PERSPECTIVES AND PROPOSALS ON THE COMMUNITY REINVESTMENT ACT

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BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

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PERSPECTIVES AND PROPOSALS ON THE COMMUNITY REINVESTMENT ACT

Thursday, April 15, 2010

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Luis V. Gutierrez [chairman of the subcommittee] presiding.

Members present: Representatives Gutierrez, Watt, Moore of Kansas, Waters, Hinojosa, Baca, Green, Clay, Cleaver, Perlmutter; Hensarling, Royce, Garrett, Neugebauer, Lee, and Paulsen.

Chairman GUTIERREZ. This hearing of the Subcommittee on Financial Institutions and Consumer Credit will come to order.

Good morning, and thanks to all of the witnesses for agreeing to appear before the subcommittee today. Today's hearing will examine proposals for improvements to the Community Reinvestment Act, given the changes in the financial services marketplace over the last decade.

We will be hearing from the lending industry, the advocacy community, and the academics on their perspectives of how CRA should be improved to make it more effective in its goal of increasing access to credit in low- and moderate-income neighborhoods.

We will be limiting opening statements to 10 minutes per side, but without objection, all members' opening statements will be made a part of the record.

We may have members who wish to attend, but do not sit on this committee. As they join us, I will offer an unanimous consent request for each member to sit with the committee and ask questions, when time allows.

I yield myself as much time as I may consume.

So much of the news we see and hear concerns Wall Street bankers. Today, we will focus on the other end of the spectrum. We will look at the safeguards for the little guy.

The Community Reinvestment Act is one of the programs that keeps our communities moving and keeps the economy moving. It literally ensures that the lifeblood of the economy—small businesses, homeownership, and investments in low- to moderate-income communities—keeps flowing.

The Community Reinvestment Act is one of the most important legacies of the civil rights struggles of the 1960's, that resulted in landmark consumer rights legislation, such as the Fair Housing

Act, the Equal Opportunity Credit Act, and the Home Mortgage Disclosure Act.

These laws have become indispensable for consumers and are often taken for granted in our current political environment. These laws help to give all of our citizens access to affordable credit, credit that is safe, free from bias, and free from discrimination, based on income, race, or even something as simple as the zip code where someone lives or the ward in which they vote.

As good a job as CRA has done over the past years, there remains so much more for this committee and this Congress to do. Minority communities have been targeted by non-CRA mortgage brokers for predatory loans, and many in our communities continue to rely on high-cost lending for paycheck-to-paycheck survival.

Lending to underserved communities has increased by the CRA. That is a documented fact.

At the same time, however, the FDIC announced in December that even though 75 percent of the banks they surveyed were aware of significantly underserved populations in their market area, only 18 percent of them included expanding access to credit to those communities as a priority in their business strategy. And that is unacceptable.

The CRA has done amazing things for our communities. As Mr. Taylor of the NCRC says in his written testimony, $4.6 trillion has been invested in our neighborhoods since the passage of the CRA through bank commitments, including $60 billion in small business lending in 2008 alone.

And this is at a time when lending on all other fronts was decreasing nationwide. In order to help our constituents recover from the current recession, to help them stop paying outrageously high fees for check cashing and payday loans, and to help our small business owners buy that new truck, that new oven, or even hire those new workers, we must do what we can to expand the CRA obligations beyond its current scope.

We must find ways to give Americans increased access to credit as well as find new ways to incentivize lenders to increase lending to underserved communities.

I look forward to working with the financial services industry, stakeholders, and low- to moderate-income communities, Federal banking agencies, and Members of Congress to help make the CRA's goals of affirmatively providing affordable access to credit to all of our communities a more expansive reality.

And before I close, I thought I would save the other side some time and allow them to focus on more substantive remarks and questions by stating that in no way did the CRA cause, facilitate, or exacerbate the mortgage crisis.

I don't think I can be clearer than that. What do Chairman Bernanke, Chairman Bair, Comptroller Dugan, Federal Reserve empirical studies, Business Week, and the Financial Crisis Inquiry Commission's great study have in common? They all agree the CRA did not cause the crisis.

Let's bear in mind the CRA was adopted to end redlining, a practice by which banks would literally draw a red line on a map around neighborhoods, usually where minorities lived, in which they did not want to offer financial services or capital to grow the economy. Let's talk about how to more effectively combat redlining today, and not about the red herring of CRA allegedly causing the financial crisis.

So now that we don't have to deal with that distraction, we will have much more time to talk about constructive issues, like how to incentivize participation in the CRA and expand the benefits of this law to more and more Americans who are struggling to build a better life for themselves, their families, and the communities in which they live and work.

I now yield to the ranking member, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman.

I believe that the Community Reinvestment Act has had a proud genesis. Thirty-three years ago, in 1977, redlining was clearly not insignificant. Too many low-income and minority individuals' credit opportunities were limited to a handful of banks that might have been reachable on a city bus route.

But years later, much has changed. Interstate banking, branch banking, Internet banking, and risk-based pricing all have helped revolutionize and democratize credit in our society as never before.

If you can gain access to the Internet at a public library, if you have access to a telephone to call a toll-free number, you can unlock countless credit opportunities for credit cards and home loans that were simply unavailable years ago.

Market competition from companies such as LendingTree.com, BankRate.com, CardHub.com, and many, many others, now provide low-income Americans with a platform to access competitive bids on financial products all across the United States, not just in localized geographic communities. In fact, the concept of a localized geographic community for banks is simply antiquated.

Now unfortunately, the recession, not to mention anti-consumer legislation which has been passed by this Congress, continues to erode credit opportunities for many of these low-income Americans.

That is regrettable; but it brings us to the great irony of this hearing yet again. Thirty-three years ago, if you examine the Congressional Record, what you see is the debate surrounding CRA was all about financial institutions denying credit opportunities to low-income and minority individuals.

Now today, much of the debate is about greedy financial institutions exploiting low-income and minority individuals by making too much credit available to these communities. So it begs the question: Is it too much or is it not enough?

Regardless of what CRA was, today it is a costly and redundant anachronism that has contributed to our economic crisis, and still enables certain activist groups to essentially shake down financial institutions, harming credit and job opportunities for all Americans.

Federal Reserve data has shown that well over 99 percent of all banks are already in full compliance with CRA; yet we know that community banks can spend up to $90,000 a year just to prove compliance.

Again, it begs the question: Are we simply having banks pay all these great sums of money to prove that they're doing something they would do anyway? Do you really have to force a bank to make a profitable creditworthy loan? And if not, are we forcing them to make loans to a universe of people that they may not otherwise make loans to; and these loans may not be financially sound loans, and indeed, they may be loans that help contribute to our economic crisis?

And when we talk about CRA loans contributing to the economic crisis, I have long contended it wasn't the size of the loans, it wasn't the number of loans, but it was one more precedent, where the United States Government put its imprimatur on a system that did not raise up the economic opportunities of the borrower, but instead lessened the credit standards of the lender. Thus, it played a role.

Also, every community banker I speak to tells me that equal or second only to BSA, CRA is their most costly compliance matter. If they simply had the money that they are spending on compliance costs, they would instead be able to capitalize at least several small businesses in their community and create hundreds of jobs.

Mr. Chairman, I would like to yield myself an additional 30 seconds.

Chairman GUTIERREZ. Absolutely.

Mr. HENSARLING. Shouldn't jobs be the number one priority of this Congress? Clearly it is not, though. Under the policies of Speaker Pelosi and President Obama, almost 4 million of our countrymen have lost their jobs since the President has been inaugurated. And we have the highest unemployment rate we have had in a quarter of a century, not to mention a tripling of national debt.

One thing our committee could do that would take a positive step in creating more jobs in America is simply to repeal CRA.

Today, I will be introducing legislation to do just that, and I urge its consideration.

Thank you, Mr. Chairman. I yield back the balance of my time.

Chairman GUTIERREZ. The gentleman yields back the balance of his time.

Do we have any members on our side seeking time? Seeing none, Mr. Royce is recognized for 3 minutes.

Mr. ROYCE. Thank you, Mr. Chairman.

If we can learn anything from the recent crisis, it should be that giving private entities public missions is fundamentally flawed.

The most glaring case was Fannie Mae and Freddie Mac, which, as Alan Greenspan put it last week, "paid whatever price was necessary" to reach affordable housing goals which were so important to their allies in Congress. This led to the GSEs taking on well over $1 trillion in junk loans, which then led to the GSEs' failure, and the collapse of the housing market.

No one has said that CRA was the primary cause of the housing crisis. What economists have argued is that CRA was a contributor to this problem. CRA falls in the same category as Fannie and Freddie. Mandating that private institutions offer loans they otherwise would not offer contributed to the erosion of credit standards throughout the market.

We can't have a situation where we in Congress muscle down 20 percent downpayment rates to get them down to 3 percent or zero percent, by the way, and not think that is going to have an impact.

And along those same lines, CRA also acted as a bargaining tool for activist organizations. The CRA requirement that banks have good CRA records for regulatory approval of a merger or acquisition gave groups like ACORN ammunition to shake down financial institutions. And that's what they were doing, shaking down financial institutions for either direct contributions or affordable housing commitments.

According to the 2007 annual report of the National Community Reinvestment Coalition, the four largest U.S. banks—Citi, Bank of America, Wells Fargo, and JPMorgan Chase—or their predecessors had made commitments under the CRA to make more than $4.5 trillion in CRA-type loans between 1993 and 2007. Countrywide Financial, through a HUD program, created their own affordable housing goals and committed to make $1 trillion in loans to low- and middle-income borrowers.

While a number of those loans went to creditworthy borrowers, many did not. And by 2008, these programs resulted in over 2 million high-risk loans. With respect to all loans made under CRA by some instruments, half were made to borrowers who made downpayments of 5 percent or less, or had below prime credit scores, both characteristics that indicated a high credit risk.

Instead of expanding this unsound law, I believe it should be significantly scaled back, or abolished altogether.

If the goal is to ensure that lending practices are not based on race or where an individual lives, many experts agree that enforcing the existing fair lending and antitrust laws would get us there, if they were enforced.

I look forward to hearing from our witnesses today, and I yield back.

Chairman GUTIERREZ. Mr. Watt, you're recognized for 2 minutes.

Mr. WATT. Thank you, Mr. Chairman. I was going to pass and go to the witnesses. But I got kind of provoked by the ranking member's statement. Because I have this recollection of a time, when I came to this committee, and CRA and many of these financial services issues were bipartisan, non-partisan, non-philosophical issues.

I won't go into a line-by-line refutation of our ranking member's statement. I just think it's a sad commentary on what has happened to this committee and the leadership on the Republican side; and perhaps what has happened to the whole Republican side of every issue, which is just so far out there that nobody can embrace it, except the most radical extremist.

And I thought this committee, I had hoped, was exempt from that. But I'm saddened to find we simply are not. So I'll just yield back, and let my statement stand for that.

Chairman GUTIERREZ. The gentleman yields back his time. And we have Congresswoman Maxine Waters, who is recognized for 3 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman.

Let me begin by saying that I consider the Community Reinvestment Act to be one of the most significant pieces of legislation to help low-income and minority communities since its enactment in 1977.

The CRA was necessary because financial institutions were discriminating against lower income and minority communities, in a practice we now call redlining.

I remember too well the days of redlining. When I entered the California State Assembly back in 1976, prior to the passage of CRA, whole communities were excluded from mortgage opportunities, simply because financial institutions chose not to lend to them.

The CRA was an important step to correct this problem, and did so by creating an explicit promise between federally insured banks and the government.

If banks met the credit needs of their entire community, including minority and low-income borrowers, they would be permitted to expand and grow their businesses.

Since the passage of CRA, small business lending and low- and moderate-income tracts increased from $33 billion in 1996 to $60 billion in 2008.

Furthermore, community development lending grew from $18 billion in 1996 to $73 billion in 2008. It is clear that CRA has played a large role in increasing homeownership, decent affordable renting housing, small business ownership, and community development investments that would not have been possible otherwise.

Yet, despite this data, critics have blamed CRA as one of the factors that led to the financial crisis for providing more lending opportunities to lower-income communities. We just heard a bit of that.

And I continue to hear that with the tightening of credit, banks are making fewer and fewer loans to small, minority, and women-owned businesses.

The facts demonstrate that CRA is not to blame, and these underserved populations should not bear the brunt of such unfounded claims.

According to a recent study, based on HMDA data, CRA banks were significantly less likely than other lenders to make high-cost loans, and the average APR and high-cost loans originated by CRA banks was appreciably lower than those by other lenders.

Furthermore, it must also be noted that the largest financial institutions that are refusing to lend to underserved populations are the same banks that received billions in TARP payouts last year. They're taking taxpayer dollars, but failing to serve the communities that need it most.

If we are to recover as a nation, then we must do it together by making sure that our underserved communities are provided the same access to credit and lending opportunities as our most served communities.

That is why CRA is so important. As we move forward, we must make sure that we not only strengthen enforcement of the current role of CRA, but that we also improve upon the role of CRA, so that it can continue to help underserved populations gain access to homeownership, and community development opportunities, and help restore our economy.

I look forward to hearing from today's witnesses about the ways in which we may further modernize CRA, and how CRA can be used to provide greater banking opportunities to underserved populations, while helping to restore the national economy.

Thank you, Mr. Chairman. And I yield back the balance of my time.

Chairman GUTIERREZ. We now will hear from the witnesses. We have Mr. John Taylor, who is the president of the National Community Reinvestment Coalition. You are recognized for 5 minutes, Mr. Taylor.

STATEMENT OF JOHN TAYLOR, PRESIDENT AND CEO, NATIONAL COMMUNITY REINVESTMENT COALITION (NCRC)

Mr. TAYLOR. Thank you, Chairman Watt, and Ranking Member Hensarling, as well.

CRA is one law that has worked well for America's blue-collar working-class people. CRA loans are made safely and soundly. CRA loans are not to be confused with the predatory and malfeasant loans made by institutions not covered by CRA, that brought down the American economy.

In 1977, a very wise and thoughtful Congress dedicated to helping all Americans achieve their version of the American Dream, passed this law, this CRA, for two very important reasons:

First, that Congress was not focused on just bailing out banks, but was rather making sure that our financial services system made loans to regular people, not only the well-heeled.

Second, Congress determined that since the American taxpayer was on the hook for ensuring that people who made deposits and investments in these banks, they wisely concluded that it was important that such banks not only loan to the rich and big corporations, but to small business owners and to first-time home buyers, and to those working their way up the economic ladder.

And the results are in. CRA has been an outstanding success. It is now well-documented that the significant lending increases and investment and service increases have been made safely and soundly to low- and moderate-income and blue-collar working-class Americans.

For example, just taking the period 1996 to 2008, the total small business lending done under CRA was over $641 billion. The total community development lending under CRA for that brief period, which community development lending is about rental housing, economic development projects, community facilities, that totalled over $480 billion. Now that's over a trillion dollars of private investments—not government investment, but private investment—in low-and moderate-income communities. That's making capitalism work fairly for everybody. With 33 years of success story under CRA, there are also lessons learned on how to improve this vital law. Please see my detailed comments on pages 40 to 43 of my testimony.

But let me just highlight a few brief recommendations.

First, we need to expand CRA coverage for existing CRA-regulated banks, to include all their affiliate lenders and to where they do a significant amount of business. We need to expand CRA's coverage to all financial institutions. Credit unions, insurance companies, independent mortgage companies, and investment banks should all have an affirmative obligation to safely and soundly loan to all Americans working their way up the economic ladder.

Second, we must increase the opportunity for women business owners and others to have more access to small business loans, by removing the veil of secrecy that now exists in banks, as to whom banks are making these loans to.

As we do in housing loans, we need to have the banks report the details on their business loans. Are they loaning to only the well-heeled and big businesses? Or are they loaning to women-owned businesses, small businesses, minority-owned businesses, and others?

Modernize the system for grading banks under CRA with more specific and detailed measures on how they are actually performing and making their loans available to working-class Americans.

Finally, strengthen the enforcement mechanisms under CRA by requiring public comment hearings on major mergers. And if banks fail to pass the CRA exams, require them to improve, or penalize them for their bad behavior.

CRA is about making capitalism work safely and soundly for the little guy and gal, not just about Wall Street and making the market work for Wall Street and big banks.

For the remainder of my time, I want to address something that Representative Hensarling said, because I want to make sure that everybody in his district who watches C-Span understands that their elected official is actually arguing to end the system which says banks can't ignore them as a working-class American—and you have to have someone in Dallas and you have to have someone in California—that this Representative is actually proposing to end a system that has worked very well, that would allow for safe and sound investments for working-class small business owners, all these people, Tea Party, and all these other people who are arguing that the banks aren't lending and we're bailing out the banks, that your Representative in Dallas, Texas, is arguing to end the system that says, "Hey, if you can pay the loan, and you're a hard-working American, and you're willing to pay your taxes, and you're willing to play by the rules, you should have access to the financial services sector," that they shouldn't just ignore you and only loan to the rich and the well-heeled and the big corporations.

That's what you're proposing, Representative Hensarling.

And let me just say, on this shakedown comment you had, I'll tell you, in my opinion, nobody shakes down the banks better than the Members of Congress.

You yourself have received over $200,000 in contributions from financial institutions over the last 2 years. And that goes directly to you keeping your job. That is not what community organizations do.

Community organizations sign CRA agreements with these banks to get them to make loans to underserved people, not loans to their campaign, that's going to keep them in office and keep them getting re-elected.

So I would be careful about where you point your finger and accuse people of shakedowns.

Thank you for the opportunity to comment.

[The prepared statement of Mr. Taylor can be found on page 139 of the appendix.]

Chairman GUTIERREZ. The time of the gentleman has expired.

Next, we have Cy Richardson, who is the vice president of housing and community development for the National Urban League.

STATEMENT OF CY RICHARDSON, VICE PRESIDENT, HOUSING AND COMMUNITY DEVELOPMENT, NATIONAL URBAN LEAGUE

Mr. RICHARDSON. Chairman Gutierrez, and Ranking Member Hensarling, thank you for the opportunity to share the perspectives and proposals of the National Urban League on CRA.

Today's hearing falls squarely within the economic empowerment discourse, both nationally and in our local communities.

Given the limited time allotted, my remarks will focus on some general recommendations for modernizing and strengthening the core purpose and utility of CRA, followed by some specific ideas for amendments of the service test, an important and highly visible core component of CRA.

I would request that my full written testimony be entered into the official record, please.

Chairman GUTIERREZ. Without objection, it is so ordered.

Mr. RICHARDSON. Before I share the Urban League's views and proposals along these lines, it is important to first address, head-on, as Mr. Taylor did, some of the disturbing and unpleasant rhetoric that surfaced during the recent period of dissonance concerning CRA and the foreclosure crisis.

In the wake of the subprime meltdown, some observers and commentators have perpetuated a dangerous myth that minority and low-income borrowers, and measures to expand the opportunities for homeownership, such as CRA, were responsible for the subprime crisis. However, a number of recent reports and studies have forcefully debunked these attacks on the CRA.

Our analysis indicates that the CRA has been effective in ensuring access to fairly priced credit for low- and moderate-income borrowers, as lenders covered by CRA are far less likely to make higher-cost loans than those not covered.

These are the facts; yet a considerable amount of time and care has been spent, and indeed will continue to be spent, disarming what the president of the Urban League, Mark Morial, termed "weapons of mass deception," under which this line of argument generally falls.

In our judgment, Congress must:

One, keep the Act fundamentally intact and seek to build on its strength by fine-tuning the measurements to remain in step with shifting markets.

We also call for a revitalized role for the public, particularly in light of the current priorities of regulatory agencies.

The following changes, among others, would allow the test to more effectively measure a bank's performance and should be included under an expanded reporting rubric.

Since many lower-income people do not live in lower-income zip codes, examiners should conduct sample surveys of the income and race and ethnic distribution of an institution's retail customers, to determine the percent of those customers who are lower income and members of minority communities.

Examiners should also construct and report a systematic analysis of quantitative data of the number and income rates of customers who use alternate ways of accessing financial products—telephone, Internet banking, smart ATMs, etc.,—and those who facilitate wire transfers to other countries.

Banks should report data on the services they provide to unbanked households and their success in using those services to recruit new customers.

Examiners should carefully examine banks' relationships with high-cost fringe lenders, for example, and determine whether those fringe lenders' disclosure activities, costs, terms, and conditions have a deceptive impact on their customers.

Banks should be required to report quantitative details of the community development services, including the number of people who attend financial literacy events and seminars, and the number of accounts that result from such events.

Finally, banks should also be examined to see whether they effectively market savings products to lower-income consumers.

Moreover, with regard to small business lending, we believe CRAs should monitor bank-lending activities to small and minority businesses, to determine if their current lending practices are user-friendly for these business concerns.

And CRA should also include an evaluation of bank participation and collaboration with local nonprofits, who themselves provide microlending to small businesses.

Bringing the Community Reinvestment Act into the 21st Century requires the same kind of care and creativity that fostered the Act in 1977, and provided for its reform in the 1990's.

The CRA has established that it can help meet the needs of low- and moderate-income individuals and communities and their material needs. Indeed, after the crisis caused by the subprime turmoil rolls through these neighborhoods, their problems are likely to be even more acute.

Finally, given the impetus for this important hearing, we strongly believe that CRA could become an even more powerful and catalytic engine to revitalize low- and moderate-income communities, coming to the fore just when the government's ability to use tax revenues to pay for infrastructure improvement and to invest in urban development is greatly diminished.

Thanks for the opportunity to comment. And I'll take any questions. Thank you.

[The prepared statement of Mr. Richardson can be found on page 123 of the appendix.]

Chairman WATT. Thank you so much, Mr. Richardson.

William Askew is the senior policy advisor at the Financial Services Roundtable. And he's next, please, for 5 minutes.

STATEMENT OF WILLIAM E. ASKEW, SENIOR POLICY ADVISOR, THE FINANCIAL SERVICES ROUNDTABLE

Mr. ASKEW. Mr. Chairman, Ranking Member Hensarling, and members of the subcommittee, I'm William E. Askew, senior policy advisor for the Financial Services Roundtable, on whose behalf I am appearing today.

Thank you for the opportunity to address the Community Reinvestment Act. The CRA was enacted to promote loans and services to low- and moderate-income neighborhoods and residents of those neighborhoods.

Since its enactment, the Act has more than achieved its goal. CRA has become an open and consultative community process. All of the participants in the process, including lenders, regulators, and community organizations, have become more sophisticated, and focused on how best to achieve the goals of the statute.

And most importantly, CRA has generated billions of dollars in new loans and investment services in both urban and rural areas around the country. This success story is well-documented.

Despite this record of success, we believe there is still room for refinement of the implementation of CRA, so institutions and community groups can better achieve the goal of the Act.

In the balance of my testimony, I'll outline recommendations for enhancing compliance with CRA. I'll also address the need to maintain the focus of CRA.

Today the overwhelming majority of banks receive a satisfactory CRA rating, and only about 10 percent achieve an outstanding rating. This result should not be surprising. Achieving an outstanding rating requires considerable effort and expenditure on the part of banking institutions, as well as just complying satisfactorily.

We believe that even more banking institutions should pursue this top rating. Toward that end, we recommend that the Federal banking agencies institute some measures to encourage more banking institutions to obtain an outstanding CRA rating.

In my written testimony, I list some specific actions the agencies could take.

Although the existing CRA regulations and interpretations encourage examiners to give extra consideration to projects and activity that are innovative and complex, our members observe that such recognition is, in fact, rare.

We recommend that the Federal banking agencies pay greater attention to innovative and complex loans and investments in conducting CRA examinations.

For example, CRA examiners should consider a bank's efforts to open and maintain homeownership preservation offices in low- and moderate-income neighborhoods, and banks programs, to systematically offer and sell deep discounts or donate properties to local community-based organizations.

The CRA regulations already acknowledge the unique character of an individual banking institution by encouraging institutions to perform their own performance context assessments in advance of CRA examination.

We recommend that the Federal banking agencies encourage examiners to give sufficient attention in regard to these assessments and the conduct of the CRA examinations, rather than just relying on quantitative pure comparisons.

In recent years, CRA examiners have placed an emphasis on mortgage lending. We recommend that the Federal banking agencies encourage examiners to give institutions sufficient recognition for non-mortgage-lending activity, such as lending to small businesses, to small farms, and community developmental lending.

Given the successful implementation of CRA, we do not favor fundamental changes to the statute. For example, we do not support the extension of CRA to securities, brokerages, mutual funds, and insurance companies. CRA has succeeded because it is linked to the charter obligation of banks and thrifts to meet the convenience and needs of their local communities.

It should not be assumed that extending CRA to institutions that are not subject to a similar obligation would be successful.

In summary, CRA has helped to transform urban and rural communities throughout the United States. The members of the Roundtable are very proud of the role they perform under the Act. We believe that with some minor refinements, the Federal banking regulators can encourage even greater benefits for local communities.

We also believe that now is not the time to change the focus for CRA. We should write a new chapter in the story, but we don't need to rewrite the story.

Thank you. And I'm happy to answer any questions you may have.

[The prepared statement of Mr. Askew can be found on page 44 of the appendix.]

Chairman GUTIERREZ. Thank you so much, Mr. Askew.

And now, we're going to hear from Eric Rodriguez from the National Council of La Raza.

Eric, you are recognized for 5 minutes.

STATEMENT OF ERIC RODRIGUEZ, VICE PRESIDENT, OFFICE OF RESEARCH, ADVOCACY, AND LEGISLATION, NATIONAL COUNCIL OF LA RAZA (NCLR)

Mr. RODRIGUEZ. Thank you, Mr. Chairman, Ranking Member Hensarling, and members of the subcommittee. It's a great privilege for us to be here.

As you have already heard, CRA is one of the most important tools the public has to ensure that neighborhoods and communities with low-income families have fair and affordable access to mainstream banking services.

The Act has helped to revitalize neighborhoods, and enable nontraditional borrowers, including many Latinos, to gain services. The Act has also helped to ensure that Latinos benefit directly from investments made by large mainstream banks, that might otherwise have left the community underserved, in many ways agreeing with what my colleague here said about many of the successes of the CRA.

But it is a good time for us to revisit CRA.

I think it's clear that at its peak, banks covered by CRA increased lending activity in low-income communities, increased the share of their loan portfolios with CRA covered loans, and outpaced similar growth in lending to low- and moderate-income families compared to non-CRA covered institutions.

Despite many of these important outcomes, developments in the financial markets, as you have already heard, have eroded some of the effectiveness of CRA. But the base purposes of this law are very strong, and the need for government and continued government intervention in mainstream markets is also very strong.

I'll give you a few examples.

One, policy and practices among regulated mainstream financial institutions have evolved over time to provide prime loans to only those individuals with long and well-established credit histories.

Automated underwriting practice by mainstream regulated financial institutions is an innovation that, in fact, minimized arbitrary and potentially discriminatory lending decisions by bank loan officers.

But it has also meant higher costs for mainstream banking institutions to serve effectively non-traditional borrowers. This high cost has often resulted in some credit rationing that effectively and unnecessarily pushed creditworthy, nontraditional borrowers, including young, foreign-born, minority, and other creditworthy borrowers into subprime markets, where predatory lending thrived.

Second, many banks now, as you have already heard, conduct business well beyond the walls of their branches. CRA-covered institutions acquired non-covered affiliates and expanded their customer base through new delivery channels, such as mortgage brokers on the Internet. Regulated banks broadened their reach, without proportional increase in CRA coverage.

Finally, an issue that's important is grade inflation through exams, which I think has really undermined accountability in the system overall.

As the effectiveness of CRA has waned over the years, providers of alternative forms of credit gained more presence and reach into low-income communities, the proliferation of non-covered institutions, including many unscrupulous lenders in low-income neighborhoods undermined the main goal of CRA to provide affordable credit to these residents.

And yet the goal remains critical today and likely well into the future that we encourage investment in communities.

To begin with, this decade has experienced a marked growth in influx of immigrant workers into low- and moderate-income neighborhoods. Many of these residents are non-traditional borrowers, who in many cases have short credit histories, and often no credit scores.

Paradoxically, their thin credit files are often the product of highly sensible financial practices, such as paying in cash, avoiding debt, and limiting their use of credit cards. In addition, many Latino minority and low-income families today remain unbanked; hold high-interest credit cards; have become dependent on small-dollar and short-term loans such as payday and car title loans; are charged unnecessary fees for auto loans; and remain more likely to receive high-cost mortgages. This is in spite of their creditworthiness.

In view of these disparities, it should be no surprise that the United States continues to maintain a persistent and staggering wealth gap between minority and White households.

And as you know, this has severe implications on the socioeconomic development of the Nation, as Latinos and minorities become a greater share of the U.S. population through 2050.

But CRA has good elements in place. It's flexible, it leverages State and local resources, and was at its best when it had extensive coverage and meaningful measurements.

I echo many of the recommendations that my colleagues have already put out there so far. And I would underscore that two important main goals need to be considered as we look at modernization: first, we have to make sure that we preserve and expand the aspects of CRA that encourage product innovation, lending, and services that are critical to helping low-income Latino families have access to affordable credit and build wealth; and second, we have to solidify incentives to direct capital toward community and economic development projects that would otherwise not gain support.

Thank you.

[The prepared statement of Mr. Rodriguez can be found on page 130 of the appendix.]

Chairman GUTIERREZ. Thank you.

Next, we have Calvin Bradford, a board member with National Peoples' Action.

You are recognized for 5 minutes.

STATEMENT OF CALVIN BRADFORD, BOARD MEMBER, THE NATIONAL PEOPLE'S ACTION

Mr. BRADFORD. Thank you, Chairman Gutierrez, and Mr. Hensarling.

As you recall, Mr. Chairman, the organizing that started to develop around CRA began in Chicago and in your neighborhoods. And I had the pleasure 34 years ago to work with Gale Cincotta of National Peoples Action, and Senator Proxmire and his staff, and officials from the South Shore Bank in Chicago, in drafting Senate Bill 406, which became the Community Reinvestment Act.

I have already submitted our statement, which has a great deal of detail about some of the issues I want to raise and some of our recommendations. And so much has been already said. I would just like to try and take my time to supplement some of that.

The first thing is, as we face the contemporary environment, we have to restructure the Community Reinvestment Act, so that it deals with our present conditions in the financial market, and how things have changed.

One of those things that of course has changed is that we now have toxic loan products. Before, we only looked at trying to get every loan in the neighborhoods. Now we have to look at whether the loan has a discriminatory impact, or whether it has a detrimental impact on the community. And the law has to be revised to take account of that specifically.

Another critical development obviously has been the merging and acquisition by the bank holding companies, so that they include investment houses and insurance companies.

And a third one is the dominance of Wall Street over the growth and proliferation of financial markets, which wasn't the case in the past.

And we developed what I call a kind of three-legged askew stool for dealing with reinvestment in the mainstream and getting money out to Main Street.

On the one hand, you have Wall Street and the banking industry, which have at their disposal their inherent power in the markets. And ultimately, I'm afraid we have to admit the fact that their values are shared by the regulatory bodies.

Second, the Consumer Financial Protection Agency, which is the only real structure we have in our government to protect consumers from predatory lending, really hangs by a thread in Congress.

What we're left with, therefore, is the third leg, which is the community organizations, the consumer organizations and civil rights organizations, which rely on the Community Reinvestment Act for enforcement, and we have to strengthen their tools.

As a context for our recommendations, I just want to comment on sort of the good, the bad, and the ugly, about the present situation that we're in.

The good part we have already covered is the over $4 trillion approaching $5 trillion worth of investment in communities in this country. And I would just like to say that the congressionally-required study by the Federal Reserve Board of the risks of reinvesting loans showed that if you looked at community reinvestment programs themselves—that is, the specific programs for community reinvestment, the loss rate in these programs was exactly zero.

And so we have had this money invested.

And I also think it's important to point out as a context that the programs that have done this reinvestment have essentially all been created by community groups, or community groups in partnerships with banks. And so we have to look at that process.

The bad has been that over the years, the regulations for the Community Reinvestment Act have been stripped of their power. The community has been taken out. In my testimony, I talk about some of the weaknesses.

For example, there's an example of three national banks that were given high CRA ratings at the same time they were sued by the Justice Department for race discrimination. They literally cut out of their service areas the City of Detroit, the City of Gary, Indiana; and the largest lender in Chicago at that time cut out the north side, west side, and south side minority communities of Chicago.

In addition to that, I worked on lawsuits against a bank called Flagstar, which was twice found in violation of Federal fair lending laws in Federal court. And after the second time it violated those laws, the OTS raised its rating to outstanding.

So I think we have to deal with that issue.

We have to deal with the issue that oftentimes a lot of lending that's detrimental isn't counted. And I'm not talking just about subprime lending; I'm talking particularly about national banks, which not only made more loans than the Comptroller admits that were subprime, but they funded the subprime industry through lines of credit, warehouse loans. And in addition, on the other end, of course, the banks were involved in the securitization.

So the entire subprime market essentially was financed by our national bank system. And today, they're financing predatory payday loans. Those have to be taken into account as well. And they have not presently been taken into account. And some of the banks, like Wells Fargo we're now seeing are essentially making their own predatory payday loans.

So those things have to be fixed. I think there are three. I'll say in ending that there are three major issues that I would like to address, and I'll answer questions about.

When you're looking at how to reform CRA, the first thing is we need to improve on mortgage disclosure and other types of business disclosure. If nothing else happens, community people need to have better information. If we had had the information we asked for on the performance of loans in the past, we might have been able to avert a great deal of this mortgage meltdown. We could have told you which lenders were making bad loans where, 10 years ago, when the neighborhood was raising these issues.

And second, we need to look at all the various types of loans that are accounted, and particularly make any kind of fair-lending violation an automatic fail for CRA.

And third, we have to put accountability back in the system, and to a great extent, that means putting the community back into the system, and allowing for challenges and a wider role for challenging what the banks do.

Thank you.

[The prepared statement of Mr. Bradford can be found on page 52 of the appendix.]

Chairman GUTIERREZ. The time of the gentleman has expired. When the light turns yellow, you have 60 seconds, so start thinking about winding down at that point. Thank you so much.

Next, we have Mark Willis, resident research fellow at the Furman Center for Real Estate and Urban Policy at New York University. You are recognized for 5 minutes.

STATEMENT OF MARK A. WILLIS, RESIDENT RESEARCH FELLOW, FURMAN CENTER FOR REAL ESTATE AND URBAN POLICY, NEW YORK UNIVERSITY

Mr. WILLIS. Thank you very much, Mr. Chairman, and members of the subcommittee. I appreciate very much being invited to come to this hearing.

I just want to briefly mention that I come to this hearing, this topic, with 19 years of experience, where I oversaw the community development programs at JPMorgan Chase. The last year-and-a-half, I spent at the Ford Foundation as a visiting scholar, where I had the opportunity to write a couple of articles on how to rethink reform of CRA. And I also spent some years as an urban economist at the NY Fed, and was a New York City housing official.

So I, in some way, wear many hats, or am fortunate to have experiences from many different perspectives. At this hearing, I represent solely myself.

I am currently employed at the NYU Furman Center, where I am a resident research fellow. But I do solely represent myself.

I have submitted formal testimony. I will try and give a quick overview of that. I also can mention that I wrote a couple of articles while at the Ford Foundation, and I have a third on the way. I would be happy to share those with members of the committee as well.

As I say in my testimony, I think passage by Congress of the Community Reinvestment Act launched a bold experiment. CRA has played a really important role in helping to stabilize and revitalize many lower-income communities across the country. Others have made clear that it was not a driver of the subprime prices. I won't spend any more time on that.

But I do feel strongly that CRA has fallen short of its potential, and is losing ground. And so it is really important that we think about reforming it.

The bases for that reform are a couple of things. We have learned a lot over 33 years about what works and doesn't work. We have also seen huge changes in the banking world, that is no longer just local banks taking local deposits, making local loans that was the core of our banking system.

And we now have large national banks and Internet and industrial loan corporations serving national markets from a limited headquarters and limited deposit-taking geography.

We do need a major revamp, and I think also part of thinking through the revamp is the need to set up a system that can continually correct itself. The term in business is "continuous improvement." I think it's very important for us to think about not just how to change it one time here, but how to create something that will continually be able to adjust to changes in the marketplace and also, by the way, to changes in how we view the best practice in community development.

So I think there are a number of things that can be done here by Congress. The first is there are a number of aspects of the core of the legislation that could be looked at. And I'll talk about those in a second.

At the same time, I think it's important that Congress also encourage the regulators to move forward here. They have been chastened by past experience and lots of debate amongst stakeholders as to what the best way to go forward is. I think it's very important that they be encouraged to use the full discretion you gave in the original legislation, which is basically one line: To encourage banks to help meet the credit needs of local communities, and give the regulators more support here for them to go and make the necessary changes to make CRA more effective.

One reason I focus on the regulators is I think, at least in theory, that their process would allow more opportunity for continuous change. I think well-designed legislation is a deliberative process, and one that takes time, and is not one designed necessarily to keep up with the changes that we have seen over the last 33 years, and that we will continue to see in the industry and in community development.

As for specific areas for legislative consideration, obviously, you have heard discussion here about expanding to other financial services firms. There are two reasons to think about that.

One is to level the playing field, so that all those who compete with each other will have the same responsibilities in the communities, whether they are banks or non-banks.

And the other is the opportunity to bring more resources to the community development table. I think we have seen how successfully on a good business basis the resources from banks have been able to help low- and moderate-income communities. Obviously, if we could find ways to bring others in, to have the same constructive role, where everybody wins, would be a good idea.

I think you also need legislative consideration about expanding CRA beyond credit. I think the regulators have tried to include other issues than just expanding access to credit—

Chairman GUTIERREZ. The time of the gentleman has expired.

Mr. WILLIS. Okay.

Chairman GUTIERREZ. Your complete written statement will be in the record.

Mr. WILLIS. All right.

[The prepared statement of Mr. Willis can be found on page 187 of the appendix.]

Chairman GUTIERREZ. Next, we have the Honorable Eugene Ludwig. He is a former Comptroller of the Currency, and is now the CEO of the Promontory Financial Group. We're very happy to have him here with us this morning.

Welcome, Mr. Comptroller.

STATEMENT OF THE HONORABLE EUGENE A. LUDWIG, CHIEF EXECUTIVE OFFICER, PROMONTORY FINANCIAL GROUP, LLC

Mr. LUDWIG. Mr. Chairman and members of the subcommittee, I want to commend you for your leadership in holding—

Chairman GUTIERREZ. We want to hear your testimony.

Mr. LUDWIG. Okay.

Chairman GUTIERREZ. If you could just get that microphone a little closer. Thank you so much.

Mr. LUDWIG. Okay. Thank you, Mr. Chairman.

Chairman GUTIERREZ. You can start all over again.

Mr. LUDWIG. Mr. Chairman and members of the subcommittee, I commend you for your leadership in holding this hearing to discuss the Community Reinvestment Act and to consider enhancements that will advance the cause of equitable credit availability, promote sound lending practices, and otherwise ensure banking services are readily available in underserved communities.

I have a written statement I submitted for the record, so let me focus on the most important aspects of that statement, please.

As this committee knows all too well, the CRA often has been misunderstood and mischaracterized over the past 33 years. The truth is that the application of the CRA has been a considerable success. It has incented banks to provide hundreds of billions of dollars in loans—we have even heard today trillions of dollars of loans and services—to low- and moderate-income Americans.

These investments have transformed neighborhoods all over America for the better. And CRA lending has been profitable and safe, almost with exception.

Nevertheless, the CRA needs to be modernized, because the financial system and the methods for delivering financial services have changed in ways no one could have predicted when the CRA was enacted. And while the facts on the ground in the LMI neighborhoods and communities have changed as well, the heart of the problem the CRA was intended to solve remains. That is, the need for the financial services sector to deliver enough support to local communities.

Thoughtful research by respected economists and community development experts show there are identified market failures that require government action to address. I cite many of these studies in my written statement.

We now have some critics who blame the CRA for the subprime mortgage meltdown and the global financial crisis. I strongly disagree. It is not only implausible that lending to low- and moderate-income Americans could have such an outsized impact on the global economy; it is also demonstrably not the case, as I go into detail in my written statement.

It is important to note, however, the economic crisis is at this moment altering our perceptions about who LMI borrowers are and where they live. High rates of unemployment are swelling the ranks of LMI borrowers in every State. Those who are unemployed are without a job for the longest period of time since the government began keeping such records in 1948.

More and more LMI borrowers are not racial minorities, living in inner cities. Many unfortunate victims of the recession were plain-vanilla credit risks, until recently.

These are just a few of the reasons why the hearing is so timely and so important, Mr. Chairman. And again, I commend you for holding it.

The CRA is part of the solution to our current economic problems, not part of the problem. Small business has created over 64 percent of the Nation's jobs over the past 15 years, and the growth of small business depends on support from the banks, which is encouraged by the CRA.

Moreover, excellent studies by the government, which have been based on CRA data have also helped in the small business area.

So if we did not have CRA, we would want to enact it. It is the essential part of the tool kit for spurring sustainable economic recovery.

Now let me return to the question of the CRA and the subprime meltdown. CRA loans and subprime loans are often viewed as synonymous; but they are not. The CRA lender making CRA loans tends to have a social, or at least a non-predatory objective. The non-bank, non-CRA lender, or the modern subprime lender, is driven to sell as many high-rate loans as it can with no particular social motivation.

The subprime crisis resulted from practices that are the antithesis, the opposite, of the CRA lending goals and the CRA lending experience.

After 2000, the subprime mortgage market evolved in a direction that made other influences on that market far more important than CRA. In one of his last pieces of research, the late Federal Reserve Board Governor, Ned Gramlich, calculated from HMDA data that only one-third of CRA mortgage loans to low- and moderate-income borrowers have rates high enough to even be considered subprime.

Similarly, Tregaron Hinckley looked at banking companies that made CRA loans in the 15 most populous metropolitan statistical areas, and found they were more conservative in their lending practices than lenders not covered by CRA.

Since 2004, over half of the subprime loans went to upper-middle-income borrowers in non-LMI tracts. An analysis of the HMDA data by Compliance Tech finds that in 2006, about 67 percent of subprime loans were upper or middle-income borrowers. LMI borrowers received only 28 percent.

Chairman GUTIERREZ. The gentleman's time has expired—

Mr. LUDWIG. I realize I'm out of time.

Chairman GUTIERREZ. I really like your testimony, but I'm sorry, I went a little overboard in terms of the time, and I apologize to everybody. It's a bias.

[The prepared statement of Mr. Ludwig can be found on page 92 of the appendix.]

STATEMENT OF VINCENT REINHART, RESIDENT SCHOLAR, AMERICAN ENTERPRISE INSTITUTE FOR PUBLIC POLICY RESEARCH

Mr. REINHART. Thank you for the opportunity to discuss the Community Reinvestment Act. Redlining is pernicious. CRA was a successful legislative response to that societal failure. But it is appropriate to take time to consider how to best continue to achieve the mission of CRA. To do so properly requires examining four widely recognized failures.

First, CRA was designed with a "hydraulic" view of banking. Deposit funds generated in particular locales were leaking out, because of an unwillingness of bankers to lend. CRA was to act as the catch basin to keep those funds within the community. That was a flawed view, even in 1977, and is far more out of sync with today's reality.

Second, far more lending decisions were made off bank premises, whether by intermediaries such as mortgage brokers, or on the Internet. CRA's scope, therefore, is too narrow.

This declining bank share is not entirely driven by technology, however. Rather, compliance costs associated with CRA and other bank regulations gave non-bank providers a decided competitive edge.

Mortgage brokering, for instance, ran on under the radar screen of regulation to offer more varied products to poor communities. Sometimes, however, innovation slipped into predation.

Third, CRA gives broad goals without detailed requirements about how to achieve them. This leaves much to the discretion of supervisory agencies, much to their delight. But experience has shown that agency attention to such matters swings like a pendulum.

Fourth, enforcement of CRA is event-driven, really only getting teeth in advance of potential changes in ownership. As a consequence, bank management is especially vulnerable to interest groups that might lodge protests during the merger application process.

CRA is at a crossroads. The wrong path would be to increase the scale and scope of regulation to address CRA's apparent flaws. A more productive route is to recognize its design flaws.

First, CRA was written when finance was a brick-and-mortar industry. In this century, banks are less important and lending opportunities are far more varied.

Second, the financial crisis has shown that the mixed model of giving private entities a public purpose is a failure. Giving bankers diffuse goals that are only episodically relevant is a very inefficient means of extracting a quid pro quo for protection, and helping the underserved.

Third, CRA is one part of the government's overall policy of subsidizing housing. By construction, if the government oversubsidizes one activity, it disadvantages others.

The Congress would be better served by expanding opportunities to build capital, including through support of small businesses and increasing incentives for equity ownership.

If the Congress decides to continue the support of homeownership, there is a better path. Price the Federal safety net so there's an explicit quid pro quo for any protection to financial firms. Use some of those proceeds to subsidize the purchase of mortgage insurance for eligible borrowers in designated areas. Educate those households to opportunities to apply for loans, and enforce the existing Equal Opportunity laws if any of those who apply are wrongfully rejected.

The problem lies not with the mission of CRA, but rather in its execution. I ask that my prepared remarks be included in the record.

[The prepared statement of Mr. Reinhart can be found on page 118 of the appendix.]

Chairman GUTIERREZ. Thank you so much to all of you.

First, I guess I want to ask Mr. Askew, from the Financial Services Roundtable, could you, in 15 to 20 seconds, describe who you represent, in terms of America?

Mr. ASKEW. We represent the Nation's 100 largest financial institutions.

Chairman GUTIERREZ. And so it is, you're representing the Nation's 100 largest financial institutions. You have come here to say we should take a new look at CRA, but we shouldn't eliminate CRA. Is that essentially your testimony today?

Mr. ASKEW. I'm saying, yes, sir, and that it worked.

Chairman GUTIERREZ. And that it worked. Thank you very much. I just want it on the record that it's not just a cabal of liberals running around town, trying to get a program, between the 100 largest financial institutions have come and sent their representative here today.

I want to go to Mr. Ludwig. Mr. Ludwig, you were giving us very important data. And in essence, then, you have found from extrapolating the data that you have looked at, that there is no correlation between the financial crisis.

Why don't you, in 30 seconds, give us your sense of the financial crisis, the subprime loan, and what CRA did or didn't have to do with it?

Mr. LUDWIG. Mr. Chairman, the crisis that we have lived through has really nothing to do with the CRA. The banks should celebrate their CRA portfolios. They have been the safest part of community lending; they have increased dramatically over the last 33 years of the Act.

Prior to my time in office, there were 17 billion; from my time forward, it's been testified here today trillions of dollars of lending. And yet those CRA portfolios are safe.

What did happen, which created the crisis, was a misuse—part of one of the elements—was a misuse of the concept of lending to low- and moderate-income people.

Chairman GUTIERREZ. Let me, if I could just ask you, because I'm going to be very disciplined on my 5 minutes—just so that everyone here understands, the Comptroller of the Currency does exactly what succinctly, what did you have as a government official—

Mr. LUDWIG. Mr. Chairman, we regulate the national banks. And during my time in office, I was asked by the President to lead the regulatory community in a reform of the Community Reinvestment Act, which resulted in new regs in—

Chairman GUTIERREZ. So as someone who regulated the financial industry, it's your testimony that they should be happy that their CRA portfolio was there, because in balance, when they look at their CRA versus non-CRA portfolio, it did very well for the financial—

Mr. LUDWIG. It's a success story for the American banking system. Yes, sir. The CRA portfolios have performed well.

Chairman GUTIERREZ. Okay. And I just want to ask one last question of Mr. Bradford. You have studied this. We have heard from the Roundtable; we have heard from the former Comptroller of the Currency. From your perspective, coming from the grassroots and understanding this, give us succinctly, CRA, the financial meltdown and the mortgage crisis, relationship, non-relationship, and why, in 30 seconds, or less.

Mr. BRADFORD. The first thing I would say is that the community was protesting the subprime lending market and this crisis way back in the late 1990's, when this thing started—not just recently when it all fell apart. And they were challenging the bank regulators as early as 1999 not to count subprime loans for CRA credit. And they were challenging HUD not to let the GSEs count these subprime loans for their credit.

So on that side, I think you have to say the community has been raising the flag. They have been the canaries in the coalmine. And I think they take great offense at being blamed for the implosion when it takes place.

Chairman GUTIERREZ. Okay.

Mr. BRADFORD. They have been warning about this.

The other thing is, most of the people who criticize the meltdown as related to CRA have played this kind of interesting sleight of hand with the numbers. What they do is they count every single loan that was made in a low- and moderate-income neighborhood as a CRA loan. And therefore, they end up counting every single predatory loan that was ever made in those neighborhoods as a CRA loan.

Chairman GUTIERREZ. I only have a minute left. And I think your last point is excellent.

I want to thank, obviously, Mr. Taylor, Mr. Richardson, Mr. Rodriguez, and all the others. I want to go around—5 minutes to ask everybody questions.

I think your last point, Mr. Bradford, is exactly something that we need to examine. That is to say that it has been brought forward in testimony here that there were 2 million loans that were originated by Washington Mutual. It's almost as though every loan from Washington—of what could be justifiably called a criminal enterprise of churning and burning. It's though the folks at Washington Mutual woke up every day and said, "Wow, we really want to make sure those low- and moderate-income neighborhoods are—so we're going to bill 2 million loans to them."

No. They charged a lot of money. They refinanced. And then they packaged and securitized those loans and infected the rest of our system. Those loans at Washington Mutual didn't have anything to do with CRA. They didn't go to their regulator and say, "We want credit for these loans," because they couldn't get credit for those loans.

The fact is only 6 percent of all subprime loans, of all high-risk loans were under CRA. Only 6 percent. And that's assuming all of them went under. And we can't assume all of them went under.

You see what a small portion they were of the total picture.

Mr. Hensarling, you are recognized for 5 minutes, sir.

Mr. HENSARLING. Thank you, Mr. Chairman. It seems to me that as we continue to have a debate of who is going to control the lending decisions in a free society, I think as we witness what has happened in our economic turmoil, clearly there were those in private banking who made a number of mistakes, plenty of mistakes.

But then I look at what government has done. And at least at the time I have studied the situation, I have concluded that we have had a number of Federal policies that either incented, cajoled, or mandated financial institutions to loan money to people to buy homes, who ultimately couldn't afford them. The family suffered. Many of them would have been better off in rental housing. The Nation has suffered collectively.

So I'm looking at what I believe to be an antiquated law, that might have served a great purpose in 1977. I'm not convinced it serves a great purpose today.

Either you have a law that is forcing banks to lend to people that they would already lend to, and at least every banker I talk to tells me along with BSA, it's their most expensive compliance cost. And if anybody believes that cost doesn't get passed on to customers in the form of less credit, or more expensive credit, you're reading a different economic textbook than I am.

So either we're forcing banks to do it, or we're forcing banks to loan to a universe of people they otherwise wouldn't loan to.

And then are those people creditworthy or not creditworthy? And if they're creditworthy, why aren't the banks loaning to them? And if they're not creditworthy, are we not going down the road of repeating the mistake in the first place?

So again, I question the rationale for the law today.

Now Mr. Taylor, you and I have had this discussion before. On the one hand, I think you have said that CRA has nothing to do with race; but you mention race in your testimony, and almost every other proponent mentions racial concerns, which are very valid concerns. Unfortunately, racial discrimination is still alive and well in the USA today,

But is this about race? Is it not about race? And if it is about race, again I would ask the question: Is the Obama Administration not enforcing the Equal Credit Opportunity Act? Is the Obama Administration not enforcing the Fair Housing Act? Is the Obama Administration not enforcing HOEPA? Is the Obama Administration not enforcing the Civil Rights Act? So is CRA there to protect racial minorities?

Mr. Taylor, you said in a previous testimony it's not, although you mentioned it in today's testimony. Is there somebody on the panel—now I'm just looking—it's not a trick question, but I would like a yes or no—does CRA, in your opinion, serve to protect racial minorities? And if the answer is "yes," do you not believe the Obama Administration is enforcing the other anti-discrimination laws in our society?

Mr. TAYLOR. Well, I may. Of course the law is written very explicitly on class lines. That is, working class, middle class, upper income—

Mr. HENSARLING. It's not a trick question. But could you reply with a yes or no?

Mr. TAYLOR. Because of the racism that you referred to, disproportionately, those classes are people of color. So de facto, you have a disproportionate application of people of color being impacted by this law.

