REPORT OF THE
CHIEF LEGISLATIVE ANALYST

Date: December 14, 2009

To: Honorable Members of the Jobs & Business Development Committee

From: Gerry F. Miller
Chief Legislative Analyst

WAS #09-02-0221

BANKING AND FINANCIAL SERVICE CONTRACTS REPORTING REQUIREMENTS ON COMMUNITY INVESTMENT

SUMMARY

Motion (Alarcon-Garcetti, et al.) (CF 09-0234) described the difficulties facing Los Angeles residents whose homes are in jeopardy of foreclosure, and discussed the need to support foreclosure prevention efforts. The Motion instructed staff to explore the potential to divest all of the City's deposits in banking and other financial institutions that are not cooperating with those prevention efforts. The Jobs & Business Development Committee subsequently refined and expanded the purpose of the Motion to ensure that the City's deposits and portfolio are invested in financial institutions that, in turn, reinvest in and benefit Los Angeles residents.

In this report, the CLA offers recommendations to improve reporting requirements for banking institutions that provide services to the City, to determine their current level of effort towards those goals. The CLA's recommendations include a proposal, patterned after a provision in Philadephia law, to allow the City Treasurer to enforce the new reporting requirements. The CLA further recommends that the City Treasurer include two provisions in the next RFP/RFQ for banking services to ensure that the selected service providers are conducting business consistent with the City's priorities, within the restrictions of federal, state and local law. Lastly, the CLA further recommends that companies that have displayed a pattern of discriminatory or other illegal credit practices, or have committed past criminal or civil violations that have resulted in significant harm to the City, should be precluded from future City contracts.

The CLA report notes that the Boards of the Los Angeles City Employees Retirement System, and the Fire and Police Pension System, have constitutional authority over the assets of the respective systems' investment portfolios. The Council may encourage, but not mandate, the investment of each plans' assets towards certain goals. Based on data provided by LACERS and Pensions, both systems appear to have begun the process of investing in a manner consistent with the Committee's intent. The CLA proposes a draft policy statement for the Council to endorse in order to offer guidance on the investments by LACERS, Pensions, and the City Treasurer.

RECOMMENDATIONS

1. Instruct the City Attorney to prepare and present an ordinance, summarized below and detailed in this report, to incorporate the following provisions into the City's Standard Provisions for City Contracts:

A. All banks and financial institutions that provide banking and financial services to the City shall be required to annually provide to the City Treasurer a statement of community reinvestment goals.

B. The City Treasurer shall have the authority to restrict or terminate financial relationships with those institutions that fail to comply with these new reporting requirements, in a manner consistent with federal, state, and local laws.

C. All banks and financial institutions that provide banking and financial services to the City shall notify the City at least 90 days prior to closing any bank branches within the City of Los Angeles.

D. No contracts for financial or banking services shall be awarded to any bank or financial institution that has exhibited a pattern of discriminatory or other illegal credit practices, or has committed past criminal or civil violations that have resulted in significant harm to the City of Los Angeles' financial interests.

2. Request that the City Treasurer include in the next RFP/RFQ for banking services a provision that would provide additional bid preference, consistent with current law, to those respondents that provide evidence of active community investment practices beyond traditional banking services.

3. Request that the Board of Commissioners of LACERS and the Pensions Board, and the City Treasurer, establish an investment floor by committing that at least 25% of the City's portfolio will be invested in financial institutions that provide evidence of active community investment practices in businesses and residences within the City of Los Angeles, or that support socially responsible activities such as green technology, low/moderate income housing, and community redevelopment, to be achieved in a manner consistent with the fiduciary responsibilities established in federal, state, and local law.

BACKGROUND

On February 2, 2009, Motion (Alarcon-Garcetti, et al.) was introduced requesting that the CLA and CAO explore the potential divestiture of "all deposits in banking and other financial institutions that fail to cooperate with foreclosure prevention efforts that include temporary moratoriums on foreclosures, renegotiation of mortgage principals to reflect current values, and good faith negotiations with mortgagees." That Motion further requests similar divestiture actions by the Los Angeles City Employees Retirement System (LACERS), Fire and Police Pension System (Pensions), and the Water and Power Employees Retirement Program (WPERP).

