

The 30th Anniversary of the CRA: Restructuring the CRA to Address the Mortgage Finance Revolution

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Described by Congressman Barney Frank as “a market-friendly model” for bank reform,¹ the Community Reinvestment Act (CRA) was passed by Congress in 1977² to fuel reinvestment as a cure for urban blight, and to promote access to mortgage capital to remedy the adverse implications of persistent redlining. In deference to concerns about unsound and unprofitable loans, the CRA did not establish specific benchmarks or levels of credit, nor did it provide much guidance as to how regulators should evaluate bank performance.³ Instead, the CRA created an affirmative obligation for banks to reinvest in poor communities.

While some critics continue to debate the effectiveness and cost of CRA regulations, a report issued by the Federal Reserve Board in 2000 concluded that mortgage loans that satisfy the low- and moderate-income (LMI) element of the CRA’s Lending Test proved to be at least marginally profitable for most institutions, and that many institutions found that CRA lending performed no differently than other lending.⁴ Others have recently raised concerns that the CRA caused the subprime debacle, but analysis of the data proves otherwise. Former Federal Reserve Governor Kroszner’s article in this publication succinctly addresses these concerns.⁵

Beginning in 1977, the problem shifted from access to credit, to access to fair credit; today the LMI community has come full circle to face renewed problems with access to credit. Over the last three decades, the proportion of loans under the CRA has continued to decline. The Home Mortgage Disclosure Act (HMDA) data from 2006 indicate that “only ten percent of all loans are CRA-related — that is, lower-income loans made by banks and their affiliates in their CRA assessment areas.”⁶

Meanwhile, 34 percent of all mortgage loans were LMI loans. Removing the ten percent of CRA-related loans, 24 percent of all loans were outside of the regulatory reach of the CRA and were LMI loans. The 24 percent of non-CRA mortgage lending includes 13 percent originated by CRA-regulated lenders outside their assessment areas and another 11 percent originated by independent mortgage companies. Therefore, while low-income borrowers and neighborhoods had increased access to credit by the mid-2000s, the majority of this lending was not covered by the CRA and therefore provided fewer consumer protections.

The importance of regulatory and supervisory uniformity and the need to restore access to fair credit for all borrowers places the CRA at the center of current discussions on regulatory reforms. This is not to suggest a return to the

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1 Barney Frank, “The Community Reinvestment Act: Thirtieth Anniversary Roundtable,” Federal Reserve Bank of Boston, October 22, 2007.

2 The CRA was enacted by Congress in 1977 (12 U.S.C. 2901(b)) and implemented by Regulations 12 CFR parts 25, 228, 345, and 563e. The CRA sought to encourage depository institutions to invest in community development ventures and lending to small businesses and low- and moderate-income (LMI) people and neighborhoods in areas where the institution maintained banking operations, consistent with safety and soundness principles.

3 See Michael Barr, “Credit Where it Counts,” *New York University Law Review* (2005), Vol. 75:600 for a summary of a broad range of CRA critiques.

4 Board of Governors of the Federal Reserve System, “The Performance and Profitability of CRA-Related Lending, A report submitted to Congress pursuant to Section 713 of the Gramm-Leach-Bliley Act of 1999.” (Washington, DC, July 17, 2000), available at <http://www.federalreserve.gov/BoardDocs/Surveys/CRAloansurvey/cratext.pdf>.

5 Governor Randall S. Kroszner, “The Community Reinvestment Act and the Recent Mortgage Crisis,” presented at the Confronting Concentrated Poverty Policy Forum, Board of Governors of the Federal Reserve System, Washington, D.C., December 3, 2008, available at <http://www.federalreserve.gov/newsevents/speech/kroszner20081203a.htm>.

6 Glenn Canner and Neil Bhutta, “Staff Analysis of the Relationship between the CRA and the Subprime Crisis,” Board of Governors of the Federal Reserve System, November 21, 2008, available at http://www.federalreserve.gov/newsevents/speech/20081203_analysis.pdf.

days of lax underwriting and opaque markets. Instead, as access to fair credit is restored, the CRA-regulated entities' expertise about safe and sound lending to LMI neighborhoods could prove invaluable for efforts to address the foreclosure crisis and stabilize neighborhoods. Beyond learning from the CRA's successes, there is also a need to address the CRA's greatest weakness: the lack of uniform coverage across the industry. This flaw enabled less supervised nonbank lenders⁷ to operate largely outside of the CRA regulatory framework and to gain market share from more closely regulated mortgage market participants.⁸ As the subprime crisis unfolds, the need for more uniform regulations and consumer protections for all borrowers has become evident.

The purpose of this paper is fourfold. First, we review the historic and regulatory changes in each decade since the enactment of the CRA. Second, we explore the evolution of the mortgage market, including the rise of large organizations, the growth of secondary market sources of funding and wholesale lending, and the proliferation of new products. Next, we discuss the current industry and regulatory challenges, focusing on the differences in lending inside and outside of assessment areas and by nonbank entities. We consider how and why this coverage varies and its adverse effects. Lastly, we consider ways to reform the CRA. We suggest applying the CRA framework to all lenders, reconsidering assessment area definitions, expanding fair lending enforcement, improving data collection for compliance monitoring, and finding ways for all institutions to provide all services.

Methodology

This article utilizes the Joint Center for Housing Studies Enhanced Home Mortgage Disclosure Act (HMDA) Database, which combines loan-level data on the char-

acteristics of one- to four-family home mortgage originations and borrower information, as well as data on lender characteristics and branch locations from the Board of Governors of the Federal Reserve System (Federal Reserve).⁹ The Federal Reserve's lender file contains information that facilitates aggregation of individual HMDA reporters into commonly owned or commonly controlled institutions, which can then be analyzed as integrated units. The assessment area definitions come from the Board's branch-location file. This article assumes that if a lending entity subject to the CRA has a branch office in a particular county, then that entire county is part of that entity's assessment area. Loans made in counties where the lending entity does not have a branch are assumed to fall outside of that entity's assessment area.

To assess the influences of economic, demographic, and housing market trends on lending, the Joint Center linked other information on metropolitan area and neighborhood characteristics to the HMDA loan-level data. These included U.S. Department of Housing and Urban Development (HUD) data used to classify loans based on both the income of the applicant and the income of the census tract in which the property is located.¹⁰

Although imperfect in many ways, HMDA data provide a complete census of mortgage lending, including information on first- and second-lien mortgages for the purchase and refinance of one- to four-family owner-occupied residences, as well as absentee-owned one- to four-family structures. Unlike other readily available data, HMDA provides information on borrower income and race/ethnicity, as well as the location of the property identified at the census tract level. This permits a detailed assessment of the impact of changing patterns of mortgage lending on both historically disadvantaged population subgroups and specific neighborhoods.

Supported in part by the Ford Foundation, the Joint Center Enhanced HMDA Database has been used to

7 "Nonbank institutions" are independent mortgage banks (IMBs) and other independent mortgage lenders. These terms may be used interchangeably throughout this paper and represent institutions that are not covered by CRA.

8 When the CRA was enacted in the 1970s, CRA-regulated depository institutions generated the majority of home mortgage and small business loans. By 2006 the share of all loans covered by detailed CRA review of LMI borrowing had fallen to just 26 percent compared to 41 percent ten years earlier.

9 The work presented here updates and expands on a previous paper by William C. Apgar and Mark Duda, "The Twenty-Fifth Anniversary of the Community Reinvestment Act: Past Accomplishments and Future Regulatory Challenges," *Economic Policy Review*, Federal Reserve Bank of New York (2002), available at http://www.jchs.harvard.edu/publications/governmentprograms/cra02-3_apgar.pdf.

10 For a more complete description of the database see Joint Center for Housing Studies (JCHS), "The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System," prepared for the Ford Foundation by the JCHS of Harvard University, March, 2002, available at <http://www.jchs.harvard.edu/research/crareport.html>. Note that in addition to information on loan originations, the HMDA data also include limited information on the sale of mortgages by loan originators to wholesale investors or mortgage conduits.

support a wide range of innovative research. To date, these data have been used in ongoing Joint Center research on the impact of the CRA on housing market dynamics,¹¹ the implications of the changing mortgage banking industry for community-based organizations,¹² and how the uneven application of mortgage market regulations in both the primary and secondary market combined to permit unfair mortgage pricing with respect to race and ethnicity.¹³ Finally, these data were deployed in a broader examination of the impact of the mortgage market meltdown on low- and moderate-income communities.¹⁴

The Regulatory Environment

The 1970s: The CRA Marks a New Era in Regulation

In the late 1970s, many inner cities were faced with urban decline and deterioration while the suburbs were booming. Housing advocates were concerned that lower-income and minority residents of inner-city communities did not have access to conventional mortgages and small business lending.¹⁵ Many reasons for this disinvestment have been put forward, including blatant discrimination in the form of ‘redlining,’ where conventional lenders refused to lend to certain borrowers or neighborhoods based on their race or income. Beyond the systemic causes of this disinvestment, some have argued that conventional lenders lacked lending rela-

tionships within these lower-income communities and/or used traditional underwriting criteria that did not address non-conforming, yet creditworthy applicants.¹⁶

Grassroots community groups working in coalition through National People’s Action pointed out that depository institutions accepted deposits from inner-city neighborhoods yet refused to lend in these same areas, choosing instead to lend in more affluent and growing suburban areas. To address concerns about how deposits were deployed, advocates argued that banks were obligated by a *quid pro quo*: if banks receive federal benefits (including federal deposit insurance, low-cost capital, or access to the payment system and the Discount Window) they are obligated to serve the credit needs of their entire service areas. This *quid pro quo* was one of the leading Congressional arguments for new legislation.¹⁷ There was also discussion at the time of a greater obligation of banks to improve access to underserved communities, with the goal of reducing discriminatory practices.