We saw—

Mr. HENSARLING. Unfortunately, Mr. Taylor, I have a limited amount of time here. If we have to have a law to force banks to lend money to this universe of individuals, do we need to have a law to force grocery stores to sell food to low-income individuals? Do we need to have a law to force auto dealers to sell cars? Food is vital, necessary for survival. Transportation, many people rely on an automobile to get to and from their place of employment.

Does anybody believe we need the effective equivalent of CRA to be imposed upon grocery stores or auto dealers?

Seeing none, we'll move on.

Mr. GREEN. I do.

Mr. HENSARLING. I'm sorry?

Mr. GREEN. I believe it. That's what the Civil Rights Act was all about—

Mr. HENSARLING. No, I would just say to my dear friend—

[laughter]

Chairman GUTIERREZ. The gentleman—

Mr. GREEN. I'm sorry, please excuse me.

Mr. HENSARLING. I'm sure my dear friend from Texas will have his 5 minutes to express his opinions.

Chairman GUTIERREZ. We will give you an extra 15 seconds.

Mr. HENSARLING. I appreciate that, Mr. Chairman.

I'm also curious, again, about forcing banks to make these loans. I have seen a study by the Federal Reserve—the Dallas Branch of the Federal Reserve—that says in the last decade, credit unions and independent mortgage and finance companies not covered by CRA that are lending to low-income neighborhoods grew faster than CRA-covered institutions. This is a Federal Reserve study.

I have seen statistics from the National Association of Federal Credit Unions that show that their loan approval rate for households with less than $40,000 of income, non-CRA-covered credit unions, was greater than that for banks subject to CRA.

So again, it begs the question: Why are you forcing them to do something that apparently financial institutions are doing anyway?

But I see I'm out of time. Thank you, Mr. Chairman.

[Discussion was held off the record.]

Chairman GUTIERREZ. And next, we have Congressman Watt.

Mr. WATT. Thank you, Mr. Chairman.

There is some question about whether we—I want to focus on the question of whether CRA or some aspects of it need to be extended to other non-bank institutions.

Mr. Askew, you had an opinion on that. And my specific question is: We extended some of the privileges that the Federal Government provides to a number of entities that were not typically having access to the discount window, FDIC insured, what have you. Would you concede that those entities ought to be covered by CRA? Or you think they should not? That's one question.

One of those entities is credit unions, for example. Do you think the CRA ought to be applied, or not be applied to them?

Mr. ASKEW. That's a good question about credit unions. But that's not my wheelhouse. And so how the function is not. But I'll try to answer that with this. Change in the assessment area and expanding this to other institutions, really you have to go back to the fundamental basis, the premise, the foundation of the CRA—

Mr. WATT. Well, now, actually I didn't go back there, because I didn't want to get into that philosophical—I actually disagreed with your characterization of what CRA was intended to do.

I looked at the statute. You say it was enacted to promote new loans and services to low- and moderate-income neighborhoods and consumers. The statute specifically says that it was enacted to help meet the credit needs of local communities, in which these institutions are chartered, consistent with safe and sound operations. I don't see anything there, really, that talks about low- and moderate-income people.

I guess a number of people have kind of made that leap. But I don't really want to go there. I'm really trying to figure out whether we ought to be extending this, are there rationales for extending it to other entities. And if that's not in your wheelhouse, I don't need a lecture about the history of CRA, because obviously we disagree about what even the basic language means.

So I—

Mr. ASKEW. I apologize for the lecture.

Mr. WATT. Yes.

Mr. ASKEW. I did not intend it that way. And I agree with your point about what CRA, the Act, was intended to do. It was asking banks to serve the entire needs of their community, not just the low and middle, moderate—

Mr. WATT. Okay. But I'm running out of time here, and I still haven't had an answer from you about whether we should extend it to any of these other entities, or not.

Mr. ASKEW. As far as expanding it to other entities, they do not have the basic—what I meant about the basic premise of the law was that they do not have a charter and a branching law, that was the basis of it with the FDIC Act, that said, "You're getting the FDIC insurance"—

Mr. WATT. But that's why I asked the question, how would you distinguish?

We have extended the benefits of some of those charter provisions to other entities. FDIC insurance, access to the window. Shouldn't we be extending CRA to at least those institutions?

Maybe I can get Mr. Ludwig's opinion on that.

Mr. LUDWIG. Congressman Watt, I do think that the CRA ought to be expanded to non-banks for a couple of different reasons.

One, the marketplace has changed. It used to be when CRA was enacted, the banking marketplace was the financial services marketplace, almost 100 percent. Things have changed in 30 years.

So we're basically causing the banks to shoulder a burden that's much broader than the banks, that ought to be extended.

Similarly, even in the banking organizations, some of them have large non-bank activities. We really ought to expand this fairly across the system.

Mr. WATT. Do you disagree with that, Mr. Askew? Just a yes or no.

Mr. ASKEW. No. I do disagree.

Mr. WATT. Okay.

Mr. ASKEW. I disagree.

Mr. WATT. Well, I was trying to get in one more question. But you stopped me from doing that.

Chairman GUTIERREZ. The gentleman's—

Mr. WATT. That's all right. I'll yield back.

Chairman GUTIERREZ. Mr. Neugebauer, you're recognized for 5 minutes, sir.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

I want to go back to, Mr. Askew, I think you mentioned that 99 percent of the banks and thrifts received either an outstanding or a satisfactory CRA rating. So basically it sounds to me as if the financial institutions were basically meeting the requirements of CRA.

I hear that some folks are thinking about devising a curve. In other words, I guess putting different criteria for one financial institution over the other. That would seem to be a major departure from the current system. What are your views on that proposal?

Mr. ASKEW. Well, we think that would be the wrong thing to do. When we say that 99 percent comply, banks, it's the law. It is the law to comply with CRA. And banks typically are in the 98 to 99 percent in all of our compliance laws. We do comply with the laws.

And so to put a bell curve on it would say that you're going to have some banks always that are not going to be compliant with the law. Even if they're doing everything that's asked of them, they're going to not be compliant with the law.

So we think that is the wrong way to go, especially when the system that we have is working.

Mr. NEUGEBAUER. Now I think also in my testimony, you said that it ought to be the goal of all of the banks to have the highest level of compliance. Did I misinterpret you?

Mr. ASKEW. I'm sorry. Maybe I miscommunicated. I'm saying that other banks should aspire for the outstanding rating—

Mr. NEUGEBAUER. Right, right, that's what I—

Mr. ASKEW. But we should have incentives for them to aspire to the outstanding rating.

Mr. NEUGEBAUER. That's exactly—and that I may not have restated what you said.

But what are some of the things that you believe that incentives—because I'm kind of one of those folks, I like incentives over the big hammer—and so what are some of the incentives that might be put in place to encourage banks to all seek the highest level of compliance?

Mr. ASKEW. Thank you. Three things: First of all, we think there should be some form of public recognition, and a claim for the institutions that achieve an outstanding rating. The information is made public, and so all of this is very public. But perhaps this committee could design an official symbol or seal, proclaiming this. It is an historical act, and it is an historical process that we have gone through, that would recognize those outstanding performers.

Second, we believe that we should provide for a longer term between examinations for those institutions. You're right, Ranking Member Hensarling, it is a costly process to go through the examination. And so for those banks, it would be an incentive, and then they could take that money and they could apply it more to the process, if they were achieving outstanding. So longer terms between examinations.

And third, decline the request for hearings, if an institution has an outstanding rating, so that if they're branching into a new market, if they're developing a new charter, then that would give them another incentive for achieving an outstanding rating.

Mr. NEUGEBAUER. And I guess the third part of my question, along the same lines: Since we do have almost 99 percent of the banks and thrifts are meeting the outstanding or satisfactory category, are the requirements too loose? Are they not strong enough?

Or as a professor at a university might say, "Ninety-nine percent of my kids are making 'As.' Am I giving a hard-enough test?"

So what would be your response to that question?

Mr. ASKEW. It's very difficult to achieve an outstanding rating. It's very difficult to achieve a satisfactory rating, if you're a large bank, on the test that they have, the three areas of the test: The lending, the surface investment test.

If you go through an examination, there are literally thousands of pages of data, where you're being compared in all of your markets and areas to meet the needs of the community.

So it is very difficult. But it's the law. And so you have to comply. And I don't think it's too easy. Oh, my gracious, I have been through these before, and so it's very difficult.

Mr. NEUGEBAUER. Well, I haven't heard any of my bank friends say that it was an easy process.

I think the other area is within the industry—and you represent the hundred largest financial institutions—do you have an idea, just say industry-wide—and every once in a while I'll see this number pop up—but do you know compliance cost industry-wide what that number is?

Chairman GUTIERREZ. You can answer that question, Mr. Askew, please.

Mr. ASKEW. I do not. But I will get you that information, and I will bring that back for the record.

Mr. NEUGEBAUER. That would be great. Thank you.

Chairman GUTIERREZ. Mr. Moore of Kansas is recognized for 5 minutes.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman.

Mr. Askew, you suggest in your testimony that responsible behavior should be rewarded, and basically increase the time between examinations, if an institution is at the top of the rating system.

Would you elaborate on this point? Explain how this will drive firms to reinvest more in their communities, sir?

Mr. ASKEW. Yes. The whole idea would be, to go to that outstanding rating takes extraordinary effort. But it takes extraordinary expense as well.

And so just to offset some of that would be to limit those examination periods. Every year, annually, you're reporting all of your data, but every 2 years, you're going through a full examination. So limiting those and then avoiding the cost.

And it's not just the here in itself. Avoiding the process that leads up to that would be beneficial to the institution. And then encourage them to achieve that outstanding rating.

Mr. MOORE OF KANSAS. Thank you.

Mr. Taylor, you have a different perspective on this issue. Why should we use limited government resources for more examinations for firms that are contributing the most to our communities? Shouldn't examiners be focused on the bad actors?

Mr. TAYLOR. Yes. Well, first off, you're not using government resources. The Federal Reserve through their fees pays for that process.

Secondly, in 1990, 1 out of 10 banks failed their CRA exam. Today, it's 1 of out of 100. The grade inflation that Cal spoke to, and other referenced, is rampant. It really is an easy task to get a passing CRA grade. What we're suggesting is that the better system would be to put more clarity into what that grade really is, and more levels of definitions of how well they passed. Did they barely pass? Did they pass strongly? Did they get an outstanding or barely pass? And put some numbers to that, so that elected officials, community leaders, and the public can see just how well the bank is doing on their exam.

Right now, it's just everybody passes. It's a stamp of approval. And I don't want to come between the bank friends that your colleague mentioned, who just left the hearing, but he might want to talk to some consumers about how difficult it really is—and we hear it every day—to get bank loans, because it really continues to be a problem.

Much as CRA has been a success story, it needs to be bolstered and strengthened in a number of ways, one of which is we have to deal with this grade inflation, as you said, everybody gets an "A."

Mr. MOORE OF KANSAS. Thank you. Some have suggested, Mr. Askew, that CRA ratings be handed out on a bell curve, so that only a few institutions receive the highest rating, and more are given average ratings.

I know the importance of bright lines and clarity with respect to the compliance for the law. You either are breaking the law, or you're not. What are your views on grading CRA on a bell curve? And what are the advantages and disadvantages, from your perspective, sir?

Mr. ASKEW. I think it would be a major disadvantage, and I think it would create problems for the regulators and for the industry. I think it would create a—the spirit of the law right now, what's happening with CRA is the people from the banks are involved and engaged in this process of finding ways to improve their community, finding ways to make their communities better.

They're engaged in the process. If you sit there and put a bell curve on it, and you say you're going to be brought into a class of performance, just based upon where you fall in the curve, it's just inappropriate. And it would be discouraging to institutions that are really performing great work, to attain those ratings.

Mr. MOORE OF KANSAS. Thank you.

Mr. Ludwig, what are your views on this, sir?

Mr. LUDWIG. Well, I think that Mr. Taylor has hit on something, that by expanding the number of categories, one might be able to get a better definitional background in terms of who's really doing the most.

I think the banks have done a solid job here. And I'm wary of a bell curve solution, because if you have really done an "A" job, you ought to get an "A." But perhaps more definition in terms of what an "A" means would add value.

Mr. MOORE OF KANSAS. Thank you. Mr. Chairman, I yield back.

Chairman GUTIERREZ. Thank you, sir.

Mr. Garrett, you are recognized for 5 minutes.

Mr. GARRETT. Thank you, Mr. Chairman.

Since the beginning of the financial crisis, there has been a lot of debate, as we see here, and throughout the country, as to whether the CRA requirements played any role, or what role, in the collapse of the housing industry.

I know the folks on the other side of the aisle and most people on this panel continue to point to the performing CRA loan data as proof that CRA had nothing to do with the housing crisis. But I really think that misses the larger point.

For as with the affordable housing goals that put Fannie and Freddie in the situation they are in, CRA requirements provided an implicit government endorsement of loans with lower underwriting standards and less creditworthy borrowers.

Both of these requirements paved the way for financial institutions to begin to develop new ways to underwrite and approve. And we see all that happened with that.

Eventually, these new methods became more and more mainstream, with the subprime market expanding. So I think it's very easy, actually, for us to be able to connect the dots on how the affordable housing goals of the GSEs and the lending requirements at CRA eventually led to the massive explosion in the subprime market, and the eventual collapse.

And now—this is the important part—we actually have a proposal to expand CRA to security firms, insurance firms, and credit unions. And I'm not even sure how traditional CRA requirements would apply to some of these industries.

And I would like to hear from you on this.

Would security firms have to purchase specific amount of MBS's that contain riskier loans? Isn't that exactly what we did with Fannie and Freddie, and that's what caused them to collapse?

Now you want to saddle all security firms with similar requirements.

And so it's no wonder, when you think about it, why the majority wants to separate safety and soundness from consumer protection in the regulatory proposal. Because that's the only way that this would work.

When security firms eventually fall under the jurisdiction of a new consumer credit restriction entity, I find it hard to believe that the prudential regulator would ever sign off on something like this.

So I ask the panel, how would this expansion—I know only one member had the opportunity to answer that—how would this expansion apply to effectively work with the expansion outside of this area that it's currently in?

Anyone? Yes?

Mr. TAYLOR. Well, I'll take a stab at it, Mr. Garrett.

First off, I just want to make sure—you keep referring to Fannie Mae and CRA, and of course, Fannie Mae has no CRA obligation—they have affordable housing goals, which are not CRA goals.

Mr. GARRETT. No. I didn't refer to them that way. I said it's the underwriting standards that the CRA allowed for to change, and the underwriting standards that came about through these, and then which led then to the changes in the underwriting standards in the rest of the market.

But could you address the question as to how this would expand?

Mr. TAYLOR. Sure. So just in terms of the institutions that we have proposed expanding CRA to, there are the credit unions, there are independent mortgage companies, there are investment banks, securities firms. Obviously, credit unions are a no-brainer. They already have depositor's insurance, just like the banks. But they actually have an added reason for us to want to make sure that they loan safely and soundly to LMI areas, as well.

Mr. GARRETT. Okay. I understand—

Mr. TAYLOR. And tax-exempt.

Mr. GARRETT. I understand credit unions—

Mr. TAYLOR. Insurance companies, it really matters in the end whether they make policies, whether it's property insurance and other kind of business policies available to the health and well-being of the neighborhood.

So getting them to report and getting them to ensure that they're, in fact, making their products available is incredibly important.

For investment banks, investment banks are critical to some of the community development lending and other kinds of major projects that need investments from the these institutions in LMI areas. So having them—

Mr. GARRETT. So would they have to end up buying a specific class of MBSs that may end up being riskier than—

Mr. TAYLOR. Not by class, but what they would have to do is the same thing the banks do. They couldn't ignore whatever economic or financial opportunities products were available in LMI areas. No one's forced under CRA to buy or to make any type of loan. No one's forced. It still has to be prudent, safe, and sound.

Mr. LUDWIG. Yes. I might add to that. I think you can give examples. That is, obviously it wouldn't be a credit example for securities firms. But in low- and moderate-income neighborhoods, there is need for financial advice and other products that are other than the credit product, that for small businesses and for some low-and moderate-income individuals would be quite helpful. Just requiring that those products be made available throughout the community on a fair basis, I think, would actually add to the fabric of those communities.

Mr. GARRETT. With that, I yield the remaining minute to the gentleman from Texas.

Mr. HENSARLING. I thank the gentleman for yielding.

Mr. Taylor, does your organization make its contributors public?

Mr. TAYLOR. Yes, we do.

Mr. HENSARLING. Have you, you organization, or any affiliate ever requested or received a contribution, including an in-kind contribution like real estate from a federally-insured depository institution subject to CRA?

Mr. TAYLOR. Yes.

Mr. HENSARLING. Would that be listed in your public disclosure?

Mr. TAYLOR. Yes.

Mr. HENSARLING. And have you, your organization, or any affiliate ever received a below-market loan from a federally insured depository institution, subject to CRA?

Mr. TAYLOR. Yes.

Mr. HENSARLING. Have you, your organization, or any affiliate ever entered into a joint venture with a federally insured depository institution, subject to CRA?

Mr. TAYLOR. Joint venture? No. We have very good relationships with financial institutions, because we obviously try to get them to do more in low-income communities, and they think our approach is one that the support.

But we do not take any operating funds from banks.

Chairman GUTIERREZ. The time of the gentleman has expired.

The gentlewoman from California is recognized for 5 minutes.

Ms. WATERS. Thank you very much. Let me thank not only you, Mr. Chairman, but our panelists for being here today.

I think it was the gentleman from the Urban League, Mr. Richardson, who talked about looking at other ways to credit the financial institutions for their CRA ratings.

What did you have in mind?

Mr. RICHARDSON. Ms. Waters, I don't think that was the statement that I had made.

Ms. WATERS. Well, let me go to a statement that you made perhaps a little bit different than the one I just asked about. Do you believe it would be effective to require greater CRA credit for institutions providing more difficult banking services, such as offering principal reduction and loan modifications, or serving areas and populations, that are culturally and geographically distant from metropolitan areas?

Mr. RICHARDSON. I don't think I could have said it better myself. Yes, we would wholeheartedly agree with such an approach. Particularly as this conundrum gets to the credit needs of a community.

I think we need to expand the scope of the conversation around how one prepares disadvantaged families to take on assets, and to sustain them. This involves information around financial education, around principal reduction, as you mentioned, on existing mortgages, and to ensure that we're connecting clients to products that are both affordable and suitable for them.

So I would agree with your statement, yes. I think banks that have made overtures toward principal reduction should receive credit commensurately.

Mr. WATT. Thank you very much.

Mr. Taylor, I know that you're involved in advocacy for low- and moderate-income housing opportunities, and on and on and on. Do you think we ought to also pay more attention to community development efforts to go along with the housing opportunities? And how should we score that? Is there some thought you may have given to what we can do to get more investment in economic development and community development?

Mr. TAYLOR. Yes. I like the idea of where you're reasoning and the question is going. And that is, trying to give banks credit where credit is due. There are some loans that are no-brainers. Some banks will just buy a pool of loans and they'll get CRA credit for that, if they're to LMI borrowers.

And then there are others who do more difficult things, like investing in community health centers, or in low-income rental housing.

And I think we ought to explore giving more credit to financial institutions that do the more difficult-to-do projects. And perhaps that could be reflected in the grading and the scoring that we were talking about earlier.

Ms. WATERS. And lastly, we always say to the community that you can check the CRA ratings. You can get your banks to tell you what they're doing and how they're doing. You can meet with bank managers.

But it really doesn't happen that way. The community does not put enough pressure on the banks to come meet with the community to talk about what it's doing and what its vision is for community support.

And I'm trying to think about ways that we, here in Congress, can support the idea that banks have to meet with the community within a certain radius of the bank, to report and to update and to get input from the community about how that bank can better serve that community.

I would like you to give that some thought, not necessarily right now.

Mr. TAYLOR. Okay.

Ms. WATERS. Because I think this is going to take a little bit of planning to maybe come up with some legislation that would accomplish that. But do you think that is something we ought to be doing?

Mr. TAYLOR. I think it is imperative that we do that. And further, I think it's imperative that they really go back to the days when they actually had public hearings, particularly when something significant was going to happen with an institution, like a merger or an acquisition.

And we average one a year now, when before we had much more opportunity for the public to be able to come to the microphone and say, "Hey, this is what the bank is doing or not doing." And you get positive and negative feedback in that.

But that whole system has been undermined by the lack of—even on major mergers like Wachovia and Wells, and Chase and

WAMU, there weren't public hearings, which is outrageous that there wasn't the opportunity for the community to give input—not just one community, but many communities—on the impacts of these kinds of mergers.

Ms. WATERS. Well, I certainly agree with that.

Thank you very much. I yield back the balance of my time.

Mr. GREEN. [presiding] Madam Chairwoman, I believe I'm next in line, given that Mr. Lee is not—we're going to him next.

Madam Chairwoman, do I need to yield 30 seconds of my time to you to finish?

Ms. WATERS. Thank you very much, Mr. Chairman. I'm finished.

Mr. GREEN. Okay.

Ms. WATERS. Okay.

Mr. GREEN. By agreement, I will be next. And what I would like to do, with my very good friend, who is seated next to me, is invite him to dinner. And I'm confident that he will accept. We are good friends, and we'll do this within the next 30 days.

Now having said that, it was invidious discrimination that caused the CRA to come into being. And invidious discrimination is what caused us to develop the Civil Rights Acts of 1964 and 1965. Invidious discrimination is what we have been fighting.

And to blame the CRA is to let the rascals go. The CRA did not promulgate—and I defy anyone to show me language wherein the CRA mandated subprime loans with prepayment penalties that coincided with teaser rates.

Show me where the CRA required that we have collateralized debt obligations, known as CDOs. Show me where the CRA promulgated and promoted credit default swaps. Show me where the CRA required negative amortization. Show me where the CRA produced or caused to be promulgated all of these exotic products, that ultimately caused not only a crisis in this country, but we were at the precipice of a crisis worldwide. And to blame poor people for a collapse, a potential collapse of a worldwide market is just incorrect.

It is written that if you know the truth, the truth shall set you free. I hope to free some souls with the next few seconds that I have.

The truth is, we ought to be grateful that there was a CRA in place, just as we are grateful for the Civil Rights Act of 1964, 1965, and the Thirteenth Amendment.

These are to a certain extent cornerstones of the society that we live in today. The diversity that we talk about didn't come about because of beneficence, and because someone just woke up one morning and decided the world would be a better place.

People marched, they fought, they lived, and some died—namely, Dr. Martin Luther King—so that we could have these opportunities.

I am going to fight to the end anyone who wants to end the CRA. And my good friend and I will have dinner, we're going to continue to love each other. But we will fight to the end this piece of legislation to end the CRA.

All of those who would like to end the CRA, end it on this panel, raise your hands, please. If you want to end it?

[show of hands]

My friend appears to be alone in his effort to end the CRA. Now he will be a better person after we have dinner.

[laughter]

Mr. GREEN. But until then, I suspect that I am going to have to do the honorable thing. I have some time left. I will yield to him some of my time. I have a minute and 28 seconds. I took some of your time, when I responded to your request. You wanted to know, does anybody think that we really have to have laws to require certain institutions to do business with certain people?

And the answer is yes. That's how we got here. Yes. Rosa Parks took that seat on that bus, and went to jail. The bus companies didn't really want to let some people ride and refused to.

I have stood in lines wherein I was rejected. I have been through what I talk about. This is not something that is a theory with me.

By the way, it was a white woman, Virginia Durr, who posted the bail to get Rosa Parks out of jail. We didn't get here by ourselves. There were plenty of people of good will of all ethnicities, who worked with us and helped us to get where we are.

But I will not allow the clock to be rolled back. And today, Dr. Benjamin Hooks died. I speak on behalf of a man who stood for civil rights and human rights all of his life, and was fond of quoting C.A. Tinsley: "Harder yet may be the fight. Right may often yield to might. Wickedness awhile may seem to reign, and Satan's cause may seem to gain. But there's a God who rules above with a hand of power and a heart of love. And when we're right, He'll help us fight." Or she. "Because He loves us, we will be free."

I yield the balance of my time to my friend.

Chairman GUTIERREZ. I ask unanimous consent that Mr. Hensarling be given 2 minutes.

Mr. HENSARLING. Well, thank you, Mr. Chairman. I don't think I need 2 minutes to accept your generous offer to go out to dinner. I am somewhat curious. I guess that means you're buying.

Mr. GREEN. I can afford it.

Mr. HENSARLING. Yes. And I want to say publicly that you are my friend. And I have never, ever doubted your heart. Your heart is always in the right place. Occasionally, we may differ, where my head is and where your head is. But I have never doubted your heart, and I look forward to that dinner.

And I think that something can always be improved in this institution with better understanding.

I would say a couple of things, again. There seems to be some debate among the panel and among many here on whether or not this is part and parcel of civil rights legislation aimed at ending, as you put it, invidious discrimination.

Again, I would ask the question—because this is very costly to institutions, and in your economic theory, that might come out of bonuses and profits. In my economic theory, the cost of compliance is coming out of loans to the very people that theoretically you're trying to help. It comes at the cost of less credit, more expensive credit, equating to fewer jobs.

Now that's what I see happening in the real world.

The other thing I would say to my friend, whom I know, whose heart is pure: If we're only going to support a law because of its proud birth—and if you listen to my comments, I agree; the genesis of this law was good, was noble, was pure, was needed—I question whether it is still effective today.

But I wonder about the converse. When you speak of invidious discrimination, Davis Bacon has its roots in invidious discrimination. That is well established in history. Yet, I believe you and most of my other friends on your side of the aisle support Davis Bacon, notwithstanding the fact that its whole purpose was to try to ensure that as Blacks emigrated from the South to the North, that they could not be hired.

So I wouldn't necessarily equate support of a policy today with its genesis. Because as you look at the family trees of some of these pieces of legislation, it may not be too pretty.

And I do look forward to our dinner.

Mr. GREEN. Thank you.

I ask unanimous consent for 1 minute, to respond.

Chairman GUTIERREZ. Without objection.

Mr. GREEN. Every test that involves empirical evidence commonly known as testing, wherein you send out persons to test lending institutions and other institutions, every legitimate test shows that people of color are discriminated against in lending.

Find a legitimate test. This is a broad statement. Find legitimate tests, where you have actually done the testing, where you have sent out the persons, equally qualified—and you will get the results, the empirical evidence—you find that people of color are still being discriminated against.

My point to you is this: If the world changed on January 20, 2009, it did change for the better. Why January 20, 2009? Something significant took place thereabouts. But there were some things that remained the same. And these things we have to continue to work to change.

My belief is that you and I working together can improve the CRA. But my belief also is that you and I will never work together to end the CRA.

We have an opportunity before us, and I look forward to working with you on it. And I'm going to not continue this, because I have been more than unfair to the Chair by encroaching on the time.

And I yield back, Mr. Chairman. Thank you.

Chairman GUTIERREZ. Mr. Lee, you are recognized for 5 minutes.

Mr. LEE. Thank you. And I apologize. I didn't get to hear a lot of the opening statements. But I'm a big believer in the fact that through this financial crisis, we had some good stewards, and these were the community banks, who today continue. They survived during difficult economic times, and they continue to be a lender throughout the communities.

I skimmed some of the testimonies, and I think maybe I want to start with Mr. Taylor, because I know that the CRA audits are typically every, is it every 4 to 5 years? And based on your testimony, it appeared that you had concerns that there was a problem with this and that they were potentially gaming in the system. I was curious as to what empirical evidence you suggest proves that.

Mr. TAYLOR. Let me start by saying I'm with you on community banks. I think the more locally-based banks, where you actually have a board of directors who live in the communities, even in the same State where these banks are located, is a good thing. And I think competition is a good thing.

So I'm with you on that.

The gaming in the system happens in a lot of ways. And in fact, it's bankers who have brought this to my attention. A CRA exam will come up, and they'll quickly look to see, "Have we done anything on this law?" And they'll find that they're deficient.

So they'll call a brother or sister financial institution, and say, "What do you have in the way of CRA loans on your shelf?" And they'll say, "Well, we have $100 million worth of housing loans." "Can I buy those for you? I'll pay you a percentage fee, if I can purchase those."

And then they'll purchase them for the purpose of the exam, and then resell them back to that institution. So when their exam comes around, they too have those same loans.

So there's a lot of this kind of gaming of the system that really isn't meaningful CRA investment. And we have brought this to the attention of the regulators. And there has been—

Mr. LEE. Well, how do you correct that problem?

Mr. TAYLOR. Well, I think it's up to the regulatory agencies, and I think part of the problem with CRA right now is we really don't have a sheriff who is enforcing the law, and not just that law, that really ensures the goal of trying to end discrimination and end unfairness in lending.

You have to have regulatory institutions that are willing to go in and look at the loan files and really see what's going on. And we just haven't had that kind of impetus from these agencies for a long time.

Mr. LEE. Well, let me jump in for a second, because I agree with that. And Washington unfortunately has this propensity, when we were having an issue, that we always have an over-correction. The pendulum swings very far in one direction, and we seem to lock in, rather than coming back closer to what we need.

My fear again, as we go through this financial regulatory restructuring, is that the community banks may begin to suffer with additional regulation outside of CRA. I think CRA has performed a need in this for the communities.

My concern as we go forward is that we are going to continue to add more regulation. And at the end of the day, community banks have a limited amount of capital that they have to spread the costs around.

Mr. TAYLOR. As you put—Mr. Lee—

Mr. LEE. And as my friend from Texas pointed out, higher costs of compliance translate to higher interest rates. And again, it's almost destructive in the fact that we want to open up capital, again to ensure that all people have access of it.

I guess let me ask this question. I want to switch places, let me go to Mr. Reinhart for a second. With regards to legislation, as I say, all legislation—I think CRA was a very important part for this country—but like all legislation as time changes, is making sure that the legislation keeps up.

And I guess your view, going forward, is this legislation still achieving its original intent?

Mr. REINHART. I think that the existing legislation served a very important purpose, but that it is inefficient, and those inefficiencies have grown over time, and that the Congress would be right to reconsider how best to achieve the mission.

Mr. LEE. Can you highlight some of those inefficiencies, or where we would need to modify to help reduce the burden on community banks, so they can better serve their constituents in these communities?

Mr. REINHART. Among other things, CRA is event-driven. It only really comes into play when there's a change in ownership. But everybody is reporting, so there's data collection, and a reporting burden associated with that.

I think it would be better to try to empower the borrower rather than think in terms of the institution.

Let me also say that part of the logic of CRA is there is this quid pro quo, that there's a Federal safety net, and you price this Federal safety net by imposing these costs on institutions.

That's a very opaque way of doing it. We would be much better off if we charged explicitly the financial institutions that get the protection. Community banks, among others, weren't the source of the problem, so it's not obvious to me why they are paying to fund the solution.

Mr. LEE. All right.

Mr. CLEAVER. [presiding] Thank you. Time has expired. I recognize the gentleman from Missouri, Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman. And I want to thank the Chair for conducting this hearing.

I am sitting here and listening to the exchange between my colleagues, and I just find it incredulous that my friend and colleague from Texas would question the need of still needing CRA after what we have just experienced as far as the financial meltdown, the steering of Brown and Black borrowers into predatory products.

The situation cries out. I'm just curious as to what planet my friend has resided on over the last 20 years. Perhaps, Mr. Richardson, you can share with the committee some of your most recent empirical data, your most recent studies in regard to discrimination that still exists in the area of borrowing.

And then I would like to also ask Mr. Rodriguez, perhaps, to share some of his recent data, that certainly proves out the need and bears out the need for the CRA.

Mr. Richardson?

Mr. RICHARDSON. Mr. Clay, the number of studies—

Mr. CLAY. Go ahead, turn on your microphone.

Mr. RICHARDSON. The number of studies are legion, which point to the steering of African-American and Hispanic prospective borrowers into subprime products.

We have been over this terrain many times before. Half of the borrowers who received subprime products could have qualified for a conventional mortgage. This is within the context of this discussion, I think I appreciate you expanding the scope.

Ms. Waters previously mentioned ways to qualitatively judge or weight credit that banks could get within the rubric of CRA.

I think more weight should be given to the financial education, the housing counseling, where we're now seeing greater efficacy, in terms of preparing folks to know what their credit needs, in fact, are. That is what they're capable of taking on to realize the American Dream.

So I think we need to step back and look at how banks are preparing clients to make use of the credit that's becoming available in their communities. I think that is the kind of better balance we're looking to effect between the kind of brick-and-mortar credit that banks get to more of the qualitative, softer preparatory services that banks can provide to create a more responsible and informed consumer of the products that they should be offering.

Mr. CLAY. Mr. Rodriguez?

Mr. RODRIGUEZ. Thank you, Congressman. I think I ticked off—and you'll find it in my testimony—just clear disparities in financial markets, there, whether it's higher numbers of unbanked more likely to receive high-cost mortgages, even though they could have qualified for prime loans, more likely to receive fees or highly packed auto loans with fees and higher costs, despite their creditworthiness.

I think we're seeing this across-the-board, which says that we still have very, very serious issues in financial markets. That warrants government intervention.

I think the question was raised before that if we had a situation where we didn't have grocery stores serving the community, would we not see that as government intervention? I think the answer is yes, if low-income people could not find a grocery store in their communities, you better believe there would be a reason to intervene in that market and make sure that they could.

And I think we still see the same problems with disparities, and a large and staggering wealth gap, which has to do with financial markets and how they're shaped. And that has to be fixed.

Mr. CLAY. As far as fine-tuning the CRA, what is the number one improvement you see that we need to make?

Mr. RODRIGUEZ. Well, I think we have raised a number of issues. Coverage has to be a big factor there, because the CRA currently covers so few institutions that are doing lending to low-income and minority communities proportionately, that has to be fixed.

Mr. CLAY. Thank you for that response.

Really quickly, Mr. Taylor, your number one recommendation for fine-tuning CRA?

Mr. TAYLOR. It is to make sure that all the banks' affiliates and where they do significant business is counted under their CRA exam, and that CRA is expanded to credit unions, independent mortgage companies, insurance companies, and investment banks.

Mr. CLAY. Thank you so much for your responses. And Mr. Chairman, I yield back.

Mr. CLEAVER. Thank you, Mr. Clay.

Mr. Perlmutter from Colorado?

Mr. PERLMUTTER. I pass.

Mr. CLEAVER. Then I'll yield myself such time as I may consume.

Let me begin with one of the questions maybe that we had not spoken publicly enough about what the law actually says, because there are a lot of misconceptions. And if you look at Section 802(b), it says that the Act mandates that all banking institutions that receive FDIC insurance be evaluated by Federal banking agencies to determine if the bank offers credit—this is important—in a manner consistent with safe and sound operations.

Are all of you familiar with that section?

Mr. TAYLOR. Yes.

Mr. RICHARDSON. Yes.

Mr. RODRIGUEZ. Yes.

Mr. CLEAVER. Is that explicit enough? Do we need to maybe tweak the language to say something that's even more explicit, that this Act is not saying you give loans, you give money to people who can't pay?

Are any of you attorneys?

Mr. TAYLOR. [raises hand]

Mr. CLEAVER. Counselor, is there another interpretation in a manner consistent with safe and sound operations, that may be—

Mr. TAYLOR. No. It's clear to the banks, it's clear to the regulators, and it's certainly clear to anybody who's really paying attention, how this works.

It's crystal clear. And that's why you have 94 percent of all the loans that are done by these CRA-regulated institutions are good performing loans.

Mr. CLEAVER. I guess the question is, I keep hearing that's somehow—one of my colleagues, who was not here earlier today is still arguing that the recession, the deepest recession we have had in the history of the Republic, was still influenced by CRA. And I just—Mr. Bradford?

Mr. BRADFORD. Well, I think the language is clear, but I think the problem is that you have to honestly face the fact that the regulators have essentially betrayed that language.

It was the regulators who decided to let banks pick the affiliates they wanted to do, and count all the subprime loans as positive credit toward the CRA. Even though they issued all these statements warning about predatory lending and about payday lending, they counted all those loans. I have never seen a single CRA evaluation where any one of these lenders, big lenders who supported it—Bank of America, Wells Fargo, all these large lenders—who supported, had their affiliates and did the subprime lending, and who supported the payday industry; and not one regulator has ever dinged them one bit on a CRA report for that.

So it isn't that the language isn't clear. What needs to be fixed is the fact that the regulatory agencies have literally betrayed Congress and the people in these communities.

Mr. CLEAVER. So we need Chairman Bair sitting at this table.

Mr. BRADFORD. You need the people who are out there, and that's also true of the criticisms they make of GSEs, because it was the community people and civil rights people who told HUD not to let them count the subprime loans as GSE goals. And HUD—

Mr. CLEAVER. It needs to rehire Eugene Ludwig.

Mr. BRADFORD. Yes, we need Gene back.

Mr. CLEAVER. Raise your hand, Mr. Ludwig. I'm going to swear you in.

[laughter]

Mr. LUDWIG. Mr. Chairman, there are many causes to the horrible crisis we have lived through. I was asked that question, and I didn't answer it completely. The simplest answer is that we had too much liquidity and we had too little regulation, too little serious regulation in the last decade.

But the one thing that it is not about, it is not about CRA. All the data, all the studies, the Federal Reserve Bank of Boston has studied it. The Federal Reserve Bank of San Francisco has studied it. The Board has studied it.

Nothing shows that the CRA has caused this kind of problem. And indeed, the CRA loans are better loans. What has happened is that people, either with good intentions or bad intentions, have conflated CRA loans with subprime loans. And in a sense, this whole CRA area—but it really angers me, because it's sort of like blaming the sheep for the fact that there are wolves—there were wolves here that took advantage of people in these low- and moderate-income communities.

But that's not CRA. That's exactly the antithesis of CRA.

Mr. WILLIS. Mr. Chairman, if I could just add very quickly from my own personal experience, the loans that were specifically done by CRA by the institution that I worked for, were all done with fixed rates. Many of them with mortgage counseling. And those loans have always continued to perform well. So they were clearly safe and sound loans to be made to low- and moderate-income people, separate from all of this other discussion.

Mr. CLEAVER. One of the problems that I find is that CRA examinations have dropped 50 percent, 50 percent since 2004. So the examiners are not even showing up.

That's one of the problems, that the people who are arguing against CRA are winning, because the examiners are not doing their jobs. Does anyone disagree?

Mr. TAYLOR. No. That gives me the opportunity to make the comment that I was trying to make to Mr. Lee, because out of his own mouth, he mentioned that small bank exams for these community development banks are happening every 4 or 5 years, closer to 5 years. So that means in a 10-year period, they see the examiner once, in the middle of that 10-year period for an exam.

And that's a 50 percent reduction of what it was. So this inordinate irrational concern about this regulatory burden on banks, as opposed to a more rational concern about whether consumers have access to credit and capital fair and fixed terms and good quality credit and capital—I just don't see the balance there.

And I think as long as we talk about CRA and its impact, and its contribution to anything bad that happened, we're not really getting at what really occurred, which was the free market being free to cajole, free to cheat, free to practice malfeasance, and being unregulated those years of deregulating these institutions. And this is what we got.

It wasn't CRA; it was the free market, free to do whatever it wanted, without any hand stepping in and saying, "That's not right, that's unsafe or unsound, we shouldn't do it that way," and simply this is what we ended up with.

But as long as we keep talking about CRA, right, we're not going to talk about Wall Street and securities firms, and—

Mr. CLEAVER. Right—

Mr. TAYLOR. Banks and the others.

Mr. CLEAVER. Yes.

Mr. LUDWIG. Mr. Chairman, your question made a number of implied excellent points.

Number one, that statute itself calls for safe and sound lending. So if there's not safe and sound lending going on under the CRA, it's not the cause of the fall of the CRA per se; it's the cause of how it has been implemented, number one. But in fact, it has been implemented in a way that is safe.

The second thing I think is very important is it is indeed a credit statute. And in today's day and age, in terms of expansion, it should go beyond being just credit. Our low- and moderate-income communities—all of our communities—need a whole plethora of financial services, not just credit.

So credit's important, and that certainly shouldn't be de-emphasized. But it certainly ought to be broader, it seems to me. And that's the implication—

Mr. CLEAVER. Thank you.

My time has expired.

I ask unanimous consent that the following documents be entered into the record: a letter from NAFCU; an article from Business Week, supporting CRA; and the Staff Report on CRA from the Financial Crisis Inquiry Commission.

Any objections?

[No response.]

Mr. CLEAVER. I want to thank all of you for being here today, and for none of you wanting CRA to evaporate. The Chair notes that some members may have additional questions for the witnesses, which they may wish to submit in writing. Therefore, without objection, the hearing record will remain open for 30 days for members to submit written questions to the witnesses, and to place their responses in the record.

If there are no other comments, this subcommittee hearing is now adjourned.

[Whereupon, at 12:09 p.m., the hearing was adjourned.]

A P P E N D I X

April 15, 2010

THE FINANCIAL SERVICES ROUNDTABLE
Impacting Policy. Impacting People.

STATEMENT OF

WILLIAM E. ASKEW

ON BEHALF OF

THE FINANCIAL SERVICES ROUNDTABLE

ON

PERSECTIVES AND PROPOSALS ON THE COMMUNITY REINVESTMENT ACT

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

APRIL 15, 2010

Chairman Gutierrez, Ranking Member Hensarling, and Members of the Subcommittee, I am William E. Askew, the Anthony T. Cluff Senior Policy Advisor to The Financial Services Roundtable ("The Roundtable"), on whose behalf I am appearing today. The Roundtable is a national trade association that represents 100 of the nation's largest integrated financial services companies. Our member companies provide banking, insurance and investment products and services to millions of American consumers.

Thank you for the opportunity to address the Community Reinvestment Act (CRA). CRA was originally enacted in 1977 to promote new loans and services to low- and moderate-income neighborhoods and consumers. Since its enactment, the Act has more than achieved its goal:

- CRA has become an open and consultative community process, with public schedules of examinations, solicitation of comments from community groups, and public examination ratings and evaluations;
- All of the participants in the process, including lenders, regulators and community organizations have become more sophisticated and focused on how best to achieve the goal of the statute; and
- Most importantly, CRA has generated billions in dollars in new loans, investments and services in both urban and rural areas around the country.

This success story has been well documented. A study by the Joint Center for Housing Studies at Harvard University found that "CRA-regulated lenders originate a higher proportion of loans to lower-income people and communities than they would if CRA did not exist."[1] A report to the U.S. Department of the Treasury found that between 1993 and 1999, depository

[1] Harvard University Joint Center for Housing Studies, "The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System" (2002).

institutions subject to CRA made over $800 billion in loans to low- and moderate-income borrowers and communities.[2] That same report also found that between 1993 and 1998, mortgage lending to low- and moderate-income borrowers increased by 39 percent, while during the same period, lending to middle- and upper-income borrowers increased 17 percent.[3] Finally, according to the National Community Reinvestment Coalition --

> banks and thrifts... have made 341,619 community development loans totaling more than $344 billion since 1996. From 1996 to 2006, the annual dollar amount of community development loans increased 219 percent- from $17.7 billion to $56.5 billion, respectively.... During this same period, depository institutions also made 12,433,172 small business loans in low- and moderate-income neighborhoods totaling more than $513 billion.[4]

Despite this record of success, we believe there is room to refine the implementation of CRA so banking institutions and community groups can better achieve the goal of the Act. In the balance of my testimony, I outline our recommendations for enhancing compliance with CRA. I also address the need to maintain the focus of CRA.

II. Enhancing Compliance with CRA

<u>Incentives for Outstanding Ratings</u>

Today, the overwhelming majority of banks receive a Satisfactory CRA rating. Only about 10% achieve an Outstanding rating. This result should not be surprising. Achieving an Outstanding rating requires considerable effort and expenditure on the part of banking institutions. We believe, however, that even more banking institutions should pursue the top rating. Toward that end, we propose that the federal banking agencies responsible for

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[2] Robert E. Litan and others, "The Community Reinvestment Act After Financial Modernization: A Baseline Report" (U.S. Treasury Department, 2000).
[3] Litan et al. (2000).
[4] *The Community Reinvestment Act: Thirty Years of Accomplishments, but Challenges Remain: Hearing before the H. Comm. On Fin. Serv.*, 110th Cong. 4 (2008) (statement of John Taylor, President and CEO, Nat'l Cmty. Reinvestment Coal.).

implementing CRA institute some measures to encourage banking institutions to obtain an Outstanding CRA rating.

Specifically, we recommend that the agencies:

- Provide for some form of public recognition or acclaim for institutions that achieve an Outstanding rating, perhaps through the design of an official symbol or seal proclaiming an Outstanding CRA rating that an institution could place in bank windows and in advertisements;
- Provide for a longer term between CRA examinations for all institutions that receive an Outstanding rating, not just those with less than $250 million in assets;
- Decline requests for public hearings on merger and acquisition applications when the acquiring institution has an Outstanding rating.

We believe that such incentives would increase the number of banking institutions earning an Outstanding CRA rating, and this would increase the flow of credit and services to low- and moderate-income neighborhoods and consumers.

Greater Focus on Qualitative Factors and Context

Although the existing CRA regulations and interpretations encourage examiners to give extra consideration to projects and activities that are innovative, complex, and high-impact, our members observe that such recognition is in fact rare. CRA should not stifle the creativity and innovation necessary to assist low- and moderate-income consumers and neighborhoods.
Too often examiners focus on simple quantitative standards regardless of whether there is under-met need, rather than the qualitative factors - and do not give sufficient credit to innovative,

complex, or high-impact projects. High-impact and complex investments, loans, and services are crucial to community development, and are needed now more than ever. Examples of these innovative programs include opening and maintaining homeownership preservation offices in low- and moderate-income neighborhoods, and a bank's efforts to systematically offer and sell at deep discounts or donate properties to local community based organizations. We recommend that the federal banking agencies pay greater attention to innovative, high-impact and complex loans, investments and services in conducting CRA examinations. CRA initiatives that are designed to meet the special needs of a community often can be much more effective than participation in general lending or investment programs.

Additionally, we urge greater attention be paid to the performance context for individual banks. No two banks are alike. Within the context of CRA this means that a simple peer analysis may not be the best means to measure a bank's CRA compliance. The CRA regulations already acknowledge the unique character of individual banking institutions by encouraging institutions to perform their own "performance context" assessments in advance of CRA examinations. These assessments are designed to help examiners consider (a) a bank's unique product offerings and business strategy as determined from data provided by the bank; (b) a bank's institutional capacities and constraints, including the size and financial condition of the bank, the economic climate (national, regional, and local), safety and soundness limitations, and any other factors that significantly affect the bank's ability to provide lending, investments, or services in its assessment area(s); and (c) a bank's past performance and the performance of similarly situated lenders. We recommend that the federal banking agencies encourage examiners to give sufficient attention and regard to these assessments in the conduct of CRA examinations, rather than just relying upon quantitative peer comparisons and demographic benchmarks.

Credit for Non-Mortgage Lending

In recent years, CRA examiners have placed an emphasis on mortgage lending, with constant pressure for individual institutions to match such lending by their peers and by demographic benchmarks, regardless of whether such benchmarks can be met in a safe and sound manner. Typically, CRA examiners have focused more on mortgage lending far more than small business, small farm, and community development lending. Nonetheless, we recommend that the federal banking agencies encourage examiners to give institutions sufficient recognition for non-mortgage lending activities. Small business lending, particularly with its attendant job creation, is just as critical a need as affordable housing, especially in this current economic environment, to the strength of communities across the country. In addition, community development lending which likewise can encompass affordable housing and economic development, although may be relatively low in terms of volume compared to mortgage lending, may have significant community impact. The CRA statute itself is not focused on mortgage lending, but all types of lending in the bank's service area. We urge the federal banking agencies to emphasize all types of lending in examinations- mortgage, small business, small farm, and community development.

III. Maintaining the Focus of CRA

In the first years of CRA, banks, regulators and community activists engaged in a paper chase, creating file after file of community credit needs assessments but funding too few community credit needs. One of the major benefits of the 1995 regulatory revisions was the creation of a regulatory regime much more focused on the business of CRA: providing credit to all of the community, including the low- and moderate-income neighborhoods and consumers.

Given the successful implementation of CRA, now is not the time to change the focus of the statue.

Similarly, we do not support the extension of CRA to securities brokerages, mutual funds, and insurance companies. CRA is based in the centuries-old convenience and needs obligation inherent in banking charters. The Act describes this obligation as follows:

> "(1) [insured bank and savings associations] are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business;
>
> (2) the convenience and needs of communities include the need for credit services as well as deposit services; and
>
> (3) [insured banks and savings associations] have continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered."

CRA has succeeded because it is linked to the charter obligation imposed on banking institutions. It should not be assumed that extending CRA to institutions that are not subject to a similar obligation would be successful. While mutual funds, insurance companies and brokerages have duties and other obligations to their customers, they are not subject to the same type of community convenience and needs obligation that is part of the bank charter. Banks are unique in this regard, and CRA is based on this unique obligation.

Moreover, proposals to extend CRA beyond banking firms raise several policy questions. What would be the basis for extending CRA to firms that are not subject to the same "convenience and needs" obligation inherent in a bank charter? If CRA is extended to non-banking firms, what types of firms should be covered? Since insurance companies and brokerages do not do much lending, how will we judge their CRA performance? Both insurance companies and brokerages have limitations to investing primarily in investment grade securities, either as a prudential standard to preserve the companies' capital or as a customer fiduciary standard. It is highly likely that these investment restrictions will pose very difficult problems to trying to apply CRA to insurance companies and brokerages. There is simply no adequate basis for a broad extension of CRA to other financial service companies.

Finally, we do not support proposals that call for additional customer information collection, monitoring and reporting. Not only would these proposals impose additional costs and burdens on the banking industry, they can jeopardize the privacy rights of our customers.

IV. Conclusion

CRA has helped to transform urban and rural communities throughout the U.S. The members of the Roundtable are proud of the role they perform under the Act. We believe that with some minor refinements the federal banking regulators could encourage even greater benefits for local communities. We also believe that now is not the time to change the focus of CRA. We should write a new chapter in this success story, not rewrite the story.

Testimony of Calvin Bradford for the National People's Action
before the
House Financial Services
Subcommittee on Financial Institutions and Consumer Credit
Hearings on the Community Reinvestment Act
April 15, 2010

Thank you, Chairman Gutierrerz, Mr. Hensarling, and members of this Committee for this chance to review the history of the Community Reinvestment Act (CRA), the performance of the federal agencies charged with the enforcement of the lending laws and the Community Reinvestment Act, and the need to update the Act to meet the needs and structure of today's financial markets. My name is Calvin Bradford. Over the past forty years, I have worked as an academic and policy analyst, a Senior Fellow at the Hubert Humphrey Institute of Public Affairs, and as an independent consultant and expert on housing and lending discrimination. My greatest pleasure, however, has been the position in which I come to you today as a board member of the National People's Action.

As you know, Mr. Chairman, the organizing that led to the CRA began in your home city of Chicago. Thirty-three years ago, I had the pleasure to work with Gale Cincotta and the National People's Action, Senator William Proxmire and his staff, and officials of the South Shore Bank in Chicago in drafting Senate Bill 406 - the Community Reinvestment Act.

As you focus a policy spotlight on the CRA to pursue the need to update the Act to meet the demands of the modern financial marketplace, you remind us of the incredible accomplishments that have come from trillions of dollars in reinvestment in low- and moderate-income and minority communities through the efforts of community-based organizations and development corporations in partnerships with local, regional, and national lenders.

In the beginning, the story of the Community Reinvestment Act is tale of the government providing for a role for citizens and the local community to shape their own path to economic revival and stability. In this respect, the public – community groups, consumer groups, civil rights groups - did their jobs well. But in the end, it is a story of the very agencies charged with protecting the citizens betraying the laws of Congress, perverting their own regulations and public pronouncements, and delivering the people of or nation into the greedy hands of unscrupulous mortgage lenders and Wall Street investment houses.

But, perhaps the ugliest chapter is being played out now, as the very working class and minority victims of this mass exploitation who for more than a decade waved warning flags about the coming disaster are being blamed by for the world financial meltdown by the defenders of Wall Street. I am not suggesting that community groups had analyzed the weaknesses of the hedge fund markets. I am suggesting something much simpler and more fundamental. While the complexities of the credit default swaps and other hedge fund maneuvers magnified the disaster, if the loans had been sound, reasonably well underwritten, and honestly marketed (and, if common sense had been applied to consider that all bubbles eventually burst), then the hedging wouldn't have been needed and the crisis would not have occurred. It was the community groups that attacked the basic weaknesses of the subprime market back when it began.

