

The Community Reinvestment Act at 30 Years

The American Bankers Association¹

Banks are in the business of financial intermediation—of bringing together those with capital and those who need capital. We do not build communities on our own, but it is fair to say that few communities in America are built—and none prospers—without banks playing their important role of putting savings to work. That is to say, our role is to help individuals and businesses build communities, of all sizes—and we compete vigorously among ourselves for the privilege. Drill down in a CRA Public Evaluation and you will read about how we compete across all income levels and all neighborhoods. Accordingly, we at the American Bankers Association (ABA) are pleased to share our views and observations on the operation of the Community Reinvestment Act (CRA).

Although initially introduced with more prescriptive standards, the CRA ultimately was passed in a form that recognized that banks best serve their entire communities by making new capital and credit available, rather than by being limited to returning the resources of one narrowly defined service area back to that same service area. A neighborhood of limited means needs access to more resources than just what their residents currently can make available themselves. Similarly, other neighborhoods may produce a surplus of savings, significantly more than can be profitably invested close to home. As finalized, the CRA recognized that reality and afforded banks a more flexible framework within which to work to demonstrate their record of helping meet “the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions.” In other words, there is an important balance in the statute that, if ignored, harms both the communities involved and the financial institutions that serve them.

No more succinct evidence that the CRA today better reflects banks’ success in serving the credit needs of

their local communities can be cited than to observe that 98 percent of banks and savings associations receive composite CRA ratings of Satisfactory or better. Some may scoff at this achievement, but the fundamental truth is that banks are tested—and disciplined—in the marketplace every day to demonstrate their responsiveness to the needs of their local communities. Those that do not serve the credit needs of their entire community do not prosper. It is therefore not surprising that the banking industry, alone in its extensive documentation of community service, excels at satisfying community credit needs.

The American Bankers Association believes that bank compliance with the spirit and letter of the Community Reinvestment Act is healthy, reflecting the fact that bankers, regulators, and community groups have all learned from one another over the past 30 years. Forging partnerships and developing a deeper understanding of the perspectives of all parties has led to an open and effective system that now more accurately reflects banks’ involvement in serving their entire communities. This evolution has not been without difficulties, but it has led to improvements. In marking the milestone of the Community Reinvestment Act’s 30th anniversary, we think that it is valuable to look back on its maturation, consider its current state, and look forward to its prospects.

Background

The Beginnings of the CRA

The Community Reinvestment Act was enacted by Congress in 1977 for the stated purpose of encouraging financial institutions to help meet the credit needs of their local communities. It is a relatively simple mandate to the banking regulators to assess the record of depository institutions in meeting the credit needs of their entire community. Since its enactment, there have been relatively few amendments to the law: requiring a

¹ *The American Bankers Association (ABA) brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation’s banking industry and to strengthen America’s economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry’s \$13.3 trillion in assets and employ over two million men and women. ABA wishes to recognize the work of staff members James Ballentine, Richard Riese, Paul Smith, and Deanne Marino in preparing this paper.*

Public Evaluation; requiring multistate examinations to include state-by-state CRA analysis; allowing regulators to give credit for investments in minority- and women-owned banks; requiring Satisfactory or better CRA ratings in order for a bank holding company to become a financial holding company; and providing some modest regulatory relief for small banks. These amendments have not fundamentally changed the initial charge of the statute: regulators should encourage and evaluate the efforts of their regulated institutions to help meet the credit needs of their communities.

Revisions to the CRA regulatory process have been much more extensive. The initial attempt of bank regulators to meet the mandate of the act put the emphasis on process rather than outcomes. Banks were assessed on 12 factors that had more to do with getting through compliance wickets than with actually delivering credit into local neighborhoods to the citizens and businesses that needed the capital. The CRA examination process became a compliance paper trail for recording the business that banks would ordinarily do without a mandate.

The CRA Becomes an Open Process, More Changes as a Result

The CRA process now is more transparent. This was not always the case. Beginning with the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), the process was opened to community members, shareholders, bankers, and the regulators themselves. As more stakeholders became aware of different pieces of the puzzle, some became dissatisfied. This dissatisfaction on the part of bankers, community activists, and regulators led to significant changes in the regulatory requirements under the CRA and to the examination process itself. Among the changes included in new regulations issued in 1995 were the recognition that CRA evaluations should be streamlined for small banks; that performance by larger banks could be achieved by providing loans, investments, and services; that all banks operated in a context taking into consideration their capabilities and their markets; and that what constituted community development should be pegged to activities with favorable impact on specified underserved market segments.

