

A Closer Look at the Community Reinvestment Act of 1977

The turmoil in the financial markets has prompted questions about whether the Community Reinvestment Act (CRA) played a role in causing the subprime crisis. New research by the Federal Reserve's Board of Governors and the Federal Reserve Bank of San Francisco indicates these claims are unsubstantiated. Even so, the sweeping changes in the financial services industry in the past 30 years suggest it may be time to review the CRA within a broader reexamination of the bank regulatory environment. Through its research, analysis, and outreach, the Federal Reserve Bank of San Francisco's Community Development department is bringing together a wide range of experts to consider the future of the CRA and how best to ensure access to credit in low- and moderate-income communities.

The Community Reinvestment Act

To understand what an evolving CRA might look like, it's important to consider the history of the regulation and the impact it has had on lower-income communities. Congress enacted the CRA in 1977 in response to concerns about "redlining," a practice by which banks denied credit to lower-income communities—areas outlined in red on a map—without regard to an individual borrower's creditworthiness. Since its passage, the CRA has encouraged federally insured banks and thrifts to meet the credit needs of all the communities they serve, including low- and moderate-income neighborhoods and borrowers, consistent with safe and sound banking practices. Regulators consider a bank's CRA record in determining whether to approve its application to merge with or acquire other depository institutions.

The CRA has changed the way banks and thrifts serve low- and moderate-income communities and consumers. Research on the impact of the regulation has found that the CRA has increased knowledge about lending and



Community Development

Through research, education, and collaborative outreach with financial institutions, community groups, and government entities, Community Development staff are working to help hard-hit communities avoid foreclosure and address economic development issues during the crisis. In putting together the report, *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act*, (Left to Right) Ian Galloway, David Erickson, and John Olson worked closely with colleagues at the Federal Reserve Bank of Boston and the Federal Reserve Board of Governors, as well as with experts in both the financial services and community development industries.

investment opportunities in lower-income areas and fostered competition among banks in these neighborhoods, thereby generating larger volumes of lending from diverse sources and adding liquidity to the market.¹ By one estimate, between 1993 and 1998, depository institutions covered by the CRA and their affiliates made nearly \$620 billion in home mortgage, small business, and community development loans to

¹ William Apgar, and Mark Duda. 2003. "The Twenty-Fifth Anniversary of the Community Reinvestment Act: Past Accomplishments and Future Regulatory Challenges." *FRBNY Economic Policy Review*. June, pp. 169-191. www.newyorkfed.org/research/epr/03v09n2/0306apga.pdf

low- and moderate-income borrowers and communities.² Moreover, studies also have found that lending to lower-income individuals and communities has been nearly as profitable as, and performed similarly to, other types of lending by CRA-covered institutions.³ Perhaps equally important has been the role of the CRA in helping to build the institutional infrastructure for community development by investing in nonprofits and community development financial institutions, and by strengthening the capacity of local organizations to develop affordable housing, promote small businesses, and deliver financial education and other asset-building programs.⁴

The Federal Reserve Bank of San Francisco's Community Development department has long worked with banks in the Twelfth Federal Reserve District to identify CRA opportunities in low- and moderate-income communities. CRA officers, with their expertise in community development finance and understanding of local credit needs, are essential partners in efforts to expand access to financial services to underserved communities.

Banks also have been key stakeholders in the department's foreclosure prevention activities, for example, by helping to fund borrower outreach events and by working with housing counselors at nonprofits to improve the loan modification process. In the latter half of 2008, the Community Development department worked with local jurisdictions to create neighborhood stabilization plans for communities with high concentrations of foreclosures. Many banks also participated in local task forces

that developed strategies to convert foreclosed homes into affordable housing.

The CRA and the Subprime Crisis

The CRA recently has been criticized for supposedly helping precipitate the financial crisis by encouraging subprime lending. New research by the Federal Reserve's Board of Governors and the Federal Reserve Bank of San Francisco suggests these claims are largely unfounded.

The Board's analysis of 2006 mortgage data found that about 60 percent of high-cost loans, which have the highest delinquency and foreclosure rates, went to higher-income borrowers or neighborhoods that aren't targeted by the CRA. In fact, only 6 percent of all high-cost loans in 2006 were made by CRA-regulated institutions or their affiliates to lower-income borrowers or neighborhoods in their CRA assessment areas, the local geographies that are the primary focus for CRA evaluation.⁵

In addition, a research paper published by the Federal Reserve Bank of San Francisco examined the performance of loans made by CRA-regulated institutions in California. Strikingly, the analysis found that loans originated by lenders regulated under the CRA were "significantly less likely to be in foreclosure" than those originated by independent mortgage companies that weren't covered by the CRA.⁶ Indeed, loans made by CRA-regulated institutions within their assessment areas were half as likely to go into foreclosure as loans made by independent mortgage companies, casting considerable doubt on the argument that the

2 Michael S. Barr. 2005. "Credit Where it Counts: The Community Reinvestment Act and Its Critics," *New York University Law Review*. May, 80:2 p. 566. www3.law.nyu.edu/journals/lawreview/issues/vol80/no2/NYU202.pdf

3 Board of Governors of the Federal Reserve System. 2000. *The Performance and Profitability of CRA-Related Lending* pp. 1-99. www.federalreserve.gov/BoardDocs/Surveys/CRAloansurvey/cratext.pdf

4 David Erickson. 2009. *The Housing Policy Revolution: Networks and Neighborhoods*. Urban Institute Press, Washington, D.C.

5 Randall S. Kroszner. "The Community Reinvestment Act and the Recent Mortgage Crisis." Speech delivered at *Confronting Concentrated Poverty Policy Forum, Board of Governors of the Federal Reserve System, Washington, D.C., December 3, 2008*. www.federalreserve.gov/newsevents/speech/kroszner20081203a.htm

6 Elizabeth Laderman, and Carolina Reid. 2008. "Lending in Low- and Moderate-Income Neighborhoods in California: The Performance of CRA Lending During the Subprime Meltdown," *FRBSF Community Development Working Paper. 05-08*. www.frbsf.org/publications/community/wpapers/2008/wp08-05.pdf

regulation contributed to the subprime mortgage crisis.

A Reexamination of the CRA

Yet, this research also suggests a need to reexamine the CRA and its relevance for the current banking environment, which has changed dramatically since the law's passage more than three decades ago. But what should a revised CRA look like? To explore this question, the Federal Reserve Bank of San Francisco's Community Development department, in collaboration with the Federal Reserve Bank of Boston, published *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act*⁷ in early 2009. The report includes essays by the leading thinkers on the future of the CRA, including bankers, academics, former regulators, and leaders of community-based organizations. It offers a broad range of ideas designed to stimulate discussion on the future of financial regulations affecting

low- and moderate-income communities. The report raises important questions: Should other types of financial institutions such as nonbank lenders and insurance companies have similar obligations to help meet the financial needs of the communities in which they are chartered? In an era of bank consolidations and Internet banking, is the geographic focus of the CRA, which is based on a local assessment area, still meaningful? What market inequalities and inefficiencies still exist, and can the CRA address these issues?

None of these questions is easily answered. The Federal Reserve Bank of San Francisco's Community Development department will continue to engage a wide range of stakeholders in a discussion of the future of the CRA to help contribute to a stronger financial services industry—one that not only provides access to credit in a safe, responsible, and equitable way, but also continues its strong tradition of improving the well-being of low-income families and communities. ■

⁷ "Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act" is available online at www.frbsf.org/publications/community/CRA/index.html.