Fair lending laws were already on the books but did not proactively address the concern that low-income and minority consumers and neighborhoods lacked access to credit. Following the civic unrest of the late 1960s and the assassination of Rev. Martin Luther King Jr., the Fair Housing Act, passed as part of the Civil Rights Act of 1968,¹⁸ and the Equal Credit Opportunity Act (ECOA) of 1974¹⁹ prohibited creditor discrimination. To support

11 Joint Center for Housing Studies, “The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System.”

12 William Apgar and Allegra Calder, “Credit Capital and Communities: The Implications of the Changing Mortgage Banking Industry for Community Based Organizations,” Joint Center for Housing Studies, Harvard University, 2004, available at <http://www.jchs.harvard.edu/publications/communitydevelopment/ccc04-1.pdf>.

13 William Apgar, Amal Bendimerad and Ren S. Essene, “Mortgage Market Channels and Fair Lending: An Analysis of HMDA Data,” Joint Center for Housing Studies, Harvard University, 2007, available at http://www.jchs.harvard.edu/understanding_mortgage_markets/index.htm.

14 Joint Center for Housing Studies, “America’s Rental Housing: The Key to a Balanced National Policy,” Harvard University, 2008, available at http://www.jchs.harvard.edu/publications/rental/rh08_americas_rental_housing/index.html.

15 While these communities lacked traditional access to credit, more predatory loans such as land contract sales (under which the borrower pays on an installment basis with few rights to equity) became common in neighborhoods like Chicago’s south side. See Joseph C. Cornwall, *The Million-Dollars-A-Day Cost of Being Black: A History of African-American, Catholic and Jewish Struggles Against Real Estate Speculation in Chicago, 1957-1981.* (Cornwall Metropolitan Studies, Rutgers University, 2002).

16 Chairman Ben S. Bernanke, “The Community Reinvestment Act: Its Evolution and New Challenges,” speech at the Community Affairs Research Conference, Washington, DC, 2007.

17 Senator William Proxmire, Statement in 123 Congress, Record Number 17604, Washington, DC, 1977.

18 The Fair Housing Act (Title VIII of the Civil Rights Act of 1968), as amended, prohibits discrimination in the sale, rental, and financing of dwellings, and in other housing-related transactions, based on race, color, national origin, religion, sex, familial status, and disability, available at <http://www.hud.gov/offices/fheo/FHLaws/>.

19 ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age, use of public assistance, or for exercising their rights under the Consumer Credit Protection Act, available at http://www.usdoj.gov/crt/housing/housing_ecoa.php.

fair lending enforcement, in 1975 the HMDA²⁰ acknowledged the failure of lending institutions to provide equal access to credit and ensured that information would be available to quantify whether institutions met the credit needs of their communities.

Enacted in 1977, the CRA established a “continuing and affirmative obligation” for federally insured depository institutions to help meet the credit needs of their local communities and required that lenders demonstrate that they serve the convenience and needs of LMI communities with both credit and deposit services. To encourage fair lending and curb the racially discriminatory practice of redlining, the CRA sought to have lenders use the same loan criteria, regardless of whether borrowers lived in lower-income central-city neighborhoods or more prosperous communities.²¹ The CRA promotes an increased distribution of capital to LMI and minority households and at its enactment, covered a substantial share of all home mortgage and small business lending activities.

The initial form of CRA enforcement included periodic non-public exams, subjective examination procedures, and the ability of regulators to delay merger or expansion proposals of institutions that did not comply with CRA obligations. The initial rulemaking established 12 assessment factors to evaluate a bank’s performance and instituted periodic CRA exams for depository institutions.²² To incentivize performance, these examinations were to be considered when an institution applies to open a branch, merge with another institution, or become a financial holding company.

CRA regulations also provided an opportunity for

public comment during the merger process. Community groups used this opportunity to pressure banks to reinvest in underserved communities and to encourage lenders to meet with community groups to consider a CRA agreement.²³ Yet, just eight of 40,000 applications were denied due to the CRA in the first decade of the regulation.²⁴ With no public disclosures of ratings, few mergers to protest, and evaluations based on the lender’s intentions instead of tangible outcomes, advocates found it difficult to evaluate a lender’s track record and pressure poor performing lenders to reinvest in low-income neighborhoods. This would change over the next two decades.

The 1980s and a Renewed Focus on Fair Lending

Arguably, CRA exams in the 1980s did little to expand lending in underserved markets, as 97 percent of institutions received one of the two highest ratings, and some regulators conducted no CRA exams at all.²⁵ In a world of limited consolidation and evaluation, the CRA had limited ability to punish poor performance or reward “good behavior” through denying or permitting mergers. While some community activists used the CRA mandate to pressure banks to experiment with new loan underwriting criteria and products to meet the needs of their communities, without publicly available ratings it was difficult for community groups to scrutinize institutional lending records and create a reputational risk for poor performance. Meanwhile, underserved markets continued to lack access to credit, and racial disparities persisted. Documenting these challenges was the ground-breaking, Pulitzer Prize-winning “Color of Money” series in the *Atlanta Journal Constitution*, which

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- 20 HMDA is implemented by the Federal Reserve’s Regulation C, available at <http://www.ffiec.gov/hmda/history.htm> HMDA was enacted to provide loan-level information to ensure that depository institutions are not engaging in lending discrimination. HMDA data became public in 1989 and are used in CRA exams to ensure that CRA-regulated lenders are serving the housing needs of their communities.
- 21 Paul S. Grogan and Tony Proscio, *Comeback Cities: A Blueprint for Urban Neighborhood Revival* (Boulder: Westview Press, 2002), p. 114.
- 22 The Federal Reserve System regulates all bank holding companies, financial holding companies, and state-chartered member banks; the Office of the Comptroller of the Currency (OCC) regulates banks with a national charter; the Federal Deposit Insurance Corporation (FDIC) regulates state-chartered banks that are not members of the Federal Reserve System; and the Office of Thrift Supervision (OTS) regulates savings and loan institutions.
- 23 A CRA agreement is made between a community organization and a bank where both commit to a specific program of loans and/ or investments. The bank may agree to a certain volume of lending and the community group may help play a specific role such as marketing or counseling. For more information see: National Community Reinvestment Coalition, “CRA Commitments,” September 2007, available at http://www.community-wealth.org/_pdfs/articles-publications/cdfis/report-silver-brown.pdf. See also: Raphael W. Bostic and Breck L. Robinson, “What Makes CRA Agreements Work? A Study of Lender Responses to CRA Agreements.” Paper prepared for the Federal Reserve System’s “Sustainable Community Development: What Works, What Doesn’t, and Why” research conference, Washington, DC, February, 2003.
- 24 Marilyn Rice Christiano, “The Community Reinvestment Act: The Role of Community Groups in the Formulation and Implementation of a Public Policy.” Ph.D. diss., University of Maryland, 1995.
- 25 Early studies of the impact of the CRA on lending patterns were hindered by the fact that HMDA initially lacked data on the income and racial characteristics of borrowers. For a review of these studies see D.D. Evanoff and L.M. Chu, “CRA and Fair Lending Regulations: Resulting Trends in Mortgage Lending,” *Federal Reserve Bank of Chicago Economic Perspectives*, Volume 20, Number 6, (1996.) See also Apgar and Duda, “The Twenty-Fifth Anniversary of the CRA: Past Accomplishments and Future Regulatory Challenges.”

raised concerns about the ongoing racial disparities in access to mortgage loans and the lack of enforcement of the CRA and fair lending laws. Meanwhile, community groups pushed Congress to adopt the Fair Housing Amendments Act of 1988 to expand the scope and strengthen the enforcement of the Fair Housing Act and address ongoing racial disparities.

After the savings and loan crisis of the late 1980s, Congress passed the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) of 1989.²⁶ FIRREA required regulators to prepare a detailed written evaluation of lenders' CRA performance; mandated public disclosure of CRA ratings and evaluations; established a four-tier descriptive rating system; and expanded the HMDA data to include race, ethnicity, gender, and income and enabled community groups to link HMDA data with census tract information to allow more detailed geographic and demographic analysis. These actions strengthened the ability of community groups to evaluate and pressure lenders to actively invest in LMI neighborhoods.

