

The Community Reinvestment Act: 30 Years of Wealth Building and What We Must Do to Finish the Job

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The Community Reinvestment Act (CRA) is a comprehensive law that has leveraged trillions of dollars in loans, investments, and bank services for minority and working-class neighborhoods. The CRA was passed in 1977 in response to the refusal of some banks to make loans available in minority and working-class communities. Since that time, the CRA has placed a continuing and affirmative obligation on banks to help meet the credit needs of the local communities in which they operate.² Further, not only has the CRA successfully deterred discrimination in lending, but it has also required that banks proactively assess and serve community needs in a safe and sound manner.

Our nation faces a serious foreclosure crisis, caused in part by widespread irresponsible lending. Had the CRA been applied to independent mortgage companies, investment banks, and other nondepository financial institutions, it is likely that the nation would not be gripped by a foreclosure crisis. The mandate to serve communities with safe and sound lending has resulted in bank lending that is considerably less risky than independent mortgage company lending. While banks have failed in the midst of this crisis, their failure rate is dwarfed by the wholesale loss of independent mortgage companies. Of

the 169 institutions that ceased operations in 2007, 167 of them were independent mortgage companies.³

In celebration of more than 30 years of its existence, this paper will describe the CRA's accomplishments and the role of community organizations in the CRA's public participation process. In addition, it will describe what steps should be taken to strengthen and update the CRA.

I. How the CRA Works and the Role of Community Groups

The CRA requires that one of four federal agencies conduct CRA examinations: the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), or the Federal Deposit Insurance Corporation (FDIC). The agencies also consider the CRA performance of depository institutions when they apply for permission to merge.⁴

A CRA exam evaluates the extent to which banks serve local community needs and assigns a rating based on the assessment of the bank's service. Both the CRA exams and ratings are available to the public.⁵ Further, CRA exams differ by the asset size and type of banks. Large Banks with assets over \$1 billion undergo the

¹ NCRC is an association of more than 600 community-based organizations that promote access to basic banking services, including credit and savings, create and sustain affordable housing, promote job development, and ensure vibrant communities for America's working families. Our members include community reinvestment organizations, community development corporations, local and state government agencies, faith-based institutions, community organizing and civil rights groups, minority- and women-owned business associations, and local and social service providers from across the nation.

² 12 USC 2901, Section 802 imposes the affirmative and continuing obligation to serve credit needs consistent with safety and soundness.

³ Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, *The 2007 HMDA Data*, available at <http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07draft.pdf>.

⁴ The Federal Reserve Board conducts exams of state-chartered banks, the Office of the Comptroller of the Currency conducts exams for nationally chartered banks, the Office of Thrift Supervision conducts exams for federally chartered thrifts, and the Federal Deposit Insurance Corporation conducts exams for state-chartered banks.

⁵ Banks receive one of four ratings: Outstanding, Satisfactory, Needs to Improve, and Substantial Noncompliance. The last two are considered to be failed CRA ratings.

most rigorous exams, while smaller bank exams are streamlined.⁶

The federal agencies are required to consider public comments in issuing CRA ratings and rendering decisions on merger applications, making the public participation process a vital component of the CRA. Comments on a bank's CRA record often bolster the bank's performance. A few years ago, NCRC assisted one of its West Virginia members in commenting on WesBanco's CRA exam, detailing poor performance in making loans to minorities and low- and moderate-income (LMI) borrowers. Due in part to the comments, the bank nearly failed its CRA exam and in fact appealed its initial rating. While the bank ultimately passed its exam, the exam delay contributed to a significant slowdown in regulatory approval of a merger application submitted by the bank, motivating the bank to significantly improve its performance as evidenced in future CRA exams.

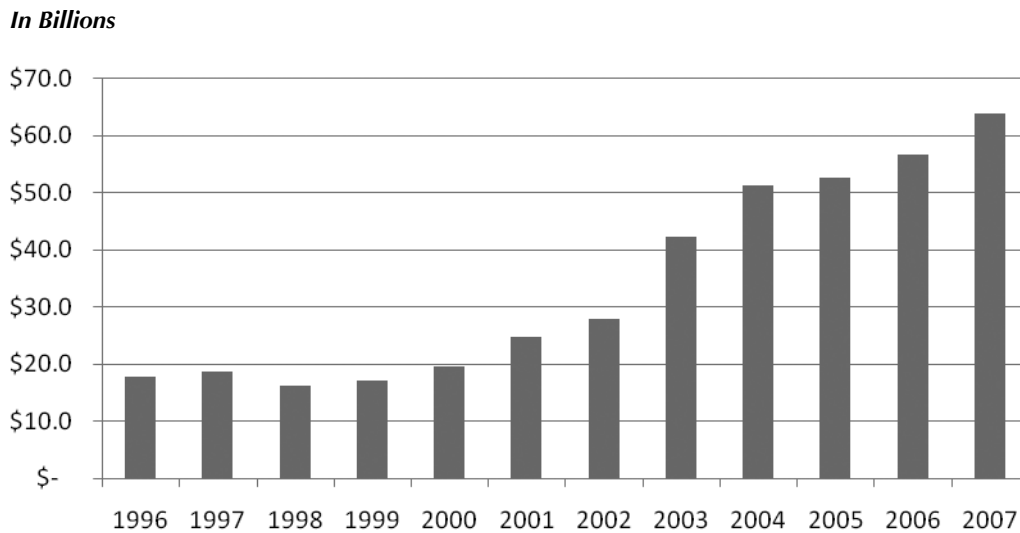
The CRA merger application process has been an important venue for community groups to approach banks about the credit needs of LMI borrowers. CRA agree-

ments are often negotiated between banks and community groups during the merger application process. NCRC's report, "CRA Commitments," has documented that banks have made \$4.6 trillion in CRA agreements and commitments to LMI and minority communities.⁷ Since the publication of CRA Commitments, Bank of America pledged an additional \$1.5 trillion during its takeover of Countrywide.⁸ Overall, banks make considerably more home loans in geographical areas covered by CRA agreements than those that are not, as documented in a study conducted by Federal Reserve economists using NCRC's CRA database.⁹

