TESTIMONY OF

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On

PROPOSALS TO ENHANCE THE COMMUNITY REINVESTMENT ACT

Before the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

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Introduction

Good morning, Chairman Frank, Ranking Member Bachus, and distinguished members of the Committee. My name is Steven L. Antonakes and I serve as the Commissioner of Banks for the Commonwealth of Massachusetts. The Division of Banks (Division) is the primary regulator of nearly 250 Massachusetts state-chartered banks and credit unions with total combined assets in excess of $225 billion. The Division is also charged with the licensing and examination of nearly 1,000 non-bank mortgage lenders and brokers, approximately 5,000 individual mortgage loan originators, and an additional 3,500 non-bank financial entities, including check cashers, money transmitters, finance companies, and debt collectors.

I commend you, Mr. Chairman for scheduling this timely and important hearing on strengthening and expanding the Community Reinvestment Act (CRA). CRA was enacted over 30 years ago. The banking industry has since undergone transformational changes, including years of bank consolidation resulting in a small handful of nationwide money center banks that hold a dominant share of the banking market; widespread securitization of mortgage loans; outsourcing of mortgage origination channels resulting in broader access to credit, but weaker controls; and significant improvements in technology which produced new delivery systems, automated underwriting, and risk-based pricing.

However, ongoing disparities between the pricing of loans made to white borrowers versus black and Hispanic borrowers clearly demonstrates that more needs to be done. Unfortunately, it will take years for many urban communities to recover from the devastation of the ongoing foreclosure crisis. More so than ever before, access to

sustainable homeownership opportunities in low- and moderate-income neighborhoods will be essential. Simply put, we can not allow the events of the past few years to undo the significant gains in homeownership among our nation's black, Hispanic, and Asian communities that CRA helped enable.

Given today's very different banking landscape, the ongoing financial crisis, and the debate and consideration of the Obama administration's financial regulatory reform initiative, including the creation of a proposed Consumer Financial Protection Agency, it is the appropriate time to consider the CRA's strengths and weaknesses; the law's ongoing relevance; and whether and how the CRA can be modernized to make it even more effective in the years ahead.

In my testimony today, I will primarily focus on three areas. First, I will address the false notion that CRA had a role in causing our ongoing financial difficulties. Second, I will relate the Massachusetts experience over the past 27 years to broaden CRA to cover institutions beyond banks, including state-chartered credit unions and most recently licensed non-bank mortgage companies. Finally, I will conclude my testimony with some thoughts on how the federal Community Reinvestment Act can be further improved to enhance the accessibility of credit in low- to moderate-income neighborhoods and individuals and to ensure such credit is sustainable over the long term.

CRA Played No Role in the Ongoing Financial Crisis

As our foreclosure crisis has deepened, an argument has been advanced recently by some that the subprime crisis was caused, in part, by CRA in that it supposedly encouraged banks to sacrifice underwriting standards to promote increased homeownership opportunities. I started my regulatory career over 19 years ago as a bank

examiner charged with conducting CRA examinations. I later managed the Division's CRA examination effort. CRA is arguably the most significant of all banking laws passed in the 1960s and 1970s to address the issue of redlining or refusing to lend in low- and moderate-income communities despite sound lending opportunities. In my view, the supposition that CRA is the root cause of the rise in foreclosures we are seeing today and the turmoil in the credit markets is completely without merit.

First, while CRA requires banks to serve all communities within which they do business, the Act specifically prohibits banks from making unsafe and unsound loans. The drafters of CRA recognized that unsustainable loans are more harmful to consumers and communities than an absence of credit availability. In addition to the obvious safety and soundness concerns, CRA-covered lenders that engaged in high risk lending -- most notably Fremont Investment and Loan, Countrywide, Lehman Brothers, National City, IndyMac, and Washington Mutual, among several others -- should have, at a minimum, been strongly criticized by federal regulators in terms of CRA compliance for originating, funding, and/or purchasing mortgage loans that borrowers could not afford and for the devastating resulting impact on neighborhoods.[1] High CRA ratings awarded in these instances were inappropriate. Accordingly, the misapplication of CRA, not the law itself, was the problem. Banks should have been punished instead of rewarded for marketing, originating, and funding loans that were not affordable or sustainable.

Second, banks, lenders and Wall Street firms did not develop later generations of subprime mortgage loans with increased risk layering and often confusing terms out of an

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[1] While Fremont Investment and Loan was ultimately assigned a less than Satisfactory CRA rating by the FDIC in 2008, it previously scored an "Outstanding" CRA rating. Virtually all large banks that had significant concentrations of non traditional mortgage loans also scored "Satisfactory" or "Outstanding" CRA Ratings.

altruistic sense of obligation to meet the needs of low- and moderate-income individuals and communities. Although reduced documentation and option adjustable rate mortgages have existed for many years, they traditionally served a niche, higher income market. There are very few instances in which a reduced documentation loan and its corresponding higher pricing structure would be appropriate for first time homebuyers. Moreover, a finite market should have existed for those interested in paying above market prices in order to provide less documentation to qualify for mortgage credit. Instead, stated income loans became the product of choice. Pushing stated income loans to low-income borrowers for homes they could not afford served only one purpose – greed.