Following introduction of that Motion, the CAO and CLA met with the City Treasurer, LACERS, Pensions, and the City Attorney's office to discuss the two major components of this Motion - divestiture authority and criteria for determining good faith cooperation with foreclosure prevention efforts.

At a hearing of the Jobs & Business Development Committee on September 8, 2009, the author of the Motion significantly broadened the intent of the proposed investment restrictions beyond divestment. Councilman Alarcon and the Committee instructed the CLA to develop a modified policy that encourages the use of the City's investment portfolio to spur local economic development, and to support 'responsible investment' of the City's assets in companies that uphold socially responsible practices that do not harm the public good. Staff was instructed not to focus on the issue of compliance/non-compliance with foreclosure prevention efforts. The Chair instructed the CLA and CAO to expand the analysis to begin creating a local version of the "Community Reinvestment Act" by establishing a set of standards for both City deposits and, as appropriate, for the City's investment practices. Those standards should encourage community lending and discourage investments in companies that do not adhere to socially responsible practices - including, but not limited to, failure to cooperate with foreclosure prevention efforts.

Creating a Local Community Reinvestment Act

Enacted in 1977, the federal Community Reinvestment Act (CRA) was designed to encourage financial institutions to improve lending and banking services across the local communities that they serve, and eliminate any forms of alleged "redlining" that discriminates in loans made to individuals and businesses from low and moderate-income neighborhoods. Under this program, all banks that receive FDIC insurance are evaluated by various Federal banking agencies to determine performance based on a variety of assessment factors (Attachment 1). Banks are rated pursuant to a five-tiered CRA rating system ranging from "Outstanding" to "Substantial Non-compliance". The CRA, however, does not contain penalties for non-compliance, although CRA ratings are considered in the case of mergers or acquisitions involving financial institutions.

The Jobs & Business Development Committee proposed to develop a local version of the CRA evaluation program for financial institutions that provide financial or investment services to the City of Los Angeles. Not only would this likely be an extensive undertaking at a time of severe financial and personnel constraints, the value of such an evaluation mechanism is unclear for the purposes of the modified Motion (Alarcon-Parks). For example, seven of the eleven banking institutions currently used by the City of Los Angeles have "Outstanding" CRA ratings, including the two entities with the largest share of the City's deposits (Wachovia and Bank of America). Also, creating a similar system to measure local efforts of banks and financial institutions based on CRA-type criteria would likely duplicate much of the work already being done by the Federal government.

Instead, the CLA recommends implementation of new reporting requirements for all banking and financial service contracts with the City to target the collection of information that is most pertinent to the issues raised in Motion (Alarcon-Parks) - foreclosure prevention and local community investment. The CRA evaluation system can be used to develop those reporting requirements, tailored to the City's needs. As noted during the September 8, 2009 Jobs & Business Development Committee hearing, the City of Philadelphia has implemented a modified form of the information and ratings provided under the existing CRA reporting systems that could serve as a starting point for the City's data compilation efforts. The Council, with the concurrence of the Mayor, has the authority to establish such requirements by ordinance in order to make them standard conditions for City contracts, including financial and banking services.

To provide the City Treasurer with the explicit authority necessary to enforce these new reporting requirements, the City Council should instruct the City Attorney to prepare and present an ordinance- patterned after City of Philadelphia Code Section 19-201 - for inclusion among the City's Standard Provisions for City Contracts. This provision would give the Treasurer the option to terminate financial relationships with those institutions that fail to comply with these new reporting provisions, in a manner consistent with federal, state, and local laws. The following is draft language for the City Attorney to base the draft ordinance:

A. All banks and financial institutions that provide banking and financial services to the City shall be required to annually provide to the City Treasurer a statement of community reinvestment goals, including, if applicable, information on small business loans, home mortgages, home improvement loans, and community development investments to be made within low and moderate-income neighborhoods in the City of Los Angeles, consistent with State law and in accordance with the requirements of the Community Reinvestment Act (12 CF Part 25). Reporting on home mortgage loans shall include summary information on the number and amount of loan modifications approved to prevent mortgage foreclosure, with detailed information on rate- and principal-reduction actions taken. Each financial institution shall also provide the City with a long term strategic plan to address any disparities in its lending and investment activities, as identified in the performance evaluation conducted pursuant to the CRA.