Given all that comes to light as we move toward regulatory reform, I will offer you the broad elements that NPA believes are essential to modernizing CRA so that it provides a basis for the future economic growth and stability in all communities with underserved financial needs and lagging local economies – urban and rural. In order to understand both the rationale and importance of these proposals, my written statement places these elements within the context of the past history and present conditions of the CRA, itself, and within the context of the current the financial markets. In doing this, however, one needs to comment, as well, on the misinformed – and at some points even racist - efforts to blame the CRA for the mortgage meltdown.

Facing the Realities of the Current Markets and Regulatory Environment

For the much simpler financial markets in which it was developed, the Community Reinvestment Act was designed to assure fair access to credit to all persons and all communities – and to serve as an engine for the creation of a development banking industry. Over the years since the Act was created, the markets have become more complex and simultaneously both more segmented and more fragmented. As the regulations for the Act have become more diffuse and lax, neither of the original goals of the Act is now being met.

The modernization of the Act needs to refocus on the original goals while taking account of the changes that have taken place in the financial markets. One critical aspect of those changes has been the increased development of loan products that are toxic either in their innate format or when concentrated in particular markets or communities. Another critical development has been the merging of banking, investment, and insurance services into a single bank holding company. A related development has been the dominance of Wall Street over the growth and proliferation of financial products. On Wall Street, the goal is not simply to invest, but to hedge those investments so that any market failures do not impact the investors. As a result, the goal of the investment community has detached itself from the welfare of the citizens. That is, what is good for Wall Street is not necessarily good for the public.

In the current meltdown, Wall Street's essential admission of any culpability is that it failed to hedge fully and soundly the risks resulting from its investments in unsound and toxic loans. In response, the structure of the regulatory reform efforts (aside from the effort to create the Consumer Finance Protection Agency [CFPA]) are aimed largely at ensuring some form of proper hedging – rather than at controlling the development or use of potentially toxic financial products. After all, increased capital requirements, for example, are basically a form of hedging, but in a different form than a credit default swap. In any event, the purpose is to protect the investor from the consequences of the investment and not to protect the public from the investment itself.

In the legislative arena, we now have a kind of skewed three legged stool developing in relation to support for community investment – which is really about getting the money to Main Street. First, in reality, regulation is focused on minimizing losses to the investors, whether they are banks, investment houses, insurance companies, or some hybrid. Second, it is the proposed Consumer Finance Protection Agency that would focus on identifying and, in some cases prohibiting, the use of products that are deceptive, misleading, or that are potentially toxic to either individuals or communities. Third, the Community Reinvestment Act is left as the main vehicle to provide fair access to sound financial products while holding financial institutions accountable for the impacts of toxic financial products.

In this model, the banking industry and Wall Street have at their disposal not only their own inherent power in the markets, but the ultimate support of their hedging values by the financial regulatory bodies themselves. The CFPA hangs by a thread in Congress. The real enforcement of the Community Reinvestment Act relies on the public and community-based organizations presently armed with very few, limited, and outdated tools. The CRA modernization, therefore, needs to face this reality.

A Brief Review of the Historical Context for the CRA

The Good

The Community Reinvestment Act grew out of the anti-redlining movement of the 1970s that was led by the National People's Action. The movement was a uniquely American effort to expand the role of the private banking industry in communities that had been underserved because of their racial composition, income levels, or because they were older and lagged behind the growing suburban communities preferred by the banks and savings institutions at that time. The movement was based on the premise that these underserved communities represented sound opportunities for profitable investments that were being overlooked. Sometimes these communities were overlooked because of a prejudice about the racial composition of the residents or simply about the age of the communities. In other ways, these communities were overlooked because the banking industry had failed to develop appropriate products, services, or skills that could open up new markets and revitalize these communities.

The CRA was based on the existing laws covering financial institutions that are chartered by the Federal government and/or that receive the substantial benefits and protections of deposit insurance. As Senator Proxmire noted in a letter circulated in December of 1976 with a draft of the CRA bill:

> The authority to operate new deposit facilities is given away free to successful applicants even though the authority conveys substantial economic benefit to the applicant. Those who obtain new deposit facilities receive a semi-exclusive

franchise to do business in a particular geographic area. The government limits the entry of other potential competitors into that area if such entry would unduly jeopardize existing financial institutions. ... The government provides deposit insurance through the FDIC and the FSLIC [Federal Savings and Loan Insurance Corporation] with a financial backup from the U.S. Treasury. The government also provides ready access to low cost credit through the Federal Reserve Banks or the Federal Home Loan Banks.

In return for these benefits, financial institutions are required by law and regulatory policy to serve the "convenience and needs" of their communities as a condition for acquiring new deposit facilities. ... However, in practice, the regulators have tended to ignore credit needs and have focused primarily on deposit needs.[1] The regulators have thus conferred substantial economic benefits on private institutions without extracting any meaningful quid pro quo for the public. ... The proposed legislation directs the bank regulatory agencies to use their leverage in approving applications for deposit facilities in a way that will benefit local communities. ... **The bill would not inject any radically new element into the deposit facility application and approval process already in place. Instead, it merely amplifies the "community need" criteria already contained in existing law and regulation and provides a more explicit statutory statement of what constitutes "community need"** (emphasis added).[2]

Therefore, the CRA was based on the existing processes for granting charters or approving acquisitions, mergers, and branching – and on the clear assumption that these activities are not a right, but are a privilege. The Community Reinvestment Act was intended to ensure that institutions that failed to meet the convenience and needs of their local communities would not be eligible for these financial privileges. Moreover, the CRA was intended to be one of the major tools in the eliminating of racial redlining and discrimination in lending.

While the Act did not specifically define the need to serve the needs of minorities or other protected classes, it did specifically require that lenders serve the needs of low- and moderate-income communities. Moreover, the regulations implementing the CRA required institutions to define a community service area in ways that were not discriminatory, to assess local credit needs, and to list the services that they intended to provide to the community. There was a specific assessment factor related to the definition of the service area. The Act stated that the lenders had a "continuing and affirmative obligation" to serve the needs of their communities. A clear role was created for members of the public to challenge applications for mergers, acquisitions and branches.

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[1] One of the main claims of the anti-redlining movement was that banks and savings institutions took the deposits from their communities and siphoned them off into the white and suburban communities.

[2] Draft of the Community Reinvestment Act attached to a letter from Senator Proxmire dated December 17, 1976.

When it became clear that neither the regulators nor the banking industry – both of whom had opposed the legislation – were going to take seriously the effort to develop programs to reinvest in underserved communities, community-based organizations and development corporations initiated their own reinvestment loan programs and challenged the lenders to participate. Today, there are many different and successful CRA programs and virtually all of them are variations of models first developed by community organizations in partnership with financial institutions.

Together, community action groups, the growing base of community-based development corporations, and the South Shore Bank in particular, provided both a political base for action and sound practical applications as support for making reinvestment part of the banking business. It is beyond the scope of these hearings to review the development banking side of the Community Reinvestment Act. We should note, however that the basis for such an industry exists and comes largely from the efforts of community-based initiatives and scores of negotiated community reinvestment agreements with individual lenders. The efforts to build a development banking industry have been frustrated in part by the fact that these agreements have never been recognized as formal obligations by the bank regulatory agencies and even though neither the regulatory agencies (including the Treasury Department), HUD, nor the Department of Commerce have ever taken seriously the role of building an economic development banking industry.[3]

While we have several programs to funnel private investment into lagging economic markets in foreign countries, the Community Reinvestment Act remains the singular program devoted to the creation of a development banking industry to serve America's own economically lagging communities. As the late Federal Reserve Governor Ed Gramlich noted several years ago, these reinvestment efforts resulted in over 3 trillion dollars in reinvestment. I have worked on both the creation and evaluation of reinvestment programs. I have watched once desolate abandoned communities being rebuilt through reinvestment. I have seen many financial institutions discover the value of private market opportunities in these communities – as it is the expansion of sound opportunities for the private financial markets that has always been the goal of the CRA.

The Bad

Aside from the act of voting, citizens have few opportunities to participate directly in public policy. The role originally given to the public in working with lenders and in challenging covered activities is one of the rare places where citizens can participate in the economic policies and practices that affect their lives and their communities. Over the years, however, revisions in the CRA regulations have weakened and undermined both the enforcement process and the role of the public and community.

[3] While we note the critical role played by Community Development Financial Institutions, isolating the skills and experience of such lending in separate institutions where the regulated lenders and the government provide support is not a replacement for the larger banking industry, itself, acquiring and developing these skills and this experience.

The revisions made to the regulations in 1995 represent the most critical abandonment of the regulatory oversight process. In the 1995 revisions to the CRA regulations, the agencies eliminated key aspects of the CRA enforcement. They eliminated the evaluation of the institution's assessment of community credit needs. In essence, they eliminated the role of the community and made the CRA process a private affair between the lender and the regulator. By what first appeared to be subtle changes in the delineation of the CRA assessment area, they actually "permitted" institutions to draw their CRA assessment areas in any way they pleased as long as the regulator could be convinced that it was a "reasonable" area for the institution to serve. In spite of some language about not discriminating and not excluding low- and moderate-income areas, what was reasonable was ultimately left to the subjective discretion of the examiner.

Above the Law: High CRA Ratings for Fair Lending Violations

When the CRA was first created, it was naturally assumed that lenders would be held accountable under the CRA for compliance with all fair lending laws. The Fair Housing Act already prohibited discrimination against minorities by lenders. In just the previous year (1976) in Ohio, the *Laufman* case had established that redlining was covered by the Fair Housing Act.[4] The Federal Home Loan Bank Board (FHLBB) had filed its own amicus brief in support of the decision in the *Laufman* case. The FHLBB was the regulator of the nation's largest savings and loans and mutual savings banks, which were the largest conventional home lenders at this time. Moreover, the Equal Credit Opportunity Act (ECOA) had just been passed in 1976, giving more direct prohibitions against racial discrimination in lending of any kind. Fair lending was clearly the law of the land already – and the bank regulatory agencies were mandated to affirmatively enforce the fair lending laws. Finally, there was the assessment factor in the regulations related to fair lending.

Immediately after the CRA was passed, HUD had contracted for a report on the likely impact of the CRA. The report includes sections on what the examination process should look like and what types of resources should be used in the examination process. At the beginning of the section on the examination of the institution's record is the statement, "The first almost elementary aspect of any assessment should be an evaluation of the lenders (sic) record under the Fair Housing Act, Equal Credit Opportunity Act, and related non-discrimination regulations. **A lender in violation of these provisions is, *a priori*, not meeting the needs of his community**" (emphasis added).[5]

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[4] *Laufman v. Oakley Building & Loan Co.*, 404 F. Supp. 791 (S.D. Ohio 1975), 72 F.R.D 116 (S.D. Ohio 1976), and 408 F. Supp. 489 (S.D. Ohio 1976).

[5] Warren Dennis, "Working paper No. 24 - The Community Reinvestment Act of 1977 – Its Legislative History and Its Impact on Applications for Changes in Structure Made by Depository Institutions to The Four Federal Financial Supervisory Agencies", Credit Research Center, Krannert Graduate School of Management – Purdue University, 1978, under a contract with HUD, pages 80-81. In a foreshadowing of the problems that we are addressing today, the report warns that aside from the Federal Home Loan Bank Board, the bank regulatory agencies have little experience with fair lending enforcement and the understanding of the fair lending laws. The report even notes that "the Federal Reserve Board continues to contest its obligations under the Fair Housing Act."

For support for this statement, the report cites a no more convincing source than the testimony of the representative of the Federal Home Loan Bank Board at the hearings on Senate Bill 406. The report goes on to review how such anti-discrimination reviews can be done, also citing the hearings on Senate 406 regarding anti-redlining regulations in California that were developed for the savings and loan department there as part of its review of lending institutions. The report continues:

> Examiners should be given a program for analyzing Home Mortgage Disclosure Act data as an integral part of the CRA review. Loan locations should be plotted on race and income coded census tract maps, with overlays for the different types of loans on the report. This device gives the examiners a tool for reviewing the institution's designation of "market area" and spotting "gerrymandered neighborhoods."

But, from the beginning, the regulators claimed that the law only applied to serving "low- and moderate-income communities". Therefore, examiners did not review racial lending patterns as part of the CRA compliance process.

When the regulations were changed in 1996, the regulators eliminated the assessment factors related to evidence of illegal discrimination. What remained was simply an instruction to consider any evidence of discrimination after the examiner had used the new scoring system to assign the CRA rating. Unlike the formal assessment factors, there were no guidelines and no scores associated with the examiner's review of evidence of discrimination. There was only the instruction to consider any actions that the lender may have made to correct the problems. In a CRA system based on numerical scores, the assessment of discrimination effectively counted for nothing.

The effects of these changes can be seen in several cases where the regulators gave "Satisfactory" and "Outstanding" ratings to institutions that were sued by the Department of Justice (DOJ) for formally redlined minority communities. I have reviewed three cases where the Department of Justice sued major metropolitan institutions for discrimination in explicitly redlining the entire city of Detroit or the minority portions of Gary, Indiana, and Chicago while the regulatory agencies gave these same lenders high CRA marks. The agencies continued to reward these lenders by approving their applications for branches, mergers, and acquisitions while the redlined communities have continued to suffer from disinvestment and subprime abuses. I have also included one case where the lender was twice found in violation of the fair lending laws in Federal court and was rewarded by the regulatory agency by raising its grade to Outstanding and continuing to approve its applications for banking privileges.

The question, then, is how to explain the cases where the Department of Justice has filed discrimination claims against a lender or a lender has been found to have violated the fair lending laws in court while the regulatory agencies continue to give these institutions the high CRA ratings and continue to grant them branching, merging, and acquisition rights. A review of these cases illustrates the issue.

The OTS and Mid America Federal

The Chicago metropolitan area is the largest African-American home lending market in the United States, and one of the largest Hispanic markets outside of the Southwest as well. Mid America is the largest independent thrift institution in the entire Chicago market. It is one of the largest mortgage lenders in the Chicago markets. Mid America is regulated by the Office of Thrift Supervision (OTS). Since 1994, the OTS has given Mid America four Outstanding ratings and one Satisfactory rating.

In 2002, DOJ filed suit against Mid America for violating the Fair Housing Act and the Equal Credit Opportunity Act.[6] In specifically citing Section 228 of the CRA regulations (Reg BB), the suit stated that, "In establishing its assessment area, also known as its community service area, boundaries under the Community Reinvestment Act of 1977, 12 U.S.C. §§2901-2906 ("CRA"), Mid America has, since at least 1996, excluded nearly all predominantly African American and African American/Hispanic neighborhoods in the Chicago MSA, even those located in close proximity to its branch offices." [See the attached map which reproduces the exhibit from the DOJ complaint.]

Even though it was a major lender in the white communities along Lake Michigan in the City of Chicago and in the northern suburbs, it defined its assessment area largely as a suburban area west of Chicago. Essentially, Mid America eliminated the minority communities within the City of Chicago and the southern suburbs.

Even if the OTS ignored the racial composition of Chicago, the regulations require lenders not to exclude low- and moderate- income census tracts from their CRA communities. According to the 2000 census, 91% of the low- and moderate-income census tracts in the City of Chicago, for example, are also minority census tracts. Looked at from another perspective, 86% of all the minority census tracts in Chicago are also low- or moderate-income census tracts. Thus, for many years, the Office of Thrift Supervision has allowed this major Chicago metropolitan area lender to exclude both low- and moderate-income and minority areas from its defined service area.

The DOJ suit cites the pattern of expansion of Mid America through the opening of branches in the Chicago metropolitan area. The complaint states that, "Mid America has engaged in a race-based pattern of locating or acquiring new offices. It has located or acquired new branch and other offices to serve the residential lending and credit needs of predominantly white areas but not those of predominantly African American or African American/Hispanic neighborhoods. Mid America has never opened any new full-service branch office in a majority African American or African American/ Hispanic neighborhood. As of March 1, 2002, of Mid America's 33 branch offices, only one,

[6] Copies of the complaints and consent decrees for this and the other DOJ cases cited in this statement can be found on the DOJ website at http://www.usdoj.gov/crt/housing/caselist.htm#lending.

Broadview, is located in a census tract in which a majority of the residents are African American. However, the Broadview branch is the only non-traditional office operated by Mid America. In contrast to all its other branch offices, the Bank's Broadview office consists solely of an ATM machine and a lobby area located inside a K Mart. Moreover, the level of services offered at the Broadview branch is substantially less than that offered at Mid America's other branches. Every other branch office offers mortgage lending or investment services, or both; neither is offered at the Broadview branch."

Opening branches is a privilege that should be granted only to institutions that have satisfied their CRA obligations. By continually allowing Mid America to expand, the OTS was rewarding a major lender in the nation's largest African-American mortgage market for engaging in racial redlining – the very practice that led to the creation of the CRA in the first place.

While DOJ settled the case by requiring the lender to open minority branches, to pay $10 million for special minority loans to compensate for past discrimination, and to develop outreach programs and to participate in existing special loan programs, the OTS still gave the lender a rating of Satisfactory after noting the lawsuit (the only rating below Outstanding that the OTS gave this lender since 1992). The OTS noted that in light of the lawsuit it could "not find the lender had not violated the fair lending laws". As the lender complied with the settlement order, the OTS gave the lender credit for expanded lending and raised the rating to Outstanding. Thus, the actions that Mid America was forced to take as the result of a consent order by a Federal court were used to raise its rating to Outstanding.

The Federal Reserve Board and Old Kent Bank

Between 1997 and 2001, the Federal Reserve Board had given three Satisfactory CRA ratings to Old Kent Bank, a major lender in the Detroit metropolitan area.[7] During this period, Old Kent defined its assessment area in terms of several counties and parts of counties that encircled the City of Detroit, but excluded the City of Detroit itself. A review of the Public CRA Evaluation reports indicates that the Federal Reserve Board was clearly aware of this exclusion and that it accepted this exclusion of Detroit and evaluated Old Kent based on the service it provided to the predominantly white suburban areas only.

In 2006, DOJ filed suit against Old Kent for violating the Fair Housing Act and the Equal Credit Opportunity Act. In specifically citing Section 228 of the CRA regulations (Reg BB), the suit stated that, "Instead of defining its assessment area in accordance with Regulation BB, Old Kent Bank circumscribed its lending area in the Detroit MSA to exclude most of the majority African American neighborhoods by excluding the City of Detroit." [See the attached map which reproduces the exhibit from the DOJ complaint.] The complaint also indicates that "As of March 2000, Old Kent Bank still did not have a single branch in the City of Detroit, where the population is more than 81% African American."

[7] The 2001 rating was given after the FRB had approved the merger of Old Kent into Fifth Third Bank.

Even if the Federal Reserve ignored the racial composition of Detroit, the regulations require lenders not to exclude low- and moderate- income census tracts from their CRA communities. According to the 2000 census, 93% of the low- and moderate-income tracts in Detroit, are also minority census tracts. Looked at from another perspective, 86% of all the minority census tracts in Detroit are also low- or moderate-income census tracts. Thus, for many years, the Federal Reserve Board had allowed this major Detroit metropolitan area lender to exclude both low- and moderate-income and minority areas from its defined service area.

The DOJ suit cites the pattern of expansion of Old Kent through the opening of branches in the Detroit metropolitan area. The complaint states that, "As of January 1996, Old Kent Bank operated at least 18 branches in the Detroit MSA. Not a single one of these branches was located in the City of Detroit. As of March 2000, Old Kent Bank had expanded its business presence in the Detroit MSA to include a branch network of at least 53 branches, located in every county of the Detroit MSA. Virtually all of Old Kent Bank's branches were located in predominantly white suburbs." Opening branches is a privilege that should be granted only to institutions that have satisfied their CRA obligations. By continually allowing Old Kent to expand (and by later allowing the merger of Old Kent and Fifth Third), the Federal Reserve Board was rewarding a major lender for engaging in racial redlining.

The DOJ complaint also cited Old Kent for failing to provide equal lending services for both home mortgage and small business loans to the minority areas that were illegally excluded from its CRA lending community. As a result, DOJ engaged in a consent order requiring corrective actions that had not been ordered by the Federal Reserve Board.

The FDIC and Centier Bank

Centier Bank is regulated by the FDIC. It serves a regional market in Northwest Indiana. The FDIC examined Centier four times between 1993 and 2003. Each time the bank was given a Satisfactory rating. This rating allowed the bank to continue to engage in branching and expansion activities which should have been denied had the institution been given a failing CRA rating. Indeed, it has become clear that even when community challenges are made, a passing CRA rating provides the lender with a safe harbor. Therefore, challenges become a fruitless gesture for lenders with passing CRA ratings – and almost all lenders have passing CRA ratings.

While Centier's delineated service area literally surrounded the City of Gary (a predominantly African-American city), through at least most of 1999, almost all of the City of Gary, and all of Gary's predominantly minority census tracts, were excluded from the delineated community. In this year (according to the DOJ complaint), "the FDIC informed the Bank that its assessment area violated the CRA and its regulations." Even at this point, the FDIC continued to give the bank a Satisfactory rating.

In 2006, DOJ filed suit against Centier for violating the Fair Housing Act and the Equal Credit Opportunity Act. In specifically citing Section 228 of the CRA regulations (Reg BB), the suits stated that, "Instead of defining its assessment area in accordance with Reg BB, Centier long circumscribed its lending area in the Gary PMSA to exclude most majority-minority neighborhoods, including having two geographically separate assessment areas for many years. Until late 1999, Centier's CRA assessment area included only three majority-minority census tracts from Gary, East Chicago, and Hammond, despite the fact that a large number of minority tracts were adjacent to the non-minority tracts included in the assessment area." [See the attached map which reproduces the exhibit from the DOJ complaint.]

According to the 2000 census, 93% of the low- and moderate-income tracts in Gary, Indiana, are also minority census tracts. Looked at from another perspective, 87% of all the minority census tracts in Gary are also low- or moderate-income census tracts. Thus, for many years, the FDIC had allowed this major Northwest Indiana lender to exclude both low- and moderate-income and minority areas from its defined service area. In allowing the institution to continue to open branches in the areas outside of Gary, the FDIC was actually rewarding Centier for its discrimination.

The DOJ complaint also cited Centier for failing to provide equal lending services for both home mortgage and small business loans to the minority areas that were illegally excluded from its CRA lending community. As a result, DOJ engaged in a consent order requiring corrective actions that had not been ordered by the FDIC.

First American Bank – Can You Pass the CRA by Switching Regulators?

First American Bank serves the markets of the Chicago and Kankakee MSAs in Illinois. In 2001, the Federal Reserve Board gave the First American Bank a Substantial Noncompliance rating based on evidence of illegal discrimination. That evidence was turned over to the Department of Justice. In July of 2004, DOJ filed suit against First American Bank for violating the Fair Housing Act and the Equal Credit Opportunity Act. First American Bank was accused of serving only predominantly white areas in its markets. This complaint was a pattern or practice case based on both marketing and lending. According to the complaint, this evidence included "comments made by American Bank officials to examiners from the Federal Reserve Bank of Chicago with respect to the Bank's lending practices which are based on racial and ethnic stereotypes."

Meanwhile, First American Bank operated under a Cease and Desist Order from the Federal Reserve based on the prior evidence of discrimination. In November of 2003, First American Bank changed its regulator to the FDIC. In March of 2004, the FDIC gave First American Bank a Satisfactory rating, thus reinstating its privileges to engage in branching and other activities while the DOJ investigation was still ongoing. In July of 2004, four months *after* the passing CRA rating, DOJ settled the case with First American Bank with a series of remedial actions that were to be taken in the future to correct past discriminatory behavior. The FDIC public CRA evaluation mentioned the

Cease and Desist Order with the Federal Reserve, but did not mention the DOJ investigation.

While the analysis in the CRA public disclosure showed some signs of more lending in low- and moderate- income areas for some loan products, none of this dealt with the issues of the lack of service and lending in minority areas. With the DOJ investigation still ongoing, the FDIC could have recognized some improvement by the bank in upgrading its rating to Needs to Improve, which would have been clearly in line with the need to carry out more fully the remedies for its past discriminatory behavior. Instead, the FDIC granted the bank a full Satisfactory rating prior to the imposition of the remedies in the DOJ settlement.

Flagstar – Violating Your Way to an Outstanding Rating

If the regulatory agencies can't identify discrimination as blatant as that described in these examples of DOJ cases, then there is a fundamental problem that surely requires Congressional action to be corrected. Still, one might try to set aside these cases by claiming that these all involved settlements where the lenders claimed that they did no wrong. That is, these cases did not involve court decisions that fair lending violations occurred. Let us turn, then, to a case where there were such legal findings.

The case of Flagstar Bank, FSB, represents that rare exception where we actually have proof of fair lending violations that we can compare to the public comments of the institution's regulator and to the CRA ratings given to the bank before and after the violations occurred. This case illustrates how even multiple legal findings of discrimination can lead a lender to an Outstanding CRA rating.

- Between February of 1994 and November of 2005, during which time the OTS gave Flagstar Bank "Satisfactory" and "Outstanding" CRA ratings, this lender was sued several times in federal court for issues related to discrimination in lending. Flagstar, in contrast, was found liable for discrimination at trial or by the court in at least two of these cases.

- In 1999, a jury in Detroit found Flagstar liable for discrimination against minority borrowers, and plaintiffs were awarded damages. Later the Sixth Circuit Court of Appeals upheld one of these findings. In 2003, in a national class action suit, a federal court in Indianapolis found a written pricing policy developed by Flagstar management in 2001 so overtly discriminatory that the court ruled against Flagstar on summary judgment. The policy explicitly stated that pricing would be different for minority and non-minority borrowers. It appears that **the discriminatory pricing policy was developed and implemented by Flagstar *while* the OTS was conducting its consumer compliance examination.**

- The OTS conducted five CRA examinations and never found Flagstar in violation of discrimination laws. During this time period, Flagstar was given a

"Satisfactory" CRA rating four times and was elevated to an "Outstanding" rating **after** the summary judgment finding in 2003.

Flagstar was one of the nation's twenty largest mortgage lenders during the period covered by this litigation. It sold loans to both Fannie Mae and Freddie Mac and was one of the largest underwriters of FHA loans through certification granted by HUD.

Moreover, Flagstar was allowed to expand significantly during this time period by opening numerous branches, expanding into a new state, and expanding to additional metropolitan areas in these states. The approval of its applications to expand was based, in part, on its CRA ratings. As a result, during the period from 1994 through 2005, Flagstar grew from just over $500 million in assets to nearly $13 billion in assets.

The actions taken by Flagstar as a result of the settlement of suits in Detroit were actually used to raise its later CRA rating. After the Federal Court in Indiana forced the elimination of its written racial pricing policy, the OTS gave Flagstar an Outstanding rating, finding no violation of fair lending laws in spite of two legal decisions. *As bizarre as it seems, Flagstar seems to have literally violated its way to an Outstanding rating.*

For the regulators, their clever and narrow use of the regulations they drafted to control their own behavior allow them to treat these regulations as a kind of regulatory "signing statement" where they can use their own discretion to reinterpret or ignore lending behavior that would violate the fair lending laws.

The Option of Including Affiliates in the CRA Assessment

In the examination process, institutions are allowed to decide whether to include the loans from their holding company affiliates. This choice may radically change the lending patterns used in a CRA examination at the choice of the institution. Moreover, this may ignore the role of affiliates in other markets where their patterns may reflect discrimination. In addition, while the CRA examinations rely on previous fair lending examinations for evidence of discrimination, the fair lending examinations specifically instruct the examiners to "limit the inquiry to what can be learned in the institution and do not contact the affiliate" (at page 15).[8]

In cases where the institution is part of a holding company, the CRA regulations allow institutions to include or exclude the lending activities of affiliates of that holding company for any particular type of loan. Where an institution decides to include the

[8] These are the *Federal Reserve Consumer Compliance Handbook*, "Federal Fair Lending Regulations and Statutes – Examination Procedures" (updated to January 2006), and *Comptroller's Handbook – Consumer Compliance Examination*, "Fair Lending Examination Procedures" (updated to April 2006), and Office of Thrift Supervision, *Examination Handbook*, Section 1200 (updated to March 2007). In the interpretive introduction to the 1995 CRA regulations, the agencies also indicate how affiliates are not to be examined, stating that, "although lending by affiliates may be treated as lending by an institution, this treatment for CRA purposes will not permit a regulatory agency to examine any institution or its affiliate if it does not otherwise have such authority."

lending of the affiliates, all of the affiliate lending for that particular loan type are to be included in the examination.

Because Citigroup represents a large bank holding company with some extremely varied and complex affiliate structures, some of the problems with the treatment of affiliates by the regulators can be demonstrated in some examples from different depository institutions that are part of Citigroup. These examples highlight some key issues related to the treatment of affiliates as well as issues related to the CRA comment and challenge process, and issues related to the treatment of claims of discrimination and violations of other credit laws.

The first example is taken from the Comptroller's Public Evaluation of Citibank, NA in 2003. In the case of the evaluation of Citibank, NA, the institution chose to include all of the affiliate lenders of Citigroup in the CRA examination. The Comptroller lists seven affiliates where the HMDA data were combined with that of Citibank for the lending test. In this case, the Comptroller assigned an Outstanding rating for Citibank's lending test, guaranteeing it a passing CRA rating overall. In this example, we are not so much concerned about the actual rating as with the process used by the Comptroller.

The assessment area for Citibank is defined essentially as the New York City area and Long Island. In this case, even though Citigroup was the largest bank holding company in the United States and made loans all across the country through various "affiliates", the Comptroller's evaluation was based on the lending patterns in just a few counties in the state of New York (essentially New York City and Long Island). Indeed, the evaluation states that, "despite the fact that the affiliates are nationwide lenders, CRA consideration was only given for those loans made in the bank's AAs [assessment areas]" (at page 7). For any other lender with affiliates that made loans nationwide, the same standard would be applied.

One affiliate, Citicorp Mortgage, was one of the largest lenders in the nation, yet only its role as part of the aggregate pattern of all the affiliate lenders in the assessment area was reviewed. Moreover, "93.7% of the HMDA loans in the local assessment area were provided by the bank and the affiliate, Citicorp Mortgage" (at page 7). One issue, then, is that the dominant pattern for the lending test may be determined by a single affiliate. One can see as a practical matter that any institution's choice to include or exclude affiliates might radically change the lending pattern in a particular assessment area.

Another issue of concern is that the analysis of the lending patterns is generally done by reviewing the composite lending for the institution and all of the affiliates combined. If a holding company channels different loan products through different affiliates, as was the case with Citigroup and many holding companies, then any disparate racial patterns associated with the segmented lending may be hidden. Since the CRA rewards lenders for the level of loans, an apparent fair distribution of loans in the merged data may mask, for example, the channeling of prime loans to predominantly white and higher income areas and the channeling of FHA and subprime loans to minority and low- and moderate-income areas.

Another reason to use the example of Citibank is that it provides a view of how the Comptroller dealt with a specific past issue of challenges to the lending practices of an institution acquired by Citigroup. Generally, the CRA evaluations rely simply on the aggregate lending patterns of the institution and all affiliates combined. The Comptroller's evaluation is somewhat unique in this regard as it does comment on the separate impact of some of the subprime affiliate lending on the overall pattern as part of a special consideration related to recent CRA challenges and lawsuits against Citigroup in relation to the acquisition of The Associates, one of the nation's largest subprime lenders.

This evaluation covered a period from October of 2000 through June of 2003. This included the time right after Citigroup's acquisition of Associates First Capital Corporation, when a nationwide coalition of community groups mounted a CRA challenge based on the claimed discriminatory and predatory lending practices of The Associates (including such issues as packing credit life insurance into the loans). The challenge was denied and the acquisition took place. The Associates was generally merged into "CitiFinancial" affiliates.

Additionally, the Federal Trade Commission had sued Citigroup (as the successor parent company) for unfair and deceptive trade practices and violations of ECOA by The Associates. The initial settlement for that case was filed in February of 2003 and included a $215 million fund for restitution.

The "Fair Lending Review" section of the Comptroller's evaluation reads:

> We found no evidence of illegal discrimination or other credit practices. However, given the previous adverse publicity involving the bank's affiliates, including Citigroup's settlement with the FTC, the following comments are presented.
>
> With the acquisition of Associates First Capital Corporation in September 2000 and subsequent consolidation with Citifinancial, Citigroup has committed to resolve concerns that had been raised against the former Associates involving alleged deceptive and abusive lending practices.
>
> In considering any potential impact to our CRA assessment of Citibank, we acknowledge Citigroup's efforts to address individual customer concerns and the minimal impact that lending by the affiliate had to the overall lending in the bank's AAs. Therefore, although the concerns were considered, they did not significantly impact our CRA assessment of Citibank. (at page 11)[9]

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[9] One may wonder about the scope of the evidence available to the Comptroller as a foundation for acknowledging "Citigroup's efforts to address individual customer concerns". Surely, some fundamental changes were made to the practices of The Associates when it was folded into CitiFinancial. One may note, however, that at the same time that the Comptroller was examining Citibank, the Federal Reserve was investigating CitiFinancial for continued misrepresentations in marketing credit insurance, for violations of

The comment on the "minimal impact" of the affiliate relates to sections of the lending test that report that two national subprime affiliates of Citigroup, CitiFinancial Mortgage Corporation (CFMC) and CitiFinancial, Inc. (CFI), were given a separate review. In accordance with the CRA examination procedures, this review only applied to the Citibank assessment area in the New York City area and Long Island. In the specific Citibank, NA assessment area, however, these lenders accounted for only "4.1% of the mortgage loans considered." The report concludes, "There was no difference at all in the bank's geographic distribution of home purchase and home improvement loans in low- and moderate-income geographies factoring CFMC and CFI loans."

While this does not cast doubt on Citibank's lending in its assessment area, this comment raises several issues about the CRA examination process. First, this indicates how the lending patterns for the CRA reviews only look at geographic distributions by area income and not race and ethnicity.

Second, the Comptroller specifically notes patterns for home purchase and home improvement loans while the major claims of potential racial bias in subprime lending at this time were focused on refinance loans, about which the Comptroller's report is silent. Third, by looking only at the role of the CitiFinancial lenders in Citibank's local assessment areas, the larger role of these subprime affiliates in other markets is ignored. Hypothetically, if there was discrimination in the lending of any of these affiliates in some other area, that would be ignored and a lender would be allowed to use the lending of these affiliates in its assessment area alone to boost its CRA rating.

For example, in 2002, the National Training and Information Center (NTIC) studied the distribution of prime and subprime loans between Citigroup's affiliates in 13 markets around the country from the 2000 HMDA data.[10] This study provides an example of how the role of subprime affiliates can vary from one market to another. In the New York City area, the market was for Brooklyn and Queens, where NTIC found that 11% of the loans were made by subprime affiliates. This was by far the lowest percentage of all the markets they studied. In Baltimore, 85% of the loans were made by the subprime affiliates. In Cleveland it was 93%. In Cincinnati, it was 94%. In Pittsburgh, it was 95%. In Syracuse it was 90%. Outside of the larger urban areas, the percentage of subprime loans was 94% in Des Moines, 96% in Wichita, and 96% in Central Illinois. This shows how one may get a very limited and unrepresentative view of the overall role of an institution's subprime affiliates when looking only at a single institution's assessment area in a CRA examination.

HOEPA, and for misrepresentations to the Federal Reserve investigators. In May of 2004, this investigation resulted in a Cease and Desist Order that included $70 million in civil money penalties.

[10] See NTIC, *Citigroup: Reinventing Redlining – An Analysis of Lending and Branch Disparities for Citigroup's Prime and Subprime Lending Affiliates*, June 2002. The percentages are taken from the summary table at page 13.

A fourth issue is whether the Comptroller's analysis actually does include all of the subprime affiliates. One affiliate which is missing from those listed by the Comptroller is Citicorp Trust, FSB (CTB). According to the CRA evaluation of CTB by the Office of Thrift Supervision (OTS) in May of 2004, this is a subsidiary of CitiFinancial Credit Company.[11]

Also according to the OTS evaluation, CTB works with another Citigroup company, Primerica Financial Services (PFS), to originate refinance loans. The OTS evaluation states:

> PFS representatives forward completed loan applications to CTB for review and approval. Nationally, there are nine loan processing offices, called $.M.A.R.T. (Save Money and Reduce Taxes) Solution Centers, that accept and process the applications. In addition, CTB has a facility in Hanover, Maryland that is responsible for the solicitation of the existing customer base for refinancing. None of these is considered a retail banking office. (at page 5)

The OTS evaluation further states that, "CTB originates first and second mortgage products primarily for debt consolidation purposes rather than refinancing purposes" (at page 5).

As a conceptual issue, debt consolidation refinance loans sold with the solicitation of other credit and insurance products and solicited for continual refinancing (flipping) are the types of loans that have been subject to the most concerns for discrimination and abuse. I know from my own experience working on suits against The Associates that at least prior to being acquired by Citigroup and becoming CitiFinancial, it continually ran marketing campaigns to flip existing loans in order to capture the remaining equity in the borrower's home, and in some cases simply to increase the interest rate and charge additional fees. Surely with this history, this should have been a major concern for the OTS.

If CBT had a depository institution in the New York City area with an assessment area overlapping with that of Citibank, NA, then one could understand that under the policy of not counting loans twice, these loans would be excluded from the affiliates included in the Citibank evaluation. The only assessment area defined for CTB, however, is for the Wilmington, Delaware, MSA. In this case, because CTB originates loans from many areas across the country, the OTS – *at its own discretion* – selected 9 other metropolitan markets outside of CTB's assessment area for review as what it termed "Supplemental Evaluation Areas" to see if the lending patterns in these comparison areas reflected that same high level of service to low- and moderate-income areas as did the small share of CTB's loans in its actual assessment area.[12]

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[11] The OTS evaluation covers a lending period from 2001 to 2003. CitiFinancial Credit Company is also not listed as one of the affiliates in the Comptroller's evaluation of Citibank, NA.

[12] A list of these areas is found in Table 9 on page 15 of the OTS evaluation.

Therefore, by fiat, the OTS appears to have removed these large pools of subprime loans from the CRA evaluations of Citigroup depository lenders in any of the nine supplementary markets that it chose for comparison. Such a move is inconsistent with the CRA regulations and allows a regulatory agency to essentially hide the loans of an affiliate when they should be counted. In the New York City MSA, for example, the HMDA data for CBT indicates that it had 1,251 loans in 2002 and 1,162 loans in 2003.[13] Since CBT is part of CitiFinancial and a subprime lender, these loans should have been included in the Comptroller's evaluation of Citibank, NA.

This action by the OTS in regard to the loans of CBT is not restricted to the case of Citibank, NA. Citibank, FSB, one of the largest federal savings banks in the nation also received a public CRA evaluation in 2003 that reflected the exclusion of the CBT loans. In this case, the OTS defined 8 assessment areas for Citibank, FSB, across the country.[14] These included the Chicago MSA, the Baltimore MSA, two Florida MSAs, the San Antonio MSA in Texas, MSAs in Connecticut and New Jersey, and the Washington, D.C. MSA. The lending test covered loans for all of 2002 and through June of 2003. Citibank, FSB also chose to have the Citigroup affiliates included in its evaluation.

The OTS also recognized the issues related to the acquisition of The Associates and reported that the aggregate level of lending by the CitiFinancial affiliates across the combined assessment areas was quite small. For example, it stated that for the loans made in 2003 (the first half of the year) only "408 are from affiliates that offer sub-prime loan products" (at page 17). As with the Comptroller's evaluation of Citibank, NA, the list of affiliates did not include CTB, stating that "The only HMDA-reportable affiliate operating within Citibank FSB's assessment areas that is excluded is Citicorp Trust Bank, FSB, which is subject to its own CRA evaluation by OTS" (at page 16).

Based on the HMDA data for 2002, CTB made 4,274 loans in the six assessment areas for Citibank, FSB. Meanwhile, the OTS evaluation reported only 5,041 loans from subprime affiliates in the assessment areas for 2003. Including Citicorp Trust Bank loans would have increased the number of these subprime affiliate loans by 85%. In 2003, CTB made 5,181 loans in the six assessment areas. Counting just half the year would be 2,590 loans. Meanwhile, the OTS evaluation reported just 408 loans from all affiliates for the first half of 2003. Including the estimated half year of CBT loans would have increased the number of these Citifinancial related subprime loans by 635%. Put another

[13] In the data presented here and in the CRA evaluations, both the loans originated and the loans purchased by the institution are counted in the lending test.

[14] Office of Thrift Supervision, Community Reinvestment Act performance Evaluation – Public Disclosure – Citibank, Federal Savings Bank, September 8, 2003. The evaluation covered lending from January 1, 2002, through June 30, 2003.

way, the OTS report which considered the subprime lending of Citifinancial affiliates to be negligible in 2003 included just 14% of the actual number of these loans.[15]

There is also some question about the accuracy of the various Citifinancial loans that the OTS did include in its evaluation. My estimates of just loans originated by the Citifinancial affiliates used by the OTS indicates that there would have been 2,144 loans all of 2003. Half of this is 1,072. This is more than two and one half times the number used by the OTS.

Finally, the OTS review of Citicorp Trust Bank itself illustrates another issue with the way the CRA evaluations may work when the institution is primarily a subprime lender and no prime affiliates are included in the analysis. CTB received an Outstanding evaluation in the lending test because both in its lone assessment area and in the "Supplemental Evaluation Areas" hand picked by the OTS, CTB had higher levels of lending to low- and moderate-income areas than did the overall market (which includes both prime and subprime loans). Of course, we know from many studies and analyses of the HMDA data that subprime lending is more highly concentrated in lower-income areas and among lower-income borrowers. It is in these generally less sophisticated markets that the concerns over deceptive practices are greatest.

The CRA process simply gives high marks to a subprime lender for concentrating its loans in this lower-income segment of the market. This reveals just how shallow the lending test really is. While CRA examiners are prohibited from examining the actual loan practices of unregulated affiliates, they can, and should, carry out an examination of the marketing, underwriting, and servicing practices of the institutions they do regulate in the CRA process. Again, while we are not claiming any abuses by CTB in this statement, as a practical matter, high concentrations of subprime loans in these vulnerable markets could reflect either creative financial assistance or predatory and abusive lending. Regulators need to look at more than just the volume of loans to judge the meaning of high loan penetration rates in these lower-income (or minority) areas.

Therefore, from these examples, it is not clear that the regulators include all of the affiliates that should be included when an institution chooses this option. Moreover, a holding company can review the lending patterns of its affiliates and the areas covered by the assessment areas of its depository institutions and structure the choices concerning the inclusion of affiliates in ways that provide the most favorable lending picture for each institution subject to the CRA.

In summary, the CRA reviews in some cases hold institutions with a major national role in lending accountable only to a single, or a select few, local markets. Moreover, a lender may receive a passing CRA rating based on only some of the markets that it is supposed to serve while it is free to ignore the lending needs of other areas.

[15] There might be some discrepancies between the exact geographic areas used for the HMDA data from the selected MSAs and the assessment areas. The data for 2003 represents just half of the 2003 data because there is no way of actually calculating from the HMDA data which loans were originated or purchased in the first half of 2003.

Regulators allow lenders to pick the affiliates to be included in a CRA review and regulators even choose to exclude affiliates even when the lender chooses to include them.

Ignoring the Negative Impacts of Lending:

The regulatory agencies charged with enforcement of the CRA have been issuing guidance and warnings about predatory lending since the late 1990s. In 2000, HUD and Treasury jointly issued a report on the abuses of predatory lending, the growth of the subprime market where predatory practices are most common, and on the dire impact of subprime foreclosures on communities – largely minority communities.[16] Yet, as is shown in the examples above, the regulators gave high ratings to lenders that had concentrated subprime lending in low- and moderate-income communities.

Just last week, Comptroller Dugan testified before the Financial Crisis Inquiry Commission that in the peak years of subprime lending (2005-2007) nationals banks "originated" just 10.6% of the subprime loans.[17] In Appendix B to his statement, however, Comptroller Dugan himself presents other studies that indicate that his figures are based on a very limited view that only includes loans with selected features that were originated directly by a national bank itself. It ignores the loans made by other affiliates of that same bank's holding company. Using the definition of "high cost" loans from the Home Mortgage Disclosure Act, the Comptroller cites other figures that include all affiliates that indicate that 54% of the subprime loans in 2006 and 79.6% of the subprime loans originated in 2007 were originated by institution subject to federal regulators.[18]

Howevr4 one counts these loans, what has been generally ignored until the work of the Financial Crisis Inquiry Commission is that the lines of credit used by the independent mortgage companies (such as warehouse loans used to originate loans and store them prior to sale or securitization) come from commercial lines of credit such as those from the largest national banks. Again, in his statement before this Commission last week, Comptroller Dugan (even using his own carefully parsed definitions) indicated that national banks provided at least $33 billion in warehouse lines of credit to subprime lenders.[19]

Therefore, while the national banks may not have made the majority of subprime loans directly, they provided the funds to the lenders that did originate the loans. In

[16] U.S. Department of Housing and Urban Development and U.S. Department of the Treasury, *Curbing Predatory Home Mortgage Lending: A Joint Report*, (June 20, 2000).
[17] Comptroller John C. Dugan, written statement submitted to the Financial Crisis Inquiry Commission, April 8, 2010, at page 8. [http://fcic.gov/hearings/04-08-2010.php]

[18] Comptroller John C. Dugan, written statement submitted to the Financial Crisis Inquiry Commission, April 8, 2010, Appendix B, at page 5.

[19] Comptroller John C. Dugan, written statement submitted to the Financial Crisis Inquiry Commission, April 8, 2010, at page 10.

addition, the national banks participated in the securitization of the pools of loans made from the bank lines of credit. In this way, the national banks provided support for the entire subprime industry at both the front and back end of the process. Without this support, the industry could not have gown to the scale where it caused the meltdown of the financial markets.

In addition lenders making loans against the future pay of borrowers (payday lenders) and lenders making loans against a person's vehicle title (title loans) have been major actors exploiting people with financial difficulties. Again, the regulators have shown a clear awareness of the abusive practices of payday lenders. The Comptroller, for example, issued an Advisory Letter (AL 2000-10) in November of 2000 warning lenders of the high risk and abusive nature of these loans.

Nonetheless, as indicated in a recent report by the Center for Responsible Lending, some of the largest mainstream banks are making high interest loans (based on the fees for the loans) against the future paychecks of the account holders.[20] In addition to these direct "payday" loans, the NPA "Payday Lender Financing Factsheet" I am submitting with my testimony shows how the large national banks are funding the payday lenders with lines of credit and other financial resources. For example, the factsheet indicates that Wells Fargo is involved in funding approximately 30% of the payday industry (based on the payday store locations).

I have never seen a single CRA public examination report that has penalized a national bank for disproportionately concentrating subprime loans in minority or low- and moderate-income areas. In addition, I have never seen a CRA examination report that even indicates that the Comptroller has reviewed a bank's provision of lines of credit to the subprime or payday lending industry or that the Comptroller has examined the bank's role in the securitization of toxic loans.

These oversights indicate that even within the current scope of the CRA, the regulators have developed such a narrow focus on granting positive credit for a few consumer loan products that the largest banks can either directly or indirectly support the most toxic lending products without any concern for how it might affect their CRA ratings.

The "Sunstroke" Legislation

In addition to issues related directly to the CRA examination process, the "sunshine" provisions of the Gramm-Leach-Bliley Act of 1999 allow the regulatory agencies at their pure discretion to impose arbitrary and extreme punishments on community groups and citizens who dare to comment on a lender's performance and engage in reinvestment agreements. Yet, no obligations are placed on the performance of lenders in such agreements. This Congressionally approved intimidation of American citizens has produced, as the banking lobby had hoped, a chilling effect on community involvement in the CRA.

[20] Center for Responsible Lending, "Mainstream Banks Making Payday Loans", February 2010.

The Community Reinvestment Act was designed to protect minority and low-and moderate-income communities from redlining and disinvestment and to create the basis for a development banking industry for underserved communities in the United States. Community-based organizations have done their work.

With few resources and sheer determination, these organizations have led the way in identifying underserved markets, proposing real business solutions, and developing the public-private partnerships to provide the structural and institutional support to channel needed reinvestment into rural, small town, urban, and minority communities. The community-based organizations often created structures or institutional vehicles to channel investments into economic development and housing rehabilitation and development activities when they did not already exist.

Since the CRA was implemented, community-based organizations have been responsible for the creation of hundreds of Community Reinvestment Act agreements and programs. I have been involved personally in projects that have reviewed hundreds of Community Reinvestment Act agreements and programs. These agreements have resulted in well over 100 billion dollars of reinvestment in once redlined and ignored communities.

Aside from the model of South Shore Bank (now called Shorebank), virtually all of the most significant, most effective, and most creative reinvestment programs have their source in models that came from Community Reinvestment Act agreements. These include state-wide or local activities across the country in most of the districts or states represented by this Committee.

These agreements are not defined in the Community Reinvestment Act itself. They arose as part of the assessment of community credit needs and the active participation of the communities that the CRA was designed to serve. Often they evolved from the failure of the lending institutions to take active steps to comply with the CRA and the failure of the regulatory agencies to enforce the Act. Since there is no right to private action under the CRA, community groups and citizens working with a broad range of development organizations not only defined their credit needs but built the programs and capacity to meet those credit needs through the models provided by these formal CRA agreements. The agreements often arose from comments placed in the CRA file, from direct contacts and negotiations with lenders, and from challenges and testimony at CRA hearings on banking applications.

The so-called "CRA Sunshine Requirements (§711) of the 1999 Gramm-Leach-Bliley Act, represent the most reprehensible use of Congress with the banking lobby and the regulators to squash this history of citizen participation in the Community Reinvestment Act.[21] On the surface, this section of the Act may appear to recognize these agreements in requiring public disclosure of their contents, terms, and conditions.

[21] The CRA Sunshine Requirements are amendments that add a Section 48 to the Federal Deposit Insurance Act (12 USC 1811 et seq.). References in this statement are to Section 48.

It might also appear on the surface that the Act brings some accountability to these agreements by requiring some disclosure by both the depository institutions (or any "affiliate" of the depository institution) and "each nongovernmental entity and person" that is a party to the agreement. In fact, the law is a bizarre form of intimidation designed to terrify community groups and individuals from making such agreements - or even from filing comments or making any contacts related to community credit needs and the CRA.

A CRA agreement is defined as any contract between "a depository institution or affiliate" and "a nongovernmental entity or person made pursuant to or in connection with the Community Reinvestment Act of 1977" (§48(a)). Essentially, any "nongovernmental entity or person" (indicated as an NGEP in the implementing regulations of the regulatory agencies) that has a "CRA communication" with the depository institution and then has a formal agreement with that institution is subject to the provisions of the sunshine requirements and enforcement actions. The implementing regulations for the Federal Reserve provide an example of the "CRA communications" that would subject an NGEP to the law:

> (a) *Definition of CRA communication.* A CRA communication is any of the following—
>
> (1) Any written or oral comment or testimony provided to a Federal banking agency concerning the adequacy of the performance under the CRA of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate.
> (2) Any written comment submitted to the insured depository institution that discusses the adequacy of the performance under the CRA of the institution and must be included in the institution's CRA public file.
> (3) Any discussion or other contact with the insured depository institution or any affiliate about—
> (i) Providing (or refraining from providing) written or oral comments or testimony to any Federal banking agency concerning the adequacy of the performance under the CRA of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate;
> (ii) Providing (or refraining from providing) written comments to the insured depository institution that concern the adequacy of the institution's performance under the CRA and must be included in the institution's CRA public file; or
> (iii) The adequacy of the performance under the CRA of the insured depository institution, any affiliated insured depository institution, or any CRA affiliate (12 CFR §207.2(b)).

Thus, virtually any person or organization that made a comment about its community credit needs, commented on or testified about the lender's past performance, or suggested a form of reinvestment could be subject to the law. As the implementing regulations of the Federal Reserve indicate, such an organization or person could be subject to all the disclosures and penalties of the sunshine requirements, even if the organization or person never actually signed an agreement with the institution. As an example of a covered agreement, the Federal Reserve regulations indicate that if a NGEP simply had a meeting with the lender and defined the specifics of a program and the lender later made a press release that reflected these conditions, this would be considered an agreement subject to the law (12 CFR §207.3(a)).

