NAAHL | National Association of Affordable Housing Lenders

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Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

Comment: Special Purpose Charters

Dear OCC Special Purpose Charters Team:

The National Association of Affordable Housing Lenders (NAAHL) appreciates the opportunity to address questions that the OCC has posed in its paper, "Exploring Special Purpose National Bank Charters for Fintech Companies." NAAHL is the national alliance of banks, Community Development Financial Institutions (CDFIs), and other private capital providers for affordable housing and inclusive neighborhood revitalization.

We strongly support the OCC's principle that any special purpose bank must maintain the "same high standards of safety and soundness, fair access, and fair treatment of customers that all federally charted institutions must meet." In particular, nondepository special purpose banks should have obligations to meet community credit needs equivalent to those applicable to insured depository institutions (IDIs) under the Community Reinvestment Act (CRA). This principle is important for three primary reasons.

- Community needs and convenience. A national bank charter should be available only to institutions that broadly serve community needs, including those of low- and moderate-income (LMI) people and places.
- Level playing field. Because nondepository special purpose banks will have the same status and attributes under federal law as IDIs, they should likewise have equivalent public obligations. Nondepository special purpose banks would have an unfair competitive advantage over IDIs unless they have CRA-like obligations.
- Regulatory arbitrage. Uneven regulatory standards would invite banks to prefer a nondepository charter in order to avoid a CRA-like obligation.

We would like to address three specific questions the OCC has raised.

3. What information should a special purpose national bank provide to the OCC to demonstrate its commitment to financial inclusion to individuals, businesses and communities? For instance, what new or alternative means (e.g., products, services) might a special purpose national bank establish in furtherance of its support for financial inclusion? How could an uninsured special purpose bank that uses innovative methods to develop or deliver financial products or services in a virtual or physical community demonstrate its commitment to financial inclusion?

Consistent with CRA, a special purpose bank should provide information appropriate to its activities that documents its service to LMI people and places. For example, an institution that provides home mortgages or small business loans should provide information on these activities similar to that provided by banks under CRA, including the share of these loans that benefit LMI people and places. New or alternative products, services, and delivery channels should be fully considered for special purpose banks and for other banks generally, either under CRA if they are IDIs or through a CRA-like regime if they are uninsured. An uninsured special purpose bank should demonstrate its commitment to financial inclusion much as a similar IDI does under CRA (e.g., by identifying the location and/or income of its customers).

4. Should the OCC seek a financial inclusion commitment from an uninsured special purpose national bank that would not engage in lending, and if so, how could such a bank demonstrate a commitment to financial inclusion?

Yes. Wholesale and limited purpose IDIs not engaged in lending already have CRA responsibilities for community development. Like prospective uninsured special purpose banks, these special purpose IDIs typically serve a nationwide (rather than a local) market and do not operate retail branches. An uninsured special purpose bank not engaged in lending should have a similar obligation.

The experience of wholesale and limited purpose IDIs under CRA is illustrative because they are required to support financial inclusion even though they generally do not engage in lending (except for those offering credit cards). Under CRA, wholesale and limited purpose banks have a community development test which they may meet in various ways. In some cases, these special purpose IDIs serve LMI people and places through partnerships with full-service banks or nonbank intermediaries, including CDFIs, nonprofit organizations, Small Business Investment Companies, and tax credit investment syndicators. In other cases, wholesale and limited purpose banks have chosen to develop their own internal capacity to provide direct investments, loans, and services. Just as some wholesale and limited purpose banks have applied their own specific core capacities to address community development needs, so too might a fintech apply its technological capacity to address these needs.

More broadly, the federal banking agencies should align the geographic service responsibilities of all special purpose banks – whether uninsured or insured.

Under the current CRA rule, each full-service, wholesale, and limited purpose IDI designates one or more assessment areas surrounding its branches and other deposit facilities. A wholesale or limited purpose IDI's assessment area typically surrounds its main office, but the bank also receives CRA consideration for activities nationwide if it is responsive to its assessment area's needs, a policy that does not apply to full-service banks. As the federal banking agencies have explained: "This different treatment accounts for the fact that wholesale and limited purpose institutions typically draw their resources from, and serve areas well beyond, their immediate communities."[1]

It is our view that local assessment areas do not make sense for special purpose banks that serve a nationwide market, whether they are uninsured or insured.

