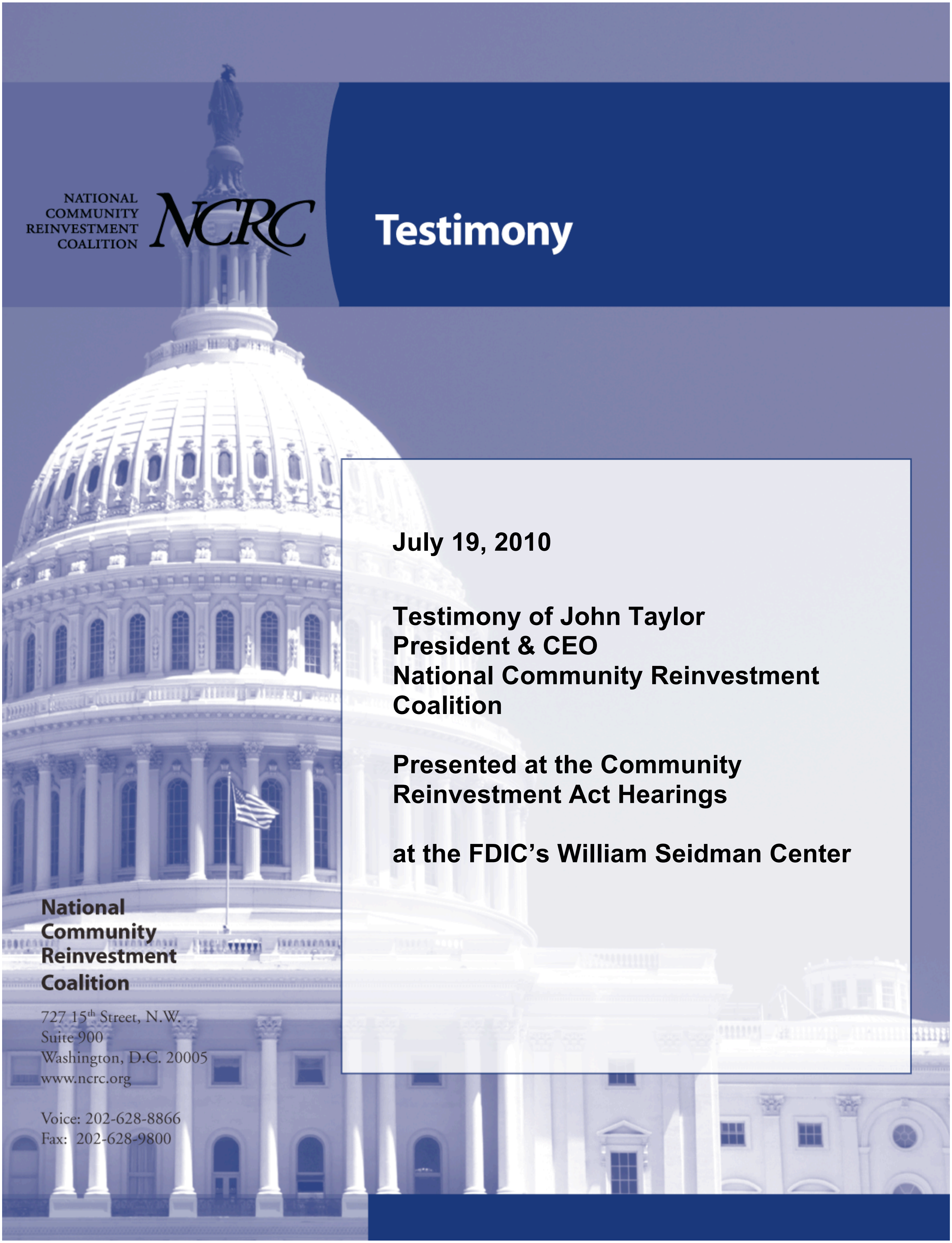


NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

July 19, 2010

Testimony of John Taylor
President & CEO
National Community Reinvestment Coalition

Presented at the Community Reinvestment Act Hearings

at the FDIC's William Seidman Center

National Community Reinvestment Coalition

727 15th Street, N.W.
Suite 900
Washington, D.C. 20005
www.ncrc.org

Voice: 202-628-8866
Fax: 202-628-9800

I. Introduction

Good morning. 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. We deliver this testimony today on behalf of those members.

The Community Reinvestment Act has worked well for over thirty years; it is a model for promoting access to financial services in a responsible way. Today, the law should be strengthened and expanded to address changes to the financial industry.

CRA acts as an antidote to the foreclosure crisis by requiring safe and sound lending. Research conducted by 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.[1] Additional studies by the Federal Reserve and other researchers consistently document that lending scrutinized by CRA exams is far less likely than lending of non-CRA covered independent mortgage companies to be high-cost and exhibit risky features, such as a piggyback loan. For example, Federal Reserve economists calculate that during 2006 -- a year of heavy subprime lending -- only 6 percent of all high-cost loans were issued by banks to low- and moderate-income borrowers and communities and considered on CRA exams.[2]

Responsible CRA-related lending and investing has been vital for low- and moderate-income communities. Over the 13-year time period from 1996 through 2008, CRA small business and

[1] 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

[2] 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 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

community development lending has totaled more than $1 trillion for America's low- and moderate-income neighborhoods.[3]

Although CRA has been instrumental in boosting lending and investments in traditionally underserved neighborhoods, it has not been adequately updated to reflect today's financial system. This has left certain aspects of the regulation and examination procedures out of date. For this reason, CRA has not realized its full potential. If CRA had been reformed such that it was uniformly applied to the majority of institutions' lending activities, the level of CRA-lending and investing would have been substantially higher and would have stood a better chance of crowding out the reckless and unregulated lending that flooded too many modest income and minority communities the last several years.

The federal agencies must undertake regulatory reforms to strengthen CRA as applied to banks. Regulatory action, while necessary, is not sufficient. The non-bank parts of the financial industry, particularly investment banks, mainstream credit unions, insurance companies, and mortgage companies, have trillions of dollars in assets, but are under no obligation to serve communities consistent with safety and soundness. Congress should apply CRA to these institutions so that communities will benefit from hundreds of billions of dollars of additional loans, investments, and services, which create much needed jobs and economic opportunities.

This testimony will discuss the role of CRA in increasing access to credit and investments, ways to bolster CRA examination criteria, suggested improvements for CRA enforcement mechanisms, augmentation of fair lending reviews, and reforms that would enable financial institutions to engage in high-impact community development. While we applaud the federal agencies' effort to improve CRA, the testimony will also describe why Congress needs to pass legislation to expand CRA to non-bank financial institutions.