Congressional concern over the CRA's effectiveness led to even broader changes in 1989. As the regulatory climate changed, the press and community advocates raised public awareness of the increasing number of mergers and focused senior banking executives' attention on the reputational risk of being labeled an unfair lender. The increase in federal regulatory action and the new public disclosures encouraged community groups to negotiate more CRA agreements.²⁷ Meanwhile, the Federal Reserve denied its first merger due to the institution's lack of effort to meet the credit needs of the community, and the Federal Reserve published a policy statement outlining a more aggressive regulatory stance towards the CRA.

CRA Regulations Did Not Keep Pace with the Restructuring in the 1990s

When the CRA was first enacted, regulated depositories largely engaged in mortgage lending through branch banking locations. However, the 1990s witnessed a radical transformation of the financial services industry with

which the CRA could not keep pace. Emerging technology in data processing and telecommunications encouraged the growth of large mortgage banking operations, though limits on the geographical expansion of deposit-taking organizations slowed this trend somewhat.

At the same time, new sources of funding for residential mortgages emerged. Rather than depend on deposits to fund loans, mortgage lending operations like the rapidly growing independent mortgage banks (IMBs) were able to tap global capital markets and institutional investors to gain access to virtually unlimited amounts of mortgage capital. This new source of funding and the ability to operate outside the confines of federal regulation enabled IMBs to capture mortgage market share from traditional banks. Indeed, according to an analysis of HMDA data, from 1990 to 1994 the share of all mortgage loans originated by IMBs more than doubled to 38 percent.²⁸ In contrast, the share of lending by traditional deposit-taking organizations declined by 20 percentage points to 39 percent, while the share of loans made by mortgage banking subsidiaries and affiliates of traditional banks held constant at just over 20 percent.

The rise of IMBs, along with equally dramatic changes in the structure of the retail banking industry, prompted a significant legislative response. In 1994, the Riegle-Neal Interstate Banking and Branching Efficiency Act eliminated most restrictions on interstate bank acquisitions, expanding the ability of banks to operate on a multi-state basis. Some advocates argued that this act was the "final move in an almost complete dismantling of long standing legal barriers to the geographic spread of banks."²⁹ After the passage of the Riegle-Neal Act, some banks extended their own branch networks across county or even state lines. However, much of this geographic expansion was accomplished by a series of mergers and acquisitions, including the acquisition of major retail banking and mortgage banking affiliates and subsidiaries that became the building blocks of today's financial services giants.

As discussed below, the geographic expansion of bank lending, the growth of IMBs, and the increasing tendency for regulated depositories to conduct their

26 *FIRREA*, 12 U.S.C. 2906(b) (2000).

27 Alex Schwartz. "From Confrontation to Collaboration? Banks, Community Groups, and the Implementation of Community Reinvestment Agreements." *Housing Policy Debate* 9:3, (1998).

28 This analysis comes from data collected by Robert Avery at the Federal Reserve Board of Governors for a paper in this publication by Robert Avery, Marsha Courchane and Peter Zorn entitled, "The CRA Within a Changing Financial Landscape," 2009.

29 Jim Campen, "It's a Bank-Eat-Bank World," *Dollars and Sense* (January/February 1998), p. 12.

mortgage banking operations through subsidiary and affiliate organizations had dramatic implications for the CRA. First and foremost, these trends called into question the basic rationale behind the CRA, namely the link between geographically defined deposit-taking and a geographically determined set of mortgage lending obligations. At the same time, these trends highlight the importance of existing CRA regulations, especially the fact that regulators could use CRA performance to deny requests for mergers or acquisition during the late 1990s.

Rather than fundamentally rethink and potentially realign the rationale for CRA intervention into private mortgage markets in the mid-1990s, the legislative and regulatory response was modest. For example, in response to concerns raised by industry and community leaders about the lack of consistent performance-based reviews and the burden of CRA compliance, the agencies began a review of the CRA in the early 1990s at President Clinton's request. The supervisory agencies issued joint regulations in 1995 to "revise the CRA evaluation process and make it more objective and performance oriented."³⁰ Focusing on specific performance measurements, these regulations required greater disclosure on a range of lending (including community development lending) and outlined specific tests for large retail, small retail, and wholesale/limited purpose institutions. The three-pronged test of lending, investment, and service was instituted for large retail depositories, while small banks received a more streamlined treatment.³¹

While the 1995 regulations sought to reduce subjectivity, examiners still consider the "performance context" and apply the relevant test depending on the institution and its marketplace. Furthermore, the CRA continues to scrutinize assessment area lending and banking services, and the revised Lending Test also measures lending by the distribution of mortgage loans to borrowers of different income levels. Because HMDA data allow monitoring of institutions' lending patterns, much of the scrutiny

from community groups has remained on the Lending Test.³² With the growing importance of subsidiary and affiliate activity, banks are also allowed to choose whether the lending, investing, or service activities of their affiliates are considered in their CRA examinations. Given that these affiliates and subsidiaries were often mortgage companies specializing in serving lower-income borrowers with risky mortgage products, it is likely that much of this volume therefore escaped examination.

In an effort to bring other banking regulation into compliance with the changing market trends, the Gramm-Leach-Bliley Financial Modernization Act (GLBA) was passed in 1999. Given the prevailing deregulation mindset, it was difficult for CRA proponents to make the case for increased regulation, and many perceived that the best course of action was not to make dramatic changes for fear of losing the CRA entirely. The most substantial effect of the GLBA was the partial repeal and amendment of the Glass-Steagall Act and the liberalization of the Bank Holding Company Act (BHCA). Glass-Steagall had erected walls between commercial banking and insurance and investment banking, which GLBA dismantled. GLBA allowed commercial banks, insurance underwriters, and investment banks to affiliate under the umbrella of a new entity known as a financial holding company, while authorizing less frequent examinations of smaller banks with Satisfactory or better CRA ratings.

Under the new rules, financial institutions could now become large conglomerates through a new financial holding company structure, so long as the holding company's depository institutions had and maintained CRA ratings of Satisfactory or Outstanding. If that and other requirements were satisfied, the financial holding company could be formed with no opportunity for public comment on the company's CRA record.³³ Interestingly, given CRA opponents' concerns over the safety and soundness of CRA-motivated lending activity, the GLBA directed the Federal Reserve System to report to

30 Robert B. Avery, Paul S. Calem, and Glenn B. Canner, "The Effects of the Community Reinvestment Act on Local Communities," Board of Governors of the Federal Reserve System, Division of Research and Statistics, March 20, 2003, available at http://www.federalreserve.gov/communityaffairs/national/CA_Conf_SusCommDev/pdf/cannerglen.pdf.

31 For current CRA regulations, see the code of federal regulations 12 CFR 228, available at http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&tpl=/ecfrbrowse/Title12/12cfr228_main_02.tpl.

32 Consistent with the renewed focus on HMDA data in CRA reviews, the Federal Deposit Insurance Corporation Improvement Act (FDICIA) required regulators to evaluate and report on potential errors in HMDA data in the public portion of CRA reports.

33 Meanwhile, with rising international concerns about the lack of U.S. federal privacy legislation and several high-profile cases against banks for privacy violations, concerns arose during the GLBA debates around the privacy of borrowers' credit reports and information. Title V of GLBA instituted greater information security requirements, a privacy notice policy offering limited privacy protections, but few restrictions on the sale of consumers' financial information. Patricia A. McCoy, *Banking Law Manual: Federal Regulation of Financial Holding Companies, Banks and Thrifts* § 4.03[3]-[5] (Lexis 2d ed. 2000 & cumulative supplements).

Congress and to make available to the public the default rates, delinquency rates, and profitability of these lending activities. These “sunshine” provisions also required public disclosure and annual report filings concerning any CRA agreements made between lenders and community groups.³⁴

CRA Revisions in the 2000s and the Rise of Subprime Lending

The revolution in mortgage finance during the 1990s spilled over into the new millennium in the form of an equally dramatic explosion of new subprime mortgage products.³⁵ These products seemed to foster expanded access to homeownership by communities and individuals not well-served by traditional prime loan products. At the time, many advocates argued that the growth of subprime lending was linked to various predatory loan features and lending practices that encouraged new borrowers to take on mortgage obligations that they did not understand or were unable to pay. Despite the importance of the rise of subprime lending to the LMI market, the largest share of this new subprime lending took place outside of the CRA-regulated channel, as we explain below.

Despite the substantial changes sweeping the mortgage market, substantive changes to the CRA were modest. The 2001 joint Advance Notice of Proposed Rulemaking (ANPR) sought comments on a range of issues concerning the limited ability of the CRA to keep pace with an evolving market; many of these issues persist today. The eight areas of investigation were: the large retail institutions’ evaluations through the three-pronged test, the small institutions’ streamlined evaluations and asset threshold, the community development test as applied to

limited-purpose and wholesale institutions, the strategic plan option, the performance context as it relates to quantitative and qualitative evaluations, the role of assessment areas to reasonably and sufficiently designate communities, the lender’s option to include affiliate activities in the CRA exam, and the current data collection requirements and maintenance of public files.³⁶

Early in the discussions, there was a proposal to increase the Small Bank asset threshold for institutions with total assets of less than one billion dollars. In response to community groups’ concerns, the 2004 Notice of Proposed Rulemaking (NPR) focused largely on the treatment of these small banks and proposed increasing the threshold to include institutions with total assets of less than \$500 million, excluding any holding company assets.³⁷ After considerable feedback, the Federal Reserve System and the FDIC developed the designation Intermediate Small Bank (ISB) and an ISB two-pronged test, and the Office of the Comptroller of the Currency (OCC) later agreed to this recommendation.

