

CRA Goes Global: A Good Idea in the United States Could Use a Makeover and a Bigger Audience

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Money is like muck; not good except it be spread.

—*Sir Francis Bacon, 1625*

Populist ire that arose from the credit crunch is being directed at banks from all corners of the globe, triggering a series of new laws and schemas, whose combined effect will be to impose on banks greater government control over their economics (more regulation on safety and soundness) and greater government interest in their social outcomes (inclusive banking). Of course, governments have the right to do this—banks make money because governments devise the laws that protect capital and property rights. Furthermore, banks cannot survive without government; it creates the enabling or disabling environment, and as we have just seen all around the world, government is the ultimate liquidity backstop in times of systemic failure. Thus, when economies are suffering, banks cannot retreat behind their credit policies, pull up the drawbridge, and wait out the global recession. For banks, the question should be, How do we do something meaningful and constructive without taking imprudent risks, or being forced by government into taking them?

In the United States, the social mandate for banks is currently formalized in the Community Reinvestment Act of 1977¹ (CRA), now well over 30 years old and showing its age. CRA encourages banks to use their financial sophistication and their capital-accumulation capacity to make the benefits of efficient financial markets more broadly accessible in their local communities, in a manner that is consistent with safe and sound operation. Housing is a core CRA asset class and an important tool for revitalizing low-income communities: housing is what anchors and improves a community, making it more attractive for subsequent investments.

The issues targeted by the original CRA—inclusive banking, redeployment of capital down-market, and the relationship between private commercial risk and public noncommercial risk—are primarily local or national issues. But today's banking world is global, both in capital flows and in multinational institutions, and that should force the field to reinterpret those original CRA goals in a global context.

¹ CRA, Pub.L. 95-128, title VIII of the Housing and Community Development Act of 1977, 91 Stat. 1147, 12 U.S.C. § 2901 et seq. More information available from the Federal Financial Institutions Examination Council (FFIEC) at www.ffiec.gov/cra/default.htm.

At the same time that bankers need to start thinking globally, other nations are acting locally. Nations as diverse as China, South Africa, and India are exploring CRA-like mandates for their banking industries. Many nations look askance at foreign banks, viewing them as exploiters, displacing local entities, heedless of local context or social, cultural, or economic requirements. It will not take much for these nations to impose new restrictions on foreign investment, foreign-to-domestic lending, or multinational banks and banking. Nor will it take them long to create taxes or surcharges that could make such banking unprofitable.

In response, the global banking community should consider a new commitment to community reinvestment, something I call an “inclusive banking charter.” This commitment should rest on four working principles:

1. *The need for community reinvestment.* Banks exist under and are protected by a regulatory umbrella that allows them to make profits. Because the regulatory support derives its legitimacy from all levels of society, and banks' depository capital comes from all levels of society, banks should recycle that capital into the communities from whence it came; otherwise capital flows will be used as a tool of disinvestment in disfavored neighborhoods.
2. *Emerging nations want their own customized forms of inclusive banking and community reinvestment.* Although the inclusive banking goal is universal, applying to all nations, each nation's response involves custom tailoring. Community reinvestment imperatives depend on the relationship between the banking sector—its strength, breadth, diversity, and profitability—and the social-investment sector, particularly in the context of urbanization and affordable housing. Thoughtlessly replicating the current CRA will not do.
3. *The current Community Reinvestment Act in the United States is due for a strategic refresh.* Although the premise of CRA—that banks can and will go down-market on a commercially viable basis, but they need government encouragement to do so as rapidly as society requires—remains as valid today as it was in 1977, so many other things have changed that the original CRA should be updated.
4. *Although a globally enforceable Inclusive Banking Charter (IBC) is impossible, critical inclusive banking/ community reinvestment principles should be globalized.* The CRA is limited to activity within the United States. Any other nation's statutory reach will be similarly bounded. Yet the world has some experience with transnational financial-regulatory agreements that transcend borders, such as Basel II.² As the United States remains the world's largest economy, with the most experience in CRA legislation and regulation, any other nation's IBC ought to take cues from, and learn from, the experience of the U.S. CRA.

2 Issued in June 2004, “The International Convergence of Capital Measurement and Capital Standards: A Revised Framework presents the outcome of the Basel Committee on Banking Supervision.” The English text may be found at <http://www.bis.org/publ/bcbs107.htm>.

The Policy Justification for Responsibly Inclusive Banking

Banks and financial institutions exist under and are protected by a regulatory umbrella that allows them to profit by taking in money from the public (deposits) at cheap rates, and then putting money back out (loans) at higher rates. Banks that use their explicit government charter and backing to profit therefore have a duty to redeploy their capital back to the community where they got it, on a commercially viable basis, with the government absorbing noncommercial risk.