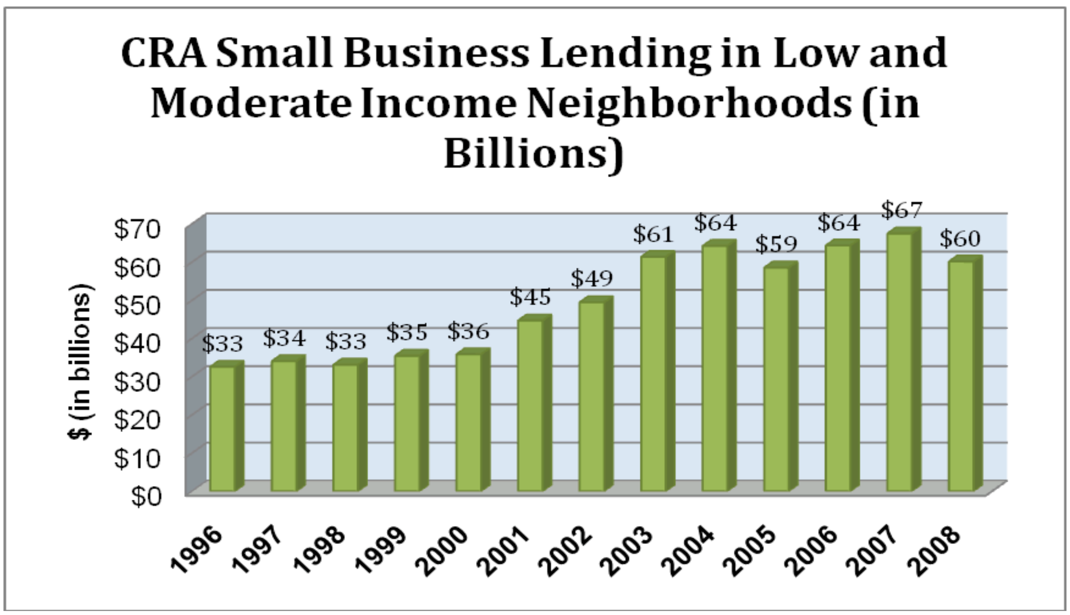
II. Role of CRA in Increasing Access to Credit, Investments, and Services

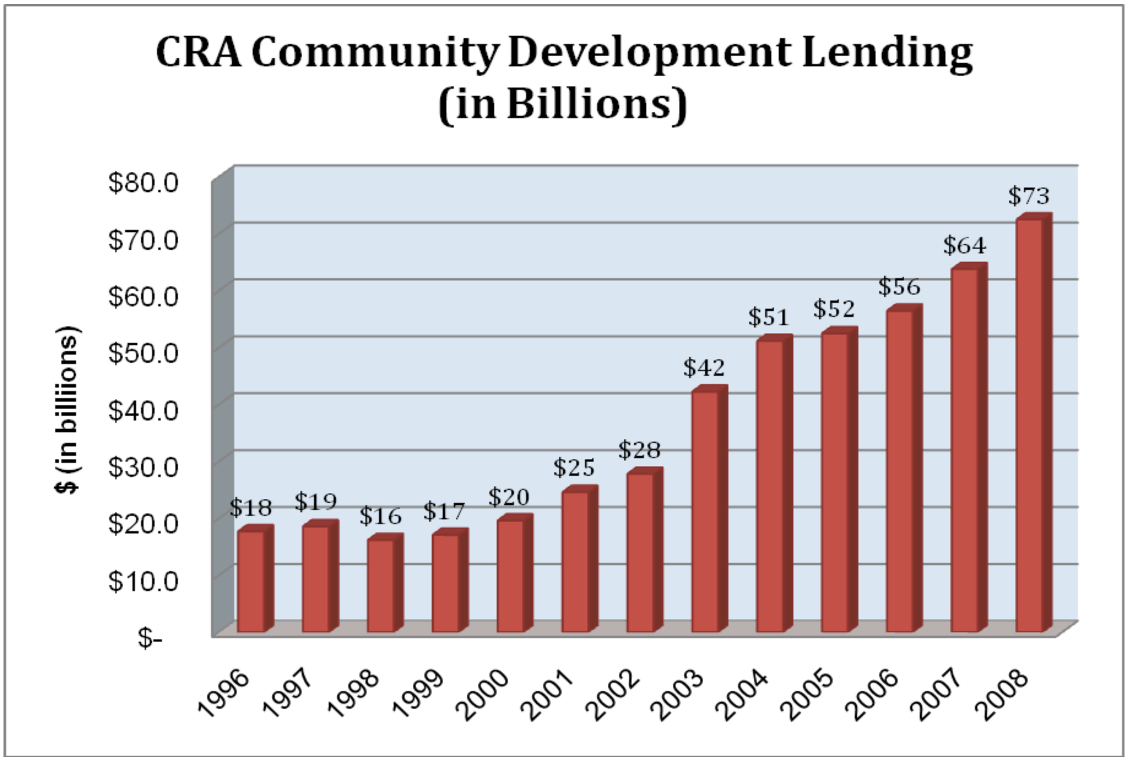
CRA's public accountability mechanisms have effectively motivated banks to significantly increase their lending, investing and services in low- and moderate-income communities. Data disclosure requirements, publicly available exams rating CRA performance and public participation

[3] Figures calculated by NCRC from data available on http://www.ffiec.gov.

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 increase in CRA-related financing that promotes holistic community development. According to data from the Federal Financial Institutions Examination Council, small business lending in low- and moderate-income census tracts surged from $33 billion in 1996 to $60 billion in 2008. Over the 13-year time period, CRA small business lending in low- and moderate-income tracts totaled $641 billion. Likewise, community development lending, which finances 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.





Past regulatory improvements to CRA have bolstered safe and sound lending in communities. Zinman found that the reforms that strengthened the CRA regulations in 1995 increased bank small business lending, and that lending increased to a greater extent in regions of the country with more rigorous CRA exams. Moreover, the CRA-related lending was just as profitable as non-CRA lending and did not "crowd out" or reduce the banks' non-CRA lending.[4]

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.[5] 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

---

[4] Jonathan Zinman, *The Efficacy and Efficiency of Credit Market Interventions: Evidence from the Community Reinvestment Act*, July 2002 (CRA02-2), published by the Joint Center for Housing Studies of Harvard University.
[5] 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

1993 and 2000.[6] 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 sustainable increases in responsible lending. In addition, NCRC calculates that CRA-covered lenders issued more than 1.8 million prime home loans worth about $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. 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 – subject to CRA -- issued $5.4 billion in community development lending and investing in Appalachia.[7] Also, bank branches had a positive impact on lending; small business lending was higher in Appalachian counties with higher numbers of bank branches.

