November 3, 2010

The Honorable Bernard Parks
Chair, Budget & Finance Committee
Los Angeles City Council
200 N. Spring Street, Room 460
Los Angeles, California 90012

**RE: Opposition to Responsible Banking Investment Monitoring Program; CF 09-0234**

Dear Chairman Parks:

The Central City Association, the Los Angeles Area Chamber of Commerce, and the Valley Industry & Commerce Association collectively represent thousands of businesses, including a substantial number of banks and other financial institutions, employing hundreds of thousands of people across the Los Angeles region. We write to express our serious concerns with the proposed Responsible Banking Investment Monitoring Program (RBO) (CF 09-0234).

The RBO purports to provide "incentives" that, upon closer read, include the complete withdrawal of the city's banking business from an entity that does not score well enough[1] or does not provide all of the information requested.[2] It is particularly unfair to single out this industry, since no other businesses that cities do business with have anything close to the statutory duties and record of investment in our communities that financial institutions have.

**Cost and Implementation**

The RBO heaps a significant bureaucratic layer of compliance on top of an existing, well-established regulatory framework. Exacerbating this phenomenon is the fact that it does it at a very local level. Therefore, if cities across the state or country had laws like the RBO, banks would have to develop separate compliance systems for each city with such a law. Fortunately, other local governments have recognized that it is not in their best interest to make it *more* difficult to do business in and with their municipality.

We must also oppose an ordinance that creates a huge amount of work for the Treasurer's office, in an environment where the city is facing a budget shortfall in the hundreds of millions and the resulting substantial reduction in workforce. The RBO asks the Treasurer to gather, compile, and analyze a massive amount of information on an annual

[1] Substitute Draft Ordinance, 10/26/10, Sec. 20.98.1
[2] Substitute Draft Ordinance, 10/26/10, Sec. 20.96

basis. *Does the Treasurer's office have the staff, and expertise, to administer the new program being proposed on an annual basis?*

Even if new resources are identified to develop and maintain the administrative program envisioned by the RBO, we do not believe it would be necessary or justified for the city to incur such a cost, given that much of the requested information is already publicly available (albeit reported based on a larger geographical area) through CRA, SEC and other reporting mechanisms. The RBO's purpose and effect are far from clear.

**Substantive Hurdles**

Many of the problems with the draft ordinance are rooted in the RBO's attempt to require banks to abide by requirements that are inconsistent with existing state and federal laws regulating the industry. How can banks comply with a municipal law that conflicts with state and federal laws, which have been developed over many decades and already blanket the industry?

For example, the ordinance is aimed at gathering and tracking information on a very local basis. However, when banks compile this information on a level smaller than their Community Reinvestment Act (CRA)-mandated "assessment areas," they may expose themselves to charges of "redlining," or other form of racial or economic discrimination.

The RBO is also flawed in that it does not establish clear standards for compliance, and does not clearly set forth the means by which financial institutions will be ranked. In establishing a 100-point scoring system, it states that institutions "will simply have their points tallied out of 100 possible points."[3] The proposed point scoring system is far from simple, and far from formulaic. Ultimately, the RBO intentionally leaves discretion to the Treasurer, Chief Administrative Officer, City Council and Mayor in a way that enables the city to change its standards from year-to-year, in response to current policy concerns. While this discretion might be useful for the city, it completely undermines a bank's ability to rely on consistent, known rules of engagement.

**City's Fiduciary Duties**

State law thoroughly and carefully mandates the conduct of cities, with respect to their financial partners. On this matter, the California Bankers Association has submitted a detailed letter, outlining some of the legal problems with the RBO in this respect (see letter, attached). In short, as the steward of substantial public funds, the city is required to invest and manage its money in a manner that brings the best return on investment. Fiscal controls do not contemplate allowing cities to pursue social or policy objectives inconsistent with these serious fiscal responsibilities.

Moreover, if a banking institution does not score well enough under the RBO, or does not provide the requested information, and is therefore precluded from obtaining the city's business, does the city undermine its ability to contract in a competitive marketplace? For

[3] Sec. 20.97.1(a)

example, there are only a handful of banks that are large enough to provide Letters of Credit to the city. What will the city do if the RBO precludes the city from doing business with them?

We understand that many are frustrated with the economy and particularly with what they perceive as an "irresponsible" banking community. However, adding a cumbersome and costly new bureaucratic program, that may ultimately expose the city to unnecessary legal challenge, serves the interests of no one. Imposing a new regulatory framework on financial institutions at a local level will only complicate the legal and business environment in our city, without achieving any meaningful reform. In fact, it might be a short-term, "paper victory" for those seeking change, but it would be an expensive one with lasting, negative effects for the city and the industry.