While depository institutions are required to provide only general data on the annual amounts of resources allocated to an agreement, the community organizations and individual parties are required to file detailed financial accountings of how each dollar that it received was spent (§48(c)).

The federal regulatory agencies may take the disclosure data and determine at their discretion that the community and any individual citizens who are party to the agreement have not fully complied with the disclosure laws. In this case, the regulatory agency is empowered by Federal law to declare the agreement "unenforceable".[22] Even more threatening, the regulatory agency may decide through its own interpretation of the agreement that the funds were not used properly by the community organizations or any individual citizens party to the agreement. In this case, the agency:

> May impose either or both of the following penalties:
> (i) Disgorgement by the offending individual of funds received under the agreement.
> (ii) Prohibition of the offending individual from being a party to any agreement described in subsection (a) for a period of not to exceed 10 years. (12 USC 1831 §48(f).

On the other hand, *there are no penalties defined in the law for a depository institution (or an affiliate) that violates the agreement in any way.* Indeed, the law specifically states that "no provision of this section shall be construed as authorizing any appropriate Federal banking agency to enforce the provisions of any agreement described" in the law (12 USC 1831 §48(g)).

This law has a chilling effect on any organization or person who would want to file CRA comments or participate in a challenge. If that organization or person later proposed a reinvestment program for that institution and the institution adopted the basic components of the program, these organizations and persons would be subject to the burdens and penalties of the so-called sunshine provisions while there are no penalties for the lender if it disregards its obligations in the agreement. Nothing is more contrary to the original intent of the CRA.

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[22] The right of the regulatory agencies to void a reinvestment agreement stands in contrast to their statements concerning CRA agreements in the interpretive comments preceding the 1995 regulations. In those comments, the agencies state, "The CRA requires the agencies to assess an institution's record of helping to meet the credit needs of its community, not to enforce privately negotiated agreements. Therefore, an institution's record of fulfilling these types of agreements is not an appropriate CRA performance criterion."

The Sounds of Silence

Since the implementation of the Gramm-Leach-Bliley sunshine provisions, only a handful of brave organizations in Cleveland, Massachusetts and a few other places have filed protests and comments on applications. For example, this Subcommittee requested and received from the Comptroller a list of all merger applications from 2000 to the present. The list includes several hundred applications. The applications involve many of the major institutions that have been the subject of protests in the past, yet the Comptroller has indicated that there has not been a single comment filed against these applications.

The Ugly

As the financial markets sank rapidly into the stormy sea of deregulation, ultra free market advocates looking for a scapegoat have resurrected their claim that the Community Reinvestment Act is to blame for the mortgage meltdown – and the entire world financial crisis. In particular, they claim that the revision of the CRA regulations in 1995 forced lenders to make risky loans to unworthy borrowers in order to serve an essentially minority market. They claim the regulators threatened banks with huge penalties and forced them to invest in subprime loans. The campaign to blame the meltdown on the Community Reinvestment Act and on lending to lower-income and minority borrowers is a perversion that stands reality on its head. The background in the previous sections of my statement provides the context to set the record straight.

Back in the 1960s when our country was famously described as "moving toward two societies, one black, one white – separate and unequal", the federal government simply ignored the racial discrimination by banks that led to the wholesale denial of lending to minorities and in communities of color. At the same time, HUD responded to its historical role in supporting the racial redlining of minority areas by virtually eliminating sound underwriting, ignoring the need for oversight of its lenders, and then flooding minority markets with FHA loans.

The predictable result was a massive exploitation of the underserved minority markets through fraud and deceptive lending practices and the combined efforts of real estate agents and FHA lenders who used FHA lending to foment racial change and racial fears and re-segregate communities for profit. Unsound and fraudulent loans produced massive levels of foreclosures and the rapid spread of blight destroyed whole segments of cities such as Detroit, Chicago, Baltimore, Cleveland, and Philadelphia.

With no response from the government, community groups from across the country formed the National People's Action and forged a multiracial, urban and rural coalition that arose from the neighborhoods of Chicago and spread across the country. NPA's fundamental focus was on discrimination in the real estate and lending industries. The Community Reinvestment Act was NPA's great achievement. For community organizations across the country it is both symbolically and practically the litmus test of any claim of financial industry reform.

Rejecting the option of financial welfare, the CRA was simply a requirement that for the benefit of taxpayer-backed deposit insurance (and, today, the bailout slush funds) the banking industry owes it to the American people to seek ways of investing and lending creatively, but soundly, in all communities. It was not a demand to loan to lower-income persons and minorities regardless of their financial situations. It was a call on the financial markets to use the creativity, ingenuity and the resources of the free market system for fair lending and to build a development banking industry in our country as a basis for the reinvestment in communities that had been discriminated against or that lagged behind new growth areas where the money flowed so freely.

When the banking industry and regulators fought against the CRA and its simple requirements, the community groups that had created it took on the responsibility for defining their own financial needs, acquiring their own skills, and forging partnerships with lenders, investors, and insurance companies for housing and business programs. For more than 30 years since the CRA has been in effect, community groups have led the way to reinvestment. They even created support services and local development organizations where these were needed. Over the years, trillions of dollars have been reinvested in inner-city communities and smaller cities and towns bringing new life to once abandoned streets and neighborhoods.

The reinvestment programs created sound products. Loan programs were specifically developed to account for the needs and situations of low- and moderate-income borrowers who were typically unfamiliar with credit markets. Counseling programs and careful monitoring of programs produced portfolios that often outperformed the larger mainstream credit markets. In its own study of CRA program loans, the Federal Reserve noted that the median loss rate on these reinvestment programs was exactly zero.[23] According to a report issued by the Federal Reserve Board of Dallas last year "...data...suggest that the CRA prevented the subprime situation from being more severe."[24]

Even Comptroller Dugan noted the outstanding performance of CRA lending in a speech back in 2008 when the "Blame CRA" theme emerged to explain the meltdown. He noted:

> Overwhelmingly, this lending has been safe and sound. For example, single family CRA-related mortgages offered in conjunction with NeighborWorks organizations have performed on a par with standard conventional mortgages.4 Foreclosure rates within the NeighborWorks network were just 0.21 percent in the

[23] *The Performance and Profitability of CRA-Related Lending Report by the Board of Governors of the Federal Reserve System*, Submitted to the Congress pursuant to section 713 of the Gramm-Leach-Bliley Act of 1999, July 17, 2000, page 70.

[24] Federal Reserve Bank of Dallas, "The CRA and Subprime Lending: Discerning the Difference" Banking and Community Perspectives, Issue 1, 2009.

second quarter of this year, compared to 4.26 percent of subprime loans and 0.61 percent for conventional conforming mortgages.[25]

Contrary to the claims of those blaming the CRA for the meltdown, the 1995 revisions of the CRA regulations weakened rather than strengthened the CRA. Nonetheless, the regulators made a point of emphasizing in the preface to the 1995 regulations that nothing in the regulations sanctioned risky loans and that no specific loan standards, ratios or measures would apply to any lender. In spite of this statement and in spite of the warnings that the regulatory agencies put out in the form of "guidance" on predatory loans, the regulators, the GSEs, HUD, naive economic researchers, and those trying to blame the CRA for the meltdown engaged in a bit of definitional slight of hand and defined all loans made in low- and moderate-income census tracts as a CRA loans. Thus, they counted every predatory loan pumped into these communities as a CRA loan in spite of the unceasing objections of the community groups, consumer groups, and civil rights groups that had been working on sound reinvestment for decades. This created evaluations the were based on the extraordinarily absurd position that concentrations of subprime loans, often to the exclusion of sound prime loans, in lower-income and middle income neighborhoods were to be rewarded with high grades for reinvestment under the CRA or for credit in meetings the GSEs housing goals.

As I have shown, in some cases, regulators even gave high CRA ratings to lenders found liable in Federal court for racial discrimination or to major lenders that explicitly cut out of their lending areas, for example, the entire City of Detroit or the minority sections of Gary, Indiana, or Chicago. In this regard, the banking regulators literally encouraged subprime discrimination by abandoning these communities to the subprime market. At the wholesale level, the regulators failed to monitor the risks on the credit lines from the major banks to the subprime mortgage lenders that gave the lenders the cash flow necessary to warehouse their loans for sale in the securities markets.

For its part, it is true that Fannie Mae again drove one of the engines that encouraged subprime discrimination and exploitation. While it had been prodded by community and consumer groups to refuse to purchase individual mortgages with certain abusive subprime characteristics at its front door, it became one of the largest purchasers of these same questionable subprime loans through its own investment in mortgage-backed securities at the back door. Its purchases in recent years were as large as one quarter to one third of the subprime securities issuances. This must go down as one of the most extreme examples of corporate hypocrisy on record – not to mention the betrayal of its affordable and fair housing obligations.

The people who created the CRA in response to the abusive and exploitive FHA lending practices of the 1970s were not stupid. They would not choose toxic loan products over sound products when they had the choice. For their part, the community organizations that had been working on reinvestment for over twenty years, warned

[25] Comptroller John C. Dugan, speech before the Enterprise Annual Network Conference, November 19, 2008.

Washington of the coming nightmare as abusive lending progressed into massive foreclosures. While the media now praises as great prophets the economists and regulators who saw the meltdown coming as early as 2005, it was the community groups in the 1990s who first suffered the scars of a new wave of foreclosures and saw in it the resurrection of massive lending scandals.

By 1995, community-based organizations had begun studies of the impacts of concentrated and abusive subprime lending that resulted in parallel concentrations of foreclosures accompanied by declining housing values and rising tides of blight and crime. Research and reports from the National Training and Information Center, the Center for Community Change, The National Community Reinvestment Coalition, the Center for Responsible Lending, the Consumer Federation of America, and host of other community, civil rights, and consumer groups have continually warned of the coming subprime disaster for over a decade. In 2000, HUD and Treasury built their own reports (*Curbing Predatory Lending* and *The Unequal Burden*) on the models of the community research and documented the alarming increase in subprime lending, unfair and deceptive practices, and the growing concentrations of foreclosures, particularly in inner-city and minority communities. Ironically, the government did not even heed its own dire warnings.

By 1999, community groups were challenging merger and acquisition applications involving subprime lenders and were challenging the regulators not to count subprime lending for CRA credit. Through a national level coalition in 1999, community-based organizations and consumer and civil rights organizations came together to challenge the acquisition of one of the largest and most notorious subprime lenders (The Associates) by Citigroup. The many documents they produced foretold of the abusive subprime practices that would eventually undermine the entire financial world. Their challenge was brushed aside and the regulatory agencies continued to ignore the gathering storm.

When Fannie Mae and Freddie Mac dove into subprime investments, it was the community groups that had created the original, and sound, GSE community lending programs that attacked this behavior. They challenged HUD not to count subprime loans as part of the GSEs housing goals.

The communities that should have been protected from abusive lending by the regulators were, instead, victimized by misleading and deceitful marketing practices designed to create credit needs and sell toxic loans. The growth of fraudulent and abusive marketing within the larger subprime market was explicitly identified in the HUD and Treasury reports. In the same year as these reports, a trial in Federal court in Philadelphia against The Associates, the largest subprime lender at that time, revealed a broad range of deceptive marketing practices and programs. One program was designed specifically to flip (refinance) existing loans purely to raise the interest rates and generate more lender fees. Another program actually tested the loan offices to make sure that when they folded fees and unnecessary credit insurance into the loan proposals they *did not* disclose this to the borrowers. Major lawsuits claiming deceptive and misleading trade practices were filed by the Federal Trade Commission or the attorneys general in states all across the country against the very largest subprime lenders (The Associates, Household Finance, Ameriquest, and Countrywide), resulting in settlements of several billion dollars. At the same time, data from Treasury indicate that reports of lending fraud in the mortgage markets (largely related to brokers and appraisers) have increased thirty-fold since 1997.[26]

Meanwhile, it was the community-based organizations and the understaffed and under funded legal assistance attorneys that developed successful interventions. By challenging fraudulent or abusive underwriting and servicing practices, these groups have been able to restructure and rescue as many as 80% of the homeowners who came to them in need - a testament to both the effectiveness of the program and the level of abusive practices in the subprime markets. While restructuring may result in some write down on the loan initially, it produces a performing loan that, in the long run, stabilizes the loan and, when done on a large scale, can stabilize the mortgage-backed securities. Indeed, the present mortgage rescue legislation is finally turning ever so reluctantly and slowly to this reality.

One of the most effective rescue programs was used by a community group in Cleveland in the Zip code with the highest number of foreclosures nationally. But while the program has proven how effective a rescue program can be, it lacked the resources to reach the scale needed to stave off the crisis either in the Cleveland market or in other communities. The community programs worked on a loan-by-loan basis with lenders and servicers through agreements made after community groups exposed their abuses to the public – but this model could never meet the full scale of the problems. Even though a few lenders account for the vast majority of the foreclosures, the legal aid programs that receive government funding also work on a loan-by-loan basis, as a Reagan era attack on legal aid for the poor still prohibits them from filing class actions.

In the end, long before the housing bubble burst and brought the pain of subprime foreclosure to the upper-middle class and high income markets, the abuses in the subprime markets had already destroyed many communities that responsible community groups had spent decades rebuilding. When the flood of foreclosures began a decade ago, the physical impact of the foreclosures was like Katrina without the water. Whole blocks of homes were boarded, abandoned, or burned. Yet, no Anderson Cooper stood in the streets of these decimated neighborhoods "keeping them honest" by exposing the government's failure to protect its citizens. No cry was raised at the failure of the government watchdogs to rescue these neighborhoods. Yet, these minority, working class, and small town communities were just as much abandoned by Washington as were the residents of New Orleans. It was the Federal Reserve Board, the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, HUD, the Department of Justice, Congress, and the Administration, individually and collectively, that failed to protect our citizens from the subprime tsunami.

[26] Financial Crimes Enforcement Network, U.S, Department of Treasury, *An Update of Trends Based Upon an Analysis of Suspicious Activity Reports*, April 2008, page 21.

There is no question that the subprime debacle has contributed to a real need to intervene to ward off a crisis in the global financial markets. Everyone recognizes the need to secure the credit markets. But the organizations that represent the communities that have already paid twice for the failure of the government to protect them from fraud and lending abuses on a massive scale want to know why it is possible to develop interventions costing hundreds of billions of dollars for Bear Sterns, Fannie Mae, Freddie Mac, AIG, and now the entire lending and investment market within a few days while the homeowners who were victimized by the lending abuses were abandoned year after year. Why, they ask, are these financial institutions too big to fail while the collected millions of homeowners American communities are not.

Those who have taken on the responsibility for the rebuilding of their communities when they were forsaken by their government decades ago; those who have kept up the fight in spite of being betrayed by their government's wholesale support of the subprime market's exotic and toxic behavior in the last decade; these citizens are mightily offended that anyone would blame them for the financial crisis.

Underpinning the Blame the CRA Campaign is the assumption that lower-income persons - and especially minorities - are so financially untrustworthy and such a high lending risk that making loans to these Americans has pushed the entire global economy to the brink of collapse. This is an exceptionally scantily veiled form of racism. To lay blame on the minority markets whose representatives have been sending out warnings for over a decade is to blame the canaries in the mine for the explosion.

Key Elements of a Meaningful Modernization of the CRA

Where Are We Now?

The regulatory agencies and the CRA "sunshine" requirements have twisted the CRA by:

(1) removing the obligation of depository institutions to define a local service in a way that eliminates racial redlining;
(2) removing the separate assessment of discriminatory actions from the formal rating process and;
(3) failing to develop and implement a sound fair lending examination process that includes both the subsidiaries and affiliates of a covered institution;
(4) relegating compliance with the fair lending laws to an undefined appendage of the rating process subject to the pure discretion of the regulatory agencies such that institutions can receive Outstanding CRA ratings while they violate the fair lending laws;
(5) removing the review of the institution's assessment of local credit needs from the evaluation process;
(6) removing the assessment of the institution's efforts to communicate with its community in defining credit needs;

(7) threatening community organizations and individuals who dare to comment on credit needs and who develop reinvestment programs;
(8) granting an institution a passing CRA rating if they have an Outstanding rating in the lending test (even if the lending area redlines minority communities);
(9) making challenges futile by granting an institution with a passing CRA rating a presumptive bias in favor of approving applications; and
(10) failing to regularly hold hearings when an application is challenged.

In response to this historical context, we offer our comments on key elements that need to be incorporated into a modernization of the CRA

1. Expand Disclosure

If no other provisions existed to provide for an expansion and update of the Community Reinvestment Act, provisions for increased disclosure must be made. CRA has resulted in trillions of dollars of successful reinvestment and in almost every case these investments were the result of a vigilant public and community that challenged a financial institution to do better. The community cannot do its job without access to usable data. In the housing markets, and to a much lesser extent in small business lending markets, Home Mortgage Disclosure Act data and Community Reinvestment Act data have been the key resource in identifying underserved markets, for defining credit needs, for identifying fair lending issues, for developing reinvestment programs and models, and for monitoring the results of reinvestment initiatives.

Home Mortgage Disclosure Act Data:

Increased disclosure is required to advance the goals of the fair lending laws and the Community Reinvestment Act. **HMDA data need to include a wider range of data on loan products, loan terms, borrower credit profiles, fees, interest rates, and sourcing (brokers, wholesale, retail, correspondent).**

The failure to include loan performance and servicing (default and foreclosure) data blocked both public agencies and the communities from identifying the impacts of the subprime lending markets before they had destroyed entire communities and wiped out billions of dollars in past reinvestment. We might well have avoided much of the mortgage meltdown had we had access to loan performance data – even in the all too limited way it has been required for FHA loans for almost 20 years.

Expanded Business, Insurance, and Investment Disclosure Data:

The extremely limited form of business lending has hampered efforts to expand commercial economic development efforts in lagging local markets all across the country. With the current Great Recession, the need for a development banking industry is greater than ever and encompasses a need much greater than the prior CRA focus on low- and moderate-income communities alone. The Community Reinvestment Act is essentially the only comprehensive resource for economic development in lagging local markets in the United States. Yet, there is almost no development banking industry in commercial lending in America because development banking has been developed around the creative efforts of community and development organizations rather than being initiated by the banking industry. Where the HMDA data created hundreds of reinvestment programs in housing, an expanded public disclosure of business lending could do the same for commercial development.

Moreover, **as the full range of financial products come under review for both their positive and negative impacts on economic growth and stability, disclosure needs to encompass this range of loans as well as providing data on insurance and securities products.**

Disclosure of Existing Program Monitoring Data:

Additionally, there are a host of new, existing and proposed programs that aim to strengthen bank performance, fix the fall-out from the mortgage crisis, and mitigate the effects of the economic collapse and all of these initiatives will and/or should produce performance data. It is imperative that these data not fall into a black hole but be brought to light where they can inform monitoring and improvements in these programs.

Data from the Home Affordable Modification Program (HAMP – generally know as the Making Home Affordable Program) provides a good example of how fair lending issues are kept out of the public form. Presently, Treasury maintains that it cannot provide any form of the HAMP data that links individual servicers to data on race or gender, or even to census tracts. This is based on a claim that such government monitoring data is not "performance data" for the program and that the Servicer Participation Agreements with the servicers in the program prohibit the publication of anything but "performance" data linked to individual servicers. Of course, since servicing is clearly covered by the Equal Credit Opportunity Act, then performance data should include information related to compliance with civil rights laws.

Disclosure of Examination Results:

Finally, in a different form of disclosure, in order for any newly proposed lending and service tests to be effective, **community groups and the public at large must have access to lending test results** to discern the players and their impact on local neighborhoods. These results should be published in a usable format for all regulated banks, their servicers, subsidiaries, and affiliates.

2. Fair Lending and Access

Background:

Probably the greatest weakness in the current CRA is the omission of a focus on fair access to financial services (including depository services) and an assessment of discriminatory practices. As I have noted in the review of the historical context of the CRA, the original CRA was passed with the assurance that fair lending laws were so clearly understood as being a part of the CRA that no direct fair lending provisions needed to be added to the CRA itself. The history of the increasing omission of fair lending and fair access to financial products and services in the examination and rating process and regulations has shown that the CRA must be amended to specifically prohibit discrimination in all forms and to include requirements for fair access to all financial products. Moreover, as indicated in the section below on accountability, **whatever else may come from the CRA modernization, it should ensure that violations of the fair lending and fair housing laws by any entity within a holding company will result in the failure of the entire holding company and all of its affiliates.**

As an historical pattern, the abusive uses of financial products has typically first manifested its impacts in minority markets and minority and racially diverse communities. From the fraud and abuses in the FHA programs in the 1970s to the toxic subprime markets of the present meltdown, minority markets have been the canaries in the mine that have provided the warnings (though unheeded) of the coming disasters in the market.

A clear focus on fair lending and fair access to sound and beneficial financial products not only makes it clear that a violation of the civil rights laws is a violation of the CRA, but it would have the practical effect of making the regulators and public pay attention to the warning signs of fraud, deception, and potentially toxic products in the markets. Had the regulators paid attention to the fair lending concerns (and many studies and reports) of the community-based and public interest groups (going back well over a decade) about the impacts of the subprime lending markets, we would have mitigated much of the present financial crisis.

Required Provisions:

All activities of all holding company entities need to be specifically covered for review for fair lending compliance, which must include loans made, purchased and securitized. Parallel requirements must apply to other financial services, such as insurance.

Wherever and however community service areas are defined, these areas must be assessed for the exclusion of minority areas as well as the traditional exclusion of low- and moderate-income areas. (We support the general concept of the 5% of the market standard contained in HR 1479.) This assessment must include a review of actual lending and service patterns as well as the communities defined as service areas in the Act or by the institution. This must also include an analysis based on the disparate concentrations of both sound and toxic products. All significant disparities need to be investigated and where there is cause to find disparate impacts or treatment, the entire holding company must be given a failing CRA rating and be required to engage in corrective action.

In addition, the review of discrimination must include all the protected categories under ECOA and the Fair Housing Act. For example, it must include assessing whether loans (or the purchasing or securitization of loans) are made to properties that fail to comply with accessibility standards or whether they exclude properties designed to serve protected classes.

3. Accountability

Beyond the expansion of the CRA beyond additional disclosure and fair access to financial products, the law is sorely in need of provisions to establish real accountability. Establishing accountability involves a least the following key types of provisions in the Act:

Coverage for Assessments and Ratings:

The Act needs to cover all entities of a holding company. Moreover, it is not enough to cover each entity individually, as is the main focus of the current bill. It is important to require an overall assessment of the entire holding company as well as an assessment of individual entities or functions.

Within this process, all of the lending (purchasing and securitization) activities of the holding company entities must be reviewed as a single function with an overall rating so that disparate patterns for different subsidiaries and channels are assessed in the context of the entire lending activity of the holding company. For example, unlike the current practice, fair lending examinations must necessarily include all of the holding companies that made (or purchased or securitized) loans in a single assessment so that any disparate patterns or dual patterns based on the different lending entities or sources are included in the assessment. While these recommendations will provide for a serious consideration of fair lending within the institutions and areas covered by the CRA and its examinations, these measures can only be effective if the fair lending examination process, itself, includes all affiliates, is subject to a regular schedule for all lenders, and results from clear revisions in the process to eliminate the failure to adequately cover such areas as marketing, steering, underwriting, and pricing.

In making reviews of lending and investments, the regulators must review both the direct consumer lending of the institution's holding company affiliates and the larger commercial lending activities that support other direct lending markets, such as warehouse lines for independent mortgage companies or lines of credit to payday lenders. Moreover, a review also needs to be made of the securities issued by the holding company affiliates and the securities purchased by the holding company affiliates. It is pointless, and even harmful to the community, to rate an institution only on the direct loans it makes while ignoring the larger impacts of the investments packaged into the securities it issues or purchases. In the subprime example, a lender may have made some loans through a CRA program while that activity is dwarfed by the holding company's purchase of toxic loans that undermine the stability of the same type of community.

Civil rights (fair lending) violations (including the review of the communities served) must result in the overall failure rating for the entire holding company. Evidence of discrimination by any affiliate or subsidiary of a holding company – or as a result of an overall (composite) lending or investment pattern or practice in any location in the United States - should be counted as evidence of discrimination that should require an automatic rating of Needs to Improve or worse for all CRA covered institutions within the holding company where evidence of discrimination is found. In this way, there would be some pressure put on the non-banking subsidiaries that are not likely to have "covered applications" by putting a hold on applications from those banking entities most likely to apply for banking privileges.

<u>A Clear Plan as a Base for Assessment:</u>

Presently, there is no clear base from which assessments are made. When the Act was first implemented, lenders were required to define local assessment areas, define the credit needs of these areas, and list the products they would provide to meet these needs. Rather than require a plan for institutions that have a failing rating based on the present amorphous standards, **the CRA should require a plan at the beginning as a base for the assessments.** Then, assessments must be made in relation to the plan (or the plan as revised subject to challenge as noted below).

Plans should recognize the different capacities and roles of different institutions and holding companies and provide for plans based on the capacities and resources of each holding company. The plans need to apply both to the holding company overall and to each individual entity. This allows each holding company, and each subsidiary, to define a role according to its own business plan and strategy. In effect, since all such entities will already have a business and marketing plan, the CRA plan simply ensures that the operating plans of the entities have a focus on and a logical link to the needs of Main Street as well as the larger investment markets.

The assessment of lending, investment and service patterns needs to account for the negative as well as positive impacts of the products provided. We recognize that the regulatory agencies have shown lack of concern for these differences in the past – most notably counting the concentration of toxic subprime loans in low- and moderate-income (and minority) communities as outstanding CRA service. Therefore, the reality is that the Consumer Financial Protection Agency is critical in providing assessments of the positive and negative affects of different financial products and services. If there is no such agency, or no meaningful assessment of financial products defined within some other regulatory agency, then we doubt that the CRA assessments will do more than provide for the future development of abusive products concentrated in minority markets.

<u>Setting a Floor Based on Existing Programs Services:</u>

The original hope for the CRA was that as products and services were created for meeting the needs of underserved communities, the successful products would evolve into norms that would set a floor for all institutions that have the capacity to provide these services. In its existing form, CRA examinations are to place the institutions performance within that of comparable institutions. This peer group comparison, however, is only based on the asset size of the lender.

A floor needs to be set by requiring institutions to provide the kinds of reinvestment products that are provided in similar markets by other institutions. Of course, there may be leeway for the particular market niches of an institution or needs that are satisfied by additional or newly created products and services. This would create at least some process for the continuing evolution of a development banking industry.

Put the Community Back Into the Community Reinvestment Act:

Over time, the public has been removed from the CRA process by ignoring substantial challenges and by the so-called CRA provisions of the Gramm-Leach-Bliley Act that released lenders from being held accountable for CRA agreements but that placed onerous obligations on public parties that even suggested CRA activities. Therefore, the first action to reinstate the role of the public should be the repeal of the "Sunshine" provisions of the Gramm-Leach-Bliley Act.

If the CRA modernization does not include its own definition of the service areas (local assessment or community service areas), **a provision should provide for challenges to areas either defined by the institution or defined by the regulatory agency for each holding company entity.**

If the modernization includes a provision for a plan (including the assessment of local area needs and the definition of products and services to be provided), then **the Act should specifically provide for public comments and challenges to the plan.**

The modernization needs to provide for hearings for challenges to applications covered by the Act for all holding company entities where there would be covered applications at issue.

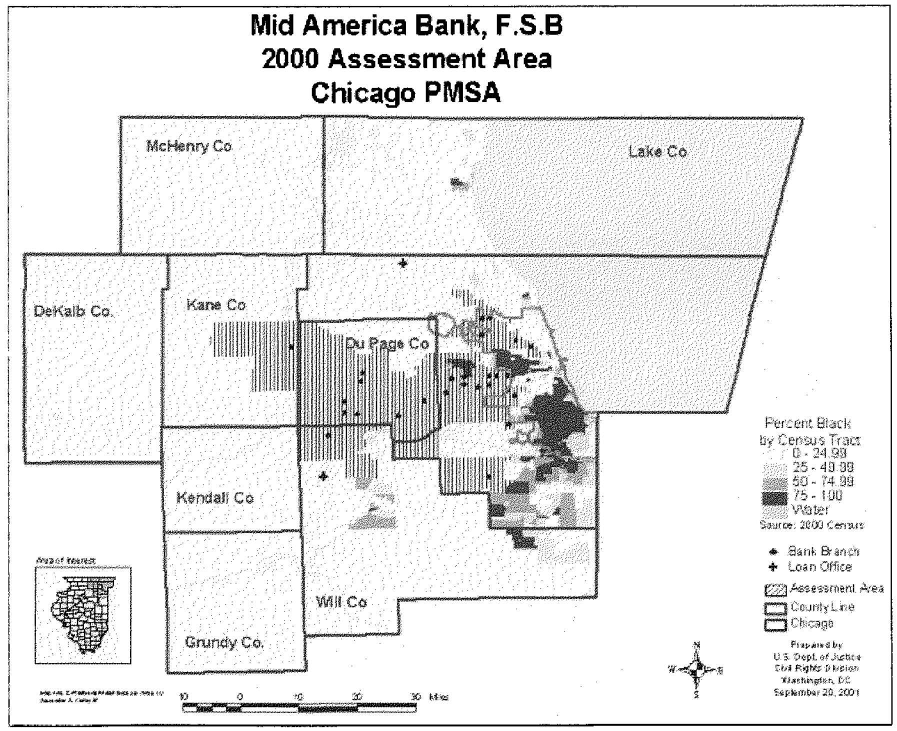
The modernization bill needs to provide for an appeal process to the assessments and ratings given to a holding company and its affiliates.

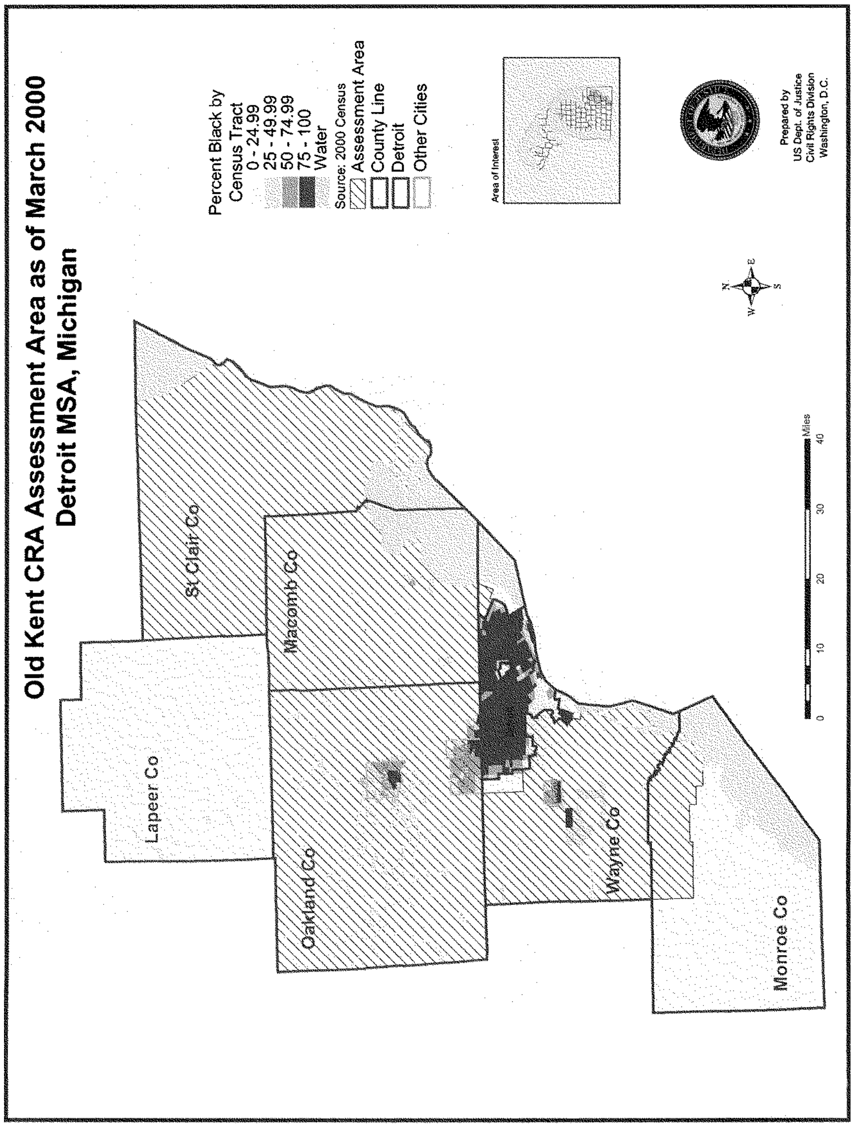
Expanding the Stated Purpose of the CRA:

In order to accomplish the expanded role for the Community Reinvestment Act, the overall purpose of the Act also needs to be expanded. This is especially true in terms of including fair access to financial services and in the goal of supporting a viable development banking industry that has the tools to reinvest in any American community that is underserved or whose economy is lagging behind the rest of the country. For example, in the present Bill (HR 1479), the following highlighted language needs to be added to the purpose in order to make clear for the first time the fair access and development banking purposes of the Act.

To enhance the availability of capital, credit, and other banking and financial services for all citizens and communities, ***to provide additional resources to ensure fair access to all financial services and markets, to promote a development banking industry in the United states,*** to ensure that community reinvestment requirements are updated to account for changes in the financial industry and that reinvestment requirements keep pace as banks, securities firms, and other financial service providers become affiliates as a result of the enactment of the Gramm-Leach-Bliley Act, and for other purposes.

Complaint Exhibit 8 - United States of America v. Mid America Bank, fsb (N.D. Ill.)




Old Kent CRA Assessment Area as of March 2000
Detroit MSA, Michigan
Lapeer Co
St Clair Co
Macomb Co
Oakland Co
Wayne Co
Monroe Co
Percent Black by
Census Tract
0 - 24.99
25 - 49.99
50 - 74.99
75 - 100
Water
Source: 2000 Census
Assessment Area
County Line
Detroit
Other Cities
Area of Interest
Miles
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20
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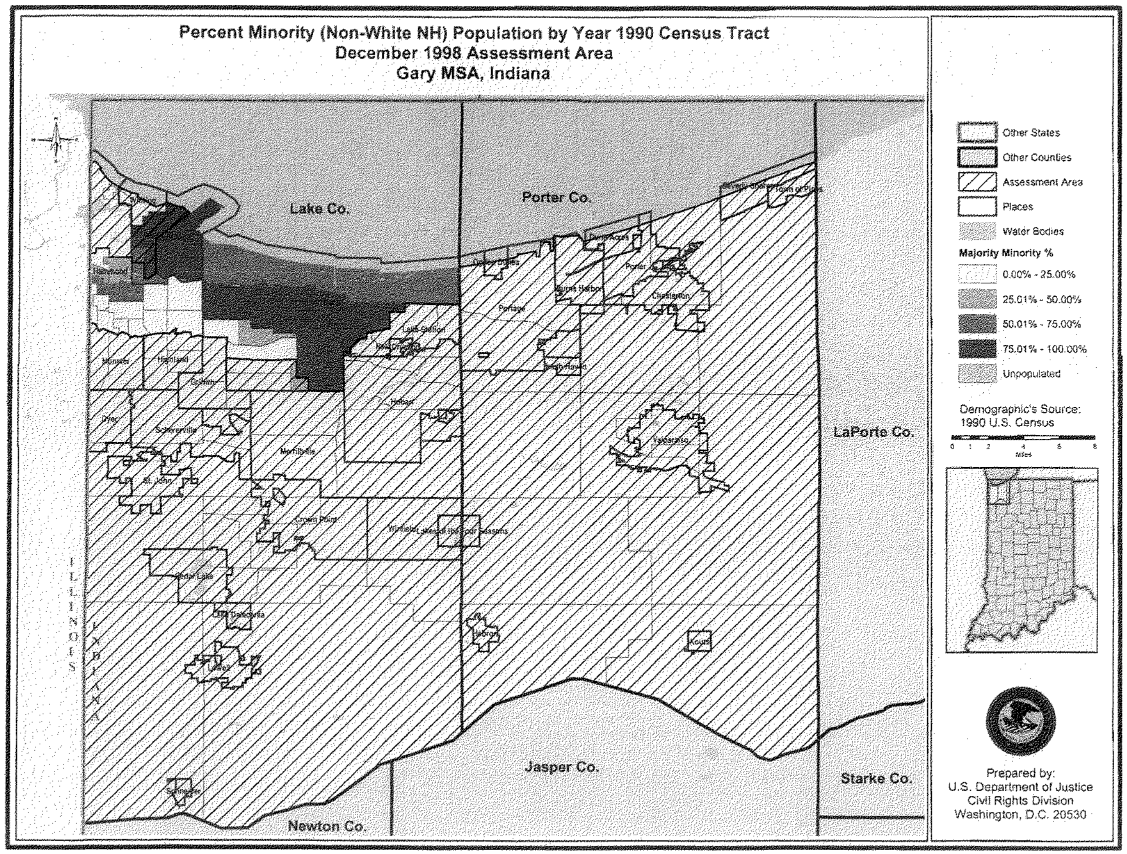
W
Prepared by
US Dept. of Justice
Civil Rights Division
Washington, D.C.


Percent Minority (Non-White NH) Population by Year 1990 Census Tract
December 1998 Assessment Area
Gary MSA, Indiana
Lake Co.
Porter Co.
LaPorte Co.
Jasper Co.
Starke Co.
Newton Co.
ILLINOIS
INDIANA
Hammond
Munster
Highland
Griffith
Dyer
Schererville
Merrillville
St. John
Crown Point
Cedar Lake
Lowell
Hobart
Lake Station
Portage
Burns Harbor
Chesterton
Porter
Valparaiso
Hebron
Kouts
Other States
Other Counties
Assessment Area
Places
Water Bodies
Majority Minority %
0.00% - 25.00%
25.01% - 50.00%
50.01% - 75.00%
75.01% - 100.00%
Unpopulated
Demographic's Source:
1990 U.S. Census
Miles
Prepared by:
U.S. Department of Justice
Civil Rights Division
Washington, D.C. 20530

WRITTEN STATEMENT OF

EUGENE A. LUDWIG CHIEF EXECUTIVE OFFICER, PROMONTORY FINANCIAL GROUP

Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
of the
U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES

April 15, 2010

Mr. Chairman and members of the Committee, I commend you for your leadership in holding this hearing to discuss the Community Reinvestment Act (CRA), and to consider enhancements that will advance the cause of equitable credit availability, promote sound lending practices, and otherwise ensure that banking services are readily available to underserved communities.

Nearly thirty-three years have passed since the CRA became law, and in that time it has done great and measurable good. At the same time, since its passage, and particularly in the past three years, we have witnessed extraordinary changes in finance. The implosion in subprime lending that began in the middle of the last decade was only a foretaste of a full-fledged, global financial crisis from which we are just beginning to emerge. We are still in the midst of teasing out the lessons from that crisis. The task today is a worthy one— to look at whether CRA lending figured into what went wrong in finance generally, and examine how the CRA can be part of setting our financial system right.

Although the CRA has been the law for decades, it has always attracted its fair share of debate. Bankers have sometimes criticized the CRA as unnecessary and burdensome, particularly to small banks. That criticism was more prevalent before the Clinton Administration's 1994 regulatory reforms of the CRA, which—as the 27th Comptroller of the Currency—it was my privilege to lead. Our efforts resulted in banks committing more new money to CRA lending than they had committed over the entire period since the passage of the Act in 1977. We accomplished this by eliminating unnecessary burdens on banks and by assessing actual performance. I might add that the credit made available to low and moderate income Americans through CRA programs during this era— the 1990s—was not only transforming for low- and moderate-income communities, but it was almost without exception profitable and safe.

More recently, the CRA's supporters have argued the CRA has not fulfilled its potential, because regulators have failed to enforce it aggressively.

At the same time, a handful of critics have argued, incorrectly, that the CRA led to the subprime lending crisis, because it pressured banks to lend to people with insufficient income and against properties that lacked enough value to collateralize the loan. Nothing could be further from the truth. I will address this in detail in my testimony, but in short, the subprime crisis resulted from practices that were the antithesis of CRA lending. Unregulated mortgage brokers who are not subject to the CRA or bank regulation originated a high volume of high-interest rate loans. The moral and social imperatives that underlie the CRA were disregarded by opportunists who swarmed into mortgage lending, unfettered by the obligations of insured financial institutions.

I am, as you have discerned by now, a staunch defender of the CRA. But that is not to say that I believe it is without flaws. We need to rethink several dimensions of the law to bring it into sync with the new realities of the modern US financial system. I will address my specific recommendations in this testimony. But first, I would like to consider the historical underpinnings of the CRA.

History, as always, is instructive in understanding how we came to be at a new crossroads in the decades-long debate over CRA. It is worth remembering that not terribly long ago, credit was only for the wealthy and powerful. Prior to the 1920s, regulators prohibited banks, including national banks, from making mortgage loans to consumers because they believed such loans were not safe. The push towards the broad-based availability of credit, however, is what has made possible the sustained prosperity that we have known throughout most of the post-World War II period. Whether it is the promise of home ownership, a college education, or a loan to start a new business, when made prudently and used responsibly, credit put in the hands of consumers and small businesses— including low-and-moderate income borrowers—is a powerful tool to better their lives. The successes that Nobel Peace Prize winner Muhammad Yunus, founder of Grameen Bank; Fazle Abed, creator of BRAC, a now global Bangladesh-based micro financing operation; Ingrid Munro, founder of Jamii Bora, a financing operation that works with the poor in Nairobi, Kenya; and a host of others is testament to the power of creative and responsible lending.

To be sure, while credit can be a powerful tool for good, it can also be misused. Some argue that lending to low- and moderate-income (LMI) borrowers is too risky and is to blame for mushrooming numbers of home foreclosures. But our boom and bust of credit cycles have little to do with lending to LMI borrowers. Rather, they are the result of both the natural tendency of financial markets to swing to excess and then bust, and to the fact that financial innovation often produces an immediate surge where the controls come off, ending in grief.

We also must recognize that the economic crisis must change our preconceptions of who LMI borrowers are and where they live. High rates of unemployment are swelling the ranks of LMI borrowers in every state; the duration of unemployment is now the longest since the government began keeping records in 1948. LMI borrowers increasingly are not racial minorities living in inner cities. Many of these unfortunate victims of the recession had been good credit risks until recently. Few of them had any role in creating the economic crisis.

The need to make job-creating investments in communities across the country makes CRA an essential tool to spur a sustainable economic recovery. The business sector will lead the way out of this deep recession, but channeling money to Wall Street will not get capital where we need it most. It is small business that will create large numbers of jobs in communities throughout the country. And the growth of small business depends on support from local lenders. Banks and finance companies will determine the rate of job creation.

I begin my testimony with a retrospective on the CRA and past reform efforts. Then, I offer some observations regarding the role of credit to consumers in causing the current crisis. And I close with some thoughts on needed improvements in consumer protections and credit policies.

A History of the CRA

There is, perhaps, no legislation enacted by the Congress over that past thirty years that is more misunderstood than the CRA. As this Committee knows, the Act is short and simple. It asks that banks lend into the communities they serve, and it expressly instructs banks to only make sound loans.

Senator William Proxmire, who led the effort to enact the CRA, recognized that the revival of inner cities depended on the availability of credit. Congress banned racial discrimination in lending in the Fair Housing Act in 1968 and in the Equal Credit Opportunity Act of 1974. Despite these measures, Congress found that it needed to outlaw redlining[1] as well, because lenders were engaging in "neighborhood discrimination," in which lenders would deny mortgages to applicants based on the

[1] Beginning in 1935, the Home Owners' Loan Corporation (at the behest of the Federal Home Loan Bank Board) in collaboration with private organizations developed maps that rated areas in and around larger American cities for mortgage lending risk. The supposedly "riskiest" (often having a remarkable equivalency to minority) neighborhoods were outlined in red. Private lenders used these maps as guides to determine where they should lend or not lend, and as a consequence, lending decisions for homes in supposedly high risk areas were not based on the income of the individual, but on the neighborhood in which the person lived.

neighborhood in which the property was located, not on the creditworthiness of an individual borrower.[2] The CRA was included in the Housing and Community Development Act of 1977 and was signed into law by President Jimmy Carter on October 12, 1977.

The question that troubled critics then – and troubles them now – is why would banks choose to ignore profitable lending opportunities? Studies show that banks, like most businesses, go after the low hanging fruit. Lang and Nakamura (1993) and Ling and Wachter (1998) find that banks have an initial informational barrier to overcome.[3] If one bank found successful lending opportunities in an area, others soon followed. Furthermore, some banks may choose to free-ride on the efforts of others and to cherry-pick the easiest lending opportunities. Racial discrimination also comes into play. Avery et al. (1993) found that lower levels of lending to blacks could not be fully explained by income and wealth.[4]

Some argue that the CRA is the wrong way to increase the flow of credit to communities. For example, Senator Robert B. Morgan, who led the opposition to the CRA, said he supported the "ultimate intent" of the CRA, which was "to assure that the credit needs of the inner city are adequately met." He argued that if it were effective, the CRA would amount to credit allocation, but if it failed, it would only discourage inner-city lending.[5] In response to such concerns regarding credit allocation, the lending quotas mandated by early drafts of the Act were removed. The enacted version of the CRA does not state the amount or the manner by which financial institutions should fulfill their community obligations, leaving a good deal of flexibility for the institutions and their regulators to determine the details of CRA compliance programs. Anticipating critics' charge that the CRA forces institutions to make bad loans, the Act explicitly provides that CRA lending should be "consistent with the safe and sound operation of such institution."[6]

The Congress only applied the CRA to banks and thrifts.[7] It reasoned that these institutions already have a "continuing and affirmative obligation to help meet the credit needs of the local

[2] 15 U.S.C. §§1691 et seq. and 42 U.S.C §§ 3601 et seq.

[3] Lang, William W., and Leonard I. Nakamura (1993). "A Model of Redlining," *Journal of Urban Economics*, vol. 33 (Spring), pp.223-34 and Ling, David C., and Susan M. Wachter (1998). "Information Externalities and Home Mortgage Underwriting," *Journal of Urban Economics*, vol. 44 (November), pp. 317-32.

[4] Avery, Robert B., Patricia E. Beeson, and Mark S. Sniderman. "Account for Racial Differences in Housing Credit Markets," Working Paper 9310. Cleveland: Federal Reserve Bank of Cleveland, December 1993.

[5] 123 Cong. Rec. H8653 (daily ed. Jun. 6, 1977)

[6] 12 U.S.C. §2901

[7] Ibid.

communities in which they are chartered, consistent with the safe and sound operation of such institution."[8] Also, banks and thrifts were deemed to have an obligation to lend in their neighborhoods owing to the government's grant of a charter that confers special privileges, such as protection from competition and access to the federal safety net, including low-cost deposit insurance from the Federal Deposit Insurance Commission ("FDIC") and inexpensive credit from the Federal Reserve Banks and the Federal Home Loan Banks.[9]

Amendments to the CRA

Since its passage in 1977, Congress has amended the CRA several times. The first revisions took place as part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), which required regulatory agencies to make public their CRA evaluations and ratings.[10] Two years later, Congress passed the Federal Deposit Insurance Corporation Improvement Act of 1991, which expanded the regulators' information disclosure requirements to include publication of both the data and the factual findings used to support the rating assigned to an institution. In making these changes, Congress sought to promote greater uniformity and transparency in CRA examinations and ratings, as activists complained that it was nearly impossible to determine regulators' assessment criteria or to monitor an institution's CRA performance.[11]

Following the FIRREA amendments to the CRA, regulators adopted a more descriptive four-level ratings scale: Outstanding, Satisfactory, Needs to Improve, and Substantial Noncompliance.[12] Ironically, this new rating scheme in the view of some community activists compressed ratings and made it more difficult to differentiate between mediocre, good and excellent ratings.[13] However, there was a shift in the distribution of ratings following the rule change, with a larger proportion of institutions receiving below-

[8] Ibid.

[9] Marsico, Richard D. *Democratizing Capital: The History, Law, and Reform of the Community Reinvestment Act.* Durham: Carolina Academic Press, 2005.

[10] United States General Accounting Office (US GAO). "Community Reinvestment Act: Challenges Remain to Successfully Implement CRA." Report to Congressional Requesters GAO/GGD-96-23. Washington, D.C.: November, 1995.

[11] Marsico (2005).

[12] Thomas, Kenneth H. "CRA's 25th Anniversary: The Past, Present and Future." Working Paper No. 346. The Levy Economics Institute of Bard College: June 2002.

[13] Thomas, Kenneth. *Community Reinvestment Performance.* Chicago: Probus Publishing, 1993.

average ratings than before, indicating that regulators were becoming more rigorous in their examinations.[14]

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 made more significant changes. Up to this point, it was unclear that a bank had much at stake in CRA assessments. Since banks needed to get a Satisfactory rating for regulatory approval of interstate branches, Riegle-Neal augmented community activists' leverage to extract CRA lending commitments. (Today, most banks that needed to branch interstate have long since done so.)

The Gramm-Leach-Bliley Act of 1999 ("GLBA") included several revisions to the CRA legislation. It requires that a banking firm and all of its subsidiaries receive and maintain CRA ratings of Satisfactory or higher to have a financial holding company and engage in expanded financial activities. Likewise, national banks need to receive and maintain at least a Satisfactory rating to establish and maintain a financial subsidiary, which a bank must do if it wants to conduct securities business. At the same time, GLBA prohibits agencies from performing CRA examinations at institutions with less than $250 million in assets or that are affiliated with a holding company with less than $1 billion in assets.[15] This has significantly reduced the number of CRA examinations. Apgar and Duda (2003) found that less than 30 percent of all residential mortgage loans were subject to CRA review in 2003.[16]

The 1995 Regulatory Reform

In 1995, regulators substantially changed the way the CRA is administered. Pre-1995, CRA examiners assessed performance based on twelve factors and then rated institutions on a five-point scale, where "1" was the highest possible grade and "5" the lowest. These ratings were opaque, subjective, and inconsistent; for instance, the Federal Home Loan Bank Board, the former thrift regulator, considered 3 to be Satisfactory while the three other federal bank regulators required a 2 rating for a bank's CRA performance to be considered adequate.[17]

Not many institutions received low CRA ratings, and those that did seemed to suffer few consequences. It was extremely rare for a regulator to deny an application for a branch or a merger based

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[14] Ibid

[15] Marsico(2005).

[16] Apgar, William C. and Mark Duda. "The Twenty-Fifth Anniversary of the Community Reinvestment Act: Past Accomplishments and Future Regulatory Challenges." *FRBNY Economic Policy Review*: June, 2003.

[17] Thomas (2002).

on an institution's CRA rating; Thomas (1993) found only eleven CRA denials out of more than 50,000 branch and merger applications between 1977 and 1989.[18]

Both regulated financial institutions and the CRA's supporters complained that enforcement was too subjective and bureaucratic, and that the examinations focused too much on process – primarily evaluating institutions based on their plans for LMI lending instead of actual lending performance.[19] In response to these criticisms, President Clinton asked the regulatory agencies in July 1993 to reform the way in which they implemented the CRA, in order to provide more standardized and objective assessments that emphasized lending performance and to make sanctions against noncompliant institutions more effective.[20] The President's goals were to:

1. Promote consistency and evenhandedness in CRA enforcement,
2. Improve public CRA performance evaluations,
3. Implement more effective sanctions, and
4. Develop more objective, performance-based CRA assessment standards.[21]

As Comptroller of the Currency, I headed the interagency review effort, which was the first comprehensive assessment since the passage of the Act sixteen years earlier. The Office of the Comptroller of the Currency and other agencies held multiple hearings in cities from coast to coast in order to gauge public reaction to the CRA, its effectiveness and its burden, and to solicit suggestions for its improvement. Thousands of pages of comments were submitted and reviewed, and the heads of the relevant agencies were personally involved in the creation of the proposed rule, sent out for comment in 1994, and in the creation of the final rule. In April 1995, the agencies released the final, revised interagency regulations. The regulations changed the system of assessment from one that was heavily subjective and paper based to one that was more objective and deemphasized form over substance compliance. The revised regulations also tailored the examination approach so that evaluations took into account the institution's size and business strategy.[22] These examination models are still used today:

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[18] Thomas (1993)

[19] Board of Governors of the Federal Reserve System. "The Performance and Profitability of CRA-Related Lending." Report to Congress. Washington, D.C.: July, 2000.

