



1303 J Street, Suite 600, Sacramento, CA 95814-2939 T: 916/438-4400 F: 916/441-5756

November 1, 2011

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

Re: "Responsible Banking Ordinance" (Council File No. 09-0234)

Dear Councilmember:

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. The City of Los Angeles' proposed Responsible Banking Ordinance (RBO) is such a matter. The presumed purpose of the RBO is to ensure that the City of Los Angeles only does business with partners that act responsibly. CBA and its members absolutely agree that the City ought to maintain high standards, and every current and prospective financial services provider to the City should be ready, willing, and able to compete for its business in part by demonstrating its record of lending, providing services, investing, and otherwise supporting community development. However, CBA opposes the RBO for the following reasons.

Most of the Information Sought is Already Publicly Available

The City would have access to most of the information listed in the RBO without enacting any ordinance at all. The federal Community Reinvestment Act (CRA) and the federal Home Mortgage Disclosure Act (HMDA) already require every bank in the country to comply with detailed regulations, and their aims are very similar to those of the RBO. Both of these laws and their accompanying regulations require every bank to make detailed reports and data available to the public detailing its record of benefiting the needs of individuals in low and middle income areas; small business lending; low-income education lending; branches and branch closings; home loan applications and originations including whether the pricing is higher than a standard index; and even (on a no names basis under HMDA) details on the ethnicity, race, sex, and gross annual income of applicants and borrowers. (See 12 CFR §§ 203 and 228).

In other words, the City could achieve most of its goals by referring to any bank's public

CRA file and HMDA report. Any data that is not available may be requested and obtained on an ad hoc basis through the RFP process. The City of Los Angeles can be assured that all regulatory data that banks furnish has been thoroughly vetted by banking supervisors and that the statutes governing the underlying activities were written specifically for the purpose of benefiting low and moderate income areas and promoting nondiscriminatory mortgage lending.

RBO is Bad Policy

If this detailed information is readily available and banks are willing to furnish the information, then why does CBA oppose the RBO? We oppose the ordinance because it is worse than unnecessary—it is counterproductive to its own purposes and, if adopted generally at the municipal level, is also bad policy. The RBO would have the immediate effect of vastly expanding the existing regulatory infrastructure of both banks that have to comply with it and the City's agencies that have to enforce it, all during a time when resources are scarce.

To comply with the logistical requirements of CRA and HMDA and the hundreds of pages of accompanying regulations and supervisory guidance, banks have needed to develop a compliance infrastructure that encompasses data collection, tracing loans and investments, evaluating grant recipients for suitability, geo-coding loans by U.S. census tracts, training, documenting compliance, and producing reports. (See 12 CFR § 228.42 and 12 CFR § 203.4 and 203.5). Nearly all banks rely on computerized data management systems that are customized to comply with the exact definitions and categories of activities required by the regulations and supervising agencies. Banks are examined for compliance with these and other regulations on a regular basis. Each bank is even required to disclose any comments and complaints received regarding its performance in fulfilling its CRA obligations, something that the RBO would not require.

In effect, the RBO seeks to propel banks toward the same general direction but on a completely different rail that features novel definitions, undefined terms, novel geographic reporting requirements, and even unsafe underwriting standards (explained in more detail below). What would be lacking—and this would be the only deficit of any significance—is that the City would not necessarily obtain information that is exclusive to the City of Los Angeles or by zip codes within the City as the RBO would require. CRA data is categorized in accordance with a bank's "assessment areas," which roughly correspond to the geographic areas in which it does business, and by census tracts. (12 CFR §228.41) HMDA data is categorized by MSA, state, county, and census tract. (12 CFR §203.4(a)(9)). For these reasons, a bank's compliance infrastructure is oriented to assemble and report data designed to meet federal regulatory mandates, which means that a bank would have to reprogram or manually extract data to comply with the inconsistent requirements of the RBO.

Each adoption of an ordinance like the RBO at the municipal level is like adding a new agency to supervise a new banking regulation, further exacerbating the allocation of scarce resources to ensure compliance rather than provide services. This would also create competition among municipalities in what is essentially a zero sum game, with adopting municipalities

seeking to draw disproportionate investments away from non-adopting municipalities. This is bad policy. The reality is that all cities and communities already benefit from the vital services that banks provide because all cities and communities are already situated in some banks' assessment areas. Cities merely have to consult the public data to compare how different banks perform; they just have to forego data that is tailored to their own cities as required by the RBO.

Detailed Flaws of the RBO

As with any statute, ordinance, or regulation banks need a clear pathway to comply. But just a cursory review of the RBO reveals serious flaws that, as a consequence, create legal uncertainties. Good policy is that which achieves its goals efficiently while minimizing unintended consequences. As already discussed, the RBO is largely unnecessary and produces significant unintended consequences for the City as well as banks. Consider now also the following flaws:

- Bank underwriting standards should not be subject to local pressures, such as requiring banks to consider a borrower's unemployment insurance when modifying loans. This is a safety and soundness issue that is squarely within the exclusive jurisdiction of banking regulators to supervise. Banks should not be placed in a position to risk supervisory criticism in order to do business with the City.
- Loan underwriting is a preempted activity for national banks and federal thrifts. The RBO, or parts of it, would apply only to state chartered institutions. 12 CFR §7.4008(d). This would create a disproportionate burden on state banks. Credit unions (unlike smaller banks) are not even subject to the CRA, so ironically they may face even greater barriers to entry if they want to compete for contracts. These flaws undermine the presumed preference of the RBO for smaller, local institutions.
- The requirement for credit rate disclosures on consumer loans and credit lines (minimum, median, and maximum nominal and effective interest rates) lacks any definitions and thus is impossible to comply with. Most banks collect no such data.
- The RBO includes undefined terms or concepts not captured by existing statutes, and this would impede banks' ability to comply, including "affordable" loans; the distinction between home improvement loans and home equity loans; "non-occupant" loans as opposed to owner-occupied (12 CFR §203.4(a)(6)); and "distressed" loans. Also "foreclosed" properties and REO properties are not synonymous.

The aforementioned uncertainties illustrate just some of the significant challenges raised by the RBO. Among other things, these flaws would make it infeasible for City officials to apply the numerical ratings in any coherent and consistent manner for purposes of comparing institutions.

Proposal Is Inconsistent With Cities' Fiduciary Duties

The City needs to consider very seriously whether the duties imposed in the RBO that require the rating of financial partners' community development activities is consistent with Government Code § 53600.3. This statute 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 the City limits a number of banks from its eligibility list based on such unrelated criteria, it also limits its options when fulfilling its duties.

Conclusion

Banks that desire to do business with the City of Los Angeles are committed to work with City officials to demonstrate their commitment to acting responsibly by investing in the communities that they serve. We do not believe that the RBO effectively furthers these goals, and therefore we do not support it.

Sincerely,



Leland Chan
General Counsel

Budget & Finance Committee
Los Angeles City Council
November 1, 2011
Page 5

cc: The Honorable Antonio Villaraigosa, Mayor
The Honorable Carmen Trutanich, City Attorney
The Honorable Members, Los Angeles City Council
Miguel Santana, City Administrative Officer
Antoinette Christovale, Director of Finance / City Treasurer