The three-way relationship among banks, government, and socially responsible inclusive banking rests on seven public-policy principles that now have global applicability.

1. ***Banks do business with the public via an asymmetric power relationship.*** Banks interact with the public in three ways: taking in money (deposits), processing money (check cashing and clearance), and putting out money (loans and investments). From the perspective of a financial or economic ecosystem, all three are essential; an economy does not work until capital is continuously cycling. Yet when the customer is poor, the power dynamics tilt in the bank's favor, and a bank may discriminate unwittingly or wittingly. Put crudely, a bank can take money from poor people by allowing them to deposit, can make money off poor people by processing their credit cards or checks, and yet can exclude poor people from credit, doing nothing to alleviate their poverty, and indeed even contributing to it.
2. ***What to a bank may look like “careful credit” could be bigotry in disguise.*** A bank that is ultra-cautious with its outlay of capital but thoughtless of its inflow becomes an agent of exclusion either intentionally or inadvertently. Were they so inclined, unscrupulous or bigoted banks could perpetuate poverty simply by redlining places, people, or ethnic groups in a self-fulfilling prophecy of disinvestment.

That sweeping credit bigotry—those infamous maps with entire sections of town marked in red (or blue in the United Kingdom), as in “not to be lent to”—was the justification for the CRA legislation. Credit bigotry is unacceptable, yet credit prudence is also desirable, and in today's more complex world, it is difficult to distinguish one from the other.

3. ***The public interest conveys a public authority to ensure inclusionary banking.*** To operate, banks need government's security resources (e.g., charters, deposit insurance).³ When these are tapped, usually in the aftermath of exuberant, spendthrift risk-taking, government quite understandably demands recompense, and not just economic but also social.

³ Deposit insurance dates to the Great Depression with the 1933 enactment of Glass-Steagall, which, among other things, established the Federal Deposit Insurance Corporation. The FDIC today insures more than 7,700 US institutions. See “History of the FDIC” (website) at www.fdic.gov/about/history/index.html.

Regulatory penance always follows a short time after excess, and no previous massive expansion of government bank regulatory oversight has ever been rolled back. U.S. deposit insurance arrived in 1933 (in the same Glass-Steagall statute that limited banking's other activities). CRA would not follow for four decades. Now, in three short years, we have seen an explosion of reluctant-but-inescapable government support:

- The Troubled Asset Relief Program⁴ (TARP) and the explicit 2008 backing of Fannie Mae and Freddie Mac in the United States.
- The Bank of England's 2007 rescue of Northern Rock,⁵ and its similar massive investments into Royal Bank of Scotland, Lloyd's, HBOS (the former Halifax Bank of Scotland), and others.
- The European Central Bank's stress tests and their consequences, including the slow-motion domino cascade of European Central Bank support for bond markets in Greece,⁶ Ireland, Portugal, Spain, and who knows who's next?

In each case, government has not merely rescued many banks from their past excesses, it is now actively replenishing their equity capitalization, with central bankers holding macro interest rates at infinitesimal levels while banks then lend the capital at spreads much wider than they enjoyed prior to the crisis.

4. *Banks should fulfill their community service obligation through banking-related activities.*

If government could do something better than the banks, it could and would: government could simply impose a tax and then redirect the proceeds into the desired outcome. But government has learned that it is better to steer and pay than row and do. Government does best not by conducting activities that mimic or even compete with business, but by establishing priorities and providing resources, creating incentives for banks to do banking business: flow capital down-market in the form of lending, investing, and inclusionary access to banking services.

5. *The right credit-access boundary is between commercial and noncommercial risks.*

Banks are in the business of taking commercial risks, a key to which is that counterparty performance is enforceable through the courts and counterparty damages are collectable. Government cannot chide banks for refusing to extend credit unless it relieves them of the noncommercial components of risk (e.g., enforceability of foreclosure

4 Enacted into law on October 3, 2008, as part of the Emergency Economic Stabilization Act of 2008, Public Law 110-343.

5 A good current summary of the events is "The Bank that Failed," *Economist*, September 20, 2007, available at http://www.economist.com/node/9832838?story_id=9832838.

6 See, e.g., "Lessons of the Crisis: Ethics, Markets, and Democracy." Speech by ECB executive board member Lorenzo Bini Smaghi, Mary 13, 2010. Available at www.ecb.int/press/key/date/2010/html/sp100513.en.html.

rights at the local level)⁷ through a suitable and enforceable contractual commitment. Making this distinction is critical because it is not bigotry to withhold credit when one cannot rely on government to be an impartial enforcer.