For an uninsured special purpose bank, the concept of a local assessment area has no relevance because, by definition, it will not have facilities for taking insured deposits. For uninsured banks, a

[1] *Federal Register*, Vol. 60, No. 86, May 4, 1995, page 22160.

community development obligation should apply on a nationwide basis and reflect the size and scope of the bank and its performance context. As is currently the case for special purpose IDIs under CRA, submission and advance approval of a strategic plan for community development should be optional but not mandatory for an uninsured special purpose bank.

To provide a level playing field for special purpose IDIs, they should be permitted to designate a nationwide CRA assessment area. NAAHL has previously proposed that the federal banking agencies issue sub-regulatory CRA policy guidance, such as examination guidance, that explicitly reflects the nonlocal nature of a wholesale or limited purpose IDI and considers activities outside assessment areas reflecting the bank's share of deposits from customers outside its assessment area. NAAHL has also proposed that the same principle should apply to internet banks, which are, in effect, full-service fintech IDIs that, like wholesale and limited purpose IDIs, typically draw their resources from, and serve areas well beyond, their immediate communities. (A copy of NAAHL's CRA proposals is attached.)

5. How could a special purpose national bank that is not engaged in providing banking services to the public support financial inclusion?

Similar to part of our response to Question 4, the experience of wholesale banks under CRA is illustrative because they support financial inclusion under CRA even though they do not provide banking services to the public. In some cases, wholesale banks serve LMI people and places through partnerships with full-service banks or nonbank intermediaries, including CDFIs, nonprofit organizations, Small Business Investment Companies, and tax credit investment syndicators. In other cases, wholesale banks have chosen to develop their own internal capacity to provide direct community development investments, loans, and services. Just as some wholesale banks have applied their own specific core capacities to address community development needs, so too might a fintech apply its technological capacity to address these needs.

This concludes our comments. We would be happy to discuss them with the OCC team.

Sincerely,

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Benson F. Roberts
President and CEO

October 16, 2015

CRA Policy Guidance on Community Development

It is essential that CRA policies keep pace with changes in the banking industry, communities, and community development practice. Taken together, the following proposals would significantly expand economic opportunity for low-income people and communities. These issues are entirely addressable through Question and Answer (Q&A) guidance, examination procedures, and similar policy instruments. *No change to the statute or regulation is required.*

In addition to these specific recommendations, we strongly urge the federal banking agencies to provide more examiner training both on CRA policies and CD practice. We also recommend that CRA specialists conduct CRA examinations in order to ensure that the nuanced judgments about community needs and opportunities required in the CRA examination process are well-informed. These steps would greatly improve examiners' consistency, accuracy, and judgment, which in turn will help banks meet community needs.

1. **Further clarify recent guidance on community development (CD).** The agencies finalized Q&A guidance in 2013 on CD and updated large bank examination procedures in 2014. This guidance is helpful, particularly by: (1) clarifying that CD activity outside assessment areas (AAs) will be considered in state[1] or institution-level ratings; and (2) removing the possibility that regional activity will be discounted because benefits to an AA might be diffuse. We strongly support the agencies' intent to help underserved communities, including rural communities and smaller cities, as well as to accommodate more efficient delivery platforms. However, the guidance is still too unclear to affect most bank decisions and, consequently, to expand communities' access to CD resources. We propose the following:

    - Definition of Broader Statewide and Regional Areas. In general, a bank receives CRA consideration for CD activity within a "broader statewide or regional area that includes an AA" (BSRA). However, a bank needs certainty when a financing decision is made that the agency will recognize a location as within a BSRA. Currently, a bank will find out only during an exam that takes place perhaps years later. To provide the certainty banks need to make real-time investment decisions while recognizing that regional definitions require some judgment, the agencies should:

        - Recognize that a BSRA includes, *at a minimum*, all states adjacent to a state in which a bank's AA is located, and that, depending upon a bank's performance context, states beyond those adjacent to the state in which a

[1] Throughout this paper, the term "state rating area" also includes multi-state metropolitan rating areas.

bank's AA is located This standard would be clear and simple, and it would address a significant portion of the concerns on this issue.