II. The CRA's Record of Increasing Access to Bank Lending and Services

The CRA has leveraged substantial amounts of loans, investments, and bank services for LMI communities. According to publicly available data analyzed by NCRC, banks and thrifts (depository institutions) have made 373,404 community development loans totaling more

Chart: Total CRA Community Development Lending 1996 - 2007



Source: FFIEC CRA National Aggregate Report Table 3 (<http://www.ffiec.gov/craadweb/national.aspx>)

6 The discussion in this section is based on the CRA regulation (see <http://www.ffiec.gov/cra/regulation.htm> for the regulation), the interagency Question and Answer document (see <http://www.ffiec.gov/cra/qnadoc.htm>), and NCRC's CRA Manual (http://www.ncrc.org/images/stories/pdf/cra_manual.pdf).

7 NCRC's CRA Commitments, available at http://www.ncrc.org/images/stories/whatWeDo_promote/cra_commitments_07.pdf.

8 See Bank of America's April 28 press release, available at http://newsroom.bankofamerica.com/index.php?s=press_releases&item=8152.

9 Raphael W. Bostic and Breck L. Robinson, Do CRA Agreements Influence Lending Patterns? 31 *Real Est. Econ.* 31, 1 (2003): 23-51.

than \$407 billion since 1996. From 1996 to 2007, the annual dollar amount of community development loans more than tripled—from \$17.7 billion to \$63.8 billion, respectively (see chart).

The Treasury Department reports that CRA-covered lenders increased home mortgage loans to LMI borrowers by 39 percent from 1993 to 1998. This increase is more than twice that experienced by middle- and upper-income borrowers during the same period.¹⁰ Likewise, a study conducted by the Joint Center for Housing Studies at Harvard University estimates that without the CRA, 336,000 fewer home purchase loans would have been made to LMI borrowers and communities between 1993 and 2000.¹¹

Moreover, the CRA's effectiveness can also be measured by comparing the lending patterns of CRA-covered banks with those of lending institutions not covered by CRA exams. NCRC found that in 2006, depository institutions extended 23.5 percent of home purchase loans to LMI borrowers, whereas non-CRA-covered lenders extended 21.5 percent. NCRC's study "Credit Unions: True to Their Mission?" showed that over a three-year period, banks consistently outperformed credit unions in offering home loans to minorities, women, and LMI borrowers in a majority of states.¹²

Remaining true to its purpose of requiring banks to serve credit needs consistent with safety and soundness, the CRA is an important antidote to the predatory lending that has contributed to the foreclosure crisis. In its review of the Home Mortgage Disclosure Act (HMDA) data, the Federal Reserve found that home loans issued by banks are significantly less likely to be high-cost and exhibit risky features. The Federal Reserve showed that

34.3 percent of the home purchase loans issued by non-CRA-covered lenders were high-cost loans in 2005.¹³ By contrast, only 5.1 percent of the home purchase loans issued by depository institutions and closely scrutinized on CRA exams were high-cost. In addition, from 2004 to 2006, independent mortgage companies extended between 55 percent and 63 percent of the high-cost piggyback loans. During the same time, depository institutions accounted for between 20 percent and 25 percent of the high-cost piggyback loans.¹⁴

The CRA mitigates home foreclosures. CRA exams reward banks for foreclosure-prevention efforts by giving banks points on their Lending, Investment, and Service Tests. Activities that earn CRA points include counseling, modifying loans, and investing in funds that finance loan modification. CRA exams provide clear incentives for banks to make safe and sound loans and penalize them for making loans that are unfair and deceptive.

III. How to Improve CRA Exam Criteria

While the overall framework of the CRA has been successful, the following need to be reformed.

- A. The geographical coverage of CRA exams.
- B. Whether CRA exams consider the behavior of mortgage company affiliates.
- C. Consideration of minority borrowers and communities on CRA exams.
- D. Evaluations for considering branching on CRA exams.
- E. Data limitations that reduce the effectiveness of CRA exams.

10 Robert Litan, Nicolas Retsinas, Eric Belsky, and Susan White Haag, *The Community Reinvestment Act After Financial Modernization: A Baseline Report*, U.S. Department of the Treasury, April 2000.

11 *The Joint Center for Housing Studies at Harvard University, The 25th Anniversary of the Community Reinvestment Act: Access to Capitol in an Evolving Financial Services System*, March 2002.

12 National Community Reinvestment Coalition, "Credit Unions: True to Their Mission?"

13 Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, *Higher-Priced Home Lending and the 2005 HMDA Data*, *Federal Reserve Bulletin*, September 8, 2006. See also Traiger and Hinckley, LLP, *The Community Reinvestment Act: A Welcome Anomaly to the Foreclosure Crisis*, January 7, 2008.

14 Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, "The 2007 HMDA Data," available at <http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07draft.pdf>.