B. On July 1 of each year, the City Treasurer shall certify to the City Council whether or not each bank and institution providing banking services to the City has complied with each requirement of this subsection in the preceding fiscal year. At the discretion of the City Treasurer and consistent with state and federal law, the City Treasurer may cease to deposit any City funds and withdraw all City funds from any bank or institution that has not complied with each of these requirements. No funds shall thereafter be deposited in any bank or institution until the bank or institution comes into compliance with each requirement and the City Treasurer has certified compliance to the City Council. The City Treasurer shall provide the City Council notification of the withdrawal of, and redeposit of, any City funds pursuant to this subsection.

On a related note, the City Council recently endorsed the recommendations of the Jobs & Business Development Committee to create a Banking District Development program, in order to improve banking services in underserved areas. Toward this end, the following reporting requirements should be included in the draft ordinance, to ensure that the City is well aware of any pending changes to banks' and financial institutions' service levels:

C. All banks and financial institutions that provide banking and financial services to the City shall provide the City with notice, if the depository proposes to close any branch, no later than 90 days prior to the date of the proposed branch closing. The notice to the City shall be sent to the City Treasurer, and to the City Clerk for distribution to each member of City Council and the Mayor's Office. That notice shall include:

(1) identification and/or address of the branch to be closed;
(2) the proposed date of the closing;
(3) a detailed statement of the reasons for the decision to close the branch; and
(4) statistical or other information in support of such decisions.

Additional criteria was discussed during the September 8, 2009 Jobs Committee hearing. This criteria was intended to flag those financial institutions that have previously harmed the City's financial interests, and eliminate those businesses from consideration for future City banking services, to prevent future harm. The following provision is also suggested for inclusion in the draft ordinance:

D. No city contracts for financial or banking services shall be awarded to financial institutions that have exhibited the following practices or actions:

1. Evidence of a pattern of discriminatory or other illegal credit practices, including but not limited to discrimination against applicants on a prohibited basis in violation of the Equal Credit Opportunity Act, the Fair Housing Act, Home Ownership and Equity Protection Act, Section 5 of the Federal Trade Commission Act, Section 8 of the Real Estate Settlement Procedures Act, and violations of the Truth in Lending Act regarding a consumer's right of rescission.

2. Past criminal or civil violations that have resulted in significant harm to the City of Los Angeles' financial interests, and were not rectified or otherwise fully mitigated through restitution, repayment, or other court imposed measures or settlement agreements.

Lastly, the Jobs & Business Development Committee instructed staff to develop an incentive mechanism, to reward 'good' behavior by banks and financial institutions. While the law is clear that the City Treasurer is required to deposit the City's assets in a manner that maximizes the return on investment, preference may be given during the contract selection process (RFP, RFQ, bid, etc.) for future banking service contracts. As such, the Council should request that the City Treasurer include the following criteria in the next selection process for banking services:

E. The City of Los Angeles is committed to support local community investment of the City's assets. As such, respondents to this RFP/RFQ should provide summary evidence of active community investment practices beyond traditional banking services, including, but not limited to, offering below-market community development loans for targeted populations, venture capital funds that invest in local businesses, and socially responsible mutual funds that use their resources to support community development. Favorable responses to this requirement will be strongly considered within the selection process for City banking and financial service contracts.