The CRA Today

The post-1995 CRA examination process reflects banks' contributions to their communities far better than the old examination procedures, fostering recognition of

the level of community-based lending banks have always engaged in. This process better balances the documentation requirements and performance of large and small banks; it augments its mandate to include visibility into antidiscrimination acts of banks; and it preserves the primacy of financially safe and sound operations.

Transparent: The fact that you can read about the performance of every bank in this country is no small feat. The availability of the bank's CRA Public Evaluation is now combined with the regulation's open solicitation to the community to comment on the institution's CRA performance. This transparency in the CRA process offers significant opportunity for community residents and groups to comment.

Balanced: By differentiating between large banks and small banks, the regulations have better balanced documentation and reporting requirements with measurement of performance. More than 88 percent of the banking assets of the nation fall under the more detailed Large Bank examination procedures; at the same time, more than 90 percent of banks by number that represent less than 12 percent of industry assets are spared certain reporting burdens because their performance evaluated is based on simplified criteria. Nevertheless, more can and should be done in this regard.

Inclusive: The CRA is not an antidiscrimination statute in the way that the Fair Housing Act or the Equal Credit Opportunity Act prohibit discrimination in lending. The regulators have added to the CRA examination process a requirement that will account for any evidence of illegal discrimination in lending or other illegal consumer credit practices. The bank regulators have done so under the argument that illegal or discriminatory credit practices cannot be said to help meet the credit needs of a community, but rather the reverse. Banks and savings institutions, unlike other lenders, are regularly examined for their compliance with fair-lending and consumer-protection laws, such as the Truth in Lending Act and federal law that prohibits unfair or deceptive acts and practices. Agencies thus have a record of the bank's compliance with these laws when the regulator conducts a CRA examination. Mandatory inclusion in the CRA Public Evaluation of a negative finding by examiners, resulting in a downgrade in the CRA rating, brings greater visibility to the fair-lending record of banks and savings associations than is seen in other, less-scrutinized sectors of the mortgage market.

Financially Sound: The CRA emphasizes that serving

the needs of the community must be consistent with the safe and sound operation of the institution. Banks are long-term institutions, invested in the long-term growth and prosperity of their cities, towns, and neighborhoods. A bank that sacrifices its financial health compromises its ability to serve its community. The history of CRA performance makes the point that sustainable progress on community development takes place only when banks and savings associations conduct their activities in a financially sound manner. The law and the regulations recognize this fundamental requirement—and the examination of institution performance cannot lose sight of this mandate when considering the context in which banks are evaluated.

The CRA process today is more reflective of the many ways that banks invest in and serve their communities consistent with a safe and sound operation.

CRA Process Improvement

The CRA examination process is one that has generally improved over time, in particular by balancing the burden between smaller and larger institutions, enlarging the range of lending that receives CRA credit in rural communities, and requiring consideration of discriminatory lending or violations of consumer credit-protection laws. Given the transparency of the evaluation process and the many avenues in which the interested public can comment, provide input, or criticize that public record, the CRA needs no other enforcement mechanism.

The CRA regulatory process must continue to evolve to meet changing markets and participants. We believe that improvements can be made in several major areas:

- Simplify the regulatory process to reduce any unnecessary burden, including updating the threshold for the Large Bank CRA exam program.
- Add flexibility to the regulations to encourage creativity and innovation by institutions to meet the credit needs of their particular communities, including financial education efforts.
- Recognize the value of the many ways in which banks support minority-owned depository institutions.

Simplify the Regulatory Process

In many ways, the CRA regulations and examination are still too complex. Bankers are required to know not

only the ins and outs of the CRA regulations but also the more complex specifics of the supplementary guidance that regulators offer in the CRA Questions and Answers (Q&As). It is notable that the Q&As are considerably longer and more detailed than the CRA regulations, and they are much harder to use. The regulators have proposed a revision of the last Q&As from 2001 and they are now available for public comment.

