to the Committee today, but we found out about testifying a mere two days before our testimony was due. We call upon Congress to commission a comprehensive study assessing the impacts of the CRA exam stretch-out on lending to working class Americans.

This reduction in frequency responded to industry complaints about so-called burden of CRA exams. What continues to astonish NCRC, however, is that the federal regulatory agencies appear to accept industry arguments about burden although the federal regulators themselves have yet to conduct their own comprehensive cost-benefit analysis regarding CRA's application to small banks.

The lack of a thoughtful cost-benefit analysis is readily apparent in the GLBA stretch-out of the small bank CRA exam schedule. The small bank exam is a quick and straightforward exam that focuses on lending and dispenses with the investment and service test of the large bank exam. For any small bank that is true to the mission of a "community banker," the small bank CRA exam is a relatively easy exam. If members of this committee actually looked at small bank CRA exams, they would be astonished that all of this noise about burden can be generated by exams that rarely exceed 10 pages in length.

Despite the brevity of the exam, its importance cannot be under-estimated. In too many poor rural communities, the CRA exam process is the only mechanism that holds small banks accountable for serving low- and moderate-income borrowers and communities. Smaller banks do not merge nearly as often as their larger counterparts, rendering the merger application process a seldom-used avenue for holding smaller banks accountable. Community groups are also not as prevalent in smaller rural communities as in large cities. Thus, the major mechanism for holding small banks accountable is the CRA exam.

Yet, GLBA has greatly diminished the most important means of accountability of small banks. Instead of once every two or three years, CRA exams for small banks now occur once every four or five years. In reality, the exams are probably less frequent since scheduled exams often get cancelled and re-scheduled. In too many cases, the result of the stretch-out of CRA exams means that small banks may be examined only once or twice in a decade as opposed to three or four times.

In their scanty amount of analysis on small bank burdens, the federal banking agencies have found that CRA regulations “impose a modest information collection burden on small institutions – an average of 10 burden hours per institution per year.”[1] In addition, the relatively few trade articles on small bank CRA exams also reveal few complaints about burden. In fact, an American Banker article shortly after the CRA regulation reform in 1995 is entitled “Small Banks Give Thumbs-Up to Streamlined CRA Exams.” In this article, small bankers are quoted as saying that the exams were not burdensome and that CRA examiners took less than one day of their time.[2]

The available evidence suggests minimal burden, but great benefits due to CRA exams. But since the 1995 regulatory changes to CRA exams, the only action by policymakers has been to reduce the rigor of CRA exams. First, GLBA reduces the frequency of small bank CRA exams. Now, the regulatory agencies wish to apply the streamlined small

[1] Federal Register, May 28, 1999 (Volume 64, Number 103), pages 29083 through 29086

bank CRA exam to more than 1,000 additional institutions. Recently, the Senate Banking Committee asked NCRC to document the damage caused by this proposed change; NCRC eagerly responded, documenting in great detail the loss in community reinvestment due to this latest proposal.

Mr. Chairman, it is clear to us that CRA is not burdensome and has greatly benefited both banks and community groups by increasing the number of profitable loans, investments, and services made to low- and moderate-income communities. We urge you to halt and reverse the trend of CRA de-regulation. A place to begin would be to repeal the stretch-out of small bank CRA exams.

**Have and Maintain Satisfactory CRA Requirement**

GLBA added a requirement that bank holding companies must ensure that all of their affiliates pass CRA exams (at least Satisfactory ratings) in order to be allowed to merge with non-bank financial institutions and take advantage of the new powers under GLBA. This requirement sends a signal that banks must comply with their obligations under

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[2] Small Banks Give Thumbs-Up To Streamlined CRA Exams, Jaret Seiberg of the American Banker, Thursday, February 1, 1996.

CRA if they wish to enjoy the privileges afforded to them by GLBA. While well intentioned, this requirement has not been applied in one case to our knowledge. A major reason for this is less than two percent of banks and thrifts fail their CRA exams, and the great majority of failing banks are smaller institutions less likely to merge or engage in non-bank financial business authorized by GLBA.

In fact, the Federal Reserve Board had one opportunity in a large and controversial merger to apply this requirement, but arbitrarily and capriciously adopted a narrow reading of the GLBA requirement. During 2000, Citigroup acquired the notorious lender Associates First Capital Corporation. A subsidiary of Associates, Associates National Bank, had a Needs-to-Improve CRA rating. Once Citigroup owned Associates National Bank, it would have had an affiliate with a Needs-to-Improve CRA rating, rendering it ineligible for GLBA powers and privileges. Confronted with the first opportunity to enforce the “Have and Maintain” requirement, the Federal Reserve punted. The Federal Reserve reasoned that the GLBA requirement applied only to the holding company that is the acquirer, not to the institution being acquired. Yet, this hair-splitting distinction is not present in the GLBA Act.

**Strengthening the "Have and Maintain" Requirement**

The intention of the "Have and Maintain" requirement was to ensure that institutions engaging in large scale mergers and embarking on broad new powers adhered to their CRA obligation to serve all communities, including low- and moderate-income ones. Unintentional loopholes have subverted Congress' ambitious and laudatory intention. Congress must close this loophole by specifying that the "Have and Maintain" requirement must apply to the institution being acquired as well as to the acquirer.

