Remarks
By
Donna Tanoue
Chairman
Federal Deposit Insurance Corporation
Before
The
Bank Administration Institute Conference
Community Development Lending and CRA Strategies for Community Banks
Arlington, VA
June 19, 2000

I believe that it is a fundamental responsibility for all of us who serve in government to really listen, without fear or favor, to everyone, and to make those words good by taking initiative.

So, since becoming Chairman of the FDIC two years ago, I've traveled the country, and have heard from bankers and community leaders, public officials and citizens, about what they think we are doing right – and what they think we should be doing differently.

Lately, I've heard a lot about the Community Reinvestment Act, and – in particular from bankers – about several unresolved issues and questions concerning small bank and large bank CRA evaluations:

Questions about why small banks are subject to CRA examinations.

Questions about small bank CRA ratings: What warrants an "Outstanding" rating and what banks should be eligible for the small bank examination?

Questions about community investments: Such as how much is enough? And are we appropriately focused on the kinds of community development activities that promote economic revitalization in our inner cities and rural communities?

Questions about loan pricing and predatory lending, such as: Has our focus on the number and amount of loans originated or purchased diverted our attention from the troubling issue of predatory lending? And should we evaluate loans for predatory features? If so, how should we conduct that review and how should our findings affect our conclusions?

There are no easy answers to these questions – and others, such as those concerning the CRA and Internet banks -- but we must work to find answers.

Why?

Because for the banking industry, for the public, and for community development professionals like you there is no burden quite like an unanswered question.

Because I often hear from representatives of small, community banks that there is no need for their banks to be subject to regular CRA examinations, let's look first at the reason why CRA applies to small banks as well as large banks. These bankers say that, by their very nature, small banks must serve the credit needs of their communities or they will fail to prosper.

Of course, the vast majority of small banks – and large banks – do help to meet the credit needs of their communities. Many are critical to the economic vitality of the cities and towns that they serve. Many bank managers serve influential roles in those communities.

Unfortunately, however, the same cannot be said for every small bank. A few banks may lend to certain segments of their communities, but not to others. Other banks invest heavily in Treasury or municipal securities, but make few loans. One bank with $120 million in assets, for example, has an 8 percent loan to deposit ratio – that's right 8 percent -- compared to an average loan to deposit ratio of 87 percent in the state in which it operates. The bank originated no community development loans and provided no community development services at the time of its last exam. Examiners correctly concluded that it was not serving the credit needs of its community and rated it less than satisfactory.

The bank was profitable and, in the words of its president, it offered customers "a safe place to put their money." However, it was not helping to meet the credit needs of its community. Not all banks – not even all small banks – serve their local communities. CRA examinations – including examinations of small banks – should distinguish between those banks that help to serve the credit needs of their local communities, including the low- and moderate-income neighborhoods in those communities, and those that don't.

Let's look next at the question of what factors would warrant a small bank CRA rating of "Outstanding."

To reduce examination burden, small bank evaluations have been streamlined to focus – in most cases – on lending. At the outset of an examination, an examiner should be primed to answer a relatively straightforward question. Do the lending data for the bank indicate that it is making loans to serve the credit needs of its local community?

To answer that threshold question, the regulation sets forth four sets of issues that the examiner considers:

First, is the bank lending – as measured by its loan to deposit ratio?

Second, is the bank's lending serving its local community in which it is chartered to do business – as measured by the percentage of its loans made within its assessment area?

Third, is the bank's lending serving a broad spectrum of its local community – as measured by the distribution of its loans among neighborhoods and by borrower income, business size, and farm size?

And the fourth issue is the bank's handling of complaints about its CRA performance – handling measured by the existence of any complaints and the effectiveness of the bank's response to them.

Normally, a bank is Satisfactory if it is an active lender, a majority of loans are in the community, the loans are distributed among income levels and business or farm sizes. If the numbers do not meet expectations of satisfactory performance, it is rated Needs to Improve, unless there are extenuating circumstances – which we refer to as "Performance Context" – that would indicate that the numbers are not providing the full story.