If CRA exams become more rigorous in each of these areas, community groups and the public can participate more meaningfully in the CRA process. For example, if lending to minorities is considered by CRA exams, then public comments on lending to minorities become more relevant. Likewise, if CRA exam analysis of branching, home, and small business data becomes more robust, community groups will have more information with which to engage in substantive dialogue about banks' CRA performance.

A. The Geographic Coverage of CRA Exams

The geographic locations covered by CRA exams consist of metropolitan areas or counties that contain bank branches. When Congress enacted the CRA in 1977, banks received deposits and made loans through branches. While some banks still issue loans predominantly through branches, others make the majority of their loans through brokers and other non-branch means.

Though the CRA regulation stipulates that assessment areas include geographical regions containing bank branches, the regulation also states that assessment areas include other geographical regions in which the bank has originated or purchased a substantial portion of its loans.¹⁵ Despite this regulatory clause, the federal agencies usually adopt a narrow definition of assessment areas for banks or thrifts that issue most of their loans through nonbranch channels. For these banks, it is not unusual to encounter CRA exams that cover only the geographical area of the bank's headquarters.

In 2007, NCRC identified several lending institutions that engaged in questionable practices, including refusal to make loans under a minimum amount (usually \$75,000 or \$100,000), refusal to make loans to row houses, and failure to offer loans within entire cities. NCRC research revealed that four banks engaged in these practices. Tellingly, only 11 to 13 percent of the loans investigated were in the banks' assessment areas.¹⁶

In addition to enabling discriminatory practices, narrow assessment areas defeat the the CRA's objective of banks responding to community needs. In one recent case, an NCRC member organization in Penn-

sylvania was concerned about the impact of a large bank merger on the bank's continued commitment to the organization's city. The newly merged institution would in fact be the largest lender (measured by the number of home loans) in the city. Because the bank did not have a branch in the city and the city was not in a CRA assessment area, the bank declined to engage in substantive discussions about future collaboration. Although it had a major lending presence in the city, the bank was not encouraged by CRA exam procedures to see how it could meet credit needs beyond home lending in that area.

The proposals in the CRA Modernization Act of 2007 address the inadequacies of assessment areas.¹⁷ Under this bill, if a bank has captured one-half of one percent or more of the local lending market, a CRA exam would designate the geographic area served by the bank as an assessment area. A procedure such as this would ensure that the majority of a bank's loans and other financial activities are scrutinized by CRA exams.

B. Whether CRA Exams Consider the Behavior of Mortgage Company Affiliates

Under the CRA, banks have the option of including their nondepository affiliates, such as mortgage companies, on CRA exams. Banks are tempted to include affiliates on CRA exams if the affiliates perform admirably, but they will opt against inclusion if the affiliates are engaged in risky lending or discriminatory policies. This is counter to the essential purpose of the CRA, which is to ensure that the institution as a whole is meeting credit needs in a responsible manner.

Four nondepository affiliates of banks were identified by NCRC's fair-lending investigations (discussed above) as engaging in redlining or other discriminatory practices. These four affiliates were not included on their affiliated bank's CRA examinations. Current CRA examination procedures enable bank affiliates to engage in such practices undetected. The CRA Modernization Act of 2007 would end this serious gap in CRA enforcement by mandating the inclusion of affiliates on CRA exams.

15 See Section 345.41 of the FDIC's CRA regulation, available at <http://www.fdic.gov/regulations/community/community/index.html>.

16 Contact the National Community Reinvestment Coalition for more information regarding our fair lending investigations.

17 See <http://thomas.loc.gov/cgi-bin/bdquery/z?d110:h.r.01289> for the text of HR 1289, the CRA Modernization Act of 2007.

C. Consideration of Minority Borrowers and Communities on CRA Exams

On a CRA exam, lending to LMI borrowers and communities is examined in detail. A major part of the Lending Test consists of scrutinizing the percentage of a bank's loans made to LMI borrowers compared to the demographics of the bank's community and the percentage of loans made to LMI borrowers by the bank's competitors.

CRA exams have a fair-lending component that assesses whether a bank discriminated by rejecting qualified minority applicants or by steering minorities with good credit to subprime loans. While the fair-lending test is necessary, it does not assess whether banks are affirmatively making loans to minorities. In other words, a bank can employ nondiscriminatory policies but still make relatively few loans to minorities because it does not market to minority communities. If lending to minorities were an explicit criterion on CRA exams, then consistently low percentages of loans to minorities would contribute to a lower rating for the bank.

Given the evidence of lending disparities by race, NCRC has called for CRA exams to explicitly examine lending and services to minority borrowers and communities. NCRC's "Broken Credit System" report shows that minority neighborhoods received larger percentages of subprime loans than predominantly white neighborhoods, even after controlling for creditworthiness and other housing stock characteristics.¹⁸ Researchers came to similar conclusions about high levels of subprime loans in minority neighborhoods after controlling for creditworthiness.¹⁹ Another NCRC study, "Are Banks on the Map?" found larger disparities in branching by race of neighborhood than by income of neighborhood in 25 large metropolitan areas.²⁰ Overall, it is probable that a consideration of lending and branching by race

of borrower and neighborhood would lessen the racial disparities in access to bank services and loans.

Prior to CRA regulatory reforms in the mid-1990s, CRA exams under "Assessment Factor D" would often assess performance of lending to minorities. An example of this approach is employed in the evaluation of Signet Bank, conducted by the Federal Reserve Bank of Richmond in 1996. If the regulatory agencies do not reinstate lending and service to minorities as criteria on CRA exams, Congress should amend the CRA to add lending and service to minorities as provided in the CRA Modernization Act of 2007.

