

Testimony of
Geoff Smith
Project Director
Woodstock Institute

Before the
Subcommittee on Oversight and Investigations

U.S. House of Representatives

Regarding
Oversight of the Office of Thrift Supervision

Thursday, May 25, 2006

Good morning. Thank you for the invitation to testify at today's hearing. My name is Geoff Smith, and I am Project Director at the Woodstock Institute. Woodstock Institute is a Chicago-based non-profit research and policy organization that for over 31 years has worked locally and nationally to promote reinvestment and economic development in lower-income and minority communities. Woodstock Institute also convenes the Chicago CRA Coalition, a group of nearly 70 community organizations with a mutual interest in increasing access to bank and thrift lending, investments, and services in Illinois' underserved communities. Woodstock Institute is a member of the National Community Reinvestment Coalition, the Illinois Coalition Against Predatory Home Loans, the Monsignor John Egan Campaign for High Cost Consumer Loan Reform, and Americans for Fairness in Lending.

My testimony today focuses on the Office of Thrift Supervision and the agency's recent actions to substantially weaken its regulation of the Community Reinvestment Act. In many ways Chicago is considered the birth place of CRA. Starting in the late 1960s and early 1970s, Chicagoan Gail Cincotta led a grassroots organizing efforts that brought national attention to the crisis of redlining and its impact on inner city neighborhoods. This organizing effort ultimately helped lead to the passage of the Home Mortgage Disclosure Act in 1975 and the Community Reinvestment Act in 1977. Both pieces of federal legislation were aimed at ending geographic discrimination in access to financial services. With HMDA, the focus was mortgage lending. With CRA, the focus was ensuring that depository institutions meet the credit needs of low- and moderate-income neighborhoods and households within the communities in which they are chartered do business.

In its early years, however, CRA was a little used and largely ineffective piece of legislation, and it wasn't until the CRA regulation was made more rigorous in the late 80s, but particularly in the mid 1990s, that CRA truly began to become effective at meeting this legislative intent. Changes implemented over this period include:

- Requiring public disclosure of bank exam results and performance evaluations;
- Shifting the emphasis of CRA exams to focus on analysis of an institution's actual performance as opposed to its processes;
- Public availability of small business lending data;
- Most importantly the instituting the three test system for banks with over \$250 billion in assets. This large bank exam evaluated an institution's CRA performance through separate tests that systematically examined an institution's lending, services, and investment to underserved markets.

These changes served to standardize the way large banks were examined under CRA and made both financial institutions and regulators publicly accountable for community reinvestment performance. It was this increased rigor introduced into CRA examinations that made the regulation effective. Evidence of this effectiveness can be seen in the active role CRA-regulated institutions have in the community development process.

- Research has shown, for example, that during the 1990s CRA-regulated mortgage lenders substantially increased their lending presence to low- and moderate-income communities and borrowers.
- Investments and loans from CRA-regulated institutions have facilitated the rapid growth of the Community Development Financial Institution industry. With the help of mainstream financial institutions, CDFIs participate in affordable housing, small businesses, and other types of economic development projects in lower-income communities that might otherwise be too risky for banks and thrifts to take on alone.
- CRA also encouraged banks to develop flexible and affordable deposit accounts and financial services available for under-banked markets.
- Encouraged banks to work closely with local community development organizations. In Chicago, CRA Coalition, has successfully negotiated and monitored CRA agreements and partnerships with financial institutions including Charter One, Fifth Third Bank, and most recently Bank One/JP Morgan. These agreements have led to increased mortgage lending in underserved markets, new

bank branches in low- and moderate-income and minority communities, and increased investment in affordable housing, small business development, and financial literacy in the region.

Despite the relative effectiveness of CRA in encouraging banks to have a presence in lower-income communities, there recently have been a number of regulatory actions that have weakened CRA put forward under the banner of reducing regulatory burden for financial institutions. The Office of Thrift Supervision was the lead agency in enacting the most extreme of these proposals. In many instances the OTS acted unilaterally, breaking away from the traditional unity of the bank regulatory agencies and making decisions in the faced of very strong public opposition.

In the summer of 2004, the Office of Thrift Supervision broke away from other regulatory agencies and unilaterally raised the asset limit for institutions it considered “small” under CRA to \$1 billion. This action was taken without the opportunity for public comment. This created an uneven regulatory playing field, significantly reduced the number thrifts covered by comprehensive, large bank CRA exams; threatened significant community development resources in rural communities and small cities predominantly served by these mid-sized thrifts; and eliminated the reporting of critical small business lending data. The three other regulatory agencies, after extensive review and public comment, adopted a more modest revision of their CRA regulation which created an “intermediate small bank” category for institutions between \$250 million and \$1 billion dollars. Unlike with the OTS, Intermediate small banks are examined under a two part CRA exam which includes a community development test that assesses an institutions provision of community development lending, services, and investments.

In 2005, the Office of Thrift Supervision acted unilaterally again and against overwhelming public opposition adopted a proposal that dramatically weakened CRA by changing the way that “large” thrifts’ (now those over \$1 billion in assets) CRA ratings are assessed. The other bank regulatory agencies continue to assess a large institution’s final CRA rating based on weighted consideration of its performance in providing

lending, investments and services to low- and moderate-income households and communities. An institution's performance on the lending portion of its CRA exam is 50 percent of its final score, while services and investments are each given 25 percent weight in the final grade. The OTS action altered this framework by allowing large thrifts to essentially opt out of providing services and investments to LMI markets. These institutions can now choose to have lending count for between 50 and 100 percent of their final CRA rating thus minimizing or completely excluding consideration of community development investments and services.

This OTS regulation sets up a circumstance where a large thrift could receive an "outstanding" or "satisfactory" on a CRA evaluation with virtually no direct presence in LMI communities. A thrift could have a large branch network with few or no branches in LMI communities, but choose not to have its level of community development services considered on a CRA exam. The thrift could make no investments in affordable housing or business development or refuse to make grants or investments to organizations that promote economic development in LMI communities, yet not have their community development investments considered on their CRA exam. The thrift could make few or no direct loans to LMI communities or borrowers, but purchase LMI loans from a third party. These loans could be years old, contain abusive prepayment penalties, or have large yield-spread premiums. This thrift could also provide a "community development" loan for a golf course that "revitalizes" a "rural" community on the fringe of a large metropolitan area. Despite virtually no presence in LMI markets, this institution could be considered "outstanding" under the current OTS large bank exam. In fact, an examination of recent OTS large bank CRA exams shows examples of institutions receiving outstanding CRA ratings with no consideration of their provision of services to low- and moderate-income consumers.

The Community Reinvestment Act has been shown to be the most effective tool available for promoting lending, investment, and services in low- and moderate-income communities. We have consistently opposed the OTS's actions to weaken CRA and continue to promote improvements to CRA that would increase access to lending,

investments, and services in low- and moderate-income markets such as the requiring the continued reporting of small business lending data for mid-sized banks and thrifts, collecting data new retail accounts opened for low- and moderate-income households; and promoting investment in declining and underserved rural markets.