6. *The right cost-pricing point is at the projected mature-business scale, with subsidies covering the pre-expansion costs.* Related to the credit risk boundary is the question of cost. Left to their own devices, financial institutions will move down-market only by moving up the cost curve—charging poorer borrowers higher rates to compensate for higher real and perceived risks of default. Once the business has become established, however, such lending can return to more normal spreads, restoring affordability. Thus, many businesses that are profitable require a non-recoverable startup cost in knowledge, information or network infrastructure, or initial activity costs. Private for-profit companies invest those costs when the post-scaling profitability justifies the return, but that will not always be so with inclusive banking, or at least, not quickly enough. Government can eliminate this barrier to growth with targeted or time-limited subsidies and tax credits. One example directly relevant to affordable housing is the blending of Low Income Housing Tax Credits with CRA equity investment goals.⁸

7. *Keep score on the basis of results, and make the scores count, with rewards and penalties associated with the scoring.* Rating of the banks' performance should be periodic and quantitative, with the results and reasoning transparent, and with a public opportunity to provide input and comment. Banks with high scores may gain preferential advantages (e.g., in opportunities to do business with the government), while those with low scores may be denied access or disadvantaged vis-à-vis growth and consolidation (e.g., bank mergers).⁹

Inclusive Banking Initiatives Globally

Globalization is pushing a number of changes that create a need for inclusive banking initiatives. Start with urbanization, the great demographic force of the twenty-first century. As more people move to cities, this puts tremendous pressure on those cities to accommodate them. Global-northern cities (e.g. New Orleans, Detroit, or Liverpool) face challenges

7 The archetypal case is Servcon in South Africa, established in 1995 to buy nonperforming loans where foreclosure was proving societally impossible as a result of widespread local government refusal to enforce vacant adverse possession, as a result of a “record of understanding” with the purchase of 50 percent of its shares by the National Department of Housing from the Banking Council, South Africa. A detailed history is available at http://www.dhs.gov.za/Content/housing_institutions/servcon.htm.

8 Low Income Housing Tax Credits (Section 42 of the Internal Revenue Code) were created as part of the 1986 Tax Reform Act and amended numerous times thereafter. For a modern perspective on CRA and its intersection with LIHTC, see David A. Smith, “LIHTC’s Bizarro CRA,” Tax Credit Advisor, March, 2010.

9 An excellent example of reward is South Africa’s Financial Sector, a transformation charter as contemplated under the Broad-based Black Economic Empowerment Act [Act 53 of 2003], described in further detail at http://www.fscharter.co.za/page.php?p_id=137.

of integrated urban renewal, while expanding slums challenge global-south metropolitan areas (e.g. São Paulo, Mumbai, Cairo, Istanbul, or Djakarta). Either way, urbanization means substantial investment in places, including expensive and complicated infrastructure, and that implies long-term capital, most of it debt, all of it reliant on real estate holding its value or appreciating.

In this case, urbanization is bringing together government (provider of law and incentives) and banks (providers of capital and risk assessment). Governments know they cannot solve the rapid urbanization/urban renewal problem alone, and that the solution requires innovation in housing finance. Meanwhile, banks know they can never solve housing affordability on their own because the simple economics of urban land markets dictate that the bottom quartile of below-market earners can never afford true market-quality housing.

Left to the private market, poor people must choose underconsumption, overpayment, or impossible commutes, all of which have their own negative consequences for not just the poor, but the middle class as well. For quality urban affordable housing, government must come to the fore with evergreen (self-renewing or continuously funded) resources. These resources can be cash or non-cash, on budget or off, administered at any of the three levels of government—nation (tax policy), state or province (lending and incentives), or locality (zoning and real estate taxes)—and they must be skillfully blended with suitable financing products and value chains.¹⁰

Second to urbanization is the growing recognition that public-private partnerships can spur successful urban policy while using the banking sector as a source of capital. When first confronted with the challenge of housing affordability, virtually every government chooses direct public intervention as its initial option. It may be called public housing (U.S.), social housing (U.K. and Europe), or some other name, but governments everywhere love to build new units (e.g., Turkey's TOKI¹¹) and rent or sell them to civil servants (e.g., Egypt's Ministry of Housing). Moving to public-private partnership for more than just construction involves a fundamental shift in government's awareness of the limitations of its natural role and the value of partnering.