D. Evaluations for Considering Branching on CRA Exams

Access to branches and deposit accounts is essential in order to assist people at low- or moderate-income levels in establishing savings and acquiring home and small-business loans. Furthermore, research conducted by the Federal Reserve demonstrated that banks offer a higher percentage of prime loans when they issue loans through branches than when they make loans through brokers.²¹ NCRC's research for the Appalachian Regional Commission revealed that small-business lending is higher in rural counties with a greater number of bank branches.²²

Because branching and access to basic banking services are vital to wealth building, the CRA Service Test should be rigorous and comprehensive, holding banks to a high standard of branching and service provision in LMI neighborhoods. Unfortunately, research has shown the contrary. A study conducted by the Center for Community Capital concluded that the CRA Service Test scores are likely to be inflated when low scores on the Lending Test and Investment Test confront banks with the possibility of CRA exam failure.²³

¹⁸ National Community Reinvestment Coalition, "Broken Credit System."

¹⁹ Paul S. Calem, Kevin Gillen, and Susan Wachter, "The Neighborhood Distribution of Subprime Mortgage Lending," October 30, 2002. See also Paul S. Calem, Jonathan E. Hershaff, and Susan M. Wachter, "Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities," *Housing Policy Debate* 15, no. 3 (2004): 603–22.

²⁰ "Are Banks on the Map," available at http://www.ncrc.org/images/stories/mediaCenter_reports/ncrc%20bank%20branch%20study.pdf.

²¹ Avery, Brevoort, and Canner, "Higher-Priced Home Lending" and "The 2005 HMDA Data."

²² "Access to Capital and Credit for Small Businesses in Appalachia," available at http://www.ncrc.org/pressandpubs/press_releases/documents/2007/NCRC%20Study%20for%20ARC.pdf.

²³ Michael A. Stegman, Kelly Thompson Cochran, and Robert Faris, Center for Community Capital, University of North Carolina, *Creating a Scorecard for the CRA Service Test: Strengthening Basic Banking Services under the Community Reinvestment Act, 2001*. Also see the Woodstock Institute, *Measuring the Provision of Banking Services for the Underbanked: Recommendations for a More Effective Community Reinvestment Act Service Test*, March 2007. Of the 14 banks in Woodstock's sample with the highest scores on the Service Test, eight had branch distributions in low- and moderate-income communities that were well below the averages for all lenders as a group in the banks' assessment areas.

Diminished attention to branching on CRA exams should be addressed. The regulatory agencies should construct clear and objective measures for comparing the distribution of branches with the distribution of LMI neighborhoods and people in those areas. The agencies should also collect data on the number and percent of deposit accounts in LMI neighborhoods so that CRA exams contain substantive analyses on the distribution of deposit accounts instead of simple assertions that banks provide services to LMI consumers.

E. Data Limitations that Reduce the Effectiveness of CRA Exams

CRA exams cannot effectively measure bank performance if data are of limited quality. Federal agencies have used HMDA data in detail on exams, but further enhancements in the use of the data are necessary.

The agencies provide detailed tables on home-loan lending. The narrative and tables on CRA exams separately analyze home purchase, refinance, and home-improvement lending. This is necessary since the separate types of home lending respond to different credit needs.

As proposed and rejected in 2004, the same procedure of separate analysis should apply to mortgage purchases.²⁴ Purchases refer to secondary market activity involving banks buying loans from other banks and mortgage companies. Loan originations refer to loans made directly by a bank. If loan originations were analyzed separately from loan purchases, it would be more difficult for banks to manipulate CRA exams through the buying of loans made to LMI borrowers immediately before CRA exams.²⁵

CRA exams should use the new pricing information in HMDA data to evaluate separately prime and high-cost lending. Just as home-purchase and refinance lending respond to different credit needs, so too do prime and high-cost lending. Also, it is important to ensure that banks making both prime and high-cost lending offer a

balanced product mix to LMI borrowers and communities. This objective can be achieved only if prime lending and high-cost lending are analyzed separately.

While the major issue associated with HMDA data has been its use in CRA exams, the predominant issue regarding small-business data is that of quality. The federal regulatory agencies significantly lessened the quality of these data by exempting Intermediate Small Banks (with assets of \$250 million to \$1 billion) from requirements to collect and report it. As NCRC demonstrated in its report for the Appalachian Regional Commission, Intermediate Small Banks are an important source of credit for small businesses, particularly in rural areas and medium-size cities and towns.

Periodic national surveys sponsored by the Federal Reserve consistently point toward the likelihood of discrimination in small-business lending.²⁶ A powerful way to reduce disparities in lending is to provide publicly data on the number of loans made to minorities and women. Yet, the CRA small-business data lack information on the gender and race of the small-business owner.

Rep. James McGovern introduced the Access and Openness in Small Business Lending Act of 2003 (H.R. 1748), which would have required reporting the race and gender of the small-business owner and mandate additional demographic detail in the CRA small-business data.²⁷ In addition to passing a bill similar to McGovern's, it is suggested that Congress either pass a bill or urge the regulatory agencies to reverse their decision exempting Intermediate Small Banks from CRA small-business data reporting requirements.

IV. How to Improve CRA Ratings

Ratings on CRA exams are a critical element of the CRA process. Some banks issue press releases announcing Outstanding ratings, while low ratings can damage a bank's reputation. Ratings also figure prominently in

24 In 2004, the federal agencies proposed separate data tables on originations and purchases only to abandon this proposal. See the February 6, 2004, *Federal Register* for the proposal, available at <http://www.fdic.gov/regulations/laws/federal/04CRA.html>.