State Consumer Protection Efforts and Massachusetts Application of CRA

The states have long been recognized as laboratories for innovation. Accordingly, many of the nation's key financial consumer protections were first implemented on the state level. For example, Massachusetts had systems for deposit insurance that predated the creation of the Federal Deposit Insurance Corporation. In addition, the federal Truth-In-Lending Act was primarily based on the Truth-In-Lending Act which was enacted in Massachusetts two years earlier. In addition, to date, 35 states, including Massachusetts, and the District of Columbia have enacted subprime and predatory lending laws[2].

More recently, a Massachusetts state law enacted in November 2007, as part of Governor Deval Patrick's sweeping foreclosure prevention legislation[3], now prohibits a lender from making a subprime, adjustable-rate mortgage to a first-time homebuyer unless the applicant affirmatively opts out of a fixed-rate product and receives counseling from a counselor certified by the Division. The purpose of the law was to create a

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[2] Source: National Conference of State Legislatures, www.ncsl.org.
[3] See Chapter 206 of the Acts of 2007.

"vanilla" fixed-rate product that was more appropriate for a subprime borrower. This concept has essentially been included in the Obama administration's regulatory reform plan to exempt certain products from higher regulatory scrutiny.

State efforts to strengthen loan origination practices and develop and implement the Nationwide Mortgage Licensing System (NMLS) to improve the supervision of non-bank mortgage lenders, brokers, and loan originators is another example of state innovation which provided the framework for federal action. The states began developing the NMLS in 2003 as a means for identifying and tracking mortgage entities. Congress embraced this effort through the 2008 passage of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act). The SAFE Act sought to raise minimum standards throughout the United States by giving states until July 31, 2009 to pass laws licensing loan originators and to utilize the NMLS. In just a year's time, 48 states and the District of Columbia have enacted legislation to implement the SAFE Act's requirements and another state's legislation remains pending.

Some assert that preserving the rights of the states to promulgate higher consumer protection standards, such as CRA, will balkanize consumer protection standards and create excessively burdensome inconsistencies. Advocates of this position argue they will be forced to operate under a "patchwork quilt" of varying state laws. However, the facts don't support this assertion. When a high federal standard is established – generally based on laws tested at the state level – the states tend to harmonize to the federal standard.

The SAFE Act is a very recent example of a coordinated state-federal approach that is accomplishing important consumer protection goals in addressing weaknesses in

mortgage regulation and doing so in a nationally consistent manner. The states implemented the provisions of the SAFE Act in a rapid and seamless manner. As a result of new federal standards that created a floor and not a ceiling, mortgage regulation and applicable law has never been more consistent.

Additionally, the notion that state enforcement will result in disparate standards is also without evidence. States have shown consistency and coordination on landmark nationwide enforcement actions.

But what also must be noted is the importance of preserving that ability of states to act in the absence of adequate federal consumer protections. For the past decade the states have filled significant voids to address issues such as predatory lending, foreclosure scams and data security breaches. There is significant benefit to well-coordinated state-federal regulation in terms of the varying perspectives and incentives. Also, mandating that the federal standards serve as a "floor not a ceiling" to state action will help promote stronger consumer protection and need not lead to the much-maligned "patchwork quilt".

In addition to conducting regular safety and soundness examinations of all state-chartered banks and credit unions, the Division also conducts consumer compliance examinations and CRA and fair lending examinations of all state-chartered banks and credit unions. In Massachusetts, the Division created administrative requirements mandating that state-chartered banks serve their entire communities prior to the passage of the federal Community Reinvestment Act. A specific Massachusetts Community Reinvestment Act was later enacted in 1982.[4]

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[4] See Massachusetts General Laws, Chapter 167 §14 and its implementing regulations at 209 CMR 46.00 *et seq*.

Massachusetts Experience Extending CRA to Credit Unions

The Massachusetts CRA has always had broader coverage than the federal law. Massachusetts remains the only state to examine all credit unions, including community, industrial, and other common bonds, for their CRA performance[5]. Extending CRA to credit unions is not as simple as just cutting and pasting the bank regulations and applying them to credit unions. Massachusetts passed the nation's first credit union act and has chartered some of the oldest credit unions in the country. The Division's extensive experience in supervising credit unions and our understanding of the credit union movement has helped us to craft some unique distinctions in the regulations to account for the differences between banks and credit unions.

