

CDFI/CRA

Memos

THE WHITE HOUSE
WASHINGTON

July 14, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING, BRUCE REED
SUBJECT: TOMORROW'S CD BANK/CRA REFORM EVENT

As you know, you are scheduled to announce your CD Bank and CRA Reform initiatives on the South Lawn tomorrow -- two economic initiatives which you approved in late April. The reason we had to schedule this event today is that the Senate Banking Committee had scheduled a hearing for July 15 on your CD Bank Bill, where Secretaries Bentsen and Espy will testify. We were unable to get an announcement date prior to your leaving for the G-7 trip but were able to get Riegle to move his hearing to this afternoon in order to accommodate you. This event is the culmination of months of planning, drafting, policy development and delicate negotiations with constituent groups and Members of Congress. Frank Newman and Gene Ludwig at Treasury and Bob Nash at Agriculture have been particularly involved in the negotiations with these groups and in developing the final proposals.

These initiatives reflect a fundamental principle of your overall economic plan: to make capital available to enterprising Americans in all communities that want to invest, spur economic growth and create jobs. Whether promoting the G-7 talks or the community development banking bill, the message is the same -- creating new jobs.

The CD Bank and CRA reform initiatives reflect a New Democrat approach to helping distressed communities create jobs and spur economic growth. Across the country, poor communities from South Central L.A. to the Mississippi Delta are reeling from a decade of declining opportunity and rising social and economic isolation. Government cannot do the whole job -- but we can be a catalyst for the private sector and bottom-up innovation in local communities. These two initiatives will result in a substantial increase in lending for distressed, underserved communities -- both by bottom-up community development institutions and by mainstream banks.

The event will include a broad range of groups and Members who are particularly supportive of these efforts. This is an historic occasion in which the major banks, community groups, the CDFI industry, and members of Congress stand together on the same platform.

The CRA Reform will be completed by regulation. Tomorrow you will send a memorandum to the four bank regulators asking them to issue performance-based regulatory reforms by January 1, 1994. Banks and community groups will be invited to participate in

the development of this regulation. Three of the bank regulators, including Gene Ludwig, will be at the event. Hugh McColl and other heads of banks with good CRA records will also be on hand to support this effort, as well as supportive community groups.

The CD Bank Bill will be transmitted tomorrow. Key members of Congress who support the bill, including Representatives Flake, Waters, and Rush as well as the Banking Committee chairs will be seated behind you and scores of Members of Congress will be in attendance.

Attached are the following documents:

- 1) a more detailed memorandum which outlines our negotiations with key constituent groups and Members of Congress;
- 2) promotional materials that will be handed out to the press and attendees, including
 - a summary of the CD Bank and CRA Reform initiatives;
 - a summary of the problems faced by credit-deprived communities (prepared with the excellent work of Alicia Munnell, Assistant Secretary for Economic Policy at Treasury);
 - highlights of the CD Bank Proposal;
 - description of the CD Banking Industry;
 - success stories;
 - highlights of CRA Reform;
- 3) a copy of the CD bank bill along with a transmittal letter and a section-by-section analysis;
- 4) a draft of the memorandum that you will send to the bank regulators; and
- 5) Q & A on both initiatives.

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MEMORANDUM FOR THE PRESIDENT

THROUGH: GENE SPERLING, BRUCE REED
FROM: PAUL DIMOND, PAUL WEINSTEIN, SHERYLL CASHIN
SUBJECT: BACKGROUND ON CRA REFORM, CDFI INITIATIVE

I. BACKGROUND

You are scheduled to announce your CRA Reform and Community Development Bank and Financial institutions initiatives tomorrow. The NEC and DPC staff, along with senior officials at HUD, Commerce, Agriculture, and Treasury, have engaged in extensive negotiations and coalition building among constituent groups and members of Congress. This memorandum summarizes those negotiations to give you perspective on the various positions and concerns of key groups and officials who will be present at the ceremony.