Determining that the CRA was basically sound, the 2005 joint Final Rule of the CRA as published by the Federal Reserve, OCC, and FDIC established the ISB category and clarified that lenders’ CRA evaluations would be adversely affected by discriminatory, illegal, and abusive credit practices in regards to consumer loans regardless of whether the loan is inside or outside of an assessment area or within the bank or an affiliate. Meanwhile, the OTS announced that it would not conduct CRA examinations for institutions holding less than \$1 billion in assets, effectively exempting nearly 90 percent of the institutions it regulates, and the FDIC proposed a similar rule.³⁸ By 2007, the OTS agreed to adopt the 2005 Joint Final Rule.³⁹ Yet, the lack of early

34 Board of Governors of the Federal Reserve System, “The Performance and Profitability of CRA-Related Lending.”

35 As described by Eric Rosengren, “Housing and the Economy: Perspectives and Possibilities,” in a speech to the Massachusetts Mortgage Bankers Association, Boston, MA, January 8, 2009: “subprime” loans refer to mortgages that have a higher risk of default than prime loans, often because of the borrowers’ credit history. Certain lenders may specialize in subprime loans, which carry higher interest rates reflecting the higher risk. Banks, especially smaller community banks, generally do not make subprime loans, although a few large banking organizations are active through mortgage banking subsidiaries. According to interagency guidance issued in 2001, “The term ‘subprime’ refers to the credit characteristics of individual borrowers. Subprime borrowers typically have weakened credit histories [and] may also display reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria... Subprime loans are loans to borrowers displaying one or more of these characteristics at the time of origination or purchase. Such loans have a higher risk of default than loans to prime borrowers.”

36 Federal Register 66 (139) July 19, 2001 <http://www.fdic.gov/news/news/inactivefinancial/2001/fil0165a.pdf>.

37 Federal Register 69 (25) February 6, 2004, available at <http://www.fdic.gov/regulations/laws/federal/04CRA.html> In addition to the increased asset-size threshold and the clarification that discriminatory, illegal, and abusive credit practices will potentially affect the CRA rating, the NPR proposed disaggregating small business and small farm loan data to the census-tract level and publicly disclosing the number, type, and amount of purchased loans, HOEPA loans, and affiliate loans.

38 See Barr, 2005 p. 105 for more details. The OTS finalized the rule on August 18, 2004. See CRA Regulations, 69 Fed. Reg. 51,155 (Aug. 18, 2004) (codified at 12 C.F.R. §563.12(t)). The FDIC proposed a similar rule, Community Reinvestment, 69 Fed. Reg. 51,611 (Aug. 20, 2004).

39 See OTS, CRA Rule Interagency Uniformity, 72 Fed. Reg. 13429 (2007).

agreement by the regulators raised concerns by advocates about potential regulatory arbitrage.⁴⁰ Meanwhile, the 2005 Final Rule left untouched important issues such as the definition of assessment areas and the unevenness of CRA coverage across mortgage lenders raised in the initial 2001 ANPR.

Today, the CRA is enforced through periodic exams that establish a public performance rating and report fair lending violations.⁴¹ Regulators take into account not only the volume of lending but also the distribution across geography and borrower characteristics as well as innovation and flexibility of lending to underserved communities. As mentioned earlier, illegal practices and fair lending violations are considered in the assignment of the lender's rating and are reported to the appropriate agencies, as clarified in the 2005 Final Rule. These ratings and the HMDA data are publicly available, allowing for press coverage, permitting public comment on bank expansion applications, and creating a tangible reputational risk for lenders who seek to grow their operations. Providing a public track record through CRA agreements and the comment process has historically given leverage to community groups to act as "regulators from below" and support enforcement efforts.⁴² It remains to be seen whether community groups will continue to have such leverage, given the rapid changes underway in the financial world.

The Revolution in Mortgage Finance

Since the CRA was passed in 1977, there has been a virtual revolution in mortgage finance—to which the CRA has failed to adapt. When the CRA was enacted, depository lenders held the majority of loans that they originated in portfolio, because underwriting standards

and mortgage documents varied considerably, and third-party investors were reluctant to purchase mortgages that lacked adequate credit enhancement and standard features. As recently as 1980, nearly half of all mortgages for one- to four-family homes were originated by deposit-taking thrift organizations and another 22 percent by commercial banks. As a result of the dramatic restructuring of the mortgage market over the past quarter-century, today the largest share of mortgage capital flows through a wide range of unsupervised or only marginally supervised entities.⁴³ Changes include the growth of secondary market sources of funding, the rise of large organizations and nonbank lenders, the proliferation of new product development, the expansion of wholesale operations, and the decline of small bank mortgage lending.

The Rise of Large Organizations

The last thirty years have witnessed a dramatic consolidation of the mortgage and banking industry. Stimulated by the globalization of financial services, the removal of federal and state-level restrictions on the expansion of operations across county and state boundaries fueled a dramatic rise in the number of large banking operations. In some instances depositories expanded by opening new branches beyond boundaries established during the Great Depression. However, growth was increasingly accomplished by a series of mergers and acquisitions that helped create a number of large multi-state and even national mortgage banking entities. Moreover, emerging technology in data processing and telecommunications and the creation of nationally recognized brands enabled larger organizations to enhance the economies of scale of their operations and the scope of their product offerings.⁴⁴

40 *The concept of regulatory arbitrage is that by reducing its regulatory oversight, a single regulator could encourage regulated entities to seek a new charter to conduct business under their supervision. To the extent other regulators depend on fees from regulated entities to fund their operations, this could spark a form of destructive competition among regulators that would drive down regulatory enforcement across the board. See letter from Consumer Federation of America to the Chief Counsel's Office, Office of Thrift Supervision, dated January 24, 2005 and regarding proposed regulation No. 2004-53. Available at <http://www.consumerfed.org/pdfs/OTScra0102405.pdf>.*

41 *As a result of amendments in GLBA, small institutions that receive a top rating of Outstanding in their last examination do not face another routine CRA examination for at least 60 months. Small institutions that are rated Satisfactory in their last CRA examination do not receive another routine CRA examination for at least 48 months. Small Banks are depository institutions with less than \$1 billion in assets (adjusted for inflation). Regulators may conduct CRA examinations for larger institutions more frequently.*

42 *Allen Fishbein. "The Ongoing Experiment with 'Regulation from Below': Expanded Reporting Requirements for HMDA and CRA" Housing Policy Debate, 3:2 (1992), available at http://www.knowledgeplex.org/kp/text_document_summary/scholarly_article/relfiles/hpd_0302_fishbein.pdf.*

43 *Supervision varies greatly among the states and amongst the regulators. For example, while the Federal Trade Commission (FTC) regulates some independent mortgage banks, they have an arguably less robust examination process.*

44 *Robert B. Avery, et al., "Trends in Home Purchase Lending: Consolidation and the Community Reinvestment Act," Federal Reserve Bulletin (February, 1999), available at <http://www.federalreserve.gov/pubs/bulletin/1999/0299lead.pdf>.*

The consolidation of the banking industry was evident on many fronts. In a companion paper in this edited volume, Avery, Courchane, and Zorn report that by 2007 the 25 largest depository institutions (determined by assets) operated nearly 40 percent of all retail banking offices, up from just ten percent in 1987. Similarly, over the two decades from 1987 to 2007, the share of deposits received by the top 25 banking organizations more than doubled to nearly 55 percent, while their share of mortgages soared nearly threefold to 67 percent.⁴⁵

These trends towards consolidation posed numerous challenges to smaller, locally-based banks and thrifts that were once the mainstay of both retail banking and mortgage lending. Lacking the economies of scale to compete with these financial services giants on many fronts, over the past two decades smaller banks and thrifts cut back on their residential mortgage origination activities or abandoned them entirely. Instead, many smaller community banks chose to focus on the provision of other forms of consumer credit (e.g., auto loans and small business loans) and other fee-based banking services. By early in the new century this transformation was nearly complete. For example, by 2006, the last full year before the onset of the mortgage market meltdown, HMDA reported that of the 4,150 banking organizations making home purchase mortgage loans, 3,977 made fewer than 1,000 loans and 3,089 fewer than 100 loans.⁴⁶ Collectively, organizations making fewer than 1,000 loans accounted for only five percent of all home purchase loans originated that year.

The Growth of Secondary Market Sources of Funding and Wholesale Lending

While the retail banking industry was consolidating, the pooling and selling of packages of mortgages to investors around the world replaced deposit-taking activities as the principal source of funding for residential mortgages. Expanding secondary market institutions included: Ginnie Mae, an organization

created to securitize the government-insured portions of the market; Fannie Mae and Freddie Mac, two government sponsored enterprises (GSEs) that securitize large shares of conventional conforming loans; and a host of Wall Street investment banks and private issuers of mortgage-backed securities (MBS).