A third force pointing to a global inclusive banking initiative is the need for a developed residential-banking sector. It takes two to tango. Banks must be willing to play, so they must be ready to engage with government, experienced with residential finance, committed to inclusive banking, and nimble enough to develop customized financial products and new community-banking initiatives and divisions. Indeed, at times a CRA emerges from an imbalance in which the banking sector is much more sophisticated and mature than the

10 Under a commission from the World Bank, the Affordable Housing Institute authored a World Bank Learning Note (WBLN) enumerating 16 types of subsidy resource, eight on-budget and eight off-budget. The WBLN is available free on request to the author at dsmith@affordablehousinginstitute.org. A good description of hybrid value chains can be found in Bill Drayton and Valeria Budinich, "A New Alliance for Global Change," *Harvard Business Review*, September 2010.

11 The Republic of Turkey's Housing Development Administration (Toplu Konut İdaresi Başkanlığı) recently completed its 500,000th home. See www.toki.gov.tr.

government, and government rightly recognizes that harnessing private expertise will be more effective than trying to compete against it.¹²

Naturally, banks also need customers with enough income to repay a home-purchase or home-improvement loan. When the nation as a whole is extremely poor, as in Haiti or Malawi, the urban poor earn so little that they can afford only the cheapest housing; thus, when a city is flooded with very poor immigrants, what they can afford is too little to be financeable formally. As a result, global-south urbanization often involves the rapid proliferation of slums and informal settlements, where informal and self-built private investment—shacks and slums—has outrun public infrastructure—roads, water, sanitation, and electrical grids.

Finally, for inclusive banking to emerge there must be a national commitment to overcoming a heritage of exclusion. America's CRA was born in part from frustration over housing as a segregationist holdover: although expunged judicially, discrimination nevertheless persisted spatially. Even vigorous enforcement of Fair Housing laws could not make buildings suddenly move or neighborhoods change overnight. During the 1960s, racial segregation in large-city public housing led to education discrimination in places such as Boston, Chicago, and New York. South Boston's violent response to school busing led to public housing integration. Spatial segregation through forced assignment to public housing in Chicago led to a series of civil-rights cases, most notably the *Gautreaux* decision, mandating poverty deconcentration through Section 8 housing subsidy vouchers.¹³ It is not surprising that the four nations most ready for CRA-esque regulation also have national legacies of exclusion: South Africa, the United Kingdom, India, and Brazil.

South Africa

South Africa already has a community-reinvestment initiative, the Financial Sector Charter,¹⁴ which emerged after the comprehensive failure of the African National Congress's first housing initiative, the Gateway program, whose collapse in some ways prefigured America's subprime fiasco.¹⁵ In 2003, political pressure compelled banks to lend in a manner that would have directed lending to particular geographies and at highly concessionary rates, nearly guaranteeing banks would lose money if they complied. Pulling together as an industry, the banking sector volunteered, at a Financial Sector Summit, a unilateral industry-

12 Such reasoning lies behind the U.S. CRA, South Africa's Financial Sector Charter, and the U.K.'s inclusionary zoning requirement, referenced later in this article.

13 An excellent study of Boston desegregation is the Pulitzer Prize-winning *Common Ground* by J. Anthony Lukas. *Gautreaux* legislation is *Hills, Secretary of Housing and Urban Development, v. Gautreaux et al.*, 425 US 284 S.Ct. 1538, 47 L.Ed. 2d 792, decided April 20, 1976. Full text is available at <http://supreme.vlex.com/vid/hills-v-gautreaux-19984031>.

14 The Broad-Based Black Economic Empowerment Act [Act 53 of 2003], described at www.fscharter.co.za/page.php?p_id=137.

15 Under Gateway, formerly excluded blacks were lent money to buy new homes, with variable-rate loans. When rates rose, defaults became epidemic, and when the banks sought to foreclose, they were confronted with repayment boycotts and township local police refusing to enforce repossession. The resulting nonperforming loans were dumped into an RTC-like entity, Servcon.

wide pledge and started a process of engaging with government and stakeholders, leading to a mooted Community Reinvestment Act being taken off the table. Under the resulting Financial Sector Charter, banks voluntarily:

- Negotiated lending and investment goals with quantitative targets;
- Agreed to report their performance publicly and transparently;
- Subjected themselves to consequences (prohibited from certain kinds of government contracting) for subpar performance or rewards for superior performance (preferred access to government contracts).

