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Subject: Comments to Budget and Finance Agenda No. 3 CFI 09-0234 Responsible Banking Investment Monitoring Program

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Responsibility starts with the abeyance of laws and not profit motivation. Though the lack of laws and regulations place the condition in a gray area, exactly what is the position of the Council in regulating or stating federal policy toward change that creates a more just means of banking.

This is not only about the Community Reinvestment Act CRA. Mortgage bankers may not be subject to the CRA. It is about responsible underwriting and no fraudulent practices.

Is the City in a position or authority to determine this. No, but they can weigh in on regulations that enforce proper business practices; and they can choose NOT to do business with firms that have practices that lead to loans appearing safer than they are, lowering the loan to value ratio and inflating appraisals.

The City sees the increased property taxes as a plus to the City budget, but in actuality the market is being manipulated.

This is an ethics issue.

Is there:

- Deregulation
- De-supervision
- De facto criminalization
- High compensation

You may need to change the criteria of what you require and participate on Federal and State policymaking.

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Has Los Angeles' Responsible Banking Initiative Been "Improved"?

Posted: 11/21/11 05:18 AM ET

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The City Administrative Officer (CAO) of the City of Los Angeles is proposing that Councilman Richard Alarcon's Responsible Banking Ordinance (RBO) be altered and adopted using much-changed implementation criteria from previous versions of the draft legislation.

On Monday November 21, 2011, the Budget and Finance Committee will meet to do an up-or-down vote on these changes. That vote could fast-track it for a full vote by the City Council as early as Tuesday November 22, 2011. But are these changes in fact

improvements to this very worthy initiative to promote greater transparency in how banks serve their communities or has what the CAO proposed set an unintended chain of consequences into motion that the City could live to regret?

According to the report released on November 18, 2011, the CAO recommends incorporating the tenets of the Responsible Banking Ordinance into the City's existing Contractor Responsibility Ordinance. It also recommends simplifying reporting and analysis criteria. But most important, the CAO recommends bifurcating treatment of the City's commercial banking and investment banking relationships. Specifically, that "the City should evaluate underwriters (investment banks) based on information pertaining to their underwriting services only. Any commercial banking services provided by their affiliates should be evaluated separately"; in other words, that the investment banking divisions of banks are not to be subject to RBO's community reinvestment criteria.

With regards to information collection, the CAO basically says they do not have the capability to collect data and analyze it. More importantly, they report that they've tried to ask banks and found what comes back to be problematic.

The report states,

As a pilot program, the CAO requested the 22 firms on the Qualified List to provide their affiliates lending information within the City of Los Angeles by zip code, as outlined in the draft RBO (see Attachment C for the Lending Information Request Form). The responses received from the firms were mixed. Thirteen firms reported that they only provide underwriting services therefore, had no lending information to submit. Two firms determined that their affiliates that participate in lending activities are separate entities and therefore, cannot report on their affiliates' business activities. However, one of these firms was able to provide their affiliate's CRA PE and SEC 10-K reports because these reports are publicly available online. Four firms were able to provide their affiliates lending information by zip code partly due to the fact that their lending activities in Los Angeles are few. One firm provided their affiliates' lending information by citywide. Another firm provided their affiliates' lending information by citywide and by zip code; however, explained that the firm can only provide information by zip code when it is publicly available. All other information not publicly available by zip code has a proprietary nature and/or is restricted by certain financial disclosure guidelines. Similarly, one other firm provided the lending information by zip code but declared that the information is proprietary and reserved the right to redact if necessary. Eight of the 22 firms provided their affiliates CRA score of which five firms received "Outstanding" scores and three firms received "Satisfactory" scores. After reviewing the responses, the data collected would be difficult to convert in a way the City can use to rank and score the financial institutions at the granular level as proposed in the draft RBO, notwithstanding the fact that the Treasurer does not have the staff nor the expertise to evaluate this type of data.

This did not surprise me on several fronts. When one asks banks broad questions, one typically gets broad answers. But note that they all responded in some fashion. The fact is that bank regulators don't ask broad questions, they ask specific ones that go into a report form that is ever-changing. Frankly, I was expecting the CAO to have figured that out and

report back to the City Council that it wanted to ask for time to create a more structured surveying method to collect RBO data that the banks could respond to in a more organized fashion and try the process out with more banks from the area one or two more times before making a final recommendation. Instead what came back was a recommendation to narrow things to three indicators: the bank's CRA scores, its performance on Housing Programs administered by the City, and its small business lending book within the City.

This "solution" has a lot of problems. The reason is because the banking industry is not a landscape where every bank looks like every other bank. Quite the contrary, just like any other competitive business, banks specialize and occupy service niches. Banks specialize. Some make home loans. Others make small business loans. Yet others serve the larger companies that have some of the biggest impact on regional economic strength. Some banks cater to private wealth while others pursue specific subsets of the community. And regulations keep changing. For instance, did you know credit unions have recently been authorized to receive government deposits? All are part of the tapestry of a regional economy, one that has to grow as a whole if it is to be healthy. I've always believed it is unwise for a city like Los Angeles to focus on such a narrow band of criteria when it comes to identifying which banking and financial institutions to seek to do business with. The City needs to say it wants to see bank responsibility as a holistic picture and come up with a way to ask the right strategic questions. So far, while this caters to political interests, I'm not convinced that it fully addresses regional economic needs.