- Publish and regularly update a list of safe-harbor BSRAs (e.g., Great Lakes States, New England, and the Southeast). This list would be consistent with the current Q&A, which cites the Mid-Atlantic States as an example of an acceptable BSRA. The boundaries of such BSRAs should be clearly defined. Again, we wish to emphasize that this list should not be exclusive.

- Promptly respond to banks seeking advance approval of a proposed BSRA. This approach preserves full flexibility to respond to regional strategies and also provides the clarity banks need.

- "Responsiveness" to community development needs and opportunities in its assessment area(s). A bank will receive consideration for a BSRA activity even if it is unlikely to benefit the AA, but only if the examiner finds that the bank has been "responsive" to its AA's CD needs. *For this purpose, a bank's "responsiveness" should be determined based on its combined CD activity in all AAs within each state, rather than for each AA separately*. A bank may have 30 or more AAs in a large state like California. The risk that an examiner might retroactively disqualify an activity for consideration because a bank was not responsive to one or a few AAs is sufficient to discourage BSRA activities not likely to benefit the AA. Note that a bank cannot rely on guidance from its examiner at the time a financing decision is made because examiners may change by the time of the examination. The agencies should also affirm that Satisfactory or better performance within a state rating area will be recognized as "responsive".

- CD activity in limited-scope review areas within a state should be aggregated and receive full consideration as part of the state rating, based on qualitative as well as quantitative factors. CD activities are just as important to limited-scope review areas (generally smaller metro areas and rural communities) as they are to full-scope review areas. However, the large bank examination procedures (p. 15-16, steps 4-6) direct that a bank's performance outside full-scope review areas will have no effect on the rating[2]. A later provision (p. 16, step 8) does say the state rating should reflect CD activities in the "institution's assessment area(s) in the state or multistate MSA." However, even if this later provision is intended to include limited-scope review

[2] At 4.b. on page 15, an examiner that finds inconsistent performance within and outside a full-scope review area is instructed to conclude: "The institution's [lending/investment/service] performance in [the assessment area/these assessment areas] [exceeds/is below] the [lending/investment/service] performance in the assessment areas within [the MSA/nonmetropolitan portion of the state] that were reviewed using the examination procedures; *however, it does not change the conclusion* for the [MSA/nonmetropolitan portion of the state]." (emphasis added) Similar language appears at 6.b. on page 16.

areas, it will be ineffective without an explicit path to override the earlier directive. CD activities in all limited-scope AAs within each state should be aggregated and considered together because CD opportunities in any given limited-scope AA may not be consistently available (as well as to minimize examiner burden). In addition, examiners should consider any qualitative information that a bank chooses to provide.

- CD activities outside AAs should receive the same consideration as similar activities within AAs, based on qualitative as well as quantitative factors. The 2013 Q&A guidance prohibits discounted recognition of CD activities in a BSRA because the benefit to the AA itself may be diffuse. However, it is not clear that CD activities outside AAs will receive the same consideration as activities within AAs.

2. **Wholesale, limited-purpose, and internet banks: location of CD activity.** In recent years, wholesale, limited-purpose, and internet banks (or "WLPIBs" for short) have grown as non-bank financial firms have obtained bank charters and internet banking has emerged. Of the 40 largest U.S. banks, 13 are WLPIBs with combined domestic assets of $1.5 trillion.[3]

   Unlike a traditional large retail bank, a WLPIB generally has no or very few deposit-taking offices and the great majority of its deposit holders are located outside its AA. For purposes of CRA, a WLPIB is usually assigned a single AA where its headquarters is located. This location is not reflective of its banking activity or capacity.

   Over-emphasizing a WLPIB's CD activity in its AA has unintended consequences. A WLPIB may feel obliged to undertake far more CD activity within its AA than the level of its local banking activity would reasonably indicate. This concern is compounded in the markets where WLPIBs tend to be chartered (e.g., Utah, Delaware, and New York City). The finite CD opportunities in those markets fall far short of what the banks' collectively need to meet performance benchmarks. The resulting hyper-competition clearly distorts pricing and can erode credit standards without actually expanding CD activity. Traditional retail banks in these areas are indirectly affected as well, since they must compete with WLPIBs for limited CD opportunities there. Meanwhile, some WLPIBs do not pursue CD activities beyond their AAs because they will receive CRA recognition for such activities only after meeting an "AA responsiveness" metric that is unknowable in real time and perhaps unachievable.