The charter ran for five years. Induced to apply their creativity to lower-income households, banks discovered that they could in fact make money in the market, with a wide array of both depository and lending products, as the banks substantially exceeded their cumulative capital targets. Their performance under the charter demonstrated its catalytic impact, focusing minds on numerous transformational issues, such as basic savings accounts and other inclusionary deposit-taking initiatives, low-income housing finance, financing of small and medium enterprises (SMEs), employment equality, and demographic representation on bank boards. In short, the charter experience successfully expanded banks' profitability frontiers down-market and turned a segment of the unbanked or underbanked into marketable customers.¹⁶

The story has one cautionary element. The charter is unilateral (a pledge by the banks without a formal quid pro quo from government), negotiated (developed via an open-ended process of engagement), and time-limited (five years). New targets are needed, but in 2008, the banking-government re-engagement stalled and is yet (as of January 2011) to be revived, although there are hopeful signs. The takeaway lesson is this: a good framework is evergreen but periodically adjustable.

United Kingdom

Despite being eminently suitable for a CRA, the United Kingdom has nothing of the kind (and the concept is greeted with horror by bankers). Through the 1970s, U.K. building societies (akin to U.S. savings and loans) "blue-lined" areas of no lending. During the 1980s, the Thatcher government intervened with regeneration schemes, including an inclusionary-zoning ordinance known as Section 106.¹⁷ Under the ordinance, developers seeking approval for urban-core redevelopment must ensure a certain percentage of homes are affordable (usually they are sold to the local authority and become government-owned council housing).

To American eyes, Section 106 is clumsy and ineffective: it is a zero-sum game, with no additional resources provided to developers in exchange for their financial concessions of

16 The charter experience is well detailed in "FSC Update," Access Housing, June 2009, published by the Centre for Affordable Housing Finance in Africa, a division of FinMark Trust, and accessible at www.finmark.org.za/documents/AHNL_June09.pdf.

17 Section 106 of the Town and Country Planning Act 1990.

affordability. Adding to the stalemate is the U.K.'s curious principle of not taxing undeveloped urban land, making open-ended land-banking a viable strategy and leaving warehoused parcels vacant squares on the urban landscape.

Logic dictates that quite soon (in legislative terms) the government will turn to banks to revitalize downtown areas, as it can unite three post-crunch developments:

- The new Conservative / Liberal Democratic coalition government is touting a Big Society led by private-sector initiatives, with a renewed emphasis on social enterprises as the delivery mode.¹⁸
- Banks, having been replenished with public money, are now announcing major profits.¹⁹
- The U.K. recently pioneered the social impact bond, a derivative tied to a nonprofit's measurable successful performance on a difficult social problem, such as juvenile crime recidivism.²⁰

Given these developments, look for the government to come to terms with the capital challenges and to table some mixture of mandates and incentives that will be later seen as the inauguration of a CRA process.

India

Despite *Slumdog Millionaire* and tourist impressions, India is predominantly rural, with only 28 percent of its land urbanized. However, given its enormous size and the speed of its urbanization, India's urban housing needs are the world's largest (outstripping even China) and most urgent. India needs housing at all levels of affordability: new construction for the upper middle class (townhouses and subdivisions), lower-middle-income high-rises to be built on greenfield sites like Tata's Nano House,²¹ and slum upgrading and formalization.

The country has a long history of societal exclusion: of Indians by the British, and of Indians by other Indians. Even today, the Dalits, formerly the untouchables, suffer discrimination in employment and housing. The exclusion has spatial consequences: India's richest urban neighborhoods may be less than a kilometer from the poorest, but they are separated by guards and gates, highways and railways. Now the government has launched a massive national campaign to eliminate slums. Rajiv Awas Yojana ("Rajiv's Housing Program," named

18 See, e.g., "Over to You," *Economist*, November 22, 2010.

19 See, e.g., Bloomberg.com, "Wall Street Sees Record Revenue in '09-10, Recovery from Bailout," December 12, 2010, available at www.bloomberg.com/news/2010-12-13/wall-street-sees-record-revenue-in-09-10-recovery-from-government-bailout.html.

20 See <http://www.socialfinance.org.uk/>, with the first Social Impact Bond having been placed in September, 2010 in the criminal justice sector (seeking to reward reductions in recidivism). Social impact bond payoffs have much in common with India's TDRs and the US's LIHTC – a future payment contingent on successful outcomes, which can then be factored for cash today by those non-government Mission Entrepreneurial Entities willing to risk their blood, toil, tears and sweat in tackling the challenge.

21 Tata builds the 'Nano home,' *Telegraph*, May 7, 2009.

after assassinated prime minister Rajiv Gandhi), is the successor to its current slum upgrading program, Jawaharlal Nehru National Urban Renewal Mission.²² At the level of formal housing with mortgageable title, India is sprouting housing finance companies (HFCs) like mushrooms, all regulated by the National Housing Bank. These HFCs will need capital, both to establish and expand their enterprises, and also periodically to liquefy their books of business.