I continue to fear this aspect of City of L.A.'s approach threatens to inadvertently disadvantage some of the most economically important commercial banks, large and small, in the region. Banks that have done a good job of containing their exposures to troubled lending will show little participation in repair programs even though they are strong investors in the community. A bank working the over-\$20M lending layer of the Los Angeles market may show poorly on small lending because it is serving a different vital aspect of the economy. Oddly, some of these poorer-showing banks based on RBO criteria are probably better equipped with the infrastructure to handle the City's business. Even weirder, some banks that make "expensive" interest and fee cost loans to small business would look good as would banks able to modify loans taking advantage of loss share agreements with the FDIC. These granularities are real and they need to be dealt with in better balance by the City of Los Angeles, or at least the ordinance needs to make provisions for them to be properly treated as part of implementation.

Things become somewhat more bizarre when it comes to investment banking services, specifically underwriting services. Here the CAO's report reads like a love letter to the investment banking divisions of the twenty-two Qualified List institutions it presently does business with. Basically, the CAO recommends exempting them from RBO criteria. There's an entire section explaining that despite the repeal of the Glass-Steagall Act, that the City still needs to treat investment banks, even ones the City has outstanding lawsuits with, as "Qualified."

Despite the fact that what remains of a decimated investment bank industry has seen all of the major players convert to Bank Holding Companies (BHCs) following the financial disaster of 2008, the CAO takes the position:

We recommend that the Council to consider each entity separately when determining the City's business involvement with that entity. In other words, the City should evaluate underwriters (investment banks) based on information

pertaining to their underwriting services only. Any commercial banking services such as credit facilities provided by their affiliates should be evaluated separately.

The CAO is basically establishing a "separate and severable" clause in the law. It basically means a bank can demand that the City must ignore any practices by any other part of their business no matter how egregiously little that institution does to benefit the region. In other words, it creates a privileged class that can and will trump local bankers. It should be struck or at least amended so as to continue to hold the entirety of an organization "responsible" for its behavior.

A far better suggestion observed by the CAO is that the City should seek to reinforce the RBO by encouraging the CAO to go further down the path of conducting investment banking transactions using a negotiated transactions approach, meaning one where more local entities are made part of the process.

The CAO report observes,

In the past three years, the City has formed the qualified underwriting teams for its bond financings to obtain the best available rates while meeting its policy goals relating to MBE/wBE/DBE participation and supporting local business growth. From July 2008 to June 2011, the City has completed 23 bond transactions (see Attachment L). These transactions consisted of four competitive sales and 19 negotiated sales. Of the 19 negotiated sales, eight transactions were senior managed by the large firms and 11 transactions were senior managed by the small to medium firms. The City has received positive feedback from its underwriters, indicating that our efforts have had a positive impact in their staffing levels in Los Angeles and have increased their participation level with other municipalities and governmental agencies. In addition, three underwriters have opened local offices and one firm has opened an office in California to demonstrate their commitment to Los Angeles and California.

Interestingly, the CAO asks for authorization to do business with the current Qualified List for three years. Just to be clear, this is an agenda item added by the CAO via this report that was not part of the RBO drafted by Alarcon et al. This is the staff writing law and should be look at as such by the Budget and Finance Committee.

My own recommendation is that City leaders should commend the CAO on progress so far but then take back control of where it goes next by instructing the CAO to expand the Qualified List beyond the 22 current members and pursue the criteria be that negotiated package consortium deals be such that in the future most transactions be constructed so that local entities fill in so that the investment banking deal team demonstrates that it meets all the RBO criteria for involvement in the regional economy. Further, City leaders should add accountability reporting to this process by,

a. Requiring the CAO issue an annual public report on the basis of continuing acceptance for each institution on the Qualified List; and reasons for removing or suspending an institution from the list.

b. The CAO should also be required to maintain an active program seek new Qualified List bidders. The results of that recruitment program to be issued as a public report annually.

c. There should be a process for the public to comment on companies that are on the Qualified List.

This is a far better solution than the CAO's coping suggestion to keep investment banks with poor showings across the full spectrum of RBO competitiveness criteria in the game by selectively narrowing their evaluation criteria to just "corporate citizenship by demonstrating their active roles in the City of Los Angeles that include but are not limited to a development or participation in charitable programs or scholarships, and policies with regard to the use of women-owned, minority owned and disadvantaged business enterprises." That's 25% of the 100 point test of the RBO draft in its last version for investment banks while commercial banks must continue to face the full test.

This is a well-meaning but I think ill-conceived approach. Basically, the City is declaring that banks may substitute truly responsible business practices that have long-term impact on the regional economy by participating in "politically correct" programs. The problem is that this imbalance ultimately makes the City an ever-riskier investment, one that will affect its credit rating. It could drive mainstream businesses based on true free market principles out of the City of Los Angeles, a trend that is already an acute problem. In blunt terms, such charitable injections tend to be tokens. They are far too little in magnitude and destroy economies in the long run by creating businesses that are ill equipped to compete with other parts of the world that will show no mercy as they also compete to survive. Or have we forgotten to pay attention to the drain outsourcing has been on the United States again? This is setting Los Angeles up to be a long run loser.

And here's the irony on the City, charities are a cost of doing business investment banks will easily pay because they do factor it into the fee and cost recovery structure of future deals. There is no free lunch.

Reference:

"REPORT BACK ON THE IMPLEMENTATION PLAN FOR THE RESPONSIBLE BANKING ORDINANCE AND AMENDING MOTION 24A," November 18, 2011, Miguel A. Santana, City Administrative Officer, City of Los Angeles, CAO File: 0220-02221-8970, City Council File: 09-0234-81

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