If, however, the data are consistent with a rating of Satisfactory, the examiner may – at the bank's option – delve more deeply into its performance to determine if a rating of Outstanding is warranted.

That analysis should focus less on numbers and more on the impact of the bank's activities on its community. For example, a bank is not going to be judged to be Outstanding because it has a 90 percent rather than 70 percent loan to deposit ratio or because it has made 95 percent rather than 75 percent of its loans in its assessment area. It will be judged to be Outstanding because it has taken a leadership role investing in its community through lending and possibly investments and services. For example:

A bank located in one of the poorest counties in the state of Wisconsin – with over 16 percent of the population living below the poverty line – exhibited the kind of leadership that warranted a rating of Outstanding. The bank's investments, in partnership with a nonprofit organization, accounted for 320 new jobs; 42 units of affordable housing; the development of 80 acres of industrial park and 163,000 square feet of industrial space; a new supermarket and retail space; and the creation of two tax increment districts.

A very small Midwestern bank -- with just $16 million in assets -- also demonstrated the kind of leadership that is recognized by a rating of Outstanding. The bank formed a community development corporation to purchase, rehabilitate, and sell old houses to low-income persons. In addition, a member of the bank's management serves as chairman of an economic development foundation, which funds a neighborhood revitalization program that provides tax rebates and loans to small businesses for the construction of new buildings or the expansion of existing buildings.

In other words, the bank that earns a CRA rating of Outstanding is the bank that sets itself apart from other lenders; the bank that provides greater benefit to under-served, sometimes difficult to serve, low- and moderate- income areas or individuals; the bank that invests in its local community. The bank that helps to revitalize the downtown business district and works in partnership with public and private enterprises to revitalize its community.

Many small banks – about one in five – have learned these lessons and earned ratings of Outstanding. Representatives from many other small banks, however, have indicated to me that they think that it is too difficult for them to get a rating of Outstanding. Many of them said that they have lowered their sights as a result – settling for a rating of Satisfactory without even trying for a rating of Outstanding. That is unfortunate. To the extent that banks strive for a Satisfactory, rather than an Outstanding, community reinvestment is diminished. None of us want that outcome. A regulatory review may help us maintain our focus on the critical aspects of small bank performance while also reducing regulatory burden.

But I want to be clear about how a small bank can earn an "Outstanding" rating today.

More often than not, it is by augmenting an otherwise satisfactory performance based on loans with qualified investments and/or a strong record of providing retail and community development services.

In other words, bankers at small institutions can use the investment test to bolster their record – but it is up to them to request it.

A small bank can earn an "Outstanding" rating without consideration of investments or services – but a high loan-to-deposit ratio and a high inside-the assessment area ratio alone will never be the primary basis of an "Outstanding" rating.

There has to be something else.

These standards have been in effect for small banks since 1996.

As you know, while consideration of qualified investment and services may be considered in a small bank examination, they must be considered in the CRA examination of large retail banks. To get an "Outstanding" CRA rating, a large bank generally would have to have good to excellent performance under the three CRA tests it is subject to: the lending, the service and the investment test.

Of the three, the lending test is the most important – it is given the most weight.

The test that generates the most questions, however, is the investment test.

Why is there an investment test?

While we expect banks to help meet credit needs in low- and moderate- income areas, it is not always easy. These areas often lack capital. Capital is necessary for safe and sound lending. Capital provides borrower equity and other re-payment guarantees. In order to lend safely, banks sometimes need to replace this missing capital. Community development organizations and programs that can tap private and public sources of capital provide a solution.

Bank investments, and other support, enable these organizations to help banks meet credit needs. This is why we have an investment test. It is all about banks helping to meet low- and moderate-income credit needs.

How much is enough?

How many qualified investments must an institution make to get a particular rating under the investment test?