Traditionally, mortgage sales and outreach efforts were conducted by the retail lending divisions of deposit-taking organizations, with loan officers who worked for the banks and thrifts that initially funded the loan.⁴⁷ Over the past decade, an increasing share of loans was funded by large mortgage banking operations termed “wholesale lenders,” including entities owned by deposit-taking banks and thrifts, stand-alone entities, and components of large Wall Street investment operations. According to one industry source, wholesale operations accounted for some 56 percent of all prime loans and 78 percent of all non-prime loans in 2005.⁴⁸

As access to non-depository sources of residential mortgage capital expanded, the growth of secondary market operations also fueled the rapid expansion of nonbank lenders, including independent mortgage banking companies, as well as a range of mortgage banking subsidiaries and affiliates of traditional deposit-taking organizations. Contributing to industry consolidation was the fact that many formerly independent mortgage banking operations merged with or were acquired by large deposit-taking operations. At the same time, several large independent mortgage and finance companies including New Century, Option One, and Ameriquest continued to compete directly with large deposit-taking banking organizations in mortgage markets across the country.

The Proliferation of New Product Development

Along with the emergence of mortgage industry giants, new approaches emerged in the marketing and sales of mortgage products to individual borrowers. For example, among the various financial services provided by banks and related businesses, consumer and mortgage lending require more extensive marketing,

45 Robert B. Avery, Marcia J. Courchane, and Peter M. Zorn, “The CRA Within a Changing Financial Landscape.”

46 Joint Center for Housing Studies tabulation of HMDA. Note that HMDA data do not uniformly cover loans made by lenders in rural markets, and hence may underestimate small bank lending in rural areas.

47 William Apgar and Allegra Calder. 2004. See also William Apgar and Mark Duda, “Preserving Homeownership: The Community Development Implications of the New Mortgage Market,” a report prepared by the Neighborhood Housing Services of Chicago, 2004, available at http://www.nw.org/Network/pubs/studies/documents/preservingHomeownershipRpt2004_000.pdf

48 *Inside Mortgage Finance*, “Top Subprime Mortgage Market Players & Key Subprime Data 2005,” (Bethesda, MD: Inside Mortgage Finance Publications, 2005).

customer support, account management, and servicing operations. Large-scale operations can spread the high fixed costs associated with these tasks across a sizeable customer base. In addition, the widespread use of risk-based pricing and arguably enhanced capacity to evaluate borrower risk gave rise to an explosion of new mortgage products. Credit scoring was also used to underwrite new types of adjustable rate mortgages (ARMs), such as interest-only and payment-option ARMs, and ever-increasing volumes of low-down-payment mortgages, stated income loans, and higher-risk mortgages. Unfortunately, many of these new products proved to be very risky and by 2002 delinquency and foreclosure rates were on the rise, especially for subprime products issued to LMI borrowers.

Industry Structure and Current Regulatory Challenges

With the complexity and depth of the financial crisis creating a collapse of the credit markets, some believe that new regulation is “up for grabs.” Since the late 1990s, changes in the structure of the financial services industry, particularly for mortgage banking, have weakened the link between mortgage lending and the branch-based deposit-taking on which the CRA was based. Further, Alan Greenspan noted the financial sector’s inability to police itself contributed to the crisis.⁴⁹ Some see the current crisis as an opportunity to promote the competitiveness of those small lending organizations that do have suitable risk management skills and understand the communities where they lend. Yet, over the longer term it is more likely that larger organizations, with their enhanced capacity to tap global capital markets and resulting operational economies of scale, will continue to dominate mortgage lending. Even so, well-managed smaller and regional-scale organizations should have the opportunity to recapture some of the market share they lost over the past three decades.

To ensure the future safety and soundness of the financial system, today’s reforms will need to address the structural inadequacies that contributed to the current crisis. The range of existing regulations (from the

consumer protections of the CRA, Home Ownership and Equity Protection Act (HOEPA), ECOA, Fair Credit Reporting Act (FCRA), and Truth In Lending Act (TILA) to the monitoring of consumer reporting and ratings agencies and the oversight of the secondary market outlets) must be considered, as some consumers will continue to be uninformed and vulnerable to those who see an opportunity to take advantage of them.⁵⁰ Below we discuss these national trends and their implications for the CRA’s impact on lending to lower-income borrowers and communities, as well as the variation in the act’s regulatory reach across metropolitan areas and individual lenders.

The CRA and Assessment Area Lending

To address the historic problem of redlining of spatially concentrated LMI borrowers and minority communities, CRA examinations have concentrated on the spatial distribution of loans according to borrower and neighborhood income. This parameter is measured by a bank’s mortgage lending record within its assessment area (the geographic areas where institutions have their main office, branches, and deposit-taking ATMs, as well as the surrounding areas where banks have originated a substantial portion of loans) and across income ranges of borrowers and neighborhoods.⁵¹ In an effort to ensure that deposit-taking institutions meet the credit needs of the communities they serve, CRA regulators evaluate the lending inside the lender’s CRA-defined assessment area and compare it to the activity of the lender’s peers. The assessment area was originally adopted to ensure that deposit money from one area is not redeployed to make a disproportionate share of loans outside the assessment area. However, future reforms will need to consider this method of comparison and determine whether an absolute standard or a different kind of comparison is best suited to today’s financial world.

As indicated by previous Joint Center research, mortgages made by depository institutions to borrowers living in their assessment areas are subject to the most detailed CRA review. As previously mentioned, CRA regulations apply only to the lending activity of deposit-taking organizations and are not uniformly applied to the subsidiar-

49 “Greenspan Says He Was Wrong on Regulation,” *Washington Post*, October 24, 2008, available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/23/AR2008102300193.html>.

50 “Return of the Predators,” *New York Times Editorial*, November 24, 2008, available at http://www.nytimes.com/2008/11/24/opinion/24mon1.html?_r=1.

51 *The Code of Federal Regulations Title 12 Part 228.41* provides that a bank must delineate one or more assessment areas within which the Federal Reserve System evaluates the bank’s record. Originally, the delineation was the area surrounding the lender’s office and branches. In the 1995 revisions this grew to include the area around its deposit-taking facilities including ATMs as well as the surrounding area in which the bank originated or purchased a substantial portion of its loans.

ies or affiliates of these organizations that conduct the bulk of their activity outside of the designated assessment areas. Meanwhile, loans made by independent mortgage companies (also called nonbanks) fall entirely outside the regulatory reach of the CRA. Given the dramatic changes in the financial landscape, with new organizational structures (financial holding companies, multinational financial enterprises, and nonbank lenders) and delivery mechanisms (internet, mobile, and phone banking), the traditional concept of assessment area no longer captures a lender's community.

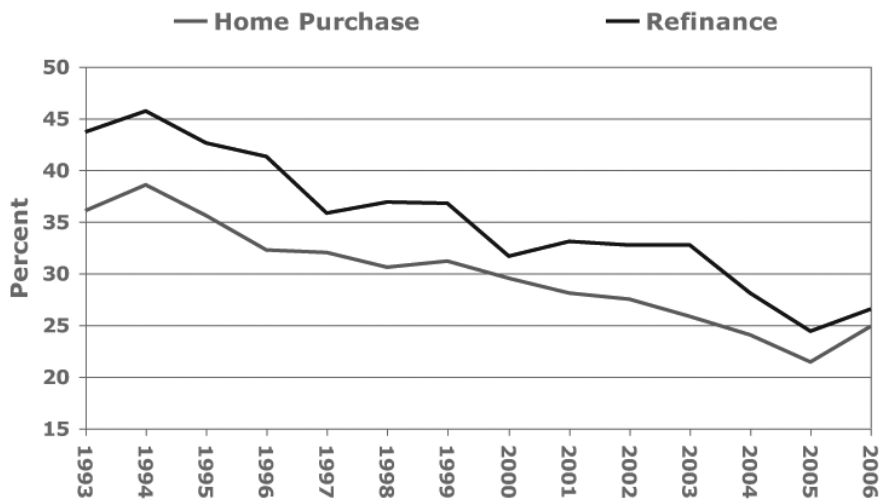
The increasing share of loans made by mortgage banking subsidiaries or affiliates of bank holding companies and by independent mortgage companies has brought a concomitant decline in the share of mortgage loans originated by deposit-taking institutions in the assessment areas where they maintain branch banking operations (Exhibit 1). Between 1993 and 2006, the number of home purchase loans made by CRA-regulated institutions in their assessment areas as a share of all home purchase loans fell from 36.1 to 26 percent. The decline was even more dramatic for home refinance lending: the CRA assessment area share fell from close to 45 percent in 1993 to just over 25 percent in 2006. For

all loans (both home improvement and refinance), the share fell from 40.6 percent to 25.6 percent.