25 The quality of HMDA data on loan purchases should be enhanced. Currently, Regulation C (the Federal Reserve regulation that implements the HMDA statute) requires data on loan purchases to include the census-tract location of property but not the race, gender, or income of the borrower. Banks should be required to collect the same information on borrower and neighborhood characteristics on loan purchases as they do on loan originations. Some banks collect complete information on loan purchases, while others do not. The rigor of CRA exams would be enhanced if data on loan purchases were made uniform. See 12 Code of Federal Regulations, Part 203, Section 203.4 for the data-collection procedure regarding purchases.

26 See NCRC's *Access to Capital and Credit for Small Businesses in Appalachia for a discussion of the literature and the Federal Reserve-sponsored surveys* available at http://www.ncrc.org/images/stories/mediaCenter_reports/ncrc%20study%20for%20arc.pdf.

27 See <http://thomas.loc.gov/cgi-bin/bdquery/z?d108:h.r.01748>.

the merger-application process. If ratings are inflated, the CRA will not be able to realize its full potential in leveraging bank financing and services for LMI communities. Grade inflation makes it difficult for community groups and members of the public to discern important differences in banks' overall performance and across assessment areas and component tests. Grade inflation therefore hinders the ability of community groups to comment meaningfully to banks and regulatory officials about various aspects of bank performance.

CRA Grade Inflation

The table below shows the current failure rate for banks has hovered between one and two percent in recent years (ratings of Needs to Improve or Substantial Noncompliance indicate a bank has failed its CRA exam). When ratings first became public in 1990, more than ten percent of banks failed their CRA exams.²⁸ For the five years thereafter, more than five percent of banks failed their CRA exams every year.

Banks improved their CRA performance over the years as they bolstered their efforts to make loans, investments, and services in low- and moderate-income communities. Yet, the low failure rate in recent years appears implausible. As discussed above, the Center for Community Capital demonstrated inflation in the CRA Services Test. In addition, Rick Marsico, in his book *Democratizing Capital*, reveals how quantitative criteria are applied in an inconsistent manner on CRA exams, suggesting that a number of CRA exams have ratings that cannot be justified.²⁹

The CRA Modernization Act of 2007 contains a number of provisions that would help prevent grade inflation. The first is introducing more ratings. Currently, the CRA component tests (such as the Lending Test) have Outstanding, High Satisfactory, Low Satisfactory, Needs to Improve, and Substantial Noncompliance as possible grades. In contrast, the final rating on a CRA exam can be one of four grades: Outstanding, Satisfactory, Needs to Improve, and Substantial Noncompliance. The final

Table: CRA Exam Ratings 1990 - 2007

Year	Outstanding		Satisfactory		Needs to Improve		Substantial Noncompliance		Total
	Count	Percent	Count	Percent	Count	Percent	Count	Percent	
1990	340	10.9%	2,474	79.5%	280	9.0%	19	0.6%	3,113
1991	407	8.3%	4,016	81.6%	453	9.2%	46	0.9%	4,922
1992	653	12.7%	4,067	78.9%	395	7.7%	40	0.8%	5,155
1993	941	14.7%	5,060	79.3%	355	5.6%	26	0.4%	6,382
1994	1,000	18.1%	4,249	76.7%	275	5.0%	15	0.3%	5,539
1995	1,363	24.3%	4,106	73.1%	138	2.5%	7	0.1%	5,614
1996	1,214	26.5%	3,275	71.5%	81	1.8%	11	0.2%	4,581
1997	829	22.4%	2,807	75.7%	59	1.6%	11	0.3%	3,706
1998	681	18.6%	2,915	79.6%	59	1.6%	7	0.2%	3,662
1999	679	18.6%	2,915	79.7%	55	1.5%	7	0.2%	3,656
2000	220	17.5%	1,001	79.6%	30	2.4%	7	0.6%	1,258
2001	132	10.6%	1,088	87.1%	23	1.8%	6	0.5%	1,249
2002	201	9.8%	1,820	89.0%	18	0.9%	5	0.2%	2,044
2003	283	10.1%	2,492	89.2%	17	0.6%	3	0.1%	2,795
2004	329	13.1%	2,170	86.1%	17	0.7%	3	0.1%	2,519
2005	244	15.9%	1,278	83.2%	10	0.7%	4	0.3%	1,536
2006	171	13.1%	1,109	84.9%	20	1.5%	6	0.5%	1,306
2007	154	10.5%	1,292	87.8%	20	1.4%	4	0.3%	1,470
Total	9,841	16.3%	48,134	79.5%	2,305	3.8%	227	0.4%	60,507

Source: FFIEC CRA Ratings Database

²⁸ See <http://www.ffiec.gov/craratings/default.aspx> for the database on CRA ratings.

²⁹ Richard D. Marsico, *Democratizing Capital: The History, Law, and Reform of the Community Reinvestment Act* (Carolina Academic Press, 2005).

rating should also include High Satisfactory and Low Satisfactory as possible grades. In this manner, the general public and the federal agencies would be better able to assess actual differences and gradations in performance.

If a low CRA rating in an assessment area triggered requirements for a bank to improve its performance, a bank would be more likely to serve all geographic areas, including smaller cities and rural areas. The CRA Modernization Act of 2007 would require federal agencies to address low ratings and would require public input in this process. If a bank receives a rating of Low Satisfactory or worse in any assessment area, it would be required to submit a CRA improvement plan to its regulatory agency describing how the bank intends to bolster its CRA performance in that specific area.³⁰ The general public would also be able to comment on the submitted plan. After the agency approves the CRA improvement plan, the bank would be required to submit quarterly reports for public monitoring purposes.