Against this backdrop, India has a formal down-market banking requirement, Priority Sector Lending, which directs banks to deliver a portion of their net bank credit into 14 priority sectors.²³ Affordable housing loans qualify, as does microfinance and credit for other antipoverty national priorities, such as small-scale industries, small business, and agriculture. The Priority Sector Lending is in some respects similar to CRA and to the Affordable Housing Goals of the GSEs.²⁴

India's inclusive banking efforts are different from those in the United States and United Kingdom, and more resemble those in South Africa because when inclusive residential lending reaches informal housing, new challenges arise. The cornerstones of the U.S. system are the mortgageable titles that can be pledged as ready resale collateral and (as is evident in South Africa) the implicit guarantee of local judicial enforcement of the lender's right of recovery.²⁵ Thus the Indian government, if it wants to induce banks to provide meaningful capital into slum upgrading and slum formalization, will need to absorb the noncommercial risks.

India can take a page from the U.S. playbook with its own variations of the Federal Housing Administration (FHA) mortgage insurance. The insurance kicks in only after default,²⁶ normal lender remedies, and a collection failure attributable to government. This is symbiotic ecosystemic evolution: government co-evolving the policy ecosystem even as it imposes a social obligation that compels banks to evolve their economic ecosystem. Such collaboration characterizes successful inclusive-banking policy expansion.

Brazil

Through the mid-1990s, Brazil experienced periods of hyperinflation. This experience squelched any development of long-term stable interest rates essential to the emergence of a proper housing finance system. The result was nonexistent residential finance; the wealthy bought homes for cash or with personal loans, not mortgages. Monetary policy stabilized

22 For more information, see "Status Note on Rajiv Awas Yojana" (pdf), issued by the Government of India 2010, available at mhupa.gov.in/W_new/NOTE_RAJIV_AWAS_YOJANA.pdf. For more information on JNNURM, operated under the Ministry of Housing and Urban Poverty Alleviation, see its Web site, https://jnnurmmis.nic.in/jnnurm_hupa/index.html.

23 Details are available Federal Bank of India, "Priority Sector FAQs" at www.rbi.org.in/scripts/FAQView.aspx?Id=8.

24 See "HUD's Affordable Lending Goals for Fannie Mae and Freddie Mac." Issue brief (Washington, DC: Department of Housing and Urban Development, January 2001). Available at www.huduser.org/publications/pdf/gse.pdf.

25 For the time being, we will overlook the current U.S. situation, where millions of foreclosed homes have no ready buyers and hence are not resale collateral, as being temporary.

26 See, e.g., 24 CFR 221, subparts C and D.

after the 1994 Plano Real and the 2001 election of Lula da Silva, as the inflation rate declined to 6-10 percent.²⁷ The nation as a whole has a robust banking sector, but it is commercial finance, not residential. Against that, under a 2003 law (Resolução 3109 Conselho Monetário Nacional²⁸) banks must earmark 2 percent of their deposits for micro-credit loans, but they are unenthusiastic participants and use of the resource is low.

Meanwhile, Caixa Econômica Federal, the government-owned savings bank, has grown to be the second largest bank in Brazil and originates roughly 70 percent of all Brazilian mortgages. Caixa and other state-influenced organizations can and do offer much lower rates for target customer groups, but the result is a crazy-quilt of finance alternatives that discourage even formal buyers of quality homes from tapping mortgage finance. Reorienting Caixa or converting its lending function into that of secondary market liquidity rather than primary origination—in other words, a post-crunch recapitalized GSE mode—would seem an essential step to rationalizing residential banking, as would broadening Resolução 3109 along the lines of India's evolving Priority Sector Lending.

Other Countries Where Inclusive Banking Initiatives Could Emerge

Other countries where inclusive banking initiatives could emerge include Australia, China, and Mexico. Each has its challenges:

- *Australia* has no analog to CRA, having only recently adopted a uniform national consumer-credit code analogous to the U.S. Home Mortgage Disclosure Act (HMDA), supplanting inconsistent state-level codes.
- *China* is experiencing both rapid urbanization and runaway development and price appreciation in a remarkable alliance between municipalities (which control land) and state-owned enterprises (flush with cash). These two groups are jointly plunging into high-end urban development fueled by high leverage, low rates, and grossly inflated values.
- *Mexico* has a long legacy of ejido land (a communitarian approach far short of fee-simple title), which has slowed its development of effective settlement procedures and hence the emergence of mortgages other than those deriving from its government mortgage bank SHF (the Sociedad Hipotecaria Federal,²⁹ analogous to U.S.'s Federal Housing Administration).