[20] Board of Governors (2000) and Apgar and Duda (2003).

[21] Thomas (2002).

[22] Board of Governors (2000).

- The first model is a basic assessment for smaller retail institutions, which measures four lending ratios.
- A second type of examination is applied to large retail banks, which consists of rigorous tests to evaluate lending, investment, and service.
- The third model is given to wholesale or limited-purpose community institutions. Those institutions are permitted to select the criterion under which they are to be evaluated: community development ("CD") lending, CD investments, and/or CD services.
- The fourth model is the "strategic plan" examination, available to firms of any size, where an institution determines its own lending, investment or service performance standards.[23]
- Under all models, each institution is evaluated within its "performance context," which reflects the institution's characteristics, including its products and business model, its peers, its competitors, its market, and the economic and demographic features of its assessment areas.
- Retail institutions are evaluated on their performance within their assessment areas, but wholesale institutions can be assessed based on their efforts nationwide.[24]

Impact of the CRA

Most studies find that the initial version of the Act only resulted in a modest increase in lending, in spite the fact that the vast majority of institutions received at least a Satisfactory rating. The amendments to the Act in the early- to mid-1990s made the ratings more transparent and increased the incentives for larger banks to achieve at least a satisfactory rating. But it was the 1995 interagency revisions to the CRA regulations that had the biggest impact on increasing CRA lending. Just as importantly, they reduced paperwork burdens on banks.

The changes made to the CRA in the 1990s coincided with a rise in CRA lending commitments from an annual commitment of $1.6 billion in 1990 to $103 billion in 1999. In 1998, a year that saw three megamergers, CRA commitments reached $812 billion.[25] [26] CRA lending volume increased greatly

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[23] Thomas (2002).

[24] Board of Governors (2000).

[25] National Community Reinvestment Coalition. "CRA Commitments," Washington, D.C.: September, 2007.

between 1993 and 2000. [27] The number of CRA-eligible home purchase loans originated by CRA lenders and their affiliates rose from 462,000 to 1.3 million.[28]

CRA grading by the regulatory agencies became tougher. Above-average ratings were at 27 percent prior to the 1995 reforms, and this fell to around 10 percent though 2001. Below-average ratings continued to hover around 2 to 4 percent even after the reforms.

One of the most comprehensive studies on the CRA's effectiveness was conducted by the Joint Center for Housing Studies at Harvard University (2002) over a period of two years, using enriched HMDA data to evaluate the CRA's performance between 1993 and 2000. The researchers found that the CRA-regulated financial institutions operating in their assessment areas outstripped non-covered or out-of-area lenders in originating conventional, conforming prime mortgages to CRA-eligible borrowers. Their multivariate statistical analyses confirmed that CRA lenders originated more home purchase loans to lower-income people and in LMI communities, and acquired a greater proportion of the LMI loan market than they would have without the influence of the CRA. [29]

Other studies find that the CRA has been effective in encouraging financial institutions to lend to redlined neighborhoods. Several statistical analyses conclude that the CRA had a positive influence in encouraging lending to LMI borrowers and in LMI neighborhoods. Litan et al. (2001) estimated that the CRA may have accounted for up to 20 percent of the growth in LMI lending among CRA lenders, and that CRA lenders were more likely to originate prime loans to LMI borrowers than were non-CRA lenders.[30] Avery et al. (1999) and Apgar and Duda (2003) concluded that the CRA has expanded lending and service to LMI individuals and neighborhoods, the former finding that this was especially true for consolidating organizations, and the latter finding that CRA lenders operating within their assessment

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[26] Regulators did not publish that information prior to the 1989 passage of FIRREA. According to the GAO, statistics on early CRA enforcement actions and ratings are unavailable.

[27] Factors other than the CRA reforms per se may also have contributed to this increase, including a strong economy, low interest rates, the development of credit scoring models, which reduced processing costs, as well as the increased use of securitization and the maturing of the secondary market, which enabled depository institutions to increase their mortgage lending volumes beyond their core deposit base and allowed non-depository mortgage financing companies to grow their lending activities.

[28] Litan, Robert E. et al. "The Community Reinvestment Act After Financial Modernization: A Final Report." Department of the Treasury: January, 2001 and Joint Center for Housing Studies. "The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System." Harvard University: March, 2002.

[29] Joint Center for Housing Studies (2002).

[30] Litan, Robert E. et al. "The Community Reinvestment Act After Financial Modernization: A Final Report." Department of the Treasury: January, 2001.

areas made a larger share of prime, conventional loans to CRA-eligible borrowers than either CRA lenders operating outside their assessment areas and non-CRA lenders.[31]

In addition, studies find that lending to lower-LMI and minority borrowers increased at a faster pace than lending to higher-income borrowers; Avery et al. (1999) found that lending to low-income borrowers increased by about 31 percent between 1993 and 1997, while lending to higher-income borrowers increased only 18 percent over the same period.[32] The number of home purchase loans made to residents of low-income neighborhoods increased 43 percent, while lending to high-income neighborhoods rose only 17 percent.[33] Moreover, Barr (2005) found that homeownership in LMI areas increased by 26 percent between 1990 and 2000, whereas it increased only 14 percent in high-income areas during the same period.[34]

The profitability of CRA lending is another area that has been studied by scholars over the past couple of decades, as the statute requires CRA lending to be safe and sound. Studies generally concur that CRA loans are profitable, although often less so than standard loans. Meeker and Myers (1996) carried out a national survey of banks, savings and loans institutions, and bank holding companies with mortgage subsidiaries. Almost all said CRA lending was profitable, although a significant proportion noted that it was less so than other types of loans. However, the researchers were only able to obtain a response rate of 16 percent to their survey and the sample of responses was not randomly selected.[35]

In a more recent survey, the Federal Reserve Board of Governors (2000) contacted the largest CRA-covered retail lending institutions. Eighty-two percent of respondents reported that CRA home purchase and refinancing loans were profitable and 56 percent reported that CRA loans were generally as profitable as other home purchasing and refinancing loans. However, 51 percent of institutions stated that CRA loans had a higher delinquency rate relative to that of all loans, although 69 percent indicated that actual charge-offs for CRA loans were either no different from, or were lower than, the rate for other

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[31] Avery, Robert B. et al. "Trends in Home Purchase Lending: Consolidation and the Community Reinvestment Act." Federal Reserve Bulletin: February, 1999 and Apgar and Duda (2003)

[32] Avery et al. (1999).

[33] Laderman, Liz. "Has the CRA Increased Lending for Low-Income Home Purchases?" FRBSF Economic Letter 2004-16: June 25, 2004.

[34] Barr, Michael S. "Credit Where it Counts: The Community Reinvestment Act and its Critics." *New York University Law Review* 75.600 (2005).

[35] Meeker, Larry and Forest Myers. "Community Reinvestment Act lending: Is it profitable?" *Financial Industry Perspectives*. Federal Reserve Bank of Kansas City: Dec., 1996.

loans. These results may be skewed by nonresponse bias, as only 29 percent or 143 of the original sample of 500 institutions provided responses. Moreover the findings may not apply to smaller institutions because the respondents were large institutions, accounting for 40 to 55 percent of all CRA-loan originations at the time.[36]

There is a study by Jeffrey Gunther, often cited by critics of the CRA, which concludes the costs of the CRA exceed its benefits. Gunther attributes the growth in LMI lending between 1993 and 1997 to: 1) the removal or loosening of unnecessary regulations, such as interest rate and geographic restrictions; 2) a reduction in information costs due to automation and improved communications technologies; and 3) the development of better relationships between real estate developers and neighborhood associations. He finds that that LMI lending at non-CRA institutions, such as credit unions and independent mortgage companies, grew faster than at CRA-covered institutions. Gunther says the LMI-share of the lending portfolios at non-CRA firms increased from 11 percent in 1993 to 14.3 percent in 1997, whereas that of CRA lenders remained at approximately 11.5 percent over the same period, adding that non-CRA lenders accounted for slightly less than 40 percent of all one- to four-family home purchase loans originated in LMI neighborhoods in 1997. All this leads Gunther to conclude that because non-CRA lenders tend to be subject to fewer regulatory restrictions than their CRA counterparts, the loosening of regulations must be the major reason for the increase in volume of LMI lending.[37]

Gunther also argues that the CRA imposes costs by encouraging institutions to take on additional credit risk. He finds that higher CRA lending levels are positively correlated to a problem CAMELS rating, defined as a "3" or higher, but negatively correlated with a problem CRA rating. He also observes a positive correlation between LMI lending volume and a problem CAMELS rating, but finds no statistical relationship between LMI volume and problem CRA ratings. Finally, Gunther finds a positive relationship between reductions in profitability and both problem CAMELS ratings and problem CRA ratings.[38]

Gunther's evidence is not persuasive. While it is true that non-CRA lenders increased their share of subprime/CRA lending to 40 percent, they increased their share of all one- to four-family mortgage originations to 56 percent, an even higher percentage, demonstrating that these lenders did not increase

[36] Board of Governors (2000).

[37] Gunther, Jeffrey W. "Should CRA Stand for 'Community Redundancy Act'?" *Regulation* 23.3 (2000).

[38] Gunther (2000) and Joint Center for Housing Studies (2002).

their community lending by as much as their overall mortgage lending.[39] Gunther also has not differentiated between CRA loans by CRA lenders, which tend to be on fair and reasonable commercial terms, with predatory loans that are more likely to be made by companies that fall outside the jurisdiction of the CRA. In 2000, institutions subject to the CRA and operating within their assessment areas originated only 3 percent of subprime loans.[40] Further, Gunther fails to prove that increased CRA lending caused the lower CAMELS ratings. There are many reasons why an institution's CAMELS rating might decline, which are unrelated to the CRA. For example, CRA lending has tended to be a small part of the business of insured depositories. As we noted above, the institutions themselves say that charge-off rates for CRA loans are approximately equal to, or are lower than, those of all other loans, although the delinquency may be higher. Perhaps the biggest weaknesses with Gunther's study are that his findings are based on small institutions and his data are old. The ratings data are from the period between 1991 and 1996, so they do not reflect the impact of the 1995 rule revisions, which emphasize lending performance over process, would have become evident. Further, it's questionable whether results for small institutions can be extrapolated to large ones, because small banks have less incentive to establish a robust CRA program.

The CRA and the Subprime Loan Crisis

Some blame the CRA for the subprime lending crisis, in large part because they assume "CRA loans" and "subprime loans" are synonyms. They charge that the Act compels banks to lower their underwriting standards in order to make loans to people who live in LMI neighborhoods.

Subprime loans hardly existed before the early 1980s because, prior to that time, it was not legal for a bank to charge different interest rates depending on the risk, to make a variable interest rate loan, or to make a loan with balloon payments.[41] Furthermore, as noted above, a combination of redlining and lending discrimination further discouraged loans to low and moderate income Americans.

[39] Joint Center for Housing Studies (2002).

[40] Joint Center for Housing Studies (2002).

[41] In 1980, the Depository Institutions Deregulation and Monetary Control Act provided banks flexibility to set rates and fees for mortgages. And on 1982, the Alternative Mortgage Transaction Parity Act allowed banks to make variable rate mortgages and mortgages with balloon payments.

As recently as 1995, only about 10 percent of mortgage originations were subprime; by 1997 that number had grown to 14.5 percent.[42] The Asian debt crisis in 1998 prompted a massive repricing of risk by investors, which resulted in a large decline in the number of subprime originations; however, the business quickly recovered and, by 2002, the volume of subprime mortgages was growing faster than ever. Data from Inside Mortgage Finance show that subprime originations grew 56 percent between 2002 and 2003.[43]

Importantly, there are key differences between the subprime loans made after 2002 and the ones made during the 1990s, when all grades of subprime loans grew at approximately the same rate. According to Chomsisengphet and Pennington-Cross (2006), the growth in subprime loans between 2000 and 2003 was almost entirely in A-rated loans, the highest grade of subprime mortgages. In fact, the originations of lower grade subprime loans generally continued to decline slightly.[44]

In his book, *Subprime Mortgages*, the late Federal Reserve Governor Edward Gramlich argues that both market and regulatory developments explain the rapid growth in subprime loans. He points out that the emergence of credit scoring offered a more inclusive and less costly way to make loans. But investors' expanding appetite for Wall Street's subprime securitizations was an even more crucial factor. The percentage of subprime loans sold into securitizations grew from 28.4 percent in 1995 to 55.1 percent in 1998 to over 80 percent in 2006.[45]

On the regulatory side, Gramlich believes the CRA did play an unintended role in the increase in subprime lending, by legitimizing doing business in formerly red-lined neighborhoods.[46] For example, he points to a study by Immergluck and Wiles (1999), which finds that over half of subprime refinances were in census tracts that were largely African-American. Gramlich interprets this as an indication that some banks were targeting LMI neighborhoods in order to demonstrate they were serving the community.

In fact, regulators began to draw a material distinction between the modern subprime loan and a true CRA loan in the late 1990s and 2000s. In the early 1990s, one might have said that many CRA loans were "subprime" in the strictest sense of the term, meaning that borrowers in LMI areas tended to have

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[42] Source: Inside B&C lending.

[43] Chomsisengphet, Souphala and Anthony Pennington-Cross. "The Evolution of the Subprime Mortgage Market," *Federal Reserve Bank of St. Louis Review*: January/February 2006.

[44] Ibid.

[45] Source: Inside MBS &ABS and Inside B&C lending.

[46] Gramlich, Edward. *Subprime Mortgages*. Washington, D.C.: Urban Institute Press, 2007.

lower FICO scores. By the early 2000s it became clear that regulators used the term "subprime" differently from the term "CRA loan," and that the CRA lenders' practices in making CRA loans differed from those of non-CRA lenders lending in the LMI areas. The CRA lender making CRA loans tends to have a social, or at least a non-predatory, objective, as it is regulated and examined by the bank regulatory agencies. In contrast, subprime lending—particularly of the 2005 to 2007 vintage—evolved into something of a perversion of the goal of the CRA; it became a kind of red-lining in reverse. The non-bank non-CRA lender, or the modern subprime lender, is driven to sell as many high rate loans as they can, with no particular social motivation.

A study by Traiger & Hinckley LLP's (2008) finds evidence of the distinction between CRA lenders and subprime lenders in of 2006 HMDA data. They conclude that banking companies that made CRA loans in the fifteen most populous metropolitan statistical areas ("MSAs") were more conservative in their lending practices than lenders not covered by the CRA. It found that 59 percent of these banks were less likely to originate high-cost loans and when they did, the average interest rate was 51 basis points lower than the rate for prime loans. Interestingly, the banks that made CRA loans in high-population MSAs were 30 percent more likely to hold the high-cost CRA loans in portfolio than were banks and non-banks that lent elsewhere. This suggests that the CRA has encouraged banks that lend in populous MSAs to take a thoughtful approach to LMI lending, instead of simply moving further out the risk curve.[47]

Since 2000, the subprime mortgage market has evolved in a direction indicating that the CRA is not a significant factor in the subprime mortgage market. Gramlich calculated from HMDA data that, "Only one-third of CRA mortgage loans to low- and moderate- income have rates high enough to be considered subprime."[48] Moreover, an analysis of the HMDA data by ComplianceTech finds that in 2006, about 67 percent of subprime loans were upper- or middle-income borrowers; LMI borrowers received only about 28 percent.[49] Indeed, LMI borrowers received the smallest share of subprime mortgage loans in each year between 2004 (when more detailed HMDA data began to be collected) and

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[47] Traiger & Hinckley LLP. *The Community Reinvestment Act: Act: A Welcome Anomaly in the Foreclosure Crisis and Addendum.* New York: Jan. 7, 2008

[48]Gramlich (2005), 25.

[49] Jourdain-Earl, Maurice. "The Demographic Impact of the Subprime Mortgage Meltdown." ComplianceTech: 2008.

2007. Since 2004, over half of subprime loans went to upper- and middle-income borrowers in non-LMI census tracts.[50]

Another indication the CRA is not the cause of the subprime crisis is that un- or under-regulated mortgage brokers played an increasingly large role in the origination of subprime mortgages. Most of these brokers are not owned by depository institutions or their affiliates, and so are not subject to the CRA. In 2004 and 2005, mortgage brokerage companies reported on more than 60 percent of all loans and applications under HMDA. Two-thirds of them were independent. According to the Federal Reserve, these independent brokers make 50 percent of all subprime loans.[51] If the CRA were a driving consideration for depositories, banks and thrifts would want to be the portals through which all LMI borrowers enter in order to ensure they receive full CRA credit for originating all qualifying loans.

As a case in point, Jim Rokakis, Treasurer of Cuyahoga County in Ohio noted that HMDA show that in 2005, when home purchase mortgage originations peaked in the Cleveland, Ohio area, that the vast majority those loans were made by un-regulated mortgage brokers. Citing a study by the Research and Advocacy Center, he said that in 2005, the biggest lender, Argent Mortgage, originated 18 percent of home purchase mortgages and that the next largest lender, Century Mortgage, originated approximately five percent. Although both firms—now defunct—were well-known originators of subprime loans, neither were subject to the CRA. Likewise, the 4th through the 6th largest lenders were not subject to the CRA. In fact, the CRA applied to only four of the top ten mortgage originators in the Cleveland area in 2005. All together, the regulated originators were only responsible for 15 percent of originations, amounting to 648 purchase mortgages. By way of comparison, home foreclosures in Cuyahoga County are on a pace to reach 15,000 for 2008. Rokakis concludes, "Did [the banks] make these loans to help their parent institutions' CRA ratings look better? Possibly. Did these 648 loans play a major role in the city's default and foreclosure crisis? Hardly."[52]

In fact, subprime mortgage lending has become a specialized segment of the mortgage business: "...[T]he market share of the top 25 firms making subprime loans grew from 39.3 percent in 1995 to over 90 percent in 2003."[53] As of July 2007, 34 percent of the top fifty residential mortgage originators,

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[50] *Ibid.*

[51] Executive Office of the President. *Economic Report of the President.* Washington D.C.: United States Government Printing Office, February 2008, Table B-76.

[52] Rokakis, Jim, "Turmoil in the U.S. Credit Markets: The Genesis of the Current Economic Crisis." Testimony before the Senate Committee on Banking, Housing & Urban Affairs, Washington DC, October 16, 2008.

[53] Chomsisengphet and Pennington-Cross (2006), 40.

measured in terms of the numbers of loans originated, were neither depository institutions nor owned by one of the fifty largest bank holding companies.[54] What's more, firms that originate subprime loans are concentrated in California. If the CRA were an overriding consideration, one would expect to see most large and regional banks competing in the subprime lending space in order to serve LMI borrowers, and it would be unlikely that subprime origination would be dominated by specialists located in California. The fact that firms not subject to the CRA have come to play such a prominent role in the subprime business suggests that firms are originating these types of loans to make money and not as a response to regulatory and/or social imperative.

In sum, the evidence shows that the emergence of securitization, loan risk pricing, and specialization is what caused the subprime mortgage market to grow. The CRA may have been one contributor to the growth, but certainly not a very important one.

Causes of the Subprime Crisis

If not the CRA, then what explains why banks and investors assumed too much credit risk? The answer is that in this most recent cycle, we had a combustible mixture of a governmental philosophy that allowed for negative savings, high liquidity, and minimal regulation; and of complex financial instruments that allowed risk to be sliced and diced and misunderstood. Much of the lending and financial excesses in this cycle were not low- and moderate-income borrowers, but upper-middle income borrowers who embraced sophisticated yet risky financial products.

The government failed to engage in sound macro-economic and financial regulatory to avoid credit spikes and busts that fuel unemployment and even force responsible borrowers into unemployment. Financiers maintained a view that housing prices would continue to rise and home values would fill the hole in the consumer's badly weakened financial statements. There were mortgage brokers and others who profited from pushing exotic loans to people who could ill afford to make the monthly payments when they readjusted. To top it off, we saw the emergence of what Nicolas P. Retsinas, Director of Harvard University's Joint Center for Housing Studies, referred to in a December 21, 2009, *Boston Globe* op-ed as "strategic defaulters." They are not LMI borrowers, and these defaulters are able but unwilling to pay. They would rather default on their mortgage obligations, viewing them as they would view a bad investment.

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[54] Source: American Banker

Researchers, Mian and Sufi (2008) show that high demand for mortgage-backed securities ("MBS") led to the surge in subprime lending.[55] Investors under-priced the risk posed by subprime collateralized mortgage obligations ("CMOs"), while investment banks and very large commercial banks created new secondary instruments to boost rates of return by greatly increasing leverage and liquidity risk. When the housing-price bubble burst, massive write-downs of these highly leveraged secondary securities soon followed.

In the period between 2004 and 2006, interest rates were low and the yield curve relatively flat – in fact, at the end of 2005 and again in January 2006, the yield curve was inverted. Yield spreads were so low that investors were not being compensated for the risks they were assuming. Investors were aggressively seeking yield and saw subprime mortgages as the ticket. Many of them assumed that the default risk of subprime mortgages, although higher than that of prime mortgages, would be relatively low. Since the economy was stable, investors thought they could take advantage of a flat yield curve to increase their returns by financing long-term securities with cheap short-term debt. Wall Street issued more and more securitization products, greatly increasing the demand for originations of subprime loan. At the retail level, mortgage brokers were pleased to oblige, as they were paid based on the volume of loans they originated.

One consequence of the de-consolidation of the mortgage origination and the mortgage holding process is the emergence of an agency problem, which undoubtedly played an important role in the events leading up to the subprime crisis. When banks make and hold a loan, they have every incentive to make certain the screening and underwriting process is done properly. After all, they stand to lose otherwise. In the originate-to-distribute model that became overwhelmingly popular prior to the subprime crisis, the originator does not suffer loss if a borrower defaults, as it bears little, if any, of the cost of underwriting mistakes and misjudgments; instead, its income is typically based on the volume of loans it sells. Likewise, financial institutions that buy these loans do not have as strong an incentive to scrutinize the loans they sell into securitization as carefully as the ones they keep – instead, their income rises the more loans they can sell into securitization.

Keys et al. (2008) confirm the presence of these agency problems in their analysis of a sample of two million home purchase loans made between 2001 and 2006. They find that originators pushed borderline, but subpar, low-documentation loans over the minimum qualifying credit score. As a result, the group of loans that lay just *above* the cutoff score defaulted at a 20 percent higher rate than those just

[55] Mian, Atif and Amir Sufi, "The Consequences of Mortgage Credit Expansion: Evidence from the 2007 Mortgage Default Crisis." Working Paper. Chicago: University of Chicago, May 2008.

below it. They also find that the information available to mortgage-backed securities holders tends to understate the true risk of borrower default.[56]

Predictably, credit standards declined, especially in 2006. Federal Reserve Chairman Ben Bernanke summed up the analysis in testimony before Congress: "The originate-to-distribute model seems to have contributed to the loosening of underwriting standards in 2005 and 2006. When an originator sells a mortgage and its servicing rights, depending on the terms of the sale, much or all of the risks are passed on to the loan purchaser. Thus, originators who sell loans may have less incentive to undertake careful underwriting than if they kept the loans. Moreover, for some originators, fees tied to loan volume made loan sales a higher priority than loan quality. This misalignment of incentives, together with strong investor demand for securities with high yields, contributed to the weakening of underwriting standards."[57]

That said, the data show that the defaults of subprime mortgages, though quite problematic, are not by themselves high enough to cause a freeze in credit markets or to push the U.S. economy into recession territory. As of June 2008, the stock of subprime mortgages outstanding was roughly $2 trillion.[58] According to Standard and Poor's, the worst of the subprime mortgage vintages originated in the post-2000 period have ninety-day-plus delinquencies of 20 percent.[59] So seriously delinquent subprime mortgages make up about 1.25 percent of all home mortgages and, even when adding in all other nonperforming 1-4 family home mortgages, the overall ninety-day delinquency rate is lower than it was in the early 1990s.[60] And it is important to remember that many delinquent mortgages do not go into foreclosure. Demyanyk and Van Hemert (2008) forecast actual foreclosure rates at less than half of the sixty-day delinquency rate.[61]

[56] Keys, Benjamin J. et al. "Did Securitization Lead to Lax Screening? Evidence from Subprime Loans." Working Paper. Athens: European Finance Association, April 2008.

[57] Bernanke, Ben S. "Subprime mortgage lending and mitigating foreclosures." Testimony before the Committee on Financial Services, U.S. House of Representatives, Washington D.C., Sept. 20, 2007.

[58] Congressional Budget Office. "Federal Housing Financial Regulatory Reform Act of 2008." Cost Estimate. Washington, D.C.: June, 2008.

[59] Standard and Poor's. "U.S. RMBS Subprime Securitization Volume Declines Amid More-Stringent Guidelines." *RMBS Trends*. New York: August 31, 2007.

[60] Source: FDIC

[61] Demyanyk. Yuliya and Otto Van Hemert. "Understanding the Subprime Mortgage Crisis." St. Louis: Federal Reserve Bank of St. Louis, Aug. 12, 2008.

Instead, a new and different kind of securitization, rather than traditional subprime mortgage securitizations, caused the meltdown in the credit markets. In effect, some on Wall Street created highly-leveraged bets predicated on the continued strong performance of traditional subprime mortgage-backed securities. Investment bankers morphed subprime mortgages into new and highly-complicated credit derivative products, many of which were based on subprime CMOs and other collateralized debt obligations, which they sold to banks and other investors worldwide. Unlike stocks, futures, or commodities, these securities were not subject to margin requirements, so banks and investors paid for these secondary securitizations almost entirely with borrowed short-term money. The resulting leverage raised the potential rate of return, but also magnified the negative impact of any diminution in value of the underlying mortgages. It was these highly-leveraged secondary and tertiary financial products that turned a problem into a crisis.

As defaults of underlying mortgages began to rise, this had cascading and magnifying effects, first on the subprime originators themselves, and then on the holders of these highly leveraged debt instruments. Many investors, realizing they had underpriced their risks, panicked. When investors pulled back, holders of the secondary and tertiary subprime securitizations were suddenly unable to roll over their debt. Many had no choice but to sell whatever assets they had – including these CMOs -- at deeply discounted prices, thereby further reducing asset values. The massive deleveraging we are all painfully experiencing today has its immediate roots in this massive, systemic margin call. Looking at the magnitude and source of the problem, one would have to conclude that CRA loans played at best a bit part in this global tragedy.

Yet another piece of evidence that the CRA is not the cause of the subprime problem is provided by the decline in the performance of the most recent vintage of subprime loans reported in the data. Standard and Poor's data show higher delinquency rates, measured on an absolute basis, for 2006 vintage loans than for earlier vintages.[62] Demyanyk and Hemert (2008) find that, after adjusting for factors such as housing-price appreciation and borrower credit rating, the average loan-to-value ratio increased while loan quality steadily declined between 2001 and 2006 – yet, the price spread between prime and subprime mortgages shrank. They attribute the declines in underwriting and in pricing to a "classic boom-bust scenario, in which unsustainable growth leads to the collapse of the market."[63]

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[62]Standard and Poor's (2007) .

[63] Demyanyk and Van Hemert (2008), Abstract.

Thus, it is apparent that the increase in subprime defaults did not result from the CRA's inducing banks to reduce underwriting standards or under-price risk. Rather, investors' desire for higher investment yields and Wall Street's response pulled the non-CRA, unregulated mortgage market in that direction.[64]

Looking Forward

Achieving a sustainable recovery requires creating large numbers of jobs thought the country. And the pace of the recovery will be driven by growth in the business sector. That is because consumers remain highly burdened with debt and have limited capacity to buy; the persistent high level of unemployment is making them reluctant to spend.

Small businesses have created over 64 percent of new jobs over the past fifteen years.[65] This means that banks and finance companies will play a crucial role in determining how fast these businesses can grow. The best means the government has for assessing the performance of banks in meeting the credit needs of the communities they serve is the CRA.

Unfortunately, the CRA is not keeping up with innovations and trends in the financial industry, such as industry consolidation and non-depository lending, and this is eroding the Act's effectiveness. The financial services business and the manner in which financial products are structured, offered, delivered, and held by institutions and investors has fundamentally changed in the last thirty years. At the time Congress was debating the CRA, banks were the dominant financial services companies and were the dominant debt holders. The banking and thrift industries have been losing ground to other financial companies over the last thirty-five years, so that non-bank lenders now hold more credit-market debt than do banks and thrifts.

New technologies, financial innovation and increased economies of scale also have contributed greatly to the transformation of the financial services sector. Today, non-banks, including hedge funds and broker-dealers, are able to collect savings and investments efficiently from all over the country, and to amass them for large borrowers and large securities offerings. Individual investors participate in

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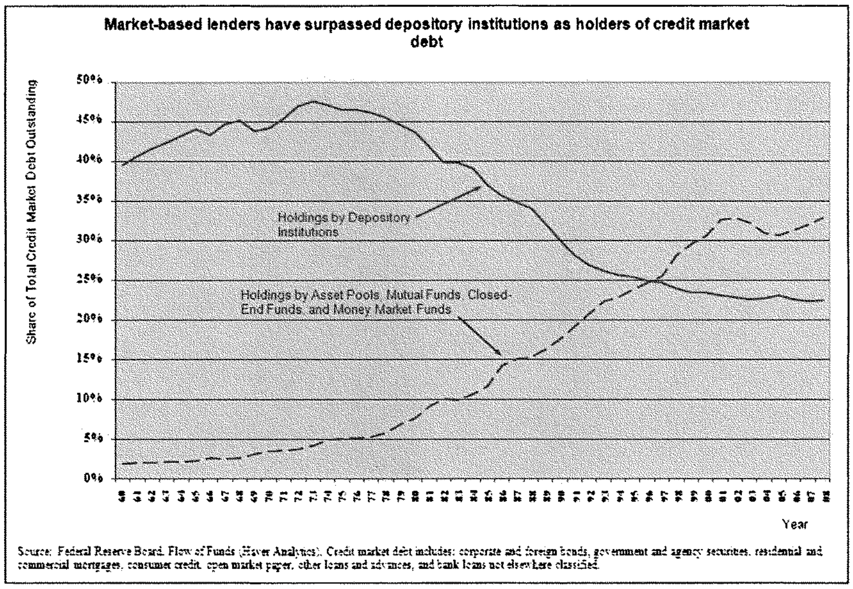
[64] The current financial turmoil continues to evolve. However, it is becoming clearer that the problem goes beyond subprime mortgages and that the originate-to-distribute model and other capital market ills have infected the prime mortgage market as well. Of course, the CRA has essentially nothing to do with the prime mortgage market. If this were a CRA-induced phenomenon, we would undoubtedly not see the same outcomes throughout the credit spectrum.

[65] Statistic reported by the Small Business Administration.

national capital markets via mutual funds, tax-deferred pension funds, hedge funds, private equity funds and so on – in so doing, they by-pass traditional intermediaries. Whereas in 1990, bank and thrift deposits exceeded mutual fund shares by $2.75 trillion, the amounts that each held were roughly equal by 2000.[66]



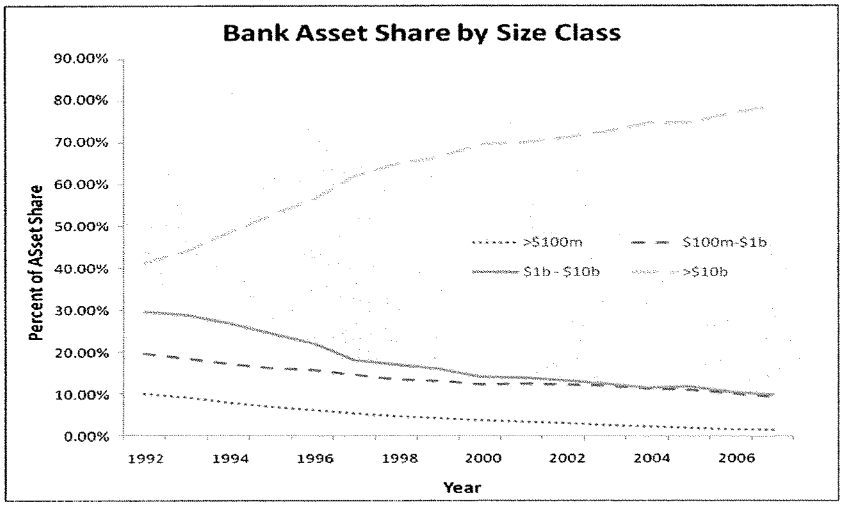
The banking industry responded to these changes in a variety of ways, including consolidating into very large, multi-state banking companies. Community banks, with clearly defined service areas, have steadily lost market share to the big money center banks. Since 1992, banks with $100 million to $1 billion in assets saw their share of banking-system assets halve, from 19.4 percent to 9.5 percent.[67] Apgar and Duda (2003) found that mergers and acquisitions extended the geographic reach of many institutions, so that by 1998, more than 25 percent of banking assets were owned by firms headquartered out of state.[68]

[66] Source: Federal Reserve Flow of Funds Data.

[67] Source: FDIC Call Reports.

[68] Avery et al. (1999).

In 2007, the average institution was twenty times larger than the average institution in 1977, and today, the ten largest banking companies hold over 67 percent of the assets in the banking system.[69]



One significant, but frequently ignored, consequence of the transformation to national financial markets is that local markets and local neighborhoods receive less individualized attention. As savings increasingly flow to large financial institutions and investment funds, investment becomes more focused on very large borrowers (both domestic and foreign). This is because large banks make loans most efficiently where the transactions costs per dollar are small. They tend to serve small borrowers with standardized loans and other products, such as lines of credit, mutual funds, and credit cards. To make money on non-standard loans — for example, by financing a start-up or a small business – requires knowledge of the borrower and experience with the local market, as well as close monitoring. A local banker or a specialized lender with knowledge of, or close proximity to, local borrowers can make individualized loans more cost-effectively.

[69] Source: Federal Reserve

A telling piece of supporting evidence is that community and regional banks more actively lend to projects that qualify for CRA credit. In 2001, banks with less than $1 billion in assets held only 16.8 percent of bank and thrift assets, but they extended about 28.2 percent of all CRA loans and more than 47 percent of CRA farm loans.[70] In fact, small business is highly dependent on community and regional banks for financing. In 2007, about 25.2 percent of commercial loans across the banking industry as a whole were in amounts less than $1 million. About 63.3 percent of the loans made by small banks were less than that amount.[71]

Recommendations for the CRA

Reigning in the excesses of subprime lending may have a disproportionate impact on LMI areas if lenders and investors take away the wrong lesson from the experience – that LMI borrowers are not good credit risks. In that case, vigorous application of the CRA is as necessary as it was in 1977, in order to ensure that there continues to be a flow of investment on fair terms to LMI neighborhoods. Indeed, inner cities and economically declining regions require large capital investment in infrastructure and the demolition or rehabilitation of dilapidated properties, if they are to be attractive environments for private capital investment. How, then, do we reconcile providing credit to the under-served while at the same time protecting consumers and the economy? I recommend the following:

1. Apply the obligation to meet the needs of LMI neighborhoods and communities to non-bank financial services companies. Their share of financial assets now exceeds those of banks and thrifts, and their holdings continue to grow. Furthermore, the Federal Reserve is in essence supporting almost all large financial services companies, regardless of charter, by giving them access to the safety net. Broker-dealers, insurance companies, and credit unions should be covered by the CRA, at a minimum. Ideally, it would also include all other major financial institutions important to the maintenance of a stable economy, such as hedge funds and private equity funds with more than $250 million in assets, consistent with the GLBA's small bank size cutoff.

   As well, an expansion of the concept of CRA to more squarely to include financial services broadly, not just credit, would help LMI individuals and geographies greatly. For example, where appropriate, an emphasis on making savings products more broadly available would

[70] Source: FFEIC.

[71] Source: FDIC Quarterly Banking Profile.

add value. In this regard, a CRA emphasis on some level of equity investment and innovation would also help LMI geographies and our economy more generally.

2. The holding company structure allows banks to reduce their CRA obligations by pushing activities out of the bank onto holding company affiliates; this has been going on for the past several years and is common in the mortgage and consumer lending areas. This anomaly needs to be rectified.

3. In many cases, the area served by a bank is no longer self-evident or defined by a geographic community. Virtually all of the top fifty banking companies have extensive interstate banking operations. Anchoring CRA obligations to the LMI area surrounding a charter or headquarters location does not reflect the reality of their businesses or their impact on LMI consumers. We need to assess whether institutions that conduct business in multiple states are reasonably distributing their CRA lending among the communities they serve. In some cases of national providers, a broad national approach to CRA is warranted.

4. In the current state of the economy, we should strongly encourage institutions to make loans that create permanent jobs in LMI census tracts. Lenders should receive CRA credit for loans to businesses that generate new jobs in LMI areas and additional credit, if the loan is to an LMI borrower.

5. We should consider granting CRA credit to lenders that establish effective loan programs for converting existing predatory loans to homeowners living in LMI census tracts into conventional loans.

Of course, the enhancements to the CRA I recommend will not be sufficient to satisfy the credit needs of LMI borrowers unless we also adopt a companion set of consumer protections. From the company store, to loan sharks, to pawn brokers, to tin men and unprincipled merchant lenders, quick buck artists have found ways to make money by taking advantage of the disadvantaged.

The evolution to global credit markets has made the financial services business more competitive, importantly driven by the rise of non-bank entities, and financial products have become more complex and sophisticated. In one sense, financial products have become less sensitive to the needs of LMI borrowers because LMI borrowers need to have greater financial sophistication to understand the risks these products pose. There are no better examples than the pay option ARMs and low-doc home mortgages that have been cultivated by the financial market's appetite for securitizable products.

The Congress should consider requiring regulators to:

1. Create appropriate underwriting practices tailored to the particular credit product. There is an enormous amount we have learned about lending responsibly and safely to low-and-moderate income borrowers that makes these loans a safe and sound credit practice – everything from rainy day reserves to credit counseling, to lending circles to more traditional income ratios and some down payment obligations.
2. Insist on disclosures to borrowers that are honest, simple, and understandable.
3. Prohibit, along with enforcement efforts that have teeth, practices – so prevalent in the past several years – of phony credit applications and real estate appraisals.
4. Police the un- and under-regulated providers of financial services.

Finally, we need to alter our national conversation about credit, placing a renewed emphasis on jobs and small businesses rather than homes. And we should study and learn from the successful practices that micro-credit and other experts have had around the world.

Conclusion

The CRA is not a panacea, but the CRA has proven it can help and help materially with the financial needs of individuals and communities. In the wake of the economic crisis these needs are as acute as ever.

The CRA needs to be modernized, but moving it into the 21st century requires the same kind of care and creativity that fostered the Act in 1977, and provided for its reform in the 1990s. The financial intermediation process, the structure of the banking system, and the methods for delivering financial services have changed in fundamental ways since 1977 in ways no one could have predicted when the CRA was enacted. The facts on the ground in LMI neighborhoods and communities have changed as well. Explicit redlining of neighborhoods by banks and thrifts is by and large a thing of the past. Innovations in technology and financial markets have lowered the cost of financing to the point that many more credit-worthy borrowers are able to access credit.

Yet, the heart of the problem that the CRA was intended to solve remains – that is, the need for the financial services sector to deliver enough support to local communities. They require sound infrastructure and healthy retail businesses. Academic studies still find evidence of information deficiencies, resulting in a more subtle, and perhaps unintended but still hurtful, form of redlining, which causes some banks to under-invest in some neighborhoods and to racial discrimination in lending. Critics who argue that the subprime crisis demonstrates that the CRA is a misguided and unwarranted intervention by the government into the financial services sector are wrong. Thoughtful research by respected economists and community development experts show there are identified market failures that require government action to address.

I am confident that providing financial services (including credit) to low-and-moderate income borrowers can be reconciled with sound consumer and sound economic practices. What's more, its benefits are sweeping and tangible; and the results can clearly be seen within households, neighborhoods, cities and states throughout the country

American Enterprise Institute
for Public Policy Research

Statement before the House Financial Services
Subcommittee on Financial Institutions and Consumer Credit
Hearing on Perspectives and Proposals on the Community Reinvestment Act

The Community Reinvestment Act at a Crossroads

Vincent Reinhart

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4/15/10

The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

Redlining, or the denial of services based on neighborhood, is pernicious. The practice thwarts opportunities for growth and leaves economic value on the table. The Community Reinvestment Act (CRA), passed in 1977, was, on balance, a successful legislative response to that societal failure. CRA focused policy makers, supervisors, and bankers on under-served, yet profitable, neighborhoods. Everyone worked up a learning curve and benefited as a result.

The success was incomplete and came with significant costs. Moreover, those costs have increased over time as the structure of markets has evolved. The Congress recognized it was aiming at a moving target in revisions to the Act in 1989, 1995, and 2005. Given that many aspects of financial regulation have been put into legislative play, it is appropriate to reconsider how best to achieve the mission of CRA.

To do so properly requires examining four widely recognized problems with CRA.

First, CRA was designed with a "hydraulic" view of banking. Deposit funds generated in particular locales were leaking out because of an unwillingness of bankers to lend. CRA was to act as the catch basin to keep those funds within the community. That was a flawed view even in 1977 and is far more out of sync with today's reality. Banks have a nationwide footprint, offer a wide array of products and services, and compete with many nonbank financial institutions. There workplace is the world, not the neighborhood.

Second, far more lending decisions are made off bank premises, whether by intermediaries such as mortgage brokers or on the internet. CRA's scope, therefore, is too narrow. It is important to recognize that this declining bank share is not entirely driven by technology. Rather, compliance costs associated with CRA and other bank regulations give non-bank providers a decided competitive edge. Indeed, some banks themselves spun off those activities to more lightly regulated entities. Mortgage brokering, for instance, ran under the radar screen of regulation to offer more varied products to poor communities. Some of that innovation tipped over into predation, producing mortgages that served brokers' self-interest by increasing lending volume and not the interests of borrowers or lenders. That is why studies have found that CRA-related lending fared relatively better during the financial crisis. But that is incomplete. Competition also created a vicious circle in which the remaining regulated entities in under-served areas had to stretch standards further to keep up their market shares to bolster their CRA scores. Thus, CRA probably contributed to the general worsening of standards.

Third, CRA gives broad goals without detailed requirements about how to achieve them. This leaves much to the discretion of supervisory agencies, much to their delight. But experience has shown that agency attention to such matters swings like a pendulum pushed indirectly by elections.

Fourth, enforcement of CRA is event-driven, really only coming into play in advance of potential changes in ownership. As a consequence, bank management is especially vulnerable to interest groups that might lodge protests during the merger-approval process. Rather than changing their ways, bankers sometimes find it easier to pave the way by token support of advocacy groups. Indeed, research indicates that banks that grow faster tend to score better with CRA compliance. This is consistent with the view that regulatory approval of expansion is a convenient means of extracting contributions to community advocacy groups.

CRA is at a crossroad. The wrong path would be to increase the scale and scope of regulation to address CRA's apparent flaws. The efficiency loss for the U.S. economy could be considerable. A more productive route is to recognize its design flaws.

First, CRA was written when finance was a brick-and-mortar industry. In this century, banks are less important and lending opportunities are far more varied. Applying for a loan need not have a physical footprint, and that empowers borrowers.

Second, the financial crisis has shown that the mixed model of giving private entities a public purpose is a catastrophic failure. The wreckage includes the reputation of the rating agencies and the status of the government sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. By all means, make financial institutions pay for the federal safety net. But do it a transparent manner through a risk-based fee. Giving bankers diffuse goals that are only episodically relevant is a very inefficient means of extracting a quid pro quo for protection and helping the under-served.

Third, CRA is one part of the government's overall policy of subsidizing housing. A short, and incomplete, list includes the tax-deductibility of mortgage interest, the subsidies to the GSEs, and their affordable loan limits. Collectively, this support helped inflate the housing bubble and made its bursting more severe. By construction, if the government over-subsidizes one activity, then it is disadvantaging others. The fundamental problem is that avenues for wealth creation in America are limited for lower-income households. As a nation, we funnel families toward housing, leaving them under-diversified and often over-levered. The Congress would be better served by expanding opportunities to build capital, including though support of small businesses and increased incentives for equity ownership.

If the Congress decides to continue its support of home ownership, there is a better path than building up the already-rickety structure of CRA. For example, consider four steps. Price the federal safety net so there is an explicit quid pro quo for any protection to financial firms. Use some of those proceeds to subsidize the purchase of mortgage insurance for eligible families in designated areas. Educate those households to opportunities to apply for mortgage loans in cyberspace. Enforce the existing equal opportunity laws if any of those who apply are wrongfully refused.

The problem lies not with the mission of CRA but rather in its execution.

National Urban League
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Empowering Communities.
Changing Lives.

TESTIMONY OF

CY RICHARDSON

VICE PRESIDENT, HOUSING AND COMMUNITY DEVELOPMENT

NATIONAL URBAN LEAGUE

BEFORE FOR THE

HOUSE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

THURSDAY, APRIL 15, 2010

"PERSPECTIVES AND PROPOSALS ON THE COMMUNITY REINVESTMENT ACT"

Chairman Gutierrez, Ranking Member Hensarling, thank you for the opportunity to share the perspectives and proposals of the National Urban League on the Community Reinvestment Act (CRA). I am Cy Richardson, Vice President of Housing and Community Development at the National Urban League. Established in 1910, the National Urban League is celebrating its centennial anniversary as the nation's oldest and largest civil rights and direct services organization serving 2 million people each year in over 100 urban communities.

Economic Empowerment – assisting our constituents in attaining economic self-sufficiency through job training, good jobs, homeownership, entrepreneurship and wealth accumulation – leads the National Urban League's five-pronged strategy to advance the mission of the Urban League Movement and is imperative to closing the "wealth chasm" between African Americans and white Americans. According to this year's *State of Black America Report*: nationally, the typical African-American family's median wealth is roughly 8% of that of white households – $9,500 compared to $116,500.

Today's hearing on perspectives and proposals for enhancing the Community Reinvestment Act fall squarely within the economic empowerment discourse both nationally and in our local communities. My remarks will provide general recommendations for modernizing and strengthening the core purpose and utility of CRA followed by specific ideas for amendments to the service test – an important and highly visible core component of CRA.

CRA and the Subprime Crisis: Disarming the Weapons of Mass Deception

However, before I share the National Urban League's views and proposals along these lines, it is important to first address head-on some of the disturbing and unpleasant rhetoric that surfaced during this recent period of dissonance concerning CRA and the foreclosure crisis.

In the wake of the subprime meltdown, some observers and commentators have perpetuated a dangerous myth: that minority and low-income borrowers and measures to expand their opportunities for homeownership, such as the CRA, were responsible for the subprime crisis. However, a number of recent reports and studies have forcefully debunked these attacks on the CRA.

Intuitively, the National Urban League and other advocates from across the country have long known that CRA's affirmative obligation to serve low- and moderate-income communities was not the cause of the foreclosure crisis. Still, pundits and politicians were looking for scapegoats on which to blame the crisis – and CRA was referenced early and often.

Our analysis indicates that the Community Reinvestment Act has been effective in ensuring access to fairly priced credit for low- and moderate-income borrowers and communities, as lenders covered by the CRA are far less likely to make higher-cost loans than lenders not covered by the CRA. These are the facts, yet a considerable amount of time and care has been spent – and indeed, will continue to be spent, disarming what the President of the National Urban League Marc Morial has termed "weapons of mass deception," under which this line of false argument falls.

General Observations and Recommendations to Modernize CRA

The current crisis demonstrates that we need to modernize and expand the Community Reinvestment Act to cover all financial institutions and enforce it rigorously to ensure economic security and community prosperity for all. In keeping with the spirit of the CRA, our recommendations are provided as broad principles, rather than prescriptive and detailed rules, most of which can be taken up at the regulatory level.

In our judgment, Congress must:

- Keep the Act fundamentally intact, and seek to build on its strengths.
- Fine-tune the measurements to remain in step with shifting markets. Extending credit that undermines financial security should receive negative (and certainly not positive) consideration. Enhancing the range of possible sanctions to include both positive and punitive consequences will give regulators greater flexibility to implement the Act. For example, regulators can vary terms and conditions for bank borrowing, and offer benefits that can partially offset perceived and real costs of expanding services.
- Revitalize the public's role. Particularly in light of the current priorities of regulatory agencies, the public can play an important and cost-effective part in advancing the Act. This will require that institutions and regulators provide deeper data on a broader set of activities.
- Address the systemic imbalance in CRA scoring to give greater weight to the full array of services and lending provided as opposed to a primary focus on brick and mortar investment.
- Strengthen the Service Test by evaluating delivery channels based on measures of effectiveness; assessing the quality of outreach and disclosure; incorporating more quantitative measures and benchmarks; and restoring coverage of the Service Test to more institutions.

Specific Observations and Recommendations to Strengthen the Service Test

While a large portion of the debate concerning CRA modernization and reform focuses on the disconnect between examination grades and the banks' performance on branch distribution and frequently vague qualitative descriptions of service test performance, there is an even larger problem in the current administration of the Service Test. The 1995 regulatory changes to the CRA regulation emphasized outcome based measurements. Outcome based measures assess an institution's extension of banking products and services to customers rather than plans or intention to deliver such products. Under the lending and investment test, data collected on mortgage or small business lending or grants and investments allow for direct analysis of an institution's extension of products to low- and moderate-income (LMI) markets. Under the Service Test, there are no data analyzed or collected that allow for similar analysis.

Ostensibly, the goal of the CRA Service Test is not merely to get a sense of branch location, but rather to measure how banks are serving the credit and service needs of the community. A different set of data is needed to measure actual bank services to lower-income communities. Those data would measure such outcomes as the number of low-cost savings accounts opened, the percent of low-income households served, and a comparison of these figures against those of comparable banks. Branch distribution data is a seriously insufficient measure of how well a bank is meeting the needs of the community. Measuring delivery channels encourages the development of more delivery channels, but not necessarily the actual delivery of products and services.

The implementation of the Service Test needs major improvements before the test can capture the reality of an institution's delivery of banking services to lower-income people and minority communities. The following changes would allow the test to more effectively measure a bank's performance and should be included under an expanded reporting rubric:

- Branch distribution should be measured in a consistent manner against the percent of households living in low-and moderate income neighborhoods in the bank's assessment area.
- Standardized data on new and existing retail checking and savings accounts should be collected and analyzed by regulatory agencies. These data should include information on account holder census tract; year opened, and average annual balance.
- Since many lower-income people do not live in lower-income zip codes, examiners should also conduct sample surveys of the income and race/ethnic distribution of an institution's retail customers to determine the percent of those customers that are lower-income and/or members of minority groups.
- Examiners should institute a systematic analysis of the full cost of retail products which will allow for comparisons among institutions.

- Examiners should also construct and report a systematic analysis with quantitative data of the number and income/race of customers who use alternative ways of accessing financial products, telephone and internet banking, smart ATMs with such features as automated money orders, and wire transfers to other countries.
- Banks should report data on the services they provide to unbanked households and their success in using those services to recruit new customers.
- Examiners should carefully examine banks' relationships with high cost fringe lenders and determine whether those fringe lenders' disclosure activities (as opposed to just disclosure notices) costs, terms and conditions have a deceptive impact on their customers.
- Banks should be required to report quantitative details of their community development services, including the number of people who attend financial literacy events and the number of new accounts that result from such events.
- Large banks inundate customers with debt products including credit card solicitations and passive checks. Banks should be penalized if these offerings are likely to have a deceptive impact on the average customer.
- Banks should also be examined to see whether they effectively market savings products to lower-income consumers.

Moreover, with regard to small business lending:

- CRA should monitor bank lending activities to small and minority businesses to determine if their current lending practices are user friendly for these business concerns.
- CRA should include an evaluation of bank participation (providing funds/underwriting assistance) and collaboration with local non-profits that themselves provide micro lending (loans under $50k).

Implications of the Change in Financial Services for the CRA

Fundamental and transformative changes in the broad financial services sector make it critically important that proposals to re-tool CRA work to ensure that commitments to low- and moderate-income neighborhoods are not forgotten. We remain concerned that the obligation to meet the needs of LMI neighborhoods is not being applied to nonbank financial services companies, whose share of financial assets now exceed those of banks and thrifts, and whose holdings continue to grow. Absent a CRA mandate that all financial services companies meet the needs of low- and moderate-income neighborhoods in the areas they serve, and an expansion of the CRA mandate to non-credit-related services, these lower-income areas will continue to be underserved in financial services and fall prey to unscrupulous practices. Low- and moderate-income areas need access to other financial services and products – insurance, savings, money transmittal, and securities services – on fair, non predatory terms. This is even more urgent as financial services continue their shift from traditional banks to a more complex set of institutions and products.