Another important reform would be to make the ratings appeal process transparent. The appeal process as currently structured is a one-sided affair enabling banks to secretly appeal ratings; this likely contributes to CRA grade inflation. Either banks should not have the right to appeal or appeals should be publicly announced with an opportunity for the general public to comment.

The importance of the rigor of the CRA exam has increased since the largest banks in the country have become much larger and will likely be involved in fewer mergers in the coming years. The top four banks (the new Bank of America after the Countrywide acquisition, the new JPMorgan Chase after the Washington Mutual acquisition, the new Wells Fargo after the Wachovia acquisition, and Citigroup) now control an incredible 52.8 percent of the nation's bank assets equaling \$7 trillion.³¹ At least two of the largest banks, Bank of America and Wells Fargo, are now close to the ten percent deposit cap. In other words, each of them owns about ten percent of the nation's deposits, meaning they cannot legally acquire other banks without divesting branches.

Thus, since these banks are unlikely to undergo significant mergers in the near and medium term, the major means to hold them accountable for CRA performance is through the CRA examination process. Ratings must therefore become more meaningful and community organizations should have increased opportunities via public improvement plans to recommend how the very large banks can bolster their performance in geographies where their CRA performance is relatively weak.

V. Bolstering the Merger Application Process and Public Participation

The merger application process presents significant opportunities for federal agencies to enforce the CRA. Yet, the enforcement of community reinvestment obligations through the merger application process has been lacking over the last several years.

In Congressional testimony in 2007, an official representing the Federal Reserve Board testified that the Federal Reserve Board has held only 13 public meetings on mergers since 1990. This is less than one meeting per year in an era in which consolidations have profoundly changed the banking industry. In addition, a Federal Reserve Board representative stated that since 1988 the Federal Reserve Board received 13,500 applications for the formation of banks, or the merger of institutions involving bank holding companies or state-chartered banks that were members of the Federal Reserve System. Yet, only 25 of these applications were denied, with eight of the denials involving consumer protection or community-needs issues.³²

Previously, the OTS required that a meeting be held between merging thrifts and community groups when requested by a community group that had submitted written comments pertaining to the merger. This procedure needs to be implemented by all the agencies. Meetings, as distinguished from public hearings, usually involve a relatively small number of stakeholders, including regulatory officials, a few community leaders,

30 *The concept of an improvement plan builds on a procedure mandated by the current CRA regulation. At section 345.43 of the FDIC's version of the regulation, a bank with a less than Satisfactory rating shall allow the public to inspect a description of its efforts to "improve its performance in helping to meet the credit needs of its entire community." This description is to be updated quarterly.*

31 *The total industry asset levels are as of June 30, 2008, see the FDIC's Statistics of Depository Institutions, available at <http://www2.fdic.gov/sdi/main.asp>. The top bank holding company asset levels are as of September 30, 2008, see the Federal Financial Institutions Examination Council National Information Center (NIC), available at <http://www.ffiec.gov/nicpubweb/nicweb/Top50Form.aspx>. The NIC asset levels for the top holding companies appear to have incorporated the recent acquisitions such as JPMorgan Chase's acquisition of Washington Mutual and Bank of America's acquisition of Countrywide.*

32 *See <http://www.federalreserve.gov/newsevents/testimony/braunstein20070521a.htm> for Ms. Braunstein's testimony.*

and representatives of the merging institutions.

In addition to meetings, a public hearing should be held when regulatory agencies receive several requests from community groups or citizens for a public forum. Meetings allow for in-depth dialogue and debate among a handful of important stakeholders. However, public hearings become necessary when hundreds of citizens and community organizations wish to testify. Regulatory officials must afford them the opportunity to testify so that the officials can understand how important the banks are to the affected communities.

In addition to holding more frequent hearings and meetings, the regulatory agencies should also bolster the rigor of its merger approval process. Since merger denials are rare, the quality of merger approvals becomes quite important in assuring continued community reinvestment. The agencies should increase the use of conditional merger approvals that require banks to improve CRA performance or to institute nondiscriminatory and antipredatory lending safeguards. Even in a case when the merger is approved without conditions, the federal agencies can describe any significant deficiencies in the CRA and fair-lending performance, and then indicate that they expect the bank to rectify these deficiencies. In fact, an “expectations” section would be beneficial as a regular feature of merger approvals and CRA exams. The section would explain in which geographic areas and in which component tests the bank has weaknesses and would suggest how the bank could improve the shortfalls (including partnering with community organizations or introducing new products or marketing approaches).

Federal agencies should also alter their stance regarding CRA agreements, since agreements have stimulated significant increases in responsible lending. They usually note in merger approval orders that CRA agreements are not required by the CRA regulation. In addition, they routinely note that they will not consider any CRA agree-

ments in the merger approval process.³³ Instead, the federal agencies should either explicitly encourage CRA agreements or implicitly encourage them by extolling the benefits of collaboration between community groups and banks.

VI. The Adequacy of Federal Agency Antidiscrimination Reviews on CRA Exams

Evidence of discriminatory and illegal lending can result in downgrades of CRA ratings for banks if discrimination and illegal lending were widespread and the lender did not take action to end the practices. However, there is little evidence that the fair lending reviews of CRA exams are rigorously testing for discriminatory lending.