   To address these anomalies, the agencies should publish guidance that:

[3] WLPIBs include, in order of size: State Street Bank ($213B in domestic banking assets); Bank of New York Mellon ($212B); Morgan Stanley ($156B); Chase Bank USA ($139B); Goldman Sachs ($128B); Schwab Bank ($119B); Ally Bank ($104B); Capital One Bank USA ($87B); Northern Trust ($84B); Discover Bank ($83B); American Express ($78B); Deutsche Bank ($54B); and E*TRADE Bank ($44B). In some cases the data reflects more than one charter. *Sources: Federal Reserve Board of Governors and Federal Deposit Insurance Corporation*.

- A WLPIB's essential non-local focus and limited local presence should inform the performance context for its AA.

- A WLPIB that has less than 10% of its deposits from depositors located within its AA should receive full consideration for CD activities outside its AA up to 90% of its total CD activity. A WLPIB that has 10-20% of its deposits from depositors located within its AA should receive full consideration for CD activities outside its AA up to 80% of its total CD activity.

- To differentiate an internet bank from a traditional retail bank, an "internet bank" could be defined as a large retail bank that receives at least 80% of its deposits from customers located outside its AA(s).

This proposed approach would help address challenges regarding CD activities by: (1) providing an appropriate context for CD activities within a WLPIB's AA; (2) relieving hyper-competition for CD activities far out of proportion to its local business activities in certain markets where WLPIBs are often chartered; and (3) providing a clear basis for considering CD activity beyond AAs, thereby facilitating more resources for underserved communities, including rural areas and smaller cities. This approach would:

- Apply only to WLPIBs. It would not apply to traditional retail banks.
- Apply only to CD loans, investments, and services. It would not apply to an internet bank's home mortgage, small business, or consumer lending, which would continue to be assessed according to the share of each bank's activity that benefits low- or moderate-income individuals and geographies.
- Extend the principle that the degree of a bank's presence within an AA should inform the performance context for that AA.
- Not conflict with or require any change to the CRA statute or rule, including the rule's definition of an AA. Because an AA is defined as the area around branches, this policy would not allow for the establishment of additional AAs.
- Not require a WLPIB to undertake CD activity outside its AA or serve any particular community beyond its AA. Rather, the approach provides a framework for considering CD activity within and beyond the AA.
- Not change expectations for a WLPIB's total CD activity. A WLPIB's size and capacity would still inform the performance context at the institution level. The proposed approach only creates a framework to help a WLPIB decide how to distribute this activity within and outside its AA.
- Be workable for a WLPIB to track. Banks already know the address of their depository account holders, except for brokered deposits. [4]

[4] For this purpose brokered deposits should be treated as coming from outside the AA. The account holder of a brokered deposit is the broker, not the original depositor. Brokers do not generally provide to a bank the addresses of original depositors.

3. **Naturally affordable rental housing.** Affordable rental housing without income restrictions should receive favorable consideration as described below.

   About 80% of the 26.3 million rental units affordable to LMI households have no restriction on tenant incomes.[5] Yet, CRA consideration for financing this "naturally" affordable rental housing stock is entirely up to each examiner's discretion.

   Indeed, Q&A guidance[6] clearly warns that affordable rents alone are insufficient to obtain favorable CRA consideration as affordable housing. Unless renter incomes can be verified, additional analysis of demographic, economic, and market data is required to determine that LMI households are likely to benefit. While we recognize that likely LMI benefit is a valid policy concern, the current policy is unworkable. Lenders need to know how an activity will be treated under CRA before they decide to develop and market a loan or investment product. But lenders generally do not collect tenant income data (and cannot do so for properties not yet occupied). Extensive market analyses are administratively burdensome for banks and examiners. As a result, the current guidance offers little or no encouragement of bank financing for much of the naturally affordable rental housing stock. Because examiners are less likely to consider rental housing outside LMI geographies, the policy is particularly unsupportive of fair housing efforts to offer affordable housing in middle- and upper-income "high opportunity" areas, an objective integral to HUD's new Affirmatively Furthering Fair Housing policy.