Respectfully,

Carol Schatz
President and CEO
Central City Association

Gary Toebben
President & CEO
Los Angeles Area Chamber of Commerce

Stuart Waldman
President & CEO
Valley Industry & Commerce Association

cc: The Honorable Greig Smith, Budget & Finance Committee Vice Chair
The Honorable Bill Rosendahl, Budget & Finance Committee Member
The Honorable Paul Koretz, Budget & Finance Committee Member
The Honorable Jose Huizar, Budget & Finance Committee Member

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October 22, 2010

Hon. Richard Alarcón
Hon. Bernard Parks
Hon. Paul Krekorian
Committee on Jobs
City of Los Angeles
Room 395 City Hall
North Spring Street
Los Angeles, CA 90012

Re: Responsible Banking Investment Monitoring Program (Council File No. 09-0234)

Dear Honorable Members:

The California Bankers Association (CBA) is writing this letter on behalf of its members, which are most of the FDIC-insured depository financial institutions doing business in the state of California. CBA is a non-profit organization established in 1891 and represents its members on matters that significantly affect the industry in California. CBA has reviewed two versions of the draft ordinance proposed by Councilmember Alarcón: the August 6, 2010 version submitted by the City Attorney's office ("Proposal") and an undated substitute draft. Because it appears that both versions have been circulated among Councilmembers, we wish to respond to both. Our comments pertain to both drafts, except that where a comment pertains only to one version, it will be indicated in parenthesis as either the (August Draft) or (Substitute Draft).

**The Proposal is Seriously Flawed**

CBA believes the Proposal conflicts with state law governing the fiduciary responsibility of municipalities (as discussed further below), is on the whole unworkable, places a relatively larger compliance burden on smaller institutions, and creates legal uncertainties. If an ordinance is to be adopted, banks need a clear pathway to comply. But just a cursory review of the Proposal reveals serious flaws that, as a consequence, create legal uncertainties. Consider the following flaws:

- Credit unions are not subject to the CRA. Thus, not only would credit unions have no rating to report, their burdens of compliance would be elevated and they would be less

likely to compete for contracts. This undermines the presumed preference of the Proposal for smaller, local institutions.

- Bank underwriting standards should not be subject to local pressures, such as requiring banks to consider a borrower's unemployment insurance when modifying loans. Does the City of LA consider it an unsafe and unsound banking practice for a bank to consider a borrower's income that is known to expire in four months? In one month? Banks are subject to comprehensive regulatory supervision by state and federal banking agencies. Banks should not be placed in a position to risk supervisory criticism in order to do business with the City.

- Underwriting is a preempted activity for national banks and federal thrifts. The Proposal, or parts of it, would apply only to state chartered institutions.

- The Proposal distinguishes between home improvement loans and home equity loans, but there is no bright line between these categories. (Substitute Draft)

- A "non-occupant" loan has no standard meaning in the banking industry. (Substitute Draft)

- No definition is provided for what constitutes a "distressed" loan (Substitute Draft) or a "modification."

- Determining whether loan activity is "within" an assessment area is not routinely straight forward (non-LA resident borrower's business could be in LA or a LA resident's business could be outside of LA). Determining the location of an institution's "deposit base" is even more nebulous in the world of branch, telephone, internet, and mobile device banking. This is another reason why consulting existing CRA disclosures is sufficient and more accurate. (August Draft)

- "Foreclosed" properties and REO properties are not synonymous. At any rate the extent that an institution utilizes its legal remedies to resolve defaulted loans is too complex a factor to have a clear bearing on its suitability to provide banking services to the City. (Substitute Draft)

- The requirement for credit rate disclosures on consumer loans and credit lines, as drafted ("minimum, median, and maximum nominal and effective interest rates"), is a compliance impossibility and would require substantial, detailed work by the City before any institution can meaningfully comply with this provision. (Substitute Draft)

- On the basis of just the aforementioned uncertainties, it would not be feasible for City officials to apply the numerical ratings for purposes of comparing institutions.