Federal Reserve research reveals that CRA has resulted in banks addressing credit needs in a safe and sound manner. As a result of CRA's requirement that banks serve communities consistent with safety and soundness, the Federal Reserve found only 6 percent of all high-cost loans in 2006 were considered by bank CRA exams,[8] meaning the vast majority of the risky lending was issued by non-CRA covered mortgage companies.

The Federal Reserve findings were supported by Traiger & Hinckley LLP, a fair lending compliance law firm, which observed that 84.3 percent of the high-cost home purchase loans in the 15 most populous metropolitan areas were issued by non-CRA covered lenders while the remaining 15.7 percent were issued by banks and their affiliates. Traiger & Hincley LLP also found that as bank branches increase, foreclosures decrease across metropolitan areas. The presence of branches had an even stronger association with fewer foreclosures than employment levels, leading Traiger

[6] 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.
[7] See http://www.ncrc.org/images/stories/mediaCenter_reports/ncrc%20study%20for%20arc.pdf.
[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 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

& Hinckley to suggest that banks were carefully underwriting loans originated from their branches because the loans were scrutinized on CRA exams.[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 adds 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 volumes of loans. Moreover, while CRA 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 examinations do not consider how banks serve 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.

[9] Traiger and Hinckley, LLP, "The Community Reinvestment Act: A Welcome Anomaly to the Foreclosure Crisis," January 7, 2008, and the addendum to the report, January 14, 2008.
[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

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 channels.

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 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

[12] See Section 345.41 of the FDIC's CRA regulation available via http://www.fdic.gov/regulations/community/community/index.html

[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.

found four banks that 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 encouraging banks to respond 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 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 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 15 percent. In other words, when CRA coverage of lending declines, the percentage of subprime loans increased in

[14] Contact NCRC on 202-628-8866 for more information regarding our fair lending investigations.

communities with greater concentrations of minorities. 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. Thus, expanding CRA's examination scope will promote housing and economic development in modest income communities.

Over the years, the Office of Thrift Supervision (OTS) had been the most proactive agency regarding assessment areas perhaps because this agency had the greatest number of non-traditional lenders without branch networks. The OTS would conduct a sample of lending in metropolitan areas outside of these thrifts' assessment areas. Yet, this sampling often involved a small percentage of the thrifts' loans, and it was not clear if the cursory examination of the loans outside of the assessment areas had any ramifications for the thrift's CRA rating. For example, the OTS' exam of Capital One, FSB conducted in the summer of 2005 indicates that only a small percentage

[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.

of Capital One's home, small business, and consumer loans are in the northern Virginia assessment area; for example, 99 percent or 3.7 million small business loans from 2003 through 2005 are outside of the assessment area. In order to compensate for the low percentage of loans in the assessment area, the examiner chose to evaluate home, small business, and consumer lending in 20 other geographical areas that represented 25 percent of the institution's lending. The examiner then presented an analysis of how often Capital One exceeded the percentage of its peers' loans to low- and moderate-income borrowers and how often the percent of Capital One's loans exceeded the percent of households that were low- and moderate-income. The examiner, however, did not explain how the results of this analysis of lending in the 20 areas that were not assessment areas impacts Capital One's lending test rating.[17]

As dissatisfying as the OTS Capital One exam was, the FDIC's exam of Ally Bank (formerly GMAC) was worse.[18] Like Capital One, Ally Bank has a national lending presence but does not have retail offices. The exam records that Ally issued 98 percent of its home loans (257,000 loans) outside of its assessment area in 2007 and 2008. The exam then states that the low percentage of loans in the assessment area does not meet the technical requirements of satisfactory CRA performance. However, according to the exam, "minimal weight was placed on this criterion in recognition of the fact that despite a low percentage of loans, the actual number of loans originated and purchased by the bank in the assessment area was significant." In a sense, the examiner acknowledges the inadequacies of current assessment area procedures but then states that the inadequacies do not matter. The lending inside the assessment area totaled about 3,700 loans. Suppose it had been much lower at 1,000 or 500 loans, would the inadequate assessment area then had been a factor?

The Community Reinvestment Modernization Act of 2009 (H.R. 1479) addresses the inadequacies of assessment areas.[19] 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. Each assessment area, such as a metropolitan areas or a rural county, would receive a rating (this is different than the current procedure in which metropolitan areas and rural

[17] See Capital One's exam at http://www.ots.treas.gov/_files/cra/CRAE_13181_20050718_64.rtf
[18] See Ally Bank's 2008 CRA exam at http://www2.fdic.gov/crapes/2008/57803_080818.PDF
[19] See http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.1479 for the text of H.R. 1479.

counties can be designated as assessment areas, and are examined but are not rated; only multi-state metropolitan areas and states as a whole receive ratings). A procedure such as H.R. 1479's 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.

To examine the reasonableness of H.R. 1479's threshold, NCRC examined lending during 2008 conducted by institutions in the Washington, D.C. metropolitan statistical area and the Atlanta metropolitan statistical area, two of the locations for this summer's CRA hearings. In the Washington, D.C. metropolitan area, NCRC's analysis shows that the top lending institution issued more than 11,400 loans and that the 38th lender -- with a market share of .5 percent -- issued 637 loans.[20] On its face, the threshold in H.R. 1479 is reasonable since the lender with .5 percent of the market still had a large absolute number of loans, even in a year (2008) experiencing a severe economic recession. The threshold also works in smaller metropolitan areas. For example, the lending institution with a market share of .5 percent of home loans during 2008 in Roanoke, Virginia issued 45 single family loans, a reasonable number that is often evaluated on CRA exams.

The current assessment area procedures resulted in CRA exams including the Washington, D.C. metropolitan area for only 6 of the 16 banks with market shares above .5 percent of loans (see table below). If H.R. 1479 was law, all of the 16 banks would have Washington, D.C. as an assessment area, as they should, since they are major lenders in the area. In the Atlanta metropolitan area, only nine of the 20 banks with market shares above .5 percent had CRA exams including Atlanta as an assessment area. Again, H.R. 1479 would require that all of these banks' CRA exams would include Atlanta as an assessment area.

NCRC believes the method in H.R. 1479 is a reasonable one for determining assessment areas. A variant of this method is for the agencies to calculate the number of loans issued by a bank in metropolitan areas and non-metropolitan counties. The agencies can then list the geographical areas in descending order of their number of loans and select the geographical areas as assessment areas

[20] The NCRC analysis considered all originations, first and second lien, but no purchases. The Washington, D.C. metropolitan statistical area combines the two metropolitan divisions of Bethesda-Frederick-Gaithersburg and Washington, D.C.-Arlington-Alexandria.

that constitute the great majority of a bank's loans. NCRC recommends that the agencies experiment with H.R. 1479's method and the variant discussed in our testimony to determine which method ensures that rural communities and large and small metropolitan areas with significant amounts of a bank's loans are covered as assessment areas.

