Remarks by EUGENE A. LUDWIG Comptroller of the Currency before the Director's Roundtable San Francisco, California

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During a recent meeting in Italy, I dined with a prominent bank supervisor who spoke of the fabled connection between Rome's greatness and the seven hills upon which it sits. I replied that by the same logic, San Francisco, built on twice as many hills, must be twice the town!

Not that I make any pretense of impartiality about the City by the Bay. It has been called the most European of all American cities, but I think that comparison mostly flatters the Europeans. As my flight approached San Francisco yesterday,with the city's panorama stretching out before me, I recalled John Steinbeck's description of the place: "a gold and white acropolis, rising wave on wave against the blue of the Pacific sky, a stunning thing, a painted thing." It is always goodfor the soul to return to San Francisco, a town long known as Yorba Buena--"the good grass," a magnet for enterprising cattlemen -- until the name was changed in 1847, exactly a century and a half ago.

There's another anniversary I'd like to talk to you about this afternoon. Twenty years ago this fall, on October 12, 1977, the Community Reinvestment Act was signed into law. That Act was predicated on two basic assumptions: first, that America's inner cities were desperately in need of new investment that the Federal government, with its budget constraints, could not provide by itself; second, that new private and public partnerships and private sector pursuit of businessopportunities were needed to complement direct governmentsubsidies.

CRA also said that private corporations that provide basic services and receive public benefits assume certainpublic responsibilities.

Twenty years after the CRA was signed into law is an opportune moment to reflect upon the past and look to the future. Is CRA still needed today? To what extent are the principles underlying it still valid? What steps can we take to ensure that in the coming decades we build upon the business and social benefits that CRA has delivered in its first twenty years? And what actions must we take to maintain the proper balance between community needs and the legitimate interests of the industry?

Let me remind you that in the beginning, there was considerable skepticism that such a balance was even achievable. Extremistson both sides shaped the initial debate. CRA instantly became the banking industry's least-favorite law--a symbol of heavy-handed, intrusive government interfering with the free market. Some bankers raised the specter of credit allocation: federal bureaucrats, they charged, were impinging on the bankers' responsibility to make those loans--and only those loans--that conformed to standard banking principles.

On the other side, some community advocates saw CRA as a panacea that would mobilize private capital to fight and win the war on poverty and urban blight--problems they blamed on tightfisted bankers indifferent to the country's problems.

In the face of these unrealistic and irreconcilable fears and expectations, federal banking regulators were slow to effectively implement CRA. This was especially true in the early 1980s, when the political climate turned hostile to regulation and government mandates. In congressional hearings timed to coincide with CRA's tenth anniversary, in 1987, testimony centered on the law's failures. Despite continuing racial discrimination in home mortgage lending, despite declining home ownership rates nationwide and disinvestment in low and moderate-income neighborhoods, the regulatory agencies were cutting back on the time and personnel devoted to CRA enforcement.

This led to CRA reform beginning in 1989. The omnibus banking act known as FIRREA required the public disclosure of each bank's CRA ratings--the first time in American banking history that confidential examination results were to be reported to the public. Regulators stepped up CRA enforcement.

Despite these efforts, complaints persisted. Critics charged that the CRA's rules and goals were unclear. The regulatory agencies were cited for failing aggressively to penalize poor performance. Bankers complained that the examination standards were applied unevenly, and that the process seemed driven by paperwork requirements rather than actual lending performance.

So, in July 1993, President Clinton ordered the regulatory agencies to develop new CRA regulations and examination procedures that "replace paperwork and uncertainty with greater performance, clarity, and objectivity." And that is what we did. After hearing from hundreds of banks, community groups, small businesses, government officials, and private citizens, we promulgated new CRA regulations that featured clearer and more objective evaluation standards, eliminated unnecessary documentation requirements, offered more flexibility in defining CRA requirements for large and small banks, and provided new opportunities for public involvement.

The results of our new emphasis on CRA compliance have been heartening. Since CRA became law in 1977, we have witnessed more than $215 billion of loan commitments for low and moderate income lending. Remarkably, $175 billion -- a full 81 percent of the total -- has happened in the past three years alone. Since 1993, when I became Comptroller, home mortgage loans to low and moderate income census tracts have risen by 22 percent, morethan twice as fast as the rate of growth in all home mortgageloans.
In the past four years, banks have invested four times as much in community development projects as they did in the whole previous thirty years. San Francisco has been a major beneficiary of these lending partnerships.