The quality of banking services provided to City residents will be judged using a combination of factors, including, but not limited to, the institution's Community Reinvestment Act (CRA) rating; the number of branches and ATMs located within, or readily accessible to, low- and moderate-income geographies as compared to the number and types of services made available to middle- and upper-income geographies; the variety of financial services offered to customers; and the level of effort made by the financial institution to offer services to the traditionally 'unbanked or underbanked' population.

The Treasurer's current banking services contracts are in effect through 2013, and contain five one-year renewal options. To expedite the process of identifying those banking and financial institutions' that demonstrate a commitment to local investment, the City Council should request that the Treasurer immediately effectuate amendments to the current City contracts to begin implementing the new reporting requirements noted in (A) through (D), above, and compile this critical information. The provisions in (E), above, are recommended for inclusion in the Treasurer's future selection process for banking services.

Socially Responsible and Locally Focused Investment Practices

The Los Angeles City Employees Retirement System (LACERS) invests approximately $9.6B in assets in support of retirement benefits to active and retired members of the system. The Fire and Police Pension System's (Pensions) investment portfolio, managed to support the pension benefits of sworn police and fire members, is close to $12.8B. The City Treasurer oversees investment of a $6.5B investment portfolio. The LACERS and Pensions systems have oversight boards appointed by the Mayor and confirmed by the City Council. The City Treasurer is appointed by the Mayor and confirmed by the City Council.

Investment of LACERS, Pensions, and the City Treasurer's portfolio of assets is conducted according to strict requirements of federal, state and local law. Article XVI, Section 17 of the California Constitution specifically gives retirement boards of public pension or retirement systems "sole and exclusive fiduciary responsibility over the assets of the public pension or retirement system" to be administered "for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system." This Section reserves for the State Legislature the authority to "prohibit certain investments by a retirement board where it is in the public interest to do so," and can be done in a manner that abides by the standards of fiduciary care and loyalty required of a retirement board. The City Treasurer's investment activities are regulated by the California Government Code.

Separately, the City Charter establishes the Los Angeles City Council, as the Legislative Branch of Los Angeles City government, as the governing and policymaking body for the City of Los Angeles. Consistent with that authority, it is appropriate for the City Council to identify public policies that will encourage socially responsible investment of the City's financial assets to guide - but not mandate - the investment portfolios managed by the City Treasurer, LACERS Board, and the Los Angeles Police and Fire Pensions Board. The Boards and managers of the respective investment portfolios will be requested to implement these City policies in a manner that does not interfere with the prudent management of Fund assets to achieve objectives that are in the best financial interest of all plan beneficiaries, in the case of LACERS and Pensions, and in the City's best financial interest, in the case of City Treasurer investment practices.

Both LACERS' and Pensions' provided the following summary information on their current investments in certain categories, as of October 2009:

Category	LACERS	Pensions
Clean/Green Technology	$107M	$48M
LA Community targeted investments	$15M	$20M
MBE/WBE partnerships	$100M	$70M
Emerging Managers	$952M	$1.396B
Real Estate, Community Redev, and Workforce Housing	$220M	$200M
LA-based managers and partnerships	$1.341B	$579M
Corporate governance	---	$299M
TOTAL	$2.72B	$2.627B

Assuming the breakdown provided by LACERS and Pensions reflects the categories envisioned by the Jobs & Business Development Committee, LACERS currently dedicates approximately 28% of its investment portfolio towards these goals, while Pensions dedicates approximately 21% of its resources in these areas, based on October 2009 balances. These figures increase and decrease throughout the year as investments are adjusted to reflect market conditions.

The City Council should suggest that governing boards of LACERS and Pensions establish an investment floor by committing that at least 25% of the City's investment portfolio will be invested in financial institutions that provide evidence of active community investment practices in businesses and residences within the City of Los Angeles, or that support socially responsible activities such as green technology, low/moderate income housing, and community redevelopment. Implementation of this goal by the respective retirement boards and the City Treasurer would be subject to the restrictions of current law, and consistent with their fiduciary responsibilities. Council's expression of this legislative intent will offer guidance on the investment practices of the City's retirement boards in a manner consistent with Council policy.