This decline reflects two distinct limitations of CRA coverage. First, from 1994 through 2006, the first full year prior to the onset of the mortgage market meltdown, home purchase lending by independent mortgage companies and credit unions (lending organizations not covered by the CRA) grew by 122 percent, nearly four times faster than lending by banking organizations operating within their CRA-defined assessment areas. Next, even among CRA-regulated institutions, the fastest growth took place outside the markets where these organizations maintained deposit-taking branches, and hence that lending was not subject to the most stringent aspects of the CRA. These out of assessment area loans are therefore not equally examined to determine whether they serve the needs of lower-income borrowers and communities. Indeed, from 1994 to 2006, out of assessment area lending by CRA-regulated banking organizations grew by 187 percent. Similar numbers were recorded for refinance lending.⁵²

The Joint Center has made a conservative and simplifying assumption: that all lending done by the depository itself and its affiliates and subsidiaries within

Exhibit 1: Assessment Area Lending Has Fallen Steadily



Note: Percent of mortgage loans originated by deposit taking organizations within their assessment area.

Source: JCHS enhanced HMDA database

⁵² From 1994 to 2006, refinance lending by CRA-regulated banks and thrifts operating in their assessment area increased by only 59 percent, compared with growth of 148 percent for non-regulated entities (independent mortgage companies and credit unions) and 334 percent CRA-regulated entities operating outside their assessment areas.

an assessment area is covered by detailed CRA examinations.⁵³ To the extent that some unknown number of loans made by affiliates or subsidiaries are not put forward for examination, this assumption results in a clear overstatement of the share of all loans subject to detailed CRA review. Note that in 2006, the last year depicted in Exhibit 1, affiliates and subsidiaries accounted for approximately one fifth of assessment area lending. As a result, the share of loans subject to detailed CRA assessment could be as low as 20 percent, assuming that all entities take advantage of the rule that permits discretion in reporting.⁵⁴ As a result, the finding depicted in Exhibit 1—that the share of all loans covered by detailed CRA review has fallen dramatically over the 1994-2006 period—is a conservative estimate of these trends.

CRA Coverage Varies By Neighborhood and Metro Area

The relative importance of assessment-area lending by depository institutions covered by the CRA also varies by neighborhood income and racial/ethnic composition,

and from one metro area to another. For example, the nation’s historically disadvantaged minority groups have less protection from the CRA given that they are less likely to receive a loan from a CRA-regulated institution. The data show that households living in higher-income and largely white neighborhoods are nearly 30 percent more likely to receive a loan from a CRA-regulated assessment area lender than a borrower living in a largely minority, lower-income area (30.7 percent versus 23.2 percent, see Exhibit 2). A similar pattern holds for refinance lending. In both instances, borrowers in lowest-income and/or minority areas are most likely to obtain mortgage finance from independent mortgage companies, entities not covered by CRA regulations, and are therefore provided fewer consumer protections.

There is also significant variation in assessment area lending across metropolitan statistical areas (MSAs). These patterns, in turn, reflect a spatial variation in banking and mortgage industry organization across metropolitan areas. Among other things, they reflect differences in

Exhibit 2: Assessment Area Lending Lags in Low-Income and Minority Areas

Neighborhood Type	Home Purchase			Refinance		
	Banking Organizations		Independent Mortgage Companies	Banking Organizations		Independent Mortgage Companies
	Inside CRA Assessment Areas	Outside Assessment Areas		Inside CRA Assessment Areas	Outside Assessment Areas	
Low-Income Neighborhood						
Minority Neighborhood	23.2	33.0	43.8	22.7	35.2	42.0
Mixed Neighborhood	24.5	38.3	37.1	21.5	41.0	37.5
White Neighborhood	27.0	40.4	32.6	25.3	43.1	31.5
Moderate-Income Neighborhood						
Minority Neighborhood	21.9	33.2	45.0	23.8	34.5	41.8
Mixed Neighborhood	24.1	37.3	38.6	23.2	39.9	36.8
White Neighborhood	29.3	40.8	29.9	26.5	43.1	30.4
High-Income Neighborhood						
Minority Neighborhood	24.1	33.8	42.2	27.8	33.8	38.4
Mixed Neighborhood	28.4	35.0	36.5	28.5	36.9	34.6
White Neighborhood	30.7	39.6	29.7	28.6	41.5	29.9
Borrower Race/Ethnicity						
American Indian	24.8	38.5	36.7	26.4	42.3	31.4
Asian	29.9	36.1	34.0	32.1	35.6	32.3
Black	19.6	35.7	44.7	18.0	42.4	39.6
Native Hawaiian	22.3	33.5	44.3	23.2	33.9	43.0
Non-Hispanic White	29.1	38.4	32.5	27.4	40.2	32.5
Hispanic	20.4	34.1	45.5	24.9	33.6	41.5

Note: First-lien loans for owner occupied properties only. The small share of loans originated by credit unions are included in outside assessment area totals.

Source: JCHS Enhanced HMDA Database, 2006

53 This assumption is common in research evaluating assessment area lending.

54 According to the Joint Center Enhanced HMDA database, of the approximately 2.3 million loans made by depository institutions directly or by their subsidiaries or affiliates in designated assessment areas in 2006, some 574,000 (or 20 percent) were made by affiliates and subsidiaries.

the competitiveness of locally based banks, the relative attractiveness of specific metro area markets to nonbank lenders, and variations in state-level banking regulations. While it is difficult to assess the exact importance of each factor, assessment area lenders can account for more than 50 percent of all mortgage loans in some metropolitan areas and less than 20 percent in others.⁵⁵

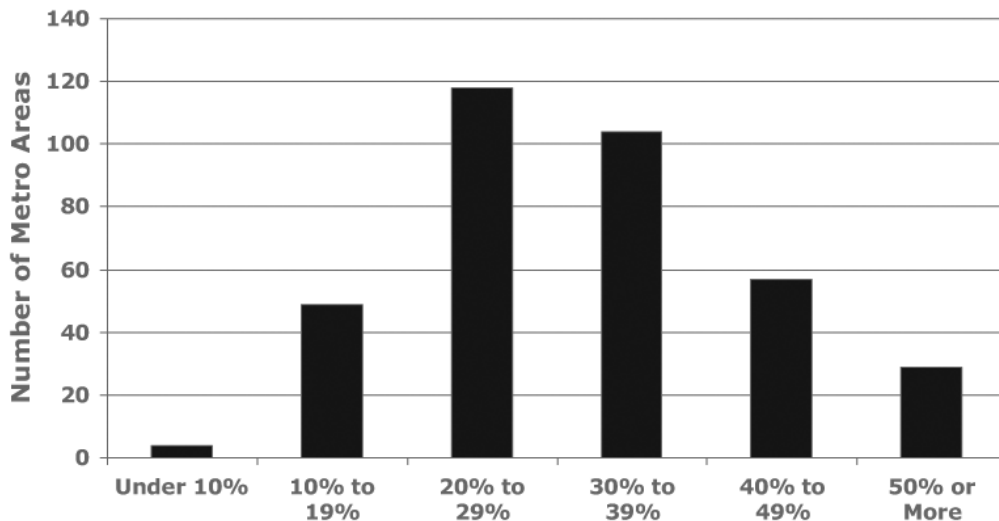
CRA Coverage Varies by Lender and Product Type

The variation of CRA coverage across three broad types of lending (in assessment area lending by CRA-regulated banking organizations, out of assessment area lending by CRA-regulated banking organizations, and lending by non-CRA-regulated independent mortgage companies) also has implications for CRA coverage. Note that CRA assessment area lenders are evaluated on the basis of their efforts in extending mortgage loans to lower-income borrowers (borrowers with incomes below 80 percent of metro area median income) and/or to lower-income neighborhoods (e.g. neighborhoods with

median household income less than 80 percent of metro area median). Since a disproportionately large share of mortgage delinquencies and foreclosures are now taking place in these same lower-income communities, some commentators have suggested that CRA requirements have contributed to the growing problem of mortgage delinquencies.

To evaluate these claims, the Joint Center reviewed 2004-2007 HMDA data on higher-priced loans, a variable designed by the Federal Reserve research staff as a proxy for non-prime lending to assess lending patterns across borrowers of differing characteristics.⁵⁶ This review suggested that the largest share of higher-priced loans made to lower-income borrowers were originated by a handful of large independent mortgage companies, while CRA regulations paid disproportionate attention to smaller assessment area lenders. Despite recent assertions to the contrary, CRA assessment area lending criteria did not play a central role in the explosion of high-risk lending to low-income borrowers living in

Exhibit 3: Assessment Area Share Varies Widely Across Metro Areas



Note: Assessment area share is the number of loans made by CRA regulated entities in designated assessment areas as a share of all metropolitan area loans. First-lien home purchase loans only. Out of 361 Total Metro Areas.