Furthermore, since failing ratings are so rare, the "Have and Maintain" requirement must be strengthened by imposing significant affirmative obligations on institutions that wish to merge. NCRC urges you to consider requiring merging institutions to submit a CRA plan with their merger application.

In the past year, merger activity has reached a frenzied pace and has included the largest mergers in history. The Bank of America and Fleet merger and the JP Morgan Chase and Bank One merger will create institutions with more than $1 trillion dollars in assets. Despite the incredible magnitude of these and other recent mergers, the Federal Reserve Board does not require any meaningful CRA plan from merging institutions. The CRA "convenience and needs" discussions in the merger applications usually consist of one or two page boasts about how great the banks' CRA performance are. The presentations also usually contain predications that the banks' CRA performance will improve once they get bigger after mergers. Yet, NCRC has too often documented with HMDA and CRA small business lending data that the amount of loans decrease dramatically after large mergers. In too many cases, banks close branches and lay-off loan offices in order to achieve merger "efficiencies."

A requirement for a meaningful CRA plan holds out hope for communities that mergers will not result in significant reductions in loans, investments, and services. A meaningful CRA plan would require merging institutions to provide the number of loans, investments, and services they made by state, metropolitan area, and rural portions of states in past years. The plan would then describe how the institution would increase their number of loans, investments, and services to minority and low- and moderate-income communities and borrowers. In addition, the plan would require meaningful performance measures such as comparisons between the percentages of loans a bank made to low- and moderate-income borrowers and communities, and the percentages of loans that the bank's peers made to these borrowers and communities. The plan would identify geographical areas (on a state, urban, and rural level) in which the bank lags its peers on the performance measures and would indicate how the bank will do better in these geographical areas.

Finally, and importantly, the CRA plan would include a fair lending component. Large institutions seeking expanded GLBA powers are often involved in making high-cost subprime mortgage loans or purchasing these loans. The Federal Reserve Board and the other banking agencies, however, are not requiring specific promises and reforms that would ensure that these loans are not predatory. In addition, large banks involved in the mega-mergers are financing payday lenders, car title lenders, pawnbrokers, and other fringe lenders. The Federal Reserve Board, however, is not requiring due diligence mechanisms for these financial arrangements although the Federal Reserve Board has used its supervisory powers to make sure that none of the banks it regulates engages in payday lending.

The CRA and fair lending plan would become the focus of discussion among banks, the regulators, and the general public during public comment periods and hearings. Currently, banks submit applications with no meaningful discussion of CRA and fair lending compliance; community groups comment on these glaring inadequacies; and the Federal Reserve then approves the merger applications with no conditions. In contrast, meaningful CRA plans would stimulate meaningful discussions about strengths and weaknesses in banks' CRA performance. The Federal Reserve Board would then encourage and/or require banks to specifically address weaknesses in their CRA and fair lending performance. The end result would be an increase in safe and sound lending for traditionally underserved communities.

NCRC believes that meaningful CRA and fair lending plans ought to be required in every merger application proceeding. At the very least, this requirement ought to apply to the larger mergers, involving institutions with one billion dollars or more in assets. Public hearings held by the regulatory agencies in states most affected by the mergers must also be automatic for the larger mergers. In addition, the CRA plan requirement could also focus on geographical areas or parts of CRA exams in which a lender scored Low Satisfactory or below.

**Updating CRA to Keep Pace with Sweeping Changes in the Financial Industry**

As lawmakers debated GLBA, NCRC and our 600 member organizations continually pointed out that while GLBA would create larger and vastly more powerful financial institutions, CRA was not being updated to keep pace with the dramatic changes in the financial industry unleashed by GLBA. GLBA did not apply CRA or CRA-like requirements to mortgage company affiliates, other affiliates that made loans, insurance companies or securities firms that would become part of holding companies. As a result, a very real possibility exists that CRA will apply to fewer and fewer assets of holding companies. At the same time, CRA was not applied to credit unions, mortgage companies and other competitors of bank holding companies. This creates an uneven playing field for bank holding companies that must comply with CRA and with institutions with no community reinvestment obligations. Of more concern to communities, the uneven application of CRA reduces the amount of community reinvestment, financial activity, and wealth building in their communities. The uneven application of CRA also undermines President Bush's call for more minority homeownership and more importantly subverts the dreams and aspirations of millions of Americans seeking to build a future for their families.

Since GLBA, NCRC worked with Congressman Gutierrez, Barrett and 34 other members of Congress to craft the CRA Modernization Act that would apply CRA to all parts of bank holding companies as well as to institutions outside of bank holding companies. If Congress wishes to ensure that GLBA benefits all Americans, it must take up all or at least parts of the CRA Modernization Act. A good place to begin would be to apply

CRA and fair lending exams to all affiliates of holding companies that lend since the Federal Reserve still hesitates to act on the GAO's recommendation of fair lending reviews for affiliates.[3] Secondly, Congress can then expand CRA to all lending institutions, including credit unions and mortgage companies.