This procedure should be uniformly applied regardless of whether a bank is large or small. A smaller bank is likely to concentrate its lending in relatively few contiguous areas, meaning that it can be reasonably expected to serve the assessment areas determined by this procedure. A larger bank will have more assessment areas using this procedure but should be expected to serve these areas. A larger bank will most likely have diverse assessment areas that can be spread out across the country or across a sizable region. And a larger bank has most likely devoted considerable resources to developing significant market share in spread out areas and should be expected to devote resources to serving low- and moderate-income borrowers in these areas as well. Since a large bank has the capacity to open loan offices or establish relationships with brokers or correspondents in various geographical areas, the large bank also has the capacity to insure that this infrastructure serves low- and moderate-income markets in these areas.

Lending Institutions with Market Share Greater than 0.5 %, DC MSA														
	Count of Institutions					**Count of Institutions under CRA Exams**						**Count of Loans**		
Market Share Criteria	Total	Banks	Credit Union	Mortgage Company	Mortgage Company Affiliated with Banks	Total	% of Total	Banks	% of Banks	Mortgage Company	% of Mortgage Company	Total Loans	Loans under CRA Exams	% of Loans under CRA Exams
>= 5%	4	3		1	1	3	75.00%	2	66.67%	1	100.00%	38,035	27,442	72.15%
2 - 4.99%	5	3	2			1	20.00%	1	33.33%	0		18,903	2,908	15.38%
1 - 1.99%	12	6		6	4	3	25.00%	1	16.67%	2	50.00%	21,488	4,678	21.77%
0.5- 0.99 %	17	4	1	12	4	3	17.65%	2	50.00%	1	25.00%	14,312	3,242	22.65%
Total (=>0.5%)	**38**	**16**	**3**	**19**	**9**	**10**	**26.32%**	**6**	**37.50%**	**4**	**44.44%**	**92,738**	**38,270**	**41.27%**

Lending Institutions with Market Share Greater than 0.5 %, Atlanta MSA														
	Count of Institutions					**Count of Institutions under CRA Exams**						**Count of Loans**		
Market Share Criteria	Total	Banks	Credit Union	Mortgage Company	Mortgage Company Affiliated with Banks	Total	% of Total	Banks	% of Banks	Mortgage Company	% of Mortgage Company	Total Loans	Loans under CRA Exams	% of Loans under CRA Exams
>= 5%	4	3	0	1	1	2	50.00%	1	33.33%	1	100.00%	40,129	20,317	50.63%
2 - 4.99%	4	2	0	2	0	0	0.00%	0	0.00%	0		15,987	0	0.00%
1 - 1.99%	12	8	0	4	1	5	41.67%	5	62.50%	0		23,962	11,203	46.75%
0.5- 0.99 %	19	7	1	11	4	3	15.79%	3	42.86%	0		17,108	2,822	16.50%
Total (=>0.5%)	**39**	**20**	**1**	**18**	**6**	**10**	**25.64%**	**9**	**45.00%**	**1**	**16.67%**	**97,186**	**34,342**	**35.34%**

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 do not perform well, or are engaged in risky lending or discriminatory practices. 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 as 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.

NCRC believes, however, that the agencies do not have to wait for H.R. 1479 to be enacted in order to mandate the inclusion of affiliates on CRA exams. During the last revisions to the CRA regulation, the agencies stipulated in the regulation that affiliate activity in the assessment area(s) will be scrutinized to ensure the lending is not discriminatory or illegal. Building upon this precedent, NCRC believes the agencies have the authority to include non-depository affiliate lending on CRA exams to ensure that the lending affirmatively responds to credit needs in a safe and sound manner and does not undercut the lending activity of the affiliated bank or thrift.

Optional inclusion of mortgage company affiliates resulted in CRA exams missing affiliates in most cases in the CRA hearing locations of Atlanta and Washington, D.C., according to NCRC's analysis cited above. In Atlanta during 2008, only 1 of 6 mortgage company affiliates of banks with a market share of at least .5 percent was included in a CRA exam that covered the Atlanta metropolitan area (see table above). Likewise, only 4 of 9 mortgage company affiliates of banks with a market share of at least .5 percent were included in a CRA exam that covered the Washington, D.C. metropolitan area.

Inadequate assessment areas and optional inclusion of affiliates combined to ensure that only the minority of loans issued by lenders with .5 percent or more of the market would be covered by

CRA exams. In the Atlanta metropolitan area 26 of the 39 lenders in 2008 with market share of at least .5 percent were banks or mortgage affiliates of banks. Of the 26 CRA eligible institutions, only 10 had CRA exams covering Atlanta. Similarly in Washington, D.C., 25 of 38 lenders with a market share of at least .5 percent were banks or mortgage company affiliates of banks. Of the 25 CRA eligible institutions, only 10 had CRA exams covering Washington, D.C..

After excluding loans made by CRA eligible institutions that did not have CRA exams covering the area and loans made by non-CRA covered institutions (credit unions and independent mortgage companies), only 41 percent and 35 percent of the loans, respectively, in Washington, D.C. and Atlanta made by institutions with at least .5 percent of the market were covered by CRA exams. The federal banking agencies cannot address the lack of CRA coverage for credit unions and independent mortgage companies, but they can address inadequate geographical coverage of CRA exams for banks and mortgage company affiliates of banks. As shown above, banks and mortgage company affiliates of banks were the majority of institutions with at least .5 percent of the market, but most of these lenders did not have CRA exams covering either Washington, D.C. or Atlanta.

If the agencies adopt the mandatory inclusion of affiliates in CRA exams, assessment areas can be determined by totaling the number of loans issued by a bank and its affiliates. As stated above, the geographical areas (metropolitan areas and rural counties) can be listed in descending order in terms of the number of loans. The agencies would then use this list to select the areas as assessment areas that constitute the great majority of loans of the bank and its affiliates.

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.

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 finds in our *Income is No Shield* report series that racial disparities in lending actually increase as the income level of the borrower increases.[21] NCRC's *Broken Credit System* report shows that minority neighborhoods in several metropolitan areas received larger percentages of subprime loans than predominantly white neighborhoods, even after controlling for creditworthiness and other housing stock characteristics.[22] This spring, NCRC released *Foreclosure in the Nation's Capital: How Unfair and Reckless Lending Undermines Homeownership*, which expands upon our previous research and shows that after controlling for various neighborhood characteristics, loan characteristics, and borrower characteristics including creditworthiness and payment-to-income ratios, minorities were still more likely to receive subprime loans and experience foreclosures than white borrowers.[23]

Federal Reserve economists came to similar conclusions about high levels of subprime loans to minorities after controlling for creditworthiness.[24] 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, and Latinos and Asians were 1.4 and 1.3 times more likely to be in foreclosure, respectively, than whites, after controlling for several lender and

---

[21] 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

[22] *Broken Credit System* available via NCRC on 202-628-8866.