Source: JCHS enhanced HMDA database

55 For further discussion see Apgar, Bendimerad, and Essene, 2007 and Joint Center for Housing Studies, 2002.

56 Starting in 2004, HMDA identified “higher-priced” loans, or loans that have an Annual Percentage Rate (APR) above a designated Treasury benchmark rate. Though APR is just one factor that lenders may use to distinguish a prime from a non-prime loan, and admittedly the threshold will change from one year to the next along with shifts in the mortgage interest yield curve, the concept of “higher-priced” loans nevertheless provides a simple and objective benchmark for assessing lending patterns across borrowers of differing characteristics. For a detailed discussion of the 2004 HMDA data used in this study, see Avery, Robert B., Glenn B. Canner, and Robert E. Cook. “New Information Reported under HMDA and Its Application in Fair Lending Enforcement,” Federal Reserve Bulletin, September, 2005, available at http://www.federalreserve.gov/pubs/bulletin/2005/summer05_hmda.pdf.

low-income and minority communities. For example, from 2004 through 2006 CRA-regulated depository institutions operating inside their assessment areas made 31 percent of all lower-priced home loans (purchase plus refinance loans) to low-income borrowers or borrowers living in low-income neighborhoods, yet accounted for only nine percent of higher-priced loans in their assessment areas made to low-income borrowers or low-income neighborhoods.⁵⁷ In contrast, less supervised independent mortgage companies dominated the origination of higher-priced loans made to low-income borrowers and communities, capturing 55 percent of this market segment. CRA-regulated banking organizations operating outside their assessment area also claimed a significant share of this higher-priced market segment.

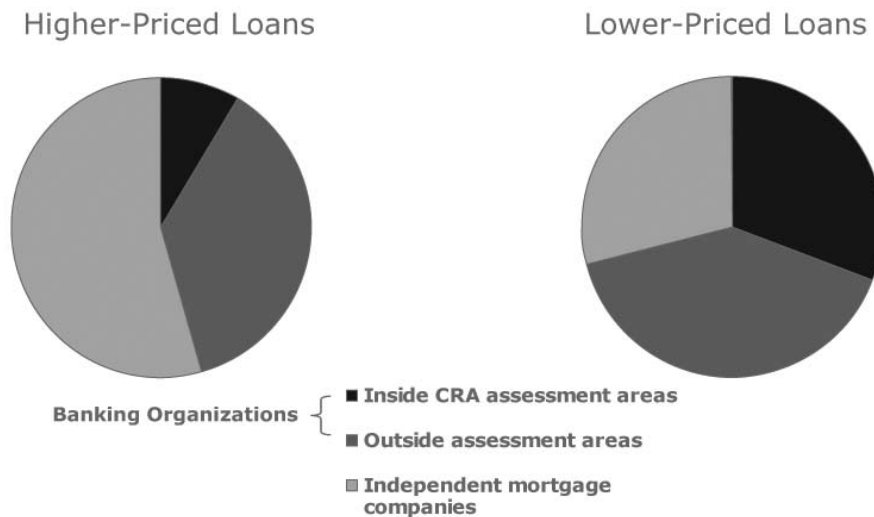
The Adverse Impact of Uneven Coverage

The spatial variation of assessment area lending across neighborhoods and metropolitan areas has implications for borrowers and lenders alike. The CRA was

designed to expand access to credit to LMI borrowers, and/or borrowers living in LMI neighborhoods in a manner consistent with the safety and soundness of the bank or thrift originating the loan. Yet, depending on which lender serves a neighborhood and/or city, borrowers have different access to credit and consumer protection.

Though not explicitly designed to promote fair lending, the CRA has historically played a role in protecting borrowers from abusive mortgage lending practices including redlining and other forms of racial discrimination. Since African Americans and Hispanics constitute a disproportionately large share of lower-income households and households living in lower-income communities, these groups have been differentially served by CRA rules designed to expand access to mortgage capital. Because fair lending reviews often accompany CRA examinations, and federal regulators have relatively recently stated that lending in violation of federal fair lending laws can reduce a lending institution’s CRA ratings, the CRA has also become a fair lending enforcement tool.

Exhibit 4: CRA Regulation Applied to Only a Small Fraction of Loans to Low-Income Borrowers or Low-Income Neighborhoods.



Note: Conventional first-lien loans for owner-occupied site-built, one-to-four family properties. Includes purchase and refinance between 2004 and 2006. Low-income borrower (neighborhood) defined as having personal income (tract median household income) less than 80% of the MSA/MD median household income. The small share of loans originated by credit unions are included in outside assessment area totals.

Source: JCHS Enhanced HMDA Database

57 For further description of this analysis of 2004-2006 data, see Kevin Park, “Subprime Lending and the Community Reinvestment Act” Research Note N08-2 (Cambridge, MA: Joint Center for Housing Studies, Harvard University), available at http://www.jchs.harvard.edu/publications/governmentprograms/n08-2_park.pdf. See also, Governor Randall S. Kroszner, 2008, footnote 4 that finds that only six percent of all higher-priced loans in 2006 only were made by CRA-covered institutions or their affiliates to lower-income borrowers or neighborhoods in their assessment areas.

While it remains important that all prime-qualified borrowers have equal access to prime loans on fair terms, guaranteeing fair terms and equal access for subprime borrowers is an equally worthy goal. Yet, the largest share of regulated banks and thrifts make no or only a few higher-priced loans. Though the reasons for this may vary, many regulated entities claim that they are unable to effectively compete in the subprime marketplace with less-regulated nonbanks. However, by choosing not to compete in the non-prime marketplace today, many CRA-regulated banks and thrifts may have ceded territory to their less-supervised competitors who saw an opportunity to use risk based pricing to compete, while CRA-regulated institutions chose not to engage in this marketplace.

In fact, nonbank independent mortgage companies do not have to meet CRA requirements and indeed may even gain a market advantage by being less regulated and meeting less stringent capital requirements. This is especially important, given the fact that many of the most risky loans—made to some of the nation’s most disadvantaged lower-income borrowers—were made by these less-regulated lending organizations. Moreover, unlike their bank counterparts who have a more visible presence in the markets they serve, many nonbanks marketed their products to subprime borrowers through thousands of less-regulated mortgage brokers and hence have less sensitivity to the reputational risks associated with originating more default-prone products.

One important consequence of this shifting competitive balance is that consumers living in areas with a limited presence of CRA assessment area lenders do not receive the same degree of CRA-based consumer protection as those living where assessment area lenders retain a more substantial market presence. This includes the consumer benefits that derive from CRA-mandated oversight of lending in LMI communities and CRA-linked engagement with fair lending monitoring and enforcement activities.

Regulatory Reform of the CRA

As argued throughout this paper, fundamental fairness suggests that the nature and extent of federal oversight and consumer protection should not depend on whether a loan application is submitted by a loan officer working for a CRA-regulated institution or a mortgage broker working for a nonbank or CRA-regulated bank

operating outside its assessment area. Nor should it matter to the consumer which particular retailer or wholesaler originates the mortgage, and which secondary market channel is tapped to secure the investment dollars that ultimately fund the loan. Instead, all consumers need access to an efficient mortgage market built on a foundation of uniform and fair regulations and oversight. While the CRA is not the cure for all the woes of the financial industry, the CRA could be strengthened considerably to ensure equal access to safe and profitable lending. Many of the critical issues raised in the 2001 ANPR were not substantially addressed and now provide a good point of departure for future regulatory reform.

Over the past decade, the combination of rising rates of homeownership and the ability of distressed borrowers to use growing home equity to refinance their way out of delinquency masked the structural flaws of the mortgage system. While some studies pointed to these flaws, the prevailing political climate favored deregulation, and the calls for reform were not heeded. As the ongoing collapse of the nation’s mortgage banking system now illustrates, reforms are vital to ensure appropriate oversight to limit future abuses as credit is restored. This section suggests some potential areas for reform.

CRA Reform Is a Good Place to Start

When Congress modernized financial services through the Gramm-Leach-Bliley Act of 1999, it did little to bring the CRA (or other consumer protection regulations) into conformance with the rapidly evolving financial services world. This created a competitive advantage for nonbank lenders and provided fewer consumer protections to their borrowers. Though nonbank institutions clearly played a key role in the boom and bust of the subprime market and the resulting market disruption and are involved in the complex matrix of financial relationships, they are subject to only limited oversight. Additionally, though the net effect of this marginally regulated lending has put the safety and soundness of the entire financial system at risk, there has still not been enough focus on the riskiest segments of the marketplace. Further, the rationale for government regulation must move beyond a *quid pro quo* for depository insurance and other federal benefits.

To realign regulation with the evolving structure of the financial services industry, uniformity of regulation is needed across all segments of the mortgage industry. To standardize the rules by which lenders operate, some

appropriate reforms might include improvement in the delineation of assessment areas, strengthening of fair lending enforcement, and improvements in compliance monitoring through software and data analysis techniques specifically designed to detect fraud.

Apply the CRA Framework to All Lenders

The CRA should be uniformly expanded to cover independent mortgage banking companies and other newly emerging nonbank lenders; it should be made applicable to the subsidiaries and affiliates of depository institutions; and it must be enforced through an appropriately funded regulator. The fact that nonbanks, affiliates, and subsidiaries are not uniformly regulated denies consumers equal access to the benefits of legally mandated federal oversight. It may also distort competition if some market participants shift business from one market segment to the next to avoid regulation. When considering how to expand the CRA, establishing appropriate evaluation methodology is critical, as the current criteria may be inadequate for application to new institution types and their lending.