These numbers should make everyone in this room proud--bankers, community leaders, and bank regulators. I am particularly proud of the OCC for leading the effort. But the job is far from complete. Despite the impact that community development activities have made in the lives of our people--an impact Ihave seen with my own eyes in visits to small towns and big city neighborhoods all across America--poverty remains an intractable and pervasive feature of American life. At last count, in1994, 15 percent of our people – and 30 percent of the African-American and Hispanic populations--subsisted below the poverty line. Across our nation, two out of every eleven children live in poverty, with all of its consequent ills: higher rates of child abuse and neglect, lower immunization rates, high violent death rates and high school drop-out rates. Two and a half millionpoor children live in California alone, where housing costs squeeze family budgets, aggravating the problems of inadequate food, clothing, and medical care.

Now, I have no illusions that CRA can bridge the huge opportunity gap for low and moderate income Americans. CRA alone cannot solve a myriad of problems--poor schools, crime, health care—that afflict low and moderate income Americans. CRA is about doing profitable business, making good loans, and providing services for those low and moderate income Americans who are able to pay for them. This is not to deprecate the genuine genius of CRA; for unlike a handout, CRA brings people into the mainstream of America's great free market, not as second class citizens, butas full, responsible participants in theirsociety.

But even without CRA's structural limitations, we have to face up to the fact that the banking industry can only do so much.
Perhaps the most difficult challenge over the long term is that CRA covers an ever-shrinking share of the financial services industry. The day may come when banks can provide all the financial services low and moderate income Americans need, including insurance and pension fund management. But we are not there yet. Nonbanks still dominate those critically important markets and are now formidable competitors in markets which bankers once did dominate.

The rise of full-service nonbank providers as relatively unregulated competitors for the business that once belonged to bankers is a phenomenon with which all of you are familiar. The numbers tell the story. In 1990, for the first time in history, nonbanks held a larger share of the nation's financial assets than commercial banks and thrifts combined. In 1993, for the first time in history, mutual fund assets exceeded bank time deposits, and the gap continues to grow. Today, Americans have close to $4 trillion invested in mutual funds, compared to under $3 trillion in bank and thrift deposits. In 1994, again for the first time in history, commercial paper outstanding exceeded the total value of bank commercial and industrial loans.

Several trends account for the loss of banking's once-dominant position in the financial services market. Advances in technology now permit nonbanks easily to obtain the information they need -- information that banks once monopolized -- to make prudent and profitable loans. Our global economy has brought new financial competitors to our shores. Demographic changes -- especially our aging population -- has created a demand for new financial products and services, some of which banks have not been legally permitted or well positioned to supply.

Banks are also subject to rules and regulations not applicableto their nonbank competitors. Most nonbank providers would admit that freedom from regulatory restraints gives them an advantage in any competition with banks. Finance companies, for example, make loans the same way banks do, but they enjoy greater freedom from capital requirements, limits on loans to single or related borrowers, and limits on transactions with parents and affiliates. Immunity from reserve requirements enables money market mutual funds to offer depositors higher rates ofinterest than the best managed bank could match. None of the non-traditional financial providers need comply with the extensive reporting requirements that apply to banks and none is subject to similar restrictions on corporate organization. And, of course, none is subject to the CRA.

I ask you: does this make sense? In an era where all financial services are converging, why does only one segment of the financial services industry have to comply with a CRA-type of responsibility? The answer can't be need. Our low and moderate income communities would welcome with open arms the special expertise, the products, and the resources that our nonbanks have to offer.

Nor can concerns about safety or profitability explain whyCRA-like principles have not been extended to nonbanks. CRA has hardly damaged banking. Quite the opposite: the greatest era of CRA activity in history, the last three years, has also seen the highest levels of bank profitability in history. Iwould perhaps not go so far as to say that the upswings in CRA activityand bank profits are cause and effect. But there is no gainsaying the evidence of mutually profitable relationships between banks and their communities that have developed and are continuing to develop in the CRA context.