Roy R. Morales
Analyst

Attachment

Lending Test Matrix

Characteristic	Outstanding	High Satisfactory	Satisfactory	Needs to Improve	Substantial Noncompliance
Lending activity	Lending levels reflect excellent responsiveness to assessment area credit needs.	Lending levels reflect good responsiveness to assessment area credit needs.	Lending levels reflect adequate responsiveness to assessment area credit needs.	Lending levels reflect poor responsiveness to assessment area credit needs.	Lending levels reflect very poor responsiveness to assessment area credit needs.
Assessment area(s) concentration	A substantial majority of loans are made in the institution's assessment area(s).	A high percentage of loans are made in the institutions' assessments area(s).	An adequate percentage of loans are made in the institution's assessment area(s).	A small percentage of loans are made in the institution's assessments area(s).	A very small percentage of loans are made in the institutions assessment area(s).
Geographic distribution of loans	The geographic distribution of loans reflects excellent penetration throughout the assessment area(s).	The geographic distribution of loans reflects good penetration throughout the assessment area(s).	The geographic distribution of loans reflects adequate penetration throughout the assessment area(s).	The geographic distribution of loans reflects poor penetration throughout the assessment area(s), particularly to low- or moderate-income geographies in the assessment area(s).	The geographic distribution of loans reflects very poor penetration throughout the assessment area(s), particularly to low- or moderate-income geographies in the assessment area(s).
Borrowers' profile	The distribution of borrowers reflects, given the product lines offered by the institution, excellent penetration among retail customers of different income levels and business customers of different size.	The distribution of borrowers reflects, given the product lines offered by the institution, good penetration among retail customers of different income levels and business customers of different size.	The distribution of borrowers reflects, given the product lines offered by the institution, adequate penetration among retail customers of different income levels and business customers of different size.	The distribution of borrowers reflects, given the product lines offered by the institution, poor penetration among retail customers of different income levels and business customers of different size.	The distribution of borrowers reflects, given the product lines offered by the institution, very poor penetration among retail customers of different income levels and business customers of different size.

Responsiveness to credit needs of highly economically disadvantaged geographies and low-income persons, small business	The institution exhibits an excellent record of serving the credit needs of the most economically disadvantaged area(s) of its assessment area(s), low-income individuals, and/or very small businesses, consistent with safe and sound banking practices.	The institution exhibits a good record of serving the credit needs of the most economically disadvantaged area(s) of its assessment area(s), low-income individuals, and/or very small businesses, consistent with safe and sound banking practices.	The institution exhibits an adequate record of serving the credit needs of the most economically disadvantaged area(s) of its assessment area(s), low-income individuals, and/or very small businesses, consistent with safe and sound banking practices.	The institution exhibits a poor record of serving the credit needs of the most economically disadvantaged area(s) of its assessment area(s), low-income individuals, and/or very small businesses, consistent with safe and sound banking practices.	The institution exhibits a very poor record of serving the credit needs of the most economically disadvantaged area of its assessment area(s), low-income individuals, and/or very small businesses, consistent with safe and sound banking practices.
Community development lending activities	The institution is a leader in making community development loans.	The institution has made a relatively high level of community development loans.	The institution has made an adequate level of community development loans.	The institution has made a low level of community development loans.	The institution has made few, if any, community development loans.
Product innovation	The institution makes extensive use of innovative and/or flexible lending practices in order to serve assessment area credit needs.	The institution uses innovative and/or flexible lending practices in order to serve assessment area credit needs.	The institution makes limited use of innovative and/or flexible lending practices in order to serve assessment area credit needs.	The institution makes little use of innovative and/or flexible lending practices in order to serve assessment area credit needs.	The institution makes no use of innovative and/or flexible lending practices in order to serve assessment area credit needs.