[23] NCRC, *Foreclosure in the Nation's Capital, How Unfair and Reckless Lending Undermines Homeownership*, Spring 2010, http://www.ncrc.org/images/stories/pdf/research/ncrc_foreclosure_paper_final.pdf.

[24] 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

borrower characteristics.[25] 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.[26] 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.

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.[27]

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 did not address racial disparities because CRA scrutinized banks' efforts to make loans in low- and moderate-income neighborhoods, but not did not examine the quality and extent of lending in communities of color. Banks do not feel the regulatory encouragement to make responsible loans to communities of color like they do for low- and moderate-income communities. Just as they did in the early to mid-1990's, the regulatory agencies must include lending and service to minorities as criteria on CRA exams.

Exams Must Be Uniformly Rigorous

<u>CRA Grade Inflation</u>

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.

---

[25] Laderman and Reid, ibid.
[26] See NCRC's *Are Banks on the Map* via http://www.ncrc.org/images/stories/mediaCenter_reports/ncrc%20bank%20branch%20study.pdf
[27] *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

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.

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

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

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 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, the agencies could have, at the very least, introduced more gradations among the passing ratings to more accurately reveal 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 well-performing CRA 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 uninformative nature of the ratings.

<u>Ratings and Point System Reform</u>

H.R. 1479 introduces two more ratings, High Satisfactory and Low Satisfactory, in an effort to produce more meaningful ratings. The agencies, however, should not wait for legislation to improve the ratings. NCRC believes that a ratings range of Outstanding, High Satisfactory, Satisfactory, Low Satisfactory, Needs to Improve, and Substantial Non-Compliance would more meaningfully reveal distinctions in bank performance. The six suggested ratings would

---

[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

[30] Richard D. Marsico, *Democratizing Capital: The History, Law, and Reform of the Community Reinvestment Act*, Carolina Academic Press, 2005.

correspond roughly to grades on student report cards and would be more revealing than the current four ratings, even if failure rates do not significantly increase. Banks, for instance, could pass but receive Low Satisfactory ratings, which approximately correspond to a "C-" grade, and indicate to the general public that the banks are barely adequate in meeting their CRA obligations. This rating system would be more meaningful than the current one which has rated approximately 80 percent of all banks as Satisfactory (in recent years, 85 to 90 percent of the banks have been rated as Satisfactory). Since there are clearly differences of performance in this large group of "Satisfactory" banks, a new rating system is needed.[31]

In order to further increase the meaningfulness of CRA exams, NCRC's suggested ratings must be possible ratings for the overall rating, for ratings on the component tests, and for ratings for assessment areas. As discussed above, the number of assessment areas receiving ratings also must be increased to include all metropolitan areas (not just multi-state metropolitan areas) and rural counties in a state (either groupings of rural counties or all rural counties aggregated into one area, whichever grouping makes sense depending on the demographics of a state). A more meaningful ratings scale, and applying ratings to more subsections of a CRA exam, provides stakeholders and the general public with a better sense of how the bank is performing as a whole compared to other banks and how the bank performs across various geographical areas and in offering loans, investments, and services.

In addition to improved ratings, a detailed scoring system is needed. Currently, ranges of points correspond to the various CRA ratings. The highest possible point total corresponding to an

[31] Some commentators will urge caution against suggestions for making exams more rigorous or quantitative. They assert that low- and moderate-income credit markets have reached or are close to the saturation point. Thus increasing expectations will compel banks to make "unprofitable" loans. We believe that there are plenty of opportunities in minority and low- and moderate-income communities to make profitable loans, as revealed by the surge of prime and responsible loans in these communities during the 1990's before the onset of subprime and exotic lending of the last several years. Studies cited above also suggest that there were plenty of creditworthy customers in these communities eligible for prime loans who instead were steered towards unsustainable high-cost and risky loans. Finally, CRA exams have sufficient flexibility to account for economic and demographic differences across geographical areas and will accordingly place more emphasis on rental housing or small business lending or other activities in areas where the cost of housing is high or the economics otherwise do not support an emphasis on home purchase lending. For an example of the viewpoint urging caution regarding quantitative measures, see Mark Willis, "It's the Rating, Stupid: A Banker's Perspective on the CRA" in *Revising 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.

Outstanding rating is 24 points with a zero indicating total failure or Substantial Noncompliance. But the scale does not make intuitive sense, nor is it 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 lending test.[32] NCRC recommends, therefore, that the agencies 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 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

[32] 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 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.

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 distinction 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 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 regarding the responsiveness to credit needs most likely reduces banks efforts to be highly attentive to the most pressing needs of communities, if they can also receive points for routine activities such as selling loans on the secondary market.[33]

The weighting system also does not distinguish 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," and "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.[34]

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

---

[33] CRA Performance Evaluation of First Community Bank, March 2009, Federal Reserve Bank of Kansas City, RSSD # 236751.

[34] 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.

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.

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.

<u>Data Enhancements Needed for Evaluations of Small Business, Consumer Lending, and Home Lending</u>

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 Dodd-Frank financial regulatory reform bill and H.R. 1479 contain important data enhancements to Home Mortgage Disclosure Act data and small business data.

Women who own small businesses, 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 about the difficulty of even established women-owned small businesses receiving loans and being asked to have their spouses co-sign applications even though they qualify for loans on their own. In other cases, NCRC's Women's Business Center, a technical assistance provider in the District of Columbia, reports that banks tell qualified women business owners that they are not qualified for loans or that they need to get jobs to qualify for loans. These bank responses do not make sense because the clients of the Women's Business Center have often been in business for a number of years and are seeking loans to expand their businesses.

The Dodd-Frank bill provides critical enhancements to the HMDA data regarding loan terms and conditions (during its hearings this summer, the Federal Reserve Board should consider HMDA enhancements that build upon and compliment those in the Dodd-Frank bill). 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 the Dodd-Frank bill, CRA exams could weight categories of loans that more precisely reflected affordability and sustainability of the loans. Banks could be penalized on CRA exams if they were burdening borrowers with loans containing high loan-to-value ratios, onerous 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 (the Dodd-Frank bill would add loan performance data recording whether the borrower was current or delinquent as a component of publicly disclosed data). 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. Finally, loan originations should be weighted more heavily than loan purchases since loan originations involve more effort and responsiveness to community needs than purchasing loans made by another institution.

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.[35] 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. 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.[36]

The Dodd-Frank bill 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 the race and gender of the small business owner to 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.[37] 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 the Dodd-Frank bill and H.R. 1479. Finally, NCRC recommends an additional data element 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 the Dodd-Frank bill and/or via regulatory action to improve small business data, CRA exams could scrutinize lending to minority and women-owned small businesses.