With respect to the credit needs of these lower income neighborhoods, the subprime crisis indicates that, when it comes to home mortgages at least, the issue may be as much about the need to protect borrowers from fraudulent or predatory lending practices as it is about the flow of capital. However, reigning in the excesses of subprime lending may have a disproportionate impact on low- and moderate-income areas. Credit availability in these areas may contract substantially if lenders and investors believe wrongly that low- and moderate-income borrowers are not good credit risks. In that case, vigorous application of the CRA would be as necessary as it was in 1977 to ensure a continuous flow of investment on fair terms.

Indeed, inner cities and economically declining regions require large capital investment in infrastructure, and the demolition or rehabilitation of dilapidated properties, if they are to be attractive environments for private capital investment, including investments in homes.

Conclusion

The financial intermediation process, the structure of the banking system, and the methods for delivering financial services have changed in fundamental ways since 1977, and they have changed in ways that no one could have predicted when the CRA was first enacted. The facts on the ground in low- and moderate-income neighborhoods have changed as well. Explicit redlining is by and large a thing of the past. Innovations in technology and financial markets have lowered the cost of mortgages and consumer financing to the point that many more creditworthy borrowers are able to access credit.

Yet, the heart of the problem that the CRA was intended to solve remains: the need for the financial services sector to deliver enough support to low- and moderate-income neighborhoods. Neighborhoods require sound infrastructure, healthy retail businesses, and a core of well-maintained homes to retain value and to attract investment. There are still information deficiencies in these areas, resulting in a more subtle, and perhaps unintended but still hurtful form of redlining, which in turn causes some banks to under- invest and contributes to racial discrimination in lending. Critics who argue that the subprime crisis proves the CRA is a misguided and unwarranted government intervention in the financial services sector are wrong, not only because the facts show that Wall Street excesses, not the CRA, caused the subprime crisis, but also because there are identified market failures that require government action to address.

Bringing the Community Reinvestment Act into the twenty-first century requires the same kind of care and creativity that fostered the act in 1977, and provided for its reform in the 1990s. The CRA has proved it can help meet low- and moderate-income individuals and communities' material needs. Indeed, after the crisis caused by the subprime turmoil rolls through these neighborhoods, their problems are likely to be even more acute. Accordingly, we urge that the CRA be expanded and refined as I have outlined herein, and that considerable legislative and regulatory effort be focused on this purpose.

Finally, within the suggested changes that I have outlined, the CRA could become an even more powerful engine for revitalizing low- and moderate-income neighborhoods, coming to the fore just when the government's ability to use tax revenues to pay for infrastructure improvement and to invest in urban development is greatly diminished.

Thank you for the opportunity to testify and I will be pleased to answer any questions.

NCLR
NATIONAL COUNCIL OF LA RAZA

PRINCIPLES TO MODERNIZE THE COMMUNITY REINVESTMENT ACT: HOW CRA CAN HELP LOW-INCOME LATINO FAMILIES BUILD WEALTH AND SECURE THEIR FINANCIAL FUTURE

Presented at

"Perspectives and Proposals on the Community Reinvestment Act"

Submitted to
U.S. House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Submitted by
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April 15, 2010

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Good morning. My name is Eric Rodriguez and I am Vice President of the Office of Research, Advocacy, and Legislation at the National Council of La Raza (NCLR). NCLR is the largest national Hispanic[1] civil rights and advocacy organization in the United States, dedicated to improving opportunities for Hispanic Americans. For more than 15 years I have been working on public policy and advocacy on behalf of Latinos, and I oversee work on a range of issues that matter to the community, from housing and jobs to health care. I would like to thank Chairman Gutierrez and Vice Ranking Member Hensarling for inviting me to share NCLR's perspective on the modernization of the Community Reinvestment Act (CRA).

For more than two decades, NCLR has promoted policies, programs, and practices that support sustainable Hispanic homeownership. NCLR conducts research and analysis on relevant public policy issues such as preserving and strengthening the CRA and the Home Ownership and Equity Protection Act (HOEPA), supporting strong fair housing and fair lending laws, and expanding access to affordable credit. In addition, NCLR is the only Hispanic-focused housing counseling intermediary certified by the U.S. Department of Housing and Urban Development (HUD). The NCLR Homeownership Network (NHN) provided first-time homebuyer and foreclosure prevention counseling to more than 50,000 families last year alone. NHN counselors are working closely with borrowers to ensure that they are prepared for homeownership and to help them avoid predatory scams. Through this effort, NCLR is working toward the advancement of Latino families, strengthening America by promoting affordable homeownership opportunities and ensuring that families facing foreclosure get the assistance they need.

Our subsidiary, the Raza Development Fund (RDF), is the nation's largest Hispanic community development financial institution (CDFI). Since 1999, RDF has provided $400 million in financing to locally based development projects throughout the country. This work has substantively increased NCLR's institutional knowledge of how Latinos interact with the mortgage market, their credit and capital needs, and the impact of government regulation on financial services markets.

CRA is one of the most important tools the public has to ensure that neighborhoods and communities with low-income families have fair and affordable access to mainstream banking services, credit, and investments. The Act has helped to revitalize neighborhoods and enable nontraditional borrowers, including many Latinos, to gain services and benefit directly from investments made by large mainstream banks that might otherwise have left the community underserved. CRA has also been an important tool, albeit indirectly, in mitigating the effects of discrimination and disparate treatment of minorities, Latinos, and immigrants within mainstream financial markets; this social goal remains essential today.

That said, CRA is facing a serious challenge as its potency and effectiveness have waned in recent years, and some question its necessity and relevance in the current market. Therefore, we thank the committee for holding this important and timely hearing, and appreciate the tone and openness to gathering ideas on how to modernize this critical law.

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[1] The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, and Spanish descent; they may be of any race.

In my testimony today I will summarize the challenges facing CRA and its influence in communities of color, identify key lessons on what has made CRA successful in the past, and share a set of principles to guide the reshaping of CRA moving forward.

Community Reinvestment Act

Established in 1977, CRA requires that regulated depository institutions safely and soundly help serve the credit needs of communities where they conduct business.[2] The Act was established in response to widespread "redlining," a practice that severely restricted credit from reaching minority and low-income communities. At the time, opponents argued that CRA goals and requirements would inhibit the growth of banks or cause them to engage in risky lending. In practice, regulators review financial institutions according to their size, require that lending and investment be conducted within the bounds of safety and soundness, and allow substantial flexibility in the range of activities considered in the determination of an institution's rating. Over time, CRA has emerged as a critical investment and affordable lending tool, lauded by regulators, banking institutions, and advocates alike.

Over the more than three decades of its existence, CRA has served an important public interest in encouraging regulated banks to lend in minority and low-income communities. With increased regulatory attention during the 1990s, banks covered by CRA increased lending activity in low-income communities, increased the share of their loan portfolios with CRA-covered loans, and outpaced similar growth in lending to low- and moderate-income families among non-CRA-covered institutions.

CRA also helped to spur mainstream regulated financial institutions to innovate in ways that have been helpful to minority and low-income borrowers. CRA encourages banks and regulated financial institutions to engage nontraditional and low-income borrowers with the benefit of increasing understanding, experience, and information about how best to serve this market and potentially lower transaction costs associated with lending activity. CRA has also spurred regulated banks to establish and strengthen relationships with local community-based organizations (CBOs), which help advance banks' goal of lending safely and affordably to low-income residents. CBOs also provide regulated financial institutions with information needed to tailor products to low-income residents, while providing support services that revitalize as well as stabilize neighborhoods and communities where banks do business. One important outcome of this activity and innovation is the creation of Community Development Corporations (CDCs) and CDFIs that have assisted in ensuring that capital and credit flow into low-income communities from regulated banks in ways that are safe and affordable. The original pilot program that led to NCLR's Homeownership Network was created in large part due to CRA.

Despite these important outcomes, developments in the U.S. financial market over time have eroded the effectiveness of CRA. While overt "redlining" (i.e., refusing to lend to residents of low-income or minority neighborhoods) appears to be a thing of the past, research demonstrates

[2] CRA is intended to encourage banks and thrifts to help meet the credit needs of the communities in which they operate—including designated low- and moderate-income neighborhoods—consistent with safe and sound banking operations. CRA only applies to federally regulated banks and thrifts whose deposits are insured by the Federal Deposit Insurance Corporation (FDIC). To learn more, please go to: http://www.ffiec.gov/CRA/.

that policy and practice within mainstream mortgage and credit markets continue to exacerbate inequality and racial/ethnic discrimination. For example, policy and practice among regulated mainstream financial institutions to provide prime loans to only those individuals with a long and well-established credit history pushed many creditworthy young, foreign-born, minority, and low-income residents into subprime markets where exposure to predatory lending has been high. Automated underwriting practiced by mainstream regulated financial institutions is an innovation that has minimized arbitrary and potentially discriminatory lending decisions on the part of bank loan officers. But it also has meant higher costs for mainstream banking institutions to effectively serve nontraditional borrowers who do not fit neatly into the model. Oftentimes low-income families, female-headed households, immigrants, and borrowers of color require more time and create relatively more cost for an institution to accurately assess creditworthiness. This high cost has often resulted in credit rationing that effectively and unnecessarily pushes creditworthy nontraditional borrowers into subprime lending markets where predatory lending has thrived. In fact, a substantial share of subprime borrowers would have qualified for prime mortgages. At the same time, the subprime lending market grew exponentially and large lending institutions emerged that were not covered by CRA. This development created a new set of challenges for those seeking to ensure affordable and equitable access to credit for low-income and minority families.

Furthermore, regulators evaluate a depository institution's performance in certain geographic areas generally determined by the presence of physical branches and based on three key areas—service, investment, and lending.[3] However, as technology has improved and regulations changed, many banks conduct business well beyond the walls of their branches.[4] CRA-covered institutions have acquired non-covered affiliates and expanded their customer base through new delivery channels such as mortgage brokers and the Internet, thereby broadening their reach without a proportionate increase in CRA coverage. Finally, community leaders have raised concerns over "grade inflation," questioning whether exams are sufficiently rigorous to hold banks accountable. In the last five years, fewer than 2% of CRA exams have resulted in "needs to improve" or "substantial noncompliance" ratings.[5] As a result, covered institutions have less to strive for and fear from their CRA exam.

CRA's diminishing influence over the development and delivery of financial products has had a devastating impact on local communities. Demand for financial services has been growing, or at least holding steady, in most communities—especially among Latino, African American, and Asian households, which are expected to drive household growth through the year 2050. As

[3] Service tests vary in scope depending on the size of the institution. For more information, see Comptroller of the Currency Administrator of National Banks, *Community Reinvestment Act Examination Procedures: Comptroller's Handbook*, CCE-CRA (Washington, DC: Comptroller of the Currency Administrator of National Banks, 1997, revised for web publication 1999), http://www.occ.treas.gov/handbook/craep.pdf (accessed April 13, 2010).
[4] For a full discussion on how changes in regulations, such as the near repeal of Glass-Steagall, and industry consolidation have impacted the significance of CRA, see Liz Cohen and Rosalia Agresti, "Expanding the CRA to All Financial Institutions," *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act* (Boston and San Francisco: Federal Reserve Banks of Boston and San Francisco, 2009) 134 –137 http://www.frbsf.org/publications/community/cra/expanding_cra_to_all_financial_institutions.pdf.
[5] House Committee on Financial Services, Subcommittee on Housing and Community Opportunity, *Fair Housing Issues in the Gulf Coast in the Aftermath of Hurricanes Katrina and Rita*, 109th Cong., 2nd sess., 2006.

CRA-covered institutions serve fewer neighborhoods for all the reasons discussed above, they leave a vacuum that is quickly filled by providers of alternative forms of credit. Neighborhoods once served predominately by depository banks have been inundated by offers and services from mortgage brokers and finance companies, subprime credit card providers, payday lenders, and auto dealer financers. Such companies have proved adept at breaking into neighborhoods underserved by CRA institutions. They have diversified their workforces, offered products that appeared attractive to unsophisticated customers, and marketed a guaranteed "yes"—tactics that banks have not employed consistently. Because these often unscrupulous providers are not covered by CRA, the overall public and social ends that the Act aims to address have become harder to reach.

And yet, those goals remain critically important to pursue within the current and future financial marketplace. To begin with, the last decade has experienced a marked growth and influx of immigrant workers into low- to moderate-income neighborhoods. Many of these residents are nontraditional borrowers who in many cases have short recorded credit histories or often no credit scores. Paradoxically, their "thin" credit files are often the product of highly sensible financial practices such as paying in cash, avoiding debt, and limiting their use of credit cards. In addition:

- **Bank accounts.** A recent report from the Federal Deposit Insurance Corporation (FDIC) found that approximately 19.3% of Hispanics and 21.7% of Blacks are unbanked, compared to only 3.3% of Whites.[6] Numerous research reports have found that high fees and balance requirements are a leading reason for not choosing to have a bank account.

- **Credit cards.** Latino and African American consumers are nearly twice as likely as White consumers to pay interest rates higher than 20%.[7] This figure becomes more troubling in light of the recession, where communities of color have been living with double-digit unemployment for more than a year. In this environment, many families are relying on credit cards to make ends meet, racking up substantial household debt.[8]

- **Small-dollar lending.** Similarly, many families have become dependent on small-dollar, short-term loans such as payday and car title loans. Many of these products have Annual Percentage Rates (APR) well over 300% and are structured in such a way that cash-strapped families will inevitably return for a new loan to pay off the original. A review of payday lenders in California revealed that they were heavily concentrated in Black and Hispanic neighborhoods, even after controlling for other explanatory variables.[9]

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[6] Federal Deposit Insurance Corporation, *FDIC National Survey of Unbanked and Underbanked Households* (Washington, DC: Federal Deposit Insurance Corporation, 2009) http://www.fdic.gov/householdsurvey/Full_Report.pdf (accessed April 13, 2010).
[7] Jennifer Wheary and Tamara Draut, *Who Pays? The Winners and Losers of Credit Card Deregulation* (Washington, DC: Demos, August 2007) http://www.demos.org/pubs/whopays_web.pdf (accessed April 13, 2010).
[8] Janis Bowdler, *Survival Spending: The Role of Credit Cards in Hispanic Households* (Washington, DC: National Council of La Raza, 2010) http://www.nclr.org/content/publications/detail/61318/ (accessed April 13, 2010).
[9] Wei Li et al., *Predatory Profiling: The Role of Race and Ethnicity in the Location of Payday Lenders in California* (Washington, DC: Center for Responsible Lending, 2009) (accessed April 13, 2010).

- **Car loans.** According to one study, 57% of Hispanic customers who financed their car through the auto or dealer finance company were charged an unwarranted markup, compared to 40.2% of White customers. The average markup for Hispanic customers was $715, compared to $464 for White customers.[10]

- **Mortgages.** Latinos are 30% more likely than Whites to receive a high-cost loan when purchasing their home. Research shows that nontraditional mortgage products such as Option Adjustable Rate Mortgages (Option ARMs)[11] and Interest-Only Mortgages are disproportionately concentrated among minority borrowers; Latinos are more than twice as likely as Whites to receive an Option ARM. Some lenders have heavily marketed Stated-Income loans to Latino families rather than take the time to verify their cash income and savings.

In view of the data above, it should be no surprise that the U.S. continues to maintain a persistent and staggering wealth gap between minority and White households with implications for the socioeconomic development of the nation. Taken together, these facts warrant continued and more effective government intervention to correct and ameliorate disparities in financial markets.

Core Elements of Success in CRA

While imperfect, CRA has many of the right mechanisms in place to become a strong force for good once again. Before discussing ways to modernize CRA, it is helpful to review what has made the Act successful, such as the following:

- **Flexibility.** CRA is far less intrusive than some alternative approaches to achieving similar goals of fair distribution of credit, such as mandating levels of investment in credit-starved areas or prescriptive lending requirements or product offerings. CRA represents a moderate approach that does not mandate specifics or require absolute levels of lending. Instead, it provides lenders and communities with substantial flexibility, consistent with safety and soundness, in meeting the goals of the Act as they relate to localities.

- **Leverages federal/state/local community investments.** CRA has not required government spending; instead, it leverages private investment toward public goals and has helped to leverage and complement the efforts of other federal agencies such as HUD and the Treasury.

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[10] Mark Cohen, "Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation," *Vanderbilt Law and Economics Research Paper* No. 07-01 (December 14, 2006) http://ssrn.com/abstract=951827 (accessed April 13, 2010).

[11] Option ARMS are nontraditional home loan products where a borrower is able to choose the payment they wish to make month to month. Typically borrowers are offered four payment options—a minimum payment, an interest-only payment, a payment that if made consistently would pay off the home in the traditional 30-year timeframe (known as "fully-amortizing"), and a payment that if made consistently would pay off the home in 15 years. Some originators abused this product by qualifying families for only the lowest payment. In this scenario, families are unknowingly adding a balance to their mortgage each month, since their payments do not even cover the interest expense. When the mortgage reaches 115% of value, the monthly payment is adjusted to reflect the higher debt.

- **Coverage.** CRA was its strongest when the majority of lenders and service areas were covered by the CRA assessments, leveling the playing field and widely encouraging investments in, as well as competition for, low-income borrowers.

- **Community engagement.** When financial institutions collaborate with community leaders to develop their commitments and compliance strategy, the result has usually been mutually beneficial. Banks can ensure that their CRA activities are responsive to local credit, banking, and development needs and that the community benefits from an open dialogue and the ability to hold banks accountable.

- **Meaningful measurements.** The Act works best when there is true competition for business in underserved communities and across assessment areas. Similarly, CRA ratings are most impactful when exams take into consideration the complete needs of the assessment area and corresponding performance, rather than serving as a mere cursory review.

Principles for Reform

In the face of the most devastating recession in generations, brought into being in large part due to irresponsible lending practices of institutions not covered by CRA, now is the right time to expand the coverage, influence, and scope of the Act. While some detractors continue to prop up "straw man" arguments to blame CRA mortgages as the impetus for the financial crisis, this myth has been soundly debunked. Policymakers must now shift their focus to aligning CRA with modern banking systems, rules, and practices. Moreover, CRA is a powerful investment tool that should be leveraged to help the national economy to recover. As it stands, banks have restricted credit at a time when economically hard-hit neighborhoods—many of which are predominately minority or low-income communities—are struggling to access capital.

In considering how to modernize CRA, NCLR has two primary goals: 1) to preserve and expand the aspects of CRA which encourage product innovation, lending, and services that are critical to helping low-income Latino families build wealth and 2) to solidify incentives to direct capital toward community and economic development projects that may not otherwise get served. NCLR offers the following eight principles on which to base CRA reform:

- **All institutions that provide consumer financial services and avail themselves of federal support of any kind must be covered by CRA.** In the wake of a near collapse of the national financial system, companies of all categories with exposure to consumer debt in the form of mortgages, auto loans, credit cards, or securities backed by these debt instruments, sought the assistance of the federal government to prevent their complete failure. Mergers were arranged with federal subsidies, federal investments were made, and new companies had access to the discount window at the Federal Reserve.[12] In exchange for having access to federal support in any form—investments, insurance, subsidy, credit, or other forms—financial institutions should be obligated to participate in the furthering of the public goals of CRA. In addition, covered institutions should not be

[12] See "Expanding the CRA."

allowed to skirt responsibilities by simply acquiring a non-covered entity. At minimum, coverage must be expanded to include an institution's non-bank affiliates and their subsidiaries. Other companies, such as mortgage finance companies, insurance companies, securities firms, and investment banks should also be included under the CRA umbrella.

- **Covered institutions must be assessed in their true geographic footprint.** A bank or company must be assessed in all of the geographic areas in which it provides consumer financial services. No longer should banks be able to provide high-quality CRA products in one area, but restrict them in non-assessment areas. This becomes critically important as technology continues to evolve and new delivery channels are developed, each of which change the way that financial institutions interact with communities and consumers.

- **CRA exams and ratings must incorporate the input of local communities.** As CRA exams have become increasingly routine, local leaders have had fewer opportunities to weigh in on banks' performance or collaborate on improvements to services and products. With CRA's flexibility should come an obligation to meet on a regular basis with CBOs and community leaders who can provide feedback on the needs of the community, as well as successful outreach and product design strategies. Implementation has worked best when CRA-covered institutions and stakeholders work jointly to develop a strategic plan to invest in service delivery, community and economic development, and lending. In addition, community stakeholders need a mechanism to provide input on a company's exam. Doing so allows organizations to communicate their positive and negative experiences with regulators and ensures that banks are being held accountable during the review process.

- **CRA-covered institutions should spur innovative and responsible investments and lending in low- and moderate-income communities, establishing best practices for the rest of the market.** Banks and finance companies should be rewarded for taking measured risks to experiment with new delivery channels, underwriting criteria, product development, and community projects. For example, creating basic startup checking accounts for unbanked individuals, developing underwriting criteria for individuals with nontraditional credit, creating alternatives to payday loans, and partnering with qualified nonprofits to provide financial or housing counseling to vulnerable clients are all factors that should count toward favorable CRA ratings.

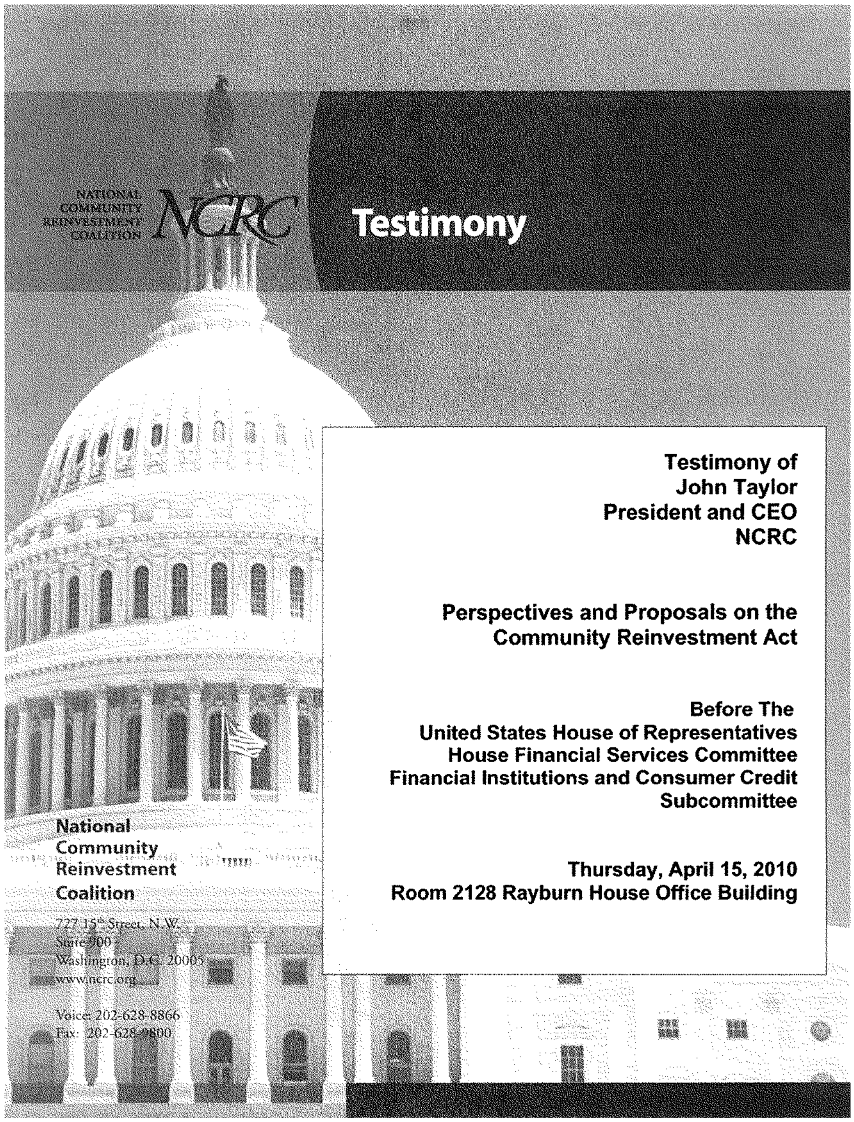
- **Exams and rating procedures must be transparent and open to the public.** While flexibility should be preserved, compliance should be gauged using simple, measurable standards such as the number and percentage of qualifying loans, grants, and other investments (sales or purchases of qualifying tax credits, for example). In addition, more data are required to hold accountable banks and other institutions that should be covered, such as insurance companies and securities firms. Communities rely on federally collected and publicly available data to assess the credit needs of their community and spot any trends that may be a cause for concern.

- **Exams must incorporate the institution's fair lending record.** In addition to reviewing a covered lender's Home Mortgage Disclosure Act data, examiners should also review the degree to which similarly priced loans are offered across neighborhoods and compared to the bank's peers, including mortgage finance companies. In particular, regulators should examine lending and services to minority borrowers and neighborhoods and be on careful lookout for discriminatory trends.

- **The practice of grade inflation has no place in sound and meaningful CRA enforcement.** CRA can only be as effective as its implementation allows. Policymakers should raise the standard required for an "outstanding" rating and regulators should provide clear explanations of their methodology, loan types examined, and the results of fair lending reviews during exams. For bank holding companies that operate lending affiliates regulated by different federal and state agencies, regulators must use a holistic approach by taking into consideration the affiliate's product mix, marketing efforts, delivery channels, and pricing models and decisions of all lending entities.

- **Investments in communities hard-hit by the economic crisis should be rewarded.** Banking services are vital to helping areas hard-hit by recession. Similar to the expansion of CRA to disaster areas in 2005, credit should be given for investing, serving, and extending credit in neighborhoods rocked by high unemployment and foreclosures. For example, partnering with and funding community-based organizations to reach out to delinquent homeowners, creating a flexible mortgage loan for the purchase of short-sale and real estate-owned properties, investing in affordable housing and community institutions, and taking steps to minimize foreclosures and help communities rebound from the recession.

Thank you. I would be happy to answer any questions.



NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

Testimony of
John Taylor
President and CEO
NCRC

Perspectives and Proposals on the Community Reinvestment Act

Before The
United States House of Representatives
House Financial Services Committee
Financial Institutions and Consumer Credit Subcommittee

Thursday, April 15, 2010
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I. Introduction

Good morning, Chairman Gutierrez, Ranking Member Hensarling, and other distinguished members of the Subcommittee on Financial Institutions and Consumer Credit. My name is John Taylor, President and CEO of the National Community Reinvestment Coalition (NCRC), and I am honored to testify today about the Community Reinvestment Act (CRA).

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

The current foreclosure and economic crisis was caused in significant part by unregulated and risky lending. The federal government has obligated $23 trillion in rescuing the financial industry. Two major rationales motivated Congress to enact CRA in 1977. First, Congress believed that all creditworthy borrowers needed to have access to financial services regardless of their income class. It was true in 1977 and still true today that few working class, blue collar citizens can pursue their American Dream or build businesses without fair access to the financial system. Second, banks must have an obligation to serve their communities in return for FDIC deposit insurance and the full faith and backing of the American taxpayer. Today, both rationales must be applied to the entire industry since government financial and institutional support rescued the financial industry from its recklessness. In addition, a broad application of CRA can safeguard the financial industry and return it to profitability by requiring safe and sound lending and investments in neighborhoods.

Modernizing CRA is one of the most important economic and job creating initiatives for Congress, as it would require an industry with trillions of dollars of assets to help create vibrant neighborhoods by providing loans and investments for affordable housing, small business creation, economic development, and support for community facilities like health care clinics. By requiring fairness and responsibility in lending and investment, CRA modernization will promote a more equitable, efficient, and prosperous country. Faced with a 9.7 percent unemployment rate and median income levels that are lower than they were a decade ago, modernizing CRA would provide a long-lasting economic recovery and help the nation climb out of the current Great Recession.[1]

The economic crisis has exacerbated a lack of access to responsible credit for broad segments of the American population. Abusive lending was originally targeted to communities of color but spread outward to white and middle-income suburbs as problematic lending practices outside of CRA-covered institutions intensified. NCRC member organizations report that rural America also experienced a risky lending marketplace as reflected by mortgages with steep balloon payments and high-rate credit card lending to small businesses. The decline in lending and investments is most effectively addressed if Congress reinvigorates the CRA by strengthening its application to banks and applying the law broadly throughout the financial industry.

This testimony will discuss the role of CRA in increasing access to credit and investments, ways to bolster CRA examination criteria, the adequacy of CRA enforcement mechanisms and needed improvements, the adequacy of fair lending reviews, reforms that would enable financial institutions to engage in high-impact economic development, applying CRA to non-bank financial institutions, and other factors inhibiting CRA's effectiveness. In the conclusion, this testimony reiterates our the recommendations for bolstering CRA and explains whether the recommendations include enacting provisions from bills introduced in Congress or whether the recommendations are additional ones from NCRC and not proposed by any existing bills.

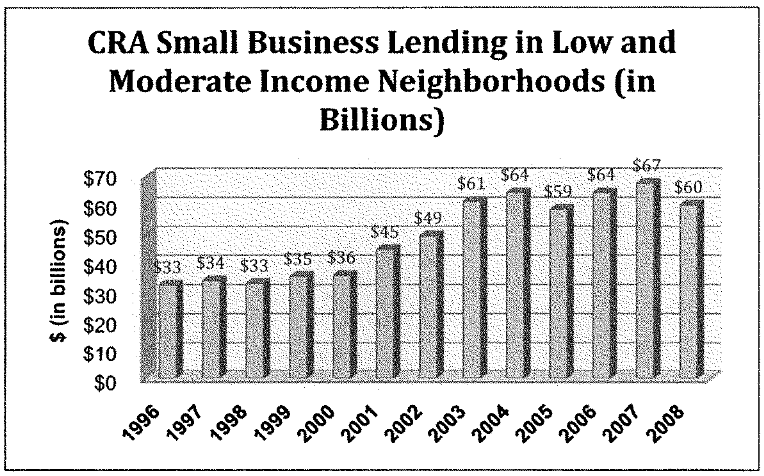
II. Role of CRA in Increasing Access to Credit, Investments, and Services

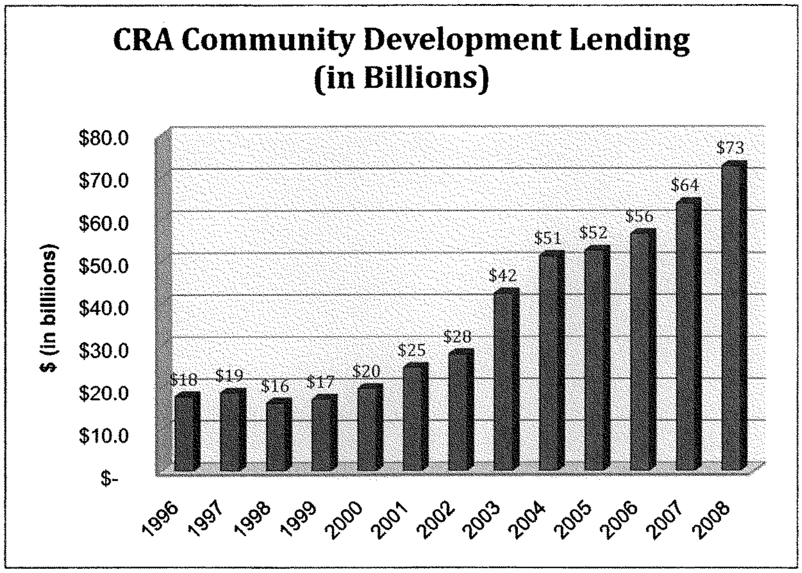
CRA's public accountability mechanisms have effectively motivated banks to significantly increase their lending, investing, and services in low- and moderate-income communities. Data disclosure requirements, publicly available exams rating CRA performance, and public

[1] Erik Eckholm, Last Year's Poverty Rate Was Highest in 12 Years: Median Income Fell, Census Finds, *New York Times*, Friday, September 11, 2009. The current rate of unemployment is 9.7 percent, see http://www.bls.gov/news.release/empsit.toc.htm.

participation procedures have encouraged banks to bolster their efforts to responsibly finance housing, small business creation, and community development.

An examination of publicly available data illustrates the dramatic increases in CRA-related financing that promotes holistic community development and responds to a wide variety of credit needs. According to data from the Federal Financial Institutions Examination Council, small business lending in low- and moderate-income tracts surged from $33 billion in 1996 to $60 billion in 2008. Over the 13-year time period, the total CRA small business lending in low- and moderate-income tracts totaled $641 billion. Likewise, community development lending, which financed affordable rental housing, economic development projects, and community facilities, climbed from $18 billion in 1996 to $73 billion in 2008. Over the entire time period, community development lending equaled $480 billion.





CRA has also supported healthy increases in home lending. The Treasury Department reports that CRA-covered lenders increased home mortgage loans to low- and moderate-income 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.[2] Likewise, a study by the *Joint Center for Housing Studies* at Harvard University estimates that without CRA, 336,000 fewer home purchase loans would have been made to low- and moderate-income borrowers and communities between 1993 and 2000.[3] This time period was before the spike of risky and high-cost lending, providing further evidence that CRA's statutory requirement for safe and sound lending has succeeded in providing increases in responsible lending. In addition, NCRC calculates that CRA-covered lenders issued more than 1.8 million prime home loans worth about

[2] Robert Litan, Nicolas Retsinas, Eric Belsky and Susan White Haag, *The Community Reinvestment Act After Financial Modernization: A Baseline Report*, produced for the United States Department of the Treasury, April 2000
[3] 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.

$300 billion to low- and moderate-income borrowers during 2007 and 2008. CRA was an important source of home lending during a difficult period for the housing market.

Often overlooked is the contribution of CRA to rural America and the connection between branches and CRA-related lending. A NCRC report, *Access to Capital and Credit for Small Businesses in Appalachia*, conducted for the Appalachian Regional Commission documents that every two years banks issued $5.4 billion in community development lending and investing in Appalachia.[4] Also, bank branches had a positive impact on lending rather than only receiving deposits. Small business lending was higher in Appalachian counties with higher numbers of bank branches.

CRA has been an important venue for banks working in partnership with community groups in responding to credit needs. CRA agreements are often negotiated between banks and community groups during the merger application process. NCRC's *CRA Commitments* publication has documented that banks have made $4.6 trillion in CRA agreements and commitments to low- and moderate-income and minority communities.[5] Since the *CRA Commitments* publication, Bank of America pledged an additional $1.5 trillion.[6] 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.[7]

Federal Reserve research reveals that CRA has resulted in banks meeting credit needs in a safe and sound manner. As a result of CRA's prudent lending requirement, the Federal Reserve found that of all the high-cost loans issued in 2006, only 6 percent were made by banks to low- and moderate-income borrowers or neighborhoods and thus even evaluated by CRA exams.[8]

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[4] See http://www.ncrc.org/images/stories/mediaCenter_reports/ncrc%20study%20for%20arc.pdf.

[5] NCRC's *CRA Commitments* via http://www.ncrc.org/images/stories/whatWeDo_promote/cra_commitments_07.pdf

[6] See Bank of America's April 28 press release at http://newsroom.bankofamerica.com/index.php?s=press_releases&item=8152. Last accessed on August 29, 2008.

[7] Raphael Bostic and Breck Robinson, *Do CRA Agreements Influence Lending Patterns?* Real Estate Economics, Volume 31 (2003).

[8] Randall Kroszner, former Federal Reserve Governor and currently at Booth School of Business, University of Chicago, *The Community Reinvestment Act and the Recent Mortgage Crisis*, in Revisiting the CRA: Perspectives on

The vast majority of the risky lending was issued by non-CRA covered mortgage companies over the years. Additional research by Elizabeth Laderman and Carolina Reid of the San Francisco Federal Reserve Bank documents that loans made by banks in their CRA assessment areas are about half as likely to end up in foreclosure as loans issued by independent mortgage companies.[9] Federal Reserve Chairman Ben Bernanke concludes, "Our own experience with CRA over more than 30 years and recent analysis of available data, including data on subprime loan performance, runs counter to the charge that CRA was at the root of, or otherwise contributed in a substantive way, to the current mortgage difficulties."[10]

Federal Reserve Governor Elizabeth Duke sums CRA's contribution to community development well by stating that "From a consumer perspective, the fact that Congress amended the CRA statute in 1989 to make evaluations public provided the transparency necessary to help create a dialogue between banks and community advocates. This dialogue contributed to an increased number of public/private partnerships that were uniquely successful in addressing the economic and community development needs of lower-income communities."[11]

III. CRA Examination Criteria Must be Broadened and Bolstered to Further Promote Lending, Investment, and Services in Communities

As successful as CRA has been in promoting sound lending and investing in communities, its full potential has not been realized due to insufficient examination criteria. Exams have been too restrictive in the geographical areas they cover and have also not automatically included mortgage company affiliates of banks that issue high numbers of loans. Moreover, while CRA

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the Future of the Community Reinvestment Act, A Joint Publication of the Federal Reserve Banks of Boston and San Francisco, February 2009, http://www.frbsf.org/publications/community/cra/index.html

[9] Elizabeth Laderman and Carolina Reid, Federal Reserve Bank of San Francisco, "CRA Lending during the Subprime Meltdown in Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act," a Joint Publication of the Federal Reserve Banks of Boston and San Francisco, February 2009, http://www.frbsf.org/publications/community/cra/cra_lending_during_subprime_meltdown.pdf

[10] Letter from Ben. S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System to Senator Robert Menendez, November 25, 2008.

[11] Speech of Federal Reserve Governor Elizabeth A. Duke, *CRA: A Framework for the Future*, At the Revisiting the CRA Policy Discussion, Washington, D.C., February 24, 2009, via http://www.federalreserve.gov/newsevents/speech/duke20090224a.htm

has been successful in promoting safe and sound lending to low- and moderate-income borrowers and communities, significant racial disparities in lending remains in part because the CRA statute and examinations do not require a consideration of bank service to minorities. Finally, the exam performance measures need to be enhanced and exam rigor would be bolstered by more accurate data on bank lending and investment activity.

As CRA modernization proceeds, the recommendations discussed in this section would be applied and adapted to all institutions with a CRA obligation as well as banks.

Expand Assessment Areas

The geographical locations covered by CRA exams consist of metropolitan areas or counties that contain bank branches. When Congress enacted 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 areas containing bank branches, the regulation also states that assessment areas include other geographical areas in which the bank has originated or purchased a substantial portion of its loans.[12] 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 non-branch channels. For these banks, it is not unusual to encounter CRA exams that cover only the geographical area of the bank's headquarters.

As a result of the narrow definition of assessment areas, the share of all loans made by banks in their CRA assessment areas has dropped significantly. A study by Apgar and Essene demonstrates that between 1993 and 2006, the share of all home purchase loans made by banks in their assessment areas fell from 36.1 percent to 26 percent. For refinance lending, the

[12] See Section 345.41 of the FDIC's CRA regulation available via http://www.fdic.gov/regulations/community/community/index.html

comparable figure was 45 percent in 1993, falling to 25 percent in 2006. Meanwhile, out of assessment area lending by banks grew 187 percent during this time period.[13]
In 2007, NCRC identified several lending institutions that engaged in questionable practices, including refusal to make loans under a minimum loan amount (usually $75,000 or $100,000), refusal to make loans to row homes, and failure to offer loans within entire cities. NCRC research revealed four banks engaged in these practices. Tellingly, only 11 percent to 13 percent of the loans investigated were in the banks' assessment areas.[14]

In addition to enabling discriminatory practices, narrow assessment areas defeat the CRA's objective of banks responding to community needs. In one recent case, a NCRC member organization in Pennsylvania 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 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 discussions about future collaboration and community development lending. Although the bank 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.

NCRC finds that incomplete assessment area coverage also has significant fair lending ramifications. Using data provided by the Joint Center for Housing Studies at Harvard University, NCRC compared the share of all home loans in metropolitan areas that were made by banks issuing loans in their assessment areas to the minority population and the share of subprime loans.

As described in the table below, NCRC found that when the share of loans made by banks in their CRA assessment areas was lower, the share of loans that were subprime was higher (this

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[13] Ren Essene of the Federal Reserve Bank of Boston and William C. Apgar of the Joint Center for Housing Studies, Harvard University, *The 30th Anniversary of the CRA: Restructuring the CRA to Address the Mortgage Finance Revolution*, in Revisiting the CRA: Perspectives on the Future of the CRA, eds. Prabal Chakrabarti et al., A Joint Publication of the Federal Reserve Banks of Boston and San Francisco, 2009.

[14] Contact NCRC on 202-628-8866 for more information regarding our fair lending investigations.

reinforces other research revealing that banks issued considerably less subprime loans than mortgage companies not covered by CRA). When the share of loans in a metropolitan area issued by banks in their CRA assessment area was less than 25 percent, the share of loans that was subprime was 23 percent and the share of the population that was minority was 25 percent (see metropolitan areas in Quartile 1 in the table below). In contrast, when the share of loans in metropolitan areas issued by banks in their CRA assessment area was greater than 42 percent, the share of subprime loans was lower at 16 percent and the percent of the population that was minority was smaller at 15 percent. In other words, when CRA coverage of lending declines, both the percentage of minorities and subprime loans increased. Increasing CRA coverage will therefore provide minorities with a greater choice of loans and lessen racial disparities in lending.[15]

CRA Coverage Dwindles as Minority Population and Subprime Lending Increase

Quartiles	CRA-covered Assessment Areas (%)	MSAs (count)	Population (median)	% Minority (median)	Subprime Share (median)
Q1	25<	90	284,107	25%	23%
Q2	25>33	92	251,101	26%	21%
Q3	33>42.5	92	256,603	28%	19%
Q4	42.5+	87	183,458	15%	16%

Expanding assessment area coverage would have a positive impact on low- and moderate-income borrowers as well as minorities. Harvard's Joint Housing Center finds that banks issue higher levels of loans to low- and moderate-income borrowers and communities inside their assessment areas than outside assessment areas.[16] It stands to reason that banks will issue more loans to traditionally underserved borrowers and communities in areas where they are examined.

[15] Data was combined for the years 2005 through 2007 in the table. For more on assessment area coverage, see Ren Essene and William Apgar, "The 30th Anniversary of the Community Reinvestment Act: Restructuring the CRA to Address the Mortgage Finance Revolution" in *Revisiting the CRA: Perspectives on the Future of the CRA*, eds. Prabal Chakrabarti et al., 12-29. A Joint Publication of the Federal Reserve Banks of Boston and San Francisco, 2009.
[16] Joint Center for Housing Studies of Harvard University, 25th Anniversary of the Community Reinvestment Act, op. cit.

Thus, expanding CRA's examination scope will promote housing and economic development in modest income communities.

The Community Reinvestment Modernization Act of 2009 (H.R. 1479) addresses the inadequacies of assessment areas.[17] Under this bill, if a bank has captured one half of 1 percent or more of the local lending market, a CRA exam would designate the geographical 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. In fact, H.R. 1479 also stipulates that a great majority of a bank's loans will be considered by CRA exams.

Mandatory Inclusion of Mortgage Company Affiliates of Banks in CRA Exams

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

Four non-depository affiliates of banks were identified by NCRC's fair lending investigations to be engaging in redlining or other discriminatory practices. These four affiliates were not included on their bank's CRA examinations. Current CRA examination procedures enable banks' affiliates to engage in such practices undetected. H.R. 1479 would end this serious gap in CRA enforcement by mandating the inclusion of affiliates on CRA exams.

Include Consideration of Bank Service to Minority Borrowers and Communities on CRA Exams

On a CRA exam, lending to low- and moderate-income 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 low- and moderate-income borrowers compared to the demographics of the bank's community and the percentage of loans made to low- and moderate-income borrowers issued by the bank's competitors.

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[17] See http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.1479 for the text of H.R. 1479.

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 non-discriminatory 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]

Federal Reserve economists came to similar conclusions about high levels of subprime loans in minority neighborhoods after controlling for creditworthiness.[19] As a result of the targeting of risky lending to minorities, Reid and Laderman conclude that African-American borrowers were 1.8 times more likely than whites to be in foreclosure, whereas Latino and Asians were 1.4 and 1.3 times more likely to be in foreclosure, respectively than whites, after controlling for several lender and borrower characteristics.[20] 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.[21] Overall, it is probable that CRA exam consideration of lending and branching by race of borrower and neighborhood would lessen the racial disparities in access to bank services and loans.

For Congressional districts, Compliance Tech has recently compiled statistics of the percentage of subprime loans to African-Americans, Hispanics, and whites for the year 2006, which was a

[18] *Broken Credit System* available via NCRC on 202-628-8866.
[19] Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. Available via pcalem@frb.gov. also Paul S. Calem, Jonathan E. Hershaff, and Susan M. Wachter, *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, in Fannie Mae Foundation's Housing Policy Debate, Volume 15, Issue 3, 2004 pp. 603-622
[20] Laderman and Reid, ibid.
[21] See NCRC's *Are Banks on the Map* via http://www.ncrc.org/images/stories/mediaCenter_reports/ncrc%20bank%20branch%20study.pdf

year of heavy subprime volume.[22] Displayed in the appendix to this testimony, the table clearly illustrates the significant disparities in subprime lending by race for Congressional districts of members of the House Financial Services Committee. In fact, NCRC finds in our *Income is No Shield* report series that racial disparities in lending actually increases as the income level of the borrower increases.[23]

Prior to the CRA regulatory reforms in the mid 1990's, 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.[24]

Racial disparities in lending is a product of multiple factors including a lack of competition in minority neighborhoods, a dual lending market, and steering abusive loans to minorities that qualify for lower priced loans. In addition, the implementation of CRA has contributed to racial disparities by scrutinizing banks' efforts to make loans in low- and moderate-income neighborhoods, but not examining the extent of and the quality of lending in communities of color. Banks do not feel the regulatory push to make loans to communities of color like they do for low- and moderate-income communities. If the regulatory agencies do not reinstate lending and service to minorities as criteria on CRA exams, Congress must amend CRA to add lending, investment, and service to minorities as provided in H.R. 1479.

Repeal Stretch Out of Small Bank CRA Exams

The Gramm-Leach-Bliley Act of 1999 established a less frequent exam cycle for small banks with less than $250 million in assets with passing CRA ratings. Small banks with "Outstanding" ratings will be examined once every five years and those with "Satisfactory" ratings will be examined once every four years.

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[22] Maurice Jourdain-Earl, Compliance Tech, Politics and the Subprime Meltdown: An Examination of Disparities by Congressional District, Political Party, Caucus Affiliation, and Race, 2009, via http://www.ncrc.org/images/stories/pdf/research/politics%20and%20the%20subprime%20mortgage%20meltdown-final.pdf

[23] National Council of Negro Women and the National Community Reinvestment Coalition, *Assessing the Double Burden: Examining Racial and Gender Disparities in Mortgage Lending (Income is No Shield, Part III)*, June 2009, via http://www.ncrc.org/images/stories/pdf/research/ncrc%20nosheild%20june%2009.pdf

[24] *See* Federal Reserve Bank of Richmond, Community Reinvestment Act Performance Evaluation of Signet Bank (Jan. 15, 1996), *available at* http://www.federalreserve.gov/dcca/cra/1996/460024.pdf

Since small banks are especially important in rural areas, the exam stretch-out must be repealed and small banks must be subject to the regular two-year exam cycle as H.R. 1479 would stipulate. An examination once every four or five years will not hold small banks accountable because small banks can relax their CRA efforts during the first two or three years and then intensify their attention to CRA in the last couple of years before their exam. In contrast, a two-year exam cycle is sufficiently short enough so that an exam can effectively scrutinize the entire time period. Thus, small banks will have an added incentive to perform during the entire time period. Small banks do not merge frequently, meaning that the adequacy of the exam is quite important for enforcing CRA.

The argument that CRA imposes regulatory burden for small banks is not convincing. In their analysis of "regulatory burden" for small banks, the federal banking agencies have found that CRA regulations "impose a modest information collection burden on small institutions – an average of 10 burden hours per institution per year."[25] The relatively few trade articles on small bank CRA exams reveal few complaints about burden. In fact, an *American Banker* article titled "Small Banks Give Thumbs-Up to Streamlined CRA Exams" published shortly after the CRA regulation reform in 1995 quotes small bankers saying that the exams were not burdensome and that CRA examiners took less than one day of their time.[26] Furthermore, in a recent article for a Federal Reserve CRA volume, Michael Barr comments on a survey conducted by the Independent Community Bankers of America of its member banks. According to the survey, the average employee cost for CRA compliance was about $84,000 per year for small banks (average assets of $216 million) and about $115,000 per year for mid-size banks (average assets of $666 million). Thus, the average CRA employee costs as a percentage of assets were insignificant—0.017 percent for mid-size banks, and 0.039 percent for small banks.[27]

In sum, the benefits of two-year CRA exams for small banks in terms of additional responsible loans and investments for communities considerably outweigh any regulatory burden.

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[25] Federal Register, May 28, 1999 (Volume 64, Number 103), pages 29083 through 29086
[26] Small Banks Give Thumbs-Up To Streamlined CRA Exams, Jaret Seiberg of the American Banker, Thursday, February 1, 1996.
[27] Michael S. Barr, *Community Reinvestment Emerging from the Housing Crisis*, in Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act, A Joint Publication of the Federal Reserve Banks of Boston and San Francisco, February 2009, http://www.frbsf.org/publications/community/cra/index.html

Exams Must Be Uniformly Rigorous Instead of Inconsistent

CRA Grade Inflation

Expanding the coverage of CRA exams related to assessment areas, affiliates, and consideration of bank performance in serving minorities is necessary but not sufficient in making CRA exams more effective. The rigor of CRA exams is also a critical issue in unleashing the full potential of CRA. Unfortunately, the evidence to-date points to CRA grade inflation as well as inconsistent quality of CRA exams.

Banks receive one of four ratings on their CRA exams: Outstanding, Satisfactory, Needs-to-Improve, and Substantial Non-Compliance. The last two ratings are considered failing ratings. As the table below shows, the current failure rate for banks has hovered between 1 to 2 percent since 2002. When ratings first became public in 1990, more than 10 percent of banks failed their CRA exams[28]. During the first five years of the public availability of CRA ratings, more than 5 percent of banks failed their CRA exams every year.

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

NCRC Analysis of CRA Ratings

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	247	16.0%	1,281	83.1%	10	0.6%	4	0.3%	1,542
2006	199	14.0%	1,194	84.0%	22	1.5%	6	0.4%	1,421
2007	212	11.9%	1,538	86.4%	26	1.5%	4	0.2%	1,780
2008	195	9.5%	1,823	88.9%	29	1.4%	4	0.2%	2,051
2009	137	7.3%	1,702	90.8%	30	1.6%	5	0.3%	1,874
Total	**10,262**	15.8%	**51,993**	80.2%	**2,372**	3.7%	**236**	0.4%	**64,863**

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 to be implausible. A study conducted by the Center for Community Capitalism concluded that 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.[29] In addition, Rick Marsico in his book *Democratizing Capital* reveals how quantitative criteria are

[29] Michael A. Stegman, Kelly Thompson Cochran, and Robert Faris, Center for Community Capitalism, 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 groupin the banks' assessment areas

applied in an inconsistent manner on CRA exams, suggesting that a number of CRA exams have ratings that cannot be justified.[30]

The inflated ratings reduce the incentives banks have to maintain and increase their responsible lending, investing, and services in low- and moderate-income communities. If banks conclude that they will receive passing ratings regardless of fluctuations in their lending, investing, and service levels, they will not be motivated to maximize their resources and attention to their CRA performance.

The federal banking agencies have not significantly changed their ratings methodology in several years in order to bolster the meaning and value of passing ratings. At the very least, the agencies could have introduced more gradations among the passing ratings in order to reveal more accurately distinctions in bank performance, which would be useful for the general public, religious and nonprofit institutions, and state and local agencies as they figure out which good CRA performing banks they want to reward by placing their deposits. Thus, the full value of CRA ratings as a mechanism for motivating bank lending, investment, and services has not been realized due to the staid approach of the agencies.