27 The Plano Real is described in Benedict Clements, "The Real Plan, Poverty" (CITY: International Monetary Fund), and Clements, "Income Distribution in Brazil," *Finance and Development*, September 1997, available at www.imf.org/external/pubs/ft/fandd/1997/09/pdf/clements.pdf.

28 Described in "Apêndice - Textos técnicos e acadêmicos" at www.bcb.gov.br/htms/Deorf/r200312/monografia.asp?idpai=REVSFN200312.

29 Created on October 11, 2001, via a decree enacting the Organic Law of Sociedad Hipotecaria Federal, regulating Article 4, fifth paragraph, of the Mexican Federal Constitution. See "About HFS" at www.shf.gob.mx/English/AboutSHF/Paginas/default.aspx.

CRA is unlikely to emerge in small countries, where the domestic banking sector is not strong enough to innovate voluntarily and the government is more interested in enticing international banks to enter than in squeezing them once they do.

Principles for an Inclusive Banking Charter That Can be Applied Globally

The CRA has generated important systemwide benefits, including:

- Knowledge transfer between banks and community development entities. Activity under CRA has taught banks how to lend down-market, how to partner with government in public-private ventures that blend economic and social resources, and how to slice commercial risk (which banks should take) from noncommercial risk (which governments should absorb).
- Financial product innovation by banks into new business spaces (e.g., lending for affordable rental, investment in Low Income Housing Tax Credits or New Markets Tax Credits).
- New business activities and profit centers (e.g., community development banks).

All of these innovative byproducts have permanently and positively influenced affordable housing lending and investment. They have also helped government make subsidies smarter, not just bigger.

Engineering a policy that applies these benefits to countries around the world will be difficult. Transnational policies are rare, but not nonexistent. Protocols such as Basel II or other conventions, such as accounting standards, can serve as models going forward. Encouraging banks to participate will be difficult too. If a bank dislikes a nation's inclusive banking rules, it can choose not to do business there. Companies weighing the potential costs of inclusive banking will reject compliance only when they think they can afford to lose that country's market. While it may not be an option for any global bank to boycott the United States, ignoring a small country may represent only a trivial reshuffling of priorities. However, from the small nation's perspective, a global bank's boycott could seriously crimp their access to the capital markets.

Finally, there are the obstacles that exist for any type of inclusive banking: corruption, weak enforcement, a large unbanked and underground economy, and nonexistent or unreliable earnings and credit histories. Even where inclusive banking is possible and feasible, national variations will be great, and they will change over time. Therefore, the system must allow for such periodic national adjustment.

These challenges notwithstanding, pressure for some action is building. Commerce and crime have traditionally gone international long before regulation and government.³⁰ Scale of criminal activity, however, impels governments to coordinate their response lest jurisdictional arbitrage encourage unethical or illicit activity to migrate to its underpoliced havens. This has occurred in global agreements (e.g., Basel II), global conventions (e.g., the United Nations' Global Compact³¹), and in wider reciprocal agreements eventually knitting into a global framework (e.g., corporate income tax treaties, anti-money-laundering statutes in the global war on terrorism).

Under transnational structures, broad coalitions of those who see themselves as the forces of good either pledge to adhere individually to coordinated policies, or adopt standards of business and then invite others to follow either voluntarily or through compliance pressure. It is no large leap, for example, to extend the corporate compliance apparatus from purely defensive activity (e.g. anti-money-laundering or Foreign Corruption Practices Act³²) to affirmative activity such as inclusive and community banking.

Elements of a Transnational Inclusive Banking Charter

A global inclusive banking charter should have global applicability and as much global standardization as possible, while allowing for national variation and changing national priorities. One policy model to consider is the U.S. Low Income Housing Tax Credit, a federal program administered by the states. The national statute specifies incentives, income targets, permissible uses, and minimum requirements. Everything else is left to individual states, which are instructed to design their own transparent plans to allocate their credits. States then score applicants consistent with their plan and report the results. In this instance, substitute "Inclusive Banking Charter" for "federal," and "individual country" for "state," and it becomes evident how an overarching program might be implemented by multiple, separate sovereign nations.