Thirdly, Congress must increase the amount of data disclosure on lending activity. Expanding upon a provision in the CRA Modernization Act, Rep. James McGovern has sponsored HR 1748, the Access and Openness in Small Business Lending Act of 2003. This bill amends the Equal Credit Opportunity Act (specifically Federal Reserve Regulation B) to permit the collection of demographic information in connection with small business loans with the applicant's consent. Currently, CRA only requires banks and thrifts to report the census tract location of small businesses receiving loans.

Unlike publicly available home loan data, the small business loan data lacks demographic characteristics of borrowers. In particular, the small business loan data does not have information on the race and gender of the small business owner. HR 1748 would update the CRA data to require the collection and dissemination of race and gender of the small

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[3] General Accounting Office, *Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending,* January 2004, GAO-04-280.

business owner. Other data enhancements include the revenue size of the small business and data on denials as well as approvals.

The home loan data has stimulated a significant increase in lending to minorities, women, and low- and moderate-income borrowers precisely because its public availability holds lenders accountable for reaching formerly neglected borrowers. Enhancing the small business data would similarly increase lending to women- and minority-owned small businesses. We know from studies conducted by the Milken Institute and others that women-owned businesses are in the dark ages when it comes to access for credit. Improvements in small business lending data would be a great benefit to half of the American population by providing women with greater chances of securing loans for their businesses.

Research has proven that CRA works to expand access to capital and credit. Using NCRC's database of CRA agreements, Harvard University, the Department of Treasury and Federal Reserve economists have shown that banks made more loans to low- and moderate-income communities in geographical areas in which they made CRA agreements. Moreover, the research concluded that banks made more loans in geographical areas in which they had branches and underwent CRA exams than in geographical areas outside the purview of the CRA exams (often because their mortgage company affiliates were not included on their CRA exams but made considerable numbers of loans in a large number of geographical areas).[4]

Lending is good for America. Access to credit and capital is the traditional method that allows any family to build equity and create wealth. CRA brings more wealth, more stakeholders, and more parity.

**Uneven Regulatory Regime Threatens Sustainability of US Banking Success**

Banks are highly regulated, but securities companies and insurance firms are not. By allowing banks and non-bank financial companies to merge, GLBA exposes banks to higher levels of risk from their lightly regulated affiliates. At the same time, banks themselves are taking on more risk by outsourcing their serving operations to foreign

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[4] The Joint Center for Housing Studies at Harvard University, *The 25th Anniversary of the Community Reinvestment Act: Access to Capitol in an Evolving Financial Services System*, March 2002; Robert Litan, Nicolas Retsinas, Eric Belsky and Susan White Haag, *The Community Reinvestment Act After Financial Modernization: A Baseline Report*, produced for the United States Department of the Treasury, April 2000; *The Performance and Profitability of CRA-Related Lending*, Report by the Board of Governors of the Federal Reserve System, July 17, 2000; Raphael Bostic and Breck Robinson, *Do CRA Agreements Influence Lending Patterns?* July 2002, available via bostic@usc.edu.

countries. This creates job loss here at home and makes it more difficult for banks to control and monitor their operations.

In addition to the safety and soundness risks, the increased financial industry consolidation and globalization creates access difficulties for low- and moderate-income borrowers. For example, consumers need insurance policies in order to secure home mortgage loans. Their bank may be covered by CRA, but the bank's insurance company affiliate is not. What happens to CRA enforcement when the bank's insurance company unfairly denies a low-income borrower for a homeowner's insurance policy? NCRC does not believe that lawmakers completely thought through the implications of industry consolidation on CRA enforcement when passing GLBA.

Clearly, the safety and soundness and fair lending oversight of non-bank financial affiliates of bank holding companies must be increased. At the same time, stronger firewalls must be created between federal regulatory agencies and financial institutions. Recently, we have all become alarmed by the case of the OCC examiner for Riggs leaving the OCC and working for Riggs while the bank was not enacting sufficient safeguards against money laundering. In the financial world shaped by GLBA, the integrity and rigor of supervisory and examiner officials assumes paramount importance.

For this reason, NCRC recommends that regulatory officials be barred from working at financial institutions for a period of five years after they leave their agencies. With all due respect, the same requirement should be imposed upon members of Congress.

**Conclusion**

If research has shown beyond a reasonable doubt that CRA works, why not update CRA and apply it evenly across the financial industry? Firstly, lawmakers should do no harm to CRA and must repeal GLBA's CRA sunshine requirement and small bank exam stretch-out. Secondly, lawmakers must apply CRA to all parts of holding companies that lend and to lending institutions outside of holding companies. Thirdly, lawmakers then must consider CRA-like requirements for non-bank financial institutions including insurance companies and securities firms.

Mr. Chairman, communities cannot afford another five years of GLBA and missed reinvestment opportunities. NCRC stands ready to support Congressional efforts to update CRA and make capitalism and the American Dream available to all Americans who work hard and play by the rules.