Ratings and Point System Reform

H.R. 1479 introduces two more ratings, High Satisfactory and Low Satisfactory, in an effort to produce more meaningful ratings. In addition, a detailed scoring system is needed. Currently, ranges of points correspond to the various CRA ratings. The highest possible point total corresponding to an Outstanding rating is 24 points with a zero indicating total failure or Substantial Noncompliance. But the scale does not make intuitive sense or is sufficiently large enough to meaningfully reflect the range of lending, investment, and service activities. For large bank exams, the complexity of the lending test alone which has five criteria and often scrutinizes four or more types of lending suggests that a scale of 0 to 24 cannot adequately reflect performance in various aspects of the test.[31] NCRC recommends, therefore, that the agencies

[30] Richard D. Marsico, *Democratizing Capital: The History, Law, and Reform of the Community Reinvestment Act*, Carolina Academic Press, 2005.
[31] See 12 CFR 345.22 for the FDIC's version of the lending test for large banks and see the interagency Q&A document Section 345.28(a)—3 for the description of the ratings matrix or existing point scale. On the large bank lending test, at least three criteria (borrower distribution of loans, geographic distribution of loans, and flexible and

create a scale of 1 to 100 or another scale large enough to meaningfully capture the range of activities. Moreover, a scale of 100 should be used for the overall rating as well as the ratings for the component tests to truly create a meaningful scoring system that causes banks to be more vigilant regarding their CRA performance in all its aspects. The component tests can still have different weights as they do now since the overall rating can be a weighted average of the component tests.

Weighting System to Reflect Affordability and Responsiveness to Local Needs

While CRA exams make some commonsense distinctions and weight aspects of performance to account for the capacities and location of banks, the weighting system does not extend far enough to encourage high levels of responsiveness to local needs. Currently, CRA exams weight some loan types and geographical areas more heavily than others based on the specialty of the bank (whether it primarily a home or small business lender, for example) and based on the percentage of its lending activity in each of its geographical areas.

The weighting system, however, does not distinguish among the responsiveness of financial activities to communities. For instance, on the investment test, purchasing mortgage-backed securities often appears to be weighted as highly as more difficult equity investments in small businesses although a well developed secondary market exists for home lending whereas equity investments in small businesses are relatively scarce. On the lending test, purchases of loans on the secondary market are weighted equally to loan originations although making a loan is often the task that is more time intensive and responsive to local needs.

An example of the lack of distinctions occurs on the CRA exam for First Community Bank, headquartered in Albuquerque, New Mexico. In a section describing community development lending, the exam states that the bank made consumer loans to Indian tribes experiencing lack of

innovative lending practices) can be considered for three or four loan types. Just a portion of the lending test can therefore exhaust the current scale of 0 to 12 for the lending test if the highest possible score could be one point for one loan type and one criterion. Four loan types multiplied by three criteria would equal 12 if the bank scored outstanding for each loan type on each criterion. There are no points left over for the other two criteria on the large bank lending test.

access to mainstream credit. It then also commends the bank for "placing home mortgage loans in the secondary market." Clearly the first activity of consumer lending on Indian reservations addresses unmet credit needs and should receive community development lending credit, but it is baffling why selling loans to the secondary market should also receive points as community development loans. This lack of differentiation about the responsiveness to credit needs most likely reduces banks efforts to be highly attentive to the most pressing needs if they can also receive points for routine activities such as selling loans on the secondary market.[32]

The weighting system also does not distinguish among the affordability of products although the Interagency Question and Answer (Q&A) document hints that banks should strive for affordability. For instance, §__.12(i)-3 of the Interagency Q&A document states that community development services include "reasonably priced remittances" and foreclosure prevention in the form of "affordable," "sustainable," "long-term" loan modifications and restructurings. Yet, CRA exams rarely implement the affordability aspect of the Question and Answer document. For example, banks with expensive overdraft programs were never penalized on CRA exams nor encouraged by the exams to be more responsive to the needs for short-term consumer credit by establishing small consumer lending programs.[33]

NCRC recommends that a weighting system be established that weights categories of loans, investments, and services that reflect their degree of affordability, responsiveness to local needs, and other CRA and fair lending criteria. Stakeholders will often discuss qualitative versus quantitative aspects on CRA exams, complaining that CRA exams focus too heavily on quantitative measurements and disregarding qualitative distinctions such as degree of difficulty and responsiveness to local needs. A weighting system would help overcome these shortcomings on CRA exams.

[32] CRA Performance Evaluation of First Community Bank, March 2009, Federal Reserve Bank of Kansas City, RSSD # 236751.
[33] Overdraft fees are estimated at $27 billion annually while penalty fees from credit cards are less, at about $20 billion per year. See Ron Lieber and Andrew Martin, *Overspending on Debit Cards is Painful, but Not for Banks*, New York Times, Wednesday, September 9th, 2009.

Currently, there is a section on CRA exams that reviews innovative and flexible lending practices. This section usually describes and extols affordable loan programs. Yet, too often, the exams flatly state that banks made only a few of these loans, making it difficult to discern whether the bank received a disproportionate amount of CRA points for innovative products that appear to be more symbolic than real. In contrast, a sophisticated weighting system that creates categories of financial activities based on their affordability and responsiveness would make CRA exams more objective and effective in motivating the type of sustainable financing needed in traditionally underserved communities.

Data Enhancements Needed

Accountability depends on transparency. If data are limited in how they reflect lending activity, the general public cannot evaluate the sustainability of loan products, nor can CRA exams effectively create weighting systems that weight categories of loans based on their affordability and responsiveness. In an effort to increase the utility of data, the President's proposal for a Consumer Financial Protection Agency, H.R. 4173 (the Wall Street Reform and Consumer Protection Act of 2009), and H.R. 1479 contain important data enhancements to Home Mortgage Disclosure Act data, small business data, and bank branch and deposit data.

Small business women, in particular, would benefit from these data enhancements since the publicly available small business data would reveal the extent to which banks are making loans to women-owned small businesses. NCRC members have informed NCRC numerous times over the years about the difficulty of even established women-owned small businesses receiving loans and being told to have their spouses co-sign applications even though they qualify for loans on their own.

H.R. 4173 provides critical enhancements to the HMDA data regarding loan terms and conditions. Several loan terms and conditions would be collected, including total points and fees, prepayment penalties, the value of the home, whether the loan is a hybrid loan with a lower teaser rate, and whether the loan is a negative amortization loan.

Using the existing information on loan pricing and the proposed enhancements in H.R. 4173, CRA exams could weight categories of loans that more precisely reflected affordability and sustainability of the loans. Banks could more readily be penalized on CRA exams if they were highly leveraging borrowers with loans containing high loan-to-value ratios, burdensome prepayment penalties, frequent negative amortization, or other loan terms and conditions that have been demonstrated to contribute to high default rates. In contrast, banks would receive higher ratings if they offered loans that demonstrated their affordability by performing well in terms of borrowers remaining current on the loan (H.R. 1479 would add loan performance data recording whether the borrower was current or delinquent as a component of publicly disclosed data). Finally, more refined home loan data and weighting systems would ensure that banks making both prime and high-cost lending offer a balanced product mix to traditionally underserved borrowers and communities.

The publicly available small business data is considerably more limited than the HMDA data, significantly curtailing its usefulness on CRA exams. Periodic national surveys sponsored by the Federal Reserve Board consistently point towards the likelihood of discrimination in small business lending.[34] A powerful way to reduce disparities in lending is to publicly provide data on the number of loans for women and minorities. Yet, the CRA small business data lacks information on the gender and race of the small business owner.

In addition, the federal agencies significantly lessened the quality of small business loan data by exempting intermediate small banks (with assets of $250 million to $1 billion) from requirements to collect and report it and thus reduced the quality of data used on CRA exams. 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 sized cities and towns.[35]

Both H.R. 4173 and H.R. 1479 would significantly augment the utility of CRA small business loan data for the general public and for CRA exams. Both bills would require that the race and

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34 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 via http://www.ncrc.org/images/stories/mediaCenter_reports/ncrc%20study%20for%20arc.pdf.

35 Ibid.

gender of the small business owner would be collected. In addition, the financial institution would be required to collect the type and purpose of the loan, the type of action taken with respect to the application (approval or rejection), the gross annual revenue of the small business owner, and the specific census tract location of the small business receiving the loan. Also, a broader array of banks and non-banks including finance companies and credit unions would be required to report the data. The exemption from data reporting for intermediate small banks would be repealed by both H.R. 4173 and H.R. 1479. Finally, NCRC recommends an amendment to either H.R. 1479 or H.R. 4173 (as it is reconciled with a Senate financial regulatory reform bill) that would require the collection of some form of pricing information such as the Annual Percentage Rate (APR) so that researchers and stakeholders can assess whether small businesses are receiving access to affordable loans.

Upon passage of either H.R. 4173 or H.R. 1479, CRA exams could scrutinize lending to minority and women-owned small businesses. CRA exams could weight loans based on their type, purpose, and responsiveness to needs. In addition, CRA exams could more precisely measure the spatial distribution of small business loans. Currently exams only measure lending in broad income categories of census tracts rather than specific census tracts, meaning that exams may fail to focus on certain neighborhoods that are particularly starved for access to credit. Furthermore, current CRA exams are not refined enough in assessing access to credit for the smallest of the small businesses. Upon passage of H.R. 4173 or H.R. 1479, CRA exams could more accurately assess lending to the smallest businesses with revenues lower than $1 million since the new data would enable examiners to measure lending to small businesses in various revenue categories below $1 million in revenue. Finally, a more complete universe of institutions reporting data (including credit unions and the intermediate small banks recently exempted from reporting requirements) would enable CRA exams to measure more effectively how all banks compare to the rest of the financial industry in meeting small business credit needs in a responsible manner.

Another area of data collection and CRA exam analysis in need of reform is assessments of bank branch and service activity. CRA exams currently measure the presence of bank branches in low- and moderate-income neighborhoods in a cursory manner for large banks and barely at all for intermediate small banks. Before the changes to the intermediate small bank exams, NCRC and New York Law School found that the 92 exams in our study recorded the number of branches in low- and moderate-income neighborhoods 97 percent of the time. After the changes to the intermediate small bank exams, the exams failed to record the number of branches in low- and moderate-income neighborhoods 32 percent of the time. In addition, 53 percent of the exams after the changes did not discuss the percentage or distribution of branches in low- and moderate-income neighborhoods.[36]

As payday lending and usurious fringe services have increased in low- and moderate-income neighborhoods, sensible public policy would be to increase emphasis on bank branches and the provision of affordable deposit and checking accounts in low- and moderate-income communities. Yet, not enough emphasis is placed on the service test for large banks and a de-emphasis on branches is occurring in the case of intermediate small banks.

H.R. 4173 and H.R. 1479 would be instrumental in rectifying deficiencies in the level of data and analysis of bank branches and service on CRA exams. The bills would require banks and credit unions to maintain and disseminate data on their branches, ATMs, and other depository facilities. The number and dollar amount of deposit accounts for the residential and commercial customers for each deposit facility would also be collected. The place of residence/business of bank/credit union customers would be provided on a census tract basis, making it possible to analyze the income level and race/ethnicity percentage of the census tracts of these customers. The bills would require these data would be used as part of CRA exam analysis.

Existing CRA exams do not adequately scrutinize the distribution of branches across neighborhoods of various income levels. Both H.R. 4173 and H.R. 1479 would not only augment the amount of data on bank branches available for CRA exams but also provide detail on the number and dollar amount of various deposit accounts. CRA exams would therefore not only measure the distribution of branches but would assess if the branches are actually effective in delivering deposit accounts to customers from neighborhoods of various income levels and racial characteristics. CRA exams, therefore, would become more effective in promoting basic

[36] Josh Silver, NCRC, and Rick Marsico, New York Law School, "An Analysis of the Implementation and Impact of the 2004-2005 Amendments to the Community Reinvestment Act Regulations: The Continuing Importance of the CRA Examination Process" in New York Law School Law Review, 2008-2009, Volume 53, Number 2.

banking services as alternatives to high-cost payday, cash checking and other fringe services. The Woodstock Institute, a NCRC member, recently conducted a study illustrating the rich types of analyses that could be conducted with more detailed data on branches and deposits.[37]

IV. Adequacy of Enforcement Mechanisms and Needed Improvements

The remarkable accomplishment of CRA is that the law has been as successful in leveraging high volumes of responsible loans and investments for low wealth neighborhoods despite mediocre regulatory enforcement at best to negligent enforcement at worst. That CRA has been as successful as it has suggests that more vigorous regulatory enforcement could promote significant increases in loans, investments, and services for traditionally underserved communities. In addition to ratings inflation, the agencies have not seized upon the profound mergers and acquisitions over the last several years as opportunities to enforce the law. They rarely hold public hearings or hold lenders accountable for improving CRA performance after mergers. The methods for rectifying the uneven enforcement of CRA is to further bolster the public participation mechanisms and enact meaningful sanctions and corrective mechanisms for poor CRA and fair lending performance.

As CRA modernization proceeds, the recommendations discussed in this section would be applied and adapted to all institutions with a CRA obligation as well as banks.

Appeal of CRA Ratings Must be Available for Members of the Public

Currently, if a bank is unsatisfied with its CRA rating, it can appeal its rating to its regulatory agency. These appeals occur in secret, so the frequency of the appeals and how often the appeals result in higher ratings are unknown. It is possible that the appeal process could play a significant role in ratings inflation. A few years ago, NCRC assisted a member in West Virginia in commenting on a major bank's CRA exam. The examiner initially failed the bank, whereupon

[37] Geoff Smith, Sarah Duda, and Malclom Bush, *Benchmarking Branch Outcomes: Using Available Data to Analyze and Improve the Delivery of Retail Bank Services to Low-Wealth Communities*, Woodstock Institute, May 2009, available via http://www.woodstockinst.org/publications/research-reports/.

the bank promptly appealed its rating. NCRC guessed that an appeal was occurring and helped our member organization write a letter asserting that the initial rating was justified. The regulatory agency chose to ignore our letter and instead gave the bank a passing CRA rating.

If the appeal process was an open one in which the agencies gave all stakeholders an equal opportunity to comment on a preliminary CRA exam, the ratings would more likely be meaningful instead of inflated. The agencies, upon the release of a preliminary exam, would provide a 60 day public comment period. The agencies would allow banks and community organizations to comment on both the overall rating and ratings in any assessment area. Then, they would add a section to the CRA exam explaining whether they adjusted any of the ratings in response to the public comments.

Public Improvement Plans and Increased Attentiveness to Local Needs

CRA exams presently are not effective in holding banks accountable for performance outside of their largest service areas, especially in the case of large banks. A large bank can have several states and metropolitan areas on its CRA exam. The large bank can often make enough loans, investments, and services in its larger markets to pass its CRA exam. Yet, the bank can score poorly in certain states, smaller metropolitan areas, or rural counties and experience no sanctions or encouragements to improve performance in those areas.

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 adequately serve all geographical areas, including smaller cities and rural areas in addition to large cities. Under the Community Reinvestment Modernization Act of 2009 (H.R. 1479), 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 it intends to bolster its CRA performance in that assessment area.[38] The general public would have an opportunity to comment on the CRA improvement plan. The

[38] The concept of an improvement plan builds upon 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.

regulatory agency must either approve the CRA improvement plan or send it back to the bank for modifications. After the agency approves the CRA improvement plan, the bank must submit quarterly reports so that the regulatory agency and general public can monitor performance under the terms of the plan.

Consequences for Failed Ratings

The lack of fines or other sanctions for failed CRA ratings can encourage banks to repeatedly fail CRA exams and neglect communities of significant resources for development. The most notorious case of repeated failure is a small bank called Uinta County Bank that serves a rural community in Wyoming.[39] The bank has racked up 20 Substantial Non-Compliance ratings from the Federal Reserve Board since 1990. Another repeat offender is Saint Casimir's Bank in Baltimore, Maryland. The bank received five Substantial Non-Compliance ratings and eked out a Needs-to-Improve rating on its last two exams in 2007 and 2009. Larger banks with considerable resources also fail to reinvest in communities. For example, North Shore Bank, an institution with $1.1 billion in assets in Illinois, turned in Needs-to-Improve ratings in 2007 and 2009.

An examination process is ineffective in holding institutions accountable when it does not rectify repeat failures. NCRC recommends the implementation of fines, commensurate with the extent of failure, as a method towards ending bank recidivism. In addition, H.R. 1479, in extending CRA to independent mortgage companies, prevents the mortgage company from selling loans to Government Sponsored Enterprises (GSEs), if the mortgage company had failed its CRA exam and then failed to receive regulatory approval for an acceptable public improvement plan. In other words, this punitive penalty would only be implemented when an institution failed its exam and then did nothing to correct its failure. The institution would have to fail twice (the second time for its refusal to correct its mistake) before being cut-off from access to GSEs. The same sanction should be applied to banks.

[39] Information on CRA exams of banks discussed in this section can be found via http://www.ffiec.gov.

Expectations of Affirmative Responsiveness to Needs

CRA exams and decisions on mergers often miss opportunities for enforcement when CRA exams pass banks or when agencies approve mergers without any requirements for improvement. Even when banks merit a passing rating or a merger approval, their CRA and fair lending performance can still be uneven, which is not often acknowledged by the bluntness or unsophisticated nature of exams and merger approvals. Banks are complex institutions, offering a multitude of loans, services, and investments. While they may perform reasonably well in a number of areas, a significant fair lending or CRA issue may remain in one or more of their products and practices. When agencies regularly refuse to acknowledge uneven performance in their public evaluations of banks, they reduce the legitimacy of the process and further damage the process by discouraging public participation. Community organizations and members of the public withdraw from the process as they become cynical about their grievances being addressed. NCRC therefore recommends a section in both CRA exams and merger approvals called "expectations of affirmative responsiveness to needs." The expectations section would describe strengths and weaknesses in bank performance. Depending on the extent and duration of the weakness in performance, the section would then recommend or require certain improvements.

More Public Hearings and Meetings during Merger Applications

The merger application process presents significant opportunities for federal agencies to enforce 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 testified that the Federal Reserve 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, the Federal Reserve representative stated that since 1988, the Federal Reserve 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 8 of these denials involving consumer protection or community needs issues.[40]

Likewise, the Treasury Department found that from 1985 through 1999, less than .8 percent (692 out of 92,177) of applications received adverse comments from community groups. Of these 692, the agencies denied just 8 for any reason; 4 percent of the 692 were withdrawn by the bank and 1 percent was returned to the banks. Ultimately, the agencies denied 8 out of 92,177 applications or less than .01 percent of the applications during the 15 year time period.[41]

The agencies also have not fully engaged the public in deliberations over mergers with profound impacts. In 2006, Wachovia acquired the largest lender of exotic mortgages, World Savings, yet there was no public hearing on this merger that posed significant fair lending and safety and soundness issues. Likewise, Regions proposed to take over Amsouth Bank in 2006. Although this merger involved two of the larger banks in the South, the Federal Reserve declined to hold a public hearing in spite of the clear ramifications for the recovery of the Gulf States after Hurricane Katrina. The Federal Reserve also declined to hold a hearing on the merger of Bank of New York and Mellon although the Bank of New York had received low ratings on two of the three tests on their two most recent CRA exams.[42]

Most recently, the agencies declined to solicit the public's input regarding the emergency mergers involving JP Morgan Chase/Washington Mutual and Wells Fargo/Wachovia. If the agencies believed that the usual application process and public comment period was not possible in these cases, they could have held post merger meetings and public hearings as requested by NCRC member organizations. These mergers had significant impacts on lending and investing. For example, community organizations in the Western part of the country were concerned about JP Morgan Chase's commitment to continue successful affordable housing and community development initiatives of Washington Mutual. By demonstrating the seriousness of the CRA

[40] See http://www.federalreserve.gov/newsevents/testimony/braunstein20070521a.htm for Ms. Braunstein's testimony.

[41] Raymond H. Brescia, "Part of the Disease or Part of the Cure: The Financial Crisis and the Community Reinvestment Act," in South Carolina Law Review Vol. 60:617, Spring 2009.

[42] Bank of New York received a low satisfactory on its lending and service test from the Federal Reserve Bank of New York on both its 2005 and 2003 CRA exams. In other words, the bank was close to failing on two CRA exams in succession. Yet, no public hearing on the merger occurred.

issues, formal agency involvement in these post emergency discussions would have facilitated mutually acceptable arrangements regarding CRA bank activities.

H.R. 1479 rectifies the regulatory inattention to public hearings and meetings. A provision of the bill would require the agencies to hold hearings when a significant number, a dozen or more, of citizens and community organizations have commented on the merger during the public comment period.[43] In addition, the bill would require smaller meetings to be convened by the agencies whenever the meetings were requested by a person or group commenting on the merger. Modeled after the procedure formerly employed by the Office of Thrift Supervision, the meeting would involve a discussion moderated by the regulatory agency between the banks and members of the public commenting on the application. While useful, comment letters by themselves are often insufficient in explaining the full ramifications of mergers. Public hearings and meetings allow the agencies to witness a more complete discussion and debate between the community and banks about the complexities and impacts of the mergers on the banks' abilities to meet community needs.

Another mechanism for strengthening merger enforcement in H.R. 1479 is a prohibition against a merger if any of the banks have a Needs-to-Improve or Substantial Noncompliance rating in any assessment area. This provision ensures that banks must adequately serve all communities including rural counties and smaller cities in addition to their larger markets. In addition, it addresses the possibility that the acquired bank has a poor CRA record. NCRC members often encounter merger approvals based on the record of the acquiring bank while the acquired bank has poor CRA performance. Such merger approvals do not ensure that the issues associated with the acquired bank are resolved. If H.R. 1479 is passed, the bill would require more consistent performance by both the acquiring and acquired bank in all assessment areas as a condition of merger approval.

[43] A threshold could be 12 comments and requests for public hearings on a small bank and 20 for a large bank.

CRA and Fair Lending Pledges as a Factor Considered on Merger Applications

CRA agreements and fair lending pledges were often negotiated in the 1990's between banks and community organizations during the merger application process. These agreements committed a bank to either fair lending reforms and/or specific levels of lending, investments, and services in specified geographical areas after mergers. The agreements become less frequent as banks began to notice that agreements were not scrutinized by the agencies. Federal agencies would usually note in merger approval orders that CRA agreements were not required by the CRA regulation. In addition, they routinely stated that they will not consider any CRA agreements in the merger approval process.[44] In the last several years, instead of negotiating agreements during mergers, banks would sometimes issue impressive sounding unilateral pledges that were difficult, if not impossible to verify, because the pledges did not specify the incomes of the beneficiaries nor the geographical areas served. While agreements were once innovative and organic mechanisms for addressing the profound impacts of mergers, they have become infrequent and debased.

NCRC recommends that CRA be amended to require agencies to consider verifiable CRA agreements and fair lending pledges as a factor on merger applications. This provision would not mandate agreements but would encourage agencies to favorably consider any substantial and well-intentioned collaborative agreement as a factor in their decision to approve a merger application. This procedure would bolster banks' abilities to serve community needs by establishing verifiable goals negotiated between banks and the communities they serve.

Establish a Private Right of Action

An effective mechanism to combat CRA grade inflation and unjustified merger approvals would be a private right of action for community organizations and members of the public. The current regulatory agencies were lax in their CRA and fair lending enforcement during the last eight years, in part, because they knew that they were immune from citizen lawsuits. A couple of pioneering lawsuits in the 1990s were dismissed by judges claiming that community

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

organizations had no standing to sue.[45] Key merger approvals have been either illegal or highly questionable. For example, the Federal Reserve Board approved Citigroup's application to acquire the Travelers insurance company before Congress passed the Gramm-Leach-Bliley Act allowing banks to acquire insurance companies. Last year, BB&T's acquisition of 300 of Colonial's branches did not involve a public comment period although the failure of Colonial Bank did not pose a systemic threat to the United States' financial system or economy.

The right of private action would hopefully be used sparingly because CRA exams, merger reviews, and enforcement would be significantly improved by Congress passing provisions in H.R. 1479. Yet, even when vigorous enforcement is the norm, a right of private action provides a necessary check and balance ensuring agency accountability in enforcing laws. A right of private action is standard in other spheres of law such as environmental law; it is sorely needed in CRA and fair lending where enforcement has been glaringly inconsistent.

V. Adequacy of Fair Lending Review 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. There is, however, no evidence that the fair lending reviews conducted concurrently with CRA exams are rigorously testing for abusive, discriminatory, and illegal lending.

In most cases, even for the largest banks in the country, 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.[46] There is no discussion of what precisely had been done to reach this conclusion.

A clear case of inadequate fair lending and other illegal practices review involved Superior Bank. This savings and loan was one of the first well-known failures of an institution that

[45] See Brescia, op. cit.
[46] 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.

offered large volumes of ill-advised exotic and high-cost loans. The Office of Thrift Supervision's 1999 exam described Superior's loans as innovative and extolled the loan terms and conditions such as payment deferrals (which could result in negative amortization) and high loan-to-values.[47] The exam did not examine how often these risky features were utilized and whether they were combined. The fair lending section found no violations of fair lending or other laws. Soon after this exam, Superior failed.

Providing more detailed descriptions of fair lending reviews should be straightforward. The agencies used to provide detailed descriptions in the fair lending section of CRA exams in the mid-1990s. For example, the Federal Reserve Bank of Richmond conducted matched file reviews of more than 300 loan applications in a CRA exam dated January 1996 of Signet Bank.[48] The exam also described regression analysis, which sought to determine if race was a factor in loan rejections. The analysis considered variables not available in the HMDA data such as credit histories, the stability of employment, and applicant debt obligations. This type of substantive fair lending review provides the general public with confidence that the regulatory agency performed a detailed anti-discrimination analysis. Ironically, it was after the CRA regulations were reformed during the mid-1990s in an effort to improve the rigor of the exams that these descriptions of fair lending reviews disappeared from the CRA exams.

Since the regulatory agencies have become lackadaisical in their fair lending reviews, NCRC recommends that Congress mandates in CRA exams detailed descriptions of fair lending review methodology, loan types examined, and results of the reviews. The fair lending review should also probe for other illegal and unsafe practices and products.

VI. Reforms that Would Enable Financial Institutions to Engage in High Impact Economic Development

High impact economic development is holistic economic development that ties together housing, small business, economic development, and community development initiatives. When a neighborhood(s) is in need of comprehensive development, the chances of revitalizing a

[47] See http://files.ots.treas.gov/cra/CRAE_08566_19990927_60.rtf.
[48] Ibid.

neighborhood(s) improves when all of these activities are undertaken together and targeted towards the neighborhood(s).

Better Data on Community Development Loans and Investments

Data exists currently on home lending, small business lending, and branching on a census tract level, but no data exists on a census tract level for community development, which includes affordable housing development such as rental housing, equity investments in small business, economic development projects such as shopping centers, and community centers. If data was available on community development on a census tract level, spatial analysis could create more effective strategies for holistic development; that is, geographic targeting home and small business lending and community development lending and investing for neighborhoods in need. In addition, the data on community development would facilitate assessments of spatial equity that would determine if inner city and suburban areas are receiving adequate amounts of community development financing.

NCRC recommends that Congress require the regulatory agencies to collect, publicly disseminate, and use community development data on a census tract level for CRA exams. The data would include categories of community development lending and investing, such as affordable housing (including rental), small business financing, and other categories.

Allow for Investments in National Funds Provided Local Needs are Met

The number of investors in Low-Income Housing Tax Credits (LIHTC) has significantly diminished with the retreat of Government-Sponsored Enterprises from the LIHTC market. National funds help overcome the diminished resources available for LIHTC investments by providing an efficient means for banks to invest in LIHTC projects. At the same time, it is imperative that banks first meet the credit needs of their assessment areas or the geographical areas in which they have branches and/or make loans.

NCRC recommends that CRA examination procedure allow points for investments in national funds provided that the banks have first met the needs for community development loans and investments in their assessment areas. The agencies should establish thresholds such as Outstanding ratings on the investment test in most of the assessment areas before a bank is allowed to invest outside of its assessment areas.[49] Also, when determining if banks have met needs in assessment areas, the expansive definition of assessment areas in H.R. 1479 and discussed above must be used. The expansive definition reflects more meaningfully all the geographical areas in which banks have a business presence and make a significant number of loans. Community development possibilities are maximized if banks are also asked to ensure that they are meeting needs for community development financing in areas in which they are making significant amounts of home and small business loans.

VII. Impact of Structure of the Financial Industry on CRA and How Could CRA be Applied to Additional Financial Service Providers

Poor Record of Non-CRA Covered Institutions

The lightly regulated and non-CRA covered segments of the financial industry have caused profound damage to the country's economy and to the community wealth-building assisted by the CRA-related lending and investing of banks. Financed by Wall Street investment banks and hedge funds, non-CRA covered independent mortgage companies, and unscrupulous mortgage brokers engaged in high volumes of ill-advised and risky loans. The Federal Reserve Board found that from 2004 to 2006, independent mortgage companies extended between 55 percent and 63 percent of the high-cost piggyback loans.[50] When risky lending was targeted to neighborhoods that benefited from CRA-related housing and community development financing, the risky lending undid the wealth creation of the CRA lending and investing by causing high levels of foreclosures, property value declines, abandonment, vandalism, and crime. The

[49] If the most recent CRA exam is more than 2.5 years old, the bank should also provide evidence to its regulatory agency that it is continuing to invest in its assessment areas before being allowed to invest outside. For example, it could produce a list of investments in its assessment areas.

[50] Robert B. Avery, Kenneth P. Brevoort, and Glenn B.Canner, *The 2007 HMDA*, the Federal Reserve Bulletin, December 2008, available via http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07final.pdf.

independent mortgage companies also experienced massive losses as a result of their lending activity. The Federal Reserve revealed that 167 of the 169 lending institutions that ceased operations in 2007 were independent mortgage companies.[51]

CRA's impact has been deterred by more responsible institutions as well. Non-CRA covered credit unions and insurance companies have not been major actors in the subprime fiasco but they have not served minority and working communities in a satisfactory manner, thereby decreasing the levels of responsible loans and insurance products available in traditionally underserved communities. Last fall, NCRC released a report, *Credit Unions: True to Their Mission (Part II),* concluding that the non-profit and tax exempt credit unions, which have a statutory duty to serve people of "small means," issue lower percentages of home loans than banks to minorities, women, and low- and moderate-income communities.[52]

NCRC analyzed banks' and credit unions' performance on three lending types: home purchase, refinance, and home improvement. Across the three loan types, banks and credit unions were assessed on 69 performance measures scrutinizing: 1) the percent of loans to various groups of borrowers, 2) denial rates confronted by minority compared to white borrowers and lower income compared to upper income borrowers, and 3) approval rates experienced by borrowers. In 2007, banks outperformed credit unions on 44 of the 69 performance indicators (or 64 percent of the time). Credit unions surpassed banks performance only 7 percent of the time, while banks and credit unions performed equally well almost 30 percent of the time. In 2006 and 2005, banks performed better than credit unions on 65 percent of the indicators.

Over the years, the National Credit Union Administration (NCUA), the regulator of credit unions, has changed credit union charters in a manner that should enable them to achieve desirable CRA and fair lending performance. The NCUA provided large credit unions with community charters that enable them to serve large areas such as Los Angeles County. By 2007,

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[51] Avery, Brevoort, and Canner, op. cit.
[52] See http://www.ncrc.org/images/stories/mediaCenter_reports/creditunionreport090309.pdf

community credit unions numbered 1,177, and had 16.2 million members and $123 billion in assets. In addition, the NCUA allowed large credit unions to add underserved areas consisting of low- and moderate-income neighborhoods to their service areas.

By 2007, credit unions serving underserved areas had increased to 673, had 17.9 million members, and held $150 billion in assets.[53] Moreover, large credit unions with over $1 billion in assets have $356 billion in total assets. While mainstream credit unions clearly have the assets, resources, and geographic reach to serve minorities, women, and low- and moderate-income communities, the evidence from NCRC's three year study suggests that they do not serve these communities as well as CRA-covered banks. Finally, the study finds that state-chartered credit unions in Massachusetts covered by a state-CRA law perform better than federally-chartered credit unions not covered by CRA in reaching traditionally underserved populations in Massachusetts.

Just as in the case of credit unions, insurance companies are not serving communities of color as well as they should. While public policy interest in access to insurance has waned in recent years, the research findings of significant disparities in access to insurance from the past appear to apply to the present day situation (no recent evidence suggests the situation has changed). The dearth of current research suggests the need for national data disclosure and CRA for insurance companies so that the provision of insurance to traditionally underserved communities can be carefully assessed.

Controlling for factors affecting the availability and the price of insurance (such as average loss cost, age of home, market value of the house, housing conditions, household income), a study conducted by an economist with the National Association of Insurance Commissioners suggests that insurance unavailability in urban areas can not be explained by the higher risk of loss in

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[53] Report to the NCUA Board from the Outreach Task Force, February 26, 2008, via http://www.ncua.gov/ReportsAndPlans/plans-and-reports/2008/OutreachTFReport-022608.pdf

these areas.[54] Using a series of regression analyses, the study reveals that, holding other factors equal, minority homeowners were less likely to acquire insurance through the voluntary market. After controlling for risk of loss, a 10 percentage point increase in the portion of minorities in a zip code is associated with a 2 percentage point increase in the portion of "FAIR plans," which are government-sponsored insurance plans of last resort for those who cannot obtain insurance in the private market. Moreover, average premiums are higher in cities and even higher in minority and low-income neighborhoods. Geographical areas with higher concentrations of minority and non-English-speaking residents are also associated with higher prices for insurance.

Similarly, Schultz[55] uses a regression analysis controlling for factors influencing agents' placement decision and finds that "agents are not located where their potential economic gain is greatest." In this study, the risk of loss was not found to be significantly different in predominantly minority areas, compared to predominantly white ones. Thus, risk of loss could not explain the finding that fewer agents were placed in predominantly minority areas. Schultz concludes that there seems to be a bias against placing agents in inner-city neighborhoods with high concentrations of minorities. This bias persists even after controlling for loss costs, agents commissions, and profitability. Moreover, underwriting rules, such as the minimum property value and the maximum age of home, had a disproportionate effect on low-income neighborhoods.[56]

Resources of and Opportunities for Non-CRA Covered Institutions

If CRA was applied to credit unions, insurance companies, securities firms, and other non-bank institutions, the resources available for CRA-related financing of comprehensive community

[54] Robert Klein. (1997). "Availability and Affordability Problems in Urban Homeowners Insurance Markets". Chapter Three of *Insurance Redlining: Disinvestment, Reinvestment, and the Evolving Role of Financial Institutions* by Squires, G. Urban Institute Press: Washington, D.C. The analysis was for 25 metropolitan statistical areas within the 13 largest states for which territory-level loss data could be obtained.

[55] Jay Schultz. (1997). "Homeowners Insurance Availability and Agent Location". Chapter Four of *Insurance Redlining: Disinvestment, Reinvestment, and the Evolving Role of Financial Institutions* by Squires, G. Urban Institute Press: Washington, D.C

[56] 44% of the houses in low-income quartiles had a value below $35,000 and 20% of the insurance companies in Missouri excluded houses valued under $35,000. Furthermore, 71% of the homes in low-income quartiles were not eligible when underwriting guidelines exclude houses built prior to 1950.

development would multiply. Credit unions, now a mature and mainstream industry, have collectively $825 billion in assets. The assets of money market funds equal $3.5 trillion.[57] Non-life insurance premiums in the United States were $652 billion during 2007.[58] Hedge funds constituted $2.5 trillion in assets.[59] In sum, if CRA were applied broadly across the financial industry, traditionally underserved communities would experience hundreds of billions of more dollars in loans, equity investments, insurance, and securities products.

How CRA Would be Applied to Non-Bank Institutions

H.R. 1479 provides a robust method for applying CRA to non-bank institutions. H.R. 1479, in turn, builds upon the framework of the existing CRA statute and regulation for examining institutions. For retail institutions, the lending test serves as a model. It is straightforward to apply the lending test to mortgage companies and credit unions and measure their lending activity to minorities and low- and moderate-income borrowers and communities. Instead of a lending test, H.R. 1479 would apply a customer evaluation test to retail insurance companies and securities firms that would measure the provision of homeowners and renters' insurance and money market funds and other securities products to minorities and low- and moderate-income customers and communities. Public data disclosure, similar to HMDA data, would enable CRA exams to measure the provision of retail non-bank products to customers and communities.

Non-bank retail institutions would also have an investment and service test similar to the tests for banks. The investment test would measure the provision of investments in affordable housing, small business, and economic development projects. The service test would measure the distribution of branches and deposit accounts by income and minority level of neighborhood for credit unions. The service test would measure the neighborhood distribution of loan offices for mortgage companies and agents for insurance and securities companies.

[57] See http://www.ici.org/pdf/fm-v18n3.pdf
[58] IFSL Research, Insurance Update 2008, International Financial Services, London, November 2008.
[59] See http://en.wikipedia.org/wiki/Hedge_fund

H.R. 1479 provides sufficient flexibility while demanding robust exams for institutions of different capacities. For example, wholesale non-bank financial institutions would have an examination that focuses on community development loans, investments, and services just like wholesale banks. Smaller credit unions and mortgage companies would either not have an investment test or they would not be expected to make as many investments as their larger counterparts, depending on the research and public comments received during a public rulemaking process after the implementation of H.R. 1479.

VIII. Other Factors that Reduce Effectiveness of CRA – Regulatory Fragmentation

The fragmentation among regulatory agencies reduces the effectiveness of CRA. The proposed Consumer Financial Protection Agency (CFPA) must receive jurisdiction for CRA. NCRC's July 2009 testimony before the House Financial Services Committee describes in detail the lax regulatory enforcement of CRA. Just as with other consumer protection laws, CRA enforcement suffers from the dynamic of four agencies lessening the rigor of enforcement in order to compete for bank business and fees. Our July testimony describes in detail how the Office of Thrift Supervision significantly weakened their CRA regulations and examinations. Then, in the pressure to compete, the other three agencies also lessened the rigor of their examinations and reduced data reporting requirements.

As discussed above, the federal bank agencies pass 99 percent of banks and thrifts on CRA exams. They have also significantly lessened public hearings during bank mergers and rarely require any measurable improvements in CRA and fair lending performance after mergers. This regulatory neglect occurred during the worst years of irresponsible lending. Although non-CRA covered institutions were major actors behind the crisis, the federal agencies should have been extra vigilant in enforcing CRA and fair lending obligations during this time period. While bank retail lending was responsible during this time period, the non-CRA covered activity by some large banks such as securitizing risky loans was not sufficiently scrutinized and curtailed by the agencies, which had opportunities to act during merger applications.[60]

The four banking agencies also have much difficulty updating and strengthening CRA. In 2001, the agencies announced the start of a process to update CRA. Several years later, the major accomplishment of this effort was not strengthening, but watering down CRA exams and eliminating small business data reporting requirements for a whole class of banks, that is, small intermediate banks. If Congress modernizes CRA, the fragmentation and indecision among the regulatory agencies could increase. It would be likely that even more agencies would administer CRA since the National Credit Union Administration would enforce CRA as applied to credit unions and other agencies would enforce CRA as applied to mortgage companies, insurance firms, and securities companies. In order to update the CRA regulation, half a dozen or more agencies would have to agree to a new set of rules. The difficulties that the four existing federal bank agencies had in updating CRA would be magnified many times over. In order to avoid this regulatory logjam as CRA is modernized, it is time to modernize the regulatory enforcement of CRA and place CRA under the jurisdiction of the proposed CFPA.

IX. Other Changes to CRA Statute or Procedure

CRA's effectiveness is bolstered when community organizations, public officials, and other stakeholders participate in the CRA process to a great extent and hold lenders accountable for their CRA performance and hold agencies accountable for enforcing CRA. The agencies and examiners are doing a poor job involving community organizations in commenting on CRA exams and mergers. NCRC member organizations report that examiners conducting CRA exams rarely approach them for offering comments on bank performance. Instead, examiners should regularly approach organizations and provide sufficient lead time for community organizations to thoughtfully prepare comments or observations. Examiners should also provide thoughtful questions for organizations to answer about bank CRA performance and needs and opportunities in their area. Finally, there must be an easier way for community organizations to contact

[60] H.R. 1479 would require agencies to scrutinize securitization activity and penalize banks through lower CRA ratings if the securitization activity facilitates abusive and unsafe lending.

examiners. Currently, it can take several calls to figure which examiner is conducting a CRA exam for a specific bank. A publicly available roster of names and phone numbers of examiners would be helpful as well as information about which examiner is assigned to which exam.

Agencies throughout the federal government should also adopt CRA-like mechanisms in their contracting decisions. Before federal agencies award contracts of $1 million or higher to banks and other financial institutions, the federal agencies should be required to receive public comments on their CRA and fair lending performance. These federal contracts are substantial; for example, Bank of America has a contract with the Department of Defense to operate "Community Banks" on overseas military installations. The public comment process before contract awards would heighten the accountability of banks to both federal agencies and the general public and thus increase their efforts in community reinvestment.

Conclusion and Recommendations

Modernizing CRA is one of the most vital legislative initiatives undertaken by the House Financial Services Committee and Congress. If CRA had been applied broadly throughout the financial industry, the foreclosure crisis would not have occurred or would have been considerably less severe because CRA requires that financial institutions serve communities consistent with safety and soundness. In fact, Federal Reserve and other research reveals that CRA has succeeded in motivating profitable and safe and sound bank lending. In addition, applying CRA broadly throughout the financial industry would significantly bolster the government's economic stimulus efforts by channeling hundreds of billions of dollars to America's neighborhoods. Moreover, the CRA reforms suggested by NCRC would heighten public participation in the CRA process on multiple levels and would thus increase the accountability of financial institutions to smaller cities and rural areas as well as larger urban centers.

NCRC's comprehensive series of recommendations include:

Augment CRA Examination Criteria (similar provisions applied to all institutions with a CRA obligation)

- Change assessment area definitions so that the great majority of bank loans are covered by CRA exams per the procedure in H.R. 1479.
- Require that mortgage company affiliates of banks and all other non-bank affiliates in bank holding companies are covered by CRA as mandated by H.R. 1479.
- Require that CRA exams scrutinize lending, investing, and service to minorities and communities of color as mandated by H.R. 1479.
- Repeal the stretch-out of CRA exams for small banks, which is a provision in H.R. 1479.
- Institute a weighting system for CRA exams that weight categories of loans, investments, services according to their affordability and responsiveness to local needs (NCRC recommendation not in any existing bills).
- Create meaningful scales of points such as 1 to 100 on CRA exams to meaningfully evaluate the multiple levels of CRA performance (NCRC recommendation not in any existing bills). Add High- and Low-Satisfactory as possible overall ratings as required by H.R. 1479.
- Enhance HMDA data to include more information on loan terms and conditions as required by H.R. 1479 and H.R. 4173.
- Enhance small business loan data to include the race and gender of the small business owner and other characteristics as required by H.R. 1479 and H.R. 4173.
- Improve the data on bank branches and deposits and require analysis of branches and deposits by income and minority level of neighborhoods as required by H.R. 1479 and H.R. 4173.

Strengthen Enforcement Mechanisms (to be applied to all institutions with a CRA obligation)

- Institute a public comment process allowing community organizations to appeal preliminary CRA ratings (NCRC recommendation not in any existing bills).

- Require public improvement plans, subject to public comment and review, whenever a bank scores Low-Satisfactory or worse overall or in any assessment area as mandated by H.R. 1479.
- Impose real consequences for failed ratings including fines (NCRC's recommendation not in any existing bills) and extending H.R. 1479's sanction to banks of cutting off access to the government-sponsored enterprises.
- Institute a requirement that CRA exams and merger applications have a section called "Expectations of Affirmative Responsivess to Needs" that recommends or requires banks to address weaknesses in their CRA and fair lending performance (NCRC recommendation not in any existing bills).
- Require the federal agencies to consider any verifiable CRA agreements and fair lending pledges during merger applications (NCRC recommendation not in any bills).
- Require the federal agencies to hold frequent public hearings and meetings during the merger application process as mandated in H.R. 1479.
- Disallow mergers between institutions with a Needs-to-Improve or worse rating in any assessment area per the provision in H.R. 1479.
- Institute a private right of action whereby community organizations and other members of the general public can challenge agencies' CRA ratings and decisions on merger applications (NCRC recommendation not in any existing bills).
- Require detailed discussions of methodology, loan types examined, and the results of fair lending reviews on CRA exams (NCRC recommendation not in any existing bills).

Reforms that Would Enable Financial Institutions to Engage in High Impact Economic Development (would be applied to all institutions with a CRA obligation)

- Require that institutions would report data on community development lending and investing and that the data would be used on CRA exams (NCRC recommendation not in any existing bills).
- Allow investments in national funds provided that needs are met in an institution's assessment area (NCRC recommendation not in any bills).

Apply CRA to Non-Bank Financial Institutions as required by H.R. 1479

- Independent mortgage companies
- Mainstream credit unions
- Insurance companies
- Securities firms
- Investment banks

Move Jurisdiction of CRA to the Proposed Consumer Financial Protection Agency

Require that before Federal agencies contract with banks and other financial institutions, they receive public comments on the CRA and fair lending performance of the institutions (NCRC recommendation not in any bills).

Appendix Tables

Subprime Lending by Race

Racial Disparities in Lending by Congressional District for House Financial Services Committee Members

Statistics from Politics and the Subprime Meltdown by Maurice Jourdain-Earl of Compliance Tech

The table below displays subprime lending by Congressional District. Minorities received disproportionately larger shares of subprime loans. Research shows that most of these subprime loans were issued by loosely regulated mortgage companies not covered by CRA. Thus, these findings demonstrate the need to include unregulated institutions under the Community Reinvestment Act and for CRA exams to scrutinize lending to minorities.

National Community Reinvestment Coalition

September 2009

Representative	Congressional District	% Subprime Loans to Whites	% Subprime Loans to African Americans	% Subprime Loans to Hispanics	Overall % Subprime
Ackerman, Gary [D]	NY-5	10.28%	23.68%	29.88%	12.78%
Adler, John [D]	NJ-3	21.38%	48.37%	39.01%	26.27%
Baca, Joe [D]	CA-43	30.47%	48.76%	45.64%	41.76%
Bachmann, Michele [R]	MN-6	21.11%	45.02%	40.16%	23.10%
Bachus, Spencer [R]	AL-6	18.30%	50.86%	44.21%	23.69%
Barrett, James [R]	SC-3	21.23%	56.19%	32.33%	25.88%
Bean, Melissa [D]	IL-8	21.24%	44.35%	41.41%	24.36%
Biggert, Judy [R]	IL-13	20.45%	50.75%	40.43%	24.12%
Campbell, John [R]	CA-48	10.23%	27.08%	32.46%	14.32%
Capito, Shelley [R]	WV-2	25.45%	37.16%	31.52%	26.68%
Capuano, Michael [D]	MA-8	13.15%	45.59%	42.43%	23.08%
Carson, André [D]	IN-7	30.13%	62.06%	64.84%	39.15%
Castle, Michael [R]	DE-00	19.12%	44.78%	33.56%	26.46%
Childers, Travis [D]	MS-1	34.95%	67.76%	47.48%	42.13%
Clay, William [D]	MO-1	30.29%	69.12%	46.38%	48.91%
Cleaver, Emanuel [D]	MO-5	28.62%	65.56%	41.18%	37.40%
Donnelly, Joe [D]	IN-2	30.27%	63.72%	43.63%	32.66%
Driehaus, Steve [D]	OH-1	23.00%	56.93%	47.51%	30.82%
Ellison, Keith [D]	MN-5	18.87%	61.44%	52.47%	26.71%
Foster, Bill [D]	IL-14	20.54%	49.67%	42.48%	26.14%
Frank, Barney [D]	MA-4	18.39%	40.14%	38.67%	20.18%
Garrett, E. [R]	NJ-5	16.77%	45.09%	28.84%	19.01%
Gerlach, Jim [R]	PA-6	15.19%	46.10%	37.07%	19.14%
Grayson, Alan [D]	FL-8	24.50%	50.32%	46.04%	33.45%
Green, Al [D]	TX-9	33.51%	72.65%	54.26%	51.58%
Gutierrez, Luis [D]	IL-4	21.21%	54.63%	44.57%	36.08%
Hensarling, Jeb [R]	TX-5	32.33%	67.30%	58.52%	41.79%
Himes , Jim [D]	CT-4	12.24%	47.49%	42.29%	20.71%
Hinojosa, Rubén [D]	TX-15	33.97%	44.19%	58.22%	53.29%
Hodes, Paul [D]	NH-2	21.74%	44.09%	32.26%	23.84%
Jenkins , Lynn [R]	KS-2	26.46%	45.99%	35.78%	28.30%
Jones, Walter [R]	NC-3	15.98%	51.19%	25.88%	22.42%
Kanjorski, Paul [D]	PA-11	30.31%	53.36%	51.47%	35.77%
Kilroy, Mary Jo [D]	OH-15	21.99%	56.13%	45.88%	25.24%
King, Peter [R]	NY-3	18.11%	48.91%	38.40%	22.52%

Klein, Ron [D]	FL-22	21.39%	52.50%	42.90%	29.71%
Kosmas, Suzanne [D]	FL-24	24.21%	47.32%	41.62%	30.54%
Lance , Leonard [R]	NJ-7	13.88%	38.00%	33.01%	18.52%
Lee , Chris [R]	NY-26	21.06%	41.85%	30.23%	23.25%
Lucas, Frank [R]	OK-3	33.60%	60.42%	44.41%	35.98%
Lynch, Stephen [D]	MA-9	17.20%	47.06%	40.70%	24.65%
Maffei , Dan [D]	NY-25	20.13%	45.45%	37.01%	23.35%
Maloney, Carolyn [D]	NY-14	4.09%	11.54%	18.71%	4.97%
Manzullo, Donald [R]	IL-16	26.03%	63.08%	45.60%	29.61%
Marchant, Kenny [R]	TX-24	19.87%	57.49%	47.07%	29.86%
McCarthy, Carolyn [D]	NY-4	20.09%	53.67%	46.19%	35.04%
McCarthy, Kevin [R]	CA-22	22.02%	50.29%	42.90%	32.20%
McCotter, Thaddeus [R]	MI-11	21.31%	51.41%	42.71%	24.15%
Mchenry, Patrick [R]	NC-10	22.47%	59.09%	41.19%	26.52%
Meeks, Gregory [D]	NY-6	35.40%	49.56%	44.17%	44.25%
Miller, Gary [R]	CA-42	12.80%	30.67%	29.74%	18.66%
Miller, R. [D]	NC-13	14.41%	48.83%	35.62%	23.07%
Minnick, Walt [D]	ID-1	21.39%	33.33%	37.05%	22.73%
Moore, Dennis [D]	KS-3	17.75%	55.96%	36.99%	21.97%
Moore, Gwen [D]	WI-4	29.37%	71.50%	51.85%	45.60%
Neugebauer, Randy [R]	TX-19	30.97%	64.85%	65.37%	38.68%
Paul, Ronald [R]	TX-14	25.56%	56.67%	43.27%	30.18%
Paulsen , Erik [R]	MN-3	17.14%	56.91%	41.81%	21.72%
Perlmutter, Ed [D]	CO-7	20.20%	51.72%	44.37%	25.94%
Peters , Gary [D]	MI-9	16.88%	51.74%	40.55%	20.62%
Posey , Bill [R]	FL-15	25.60%	48.36%	46.86%	33.93%
Price, Tom [R]	GA-6	12.61%	38.75%	27.77%	15.83%
Putnam, Adam [R]	FL-12	29.99%	56.00%	50.19%	38.77%
Royce, Edward [R]	CA-40	13.94%	33.06%	35.67%	21.77%
Scott, David [D]	GA-13	23.80%	48.49%	43.74%	39.74%
Sherman, Brad [D]	CA-27	17.67%	38.80%	37.22%	27.33%
Speier, Jackie [D]	CA-12	7.08%	19.29%	22.46%	12.60%
Velazquez, Nydia [D]	NY-12	13.35%	50.47%	39.78%	26.56%
Waters, Maxine [D]	CA-35	24.78%	42.00%	43.70%	38.96%
Watt, Melvin [D]	NC-12	18.32%	49.37%	37.71%	28.78%
Wilson, Charles [D]	OH-6	29.14%	59.09%	37.97%	30.78%

Testimony of Mark A. Willis
Resident Research Fellow
Furman Center for Real Estate and Urban Policy
New York University
Hearing of the Subcommittee Financial Institutions and Consumer Credit
of the House Financial Services Committee
"Perspectives and Proposals on the Community Reinvestment Act"
10:00 a.m., Thursday, April 15, 2010
2128 Rayburn House Office Building

Good morning Mr. Chairman and Members of the Subcommittee. My name is Mark A. Willis, I am a Resident Research Fellow at the Furman Center for Real Estate and Urban Policy at New York University. I represent solely myself at this hearing.