I recognize that even to raise the question of whether to extend the principles underlying CRA to other parts of the financial services industry will generate controversy and elicit many questions in response. Insurance and securities firms will ask: how can we meet a CRA-like requirement for low and moderate income lending when our business has nothing to do with making loans? Mortgage companies, pointing to their growing share ofthe low and moderate income mortgage and consumer lending markets, will ask: what's the point of involving a third party to encourage us to do what we are doing already? Pension fund managers will ask: how can we be expected to reconcile outside mandates with our fiduciary duties to employees and retirees?And all nonbanks will doubtlessly ask why they should have to assume CRA-like obligations when, according to them, they don't even share in the public subsidies enjoyed by banks in the form of deposit insurance, access to the Federal Reserve's discount window, and so forth.

I do not believe these questions should keep us from considering how the principles underlying CRA might be extended to embrace the broader financial services industry. To help low andmoderate income Americans have fair and equal access to financialservices does not necessarily mean the imposition of a CRA-type of responsibility in a rigid, one-size-fits-all way. Indeed, justas our new CRA regulations enable us to differentiate between the needs and capacities of both large and small banks, community investment requirements for nonbanks could be flexible enough to accommodate different corporate strategies and structures. For example, nonbanks could enter into partnerships with Community Development Financial Institutions in the same way that conventional institutions have done--through co-investments, contributions to lending pools, and so on. I have seen proposals for parallel banks to establish and fund a National Reinvestment Bank, which would provide a capital base for CDFIs. Making insurance coverage more accessible and affordable would be a worthy CRA-like goal.

Let me emphasize once again that I am not endorsing any particular arrangement--or any arrangement. But I am suggesting that we ask these important questions and begin thinking about how these responsibilities should beshared.

There is no doubt that many nonbanks are already doing various kinds of good work that serves the broader public interest. So did many banks before CRA was passed. Nonetheless, CRA has added value. It has helped bring banks and community leaders together. It has given a sharper focus to the needs of our underserved communities. It has given us a way of assessing our communities' credit needs and measuring how well our lenders are meeting them over time. It has provided a tool for ensuring that, forexample, mortgage lending by financial institutions addresses the housing needs of all our people, not just the most affluent ones. It has enabled us to separate serious programs from those that may make good public relations sense but little long term difference in the life of a community. It has enabled us to do a better job of ensuring that basic financial services are available to all Americans without discrimination.

Finally, it is important that we address the question of thequid pro quo that allegedly rewards banks for their CRA activities with a supposedly lavish array of public benefits unavailable to nonbank providers. We have been hearing much of late about this so-called "safety net" subsidy. Let me say parenthetically that recent empirical research finds that this bank subsidy argument does not hold water--that only a small minority of banks receive a net benefit, which is minimal at best.

In the present context, however, we must keep in mind that nonbanks enjoy significant public benefits, too--benefits that reduce their costs of doing business and represent significant actual and potential liabilities to the nation's taxpayers. Although mutual funds and pension funds are backed by industry-funded guarantee associations, both the Securities Investors Protection Corporation and the Pension Benefit Guarantee Corporation have standby lines of credit with the U.S. Treasury -- $100 million for PBGC, $1 billion for SIPC. Securities firms have access to the Fed's discount window. Insurance companies benefit from a variety of congenial public policies: in most states, insurers can deduct contributions to the guarantee funds from their state taxes. Insurance annuities build value tax deferred. Finance companies do a bustling business in federally-subsidized loans to home buyers, small business people, and students. One other thing nonbank providers share is the benefit of the increasingly widespread assumption among investors that the Federal Reserve would exercise its authority as lender of last resort to stave off short-term liquidity crises for nonbanks as well as banks.

We live in an age that is redefining--and quite properly so--the role of government in the lives of our people. CRA--a law that calls for no public expenditures, little bureaucratic intervention, and local control--has become a model for this new relationship. As we move forward into the 21st century, I believe we must begin now to seriously focus on this central question: to what degree should financial providers beside banks be asked to step up to the plate and participate in a CRA-like program asthe banking industry has done? I look forward to fruitfuldiscussions on this question in the months ahead.