   Other federal policy makers have adopted an affordability metric based on the initial rent relative to the local area median income. The Federal Housing Finance Agency, in setting affordable rental housing goals for Fannie Mae and Freddie Mac, determines affordability based solely on rents, not incomes, "[b]ecause lenders generally do not collect income information on tenants."[7] Similarly, the housing finance reform bill approved last year by the Senate Banking Committee used the same methodology in setting affordability requirements for entities eligible for federal guarantees of multifamily mortgage-backed securities. This approach is widely regarded as reasonable and workable.

   We propose here a policy approach that is clear, predictable, data driven, consistent with other federal affordable housing policy, and easily administered. According to HUD, LMI

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[5] About 26.3 million rental units are affordable to households with incomes at or below 80% of the area median (Source: HUD, *Worst Case Housing Needs: 2015 Report to Congress,* Table A-12). About 5.6 million affordable rental units are subject to federal income restrictions, including 3.0 million HUD assisted units and 2.6 million LIHTC units. Sources: HUD FY 2013 Annual Performance Report / FY 2015 Annual Performance Plan, http://portal.hud.gov/hudportal/documents/huddoc?id=HUD_FY13APR_FY15APP.PDF , p. 36, and HUD LIHTC Data Sets http://www.huduser.gov/portal/datasets/lihtc.html

[6] Q&A Section __12.(g) (1)-1.

[7] 2015–2017 Enterprise Housing Goals; Final Rule, *Federal Register*, Vol. 80, No. 171, September 3, 2015, p. 53423.

renters actually occupy 72% of the units affordable to them.[8] If all rental properties were similarly occupied, requiring that 70% of the units in a property must be affordable would likely result in majority LMI occupancy (70% X 72% = 50.4%) and thereby qualified for full consideration under CRA. However, because a property is more likely to be LMI occupied if it is located in a LMI geography, we recommend a somewhat lower threshold in LMI geographies and a somewhat higher threshold in middle- and upper-income geographies.

- ***In a LMI geography:*** full consideration if a majority of the units in the property have affordable rents; and pro-rata consideration if a minority of the units have affordable rents. No further discounting is appropriate because housing with affordable rents in LMI geographies also contributes to neighborhood stability and revitalization. Many examiners already follow this approach.

- ***In a middle- or upper-income geography:*** full consideration if at least 80% of the units have affordable rents; and pro-rata consideration multiplied by 2/3 if less than 80% of the units have affordable rents. The 2/3 factor reflects the likelihood that a significant portion of the units may not by occupied by LMI renters.

4. **Primary CD purpose.** Q&A guidance should clarify that the entirety of an activity has a "primary purpose" of CD if it is undertaken in conjunction with a federal, state, or local government CD program or formal policy and at least 20% of the dollars or beneficiaries are identifiable to a CD purpose. Q&A section __.12(h)-8 provides consideration for the full amount of an activity with a "primary purpose" of CD even if less than "a majority of the dollars or beneficiaries of the activity are identifiable" to CD purposes, provided that: (1) the express, bona fide intent is primarily CD; (2) the activity is specifically structured to achieve the CD purpose; and (3) the activity accomplishes or is reasonably certain to accomplish the CD purpose. However, this policy has proven too complicated to implement clearly and consistently. For example:

   - The Low Income Housing Tax Credit (LIHTC), the federal government's primary policy to produce and preserve affordable rental housing, requires that at least 20% of the units serve low-income households. However, if less than a majority of the units are low-income restricted, some examiners consider only a pro-rata portion of the investment. To ensure CRA recognition for the entire investment, some banks consequently require sponsors of mixed-income LIHTC developments to establish complicated and expensive condominium ownership regimes in which LIHTC investors own only the income-restricted units and a separate entity owns the other units. Since the full investment is based on the LIHTC, it would clearly appear to satisfy the "primary purpose" requirement and receive full consideration. Indeed, the

[8] HUD, *Worst Case Housing Needs: 2015 Report to Congress,* Table A-12. For this purpose, affordability is based on rents not exceeding 30% of 80% of the area median income.

preamble to the Q&A favorably cites LIHTC in this context[9], but the actual Q&A does not.