As background, I spent nineteen years in community development at JPMorgan Chase and Chase Manhattan Bank where I oversaw all of its community development programs and products to help strengthen low- and moderate-income communities. Since leaving JP Morgan Chase just under two years ago, I was fortunate to be offered a position as a Visiting Scholar at the Ford Foundation to work on ideas for reforming the Community Reinvestment Act (CRA). Most recently, I have joined the Furman Center for Real Estate and Urban Policy at New York University as a Resident Research Fellow. Also of some relevance to my testimony is my earlier career as an economist at the New York Fed and as a Deputy Commissioner at New York City's Department of Housing Preservation and Development. I have attached a brief biographical summary at the end of this statement.

The passage of the Community Reinvestment Act in 1977 set in motion a bold experiment that has yet to achieve its full potential. By encouraging increased availability of capital, Congress aspired to stabilize and revitalize lower-income communities. While CRA has had a number of successes over the past decades, it has fallen short of its original goals, because it has been slow to rectify its own shortcomings and has failed to adapt to changes in the banking industry and community development practices. The last major re-write of the regulations was in 1995 and amendments since have been limited and infrequent. As a result CRA is in need of a major revamp. Like all regulation, the key to an effective reinvention of CRA lies in the details. Today I will outline several key reforms, some of which can be accomplished through regulatory changes, and others that require legislative action.

(Some critics have asserted that CRA should be repealed, alleging that it was a or the primary driver of the subprime crisis. The evidence is in fact to the contrary: of all the higher cost loans made in 2005-6, a mere 6% of those were made by banks in their CRA assessment areas. Furthermore, my own experience was that the few loans that were done specifically for CRA purposes have continued to perform relatively well, given the current levels of unemployment and underemployment. Generally these loans were at fixed rates and the borrowers were often required to go through mortgage counseling.)

The CRA legislation sought to encourage banks to help meet the credit needs of all communities where they were taking deposits, with a special focus on lower-income communities, consistent with the safe and sound operation of the institution. It created an affirmative obligation (sometimes also called a duty to serve) for banks to seek to expand access to credit to underserved consumers and neighborhoods, and was specifically not structured as a prohibition of certain behavior, the approach taken by many other statutes and regulatory schemes.

Implementation of this affirmative obligation was delegated to the four regulatory agencies that oversee the banks (the Office of the Controller of the Currency, the Federal Reserve, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation). The statute gave them broad latitude in determining the measure they can use for evaluating performance as well as the procedures they can use to examine the banks. All of this is embodied in the regulations, exam guidelines, and Q&As.

Falling Short and Losing Ground

Despite its substantial successes, CRA has fallen short of its potential and is continuing to lose ground for a number of reasons. The core problem is the absence of an easy way to measure the incremental impact of a bank's CRA activities on the community. T first glance, it may seem to make sense to measure the number or dollar amount of loans a bank has made or evaluate the bank's share of the lower-income marketplace compared to its share of the middle and upper income marketplace (called parity tests). But the results can be misleading as they do nothing to gauge the quality of the loans or whether the loans would have otherwise been made. For example, a $50,000 loan to a small business or a $500,000 to a small affordable housing project may be more critical to the well-being of a community than hundreds or thousands of home mortgage loans that would be made as a matter of course by any number of different mortgage companies. Similarly, philanthropic grants given to support local organizations involved in community development receive little credit because they involve small dollar amounts even though they can have a critical and large impact. Also, small amounts of below-market financing can be critical for community development financial institutions (CDFIs) to be able to carry out their missions.

In order to meet volume and parity measures, banks have sometimes undertaken activities that are a waste of resources, if not counterproductive altogether. Banks have been driven to buy market share by offering borrowers bigger and bigger subsides, or to open unprofitable branches in lower-income neighborhoods, sometimes even damaging the economics of local banks that were already there. Banks have even resorted to selling mortgages to each other to boost their mortgage numbers, providing employment for investment bankers but doing nothing to increase the number of mortgages available in the community. By forcing investments that do not make economic sense, CRA can have the counterproductive effect of undermining the business case for lending and investing in lower-income neighborhoods. Yet, despite these consequences, exams have increasingly been base on quantitative measures of production.

A second set of problems trace themselves to the changes in the banking world since the legislation was enacted in 1977 when banking was mainly a *local* affair with *local* banks serving their *local* markets. The business of banking has seen tremendous changes since then, and has seen considerable changes even since the last major re-write of the regulations in 1995. In the nineteen seventies, local banks collected deposits and made loans to community businesses and individuals. Now we now have large, national and regional banks that collect deposits and offer products and services across large footprints, relying on the efficiencies of production models that benefit from economies of scale. We now also have internet banks and industrial loan companies which serve large, even national, geographies, but take deposits in only one or a limited number of locations.. Lastly, our ideas of how a bank can best help a local community have evolved beyond the narrow notion of expanding access to credit to include the provision of affordable transaction and savings accounts as well as housing that serves a broad range of income groups..

The current economic/financial crisis has only served to further weaken CRA's impact just when lower income communities are most in need of support. The increased focus of the regulators, government officials, investors, and the public on safety and soundness has meant less focus on CRA. With many mergers being driven by financial problems and with the widespread concern with entities that are too-big-to-fail, it is now less likely that regulators will be calling for public meetings to review a bank's CRA performance as part of the process for approving a merger or acquisition. As a result public input and scrutiny will be less, and banks will have less reason to be concerned that their reputations will be impugned.

Some Fixes Require Legislation, Lots of Opportunity for Regulatory Reforms
CRA can be reformed through both legislative and regulatory changes. In fact, legislative action could embody all the necessary changes. However, legislation may not be the best route for many of the changes that would make CRA more effective. Much can be done through regulatory changes which could avoid some of the pitfalls in relying too broadly on legislation as the best way to bring about change.

Key to maintaining CRA's effectiveness is to continually update it. So attention needs to be paid to some downside risks of relying exclusively on the legislative route. First, and perhaps most important, legislation is hard to amend or update; and the current criticism of CRA (albeit without a factual base) portends an uphill battle. If the regulatory process for updating CRA has been slow, then legislative action has the danger of being even slower. Second, to the degree that detailed prescriptions become embedded in the statute, regulators could be severely limited in their ability to fix even minor problems as they arise. Third, we need to be vigilant to ensure that reform of CRA doesn't become an attempt to remedy perceived shortcomings of other legislation such as fair lending. CRA is not and cannot be the panacea for other legislation that is not working.

Congress has given the regulatory agencies broad discretion but their past efforts to re-write and update the regulations have proved to be painful, sparking lots of controversy with many critics expressing dissatisfaction with the results and few cheers for a job well done. The challenge now is to motivate the regulators to take on the task of re-writing the regulations. Three specific steps could be taken to help unblock the road.

1. Empower a Lead Agency

Regulatory change is never easy, but the difficulty is more than quadrupled when it is necessary to achieve unanimity among all of the four banking agencies enumerated in the statute. Designation of one of the agencies to take the lead would be a good first step along with setting a tight timetable and providing sufficient staffing and analytic resources, and authority to resolve disputes. A specific role for Congress would be to help build a sense of urgency by holding hearings like these that gather ideas for overcoming the shortcomings of the current rules and reinforce support for the regulators undertaking new reforms.

2. Focus on Common Ground Among Stakeholders

Everyone would agree that lack of consensus among stakeholders makes it hard for regulators to change the rules. Yet, the status quo leaves a lot to be desired, and the resolution of some issues could provide significant benefits to all parties. Unfortunately, the key stakeholder groups see the issues from quite different perspectives and often miss areas where their interests overlap. Any effort to find the common ground requires an understanding of the different perspectives among stakeholders. The following outlines some of the issues that underlie the concerns of advocates, bankers, and regulators

Advocates

Advocates, a term that encompasses a wide range of community-based organizations, come with one or more different perspectives. There are those who see the issues through a social justice lens and are exclusively focused on the needs of the communities they serve. Generally speaking, those advocates believe that banks should simply do the right thing, and if the banks do not, they should be sanctioned in some way. Others see CRA as a way to develop on-going and sustainable relationships with banks where both parties benefit—the community gets the funds needed for individuals to buy homes, etc., and for the construction of new projects and the financing of new business and the banks get new (and profitable) customers for its products and services. And of course there are those advocates who feel that both perspectives have validity. Both groups look to establish lines of communication with banks to try to resolve issues and develop partnerships.

Another area that concerns many advocates is grade inflation. Without a clear understanding of what is expected of a bank to get a Satisfactory Rating or even an Outstanding Rating, advocates worry that the exams are too easy or are becoming easier over time. Since the vast majority of banks do get one of these two "passing" grades, it is a legitimate question as to whether the test is hard enough or have banks actually devoted the appropriate resources out of self interest (e.g., concern for their public reputation or for gaining approval of applications to merge, acquire, or open a branch).
Advocates also generally want to see more resources dedicated to stabilizing and revitalizing lower-income communities. They look to bring other financial sector firms

under some type of CRA-like affirmative obligation and they want to make sure that all communities, both large and small, across the country benefit from CRA.

Bankers

Bankers have an inherent allergy to the idea of more regulation; they are reluctant to entertain a broad discussion about reform of CRA since they worry that new regulations might end up making it harder for them to operate. Bankers are judged by their ability to get results and many do not want to risk change now that they understand and can deal with the current system. CRA officers also have to spend a fair amount of time working with their colleagues in other business lines so any changes in the rules would require devoting time and resources to re-educating their colleagues, who are often skeptical of how CRA works in practice, even when they are sympathetic to its purpose.

Bankers also operate in an environment where every business line is its own profit center. Even if the central staff monitoring CRA performance across the institution is not itself a profit center, it works with units that wake up every day thinking about how to improve revenues and control costs. In this environment, the only truly successful way to ensure that a product or service will be available on a sustained basis to as wide a customer base as possible is to show that it can make at least some money, even if the profit potential falls somewhat short of the bank's hurdle rates. A product or service that loses money will simply not be sustained, regardless of the amount of cajoling. One that makes money will grow and receive dollars for innovation and infrastructure that can improve the product over time and lower its costs. As for philanthropy or for loans made at a loss (i.e., at rates below the rate the bank charges internally for its funds), they are items which are budgeted annually at a level often based on the overall profitability of the company and not necessarily a reflection of demand.

Regulators

Regulators also have a perspective that is important to take into account. The regulators know that they cannot make all stakeholders (bankers, advocates, or politicians) happy so they are reluctant to undertake the process of reform. No matter what they do, they open themselves up to criticism from all sides. In addition to issues of substance, the regulators are also criticized for how the criteria they use to determine the CRA rating of a bank. Unfortunately, the best way to be able to defend their assessments and to be more consistent across banks is to create more bright lines between what counts and what does not and to make the exams more quantitative. Unfortunately, as we have seen, this increasing reliance on pure numbers has its own downsides and the more details in the regulations, the more rigid the system has become.

The most promising way to break down the perceptual barriers among the stakeholders would be to engage them all in an open and candid discussion. Common ground might be found between regulators who would benefit from greater clarity of the guidelines which would could allow for more consistency in the ratings across banks, bankers who would benefit if they could put together their business plans with more confidence of the outcome if they meet their goals; and advocates who would benefit from having clearer standards against which to judge the banks. Similarly, facilitating more regular updates of the regulations could make it easier for the different stakeholders to allow for experimentation and new ideas with the knowledge that subsequent fixes would be possible. To the extent such a dialogue would uncover areas of agreement, the regulators would then have a constructive place to start to revamp the regulations

3. Show How Reform Need Not Be a Zero Sum Game

Many of the stakeholders are also reluctant to support change since they fear that giving more credit to one element of the exam will necessarily decrease the importance of another. This concern that CRA is a zero-sum game is understandable given the way the current system for large, retail banks derives an overall rating for a bank by taking a weighted average of the results of the Lending, Investment, and Services tests, each of which is itself a weighted average of its components. If, for example, more weight were given to the funding of affordable rental housing and CDFIs (both essential elements of what are called community development loans) under the Lending test, then, all else equal, the value of mortgage loans and small business loans would have to diminish. Thus it is hardly surprising that those who want to preserve the level of attention now paid to home mortgages and small business loans are reluctant to contemplate changes that may lead to a reduction in the importance of these loan activities.

One way out of this trap would be to expand upon the current approach that requires a bank to achieve at least a minimal "passing" grade on the Lending Test in order to be eligible for an overall "Satisfactory" rating. Other products and services or groups of products and services (e.g., a community development test, see below) could receive similar treatment, making the passing of each of them of equal importance, at least with regard to being able to achieve a passing grade overall.

Specific Proposals to Significantly Improve CRA's Effectiveness

If these three steps help to unstick the process for updating regulations, there is much that can be done through regulatory changes. In particular, the agencies could restructure the exams to be clearer and more specific about what is specifically required or desired from the banks of different types and sizes and in different neighborhoods. They could modify or replace tests that give credit for activities that do not have a positive incremental impact on lower-income communities or, indeed, are harmful. They could redesign the system to provide quick feedback on emerging issues and products. More rapid and regular updates would create a system that achieves continuous improvement.

Make "Satisfactory" an Explicit Floor and Specify Required Products or Services

To add teeth to CRA and to clarify its requirements, an overall rating of "Satisfactory" should be made an explicit pre-requisite for a bank to apply for any of the regulatory approvals covered by the CRA statute. In addition, the products or services required for a "Satisfactory" should be laid out through a series of minimum standards. Failure to achieve these minimums would result in an overall rating below "Satisfactory." This approach eliminates the zero-sum problem, at least with regard to qualifying for a "Satisfactory," and addresses some of the concerns of advocates that the regulators have not been tough enough "graders" or flunked enough banks. Additional gradations might make sense but increasing the number of overall rating levels beyond the current four would require legislation.

In particular, minimum levels of performance should be set for individual products or services or for groups of them (just as the existing Lending Test looks at the collective performance of a bank with respect to both home mortgages and small business loans). Groupings make sense particularly when better performance on one component can compensate for a lesser performance on another.

In addition to requiring a minimum performance level for home mortgage and small business loans, there could be a "minimum" test for retail services which could combine an evaluation of the geographic distribution of branches, an examination of the bank's policy with regard to closing branches, and an assessment of the effectiveness of any alternative delivery systems for the same products and services found in branches. Another approach might be to set a minimum level of performance under consumer compliance that covers discrimination, consumer safety, and unfair and deceptive marketing practices. Still another might be a community test as described below.

Calibrating the "height" of these minimums requires a comparison of the costs of meeting them versus the incentives needed to induce banks to comply. Just as the incentives built into CRA are limited, any requirements that banks supply particular products or services should also be limited. If the minimum standards are set too high individually or collectively, then the regulations will run the risk that some banks may choose to live with a failing grade. While those banks that anticipate needing any of the delineated powers in the statute, e.g., for permission to merge or acquire, will be highly motivated to try to comply, many banks will likely set a lower bar as to what they consider to be reasonable.

Create a Community Development Test

The exam protocol for large, retail banks lacks a community development test which combines community development lending, investments and services. Yet, this array of activities is critical for stabilizing and revitalizing neighborhoods—the original intention of the legislation. Community development loans and services are too important to be systematically undervalued as they are at present for large, retail banks. Furthermore, if it were possible to treat all of these activities under one umbrella, a bank would be free to respond to local needs and opportunities, whether they be loans, investments, services or a melding of the three.

One way to create a community development test would be to give banks the option of adding community development loans and services to the existing Investment Test. Banks could also be allowed to increase the weight given to this expanded test (perhaps by up to 50 percent), with a concomitant reduction in the weight given to the now narrower Lending Test. Moreover, the problems with the parity tests mean that the evaluation of home mortgage and small business lending also needs to be addressed as noted earlier. The new Community Development Test may also call for one or more minimum standards of the type discussed above. Also, as a result of having this new test, reshufflings of the remaining components of the Lending and Service tests should also be on the table in order to adjust the groupings to be subject to a minimum standard.

Calibrating Quantity versus Quality, Production versus Process

Over the years, examiners have tried various ways to measure bank compliance with the affirmative obligation imposed by CRA. Some have been better aligned than others helping to stabilize and revitalize lower-income communities. It has proven difficult to measure directly the net incremental impact of a bank's actions on a community. Regulators have relied on such proxies as the amount of production (e.g., the number of loans), the market share of a bank in the lower-income community compared to that of the industry as a whole (also referred to as a parity test), and local efforts to market a product. The 1995 switch from measuring process to production was hoped to be an improvement but, as discussed above, this generated its own set of unintended consequences and the perfect yardstick has yet to be found. Some of the new tests have even had the perverse result of encouraging counterproductive behavior on the part of the banks through the sparking of destructive competition. These tests need to either be eliminated; be placed in a broader context that incorporates a number of different tests; or be reputable based on economic factors or the absence of need (see next section regarding a safety value).

Whether these tests that promote destructive competition are replaced or put in a broader context, it is time to include both quantitative and qualitative measures of production and process. By combining these approaches, it may be possible to better approximate an evaluation of a bank's positive incremental impact on lower income communities. Tests need to be devised for each of the minimum standards for a "Satisfactory" as well as what is needed for an "Outstanding." To ensure tests continue to work as intended, they should be reviewed regularly and modified or replaced as appropriate. The regulations also need to embrace and assess new practices in the community development field.

Finding the right balance between quantitative and qualitative measures is essential since as noted earlier, smaller size loan can have as much, or more, impact than a larger one. Process measures will help evaluate more nuance community impacts that cannot be identified with existing measures. For example, testing whether a bank has conducted valid needs assessments would encourage banks to maintain an on-going dialogue with the community. Similarly, developing a test to gauge if the community truly has access to bank officials with sufficient authority to be responsive to their ideas and concerns could satisfy this goal. In determining if a bank is doing enough extra to justify an "Outstanding," the test could require evidence of innovative products and services or of the dedication of sufficient expertise and resources to be able to structure innovative deals. This test would also encourage continued support for separate, specialized lending units. Of course, these types of tests would require examiners to be both well-trained and empowered to make the necessary judgments in the field.

One particularly difficult issue involves the pricing of products to serve lower-income communities. In some cases the existence of CRA actually impedes the availability of products because banks hesitate to charge the price needed to cover costs and earn a reasonable rate of return. Regulators should clarify the role that the price of a product plays in evaluating a bank's performance. While pricing may be a key issue for advocates who worry about "fairness," the regulators might prefer to focus on the availability of the product or service as well as the long term prospect that more market competition could drive down the price as volume grows and banks invest in improving the product and the technology used to produce it.

Incorporate a Safety Value to Guard against Unintended Consequences
Since the tests are likely to be, at their best, imperfect measures of the desired outcome, it is important to provide a safety value to minimize the chances that the regulations will force banks to undertake counterproductive activities. Before being made to over saturate or over subsidize a market, a bank should be allowed to defend its record by being able to show that the community is already being well served or the economics simply cannot work (e.g., the case of the $8000 subsidy for those getting a home mortgage). A formal "appeals" process should be established so that banks can make such a case and so overcome any initial judgment based on numbers alone of inadequate performance.

Add More Exam Protocols
Regulators should set up additional exam protocols to adapt to the realities of the geographic reach of internet banks and others that serve regional or national banks. Banks serving a nationwide market should be offered full credit for CRA-eligible loans, investments, and services made in any geography across the country, thus encouraging them to serve those lower-income markets. A similar approach might be applied to regional banks that would be able to serve all localities within their region regardless of the existence of a local deposit-taking facility. Such rules would help to ensure every community has access to capital at competitive prices. Such reforms would also allow for further geographic diversity in the portfolios of these banks and would reduce the pressure to over concentrate in some of their headquarter cities. Likewise, they would allow more capital to flow to regional and national loan funds which would then be free to serve all lower-income communities within their service area. (This approach differs in a significant way from those that propose expanding the definition of Assessment Areas to include geographies where a bank lends money but does not take deposits. Such an expansion of CRA responsibility needs to be thought through carefully, as it could result in, for example, the need to spread philanthropic and low cost loan money even more thinly. Since these proposals move away from focusing only on where a bank takes deposits, it may also require legislative change. See below.)

These changes may not be enough to provide access to credit in small communities with banks that are so small they only have to meet the stripped down lending test or with banks that only have a small share overall of the local mortgage or small business market. In these cases, the regulators could go further and offer extra credit to any bank that lends, invests, or provides community development services in these communities, regardless of where the bank takes deposits.

Another reason to design a special exam protocol for the largest banks is to identify a way to shorten exams that can currently consume 18 months or longer. These protracted exams tie up the resources of all parties for months, and banks justifiably complain that they are halfway through their business plans for the next exam before they fully know what rules they should be operating under. The result is an elongated feedback loop that slows the process of continuous improvement for all parties concerned. Exams should be able to be completed faster or, at a minimum, any changes in how different activities are being evaluated need to be communicated on a real-time basis

Special rules could also be developed for banks that have affiliates (i.e., other subsidiaries of the holding company) that are relatively large and perform activities that would be included in a CRA exam if they were a direct subsidiary of the bank itself. Currently, regulators do not look at non-bank affiliates unless the bank itself volunteers to include them in its exam. One approach would be to take into account the size and nature of the affiliates in determining the appropriate level of CRA activity expected from the institution.

Another alternative, particularly for the internet banks and others that serve national markets, but only take deposits in limited geographies, would be to require each of them to create their own custom-made "strategic plans." Once the plans are approved, banks would be able to be confident of how much of its efforts can go to communities beyond its hometown. Before adopting this approach, however, it would be useful to better understand the historic reluctance of banks to take up the option of creating a strategic plan.

Formalize a Process to Adjust Exams for Local Market Conditions

Another area worth exploring is to devise a more formal process for allowing exams to be adjusted based on variations in local needs. What may be valuable for today's Cleveland may not be so for Chicago. At the time of an exam, a bank has the ability to make the case for any local variations in its performance. Analyses of local needs can be incorporated in the "Performance Context," a document prepared by the banks as part of the examination process as part of the analyses they provide the examiners. This path is filled with uncertainty, though, since examiners can then reach different conclusions after reviewing the data or talking with the community.

To eliminate this uncertainty, regulators could play a more proactive role and take the lead in compiling an assessment of local needs. If they did, then banks could have the option of shaping their CRA programs in each locality around either the standard CRA framework or around the special finding for each locality. Alternatively, the regulators could try to make more attractive the existing option for banks to develop their own strategic plan. Such a plan requires regulatory approval but has the advantage of allowing a bank to set up its own criteria for being evaluated under CRA. Few banks have thought it worthwhile to pursue this option, but perhaps it could be modified to be more attractive.

Hold Public Hearings Annually to Review the Latest CRA Data

Input from the public has played a crucial role in alerting the regulators to community needs and the role a bank plays in a community. This input is in danger of being lost as fewer mergers and acquisitions will reduce the opportunities for public involvement. The regulators should consider holding regular joint meetings ever year to review the latest CRA data. Congress could also hold annual hearings. (To make holding these hearings mandatory, legislation may be the best route.)

A related and contentious issue is the push by advocates and researchers for the collection of more extensive data under CRA. The issues involved should be considered independently of the debate of how much detail to collect under HMDA, which is separately authorized and has its own rationale. While it is important that examiners have the data they need to carry out their responsibilities, it is a different question as to which of this data should be made public. Banks are concerned about cost, customer privacy, providing proprietary information that could be valuable to their competitors, and fueling a proliferation of law suits. But it is also the case that more data available to the public could allow for more fact-based and constructive discussions. The answer requires a balancing of the interest of the banks and the public.

One way to resolve of this tension between the banks and the public would be to determine what type and amount of information is necessary to allow advocates and others to make the case that a problem may exist. This would shift the burden of proof back to the bank to explain why the data looks the way it does. While the data made public may not suffice for a court of law, it would at least be enough to help guide the regulators to where they should do more in-depth analyses.

Proposed Fixes that Can Be Done Only Through Legislation
Some of the proposed reforms can only be done through legislative action. The following are some of those ideas.

<u>Add an Affirmative Obligation to Regulatory Reform Legislation</u>
One way to expand CRA-like responsibilities beyond the banks would be to look for opportunities to build an affirmative obligation into financial reform legislation as part of any new/expanded regulatory scheme. If made a part of the responsibilities of a consumer financial protection agency or bureau, for example, then all the players providing the covered consumer products and services would share the same obligation to lower-income communities, thereby creating a level playing field, reducing the danger of a race to the bottom, and spreading any cost across a larger universe of firms than just banks alone.

<u>Tighten Complementary Laws</u>
Anti-discriminatory laws can be critical to helping lower-income communities thrive. The apparent targeting of minorities with toxic subprime products has hurt many of these communities. Rather than explicitly include race or ethnicity in CRA, a better approach may be to strengthen and effectively enforce existing fair lending laws. It might also work to help to add an affirmative obligation to those laws rather than to enmesh the CRA itself in the process of investigating discrimination, which often requires reviewing individual loan files, a process that seems best done as it is now by the regulators as part of their fair lending examines.

Beyond Credit

The original sharp focus of CRA on "credit" may be outdated and it may be time to include other kinds of bank products and services. To explicitly require the provision of transaction and savings accounts that serve lower-income communities, for example, may require new legislation although the current statute may already provide enough latitude.

Expand Incentives

Since the value placed on achieving an "Outstanding" appears to be falling for some banks, additional incentives may be necessary just to maintain the status quo. One way to bolster CRA would be to offer to provide an explicit monetary benefit for achieving an "Outstanding." A proposal mooted a few years ago was to reduce assessments imposed by FDIC to maintain its insurance fund.

It has already been shown that monetary incentives can induce banks (and others) to provide more products and services in lower-income communities. Notable successes have been the CDFI Fund and the Low Income Housing and New Markets Tax Credit programs. The government should consider additional ways to subsidize products or services that generate externalities that benefit the community as a whole.

Expansion of Assessment Areas

Some advocates have proposed changing some of the basic tenets of CRA. For example, as some banks now sell home mortgage, credit card, and other products and services beyond the markets in which they take deposits, advocates note that in some communities the remaining local banks may not be of sufficient size to have the resources to revitalize their communities. One proposal to address this problem is to expand a bank's CRA responsibility to also cover geographies where it makes loans. While the problem may be real, the proposed solution risks diluting the efforts now being made by banks in their own communities. How would, for example, banks serve these additional communities where they may not even have a physical presence or local staff? Would it drain resources now deployed elsewhere? Would it require banks to spread more thinly the very valuable but limited resources set aside for philanthropic grants and below-market loans? Since the budgets for these purposes are generally set centrally and are not likely to be expanded simply because of a change in geography, some communities and localities will end up with less.

Another question regards the level of activity that would trigger the obligation. In a bill now before Congress, the proposed trigger is any level of loan activity in excess of 0.5% the local market. With such a low threshold, this provision could have the opposite effect, leading banks to avoid making any local loans where the number that would trigger a local obligation is too small to be worth the effort. This could deprive the local community of having more firms compete for their business, decreasing access to credit. Lastly, how much burden would this add to the regulators who would have to evaluate these additional geographies? Would it make exams even longer, further attenuating the feedback loop?

Consider Expanding Beyond Banking
Advocates would like to see other financial services companies (and non-bank affiliates of banks) covered by a CRA-type affirmative obligation in order to bring more resources to the field. The insurance is one example often cited. The proposal also has the advantage of helping to level the playing field to the extent banks compete with these other companies for customers. However, before rushing to pass legislation, many of the issues faced by CRA over the last thirty-two years need to be confronted: What particular products or services should be covered? Is the community underserved with regard to them? Would the benefits (including externalities) of providing them exceed the costs? If so, what would be the best way to cover all the firms playing in that particular market? If there is a problem with profitability, would monetary incentives be preferable? The clearer the answers are to these questions, the more effective the legislation will be in helping communities.

Conclusion
In addition to seeking the above statutory changes, there are several ways that Congress can help us move towards a more effective CRA, including: holding hearings like this to gather ideas; working to find common ground among stakeholders; and encourage the regulators to focus on the task of revamping the regulations and supporting those efforts to make CRA better able to stabilize and revitalize lower-income communities. To the extent common ground can be found that works for all parties, lower-income communities will be the beneficiaries.

Biography

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Mark A. Willis recently became a Resident Research Fellow at New York University's Furman Center for Real Estate and Urban Policy following the completion of his tenure as a Visiting Scholar at the Ford Foundation where he worked on community development and the financial services sector. Previously, Mr. Willis spent 19 years in community-development banking at JPMorgan Chase overseeing its community development programs and products to help strengthen low- and moderate-income communities. He founded the Chase Community Development Corporation and became executive vice president and head of the Community Development Group with a staff of 250, outstandings in excess of $3 billion, and revenues of $30 million. Over those years, he had responsibility for the development and implementation of innovative lending and investment programs for affordable housing, community economic development, small businesses, and affordable home mortgages; community relations; and corporate oversight of Fair Lending and Community Reinvestment Act compliance. Mr. Willis also served as the President of the Chase Manhattan Foundation from 1998 to 1999.

Before joining Chase, Mr. Willis held various positions in economic development and tax policy with the City of New York, and from 1986 to 1989, he was Deputy Commissioner for Development of the Department of Housing Preservation and Development. Before joining the City, he was an urban economist at the Federal Reserve Bank of New York.

Mr. Willis co-chairs Housing First! in New York City and has previously chaired the New York Community Investment Company and the Consumer Bankers Association's Community Reinvestment Committee, and co-chaired Living Cities: The National Community Development Initiative. Mr. Willis has also served as a member of the Bankers/Community Collaborative Council of the National Community Reinvestment Coalition. He currently serves on a number of boards including the executive committees of the Center for Housing Policy and the Greater Harlem Chamber of Commerce as well as the advisory board of the Office of Financial Empowerment of the NYC Department of Consumer Affairs. Mr. Willis teaches Housing and Community Development Policy jointly at New York University's Law and Wagner schools.

Mr. Willis has a B.A. degree in economics from Yale University, a J.D. degree from Harvard Law School, and a Ph.D. degree in urban economics and industrial organization from Yale University.

Community Reinvestment Act had nothing to do with subprime crisis

Posted by: Aaron Pressman on September 29, 2008

Fresh off the false and politicized attack on Fannie Mae and Freddie Mac, today we're hearing the know-nothings blame the subprime crisis on the Community Reinvestment Act — a 30-year-old law that was actually weakened by the Bush administration just as the worst lending wave began. This is even more ridiculous than blaming Freddie and Fannie.

The Community Reinvestment Act, passed in 1977, requires banks to lend in the low-income neighborhoods where they take deposits. Just the idea that a lending crisis created from 2004 to 2007 was caused by a 1977 law is silly. But it's even more ridiculous when you consider that most subprime loans were made by firms that aren't subject to the CRA. University of Michigan law professor Michael Barr testified back in February before the House Committee on Financial Services that 50% of subprime loans were made by mortgage service companies not subject comprehensive federal supervision and another 30% were made by affiliates of banks or thrifts which are not subject to routine supervision or examinations. As former Fed Governor Ned Gramlich said in an August, 2007, speech shortly before he passed away: "In the subprime market where we badly need supervision, a majority of loans are made with very little supervision. It is like a city with a murder law, but no cops on the beat."

Not surprisingly given the higher degree of supervision, loans made under the CRA program were made in a more responsible way than other subprime loans. CRA loans carried lower rates than other subprime loans and were less likely to end up securitized into the mortgage-backed securities that have caused so many losses, according to a recent study by the law firm Traiger & Hinckley (PDF file here).

Finally, keep in mind that the Bush administration has been weakening CRA enforcement and the law's reach since the day it took office. The CRA was at its strongest in the 1990s, under the Clinton administration, a period when subprime loans performed quite well. It was only after the Bush administration cut back on CRA enforcement that problems arose, a timing issue which should stop those blaming the law dead in their tracks. The Federal Reserve, too, did nothing but encourage the wild west of lending in recent years. It wasn't until the middle of 2007 that the Fed decided it was time to crack down on abusive pratices in the subprime lending market. Oops.

Better targets for blame in government circles might be the 2000 law which ensured that credit default swaps would remain unregulated, the SEC's puzzling 2004 decision to allow the largest brokerage firms to borrow upwards of 30 times their capital and that same agency's failure to oversee those brokerage firms in subsequent years as many gorged on subprime debt. (Barry Ritholtz had an excellent and more comprehensive survey of how Washington contributed to the crisis in this week's Barron's.)

There's plenty more good reading on the CRA and the subprime crisis out in the blogosphere. Ellen Seidman, who headed the Office of Thrift Supervision in the late 90s, has written several fact-filled posts about the CRA controversey, including one just last week. University of Oregon professor and economist Mark Thoma has also defended the CRA on his blog. I also learned something from a post back in April by Robert Gordon, a senior fellow at the Center for American Progress, which ends with this ditty:

It's telling that, amid all the recent recriminations, even lenders have not fingered CRA. That's because CRA didn't bring about the reckless lending at the heart of the crisis. Just as sub-prime lending was exploding, CRA was losing force and relevance. And the worst offenders, the independent mortgage companies, were never subject to CRA — or any federal regulator. Law didn't make them lend. The profit motive did. And that is not political correctness. It is correctness.

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DRAFT: COMMENTS INVITED

Financial Crisis Inquiry Commission

Preliminary Staff Report

THE COMMUNITY REINVESTMENT ACT AND THE MORTGAGE CRISIS

APRIL 7, 2010

This preliminary staff report is submitted to the Financial Crisis Inquiry Commission (FCIC) and the public for information, review, and comment. Comments can be submitted through the FCIC's website, www.fcic.gov.

This document has not been approved by the Commission.

The report provides background factual information to the Commission on subject matters that are the focus of the FCIC's public hearings on April 7, 8, and 9, 2010. In particular, this report provides information on the Community Reinvestment Act. Staff will provide investigative findings as well as additional information on these subject matters to the Commission over the course of the FCIC's tenure.

Deadline for Comment: May 15, 2010

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The Community Reinvestment Act and the Mortgage Crisis

The purpose of this preliminary staff report is to provide background on the Community Reinvestment Act (CRA). Section I provides background on the CRA. Section II discusses the evidence on CRA's contribution to an increase in the number of risky mortgages originated.

I. BACKGROUND ON THE COMMUNITY REINVESTMENT ACT

The CRA[1] was enacted in 1977 to encourage depository institutions (or "banks") to lend to their local communities. Chairman Ben Bernanke of the Federal Reserve Board said in a 2007 speech:

> Public and congressional concerns about the deteriorating condition of America's cities, particularly lower-income and minority neighborhoods, led to the enactment of the Community Reinvestment Act. In the view of many, urban decay was partly a consequence of limited credit availability, which encouraged urban flight and inhibited the rehabilitation of declining neighborhoods. Some critics pinned the blame for the lack of credit availability on mainstream financial institutions, which they characterized as willing to accept deposits from households and small businesses in lower-income neighborhoods but unwilling to lend or invest in those same neighborhoods despite the presence of creditworthy borrowers.

Since enactment, the CRA has been amended several times, often in tandem with other changes in housing policy. These changes included: in 1989, agencies were required to issue CRA ratings publicly along with written empirical performance evaluations; in 1994, the Riegle-Neal Interstate Banking and Branching Efficiency Act repealed restrictions on interstate banking and listed CRA ratings received by the out-of-state bank as a consideration in evaluating banks' applications to create interstate branches; and in 1995, the CRA was revised with the intent of systematizing its enforcement and reducing its regulatory burden.

Under the CRA, banks are periodically examined to evaluate the extent to which they are adequately serving their communities. Based on the examination, regulators assign each bank one of four CRA performance ratings: outstanding, satisfactory, needs to improve, or substantial noncompliance. CRA ratings are used by banking regulators when considering applications by banks for approval of mergers and acquisitions or other types of applications. Regulators can deny applications based on an applicant's poor CRA rating.[2]

[1] 12 U.S.C. §§ 2901-2908 (2000).
[2] For example, in 1989 the Federal Reserve Board denied an application by the Continental Bank of Chicago to acquire Grand Canyon State Bank based on Continental Bank's poor record of CRA compliance. Michael Quint, "Fed Blocks Continental Bid to Acquire Bank in Arizona," *New York Times*, Feb. 16, 1989.

For purposes of CRA examinations, each bank defines a geographic "assessment area," in which its practices are evaluated.[3] For retail banking institutions, the assessment area includes the geographic areas in which it takes deposits or originates loans. Regulators use three tests to evaluate each bank's performance of its CRA obligations: an investment test, a service test, and a lending test. The investment test evaluates the bank's investments that have a community development purpose. The service test considers the bank's provision of retail banking services, for example through branches and ATMs, in the assessment area. The lending test, which is the most relevant test for the mortgage market, considers the geographic distribution of the institution's borrowers, as well as the distribution of lending across different types of borrowers.

For residential mortgage loans, regulators consider in particular (a) the proportion of the bank's loans in its assessment area; (b) the geographic dispersion of the bank's loans within the assessment area; (c) the amount of lending done in low-, moderate-, middle-, and high-income geographies in the assessment area; (d) the amount of lending to low-, moderate-, middle-, and upper-income borrowers; and (e) the bank's use of innovative or flexible lending practices in a safe and sound manner to address the credit needs of low- or moderate-income individuals or geographies.[4] Both originations and purchases of loans count towards a bank's CRA obligations.[5] Importantly, CRA ratings are based on the actual historical performance of the institution and generally may not rely on plans or commitments for future action.[6] The CRA does not require banks to make loans that are inconsistent with safe and sound operations. Institutions "are permitted and encouraged to develop and apply flexible underwriting standards for loans that benefit low- or moderate-income geographies or individuals, only if consistent with safe and sound operations."[7]

II. THE CRA AND THE MORTGAGE CRISIS

In the wake of the foreclosure crisis, when default rates on subprime loans increased sharply, some argued that the CRA contributed to the crisis by encouraging lenders to originate riskier loans.

[3] 12 CFR 25.41.
[4] 12 CFR 25.22. Low and moderate-income census tracts are tracts with median family income less than 80 percent of the metro area's median family income.
[5] 12 CFR 25.22(a)(2).
[6] *See, e.g.*, Federal Reserve Board Order approving the merger of NationsBank and BankAmerica (1998, p. 63), at http://www.federalreserve.gov/boarddocs/press/BHC/1998/19980817/default.pdf; Federal Reserve Board Order approving the merger of Bank of America and FleetBoston (2004, pp. 51-52), at http://www.federalreserve.gov/boarddocs/press/orders/2004/20040308/attachment.pdf. CRA regulations do allow banks to establish an optional strategic plan for meeting the credit needs of its assessment area and to be assessed for CRA compliance based on its performance meeting the goals of an approved strategic plan. See 12 CFR 25.27. Only two banks currently have approved strategic plans for CRA. *See* http://www.federalreserve.gov/dcca/cra/stratpln.htm.
[7] 12 CFR 25.21(d).

One challenge in evaluating the CRA's role in encouraging the origination of risky loans is determining which loans were made because of the CRA and would not have been made in the absence of the CRA. The first step in such an analysis is to quantify the flow of loans that helped the originator meet its CRA obligations. Glenn Canner and Neil Bhutta, economists at the Board of Governors of the Federal Reserve System, have collected data that help to answer this question. They estimate the fraction of subprime originations that would have helped the originating bank earn a good CRA rating using the 2006 Home Mortgage Disclosure Act (HMDA) data.[8] Among all mortgages originated in 2006, 28 percent were originated by banks subject to the CRA within their CRA assessment areas. The remaining 72 percent were made by banks outside of their assessment area or were made by mortgage lenders not subject to the CRA. Of all mortgage originations, 10 percent were originated by banking institutions and affiliates subject to the CRA within their CRA assessment areas to low-and moderate-income borrowers or in low- or moderate-income neighborhoods.

This category of mortgages for which banks could have received CRA credit (i.e., mortgages that were made in assessment areas to low-income borrowers or in low-income neighborhoods) includes relatively low-risk loans.[9] To estimate the fraction of *subprime* mortgages that were CRA-related, Canner and Bhutta (2008) use whether the mortgage was "higher-priced" according to the HMDA data as an indicator for whether it was a subprime loan. While this is of course an imperfect measure of whether a loan is subprime, among higher-priced mortgages, only 6 percent of all higher-priced loans were made to low- or moderate income borrowers or in low- or moderate-income neighborhoods by CRA-covered lenders in their assessment areas.

An important caveat to the analysis of Canner and Bhutta (2008) is that it does not include purchases of mortgages by depositories for which they can receive CRA credit. For example, some mortgages originated by independent mortgage companies may be purchased by depository institutions whose assessment area includes the borrower. The HMDA data unfortunately lack sufficient detail to identify such purchases. The HMDA data do report whether each originated loan is sold to a depository institution within the reporting period. In 2006, of the 14 million mortgages originated, 664,204, or 4.8 percent, were sold to a depository institution. Of these 4.8 percent, only a fraction were within the assessment area of the purchaser.[10]

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[8] Canner and Bhutta (2008).
[9] A 2009 report by authors from the Center for Community Lending and Center for Responsible Lending discusses borrower characteristics from a national program in part designed to help lenders covered by CRA meet their CRA obligations. The report states, "3.21 percent of our sample of community lending borrowers were 90-days' delinquent or in foreclosure process in the second quarter of 2008. This was slightly higher than the 2.35 percent delinquency rate on prime loans but well below the 17.8 percent on subprime loans nationwide." http://www.ccc.unc.edu/documents/Risky.Disaggreg.11.09.Final.pdf
[10] *See* 2006 HMDA National Aggregate Table 3-2, at http://www.ffiec.gov/HMDA/online_rpts.htm

In addition, many large mortgage lenders made public commitments to lend to low- and moderate-income and minority households.[11] (This category may include loans that do not meet CRA specifications. For example, CRA exams require that a bank had made qualifying loans to borrowers with prescribed income characteristics within its assessment area. In addition, CRA exams are unrelated to a borrower's race.) In a recent paper, Edward Pinto, a consultant to the mortgage-finance industry, compiled figures on reported lending pursuant to such commitments from five large originators' press releases.[12] He estimates a total of $2.127 trillion in such originations from 2001 to 2008. To calculate the total stock of such mortgages still outstanding in 2008, one needs to know what fraction of each year's originations were paid off by the borrower or defaulted prior to 2008. Using estimates of the prepayment rate of mortgages from Anthony Pennington-Cross and Giang Ho (2006), which focuses on subprime lending,[13] we estimate that approximately $931 billion of these mortgages would still be outstanding as of 2008. About $11 trillion in total mortgage debt was outstanding in 2008, so the originations made pursuant to these commitments from these five lenders amount to about 8.5 percent of the stock of outstanding mortgages in 2008.[14] As a reference point, mortgages to low- and moderate-income and minority households comprise 36 percent of all mortgage originations in 2008.

These summary statistics provide a sense for the scale of CRA-related lending, as well as the scale of lending done to low- and moderate-income and minority households pursuant to public commitments. However, it is possible that much of this lending would have been done even in the absence of the CRA. Stuart Gabriel, an economist at UCLA, and Stuart Rosenthal, an economist at Syracuse University, in a 2009 paper and, separately, Bhutta (2010) attempt to estimate whether CRA caused additional lending. Both papers find little increase in bank mortgage originations due to the CRA. Gabriel and Rosenthal conclude that "on balance, the lack of more compelling evidence of .... CRA effects on mortgage lending ... among targeted underserved [census] tracts is striking..." Bhutta similarly concludes that "[o]n average, the CRA appears to have had little impact, including during the mid 2000's when lending to lower-income areas soared."[15]

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[11] These commitments do not contribute to CRA performance ratings as examinations focus only on actual originations. While comments and feedback received from community groups and the public do have some weight in a bank's CRA exam, these comments and feedback are only considered in regard to a bank's CRA lending, which is a subset of the bank activity potentially described in a press release related to commitments.
[12] Pinto (2010, pp. 12-15). The originators included in Pinto's estimates are Bank of America, JP Morgan Chase, Citibank, Washington Mutual, Countrywide, and affiliates thereof.
[13] Specifically, based on data from Pennington-Cross and Ho (2006) that estimates propensity for subprime loans to prepay or default, we assume that 90 percent are outstanding after 1 year, 63 percent after 2, 42 percent after 3, 24 percent after 4, 17 percent after 5, 10 percent after 6, and 3 percent after 7.
[14] To the extent that other large institutions fulfilled commitments to make loans to low- and moderate-income and minority borrowers, 8.5 percent understates the amount of commitment-related mortgages outstanding in mid-2008.
[15] Bhutta (2010, Abstract).

Another study has examined the relative performance of CRA loans. Elizabeth Laderman and Carolina Reid (2009) compare the performance of loans made by CRA-regulated lenders in their assessment areas to those made by independent mortgage companies, which are not subject to the CRA. To be sure, loans made by CRA-regulated lenders to low and moderate-income borrowers in their assessment areas default at a higher rate than loans made to the typical borrower by these same lenders. However, they find that the foreclosure rate of mortgages originated by independent mortgage companies was about twice the foreclosure rate of mortgages originated by CRA-regulated lenders. Moreover, after accounting for the effect of other characteristics of the loans and the borrowers, such as income and credit score, they find that loans made by CRA-regulated lenders in their assessment areas are *less* likely to default than similar loans made by independent mortgage companies.

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Fred R. Becker, Jr.
President and CEO

April 14, 2010

The Honorable Luis V. Gutierrez
Chairman
Subcommittee on Financial Institutions
and Consumer Credit
House Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Jeb Hensarling
Ranking Member
Subcommittee on Financial Institutions
and Consumer Credit
House Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Gutierrez and Ranking Member Hensarling:

I am writing to you on behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association exclusively representing the interests of our nation's federal credit unions, ahead of tomorrow's hearing entitled "Perspectives and Proposals on the Community Reinvestment Act."

As you are aware, the Community Reinvestment Act (CRA) was adopted as a punitive measure to punish specific bad actors – namely banks and thrifts – for engaging in discriminatory practices such as redlining and disinvestment. While some may say that CRA was to blame for the sub-prime crisis, we do not believe that to be the case. Credit unions were not included under CRA because there has never been any evidence that credit unions have engaged in these illegal and abhorrent activities. Credit unions are inherently invested in their communities, operating unlike other depository institutions with a not-for-profit cooperative structure and a common bond membership. Credit unions embrace the unique relationship that they have with their community and play an important role in providing important financial services to underserved individuals. By law, credit unions can only take deposits from and make loans to their membership. As many have wisely noted, if all financial institutions acted like credit unions, there would be no need for CRA. We firmly believe that placing CRA requirements on credit unions would create new regulatory burdens without public benefit—a solution in search of a problem. We oppose all such efforts to do so.

Many credit union members come from the low income and minority populations of our society. Although banks and thrifts are subject to CRA, HMDA data clearly indicates that credit unions are outperforming banks and thrifts in terms of loan and price spreads as well as service to these particular segments of the population.

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The Honorable Luis V. Gutierrez
The Honorable Jeb Hensarling
April 14, 2010
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We would also like to respond to a related report released last year by the National Community Reinvestment Coalition (NCRC), entitled "Credit Unions: True to Their Mission, Part II." NAFCU believes that the analysis and conclusions drawn by the NCRC, favoring an extension of CRA requirements to credit unions, are deeply flawed.

The NCRC report uses data compiled under the Home Mortgage Disclosure Act (HMDA) as the basis for its analysis of bank and credit union performance in serving disadvantaged communities, and to advocate for the extension of the Community Reinvestment Act (CRA) to credit unions. Unfortunately, NCRC fails to accurately represent the data, choosing to instead draw negative conclusions about credit union lending in low- and moderate-income communities.

An examination of Mortgage Loan Approval Rates[1] under the 2008 HMDA data shows that credit unions outperform banks and thrifts across the board (see table below). Further, the percentage of credit union borrowers (approved loans) with incomes of less than 80% of the HUD median family income for the area is higher among credit unions (25.9%), as compared to banks and thrifts (24.7%). That is, credit unions have a greater percentage of their loans going to lower income populations than banks and thrifts, despite banks and thrifts already being subject to CRA.

Mortgage Loan Approval Rate*

Approval Rate,* All Mortgage Loans**

	All Applicants		White Applicants		Minority Applicants	
	Applicant Income		Applicant Income		Applicant Income	
	Less than $40,000	$40,000 or More	Less than $40,000	$40,000 or More	Less than $40,000	$40,000 or More
2008						
Credit Unions	70%	85%	72%	87%	52%	73%
Banks	55%	68%	59%	70%	40%	54%
Thrifts	63%	73%	65%	75%	50%	62%

Source: Federal Financial Institutions Examination Council HMDA Data

*Loans originated plus loans approved but not accepted as a percent of all loan applications. Minority applicants include those who identified themselves as Native American, Asian/Pacific, Black or Hispanic.

**All loans include home purchases, home improvements, or refinancings, when race information is collected

[1] Approval rates are used as the denial rate is an inaccurate measure of lending performance. This is because one denial on a small pool of applicants will have a greater impact than on a large pool of applicants.

We also believe that HMDA numbers for banks and thrifts need to be examined carefully. Many have taken to approving expensive, sub-prime loans where they did not make loans before (which some may term "reverse red-lining"), and this fact is supported by the same HMDA data the NCRC attempts to twist to its advantage. The NCRC report concludes that, based on 2007 HMDA numbers, disparities in white versus minority approval rates are higher at credit unions than at banks. While a superficial examination may lead one to believe this, a complete and accurate analysis of the data reveals that the lower rate spread for banks is artificially enhanced by a substantial amount of sub-prime loans made to minority applicants. According to 2007 HMDA data, banks charged at least 3% higher than the Treasury yield on 20.8% of loans made to minorities with household incomes under $40,000 and thrifts were outside the spread on 34.7% of their loans to this population, while credit unions were only outside of the yield spread on 4.4% of their loans. Credit unions continue to beat banks and thrifts when examining the 2008 HMDA data (see chart below), even after banks and thrifts had stopped their focus on pushing borrowers into sub-prime loans.

Approved 1-4 Family Purchase Loans
Percentage of Approvals with Rate Spreads* >= 3%

	2008					
Percentage Reporting Above 3 Percent Spread	All Approvals (with race data)		White Approvals		Minority Approvals	
	Household Income		Household Income		Household Income	
	Less than $40,000	$40,000 or More	Less than $40,000	$40,000 or More	Less than $40,000	$40,000 or More
Credit Unions	**4.8%**	**2.4%**	**4.6%**	**2.3%**	**7.1%**	**2.4%**
Banks	**13.5%**	**7.6%**	**13.5%**	**7.6%**	**13.9%**	**8.0%**
Thrifts	**14.1%**	**8.1%**	**13.6%**	**7.7%**	**16.7%**	**10.5%**

Although banks and thrifts are subject to CRA requirements, HMDA data clearly indicates that credit unions are outperforming them in lending to low- and moderate-income communities. An educated analysis of HMDA data distinctly shows that credit unions are making smaller mortgage loans than banks and thrifts, and have a higher percentage of mortgage loans going to low- and moderate-income communities.

The NCRC report also examines the case of Massachusetts, which is one of two states that extend CRA obligations to state-chartered credit unions. NCRC concludes that the state-chartered credit unions in Massachusetts outperform federal credit unions by a small percentage. However, such a comparison is defective; state-chartered credit unions in Massachusetts have the ability to define their fields of membership in their by-laws (an authority not granted to federal credit unions), and therefore have greater control over who they can choose to serve. Furthermore, federal credit unions that are not defined as "multiple common-bond" credit unions are prevented from adding underserved areas to their fields of membership. Ironically, it is the same banks that help fund the NCRC that have fought for this restriction through litigation like *American Bankers Association, et al. v. National Credit Union Administration* (2005).

NAFCU would like to thank you for the opportunity to share our thoughts and for holding this important hearing on the Community Reinvestment Act. We believe that credit unions are an example of how depository institutions can reinvest in the community by providing minorities and those with lower incomes more reasonable mortgage loans. We would like to continue to work with you and the Subcommittee to address this important issue. If we can be of any further assistance to you or your staff, please do not hesitate to contact myself or Brad Thaler, NAFCU's Director of Legislative Affairs, at 703-842-2204 or bthaler@nafcu.org.

Sincerely,

Fred R. Becker, Jr.
President/CEO

cc: Members of the Subcommittee on Financial Institutions and Consumer Credit