Another example of the drift into complexity came with the recent revisions to the CRA regulations rebalancing the definition of a Small Bank so as to relieve such institutions from unnecessary burdens. Based on FDIC data, banks with over \$1 billion in assets accounted for 88.3 percent of industry assets as of September 30, 2007. Proportionately and in absolute dollars, more banking assets are covered by the \$1 billion large-institution test today than were covered in 1995 (80 percent), when the Small Bank/Large Bank distinction was first established and set at \$250 million in assets. While this change was an excellent example of the evolution of the CRA regulations, we note that in making this change the banking agencies added an entirely new CRA examination: the Intermediate Small Bank CRA Examination. To go from the simplicity of two examinations—one for small banks and one for large banks—to three examinations, with the new one containing a wholly new approach to assessing community development activities, was simply an unnecessary complication of already-complicated regulations. Periodically updating the threshold so that it is pegged at a level that captures 80 percent of banking industry assets within the large-institution test, and eliminating the intermediate examination, would reduce burden without in any way reducing performance.

Add Flexibility

The regulations and examination process should encourage institutions to be responsive to changing markets rather than simply preserving a standardization to make measurement easier for the examiner. As a specific example, the definitions used to determine whether a loan, investment, or service is community development that qualifies for CRA credit are still too complex and narrow in scope. For example, bankers, members of Congress, and communities know that many of our citizens need a much higher level of financial literacy to function well in our complex economy. Many banks in fact participate in providing financial literacy training—training that

benefits the entire community—by educating the general public on how to save, budget, use credit wisely, evaluate financial-services offers, and qualify to buy a home. Bankers also are leaders in bringing financial education programs into the schoolroom. However, under the CRA regulations, many of these factors are not recognized as having a CRA value, because the training does not fit the rather narrow restrictions requiring that any program document that a majority of the participants are low- or moderate-income residents. Frankly, proving such an impact can be daunting for bankers in the community. More important, this restriction fails to recognize how our financial markets have evolved and how broad the need is to establish financial literacy in all economic and educational strata of our society. In this case, and in others, CRA evaluations need to be more flexible to allow for—if not encourage—banks to be creative and innovative in meeting the credit needs of their communities.

Recognize the Value of Supporting Minority-Owned Institutions

The CRA review process needs to recognize more fully the value added through the specialized expertise bankers develop in meeting their community development needs. For example, minority-owned institutions were pioneers in helping underserved neighborhoods before the CRA existed, and their perseverance in serving those markets has made them worthy partners in leading further efforts to build stronger, more economically vibrant communities. It is past time for the agencies to adopt regulations that recognize—and thereby encourage—the investments in, and support of, minority institutions by majority institutions, something that Congress authorized 15 years ago but still is not implemented in the CRA process. While we welcome the additional guidance on minority-owned institutions included in the January 2009 Q&As, it is important to incorporate this in the actual rules.

Beyond the CRA

In the 30 years that have passed since the adoption of the CRA, the market for credit and for financial assets

has continued to diversify. Although the CRA itself is tailored to the banking industry, its core concepts of helping to meet the financial needs of one's entire community, applying standardized but flexible criteria to measure performance, and providing public visibility for the resulting evaluation are applicable to other sectors. For example, credit unions have a specific charter mission to serve persons of modest means, but they are not subject to any regular, objective testing as to whether they are actually meeting their mission. This issue becomes increasingly important as many credit unions seek community-based charters. Of course, the CRA in its current regulatory detail should not be applied "as is" to other financial sectors; rather, we see that the appropriate level of objective, measurable performance documentation combined with a high degree of transparency can be a model for other regulators to encourage their depository institutions to demonstrate their commitment to the communities they are chartered to serve.

Conclusion

Bankers are committed to making credit available to the communities in which they operate. This commitment is part of the very business of banking. The CRA process documents and makes that commitment visible to the entire community. The many refinements that have been made over the last 30 years have improved this visibility. However, in striving to meet regulatory tests and processes in achieving this goal, institutions and regulators alike must embrace the challenges that the development of new technologies, delivery systems, and methods of operation present. ABA appreciates working together with bank regulators to face these challenges, and we seek to continue to work together to improve our effectiveness in this process while minimizing the unnecessary burdens that the process can sometimes impose. ■