One model to consider is the Massachusetts Mortgage Lender Community Investment (MLCI) law, which took effect on September 5, 2008.⁵⁸ While it may still be too early to evaluate the strengths and weaknesses of the MLCI, the fact that it is uniformly applied to all Massachusetts mortgage lenders and mortgage loans is a step in the right direction. The MLCI created a two-pronged test to evaluate a lender's lending and services, similar to the intermediate small-bank approach mentioned earlier. The MLCI Lending Test considers the geographic distribution of lending to LMI areas, borrower characteristics, innovative or flexible lending practices within the bounds of safety and soundness, fair lending performance, and loss of affordable housing. This last criterion was developed to allow the MLCI to proactively consider predatory practices that reduce the stock of affordable housing, such as early payment defaults. The Service Test of the MLCI is unusual in that it considers the availability and effectiveness of the lender's delivery systems to LMI communities (such as whether they incorporate

the internet), as well as the lender's community development services and loss mitigation practices.

Expand Assessment Area Definitions

Expanding the definition of assessment area has gone unaddressed in previous rule making and should be placed at the top of a reform agenda. Most agree that the assessment area definition does not account for today's world of electronic banking and national-scale mortgage-lending operations. In light of these changes, the traditional concept of assessment area needs to be reconsidered. In moving forward, it would be useful to review the comments provided in response to the 2001 ANPR. For example, the National Association of Homebuilders proposed that assessment areas should be where retail banking services are delivered and not related to branch or ATM locations.⁵⁹ Alternatively, the National Community Reinvestment Coalition suggested that assessment areas should be expanded to any state or MSA where the lender (including the independent mortgage companies and the subsidiaries and affiliates of regulated depositories) achieves a significant market presence—such as one-half of one percent of all loans.⁶⁰

Other regulations have already broadened the concept of assessment areas and could be considered. The 2008 Massachusetts law (MLCI) assigns the assessment area as the entire state, unless a lender "opts out" and the request is approved by an examiner. Because of the difficulty of assigning a geographic assessment area for lenders serving military personnel, the current CRA regulation defines the assessment area as the entire customer base which in essence abandons assessment areas altogether and does not address non-customers who are not served. Similarly, Massachusetts uses the membership base as the definition for assessing credit unions. These approaches could be adapted and applied to internet banks and other non-traditional entities. As mentioned previously, the current practice is to compare an institution to its peers. Future reforms will need to address the evaluation methodology, and an absolute standard may be more appropriate.

58 *The Commonwealth of Massachusetts is one of three states (the others are Connecticut and New York) that examine financial institutions, including state-chartered credit unions, for compliance with community reinvestment at the state level. The Massachusetts statute M.G.L. c. 167, section 14 and the implementing regulation 209 CMR 46.000 is generally based on the federal legislation yet has an extra exam category of "high satisfaction" to better characterize lender performance, available at http://www.mass.gov/?pageID=ocamodulechunk&L=4&L0=Home&L1=Government&L2=Our+Agencies+and+Divisions&L3=Division+of+Banks&sid=Eoca&b=terminalcontent&f=dob_209cmr54&csid=Eoca.*

59 *National Association of Homebuilders, "Comments on Advance Notice of Proposed Rulemaking Regarding CRA," Letter from David Crowe, Senior Staff Vice President, Washington, DC, October 18, 2001.*

60 *National Community Reinvestment Coalition, "Comments on Advance Notice of Proposed Rulemaking regarding CRA," letter from Josh Silver, Vice President of Research and Policy, Washington, DC, October 2, 2001.*

Expand Fair Lending Enforcement

Unlike other antidiscrimination laws, fair lending laws are enforced by banking regulators, who examine regulated banks for illegal and discriminatory practices, which are contrary to the goals of the CRA and can jeopardize the safety and soundness of the banking system.⁶¹ CRA loan-level reviews are an important method for ensuring that regulated entities are in compliance with fair lending laws. When examiners identify a poor program, they issue a compliance report and may choose to examine that violator more often, enter informal enforcement actions, or use formal public enforcement actions.⁶² While adverse findings and illegal credit practices are factored into the CRA rating by examiners, it remains unclear what specific criteria or thresholds are used to ensure that a lender's score is reduced according to its fair lending violations.⁶³

While regulators believe that their proactive approach allows few violations, a gap in oversight can occur when not all institutions are subject to loan-level review or not all loans are included in these reviews. Violations appear to be increasing within under-supervised channels, and hands-on loan oversight and fair lending review may help remedy these violations. Beyond applying fair lending review to non CRA-regulated institutions and evaluating fair lending according to race and other protected status, the inclusion of egregious violations in the public performance report could also increase transparency and strengthen fair lending enforcement.

Use Improved Data Collection and Software to Improve Compliance Monitoring

HMDA data have provided a critical tool for regulators, lenders, and community groups to evaluate whether covered institutions and loans are meeting the credit needs of the communities they serve. HMDA statistical analysis has allowed regulators to evaluate fair lending violations and identify potential problem lenders or products. Meanwhile, the public disclosure of HMDA

has created greater transparency and enforcement of CRA regulations and allowed community groups to evaluate the contributions of lenders who serve their communities.

Yet, to conduct thorough analysis, regulators have at times purchased data from private sources to enforce public regulations. It is in the public interest for regulators to have access to loan-level data, like those collected under HMDA, that include detail on loan pricing and creditworthiness; in this way, regulators can provide proper oversight and examiners can conduct thorough file reviews. Furthermore, though some claim that increased data collection for regulatory or public uses is onerous, those data are already provided to private data aggregators in machine-readable form. In short, given better and more uniform loan-level data, regulators may be able to conduct more focused (and potentially automated) reviews to detect mortgage abuse and fraud.

All Institutions Provide All Services

The CRA was established to ensure that if a lender is in the mortgage business, it must be safely and soundly in the business for all customers. Recall that the CRA was designed to ensure that regulated banks and thrifts met the credit needs of all residents of their communities. Though we acknowledge that specialization has a role in mortgage lending, in the same way that utility companies cannot decide to serve only some neighborhoods, cherry-picking borrowers or even neighborhoods with specific credit scores is not in the public interest. CRA implementation should ensure that regulated entities do not opt out of their responsibility to meet the needs of the credit impaired, but otherwise sound, low-income and low-wealth borrowers who participate in the non-prime market.

All lenders should be required to evaluate all customers using adequate underwriting and appraisal techniques. At minimum, each regulated entity could be required to serve the full range of the credit needs of the community by offering referrals to other entities that provide non-

61 John R. Walter, "The Fair Lending Laws and Their Enforcement," *Federal Reserve Bank of Richmond Economic Quarterly* 81:4 (1995).

62 *Formal public enforcement actions may include civil money penalties, Written Agreements, or Cease and Desist Orders. Bank regulations also mandate that the regulator refer all patterns and practices of discrimination to the Department of Justice, which determines whether or not to investigate and whether the results warrant an administrative enforcement by the FRB, a public civil enforcement, or a settlement.*

63 Sandra Braunstein, "The Community Reinvestment Act and fair lending examination processes," *testimony before the Subcommittee on Domestic Policy, Committee on Oversight and Government Reform, U.S. House of Representatives, Washington, DC, 2007. Located at: <http://www.federalreserve.gov/newsevents/testimony/braunstein20071024a.htm>. Braunstein's testimony provides two excellent examples of when violations did and did not require a reduced CRA rating.*

prime mortgages on a fair and non-discriminatory basis, or growing correspondent relationships with specific lenders or nonprofits. Admittedly, mandating that any particular market participant engage in non-prime lending is fraught with peril. Over the years, many regulated thrifts and banks, often working in conjunction with non-profit organizations, have developed the capacity to participate in non-prime markets. This evidence suggests that, given the proper incentives, banks and thrifts now largely specializing exclusively in prime lending could also acquire the expertise necessary to participate in the non-prime market and serve low-wealth, low-income, and/or subprime borrowers who cannot qualify for prime loan products.

Reform of Other Elements of the Regulatory Environment

This paper calls for uniform regulation for all mortgage lenders to reduce predatory practices, ensure a certain degree of consumer protection, and level the playing field for all lenders. Because many of the basic consumer protections are in place in the CRA-regulated portions of the market, the CRA provides a valuable framework for successful and cost-effective lending regulation market-wide. Yet, CRA reform is just one of a broad range of needed reforms in the financial system. Though a uniform CRA could address many of the concerns about access to fair credit, it is also critical to reinforce the consumer protections offered through the Truth In Lending Act, the Real Estate Settlement Procedures Act, and the Home Ownership and Equity Protection Act (HOEPA).

In remarks made to the CRA and Fair Lending Colloquium in Boston in 2001, the late Federal Reserve Governor Edward M. Gramlich reminded his audience that the art of CRA regulation is the balance between assessing the quantity and quality of an institution's lending and determining whether it has had a net positive effect on the community. Undoubtedly, the CRA has given financial institutions incentives to reinvest in underserved communities and community development organizations. As CRA regulations are expanded to apply to all mortgage lenders, considering how the CRA has helped to provide LMI borrowers better access to fair credit is worthy of examination. ■

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