There is no "bright line" standard used by examiners to evaluate the record of a large bank in making qualified investments. I suspect many of you have heard rumors to the contrary. However, although the agencies have in the past discussed whether strict quantitative standards for investment test ratings should be established - for example, qualified investments relative to capital, earnings, or assets - such standards have not been adopted. Investment test ratings continue to reflect a judgmental assessment of quantitative and qualitative factors.

What if there are few if any suitable investment opportunities in a particular bank’s assessment area? We recognize that different banks have different limitations. Some institutions may be able to take the lead in forming community development organizations or bank consortia. Although others may not, they may be able to participate if others take the lead.

In brief, taking a leadership role would contribute to an "Outstanding" investment test rating. Simply participating in limited opportunities may only contribute to a "Satisfactory" investment test rating. However, keep in mind that even a "Satisfactory" rating on the investment test would not rule out an overall exam rating of "Outstanding."

Banks may also overcome limited investment opportunities in their assessment areas in other ways. They seek opportunities near by, or in the broader statewide or regional area, that includes the assessment area. This too can help to augment satisfactory performance, to help obtain an "Outstanding" investment test rating. People who work in one area, may live in another. The positive impact of community development in one area can spill over into nearby areas. The extent to which assessment areas benefit can contribute to an improved rating. In fact, the agencies have recently released for public comment a proposed question and answer guidance on this very issue.

Some have suggested an alternative to the investment test. Instead of separate evaluations of community development loans, investments and services among the three tests as occurs now, they propose a "community development test" for large retail institutions. The test, which would be in addition to a retail lending and a retail services test, would consider all three-community development activities – loans, investments, and services – under a single test. At present, they are split among the three tests. In this way, a bank could compensate in one community development activity for lack of opportunity in another. Or, a bank could focus on one activity more than another to obtain a higher rating. And banks would no longer have to worry about whether they have "too many loans, not enough investments."

This proposal deserves serious consideration – and I've asked FDIC staff to work with our counterparts at the other federal regulatory agencies to develop an alternative that would address the problems currently associated with the investment test. In so doing, they will actively seek your input.

Bankers have also asked me: How do we ensure that predatory loans do not help a bank's CRA record?

As many of you know, I have directed FDIC staff – in cooperation with the staff from the other agencies – to revise our CRA examination procedures to ensure that banks are not rewarded for making predatory loans. The problem is that our examination procedures today concentrate on where a loan was made without regard for the characteristics of the loan. As such, we need to develop guidance to ensure that banks do not have an incentive to acquire loans in low- and moderate-income neighborhoods -- irrespective of pricing, fees, and restrictions.

We also must assure that banks that are actively combating predatory lending by others – like a Chicago bank that helps homeowners who have taken high-rate loans from predatory lenders refinance those loans at market rates – receive appropriate CRA credit for their work. You will hear more about that in our predatory lending panel this afternoon.

We are already exploring these issues. In the meantime, I urge you to think about appropriate solutions and share your thoughts with us.

As you know, with the release of the revised CRA regulations in 1995, the agencies promised to conduct a full review of the rule seven years later, in 2002, five years after it was fully implemented in 1997.

The review should determine whether the rule has been effective in achieving its goals, including:

- Emphasizing actual bank performance, rather than the process used to achieve it.
- Promoting consistency in evaluations.
- Eliminating unnecessary burden.

It seems to me that we can begin this review now – five years after the release of the revised regulations -- focusing on the issues that I talked about today, and I'll recommend to my colleagues at the other banking agencies that we begin reviewing our regulations now.

These are serious issues – they deserve our attention. To really listen is to give others your attention, to weigh their words fairly, and to act on them if action is called for.

Government can be a positive force in the life of our people, but only if it is fair, and only if it is responsive.

I have heard what bankers say about CRA, we are giving them a fair hearing, and when we find change necessary, change will come.

Thank you.

Last Updated 06/19/2000