---

[35] 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.

[36] Ibid.

[37] The bills would require that the gross annual revenue size of the small business loan must be collected in all cases. Currently, the small business revenue is only collected when the bank relies on income to make a credit decision (see §___.42(a)(4)-4). The result of this procedure is to exclude revenue size on many loans, decreasing the ability of the data to reveal whether banks are reaching businesses of different sizes.

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 the Dodd-Frank bill, 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 banks compare to the rest of the financial industry in meeting small business credit needs in a responsible manner.

Consumer lending data is also an issue that must be addressed by the regulatory agencies, particularly since neither the Dodd-Frank bill or H.R. 1479 address consumer lending data. Currently, consumer lending is not included on CRA exams unless the "substantial" majority of an institution's loans are consumer loans or unless the institution requests that consumer lending be examined (see §__.22(a)(1)-2 in the Interagency Question and Answer Document). This procedure should change, however, because banks should be encouraged to offer responsible consumer loans as alternatives to abusive payday loans and other usurious products. Moreover, consumer lending data should be collected and publicly disseminated in a manner similar to HMDA data.

Currently, CRA exams are hamstrung in their abilities to rigorously evaluate consumer lending since industry-wide data does not exist for consumer lending. In the absence of industry-wide data, the Capital One exam discussed above, for example, could only compare consumer lending to the demographics of the geographical areas on the exam but could not compare Capital One to its industry peers. The examiner seemed to accept Capital One's explanation that a low level of consumer lending to low- and moderate-income borrowers could be explained by the thrift's representation that its consumer lending was a "prime to super-prime business that attracts a more affluent borrower."[38] The examiner would less readily accept this questionable explanation if industry-wide data were available to compare the thrift's performance against its peers to determine if the thrift was ahead or behind its peers in the percentage of consumer loans offered to low- and moderate-income borrowers.

The Service Test: Measuring Access to Banking Services

In response to the agencies' question about promoting services for un-banked and under-banked populations, NCRC believes that the rigor of the service test and the quality of deposit data must be improved in order to provide incentives for banks to offer more services for under-banked populations. 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 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.[39]

As payday lending and usurious fringe services have increased in low- and moderate-income neighborhoods, sensible public policy would 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. 1479 would be instrumental in rectifying deficiencies in the level of data and analysis of bank branches and service on CRA exams. The bill would require banks to maintain and disseminate data on their branches, ATMs, and other depository facilities. The number and

---

[38] Capital One FSB CRA exam cited above, see page 15.

[39] 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.

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 customers would be provided on a census tract basis, making it possible to analyze the income and minority level of the census tracts of these customers. The bill would require these data would be used as part of CRA exam analysis.

Data collected under H.R. 1479 would bolster the rigor of the CRA service test. The regulatory agencies should not wait for Congress and should consider requiring these type of enhancements to deposit data. With this data, CRA exams would not only measure the distribution of branches across census tract categories 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 banking services as alternatives to high-cost payday, cash checking, and other fringe services. The Woodstock Institute, a NCRC member, conducted a study illustrating the valuable types of analyses that could be conducted with more detailed data on branches and deposits.[40]

The service test could also be improved regarding its measurement of services and products specifically tailored for un- and under-banked populations. Many CRA exams will applaud a special affordable deposit account, counseling, or other service, but will not offer much information on how many of the products were actually provided to low- and moderate-income customers. If a bank seeks CRA points for low-cost banking accounts, Individual Development Accounts, remittances, or other services for low- and moderate-income borrowers, it should be required to provide detail to the examiner on the quantity of these services it actually provided. Since this data is not standardized like HMDA or CRA small business loan data, it is hard to know whether a bank is offering a high or low number of affordable services targeted to the under- or un-banked populations. However, if the agencies are more insistent upon requiring data for these types of accounts, some sort of database or method of comparing levels of accounts by asset size of institution could be developed over time. When methods for making quantitative comparisons among banks concerning levels of services for the under-banked are

[40] 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/.

more developed, the service test will hold lenders more accountable for delivering these services and will therefore stimulate banks to provide more of these services.

CRA Asset Thresholds and Designations

NCRC strongly recommends that the agencies keep the asset thresholds and designations as they are currently. The asset thresholds appropriately provide the most streamlined exam for the smallest institutions, a more demanding but still streamlined exam for intermediate small banks, and the most strenuous exams for large banks. If anything, the thresholds most likely provide too many institutions with the more streamlined exams. While the agencies will likely receive input to make more banks eligible for streamlined exams, NCRC asks the agencies to hold the thresholds where they are. The CRA regulation and examination procedures such as performance context can accommodate the remaining factors that can impact performance for banks of various sizes. Since 99 percent of the ratings are Outstanding and Satisfactory, banks of various sizes have demonstrated that they can handle their tests. If anything, the tests are too easy as documented above.

Community Contacts

CRA's effectiveness is bolstered when community organizations, public officials, and other stakeholders participate in the CRA process to a great extent; this has the effect of holding lenders accountable for their CRA performance, and holding agencies accountable for enforcing CRA. The agencies and examiners are doing a poor job getting community organizations involved in commenting on CRA exams and mergers. NCRC member organizations report that examiners conducting CRA exams rarely approach them to offer 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. For example, examiners can share preliminary data analyses with community organizations and ask their opinions about whether banks' products or marketing approaches account for any striking data patterns (either revealing little or significant penetration of low- and moderate-income markets).

Finally, there must be an easier method for community organizations to contact examiners. Currently, it can take several calls to figure which examiner is conducting a CRA exam for a specific bank. The Office of the Comptroller of the Currency (OCC) recently informed NCRC that their community affairs officers can serve as liaisons between CRA examiners and community organizations. This is the clearest procedure established by any of the agencies. The agencies should clearly identify staff with phone numbers and e-mails who can direct CRA comments to the examiners and who can arrange for meetings and conversations between the examiners and community organizations. The OCC, however, hesitates to officially announce this system because the Deputy Comptrollers are identified in an appendix to the CRA regulation as the recipients of CRA comments. The Deputy Comptrollers are relatively obscure officials and are not as accessible to community groups as community affairs officers. As the agencies change the CRA regulation, they must institute clear and understandable procedures for commenting on CRA exams and merger applications.

The discussion on CRA exams of community group comments is also usually truncated and not informative. If a community group has offered a comment describing a strength or weakness in bank performance, the examiner should accurately summarize the comment and then offer an explanation and analysis indicating whether the examiner agrees or disagrees with the comment and whether the comment will influence the rating overall or in any geographical area or component test.