II. SUPPORT FOR CRA REFORM, CDFI BILL

A. Community and Consumer Groups. When we first met with groups like ACORN, Center for Community Change, Community Reinvestment Coalition, ONE, Consumers Union and Consumer Federation of America, they expressed substantial concern that (1) the CDFI bill would lead to the creation of a separate and unequal system of banking for distressed communities, (2) that CRA reform by regulation could lead to diminution of lending by regulated banks and thrifts in distressed communities, and (3) that we might be contemplating a "safe harbor" from CRA for mainstream banks that invested in CDFI's. Through the careful explanations of Undersecretary Newman, Comptroller of the Currency Ludwig, Assistant Secretary Nash, and the NEC and DPC staff at a series of private discussions and presentations at public forums, these groups generally came to agree with the three principles that you set for reform of CRA by regulation:

- reform the CRA assessment criteria to focus on actual lending performance in the circumstances of the local community and particular bank
- exercise the full array of enforcement sanctions currently available so that full scrutiny and public comment is not limited to go/no-go decisions on acquisitions and mergers

- train a corps of specially trained CRA examiners to focus on lending performance, not on the extent of community public relations and image

The groups eventually expressed a strong preference for reform of CRA through regulation this year, rather than running the risk of seeking legislation in Congress that might lead to weakening CRA. They also came to understand that mainstream banks would get some credit, but not a "safe harbor," for investing in CDFIs. Despite this understanding and support, however, some community groups and some consumer groups are concerned about our rhetoric (e.g., "substitute performance for paperwork") and need constant reassurance that they will be full participants in the development of CRA regulatory reforms with the Bank regulators.

B. CDFIs. At the outset, there was also some concern from non-depository CDFI's (e.g., Community Development Corporations and revolving microenterprise or community development funds) and Credit Unions that they either would be excluded from our CDFI initiative altogether or would be at a disadvantage compared to depository institutions like South Shore or Elk Horn. When we explained that the basic criterion was ability to match the CDFI Fund's investments and then to leverage the resulting public-private investment to multiply the actual loans to community and economic development, they came to understand both how they were eligible and would be challenged to demonstrate their own ability to perform and to become self-sustaining.

Mainstream banks with wholly-owned CDC subsidiaries and state economic development authorities initially expressed some concern because they are not eligible directly for funding in our CDFI bill. Rather, the CDFI bill and CRA reform will encourage local CDFI's to join in lending networks and investment consortia with such mainstream banks and public finance authorities to help them fulfill their own public mission and community reinvestment activities. Although there was not great joy, most mainstream banks with CD subsidiaries came to accept and understand why we targeted resources on "bottom-up" CDFIs.

C. Mainstream Banks. Many mainstream banks originally wanted to support their own investment in CDFI's and a national CDFI fund in exchange for some form of interstate branching or a CRA "safe harbor." But many of these banks have come to accept that no such financial reform is or should be considered this year. Several mainstream banks have endorsed the proposal to reform CRA through regulation, while many more have agreed to participate in the process of developing regulatory reforms rather than run the gauntlet of reforming CRA through legislation. Once you ask the regulators to proceed with this process, mainstream banks and banking interests and the representatives of small banks will participate and, at this time, appear willing to accept a new focus on actual performance in exchange for avoiding paperwork related to community relations. Some mainstream banking interests have even expressed a willingness to consider using "geocoding" -- indexing loans by geographic area -- and "independent testers" to measure their community reinvestment performance rather than the current emphasis on community public relations processes and documentation.

There is a risk, however, that some mainstream banks may lobby Congress for

amendments to our CDFI bill that would seek CRA relief or major financial reform in Congress.

D. Congress. The House and Senate Banking Committees have dealt with a lot of bad news over the past decade and there is much pent-up demand by some for major financial reform. No one seriously believes such major reform has any chance of passage this year because of the opposition of non-regulated financial service sectors and because of tensions between mainstream banks and representatives of the small banks and the consumer and community groups. Nevertheless, there are several members, both Democratic and Republican, who might seek to add reforms onto any CDFI bill in hopes of winning broader support. We have been warned that if our CDFI bill becomes such a "Christmas tree," there will be no chance for passage.