**Proposal Is Inconsistent With Cities' Fiduciary Duties**

With regard to cities contracting with financial partners in connection with carrying out their legally-prescribed fiscal responsibilities, we ask whether the nature and level of community activities are proper factors to consider. Government Code Section 53600.3 makes governing bodies of local agencies (or persons authorized to make investment decisions on their behalf) "trustees" and "fiduciaries" subject to the prudent investor standard. By law, their "primary objective" is "to safeguard the principal of the funds under its control." Their secondary objective is to "meet the liquidity needs of the depositor." The third objective is "to achieve a return on the funds under its control." (See section 53600.5). These are serious duties, as explained in Section 53600.6:

> "The Legislature hereby finds that the solvency and creditworthiness of each individual local agency can impact the solvency and creditworthiness of the state and other local agencies within the state. Therefore, to protect the solvency and creditworthiness of the state and all of its political subdivisions, the Legislature hereby declares that the deposit and investment of public funds by local officials and local agencies is an issue of statewide concern."

Nowhere in this statute is it contemplated that pursuing an unrelated policy objective such as making CRA activities traceable is consistent with an agency's fiduciary duties to safeguard principal, meet liquidity needs, and achieve a return on funds. If a city limits a number of banks from its eligibility list based on such unrelated criteria, does it not also limit its options when fulfilling its duties?

**Proposal Is Unnecessarily Burdensome**

We understand and appreciate the sentiment behind the Proposal. The Councilmember wishes to maximize the leverage that the City has in approving contracts to secure economic and social benefits for its residents. The Proposal also apparently seeks to favor smaller, local financial institutions that primarily serve the City of Los Angeles. It is interesting to note that the Proposal implicitly acknowledges that the CRA, which all FDIC-insured depository financial institutions are subject to, virtually ensures that a large municipality such as Los Angeles does and will continue to benefit from substantial bank lending, services, and investments. (For example, the Proposal weighs, among other factors, an institution's latest CRA evaluation).

A significant concern that underlies the entire Proposal is the need for a bank contractor to *report* LA-specific activities, not *whether* banks adequately provide vital community services. It can hardly be refuted that banks and savings institutions have supported and complied with both the spirit and letter of the federal CRA for over three decades since its enactment in 1977. Among other things, this means that the vast majority of bankers today have never served in a banking organization that did not, as a matter of law and company principles, reinvest in the communities in which they do business. Today, even banks of modest size commit millions of

dollars in loans to individuals and small businesses in low to moderate income communities, as well as make grants, perform services, and engage in other community development activities. For decades, banks have established a record of benefiting communities above and beyond the ordinary course of business that cannot be matched by any other industry. No other businesses that cities do business with have similar commitments or statutory duties, nor come close to matching banks' record of reinvestment.

CBA cannot support the Proposal because it substantially increases regulatory burdens and thus makes it less likely for banks, especially smaller banks, to be able to meet the City's heightened demands. Compliance with CRA regulations already consumes enormous amounts of bank resources. Banks spend disproportionate amounts having to comply with the logistical requirements of the complex regulation in the form of tracing loans and investments, evaluating grant recipients for suitability, geocoding, training, documenting compliance, preparing for examinations, and producing reports. All of these costs come on top of making loans, investing, and performing services.

We understand that mandatory CRA-generated data and disclosures do not meet the tracking needs of individual cities. This is because banks are required to report and publish CRA data in the manner required by their regulators. Banks are examined and are expected to report CRA activities based on their assessment areas, which roughly correspond to the geographical areas in which they do business. For the most part, banks do not delineate assessment areas by political boundaries smaller than counties. A major reason is that designating, and tracking by, any smaller subdivisions expose banks to charges of redlining and regulatory criticism. Some activities such as loans can be tracked by geocodes, but geocodes do not necessarily correspond to political boundaries or postal codes of cities. Metropolitan Statistical Areas are also used, which are U.S. Office of Management and Budget designations that encompass areas much larger than individual cities.

Thus, the immediate consequence of any local CRA-like ordinance requiring city-specific commitments and reporting will be the dedication of even more resources to satisfy compliance. We recommend that, rather than require institutions to create additional research and paperwork, at great cost to banks, the City should take advantage of reports and data that banks are already required to generate, namely information in the CRA public file and Home Mortgage Data Act (HMDA) reports. These documents are in fact intended to allow the public to evaluate banks' credit and other performance factors.

The reality is that all cities and communities already benefit from the vital services that banks provide under existing CRA activities because the cities and communities are already situated in banks' assessment areas. Investments in LA are already being made, and we object to the singling out of the banking industry for specific legislative focus. It is a difficult time for the City and its residents, but also for businesses, including banks. It is not the time to pile on punitive legislation. It does not help anyone.

**Conclusion**

Once again, CBA and its members are committed to work with the City of Los Angeles to invest in the communities that they serve. We will continue to find innovative ways promote mutual goals. We do not believe that the Proposal effectively furthers these goals, and therefore, we do not support it.

Sincerely,

Leland Chan
General Counsel