

MEMO# 12396

July 26, 2000

LEGISLATION TO IMPOSE CRA REQUIREMENTS ON MUTUAL FUND COMPANIES INTRODUCED IN HOUSE

[12396] August 3, 2000 TO: BOARD OF GOVERNORS No. 48-00 FEDERAL LEGISLATION MEMBERS No. 12-00 PUBLIC INFORMATION COMMITTEE No. 32-00 PRIMARY CONTACTS - MEMBER COMPLEX No. 55-00 RE: LEGISLATION TO IMPOSE CRA REQUIREMENTS ON INVESTMENT COMPANIES INTRODUCED IN HOUSE Representatives Tom Barrett (D-WI) and Luis Gutierrez (D-IL) recently introduced legislation in the House that would subject a broad range of financial services companies, including investment companies, to Community Reinvestment Act (CRA) requirements. Specifically, the "Community Reinvestment Modernization Act of 2000" (H.R. 4893) directs the SEC to establish a CRA rating program for securities companies—which includes all federally registered brokers, dealers, investment advisers and investment companies—and requires the SEC to take these ratings into account when considering their applications. The bill would also require each securities company, mortgage bank and insurance company affiliate of a financial holding company or bank holding company to have a satisfactory CRA rating. Current Law The CRA was passed in 1977 in response to concerns over the practice of "redlining," or discriminating based on geographic location, by banks. It requires federal regulators to take into account whether a bank is serving the credit needs in its chartered community when evaluating a bank's application to expand. Since its enactment, the CRA has only applied to depository institutions. This is because Congress in 1977 determined that it was appropriate for banks to be required to serve their communities as a fair exchange for the substantial economic benefits that banks receive from the government, including deposit insurance, access to low-cost credit and restricted competition. H.R. 4893 would expand the list of institutions subject to CRA to include other financial service providers including securities companies, insurance companies and mortgage banks. New Legislation H.R. 4893 asserts that a securities company has a "continuing and affirmative obligation" to meet the need for financial services in its community, including the needs of low- and moderate-income people and neighborhoods. According to the bill, a securities company's community (or "assessment area") would be where it maintains a retail office, is represented by an agent, or has at least 0.5% market share. H.R. 4893 directs the SEC to establish a program to assess how well securities companies fulfill their CRA obligation based on three factors: customer evaluation, "community development investments" and performance. 2Customer evaluation. First, the SEC program would evaluate a securities company's number and distribution of customers throughout the community, along with the dollar amounts of the customers' investments. It would also consider the extent to which the company has adopted "innovative and flexible marketing methods" that facilitate the sale of securities to low- and moderate-income customers, such as low minimums for opening accounts and low

transaction fees. Community Development Investments. Second, the program would measure a company's number and dollar amount of "community development investments." It would also assess a company's responsiveness, through community development investments, to their community's credit, capital and development needs. H.R. 4893 defines community development investments as investment activities that "revitalize and stabilize low- and moderate-income neighborhoods and directly benefit low- and moderate-income individuals." The legislation provides examples such as investments in affordable housing, community services, and small-business and economic development. Performance. Finally, the program would appraise a company's performance in the community through three criteria: the number of retail offices opening or closing (in the community), the adoption of "alternate marketing systems" for low- and moderate-income neighborhoods, and the provision investment education and services for these neighborhoods. H.R. 4893 describes an "alternate marketing system" as a means for low- and moderate-income persons to gain electronic access to the company at community centers and similar locations. The SEC would be required to provide initial and overall CRA ratings for each securities company based upon the three factors described above. The SEC would also be required to provide the opportunity for comment on the overall rating. Interestingly, the bill specifies that the SEC, in its assessment of a company's "affirmative obligation," may not take into account any securities or investment practices by a company that unlawfully discriminates or has a negative impact on its community. Nevertheless, H.R. 4893 directs the SEC to reduce a company's CRA rating if it has engaged in a negative or discriminatory practice. The rating would be required to be "taken into account" by the SEC when considering a company's application. The ratings would also be taken into account when a bank holding company seeks approval to expand its financial activities. We will keep you informed of further developments concerning this issue. Matthew P. Fink
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