IV. Community 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 neighborhood(s) improves when all of these activities are undertaken together and targeted towards the neighborhood(s). This section suggests reforms that have the potential to channel bank resources for community development.

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 such as rental housing, equity investments in small business, economic development projects such as shopping centers, and community facilities such as health care centers. If data was available on community development on a census tract level, spatial analysis could create more effective strategies for high impact economic development; that is, geographic targeting of home and small business lending and community development lending and investing for neighborhoods in need. An improved targeting of resources and financing for a range of community projects would improve the chances of high impact economic development in neighborhoods. In addition, the data on community development would facilitate assessments of spatial equity that would determine if rural areas and inner city and inner suburban areas are receiving adequate amounts of community development financing.

NCRC recommends that the regulatory agencies 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.

A Community Development Test

The regulatory agencies should also consider creating a community development test to replace the investment test for the large bank exam. A community development test already exists for intermediate small banks. A community development test on the large bank exam has the potential to increase community development lending and investing. Currently, community development loans are considered on the lending test, but community development loans can receive short shrift since they compete with home, small business, and other types of lending for attention on the lending test. Because community development lending for economic development projects such as shopping centers, affordable rental housing, and other large scale projects is more similar to community development investments (called "qualified" investments), it makes sense to combine consideration of community development loans and investments on a "community development" component exam. In addition, moving community development loans to a community development exam would likely provide more incentives for this type of lending and thus could bolster important community development financing such as construction lending for affordable rental housing.

NCRC does not support moving community development services to a community development exam. Community development services refer to a range of activities including school savings accounts, financial counseling, and international remittances.[41] Many of these services are either types of bank deposit accounts or similar to bank deposit accounts. Therefore, community development services are often delivered through a bank's physical infrastructure in communities. Consequently, it makes more sense to consider whether bank branches or other facilities are effectively delivering these services to low- and moderate-income communities on the service test than on a community development test.

The study conducted by NCRC and New York Law School observed diminished attention to branching when elements of the service test were moved to a community development test in the case of intermediate small banks. In contrast, the study observed more community development loans and investments after the change to the community development test for intermediate small banks. Therefore, the community development test is an appropriate method for evaluating community development loans and investments but not for evaluating bank services.[42]

Allow for Investments in Multi-Regional 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. Multi-regional 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

[41] See § ____.12(i)-3 of the Interagency Questions and Answers Regarding Community Reinvestment.
[42] Silver and Marsico op cit.

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.

Granting favorable consideration for community development outside of assessment areas is a complex issue that could either benefit or starve underserved areas for resources. For example, suppose a regional bank in the Midwest is located in a depressed city but can get favorable consideration for investing in a Low Income Tax Credit project located on the West Coast. If the regional bank has not adequately served its assessment area with investments, providing CRA points for the West Coast project has deprived its hometown of much needed investments. On the other hand, if a large bank headquarted in a large East Coast city has served the East Coast city well, then it should receive points for a Low Income Housing Tax Credit project in the Mississippi Delta, which is in need of affordable housing.

The method for ensuring that consideration outside assessment areas augments funding for underserved areas instead of depriving underserved areas is making sure that assessment areas needs are well served. NCRC recommends that CRA examination procedure allows points for investments in multi-regional 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. If the most recent CRA exam is dated (more than 2.5 years old), then the agencies should ensure that the bank has maintained its performance in its assessment areas. Performance can certainly vary between the time period in a dated exam and more recent years. Therefore, a bank with a dated exam 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, which the regulatory agency can compare against the previous CRA exam to make sure performance is being maintained.

The current practice of allowing investments beyond assessment areas without a bright line of acceptable performance in assessment areas leaves many smaller cities and economically depressed areas in danger of losing needed sources of investment from banks headquartered in these areas. Since 99 percent of banks receive Outstanding and Satisfactory ratings, the current practice that allows the great majority of these passing banks to go outside of assessment areas will permit a significant number of banks to venture outside of assessment areas who have not adequately served their areas. The agencies must, therefore, create improved procedures for allowing community development financing beyond assessment areas.

The expansive definition of assessment areas in H.R. 1479 and discussed above can help resolve issues associated with investing outside of assessment areas. The expansive definition reflects more meaningfully all the geographical areas in which banks have a business presence and make a significant number of loans. A more accurate definition of assessment areas will lessen the current difficulties some large banks have in investing in multi-regional funds since an improved definition will capture more geographical areas including those served by multi-regional funds as assessment areas. Finally, community development possibilities are maximized if banks are also asked to ensure that they are meeting needs for community development financing in newly defined assessment areas in which they are making significant amounts of home and small business loans.

V. Enforcement Mechanisms and Incentives

In their announcement for public hearings, the agencies have asked about incentives for improving CRA performance. While some incentives might be warranted, NCRC believes that the agencies also need to consider bolstering enforcement mechanisms. If the mix of carrots and sticks tilts too much towards carrots, the likely result is that only a few more institutions will strive for Outstanding ratings while the great majority will settle for mediocre CRA performance because they do not have to be too concerned about any possible sanctions.

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 the bank promptly appealed it's 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 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.[43] The general public would have an opportunity to comment on the CRA improvement plan. The 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. The agencies should not wait for H.R. 1479; they can institute a public improvement requirement via regulatory rulemaking.

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.[44] 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. Any fines banks pay can be directed towards a fund that finances community development in economically depressed parts of the

[43] 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.
[44] Information on CRA exams of banks discussed in this section can be found via http://www.ffiec.gov.

country. In addition, a public improvement plan requirement discussed above should help in avoiding repeat failures.

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 waned 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.[45]

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.

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 issues, formal agency involvement in these post emergency discussions would have facilitated mutually acceptable arrangements regarding CRA bank activities.

The agencies must reverse the inattention to hearings and must regularly hold public hearings on mergers. In addition, the agencies should convene smaller meetings whenever the meetings are 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

[45] See http://www.federalreserve.gov/newsevents/testimony/braunstein20070521a.htm

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 is a prohibition against a merger if any of the banks have a Needs-to-Improve or Substantial Noncompliance rating in any assessment area or as the overall rating. Modeled after the Gramm-Leach-Bliley provision of Satisfactory and above ratings required when banks wish to enter non-banking business, this proposal ensures that banks must adequately serve all communities including rural counties and smaller cities in addition to their larger markets. It also 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.

Finally, NCRC requests that the agencies do not approve merger or branch applications while another public agency is conducting a fair housing or fair lending investigation. Over the years, NCRC member organizations, in their comments on pending applications, have asked the federal bank agencies to delay a decision until an ongoing fair housing investigation is completed. The agencies are inconsistent, sometimes agreeing to delay a decision, but other times approving the application before the investigation is complete. The other agencies involved, often the Department of Housing and Urban Development and the Department of Justice, do not commence fair housing/lending investigations on frivolous complaints but instead only commence investigations if the complaints are substantive and involve significant racial disparities. Therefore, it is premature to grant a bank new powers until the fair housing/lending investigations are completed.