- Tax-exempt multifamily housing bonds, another major federal policy expressly designed to promote affordable housing, also require at least 20% of the units to be low-income occupied. Banks that purchase these bonds or provide credit enhancement for these bonds should likewise receive consideration for the full amount of their participation.

- States and localities also have their own programs and policies designed to promote affordable housing, including direct grants and loans, as well as zoning policies. For example, the state of Massachusetts anti-snob zoning law (Chapter 40B) promotes housing in which at least 25% of the units serve LMI households and several localities have inclusionary zoning policies. Banks should receive consideration for the full amount of an activity in conjunction with state or local government programs and policies, provided that at least 20% of the "dollars or beneficiaries are identifiable" to an express CD purpose of the policy or program.

5. **Letters of credit (LCs), loan guarantees, and other credit enhancements should receive full recognition and weight as CD loans.** Q&A section __.22(a)(2)-1 misclassifies LCs as "loan commitments", adding that "[i]nformation about lending commitments will be used by examiners to enhance their understanding of an institution's performance, but will be evaluated separately from the loans." In fact, providing a LC, loan guarantee, or similar credit enhancement is not just an offer to extend credit that may or may not be fulfilled; it is as much an actual extension of credit as a direct loan. Unlike a loan commitment and exactly like a loan, a LC requires a bank to assume credit risk and reserve capital. In fact, a LC, loan guarantee, or similar credit enhancement transfers risk from the actual lender immediately upon execution. LCs, loan guarantees, and similar credit enhancements serve an important function in CD financing, and are often integral to construction financing and tax-exempt bond structures. The most efficient CD financing execution for borrowers may require a bank LC that enables the participation of capital markets investors. Dismissing LCs, loan guarantees, and similar credit enhancements as less valid or important than a direct CD loan not only misconstrues these realities, but also discourages innovation and market efficiency. Revising the Q&A to clarify that LCs will receive full recognition and weight would also complement other recent guidance elevating the importance of CD lending.

6. **A bank with an Outstanding CRA rating should receive expedited processing of its applications for regulatory approvals listed in the Rule**. Historically, the primary regulatory effect of a bank's CRA rating has been its impact on the approval of an

[9] "If the express, bona fide intent of an activity is community development, even though the measurable portion of any benefit bestowed or dollars applied is less than a majority of the entire activity's benefits or dollar value, the agencies continue to believe that it is important that such activities, such as projects involving low-income housing tax credits, receive full consideration." *Federal Register,* Vol. 75, No. 47, March 11, 2010, p. 11643.

application, especially for charter mergers, acquisitions, or conversions. However, this significance wanes in periods when charter mergers and acquisitions are infrequent, as has been the case for several years. Accordingly, many banks are questioning whether achieving an Outstanding CRA rating is worth the effort or, alternatively, a Satisfactory rating is sufficient.

To encourage banks to strive for an Outstanding rating, we recommend that the agencies provide expedited processing of applications from banks with Outstanding CRA ratings. We stress that expedited processing itself would not in any way imply favorable disposition of an application or provide a safe harbor protection against community objections. Rather, our proposal recognizes that banks, and especially large banks, routinely seek agency approvals and an expedited review would be beneficial to banks with Outstanding CRA records. This recommendation is squarely within the current rule. In addition to applications for charter mergers and acquisitions, the rule directs the agencies to take "into account the record of performance under the CRA of each applicant bank in considering an application for: (1) The establishment of a domestic branch; (2) The relocation of the main office or a branch; [and] (3) … the acquisition of assets or assumption of liabilities of an insured depository institution…."

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In conclusion, we believe these proposals will help banks respond more effectively, efficiently, and quickly to CD needs by:

- Clarifying the rules of the road. (Proposal #1, 2, 3, 4, 5)
- Elevating the qualitative elements of CD. (#1)
- Reaching historically underserved rural and smaller metro areas. (#1, 2)
- Allowing more strategic flexibility. (#2)
- Responding to changes in the banking industry. (#2)
- Coordinating better with other governmental policies. (#4)
- Supporting unsubsidized CD activity. (#4)
- Accommodating more efficient delivery of CD resources. (#5)
- Motivating outstanding CRA performance. (#6)

We appreciate the agencies' consideration. For additional information, please contact Benson (Buzz) Roberts at broberts@naahl.org or 202-293-9853.