Investment Test Matrix

Characteristic	Outstanding	High Satisfactory	Satisfactory	Needs to Improve	Substantial Noncompliance
Investment and grant activity	The institution has an excellent level of qualified community development investment and grants, often in a leadership position, particularly those that are not routinely provided by private investors.	The institution has a significant level of qualified community development investments and grants, occasionally in a leadership position, particularly those that are not routinely provided by private investors.	The institution has an adequate level of qualified community development investments and grants, although rarely in a leadership position, particularly those that are not routinely provided by private investors.	The institution has a poor level of qualified community development investments and grants, but not in a leadership position, particularly those that are not routinely provided by private investors.	The institution has a few, if any, qualified community development investments or grants, particularly those that are not routinely provided by private investors.
Responsiveness to credit and community development needs	The institution exhibits excellent responsiveness to credit and community economic development needs.	The institution exhibits good responsiveness to credit and community economic development needs.	The institution exhibits adequate responsiveness to credit and community economic development needs.	The institution exhibits poor responsiveness to credit and community economic development needs.	The institution exhibits very poor responsiveness to credit and community economic development needs.
Community development initiatives	The institution makes extensive use of innovative and/or complex investments to support community development initiatives.	The institution makes significant use of innovative and/or complex investments to support community development initiatives.	The institution occasionally uses innovative and/or complex investments to support community development initiatives.	The institution rarely uses innovative and/or complex investments to support community development initiatives.	The institution does not use innovative and/or complex investments to support community development initiatives.

Service Test Matrix

Characteristic	Outstanding	High Satisfactory	Satisfactory	Needs to Improve	Substantial Noncompliance
Accessibility of delivery systems	Delivery systems are readily accessible to all portions of the institution's assessment area(s).	Delivery systems are accessible to essentially all portions of the institution's assessment area(s).	Delivery systems are reasonably accessible to essentially all portions of the institutions assessment area(s).	Delivery systems are accessible to limited portions of the institution's assessment area(s).	Delivery systems are inaccessible to significant portions of the assessment area(s), particularly low- and moderate-income geographies and/or low- and moderate-income individuals.
Changes in branch locations	To the extent changes have been made, the institution's record of opening and closing branches has improved the accessibility of its delivery systems, particularly in low- and moderate- income geographies and/or to low- and moderate-income individuals.	To the extent changes have been made, the institution's opening and closing of branches has not adversely affected the accessibility of its delivery systems, particularly in low- and moderate- income geographies and/or to low- and moderate-income individuals.	To the extent changes have been made, the institution's opening and closing of branches has generally not adversely affected the accessibility of its delivery systems, particularly in low-and moderate-income geographies and/or to low- and moderate-income individuals.	To the extent changes have been made, the institution's record of opening and closing branches has adversely affected the accessibility of its delivery systems, particularly in low- and moderate-income geographies and/or to low- and moderate-income individuals.	To the extent changes have been made, the institution's opening and closing of branches has significantly adversely affected the accessibility of its delivery systems, particularly in low- and moderate-income geographies and/or to low- and moderate-income individuals.
Reasonableness of business hours and services in meeting assessment area(s) needs	Services (including where appropriate, business hours) are tailored to the convenience and needs of the assessment area(s), particularly low- and moderate- income geographies and/or individuals.	Services (including, where appropriate, business hours) do not vary in a way that inconveniences certain portions of the assessment area(s), particularly low- and moderate-income geographies and/or individuals.	Services (including, where appropriate, business hours) do not vary in a way that inconveniences portions of the assessment area(s), particularly low- and moderate-income geographies and/or individuals.	Services (including, where appropriate, business hours) vary in a way that inconveniences certain portions of the assessment area(s), particularly low- and moderate-income geographies and/or individuals.	Services (including, where appropriate, business hours) vary in a way that significantly inconveniences many portions of the assessment area(s), particularly low- and moderate-income geographies and/or individuals.
Community development services	The institution is a leader in providing community development services.	The institution provides a relatively high level of community development services.	The institution provides an adequate level of community development services.	The institution provides a limited level of community development services.	The institution provides few, if any, community development services.