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 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.

---

[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.
[47] See http://files.ots.treas.gov/cra/CRAE_08566_19990927_60.rtf.
[48] Ibid.

The agencies must restore detailed descriptions in CRA exams 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. Banks have failed CRA exams because they made or financed unsafe loans; the fair lending review must routinely indicate whether the review found evidence of unsafe and unsound loans.[49]

Incentives

Some commentators will favor "incentives" to coax institutions into improved CRA performance. We would be supportive of exploring programmatic methods to increase tax credits under the Low Income Housing Tax Credits or New Markets Tax Credit for institutions receiving Outstanding ratings.

NCRC also suggests that the federal agencies can provide incentives for banks to work with community organizations on CRA agreements. 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.[50] 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.

[49] See FDIC CRA exam of CIT Bank of May 2008. The bank failed because it purchased high levels of problematic subprime and non-traditional loans. http://www2.fdic.gov/crapes/2008/35575_080512.PDF

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

NCRC recommends that the agencies consider verifiable CRA agreements and fair lending pledges favorably during merger applications. Verifiable agreements would provide detail on the numbers of safe and sound loans, investments, and bank services to minorities and low- and moderate-income communities. This procedure 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. The procedure would bolster banks' abilities to serve community needs by establishing verifiable goals negotiated between banks and the communities they serve.

NCRC is opposed to incentives that involve exemptions from CRA review on merger applications or decreasing the frequency of CRA exams for institutions with Outstanding ratings. CRA performance is likely to decline when institutions receive less frequent exams and public scrutiny. An examination once every four or five years (as is the case for small banks under $250 million as mandated by the Gramm-Leach-Bliley Act) will not hold banks sufficiently accountable because 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. The tendency is for the examiner to focus on most recent performance and review performance 3 or 4 years ago in a more cursory manner. In contrast, a two-year exam cycle is sufficiently short enough so that an exam can effectively scrutinize the entire time period. Thus, banks will have an added incentive to perform during the entire time period.

Mergers have been an important time for CRA enforcement. Even if both banks have passed their most recent CRA exam, performance for each bank is unlikely to be uniform in all of their assessment areas. Moreover, mergers involve significant changes in how the banks will operate. For instance, decision-making on CRA programs often becomes more centralized, meaning that community organizations and other stakeholders will not have easy access to bank CRA officers which may move to remote cities. Given the significant changes that occur during mergers, it is imperative that the general public has the opportunity to comment on CRA, anti-trust, and the other usual factors considered in merger applications. It is also imperative that the regulators consider CRA and all other factors in all cases before deciding on merger applications.

VII. The Need for Congress to Apply CRA to Non-Bank Financial Institutions

Although the federal banking agencies cannot apply CRA to non-bank financial institutions, a short description of the failure of non-CRA covered institutions to serve credit needs in a responsible manner illustrates the need for Congress pass CRA modernization legislation while the banking agencies also work to improve CRA.

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.[51] 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 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.[52]

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

[51] 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.
[52] Avery, Brevoort, and Canner, op. cit.

underserved communities.[53] 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.[54]

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.

Conclusion and Recommendations

Modernizing CRA is one of the most vital policy initiatives undertaken by both Congress and the federal banking regulatory agencies. 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

[53] 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 these areas. 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; see 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.
[54] See http://www.ncrc.org/images/stories/mediaCenter_reports/creditunionreport090309.pdf

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

- Change assessment area definitions so that the great majority of bank loans are covered by CRA exams.
- Require that mortgage company affiliates of banks are included on CRA exams.
- Require that CRA exams scrutinize lending, investing, and service to minorities and communities of color.
- Institute a weighting system for CRA exams that weight categories of loans, investments, services according to their affordability and responsiveness to local needs.
- Create meaningful scales of points such as 1 to 100 on CRA exams to evaluate the multiple levels of CRA performance.
- Add High- and Low-Satisfactory as possible overall ratings. Increase the number of geographical areas receiving ratings to include all metropolitan areas and rural counties served by the bank.
- Enhance HMDA data to include more information on loan terms and conditions as required by the Dodd-Frank bill and H.R. 1479.
- Enhance small business loan data to include the race and gender of the small business owner and other characteristics as required by the Dodd-Frank bill and H.R. 1479.
- Collect and publicly disseminate consumer lending data in a format similar to HMDA data and use this data on CRA exams.
- Improve the data on bank branches and deposits and require analysis of branches and deposits by income and minority level of neighborhoods.

- The service test for intermediate small banks and large banks needs to be more rigorous, using existing and new data to more precisely measure the level of bank services to low- and moderate-income communities.
- The asset thresholds for various tests are appropriate; banks of different asset sizes currently have exams that are suitable for measuring their CRA performance.
- Create a transparent and clear procedure for receiving comments from community groups and the general public on CRA exams. Examiners should carefully summarize any comments and indicate whether the comments will influence any of the ratings on the exam.

Reforms that Would Enable Financial Institutions to Engage in High Impact Community Development

- Require new data on community development lending and investing on a census tract level and use the data for CRA exams.
- Allow investments in multi-regional funds provided that needs are met in an institution's assessment area. Develop careful procedures for certifying that the institution has met the needs of its assessment area.
- Move community development lending to a new community development test in the large bank exam, but keep community development services in the service test.

Strengthen Enforcement Mechanisms

- Institute a public comment process allowing community organizations to appeal preliminary CRA ratings.
- 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.

- Institute a requirement that CRA exams and merger applications have a section called "Expectations of Affirmative Responsiveness to Needs" that recommends or requires banks to address weaknesses in their CRA and fair lending performance.
- The federal agencies should favorably consider any verifiable CRA agreements and fair lending pledges during merger applications.
- The federal agencies should hold frequent public hearings and meetings during the merger application process.
- The federal banking agencies should not approve bank applications until any fair housing/lending investigation of another agency is completed.
- Disallow mergers between institutions with a Needs-to-Improve or worse rating in any assessment area.
- Require detailed discussions of methodology, loan types examined, and the results of fair lending reviews on CRA exams.
- Explore programmatic methods to increase tax credits under the Low Income Tax Credits or New Markets Tax Credit for institutions receiving Outstanding ratings. Do not institute any safe harbor for any set of institutions, exempting them from merger reviews or stretching out their CRA exams.

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

NATIONAL
COMMUNITY
REINVESTMENT
COALITION
NCRC

National Community Reinvestment Coalition
727 15th Street NW, Suite 900
Washington, DC 20005
V: (202) 628-8866 F: (202) 628-9800
http://www.ncrc.org