We have therefore worked closely with the Banking Committee staffs, key members, Banking Committee Chairs, and Leadership to secure support for a narrowly focussed CDFI bill and reform of CRA by regulation. Subcommittee Chair Joe Kennedy, an early supporter of strengthening CRA by legislation, was the first to embrace your two-part strategy of strengthening CRA by regulation and a narrow CDFI bill. Chairmen Gonzales and Riegle also endorsed this approach early on. Subcommittee Chair Kanjorski, a proponent of new legislation to support secondary markets for small business loans, also agreed to support the narrow approach this year while he sought to build support for his proposed reform for next year.

Representative Waters, a proponent of strengthening CRA by legislation and of a much more ambitious CDFI bill, agreed to endorse your two-part approach, while reserving her right to press for more funding. Representative Rush, who has over 70 co-sponsors for a CDFI bill that is very similar to ours (but with a secondary market, tax advantages for deposits in CDFI's, and much greater funding) came on board after lengthy discussions and extended but friendly negotiations with Howard Paster and Treasury, OMB, and White House staff. There will be a major push from these members, and their supporters, to provide substantially more federal funding for the CDFI Fund beginning in FY 95. They understand that, at this late date in the appropriations calendar, we will be doing well to get the \$60 million that you requested for FY 94.

Representative Flake was an early opponent of CDFI legislation of any kind and supported reforming CRA by legislation and rewarding mainstream banks under his Bank Enterprise Act (BEA) for investing in distressed communities by lowering their FDIC insurance premiums on such loans. The BEA was authorized but not funded last year. Gene Ludwig, Frank Newman, and White House staff persuaded him that he could be actively involved in the CRA regulatory reform, including through his Oversight Subcommittee if necessary. Out of his personal respect and support for you, he also agreed to hold off on pressing his BEA funding request, pending completion of the CRA regulatory reform, while we studied the merit and need for the insurance premium subsidy for loans in distressed communities.

Finally, Subcommittee Chair Neal, at a meeting of Banking Committee and House Leadership, agreed to withhold his proposal for interstate branching this year in order to allow a narrow CDFI bill to proceed. With this unusual unanimity among Banking Subcommittee Chairs, Chairman Gonzales proposed a single set of hearings and mark-up before the full Banking Committee, rather than the usual round of separate subcommittee hearings, in order to assure prompt consideration and as narrow a focus as possible for your CDFI bill.

We are now just beginning the process of exploring broader Republican support in the House and the Senate for your two-part approach. All members of the Banking Committees will be invited to your White House announcement. By then, we may have a better handle on which Republicans, whether or not on the Banking Committees, may wish to support your two-part approach.

III. NEXT STEPS AND CONCLUSION

We have come a very long way in putting together a coalition of community and consumer groups, the CDFI industry, major segments of the mainstream banking industry, and important factions in Congress to support your two-part program to strengthen CRA by regulation and to enact legislation supporting CDFIs. Your announcement of both initiatives before all segments of this nascent coalition can solidify support and set the stage for what will no doubt be difficult negotiations between the diverse interests before the Regulators on CRA reform and a challenging but doable legislative session in Congress on the CDFI bill. Because of the highly partisan atmosphere and the narrow Democratic majority in the Senate, there may well be difficult negotiations ahead in the Senate. In addition, we may face challenges in the House to keep the CDFI bill straightforward and clean.

If we do succeed in continuing to build the coalition of support for your two-part strategy, deliver a strengthened CRA through regulatory reform and enact a straightforward CDFI bill, we will have laid the foundation for substantial reinvestment in distressed communities all across America. We will have built a platform for considering greater support for community reinvestment in the years ahead, through mainstream banks and thrifts, a growing network of CDFI's, and even the unregulated financial industry on a voluntary basis. And, you will have succeeded in bringing diverse interests together behind the basic principle of investing in underserved communities.