In most cases, even for the largest banks, the fair-lending section of the CRA exam reports in one to three sentences that the regulatory agency tested for evidence of illegal and discriminatory lending and that no such lending was found.³⁴ Yet there is no discussion of what precisely had been done to reach its conclusion.

In the past, agencies provided detailed descriptions in the fair-lending section of CRA exams under the “assessment factor” format of the exams. For example, under Assessment Factor F, which assessed evidence of discriminatory or illegal practices, the Federal Reserve Bank of Richmond in January 1996 conducted matched file reviews of more than 300 loan applications in a CRA exam of Signet Bank. The exam also described a regression analysis, which sought to determine if race was a factor in loan rejections.

A substantive fair lending review, similar to the one for Signet Bank, provides the general public with confidence that the regulatory agency performed a detailed anti-discrimination analysis. Based on their experience with banks, community groups can comment on whether the

33 See, for example, <http://www.federalreserve.gov/newsevents/press/orders/orders20080605a1.pdf>. Footnote 35 on page 18 discusses CRA pledges.

34 For example, a federal agency had this to say on the CRA exam’s fair-lending review of one large bank with several affiliates, a number of whom make high-cost loans: “We found no evidence of illegal discrimination or other illegal credit practices.” That was the only sentence in the fair-lending review section. In another instance, NCRC examined a thrift that specialized in subprime lending. The CRA exam report for that thrift noted that it issued a high percentage of loans to low- and moderate-income borrowers. The CRA fair-lending review, however, did not describe if the examiner made any efforts to determine if the subprime lending was conducted in a nondiscriminatory manner or was consistent with safety and soundness (See Office of Thrift Supervision CRA exam of Eastern Savings Bank, FSB, Docket # 08183, August 2005). In another case, an exam mentioned that a bank specialized in adjustable-rate lending, but the fair-lending review did not mention whether the examiner assessed if the loans were offered in a nondiscriminatory manner and whether they were safe and sound. (See Federal Deposit Insurance Corporation CRA exam of Franklin Bank, SSB, Certificate Number # 26870, January 2005.)

fair-lending tests described by the exam scrutinized specific lending products or practices that are problematic. Detailed descriptions of fair-lending reviews enhance the rigor of the examination process by increasing transparency and promoting informed public dialogue.

Safety and soundness reviews should be integrated with the fair-lending review and the overall CRA exam. Examiners should disqualify from favorable consideration on CRA exams any subset of loans, such as nontraditional and subprime loans with multiple risky features, that exhibit delinquency and default rates much higher than industry averages.³⁵ If such risky lending is widespread, the CRA rating should be downgraded, especially if this type of lending targets LMI borrowers, minorities, and other classes of borrowers protected by the Fair Housing Act or the Equal Credit Opportunity Act.

Although the great majority of institutions failing because of unsafe and unsound lending have been independent mortgage companies not covered by the CRA, some of the failures were banks and thrifts.³⁶ The CRA exams of two of these lenders, Fremont Investment and Loan and Indymac, do not discuss the safety and soundness of their lending practices.³⁷ In Fremont's case, the FDIC issued a failed CRA rating on the exam after the FDIC issued an enforcement order requiring the bank to cease and desist from unsafe and unsound lending. The CRA exam preceding the enforcement order gave Fremont Investment and Loan an Outstanding rating. These two cases illustrate that safety-and-soundness reviews need to be uniformly rigorous, with findings clearly discussed on CRA exams.

VII. Less Frequent CRA Exams for Small Banks

The Gramm-Leach-Bliley Act (GLBA) of 1999 reduced the frequency of Small-Bank CRA exams. Under GLBA, Small Banks with assets under \$250 million are examined only once every four years if they have a Satisfactory rating and once every five years if they have an Outstanding rating.³⁸ In contrast, banks with assets above \$250 million are examined every two years.

When Small Banks are examined infrequently, they have less incentive to adhere affirmatively and continually to their reinvestment obligations. They also have reduced incentives to make sufficient loans to low- and moderate-income borrowers during the four- or five-year period between exams, and they may focus their efforts only during the last year or two before their exams. Increasing the frequency of Small Bank exams is necessary when considering that CRA exams are usually the only accountability mechanism, as Small Banks rarely merge.³⁹

VIII. The Need to Extend the CRA to Nonbank Financial Institutions

In the 30 years since the enactment of the CRA, the financial industry has evolved incredibly. Banks now face more formidable competitors than they did in 1977. As long as these competitors remain uncovered by the CRA, it is likely that their lending will be less safe and

35 *Loans that exhibit problematic features highlighted by the interagency guidelines for subprime and nontraditional lending should be subjected to rigorous scrutiny on CRA exams. If such lending exhibits high delinquency and default rates, the lending should not count on CRA exams and should also be penalized in terms of reduced CRA ratings. See <http://www.federalreserve.gov/newsevents/press/bcreg/20060929a.htm> for the final version of interagency guidance on nontraditional lending, and <http://www.federalreserve.gov/newsevents/press/bcreg/20070629a.htm> for the final guidance on subprime lending. Another safety and soundness screen employed on CRA exams should be determining if any subset of loans violate the July 2008 Federal Reserve changes to its Regulation Z and HOEPA rules. See <http://www.federalreserve.gov/newsevents/press/bcreg/20080714a.htm>.*

36 *According to the Federal Reserve's Bulletin article (<http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07draft.pdf>) on the 2007 HMDA data, 169 institutions ceased operations and did not report HMDA data in 2007; 167 of these institutions were independent mortgage companies not covered by CRA. A large number of these institutions closed due to unsafe and unsound lending practices.*