In broad brush strokes, a global inclusive banking charter would have a number of elements, such as creating an incentive for outcomes (e.g., capital volume), not efforts or processes. It would be self-scored (probably by independent third parties hired by each bank) but externally auditable through transparent, publicly available quantitative reports. The charter would, like the CRA, encourage innovation but not compel unsound lending and not require banks to deliver invisible subsidies (e.g., through concessionary rates). In each

30 An early example of the need for globalized action against organized crime was the multi-decade campaign against the Barbary Pirates, starting in 1783 and continuing until the second war with Algiers, in 1815. See Gerard W. Gawalt, "America and the Barbary Pirates: An International Battle against an Unconventional Foe" (Washington, DC: Library of Congress, Thomas Jefferson Papers), available at http://memory.loc.gov/ammem/collections/jefferson_papers/mtjprece.html.

31 A voluntary initiative under the aegis of the United Nations, first announced by then-Secretary General Kofi Annan at Davos on January 31, 1999, then officially launched on July 26, 2000 at U.N. headquarters. For more information, see www.unglobalcompact.org/index.html.

32 The Foreign Corrupt Practices Act of 1977, as amended, 15 USC §§ 78dd-1 et seq, more information available at <http://www.justice.gov/criminal/fraud/fcpa/>.

nation, government would have to be an active partner, not only in creating the policy framework, but in sharing the risk of these socially redeemable financial transactions. For example, governments could assume noncommercial risk (e.g., judicial failure to enforce reclamation of adverse possession after foreclosure). Government would also have the sole responsibility for any long-term subsidy necessary for affordability.

In time, the market that would grow up from these new policies would evolve on the basis of market size, population (including at low-income levels), and the commercial-bankability possibilities. Banks might start by making loans at cost, or marginally below market, and with credit policies marginally more liberal than normal. Over time, the below-market rates and above-market credit policies would blend into true market lending, not because the capital became more expensive, but because the market matured. If markets follow their normal course, such as we saw in the evolution of the affordable housing economy in the United States, banks would begin to make a decent profit on this activity on a risk-adjusted market-return basis. And in the long run, it would not depend on subsidy to make lending possible.

Another policy to consider in formulating the charter would be to look to how CRA has, and has not, worked over the past 30 years. On the basis of that experience, I recommend the following:

- ***More institutions encompassed.*** All major financial institutions, not just deposit-taking banks, should be subject to the charter. Any major entity that has explicit or systemically implicit government backing—that is, insurance companies, investment banks, and commercial banks, to name the obvious—should have a community reinvestment obligation.
- ***More capital forms recognized.*** Rather than a bright-line division into debt and equity, think in terms of spending and risks accepted. Myriad capital forms—guarantees, swaps, securitized strips, credit enhancement, indeed every fragmented capital slice that has a commercial purpose—should be eligible for inclusion as a qualifying capital deployment.
- ***More alignment with economic distress, less with geography as its proxy.*** If the data technology will permit, instead of a geographically bounded definition of a target area (the service area in the parlance of the CRA), develop one aimed at socioeconomic need. (India is GPS mapping every slum in the country,³³ over 6,500 of them, and is planning on conducting detailed on-the-ground censuses.)
- ***More innovation credited.*** In addition to broadening the eligibility of spends and risks for charter credit, give bonus points for innovation.
- ***Eliminate the churning incentive.*** Currently, CRA gives credit to new investments and not for “holding” an existing investment. This creates an incentive to constantly make

33 "For accurate data, government plans to map slums," *The Times of India*, February 15, 2010, accessible at <http://timesofindia.indiatimes.com/india/For-accurate-data-govt-plans-to-map-slums/articleshow/5574451.cms>.

new investments (or the appearance of a new investment). The inclusive banking charter should treat capital deployed in an existing investment as being as valuable as a new spend.

- *Uniform examination.* For curious historical reasons, the CRA is regulated by four independent entities (the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Reserve System), a structure that invites inconsistency. There should be one examining body for the inclusive banking charter, and by implication it needs to be supra-national.

Why Banks Themselves Should Take the Lead

If banks do not extend their thinking to help government, government will demand that help eventually. When it does, government will be acting with only the best of motives—healthy capital flows and healthy communities—but it can do harm nevertheless out of ignorance or unsophistication. Banking is complex, jargon-intensive, and fast-moving. To the less informed, good credit discipline can look like bigotry or redlining. Refusal to assume noncommercial risk (e.g., of government counterparty performance) can be interpreted as blackballing. In its zealous efforts to stamp out prejudice, government could do much more harm than good. Banks should and can forthrightly acknowledge a social responsibility to bank expansively (reaching out to those as yet underbanked) but sensibly, and to work with government to craft programs that make government responsible for noncommercial risk, and for permanent subsidy.

For the banks, the devil one designs for oneself is far better than the one a frustrated government can impose. For banks' own survival and self-preservation, they must help evolve the regulatory ecosystem. Global inclusive banking is part and parcel of what banking is supposed to do.

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