First, for credit unions that do not serve a geographic area (i.e. industrial credit unions), the notion of an "assessment area" has limited value. Since they can only lend to credit union "members" and since their membership is based on where someone works and not where they live, such credit unions can not be expected to serve a geographic assessment area. Therefore, the Massachusetts CRA regulations[6] allow such credit unions to define their entire membership as their assessment area for the purpose of compliance with CRA.

Second, for small industrial credit unions, the parts of the examination dealing with geography are not considered under the small institution performance standards. This includes the percentage of loans originated inside the assessment area and the geographic distribution of loans. Rather, the Division reviews the credit union's loan-to-

[5] Connecticut performs CRA examinations of community-based credit unions.
[6] See 209 CMR 46.00 *et seq.*

share ratio, its lending to members of different incomes, and its fair lending performance and record of responding to complaints.

Finally, for large credit unions (those over $1 billion in assets), the Division does not conduct an Investment Test. Since credit unions are severely limited by statute from most investment activity, including investments that might be considered under the Investment Test for large institutions, such a review would be meaningless. Therefore, the Division uses the Lending and Service Tests to evaluate a large credit union's CRA performance.

Massachusetts Effort to Extend CRA to Mortgage Companies

The Massachusetts 2007 foreclosure prevention law also extended Community Reinvestment Act-like requirements to licensed mortgage lenders originating 50 or more mortgage loans a year in the Commonwealth. Thus, Massachusetts became the first state in the nation to extend CRA to non-depository lenders. This is further evidence of how deeply Massachusetts believes CRA is part of the answer to the current economic difficulties and not part of the problem.

The CRA mandate requires the Division to conduct public examinations of licensed mortgage lenders to determine their record of meeting the mortgage credit needs in the Commonwealth. Similar to the Massachusetts experience in supervising credit unions for CRA, the Division has had to make adjustments to its regulations for mortgage lenders. Most importantly, the whole idea of an assessment area is irrelevant for the non-bank mortgage lending industry. These companies do not take deposits and, in many cases, do not have any branches. In fact, many companies do not even have a physical presence in Massachusetts. Therefore, the Division has eliminated any requirement for a

mortgage lender to define a specific assessment area and will, instead, evaluate the mortgage lender's performance in meeting the mortgage credit needs throughout the Commonwealth, including both lending and services.

In an effort to increase the pace of lenders responding to homeowners hardest hit by the foreclosure crisis, successful loan modifications completed for delinquent borrowers (or lack thereof) are also assessed during the Division's examination process. In addition to loan modifications, other efforts to prevent foreclosures are reviewed, including loans and services designed to keep delinquent homeowners in their homes.

Finally, the Division has included a suitability standard in its regulations for mortgage lenders. The federal CRA regulations include an assessment of a bank's use of innovative or flexible lending practices in a safe and sound manner to address the credit needs of low- and moderate-income individuals or geographies. The Massachusetts regulations have extended this concept to not only review whether a mortgage lender uses flexible or innovative practices, but also consider the suitability of such products or practices for low- and moderate-income individuals.

The first mortgage lender CRA examinations are being completed by the Division at this time. The first public ratings and public evaluations will be made available shortly.

Suggestions to Improve CRA

In my testimony, I have provided information relative to how Massachusetts has expanded the reach of CRA to include credit unions and non-bank mortgage lenders. In addition, I offer the following ideas for modernizing the CRA and making it made more

effective in fulfilling its goals of ensuring access to credit throughout the United States, including communities and individuals of low- and moderate-income.

Require Affiliate Lending to Be Reviewed

Earlier in my testimony, I rejected the false contention that CRA was a contributing factor to the current economic crisis. However, there is another fallacy that is being spread by a few of the defenders of large banks; namely that CRA-covered banks had nothing to do with the subprime mortgage mess. It is true that the vast majority of community banks did not engage in subprime or non-traditional mortgage lending, did not buy subprime loans, did not fund subprime lenders, and did not securitize subprime mortgage-backed assets. However, some of the largest banks in this country were either directly or indirectly involved in the subprime and non-traditional mortgage markets. And yet, in nearly every case, the largest banks have consistently received "Satisfactory" or "Outstanding" CRA ratings.

If CRA mandates that a bank only lend consistent with safe and sound banking practices, how is it then that these large, nationwide banking institutions were able to consistently achieve "Satisfactory" or Outstanding" CRA ratings? Part of the answer may be that the current CRA regulations basically allow banks to only have their "good" loans considered and their "bad" loans can be shielded in either a subsidiary or affiliate institution. The joint CRA regulations of the four federal bank regulators specify that a bank, "at a bank's option", can have the lending, investment, and service activities of an "affiliate" considered. An affiliate can be a subsidiary, a parent organization, or other