37 *See December 2004 Office of Thrift Supervision exam for Indymac, FSB; September 2005 FDIC exam of Fremont Investment and Loan. The FDIC Cease and Desist Order against Fremont of March 2007 and FDIC CRA exam of Fremont, dated August 2008.*

38 *The Gramm-Leach-Bliley Act of 1999 mandates that the frequency of CRA exams for small banks with assets below \$250 million depends on their most recent rating. Small banks with a Satisfactory rating will undergo a CRA exam in four years; small banks with an Outstanding rating will undergo a CRA exam in five years. For the text of the Gramm-Leach-Bliley Act, see <http://thomas.loc.gov/cgi-bin/query/z?c106:S.900>.*

39 *While the benefits of more frequent exams are clear, the costs of more frequent exams appear to be minimal. In their analysis on small-bank burdens, the federal banking agencies have found that CRA regulations "impose a modest information collection burden on small institutions – an average of ten burden hours per institution per year." Federal Register 64, no. 103, May 28, 1999, 29083–86.*

sound than the banks and/or that they will offer a smaller portion of loans than banks to low- and moderate-income communities. Credit unions and independent mortgage companies do not offer as high a percentage of home loans to LMI borrowers as banks. NCRC's fair-lending investigation, discussed above, revealed that 26 of the 35 institutions engaged in redlining and other discriminatory practices were independent mortgage companies not covered by the CRA.

Congress needs to follow the example of the state of Massachusetts, which has covered credit unions with the CRA for a number of years and also recently enacted a community reinvestment requirement for mortgage companies. Similarly, the CRA Modernization Act of 2007 would require the application of the CRA to independent mortgage companies, and it would also require the application of the CRA to insurance companies by imposing HMDA-like data-disclosure requirements. A number of states already collect and provide data on insurance provision to the general public.⁴⁰

Moreover, the CRA Modernization Act of 2007 would require the application of the CRA to securities firms. CRA exams would measure the extent to which securities firms are serving LMI and minority consumers. Wealth building would be augmented considerably if more people of modest means and minorities had access to mutual funds and similar products. In addition, if a law channeled more securities firm investments into minority and working-class neighborhoods, the economic development prospects of these communities would be significantly enhanced.

IX. Conclusion

In light of the present-day lending crisis and its disparate impact on minority and LMI communities, the CRA needs to be modernized and enhanced. The CRA has been effective in bringing trillions of dollars in loans, investments, and services to LMI communities, yet too many LMI and minority communities are still left out of the financial mainstream. If America is to become a truly financially inclusive society, the application of the CRA to banks by federal agencies needs to be strengthened. In addition, the CRA needs to be applied to nonbank financial institutions. The CRA's effectiveness will be bolstered further if reforms

are initiated that facilitate community participation.

In summary, the following steps need to be taken:

Improve CRA Exam Criteria

- Assessment area procedures must be reformed so that a great majority of a bank's loans are on CRA exams.
- All nondepository affiliates of banks must be included on CRA exams.
- CRA exams should explicitly consider lending, investments, and services to minority borrowers and communities.
- Federal agencies need to enhance the rigor of the Service Test and increase data collection of bank deposit accounts (at least by income level) of neighborhoods. The Community Development Test for Intermediate Small Banks must also examine branching and deposit accounts more strenuously.
- CRA exams should separately consider purchases and loan originations, as well as prime and high-cost lending.
- The quality of CRA small-business data needs to be enhanced through the disclosure of the race and gender of the small-business owner.

Improve CRA Ratings

- CRA grade inflation needs to be counteracted by increasing the number of possible ratings.
- The ratings appeals process should be either nullified or made transparent with an opportunity for public comment.
- Low scores for any assessment area should trigger regulatory enforcement, including the submission of improvement plans.
- The rigor of CRA exams must increase, particularly for the largest banks, which are now less likely to merge. CRA exams thus become the major means of CRA enforcement for the new megabanks.

Bolster the Merger Application Process and Public Participation

- The agencies should hold more public hearings on merger applications and issue more conditional merger approvals.
- Merger approvals and CRA exams need to contain an "expectations" section detailing specific

⁴⁰ Gregory D. Squires, Sally O'Connor, and Josh Silver, *The Unavailability of Information on Insurance Unavailability: Insurance Redlining and the Absence of Geocoded Disclosure Data*, *Housing Policy Debate* 12, no. 2, Fannie Mae Foundation, 2001.

improvements the agencies expect banks to undertake. Even in cases of merger approvals and passing CRA grades, balanced and comprehensive discussions in “expectations” sections could motivate enhanced lending, investing, and services by banks.

Bolster Federal Agency Antidiscrimination Reviews

- The CRA’s scrutiny of illegal and predatory lending practices should become more transparent and rigorous.
- Safety and soundness exams should be integrated with fair-lending reviews and CRA exams.
- Increase the frequency of Small Bank CRA Exams.
- The stretch-out of the Small Bank CRA exam cycle needs to be eliminated. Small banks should be examined as frequently as Large Banks.
- Extend the CRA to Cover Nonbank Institutions, Including credit unions, securities companies, mortgage companies, insurance firms, and investment banks. ■

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Mr. Taylor serves on the board of the Association for Enterprise Opportunity. He has also served on several national boards, including the Consumer Advisory Council of the Federal Reserve Board, The Fannie Mae Housing Impact Division, The Freddie Mac Housing Advisory Board, and many others. In 2005 and in 2006, he was named by The Non-Profit Times as one of the top 50 most influential non-profit leaders in America.

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